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The End of Capitalism, Again? An institutional-evolutionary view

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Abstract

The Global Financial Crisis of 2008 was the most severe since 1929. In the years that followed, a major debate on the future of global capitalism emerged. Within this debate a number of studies have argued that the crisis is a symptom of a deeper structural decline. This ‘capitalism is ending’ argument is derived from analysis focussed exclusively on the developmental contradictions of the capitalist system. Against that approach, I argue that institutional regulation plays a central role in managing capitalist development, and thus adequate analysis must include contradictions and institutional regulation. In this thesis I use institutional-evolutionary theory to critically assess the limitations of key arguments in the debate on capitalism’s future. Institutional-evolutionary theory is based on a contemporary revival of Thorstein Veblen’s work. I argue the theory contains the resources for investigating the historical specificity of capitalism. Following critique of existing debates on the future of capitalism post-2008, I develop an original analysis of the evolution of bank bailout policy since the 18th century. This policy was crucial to avert systemic risk in 2008, as well as in many previous crises. In this thesis, I argue that the global diffusion of bailout policy is a case of Darwinian institutional evolution, involving a process of variation, selection, and retention of institutions. Furthermore, I argue that bailout policy is a case of evolutionary sub-optimal lock-in. This finding has implications for banking regulation, and the political economy of future banking crises. Understanding the future of capitalism requires knowledge of its institutional logic, how this generates a specific historical trajectory, and the possibilities and limits of agency to regulate this pattern of development in desired ways. In this thesis I address each of these elements, and in doing so contribute to knowledge of capitalism as an evolving social system.
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Introduction. Capitalism in Crisis

If Lehman goes down, it will be Armageddon – Harry Miller, Lehman’s head bankruptcy lawyer, September 14th, 2008.

On Monday 15, September 2008 the sixth biggest bank in the United States by total assets, Lehman Brothers, declared the largest bankruptcy in American history. Armageddon, as predicted by Miller, promptly followed. The bank had assets of $691 billion and was extensively connected with global financial trade. While the direct losses were immediate and large, it was the potential for hidden losses that sparked financial panic, contagion, and Miller’s cataclysmic scenario. Lehman’s bankruptcy froze global inter-bank lending, led to runs on the global commercial money markets and resulted in a general loss of confidence in the American, and then global, financial system.

After initially refusing to bail out Lehman Brothers, the United States government engaged the quickest of policy reversals in the face of a growing financial panic. Two days after Lehman’s bankruptcy, the insurance firm AIG was bailed out at a cost of $85 billion. Within four days of ground zero the Secretary of the Treasury, Henry Paulson, and Chairman of the Federal Reserve, Ben Bernanke, came before a hastily convened meeting of Congressional leaders to push forward a $700 billion rescue package. An article in the New York Times reported that Bernanke sold the proposal in no uncertain terms, quoting him as stating: ‘If we don’t do this, we may not have an economy on Monday’ (Sorkin, Henriques, Andrews, & Nocera, 2008). As it happens, Congress was not convinced and knocked back the plan. However, with fear left unchecked the panic amplified, and two weeks after Lehman’s collapse Congress passed the Troubled Asset Relief Program on October 3, 2008. Paulson and Bernanke got their $700 billion and in the coming weeks and
months, ‘Sunday announcements concerning bailout deals became the new business-as-usual’ (Graham, 2010, p. 119).

Between September 2008 and August 2009, the global financial system teetered on the edge of a systemic breakdown, as all the while government intervention continued in order to prevent that outcome. It was a period marked by ‘crisis-driven forms of Keynesian reflation, seat-of-the-pants industry policy, and even pseudo-nationalizations’ (Peck, Theodore, & Brenner, 2009, p. 95). Trillions of dollars were wiped off the value of global equity markets (Varoufakis, 2011). In early 2009 a Financial Times article captured the palpable sense of fear and uncertainty:

[N]ot only is the financial system plagued with losses of a scale that nobody foresaw, but the pillars of faith on which this new financial capitalism were built have all but collapsed. That has left everyone from finance minister or central banker to small investor or pension holder bereft of an intellectual compass, dazed and confused (Tett, 2009).

The article goes on to report an assessment by Bernie Sucher, the head of Merrill Lynch’s operations in Moscow, who put things this way: ‘Our world is broken – The last time I ever saw anything like this, in terms of the sense of disorientation and loss, was among my friends [in Russia] when the Soviet Union broke up’ (Tett, 2009). Sucher is verbalizing what Varoufakis describes as the ‘collective aporia’ that struck during the heart of the crisis, a state of ‘intense puzzlement in which we find ourselves when our certainties fall to pieces’ (2011, p. 1). This aporia was a result of the fact that the capitalist world order was in disarray. Unlike the crises of the preceding decades, such as Britain’s Black Wednesday currency debacle in 1992, the 1997 Asian financial crisis, the Russian rouble crisis of 1998, or the dotcom crash in 2001, this crisis affected all the major financial centres of the world (Reinhart & Rogoff, 2009), and precipitated the largest collapse in global trade since the 1930s (Helleiner, 2011). Governments the world over were intervening in their economy to an extent that has no modern parallel outside of war-time. It was not until the anniversary of Lehman Brothers bankruptcy in September 2009 that Fed chairman
Ben Bernanke felt confident enough to declare that the crisis was ‘very likely over’ (Swedberg, 2010, p. 93).

A couple of years later, it almost seemed as if capitalist Armageddon had never happened. The financial markets that had led us to the brink were once again ‘raised to the status of omniscient and implacable forces of inevitable (and ultimately benign and productive) economic logics’ (Morgan, Froud, Quack, & Schneiberg, 2011, p. 148) Part of this quick rehabilitation of finance lies in the nature of the post-crisis analysis that emerged, the framing of the problem and the narratives that eventually came to dominate in the aftermath. In the public arena governments and media tended to focus on two stories, that of individual moral failure in the form of the greedy banker, or of regulatory failure by an inept state (Curtis, Harney, & Jones, 2013, p. 65). In a review of 21 books on the crisis Lo highlights a common set of questions that had emerged:

Did CEOs take too much risk, or were they acting as they were incentivized to act? Was there too much leverage in the system? Did regulators do their jobs or was forbearance a significant factor? Was the Fed’s low interest-rate policy responsible for the housing bubble, or did other factors cause housing prices to skyrocket? Was liquidity the issue with respect to the run on the repo market, or was it more of a solvency issue among a handful of “problem” banks? (Lo, 2012, p. 173).

These questions indicate a general focus on individuals and regulatory systems. They refer to factors that certainly played a role in the crisis, the degree of which is the subject of ongoing debate. Although I will provide answers to some of those questions, the main goal of this thesis is to ask a different question concerning the 2008 crisis. The debates post-2008 have, I will argue, settled on important but proximate causal factors in their attempt to understand the crisis. The ultimate causal factor that should be point of entry for investigation are the institutions of capitalism. It is the institutions being regulated, rather than the institutions doing the regulation, that constitute ground zero for 2008.
Furthermore, investigating the crisis through this entry point poses a bigger question, one that extends beyond the 2008 crisis, stretching backwards into history, as well as forwards into our future. It poses the question of social evolution. Thus, in discussing the limitations of typical studies on the Global Financial Crisis, Sewell makes an observation shared by this thesis:

As cogent as some of these analyses might be, they rarely touch on a larger question that, in my opinion, the crisis insistently poses: the question of capitalism itself as a moving force in history. In recent decades, few in the contemporary social sciences, beyond a relatively small Marxist remnant, have taken seriously the notion that capitalism as a socioeconomic system has intrinsic dynamics that impart a specific direction and rhythm to modern history (Sewell Jr, 2012, p. 303).

Sewell is here pointing towards a more abstract question than is typically undertaken by studies focussed on the contextual and contingent factors that trigger a particular crisis. The question posed is that while every capitalist crisis is to some degree unique, there are also commonalities in every case. The Dutch tulip bubble of 1635-36 and the 2001 dot com bubble ‘are clearly recognizable as members of the same species—the speculative bubble’ (Sewell Jr, 2008, p. 519). Similarly, Kindleberger and Aliber document four centuries of financial crises, calling such events a ‘hardy perennial’ (2015, p. 5). Reinhart and Rogoff (2009) go a few centuries further, placing the 2008 crisis in the context of eight centuries of financial folly. In chapters eight and nine of this thesis I will document two centuries of bank bailouts exhibiting both the commonalities and uniqueness of financial crises.

While the exact context and set of contingent factors are unique in the development of every crisis or recession, the argument to be pursued here is that there is also in every case an identifiable set of shared causes and outcomes, a shared logic of unfolding. Of this, Sewell states: ‘This recurrent logic must, in some sense, be extremely abstract, since the concrete institutions and materials through which the repetitive pattern manifests itself change radically over time’ (Sewell, 2008, p. 521). It is this ‘abstract’ logic arising from the core institutions that make a capitalist
economy which imparts a direction to capitalist history. In framing analysis of the 2008 crisis this way a particular set of questions arise: what can the 2008 crisis reveal about the institutions of capitalism, about the logic they impart upon the direction of history, the behaviour they impart upon agents, and the limits and possibilities these institutions hold for the future. In short, this thesis investigates what the 2008 global financial crisis can tell us about the future of capitalism, understood an evolving social system with an intrinsic pattern to its history.

To answer such a question I argue that an institutional approach is crucial for understanding the historical specificity of a social system. Institutions are ‘systems of rules’ (Hodgson, 2015, p. 45, see also North 1990; Crawford and Ostrom 1995), formal and informal, by which social action is structured. Put another way, they are ‘the durable relations embedded in collectivities of norms, mores, folkways, organizations, and effective laws which fundamentally condition and act as means toward social practices’ (O’Hara, 2000, p.2). Institutions, therefore, are the fundamental units structuring all societies, and therefore the political economy of capitalism too.

Consequently, this thesis argues that the theoretical tradition of institutional political economy (Burlamaqui, Castro, & Chang, 2000; J. L. Campbell, 1997; Chang, 1994, 2000; 2002; Crouch, 2005; Dugger, 1988b; Elliott, 1978; Heilbroner, 1986; Lazonick, 1991; P. A. O’Hara, 2000; Streeck, 2009, 2010, 2011, 2014a, 2016b; Streeck & Thelen, 2005) contains the resources for investigating the historical specificity of capitalism. However, institutional political economy poses a theoretical conundrum. Chang highlights that this form of institutionalism follows ‘a long tradition stretching from Karl Marx through Thorstein Veblen, Joseph Schumpeter, Karl Polanyi, Andrew Shonfield and Herbert Simon’ (Chang, 2002, p. 551). Such a list of luminaries clearly provides the theoretical resources for the research question under consideration here. It also offers conflicting theoretical systems and incompatible concepts.
Here I apply the theoretical system of just one of these founding figures. I argue that Thorstein Veblen’s Darwinian institutional economics offers the most suitable theory for assessing the 2008 crisis, its causes and its implications. Veblen’s work has been subject to a recent revival and reconstruction as institutional-evolutionary economics. Geoffrey Hodgson’s work has been seminal in this reconstruction of Veblen’s theory (Camic & Hodgson, 2011b; Hodgson, 1988, 1992, 1993, 1995a, 1998c, 2001, 2002, 2004a, 2004b, 2007a, 2007b, 2007c, 2010, 2015; Hodgson & Knudsen, 2006b, 2010). Building on Hodgson’s work I will critique, amend and extend Veblen’s theory in order to develop an institutional-evolutionary theory of social change.

In light of this, the thesis will proceed in three Parts. Part I places Veblen within the institutional political economy tradition, highlighting commonalities and differences with other founding thinkers. I trace out the historical emergence of Veblen’s critique of classical and neoclassical economics and his development of a Darwinian economics. I outline the latter’s initial popularity, which was followed by a falling out of intellectual favour, and lastly, its contemporary reconstruction. As a result, Part I provides a theoretical framework for critically engaging the question of capitalism’s future that will be addressed in the remainder of the thesis.

In Part II of the thesis I critically review studies within traditional economics and political economy that engaged analysis of the 2008 crisis and its implications for capitalism. Here I outline three themes on what the crisis means for capitalism that emerge from this literature, including the traditional economic view that ‘capitalism will continue indefinitely’, and two political economy themes. These are ‘capitalism is ending’, and ‘capitalism is unlikely to end soon’. I use institutional-evolutionary theory to assess key arguments. In Part III, I refine the initial research question, and ask: what can the evolution of bank bailout policy tell us about the institutional evolution of capitalism? This narrower question focuses on the main policy that averted systemic contagion during 2008, bank bailouts, and involves
assessing the primary institutions of capitalism, their logic, and the ability of institutional regulation to marshal that logic in desired ways.

Contributions to knowledge are as follows. In Part I of the thesis I contribute to the development of institutional political economy by outlining the limits of its current state of theoretical heterogeneity. Excessive heterogeneity limits theoretical development in two ways: it involves mixing aspects of theoretical systems that are ultimately incompatible; and second, it limits the opportunity to apply, test, and refine a single coherent body of thought over time. I argue institutional political economy would benefit through more focussed efforts to develop a system of theory over time. I propose Thorstein Veblen’s evolutionary economics as suitable for such a role. The latter will provide the theoretical framework for Parts II and III.

In Part II institutional-evolutionary theory is applied to provide an original critique of the limitations of current debates on the future of capitalism, as offered by traditional economics and critical political economy. I use empirical evidence gathered from secondary sources to support theoretical critique, and I refute the claim that global capitalism is in structural decline. In Part III, the thesis provides an original theoretical analysis of the evolution of financial institutions in response to crisis since the 18th century. This evolution has resulted in ‘Too big to fail’ policy diffusing globally. I argue that this history holds important insights about the 2008 crisis, about institutional evolution and diffusion, and about the systemic logic of capitalism and financial crisis. Based on analysis of this history, I argue that bank bailouts are an evolutionary sub-optimal lock-in peculiar to capitalist development. The fundamental connection between risk and financial innovation means that there is no regulatory solution to ‘Too big to fail’ in the context of a capitalist system.

**Thesis Overview**

Part I comprises five chapters, and develops an institutional-evolutionary theory of social change. Chapter One outline the diversity of historical traditions that have fed
into the development of institutional political economy, including how they diverge, as well as important common ground that distinguishes the approach from traditional economics. I outline key achievements in the field. However, I also count the costs of theoretical pluralism, and argue that application and testing of an internally consistent theoretical system over time would benefit the development of institutional political economy. I argue that institutional-evolutionary economics offers an integrated and rich theoretical system for this task. It further offers a theory highly adapted for the research question under investigation here.

Chapter Two charts the historical origins of institutional-evolutionary theory in Thorstein Veblen’s radical economics. Veblen integrated Darwinian principles into his economic theory, as well as William James’ instinct-habit psychology, and proposed a radical new form of evolutionary economics. In developing his system he also outlined a sustained and cutting critique of classic economics, and the neoclassical synthesis of the late 19th century. Many aspects of this critique continue to be relevant today, due to the ongoing dominance of neoclassical ideas within traditional economics.

Chapter Three outlines how after initial success in American academia, Veblen’s evolutionary approach to institutional economics fell out of intellectual favour. I highlight how misguided fears about the role of Darwinism in social science, along with shifting intellectual currents, led Veblen’s contemporaries and students to abandon his radical project. Contemporaries such as John R. Commons dropped Darwinian ideas and instead developed concepts for legal and historical institutionalism. Recovering this history is important because social science today still struggles to integrate biology into its theories, despite the strong evidence that humans are in fact biological. Darwinism continues to be misunderstood as denying agency, as John R. Commons believed in leaving aside Veblen’s work.

Chapter Four is the first of two chapters engaging with Geoffrey Hodgson’s reconstruction of Veblen’s work. In this chapter I discuss a number of important criticisms laid against Veblen’s theory, argue for the continuing relevance of his key
contributions, and link his work to recent developments in the social sciences which confirm many of Veblen’s original arguments. I outline recent evidence from evolutionary psychology that vindicates Veblen’s original application of William James’ instinct-habit psychology. This chapter also outlines a critique of Veblen’s arguments regarding how technology impacts upon cultural development.

Chapter Five turns to Geoffrey Hodgson’s efforts in fortifying a number of half-built ramparts holding up Veblen’s theoretical edifice. This involves a wide-ranging recourse to contemporary developments in philosophy, as well as the social and natural sciences. I bring together key elements of institutional-evolutionary theory developed over the past three decades that are otherwise scattered across the literature, including the philosophy of emergence, population thinking, generalized Darwinism, and domain-specific mechanisms of evolution. I critique a debate on whether variations or commonalities across capitalist economies are more important in determining social change. I argue this dichotomy is misguided, and can be productively resolved using population thinking.

Part II takes up the debate on the future of capitalism post-2008. I review key debates, assess major claims, and use institutional-evolutionary theory to critique political economy, and provide conceptual tools to overcome identified weaknesses. I focus attention on the ‘capitalism is ending’ versus ‘capitalism is unlikely to end’ debate.

Chapter Six elaborates the view from traditional economics on what the 2008 crisis implies for future economic development. I sketch out the implicit ‘end of history’ view undergirding traditional analysis, and point out that there is no theoretical attempt to view the crisis as a historical dynamic or evolutionary trend. Instead analysis is focussed on contingent factors such as state regulation and individual morality. Veblen’s original critique of the narrow ontological foundations of neoclassical economics is shown to be still relevant today.

Chapter Seven reviews the key arguments in the political economy debate on the future of capitalism. Here history and system dynamics are the focus of
attention, and predictions of the future evolution of capitalism are forthcoming. The ‘capitalism is ending’ view comprises of studies which argue that capitalism’s contradictions are systemic and incurable, meaning they cannot be institutionally managed. For that reason global capitalism is claimed to be in terminal decline. Opponents of that view argue the global economy is far more durable and dynamic, again due to systemic factors. After identifying the key arguments for both positions I turn to chapter eight, where I critique the ‘capitalism is ending’ view.

Chapter Eight critically engages key arguments that technological unemployment, low-growth/stagnation, or sovereign debt-default in Western economies will be fatal to the world economy. Drawing on institutional-evolutionary theory and secondary data, I assess and refute each of these arguments. I further critique the claim that a China-led Asia will not drive future global growth, and highlight theoretical weaknesses in Western-centric analyses of capitalism. Here I argue that the evolutionary concepts of ‘population thinking’ and the ‘impurity principle’, discussed in chapter five, are vital for understanding global capitalist dynamics. Part II establishes that global capitalism is not in terminal economic decline.

Part III turns to an original analysis of the development and diffusion of bank bailout policy, arguing it highlights a key trend that will impact future political economy. ‘Too big to fail’ policy was essential for averting a global financial meltdown in 2008. I argue that the institutional history of bank bailout policy provides insights on the logic of capitalism’s historical evolution. Chapter nine examines instances of bank bailouts globally between 1792 and 1984, the latter year being when ‘Too big to fail’ policy was officially acknowledged in the United States. I identify an evolutionary process of variation, selection and retention as determining the contemporary institutionalization of ‘Too big to fail’ as a global policy. I argue that this history provides evidence to support Veblen’s hypothesis that institutions act as units of selection.
Chapter Ten takes up the argument that bank bailouts are a case of Darwinian institutional evolution. Here I examine political reactions and significant anti-bailout sentiment generated by bailouts in the United States during the 1980s and again in 2008/2009. In 1991 and 2010 significant pieces of legislation were formulated to end ‘Too big to fail’. The chapter examines both of these legislative Acts, and assesses the reasons why despite political will to end bank bailouts a ‘systemic risk’ clause was maintained. I argue that capitalism’s institutions impart risk-taking behaviour to agents because the economy requires risk-taking to function. The possibility of excessive risk is embedded within this behavioural matrix, and as a result there can be no final regulatory solution to the problem of ‘Too big to fail’ within a capitalist economy. The policy is an example of evolutionary, sub-optimal lock-in. It is the best possible solution to systemic risk, but sub-optimal due to the political and economic costs involved. Bailouts generate almost as big a set of problems as they solve, through undermining capitalist ideology and incurring large economic costs. The policy persists, not due to political agency, but in spite of it, as a consequence of institutional evolution. The final section of this thesis concludes.
Part I: Theorizing Social Evolution
Chapter 1. For an Institutional-Evolutionary Political Economy

This research argues that an institutional approach to political economy is appropriate for assessing socio-economic evolution. However, institutional political economy presents a problem of diversity. For instance, Chang argues that institutional political economy follows ‘a long tradition stretching from Karl Marx through Thorstein Veblen, Joseph Schumpeter, Karl Polanyi, Andrew Shonfield and Herbert Simon’. (Chang, 2002, p. 551). Another institutional political economist, Wolfgang Streeck, argues that the theoretical lineage is Marx, Luxemburg, Weber, Schumpeter and Polanyi (Streeck, 2011, p. 140; 2014a, 2014b, 2016b). Cangiani presents an institutional political economy connected to thinkers ranging ‘from Karl Marx to Thorstein Veblen, from Max Weber to Adolf Löwe and Karl William Kapp’ (2017, p. 915). However, none of these studies make explicit the theoretical similarities and differences which these list of luminaries represent, to say nothing of the diverse politics expressed therein.

A survey of the literature further highlights how the ideas of these luminaries are operationalized in highly insightful ways (e.g. Burlamaqui, Castro, & Chang, 2000; J. L. Campbell, 1997; Chang, 1994, 2000; 2002; Crouch, 2005; Dugger, 1988b; Elliott, 1978; Heilbroner, 1986; Hodgson, 1988, 2004b, 2007a, 2015; Lazonick, 1991; P. A. O’Hara, 2000; Streeck, 2009, 2010, 2011, 2014a, 2016b; Streeck & Thelen, 2005). Some of these will be discussed in more detail below. For now I wish to point out that diversity provides resources for creative synthesis. However, it also poses the danger of offering a theoretical ‘grab bag’ of ideas that will eventually run into self-contradiction. Consider the fact that the combined list of preeminent thinkers identified above hail from pronounced and significantly different theoretical traditions, from revolutionary Marxism, to Veblen’s Darwinian institutionalism, to
Weber’s interpretive sociology, through to the reform-orientated institutionalism of Shonfield.

There are important cleavages within that spread, such that at a certain point creative synthesis of such thinkers must either move towards reconciling contradicting elements, thereby building a unified body of thought, or face theoretical contradiction that will undermine analysis. If these foundational figures can be connected by some shared commitments, and I shall argue below they can, it is still the case that as currently developed within the literature institutional political economy is a fractious body of thought. This chapter therefore aims to do two things. First, given the above noted ambiguity regarding the relationship between foundational thinkers within institutional political economy, I argue we need a clear account of how the tradition is connected by shared commitments, and also to acknowledge that there are significant differences. To achieve this I engage an extensive literature review, identifying key tenets undergirding all institutional political economy. These shared commitments are brought into further relief as the condition by which we can distinguish an institutional political economy from traditional neoclassical economics and rational-choice institutionalism. Second, I argue that while theoretical diversity has it benefits, it also presents the problem of contradiction. Thus, another approach is to develop a systematic and integrated theoretical system.

The second goal of this chapter is to argue that an existing strand of institutional political economy based on the work of Thorstein Veblen offers an internally consistent and systematic theory of socio-economic life. Noteworthy of Veblen’s American institutionalism was its attempt to develop a social theory that utilized Darwinian philosophy, referring to ‘an unrelenting search for causal explanations’ (Hodgson 2004b, p. 65), a Darwinian-inspired theory of institutional evolution, and a highly developed theory of agent socialization based upon William James (1890) instinct-habit psychology (Camic & Hodgson, 2011b; Hodgson, 1992,
Veblen’s ambitious programme of ‘institutional economics’ was intellectually prominent at the turn of the twentieth century (Rutherford, 1997). However, its programme fell out of favour post World War Two, to be supplanted by neoclassical economics, and to a lesser extent Keynesian and behavioural economics.


This chapter proceeds as follows. Section one reviews the studies in institutional political economy, highlighting the theoretical pluralism in the field. Section two highlights how a research agenda based on comparative capitalism both connects much institutionalist research, and represents a political cleavage between reformists and revolutionary approaches within the tradition. Section three outlines common ground within the institutionalist tradition, namely a historical and structural approach to social analysis. Section four will summarize the review of institutionalist literature, and propose institutional-evolutionary economics as a coherent and theoretically rich body of thought that holds much potential for furthering the field. Furthermore, I argue that this theory offers the most developed tools for assessing the research question under investigation in this thesis.

1.1. Diversity in Institutional Political Economy

Institutional political economy approaches to studying economic life re-emerged in prominence amongst social scientists during the 1980s (J. L. Campbell, 1997), and have continued to proliferate since that time (Baccaro & Pontusson, 2016; Boyer,
This tradition of economic study is in fundamental opposition, methodologically and theoretically, with traditional neoclassical economics. Throughout this thesis I critique the limitations of traditional economics relative to institutional economics. Consequently, before going any further I will define the term ‘traditional economics’.

By traditional neoclassical economics I refer to the economic theory that dominates academic economics, the theory that ‘one finds in university textbooks, discussed in the news media, and referred to in the halls of business and government’ (Beinhocker, 2006, p. 24). This economic theory developed out of the marginal revolution led by William Jevons, Leon Walras and Alfred Marshall at the turn of the twentieth century (Heilbroner, 1997), and came to dominate academic economics during the twentieth century (Colander, 2000). Of the marginalists, it was Leon Walras’ model of general equilibrium that came to dominate as the axiomatic foundation on which neoclassical economic theory was hung (Bowles & Gintis, 2000). Colander identifies the core set of principles of this theory as follows:

…utility-maximizing by consumers and profit-maximizing for firms, far-sighted individual rationality, and a belief in equilibrium, which meant that, structurally, individual's decisions in the models fit reasonably well together…By the late 20th century, these principles formed the core of economists' vision of reality, in the sense that all economic models were built on these principles, or around variations of these principles like assumptions of bounded rationality or imperfect information (2000, pp. 126-127).

The axiomatic assumptions concerning utility-maximizing as a universal behaviour, boundless rationality, and general equilibrium undergirding traditional neoclassical theory are resolutely contested by institutional economists since Thorstein Veblen asked ‘Why is economics not an evolutionary science?’ (Veblen, 1898b). Chapter two will discuss this original critique by Veblen in detail. When referring to traditional economics through this thesis, it is the above theory to which I refer. In addition, I note that since the 1980s economics the dominance of traditional economics has been
internally critique by economists developing game theory, evolutionary theory, and experimental economics in ways that challenge traditional principles (Davis, 2006, 2007; Hodgson, 2007a). Nevertheless, these heterodox approaches have yet to supplant traditional neoclassical theory from its dominant position. I return to a review of institutional political economy.

The diversity of institutional political economy can be illustrated by the following studies. Mattick (2011) develops a critique of financialization in the post-war era as an outcome of the insatiable drive for profit arising from capitalist institutions. In doing so he draws vicariously on insights from Marx, Veblen and Wesley Mitchell. Chang (2002) develops an institutional critique of neoliberal claims that markets can operate without any regulatory and legal role for the state. He identifies Marx, Veblen, Schumpeter, Polanyi, Shonfield and Simon as inspirational thinkers, but doesn’t specifically operationalize any of these thinkers’ key concepts, nor offer a developed account of how they should relate. Chang does, however, point to an important common ground within the tradition, given as the view that ‘institutions are not simply constraints on the behaviours of preformed and unchanging individuals…but also as shaping the individuals themselves’ (2002, p. 551-552). I will discuss this point further in section three.

Cangiani (2017) develops an institutional critique of neoliberal policy and financial rent-seeking that builds on Polanyi’s institutional approach. The study focuses on Polanyi’s work, and relates Marx and Polanyi’s work at a general level, noting that each viewed capitalism as a society, and not simply economic relations that could be understood in isolation to politics and culture. Cangiani states that Marx and Polanyi understood ‘society as a system of relations among human beings, thereby tracing the distinction between natural and historical laws…[and]…the failure to understand society in its historical-institutional setup results in explanations of social processes in terms of natural laws’ (2017, p. 931). This point is another strong line of connection between all institutional political economy, which again will be explored further in section three.
Lazonick (1991) exhibits a highly pluralistic approach in his argument that market coordination has given way to business organization and planning by the firm as the primary force coordinating economic life during the twentieth century. In making his case he draws upon insights from Karl Marx, Joseph Schumpeter, Alfred Marshall and Alfred Chandler. Marx is drawn upon for his ‘focus on the utilization of productive resources’, Schumpeter for his ‘focus on the development of productive forces’ and Marshall for his ‘focus on planned versus market coordination in the generation of cost reductions’ (1991, p. 8), in arguing that business organization through the firm is more important than market forces in coordinating modern economic development. As such, Lazonick’s work constitutes a direct challenge to traditional neoclassical economics, especially equilibrium theory.

Streeck’s institutional approach can be temporally divided as weighted towards particular schools of thought in different periods. His earlier work (Crouch & Streeck, 1997; Streeck, 1997; Streeck & Thelen, 2005) can most clearly be viewed as following in the tradition of Andrew Shonfield’s (1965) comparative institutionalism that sought to assess the various ways different nation-states have regulated and managed capitalist development. In following Shonfield’s lead Streeck’s earlier work is primarily concerned with understanding global capitalism as composed of distinct national varieties, and assessing how these variations evolve through path-dependent processes.

Streeck’s later work (Streeck, 2014a, 2014b, 2016b) takes a pronounced Marxist turn, focusing on the contradictions of capitalism, and what he argues are the unmanageability of these contradictions. These latter studies by Streeck contribute to the ‘future of capitalism’ debate. I outline Streeck’s position in chapter seven, and critique it in chapter eight. The earlier and later institutionalisms of Streeck contain significantly divergent theoretical orientations, the one focussed on variation in capitalism, the other on fundamental commonalities across all capitalist economies.

As highlighted, many institutional political economy studies are relatively particularistic, in the sense that taken together they do not lend themselves to the
development of an integrated theoretical framework. This results from the fact that studies draw upon a wide range of thinkers from different schools of thought. Sometimes elements of these thinkers are critically integrated to some degree, by identifying shared concerns and methods, sometimes foundational thinkers are simply named as inspirational figures with no clear indication as to how they should relate. These singular studies represent a theoretically fractious body of thought. I will now turn to some institutional political economies studies that have attempted to integrate some key thinkers.

The Veblen-inspired ‘radical institutionalism’ (Dugger, 1988a, 1988b, 2006; P. A. O’Hara, 2000; Stanfield, 1989, 1995), has sought to develop an institutional theory based upon a synthesis of Marx and Veblen’s work. Radical institutionalism views itself as ‘a first cousin to Marxism’ (Dugger, 1988a, p. 1), in light of the fact that Veblen agreed with Marx’s analysis of capitalism on a number of fronts: he accepted the importance of economic relations in shaping wider social relations; he called for a socialist solution to capitalism; and he held similar views on theories of capital and productive versus unproductive action (P. A. O’Hara, 2000). Building on Marx, radical institutionalists reject reform in favour of radical change as the only solution to capitalist social ills; they view the economy as a dynamic process rather than tending towards equilibrium; and see economics as thoroughly politicized. Under Veblen’s influence radical institutionalism rejects notions of self-regarding economic rationality found in neoclassical economic theory (Veblen, 1898b, p. 390; [1907] 2007b, p. 440).

Neoclassical economic rationality refers to the claim that all agents are utility-maximizing (Chaudhuri, 2009, p. 3), whereas Veblen argued that other norms and values acquired during the socialization process influence economic behaviour. Dugger (1998a, p. 2) identifies two major differences between Marx and Veblen. First, Veblen did not think an egalitarian society was likely, due to his pessimistic view of humans as status-seeking and power-seeking agents. Second, Veblen disagreed with the labour theory of value, because he did not see value being
attributable to any single factor of production. Despite these differences, radical institutionalists see Marxism and Veblenian institutionalism as compatible.

However, other commentators on the relationship of Marx to Veblen argue that they are not reducible to one another (Hodgson, 2004b; Penner, 2011) despite sharing much in common (Simich & Tilman, 1982). Beyond the labour theory of value, Veblen rejected other components of historical materialism. First, he disagreed with the universal status afforded to class conflict over economic distribution by historical materialism, since ‘the sentiment which animates men, singly or collectively, is as much, or more, an outcome of habit and native propensity as of calculated material interest’ (Veblen, [1907] 2007a, p. 308). Thus, Veblen did not view class conflict as fundamental, or universal, to every historical society. Second, Veblen developed a Darwinian-inspired theory of social evolution that is theoretically incompatible with historical materialism. Marx and Veblen each represent a unique approach to social study based on different philosophical and methodological foundations.

Hodgson’s work (Hodgson, 1988, 1993, 2001, 2004b, 2015; Hodgson & Knudsen, 2010) highlights these theoretical differences. Hodgson argues that radical institutionalists have underplayed irreducible differences between Marx and Veblen (Hodgson, 2004, p. 132). Veblen makes significant recourse to evolutionary biology in order to understand the biologically-endowed motivation-structure of the human organism and its related psychology, and how this impacts the process of socialization. Such an approach has no analogue either in Marx, or in any of the other major institutional thinkers. A further point of distinction separating Veblen from the rest of the field is his use of Darwinian evolutionary theory.

Hodgson argues that Veblen developed Darwinian evolutionary theory to be applicable beyond the biological domain. Veblen understood Darwinism as providing ‘a specific framework for understanding the evolution of all open, complex systems, that have varied and replicating elements with different capacities to survive’ (Hodgson, 2004b, p. 8, 2015, p. 40). This extension of Darwin’s ideas is
referred to as ‘generalized Darwinism’ (Buskes, 2013; Hodgson & Knudsen, 2006b), referring to a metatheory of change that is valid in multiple domains, including biological evolution and social evolution. I discuss this idea further in chapter five. Veblen’s theory stands alone as its own system, as Anderson pointed out, stating that Veblen ‘is the creator of a new system of theory’ (Anderson, 1933, p. 622). Across the next four chapters I argue this assessment is true. As a result, any attempt to integrate Veblen with Marx, can only occur by giving up this new system of theory in lieu of a significantly reduced and emasculated reading of Veblen’s work.

A final important point of difference within institutional political economy relates to different position taken by institutionalists following Shonfield’s comparative approach and Marxism regarding the possibility for institutional reform and social fixes of capitalist ills. On the one hand, Marxism has never deviated from the conclusion that ‘capitalism must be replaced’ rather than reformed since the social ills it generates ‘are part of the DNA of the capitalist system’ (Lebowitz, 2006, p. 12; Mandel, 1971; Roberts, 2016). Revolution over reform is an axiomatic principle of Marxist political economy. However, as the next section will show, institutionalists have a long tradition of seeking reform of the economic system. Consequently, development of institutional political economy must account for a political cleavage within its tradition.

1.2. Comparative Capitalism and the Programme for Economic Reform

‘Comparative capitalism’ is a research agenda that connects much institutionalist research from the later twentieth century onwards. One goal of comparing political economies was to glean insights for positive reforms. Consequently, where Marx, and to a lesser extent Polanyi, conceived of capitalist social relations as entailing ineradicable tensions (Marx, 1990; Polanyi, 1944), later institutionalists moved away from notions of interminable class conflict and revolution. Andrew Shonfield’s (1965) seminal work highlighted the institutional diversity under which modern
capitalist relations were reproduced in different nation-states, and which resulted in vastly different social outcomes.

Specifically, Shonfield sought to show that capitalism could be made to work through institutional management of its contradictions, highlighting the successes of models of capitalism found in Sweden, France, Germany and Italy to vitiate capitalist exploitation as evidence. Each model exhibited different ways of instituting the market, of managing and reducing capitalist exploitation, implemented various forms of social welfare that was absent in earlier periods, and also utilized macro-economics to reduce the severity of the business cycle. These variations of capitalism appeared theoretically unexplainable within Marxist formulations that have often posited ‘a global system of capitalism that is coherent and unified and which can only be dismantled as a whole’ (Block, 2000, p. 84; Gibson-Graham, 1996).

Marxist political economy has long contained a theoretical blind spot regarding institutional variation, with Marxists themselves coming to acknowledge this ‘institution-gap’ in their analysis (Kannankulam & Georgi, 2014, p. 60). A number of Marxists studies have sought to address this issue (e.g. Gough, 2014; Hartmann, 2014). However, chapter eight highlights that there is still a pronounced tendency within Marxist analysis to assess the global political economy as a single, unified system, leading to inadequate assessments of capitalism’s future. Returning to the point at hand, comparative institutional analysis has tended to be reform-orientated, and therefore contrary to Marxist presuppositions that view reform as impossible.

A central conviction underpinning Shonfield’s work was the idea that capitalist states would all converge towards a mixed economy in which the free market would be heavily regulated for the public good through state intervention (Boyer 2005). Consequently, Shonfield’s institutionalism ‘was not just about diversity, but also about ‘convergence’ of modern democratic capitalism on a version of ‘embedded liberalism’” common in the post-war era (Crouch & Streeck, 1997, p. 5). ‘Embedded liberalism is used by Ruggie (1982) in reference to the post-war
consensus among Western governments that certain social goals should be institutionally secured, even if it cost some economic efficiency. This latter approach died in Britain and America under Thatcher and Reagan administrations respectively, as neo-liberal politics reinforced the idea that social goals must follow from first achieving market efficiency, not in lieu of it (Larner, 2000; Peck, 2012). By the 1990s institutionalists wondered whether the direction of state capitalism globally would now converge towards the Anglo-Saxon model of liberal capitalism (Streeck, 1997). However, this has not occurred, and there is a strong consensus that ‘no unique or optimal combination of subsystems and institutions in capitalism’ will emerge as a normative convergence point for all other combinations (Hodgson, 1996, p. 381; see also Amable, 2000; Boyer, 2005; Hall, 2007; Hall & Soskice, 2001; Streeck & Thelen, 2005).

In light of this latter point, comparative studies of capitalism have continued to follow the approach outlined by Shonfield, generating a vast body of work (for example Albert, 1993; Amable, 2000; Aoki, 2001, 2010; Baccaro & Howell, 2011; Baccaro & Pontusson, 2016; Crouch, 2005; Dore, 1997, 2000; Hall & Soskice, 2001; Mastroeni, 2012; Sabel, Herrigel, Deeg, & Kazis, 1989; Streeck & Thelen, 2005). This research has drawn liberally upon the three social science institutionalisms that consolidated during the latter half of the twentieth century (Campbell 1997; Hall & Taylor 1996). In brief these are rational choice institutional, which understands socio-economic institutional order as a consequence of agents seeking economic efficiency (North, 1990; O. E. Williamson, 1985); historical institutionalism, which focuses on the effects of path dependency in shaping political antagonism between interest groups (Hall & Taylor, 1998); and sociological institutionalism, which emphasized a Durkheimian focus on the role of normative and cognitive ideas for regulating and legitimizing social action (DiMaggio & Powell, 1991).

The main proposition of the comparative literature is that ‘the institutional dimension is crucial if one wants to account for the coexistence of different types of modern developed economies’ (Amable, 2000, p. 645). Reasons for ongoing diversity
include ‘path dependent’ development (Arthur, Ermoliev, & Kaniovski, 1987; Mahoney, 2000; Pierson, 2000), referring to the fact that all societies have their own unique customs and social practices resulting in unique evolutionary patterns of development, as well as historical inertia, even when they also have institutions common in other societies (J. L. Campbell, 2004). Another cause of diversity is ‘institutional complementarity’, which refers to the fact that many, if not all, institutions require other institutions to reproduce themselves effectively (Crouch et al., 2005). Each society has their own unique mix of institutions that have developed in complement to one another. As a consequence, an institution that works well in one society cannot necessarily be simply grafted into another society, since the existing complement of institutions in the new society may not support the new institution. The effects of path dependency and institutional complementarity tend to militate against complete institutional redesign or copying of other national models, and consequently tend to lock-in institutional diversity. As Streeck has succinctly stated: ‘Each nation has its own history of incorporating capitalism into its institutional and class structure and regulating the intersection between capitalism and society. No two such histories are the same nor are their results’ (2016c, p. 246).

One of the more influential strands of comparative capitalism has been the ‘varieties of capitalism’ (VoC) approach (Hall, 2007; Hall & Soskice, 2001, 2003). This approach is built upon a firm-centred analysis of economic development, based upon a relational view of action. Firms must solve coordination problems, whereby success is to a large extent dependent upon being able to interact effectively with other social actors on issues including: wage bargaining, training and education, corporate governance, employee management. Coordination places limits on firm agency since firms must always face a ‘set of coordinating institutions whose character is not fully under their control’ (Hall and Soskice, 2001, p.15). For this reason successful firms are ones which can most effectively utilize the advantages available when operating within a given social framework, and it is also for this reason that in important ways ‘strategy follows structure’ (ibid, p. 15). This means
that successful firms devise economic strategy to suit the institutional structure and norms of the societies under which they operate in. As a result, corporate structures of global multinationals also must reflect a degree of institutional variation in line with the markets in which they operate.

Criticisms have been made of the VoC research agenda. First, it is argued that it reproduces errors in neoclassical theory that result from a theory of rational utility-maximization as the trans-historical motive driving agent behaviour (Jessop, 2014). This leads to the view that institutional variations of capitalism are ‘institutional equilibria from which rational actors do not have any incentive to deviate’ (Baccaro & Pontusson, 2016, p. 178). VoC has been critiqued for maintaining a too rigid binary division of capitalist variation as fitting either a liberal or coordinated market economy, or sometimes a mixed economy (Boyer, 2005; Gough, 2014). Criticism of this model is directed at how system evolution is theorised ‘only in the narrow sense of reactions to exogenous shocks that return them to equilibrium. Functionalist change of this sort is ahistorical; it is no more than negative feedback in the service of restoring an essentially indelible, unchangeable, eternal condition’ (Streeck 2016: 245).

A further criticism is that within VoC research the focus on variation has led to a failure to theorize in sufficient detail the commonalities shared by all capitalist economies (Bruff, 2011; Streeck, 2010). Drawing upon Marx’s work, this critique points out that studies on variation often fail to theorize the powerful, crisis-producing effects of capitalist relations. If studies do acknowledge such contradictions it typically ‘assumes they can be harmonised more or less effectively’ (Jessop, 2014, p. 50). Hall has sought to update the ‘varieties of capitalism’ programme in light of some of this criticism, for example by placing a greater emphasis on distributive conflicts and how they drive change (Hall, 2007, p. 40). Streeck (2016) and Baccaro and Pontusson (2016) have proposed a ‘growth model’ approach to replace the VoC rational-choice model. The ‘growth model’ seeks a greater focus on power relations, and rejects fixed apriori typologies of economic
variation, instead proposes a dynamic study of the interaction between a national growth strategy and the political-economic structure of a nation, comprised of groups who may contest or facilitate that strategy.

In coming to a close in this section I highlight a clear difference between comparative institutionalism and Marxist institutionalism. While some Marxist studies now examine capitalist variation, and while some comparative studies are more attuned to conflict and power, it should be nevertheless clear that true integration of these approaches is impossible, since the ‘epistemological and analytical presuppositions and, above all, the (mostly implicit) political aims are too different’ (Kannankulam, 2014, p. 60). Comparative approaches seek to understand how and why capitalism can be effectively regulated. Whereas all Marxism theory already presupposes that capitalism cannot be socially managed in the long-run. Thus to return to the question of institutional political economy heterodoxy, I argue that a tradition that claims Marxism and Shonfield’s comparative capitalism as foundational to its approach, needs to clarify the insoluble limits of such heterogeneity.

1.3. Common Ground in Institutional Political Economy

Institutional political economy understood ‘society as a system of relations among human beings, thereby tracing the distinction between natural and historical laws’ (Cangiani, 2017, p.931). This historical method flows from the work of Karl Marx. Heilbroner argues that one of the enduring contributions of Marx to social science was his ‘discovery of an unsuspected level of reality beneath the surface of history’ (1980, p. 17), and furthermore, the development of a historical mode of analysis to reveal this reality. This aspect of society is today known as social structure, and Heilbroner argues that Marx is the modern founder of ‘socioanalysis’, a mode of inquiry that is able to assess structural and historical relations and therefore ‘opens an understanding of society that is otherwise totally inaccessible’ (ibid, p. 138). Or as
Schumpeter put it: ‘[Marx] was the first economist of top rank to see and to teach systematically how economic theory may be turned into historical analysis and how the historical narrative may be turned into histoire raisonnée’ ([1942] 2008, p. 44, emphasis original). For this reason that Hodgson praises Marx for developing a theoretical ‘highpoint’ of the concept of social structure and how it impinges upon social development (Hodgson, 2004b, p. 13). Marx set the grounds for understanding society this way (Heilbroner, 1980), laying tracks that later thinkers followed. In this broad sense Marx provided a foundational approach to social analysis that all institutionalists utilize to a more or less degree.

While acknowledging that figures who followed Marx took their analysis in different directions, and in doing so generated different sets of concepts and theoretical traditions along the way, Marx’s structural and historical approach is common to all major traditions of institutional political economy. Veblen argued that for economics ‘the subject of inquiry is the conduct of man in his dealings with the material means of life, the science is necessarily an inquiry into the life-history of material civilization’ (Veblen, 1909b, pp. 627-628). Here Veblen emphasized that economic life intersects with all other aspects of life, and study of it must not be isolated ‘from all other phases and bearings of human culture’ (ibid, p. 628), thus indicating a view of capitalism as a society rather than only an economy. Weber’s ([1930] 2001) classic study on the cultural origins of capitalism examined how the Calvinist doctrine of predestination were interpreted in a manner whereby economic success was viewed as indicating that the agent succeeding was one of God’s chosen. In this way religion became an important causal factor driving capitalist economic behaviour, again emphasising a holistic view of social relations, examined historically and structurally for causal relations flowing between institutional spheres.

Schumpeter ([1942] 2008) and Polanyi (1944) adopted similar approaches in asking whether non-capitalist values prominent in modern capitalist societies could be reconciled with capitalist exploitation and inequality over the long-term.
Consequently, at a broad level, a positive connection between all institutional political economy is its concern with the co-evolution of political and economic institutions, and how this impacts the entire social structure (Elliott, 1978; Fusfeld, 1977). This stands in contrast against unrealistic conceptions of the economy as a neutral domain separate from the rest of social life found in traditional economics. Institutional political economy places emphasis upon ‘political factors in economic life and the conception of the economy as a system of power’ (Commons, 1924; Elliott, 1978, p. 92; J. K. Galbraith, 1971). The starting premise is one which conceives ‘society and economy as densely intertwined and closely interdependent’ (Streeck, 2011, p. 137).

This holistic approach to economy and society unambiguously distinguishes institutional political economy from the approach taken by traditional neoclassical economics based upon Walrasian equilibrium theory. Institutionalists have critiqued neoclassical economics on grounds that it divorces economic activity from the wider non-economic social spheres within which it exists is causally related to (Heilbroner, 1990; Hodgson, 1988; Veblen, 1909b). As Heilbroner points out, in standard neoclassical theory capitalism appears ‘only as a “system” of tightly specified market-mediated relationships, rather than as a continuously evolving social order’ (ibid, p. 1107). According to Walrasian neoclassical economics such a system is historically static, with market relations understand as a “natural” outcome of a universal behavioural characteristic, ‘rational’ utility maximising, ascribed to all humans.

In neoclassical economics the term ‘rational’ is used to refer to the specific motivation and logic by which actors make economic decisions. Specifically, the concept entails the view that ‘humans are primarily motivated by “self-regarding” preferences’ and during economic interactions they base their strategy exclusively to ensure the greatest ‘utility’ is achieved, which in economic life refers to the greatest monetary payoff (Chaudhuri, 2009, p. 3). This view of rationality has a long history of critique by institutional economists (Hodgson, 1998a, 2004b; Mitchell, 1910;
Veblen, 1898b, 1909b). These critiques will be discussed further in chapters two and three. The ahistorical and static neoclassical model of economic life stands in contrast to the ‘strong’ institutional political economy approach, which views social change as a dynamic process both constrained and pushed forward by historical forces (Heilbroner, 1986; Hodgson, 2001; Streeck, 2014a). For institutionalists, all markets, like society itself, are institutional constructs in a constant state of flux. The constructed nature of markets is evidenced by the necessary range of formal and informal institutions that define rights, obligations and power hierarchies; while dynamic aspects are evidenced by ongoing political contestation and re-negotiation by interested parties regarding the nature and scope of these rights and obligations, which in turn is reflective, and constructive, of economic power hierarchies (Chang, 2002).

Thus far, I have argued that institutional political economy is connected by a shared view of capitalism as a society rather than just an economy, thus demarking a major difference in approach relative to traditional neoclassical economics. However, during the latter half of the twentieth century a form of rational-choice institutionalism, termed the ‘new institutional economics’ to distinguish it from the ‘old’ American institutional economics of the early twentieth century based on the work of Thorstein Veblen, Wesley Mitchell and John R. Commons (Rutherford, 1994), has emerged as a critique of traditional neoclassical theory. It is worth a brief overview of this development, which is important in its own right, but also because it serves one purpose of this chapter to delineate the essential characteristics of institutional political economy.

The new institutionalism was initially developed by figures such as Oliver Williamson (1975, 1985, 2000), Douglas North (1981, 1989, 1990) and Ronald Coase (1992, 1998). The new institutionalists sought to develop a response to deficiencies in orthodox neoclassical theory. As noted above, one problem with neoclassical theory was that it had no theory of institutions or historical change (Hodgson, 2001), instead viewing the market in terms of a spontaneous equilibrium arising from the
interactions of knowledgeable, rational utility-maximizing individuals who know precisely their preferences at any given moment. The market was viewed to work efficiently, unless government regulations and institutions prevented these agents from exchanging with one another as they pleased.

During the 1970s the new institutionalists rejected the view of frictionless markets, or that institutions were barriers to efficient trade, by developing the concept of transactions costs and path dependency. For example, in a seminal article Coase (1937, p. 388) asked why a factor of production, management, would exist whose function is coordination, if the price mechanism already ensured such coordination? The answer was given in terms of transactions costs. Prices have to be discovered, negotiations have to be engaged for every exchange of goods, and contracts have to be made up. The point is that there is significant transaction costs involved in trading by single agents interacting within markets governed by the price mechanism. Coase then argues that: ‘The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism’ (1937, p. 390). The firm greatly reduces all of these costs by internalizing entire processes of production and their attendant relations between factors of production within a single organization through vertical integration.

Through such integration multiple contracts between factors of production can be made obsolete, reducing the costs involved in such contracting. Furthermore, vertical integration also works to significantly reduce the cost of acquiring information needed for trading. The firm, the argument goes, is a non-market organization that develops in order to deal with transactions costs, and this involves planning separate from, and apriori to, actual market trading. In coming to the conclusion that the market is not simply a spontaneous order, the new institutionalists made a significant advance on orthodox economic theory. Coase highlighted the difference as being the realization that Marshall’s (1961) axiomatic example that ‘lone individuals exchanging nuts for berries at the edge of the forest’ served as a ‘complete’ theory of market exchange was inadequate (1992, p. 718).
Consequently, the major focus of the new institutionalist paradigm has been to assess the necessary function of institutions to improve the efficiency of market relations spontaneously arising between individuals (North, 1990; O. E. Williamson, 1975, 1985). In doing these theorists sought to reconstruct traditional rational choice economics into an institutional version of rational choice. This involved modified assumptions regarding the possibility for rational utility maximizing based on Herbert Simon’s (1957) concept of ‘bounded rationality’. The latter implies that rational utility maximizing produces suboptimal formulations of preferences due to limited access to relevant information and limited cognitive abilities of individuals to process that information (J. L. Campbell, 2004; Rutherford, 1994). Institutions were considered as ways of dealing with transaction costs between individual who were seeking to maximize their self-interest. Thus, while providing some important critiques of neoclassical theory, the new institutionalism maintained neoclassical theory’s view of utility maximizing as the central drive leading to economic institutions.

Furthermore, while new institutionalist economics accept that institutions may affect individual behaviour, for example through sanctions, institutions are not viewed as affecting the deeply held preferences that drive behaviour. As a result, the most fundamental difference between the ‘new’ rational-choice institutionalism and institutional political economy, is that the latter argues that historical institutions make for historical individuals. That is, the fundamental preferences and motivations of individuals are in large part a product of their historical and institutional life. By acting within an institution individuals internalize some of the values of the institution they enact through institutional practice. This is termed the ‘constitutive role of institutions’ (Chang, 2002, p. 554; Rutherford, 1984), or referring to the same process ‘reconstitutive downward causation’ (Hodgson, 2000; 2001, p. 294). The power of social structure to mould individuals at this deep level of basic motivation was one of Marx’s key insights:
The principal agents of this mode of production itself, the capitalist and the wage-labourer, are as such simply embodiments and personifications of capital and wage-labour – specific social characters that the social production process stamps on individuals, products of these specific social relations of production (Marx, 1991, pp. 1019-1020).

Here Marx highlights the crucial role played by the historically specific set of social relations, in this case capitalism, in shaping the subjective character of the agents living within those relations. In doing so Marx provides highly developed concepts for progressing beyond a methodological individualist account of social evolution, with this point serving as an axiomatic theme in institutional political economy.

In fact, this point brings us to another defining idea shared by proponents of institutional political economy. Insofar as institutional political economy is unified in a negative sense due to its opposition to the rational-choice institutionalism, we find also a positive corollary in that it implies a common theoretical insight. Institutional political economy does not start from a universal deductive hypothesis postulating preformed and unchanging characteristics about individuals as independent variables, but rather sees institutions as shaping behaviour, rather than simply imposing constraint. This implies that individuals are themselves dependent variables for which hypothesis are constructed based on theorized causal dynamics resulting from wider social structures (Elliot 1978), as opposed to the ahistorical, preformed individual of neoclassical economic theory. In that light, Hodgson concisely sums both the heterogeneity of institutional theory and a core element that provides a degree of shared identity:

Institutionalists do not have a very good record in defining and agreeing among themselves upon the essentials of their approach. I submit, however, that there is a core idea in institutionalism that above all others helps to define its identity. The idea that institutions can be reconstitutive of individuals is arguably the most fundamental characteristic of institutional economics. Obviously, institutions themselves differ, in time and in space. However, individuals
themselves are also likely to be radically affected by these differences. Different institutions can act as more than constraints on behaviour: they may actually change the character and beliefs of the individual (Hodgson 2004: 257).

The insight on the reconstitutive role of social structure relative to individuals is a firm foundation on which to distinguish institutional political economy from rational-choice approaches. Whether following Marx, Veblen, Polanyi or Weber, for ‘strong’ institutionalists ‘society is not a product of competitive contracting but its precondition’ (Streeck, 2011, p. 154).

**Conclusion**

This literature review has highlighted the theoretical diversity of institutional political economy approaches to the study of economic life, as well as some strengths and weaknesses of the varying schools of thought within the field. The institutional field is far vaster than can be managed in a chapter. As a result, the above review is best viewed as a scaled map outlining the general boundaries of the terrain, as well as illustrating some defining topographical features. Like all maps, it must by necessity leave aside the finer details of such a vast territory. What the map does usefully highlight is that institutional political economy is a highly diverse field, is populated by numerous traditions built upon different analytical approaches, different conceptual frameworks and presuppositions and marked by significantly different political orientations. Spanning those cleavages are numerous singular studies that operationalize novel, if partial, syntheses of key thinkers.

Lazonick’s (1991) study illustrates this point. He productively applied insights from Marx and Marshall amongst others in his study of business organization. But to continue building on this synthesis would involve the unlikely task of integrating historical materialism and neoclassical economics into a single framework. Such studies are therefore singular in approach. I argue that so long as synthesis is partial, abiding contradictions between key thinkers mean this approach does not lend itself to a coherent theoretical framework for building a consistent body of research.
Alongside theoretical diversity, I have argued that institutional political economy can nevertheless be connected in a positive sense, in that it is grounded in a historical, structural and sociological approach pioneered by Marx, and developed in significant ways by luminaries such as Weber, Veblen and Schumpeter. This ‘strong’ institutionalism views social relations as playing a major role in constituting the preferences of individuals. Whereas, in contrast, rational-choice institutionalism starts from pre-given individuals whose goal-orientation of rational utility-maximizing is understood as trans-historic. From that latter viewpoint, society is an outcome of universal individual self-interest put into action under given institutional constraints. Institutional political economy is therefore distinguishable from the ‘new’ institutional economics of North, Coase and Williamson.

In light of the points made in this literature review, I now propose institutional-evolutionary economics economy as offering a path forward for developing an integrated framework for studying socio-economic life. Institutional-evolutionary theory is built upon a modern reconstruction of the seminal work of Thorstein Veblen. Amongst his many innovative theoretical achievements, Veblen developed a sustained critique of neoclassical economics, outlined a Darwinian-inspired theory of institutional evolution, and offered a powerful synthesis of William James (1890) instinct-habit psychology and social theory to develop a theory that linked micro-behaviour of agents to macro-level institutional socialization. It is argued that Veblen developed a new system of theory (Anderson, 1933; Hodgson, 2004b), the fruits of which I argue can best be realised by developing this system on its own terms. The benefits of an integrated framework is that it allows for building a coherent body of thought over time.

Across the next four chapters I argue in detail that Veblen’s work offers a major step in the direction of a more complete theory of socialization than is currently available in social theory, due to its divorce from biology during the twentieth century (Hodgson, 2004b; Mithen, 1998, p. 9; Wrong, 1961, p. 184). Veblen (1914) insisted that the explanation of cultural life absolutely had to entail
understanding of the biological organism and its evolved capacities. The evolved capacities of the human body are the foundation out of which culture emerges, and the medium through which it must inescapably operate. Biology matters for any full explanation of social life. As Hodgson points out, the problem in social theory during the twentieth century has been its failure to incorporate biology, while on the other hand, an equally untenable position taken by sociobiologists is that everything can be explained using biology (Hodgson, 2004b, p. 41). Veblen took neither of these absolutist paths, and instead related biology to social theory with a careful appreciation of the latter.

These above points will be developed in detail, and in the context of the major debates within the literature, in chapters two through five. In chapter two, I provide an account of the historical rise of Veblen’s institutional-evolutionary economics. This will involve outlining how Veblen’s work was inspired by Darwinian’s revolution in scientific thinking, leading him to argue for an evolutionary economics. Chapter two will engage a thorough reading of Veblen’s critique of the limitations of neoclassical economics, which is still relevant today, in light of the continuing influence of the latter traditional economics. I will also discuss how Veblen developed instinct-habit psychology within a theory of institutional change.
Chapter 2. Thorstein Veblen’s Radical Economics

In the next four chapters of Part I of this thesis, I present and argue for institutional-evolutionary economics as an integrated theory for studying capitalism. The crisis of 2008 has resulted in a major debate on the future of capitalism, which will be engaged with in detail in Parts II and III of the thesis. At the heart of this debate is an evolutionary question, one which Veblen’s theory is eminently suited to answering. This chapter will outline the historical emergence at the turn of the twentieth century of an institutional-evolutionary theory of social change developed by Thorstein Veblen. Veblen is widely recognised as the intellectual founder of American institutionalism (Hodgson, 2004b; P. A. O’Hara, 2000; E. Reinert & F. L. Viano, 2012). This chapter will trace the historical emergence of American institutionalism, under the aegis of Thorstein Veblen and his Darwinian institutional-evolutionary economics. Chapter three will discuss the loss of a number of Veblen’s most innovative theoretical innovations, as American institutionalism dropped Darwinian principles and instinct-habit psychology from its theoretical repertoire.

In brief for now, the rise and premature fall of institutional-evolutionary economics occurred between 1898 and the 1940s. In 1898 Veblen published his seminal paper ‘Why is Economics not an Evolutionary Science?’ that heralded his radical new approach; whereas by the 1930s, growing hostility within the social sciences to the use of Darwinism and instinct-habit psychology coincided with a decline of his brand of institutionalism (Hodgson, 2004b; Rutherford, 1998). Many of the arguments against Veblen’s theoretical synthesis of social theory with biology still persist today. These debates will be discussed in detail in chapter four. On the

To gain critical perspective on the resurgence of interest in Veblen’s work it is important to ground any reconstruction in a detailed appraisal of the origins and original demise of institutional-evolutionary economics. Thus, the history of American institutionalism taking up this chapter and the next are not merely for curiosity, but are essential to developing an intellectual foundation for twenty-first century institutional-evolutionary economics. The chapter will proceed as follows. Section one places Veblen in historical context, outlining his influence within the discipline of economics and the wider social sciences, and contextualizing his work as a positive reaction to the transformational impact of Darwin’s (1859) *Origin of the Species* on scientific thought at the end of the nineteenth century. Section two will elaborate Veblen’s critique of classical economics. Section three will present Veblen’s critique of marginalism, the nascent neoclassical synthesis emerging in economics, and his arguments for an evolutionary economics. Section four introduces Veblen’s appropriation of William James (1890) instinct-habit psychology. The final section concludes with a summary of the argument.
2.1. Thorstein Veblen and the Darwinian Revolution

Thorstein Veblen is today viewed as among ‘the most influential economists and social theorists of the twentieth century’ (Camic & Hodgson, 2011a, p. i; Heilbroner, 2000; Hodgson, 2004b; Louca & Perlman, 2000; P. A. O’Hara, 2000; E. Reinert & F. Viano, 2012). While typically discussed in relation to economic theory, Veblen’s argument that evolutionary processes applied beyond biology had a broader impact also, as they ‘helped define the post-Darwinian programme of inquiry into all the sciences’ (Banta, 2007, p. xv). Nevertheless, it is in economics where Veblen’s greatest contribution has been. Here he developed a cutting critique of neoclassical economics view of *homo economicus*, and also of the theory of general equilibrium standing at the heart of the neoclassical synthesis based on the ideas of Leon Walras ([1874] 1954). Against that Veblen offered a unique synthesis of Darwin’s insights into evolutionary mechanisms governing complex systems, instinct-habit psychology of William James (1890b) and institutionalism to develop his own model of socio-economic evolution.

Renewed contemporary appreciation for the philosophical and psychological principles Veblen utilised (Camic & Hodgson, 2011a; Twomey, 1998) indicate the depth and prescience of his original synthesis. Veblen’s work has ‘influenced thousands of economists’ over the past century in the United States and Europe (P. A. O’Hara, 2002, p. 79), and his work is garnering increasing interest by economists dissatisfied with neoclassical general equilibrium theory (Hodgson, 2007a, 2007c). Veblen’s re-emergence is connected to the fact that he is ‘the intellectual father of the two most influential economic schools to offer an alternative to today’s mainstream economics: evolutionary economics and institutional economics’ (Reinhert and Viano 2012: 1).

Veblen published one hundred and fifty or so research articles and books over his lifetime, with a complete bibliography listed in Camic and Hodgson (2011b). A true inter-disciplinarian, Veblen’s works contain economic theory, social theory,
historical analysis, psychology, biology and anthropology, and irreverent political commentary. His contributions include his philosophical grasp of the role played by unexamined theoretical preconceptions in science (Veblen, [1899] 2007a, [1899] 2007b, [1900] 2007); his application of instinct-habit psychology to theorise agency-structure causal relations, which was most fully developed in *The Instinct of Workmanship* (Veblen, 1914); and his attempt to formulate a unified theory of institutional evolution, with the clearest presentation of this found in *The Theory of the Leisure Class* (Veblen, [1899] 1970). In this chapter I will restrict myself to a clear elaboration of Veblen’s critique of the incumbent economic theories of his time, as well as his efforts at developing a new theoretical system. I leave a detailed critique of Veblen’s shortcomings until chapters four and five.

Veblen’s article ‘Why is Economics not an Evolutionary Science?’ (Veblen, 1898b) is a foundational text in institutional-evolutionary economics, and marked the ‘beginnings of a major paradigm shift in economic thought’ (Hodgson, 1998b). Published at the turn of the twentieth century, almost forty years after Darwin’s (1859) *The Origins of the Species*, it marked one of the earliest efforts to apply Darwinian principles to cultural evolution. This seminal paper by Veblen can be productively read alongside three articles that were published soon after (Veblen, [1899] 2007a, [1899] 2007b, [1900] 2007). These are titled ‘Preconceptions in Economic Science’, containing parts I, II and III. These latter articles provided an extended historical analysis of the critique of classical economics and marginalism given in the 1898 article, as well as outlining the crucial difference between pre- and post-Darwinian metaphysical preconceptions regarding causal process.

In combination, these four articles outlined Veblen’s critique of what he refers to as ‘classical economics’. For Veblen ‘classical economics’ refers to works ranging from the 18th century French Physiocrats and Adam Smith, through to the marginal revolution at the end of the 19th century and the works of William Jevons, Leon Walras and Carl Menger. He coined the term ‘neoclassical in 1900 (Aspromourgos, 1986) in reference to Alfred Marshall’s (A. Marshall, [1890] 1961) systemization of
marginal and classical economics. The ‘Evolutionary Science’ and three ‘Preconceptions’ papers thus provided the initial arguments for a new evolutionary economics based on Darwinian philosophy.

The papers were written during a period in which wider historical shifts concerning general views of the metaphysical foundations of the sciences were taking place, shifts which Veblen actively sought to shape through his contribution to economic theory. This involved a shift from a teleological understanding of causal relations, often involving some sort of divine or animistic force, to a purely mechanical view of cause and effect. Karl Marx had observed the following on Darwin’s impact in a letter to Lassalle in 1862: ‘Darwin’s book is very important…the death-blow dealt here for the first time to ‘teleology’ in the natural sciences’ (Marx, 2000, p. 565). Mayr made a similar point not long after the hundredth anniversary of *The Origin of Species*, stating: ‘It has taken 100 years to appreciate fully that Darwin’s conceptual framework is, indeed, a new philosophical system’ (Mayr, 1964, p. xviii). The high stakes at play are indicated from the outset of ‘Why is economics not an evolutionary science?’, with Veblen arguing that ‘economics is helplessly behind the times, and unable to handle its subject-matter in a way to entitle it to standing as a modern science’ (Veblen, 1898b, p. 373). The reasons for this deficiency, argues Veblen, are to be ultimately found in the various ‘preconceptions’ through which economic science has approached its subject matter. The term ‘preconceptions’ is used by Veblen to refer to metaphysical and ontological assumptions made by classical economists that impart a teleological explanation of social and natural change.

The consequences of the Darwinian revolution for all the sciences is that it undermined these existing assumptions underpinning teleological explanations. In effect, it demanded a new metaphysical foundation on assumptions about causality: ‘[the] ultimate term or ground of knowledge is always of a metaphysical character…Before anything can be said as to the orderliness of the sequence, a point of
view must be chosen by the speculator, with respect to which the sequence in question
does or does not fulfil this condition of orderliness’ (Veblen, [1900] 2007, pp. 149, 162).
Veblen argued that technological progress always rests on the habit of thought based
upon the ‘imputation of causal sequence’ or ‘mechanical continuity’ (Veblen, [1899]
2007a, p. 102). Elsewhere, he argued ‘causal sequence…is of course, a matter of
metaphysical imputation. It is not a fact of observation, and cannot be asserted of the
facts of observation except as a trait imputed to them’ (Veblen, [1908] 2007a, p. 34).
What Veblen is pointing out is that causality is premised on a theoretical
preconception supplied by abstract thought, as opposed to observation, or as
Heilbroner states: ‘All views of the world express philosophical premises, tacitly if
not explicitly’ (Heilbroner, 1980, p. 29). For Veblen, such premises are ‘something in
the way of a preconception’ and one which is usually ‘accepted uncritically, but
applied in criticism and demonstration of all else with which the science is
concerned’ (Veblen, [1900] 2007, p. 149). For Veblen, Darwin’s theory of evolution
had brought into full view the many preconceptions underpinning economic science.
His point about ‘uncritical’ acceptance of metaphysical assumptions is aimed
squarely at the classical and neoclassical economists, indicating a flaw in their
thinking. As a result, it is the philosophical consequences of Darwin’s revolution that
inspired Veblen’s critique of the economic theory of his time. I now turn to the
details of that critique.

2.2. Theoretical Preconceptions and Pre-Darwinian Economics
For Veblen, the flawed preconceptions of classical economics were brought into view
as a consequence of Darwin’s work. Veblen criticised economists who occupy
‘themselves with repairing a structure and doctrines and maxims resting on natural
rights, utilitarianism, and administrative expediency’ (Veblen, 1898b, p. 374), finding
all such approaches inadequate in light of the ‘modern’ evolutionary approach. In
the first ‘Preconceptions’ paper Veblen critiques both the French Physiocrats and
Adam Smith, both writing during the 18th century, on the grounds that they study
economic phenomena using a mix of impersonal causal analysis, in line with evolutionary theory, and a form of ‘preconception, which yields a discussion of teleological sequences and correlations’ ([1899] 2007a, p. 100). The latter is for Veblen representative of a pre-Darwinian non-modern science because it involves invoking an uncaused cause. With the Physiocrats, Veblen argues that a teleological trend to economic evolution in their work arises due to preconceptions based on ‘natural rights’ and the ‘Law of Nature’, which determine the ‘point of departure’ and ‘the terms in which they were content to formulate their knowledge’ (ibid, p. 87). Thus, while Veblen acknowledged that the Physiocrats did deal extensively with economic facts, their metaphysical preconception was that economic life was essentially the working out of the Law of Nature. The latter refers to an imputed trend understood to govern the unfolding of economic life in ways that are ultimately beneficial to human welfare (ibid, p. 88).

Thus, a sort of deistic force works behind the scenes, to ensure growing material affluence for society, with the study of economic facts understood and assessed according to how they comport with this higher trend. One fatal outcome of this viewpoint, argued Veblen, was that Physiocracy was largely blind to the importance of increases in productivity due to social processes not directly linked to agriculture. Nature was viewed as the sole source of wealth within their scheme, such that the productivity of an activity is judged solely and strictly by whether ‘it heightens the effectiveness of the natural processes out of which the material of human sustenance emerges; otherwise not’ (ibid, p. 91). Thus, the grounds on which the Industrial Revolution was to emerge, and the massive increases in productivity from factory production, were completely hidden from view in Physiocratic theory.

Here Veblen foreshadows a critique made later by Heilbroner, who summarized the major weakness of the most modern of the Physiocrats, Anne Turgot, as a result of failing to perceive that ‘the economic significance of capital and “land” lies in their social, not their natural attributes’ (Heilbroner, 1997, p. 52). Nevertheless, Heilbroner goes on to note that the Physiocrats did make important
advances over pre-Enlightenment economic theory that dealt almost exclusively with the moral issues of commercial life. The Physiocrats, on the other hand, started out in a new direction that prefaced modern macroeconomic theory (ibid, p. 36). It was the Physiocrats who devised the *Tableau Économique*, a method of accounting aggregate income and costs across the main sectors of the economy, as well as how these sectors interacted dynamically. In doing so they were pioneers in assessing the economy as a processes possessing an internal and structured order.

With Adam Smith, Veblen argues much scientific progress was made in understanding economic life, but that gains were made alongside a tendency towards relapse into an animistic habit of thought underlying Smith’s conception of economic change. Veblen’s assessment of Smith’s work is again orientated towards indicating how ‘a teleological bent shapes the general structure of his theory and gives it consistency’ (Veblen, [1899] 2007b, p. 125). Veblen argues that Smith’s preconceptions entail a form of deism, based on the conviction ‘that there is a wholesome trend in the natural course of things’ (ibid, p. 114). For Veblen, this means that while Smith’s benign force then leaves humans to act as they will without any further direct imposition on their activities, the argument assumes that free markets comport with a higher deistic plan for nature:

‘The guidance of the invisible hand takes place not by way of interposition but through a comprehensive scheme of contrivances established from the beginning. For the purpose of economic theory, man is conceived to be consistently self-seeking; but this economic man is a part of the mechanism of nature, and his self-seeking traffic is but a means whereby, in the natural course of things, the general welfare is worked out’ (Veblen, [1899] 2007b, p. 115).

Thus, Smith’s theological preconception provides naturalistic support to utility-maximizing behaviour as aligning with deistic design, with Veblen noting that ‘the motives and movements of men are normalised to fit the requirements of a hedonistically conceived order of nature’ (Veblen, [1899] 2007b, p. 128). Veblen is critical of this naturalisation of economic man within a higher framework of
teleological character, since the latter involves imputation of a ‘quasi-spiritual or non-causal element’ (ibid, p. 116). It is precisely this sort of theologically-derived uncaused cause that is inadmissible within a post-Darwinian science. Veblen notes that Smith’s economic theory does not deny things can go wrong, or that economic life can evolve in an untoward way as a result of human agency.

Arrighi’s (2007) assessment of Smith’s grasp of historical sociology highlights Veblen’s point. Arrighi points out that in Smith we find a nuanced consideration of the role of institutions in economic development. Smith understood development in terms of a three-stage process that followed ‘natural’ laws, which could be inhibited or supported depending on a society’s institutional framework. Smith states: ‘According to the natural course of things, therefore, the greater part of the capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and, last of all, to foreign commerce (A. Smith, [1776] 2005, p. 310). Institutional arrangements, argues Smith, may slow down or speed up the natural course of development, of which he states: ‘This order of things is so very natural, that in every society that had any territory, it has always, I believe, been in some degree observed’ ([1776] 2005, p. 310). Smith’s point is that every society must have initially developed its agricultural sector to some degree before towns were established, and these towns must have engaged in some ‘coarse’ manufacturing before foreign trade is initiated. Smith regards China is regarded as having most fully followed this ‘natural’ route, and gained great opulence in doing so (Smith [1776] 2005, p. 555; Arrighi, 2007, p. 49). Smith then notes that the Europeans have diverted from this path:

But though this natural order of things must have taken place in some degree in every such society, it has, in all the modern states of Europe, been in many respects entirely inverted. The foreign commerce of some of their cities has introduced all their finer manufactures, or such as were fit for distant sale; and manufactures and foreign commerce together have given birth to the principal improvements of agriculture (ibid, p. 311).
What Smith is highlighting here is that the institutional framework of a nation can significantly impact its manner of economic development, and that the Europeans had subverted the ‘natural’ path by turning to foreign commerce before fully developing either their manufacturing industries or agriculture. However, Smith then argues that while this subversion has had some economic benefits for the European countries, it departs from the divine order and incurs costs in so doing: ‘This order, however, being contrary to the natural course of things, is necessarily both slow and uncertain’ (ibid, p. 337). He contrasts this ‘with the rapid advances of our North American colonies, of which the wealth is founded altogether in agriculture’ (ibid, p. 336).

Smith assumes that conditions leading to less favourable outcomes will eventually desist, at which point there will necessarily be an automatic return to the ‘natural’ development of economic life. This is an animistic view, as it presents economic unfolding in terms of teleological determinism, whereas ‘in the case of a causal sequence simply, the mere cessation of interference will not leave the outcome the same as if no interference had taken place. This [Smith’s] recuperative power of nature is of an extra-mechanical character’ (Veblen 1899 [2007]-b, p. 116). Veblen points out that Smith’s metaphysics of the natural order is not ultimately ‘of the nature of cause and effect’, since his imputed natural trend remains as a self-sustaining latent force during interruptions in natural causal sequences, which can then auto-reactivate when disruptive activities cease, all the while remaining a mysterious and uncaused agency acting in the background of economic evolution.

Smith’s theory of the ‘natural order’ influences his theoretical system at multiple levels, for example, impacting his theory of crucial economic categories such as price levels. Smith argues there is a ‘real’ or ‘natural’ price level for things such as labour rates, profits of stocks and land rent. The paradox here, notes Veblen, is that ‘the real, or natural, value of articles has no causal relation to the value at which they exchange’ (ibid, p.120). The ‘natural price’ for Smith is the price arising from perfect competition, but this price has never been realized in any market in
history, since perfect competition is an ideal that never materializes. Not least because it requires perfect knowledge held by all parties to a transaction, and zero transaction costs in the buying and selling of goods (Beinhocker, 2006; Stiglitz & Weiss, 1981). These conditions can never be met, since uncertainty is fundamental in economic life (Greer, 2001), as are transaction costs in a physical space-time reality where all activity entails a minimum time and energy cost of a value greater than zero.

Smith subsumes institutionally and socially determined prices arising from normal capitalist trade as deviant sub-categories of his uncaused, unrealized and preconceived ‘natural’ price. Thus, Smith’s preconceptions result in him treating theoretical prices as fundamental, and actual prices as aberrations from the ‘natural’ trend. Pack (2010, pp. 61-63) has similarly critiqued the manner in which Smith uses the conceptual device of theologically-derived ‘naturalisation’ to ground many of his central claims about economic life. This critique sits within a wider debate on Smith’s work, wherein a number of studies argue that Smith’s deism can be stripped from his work without impairing his social theory (Flew, 1987, pp. 200-201; Hamowy, 1987, pp. 3-4), whereas Hill argues that the structure and intelligibility of Smith’s theory hangs on his theological framework, such that the latter cannot be removed without undoing the theoretical structure (Hill, 2001). Hill only provides a brief reference to Veblen, noting that he had identified the role of deism in Smith’s theory. However, I argue that Veblen does much more than this. He provides a detailed critique of Smith that provides substantial support to Hill’s position within this debate.

Veblen’s goal in critiquing Smith is directly related to his efforts to unpack the implications of Darwin’s revolution relative to theological and teleological explanations common across the pre-Darwinian sciences. Furthermore, Veblen seeks to make clear how theoretical preconceptions play a fundamental role not only in setting and framing the departing point of study, but also in the way facts are treated. In that light, it should be emphasized that Veblen has a specific task in mind
in critiquing Smith, which is to reflect Smith’s analysis through the prism of Darwin’s revolution, and highlight the fundamental shift that has occurred in moving to a post-Darwinian science. Consequently, Veblen is not arguing that Smith’s entire analysis is faulty, or of no value. Veblen admiringly acknowledges Smith’s progress taken in total, stating: ‘Much of the advance he achieved over his predecessors consists in a large and more painstaking scrutiny of facts, and a more consistent tracing out of causal continuity’ (Veblen, [1899] 2007b, pp. 125-126).

Smith’s Wealth of Nations is rightly regarded as one of the great works of structural sociology (Giovanni Arrighi, 2007), particularly for his analysis of the market ‘as an order bestowing mechanism’ (Heilbroner, 2000, p. 61). Thus, while Smith viewed the spontaneous order and unintended self-organization of capitalist economic life as in the final instance comporting with his deism, he also analysed economic life as a concrete and spontaneous institutional social formation. Thus, his work contains preconceptions representative of pre- and post-Darwinian science.

2.3. From Physics Envy to Evolutionary Economics

Veblen’s critique of economic preconceptions seeks to highlight assumptions that prevent economic science becoming fully ‘modern’, that is, Darwinian in ethos. By this measure, the marginal revolution and the resultant neo-classical synthesis developed by Alfred Marshall fails badly for Veblen on two grounds: first, the narrow view of human motivation grounded in utilitarian terms; and second, the aping of physics is inappropriate relative to economic theory’s core concerns.

Beginning with marginalism and its utilitarian philosophy, Veblen’s engagement with anthropology led him to reject this particular preconception as utterly false. He notes that for utilitarian economic theory ‘the substantial economic ground is pleasure and pain: the teleological order…is the method of its working out’ (Veblen, [1899] 2007b, pp. 131-132). For Veblen, this fundamentally false preconception concerning human motivation overshadows the entire working out of
utilitarian theory, serving as a point of departure for study of economic life, and the
final ground for synthesizing the findings. This results in the fallacy of eliminating
from investigation an enormous array of social relations and social facts that
impinge upon the unfolding of economic life. Marginalism reduces the whole
complex of human affairs down to the fact that humans seek pleasure and avoid
pain, with this calculus entering as the sole and inviolable measure by which all
economic activity is judged as worthy of entering into or not. As Veblen argues:

Human nature being eliminated, as being a constant intermediate term, and all
institutional features of the situation being also eliminated (as being similar
constants under that natural or consummate pecuniary regime with which the
pure theory is concerned), the laws of the phenomena of wealth may be
formulated in terms of the remaining factors (Veblen, [1899] 2007b, pp. 143-144).

The remaining factors being but the ‘vendible items’ produced and then bought and
sold on the market, and which fall under economic laws now transformed into
‘algebraic relations subsisting between the various elements of wealth and
investment…elemental factors acting and reacting through a permutation of values
over the heads of the good people whose welfare they are working out’ (ibid, p. 144).
As Veblen points out, the majority of actual economic life disappears from view,
with the most outlandish theoretical outcomes then following from this, as
cautistically depicted:

They are hedonistically “natural” categories of such taxonomic force that their
elemental lines of cleavage run through the facts of any given economic situation…so
that, e.g., a gang of Aleutian Islanders slushing about in the wrack and surf with rakes
and magical incantations for the capture of shell-fish are held, in point of taxonomic
reality, to be engaged on a feat of hedonistic equilibration in rent, wages, and interest.
And that is all there is to it. Indeed, for economic theory of this kind, that is all there is
to any economic situation (Veblen, [1908] 2007, p. 193)

Here Veblen brings into relief the absurdity of the theory of universal rational
utility-maximising by applying it to a culture and circumstance where it clearly has
no explanatory power. Later commentators have developed a critique of this
preconception on similar grounds, arguing that rational-egoism and utility maximization are only part-descriptions of human behaviour, and therefore not adequate for a complete theory of economic motivation (Fukuyama, 1995; Hodgson, 2015). These studies argue that neoclassical theory of utility-maximizing falls into tautology when, for example, even altruistic and other-directed activity are viewed as rational utility-maximising by conferring psychic pleasure on the individual. In this way the concept of utility-seeking stretches to ‘cover every eventuality or behaviour’ (Hodgson, 2015, p. 68), and in covering everything explains nothing.

Hodgson argues that in its tautological formulation the concept of utility-maximization is unfalsifiable (2015, p. 68). And while it is reasonable to accept that utility-maximizing applies to some degree to every living creature with a survival and procreation instinct, at this level of generality it tells us nothing specific about complex socio-historical life. Weber’s ([1930] 2001) classic study of the origins of the ‘spirit of capitalism’ is a counter-point to such generality and failure to account for culture in economic life. Weber explains how a unique religious interpretation of the relationship between everyday activity and the afterlife resulted in highly motivated economic activity by European Calvinist Protestant merchants. The Calvinist doctrine of Predestination described how some individuals were predetermined by being God as one of his ‘chosen’, but that this could not be directly known by those individuals. However, indirectly, one could know, since success in worldly activity indicated being God’s chosen. Consequently, for the merchants their ‘feelings of religious anxiety’ over whether one was ‘chosen’ in the eyes of God (Weber, [1930] 2001, p. 67) was expressed through their attempts to be economically successful. Thus, Weber showed that the Protestant work ethic had religious underpinnings, and not a trans-historic desire for utility-maximizing. Later studies have thus followed a similar critique as Veblen.

Veblen also critiqued the emerging neoclassical synthesis for its aping of physics in ways inappropriate to economics’ subject matter, a critique reiterated by a number of recent studies (Beinhocker, 2006, chap 3; Mirowski, 1989). Veblen notes
that following the success of the physical sciences, there was a trend within the social sciences to apply methods and ideas from these disciplines. In particular, the neoclassical synthesis at the turn of the 20th century was built upon the concept of ‘statics’, referring to the theory of physical systems tending towards a state of equilibrium. The problem being that ‘there is much in the received economic theories to which the analogy of bodies at rest or of forces in equilibrium will not apply’ (Veblen, [1899] 2007a, p. 83).

As Veblen argues, the better part of economic subject matter is least suited for approach through a theory of statics. He states, ‘it seems scarcely to the point to speak of the statics of production, exchange, consumption, circulation…the theory of a process does not belong in statics’ (ibid, p.83). Despite the accuracy of this critique, traditional orthodox economics has persisted with its foundation in statics throughout the twentieth century, making Veblen’s critique of continuing relevance. For example, while attempts have been made to overcome the complete non-applicability of a static Walrasian general equilibrium ‘auction’ model of real prices, the neo-Walrasian dynamic stochastic general equilibrium model (DSGE) is additive rather than transformative. It develops a stochastic model of the standard neoclassical growth model, thereby extending the basic faulty premises of the original, rather than removing them (Marchionatti & Sella, 2017).

Veblen sums up the argumentation across ‘Why is Economics not an Evolutionary Science?’ and the three ‘Preconception’ papers by highlighting the central point of difference here between the evolutionary view and the classical view he has critiqued. Within the classical view the whole development of life typically finds its final grounding in an overarching and teleological developmental trend determined by some ameliorative causal power, be it the Physiocrats Law of Nature or Smith’s theistically-derived ‘natural path’. Veblen’s evolutionary approach aims to do away with what he regards as a last remnant of uncaused teleology in economic theory, arguing that ‘there is no definitively adequate method of life and
no definitively adequate worthy end of action, so far as concerns the science which sets out to formulate a theory of the process of economic life’ (Veblen, 1898b, p. 391).

Following the Darwinian norm, Veblen is arguing that there is no ‘natural’ path or endpoint to economic development. Instead, Veblen understands social evolution in a Darwinian sense, which is branching rather than linear (Buskes, 2013, p. 668), and with no specific evolutionary branch more natural than any another. The only measure of a branch of development is whether it is fit for purpose relative to environmental demands of reproduction. While Veblen rejected any uncaused teleological force, he recognised that from the perspective of any given economic agent undertaking action economic life is teleological ‘in the sense that men always and everywhere seek to do something’. The difference with this type of teleology is that it does have a cause, a combination of evolutionary-endowed instinctive drives and their mediation by culture. Biological drives are general urges to act in certain ways, whereas what agents ‘seek to do’ in specific detail to fulfil these drives is always historically determined. Thus biology and social theory are connected without reducing one to the other. The next section discusses this crucial point further. Veblen further points out the need for historical specificity by arguing ‘what, in specific detail, they [agents] seek, is not to be answered except by a scrutiny of the details of their activity’ (ibid, p. 391). This point is indicative of the historical method common to institutional political economy.

Any theory that is based in the last instance on an overarching trend is strictly ‘an extra-evolutionary preconception, and lies outside the scope of an inquiry into the causal sequence in any process’ (ibid, p. 392). Here, then we find the abiding difference between the pre-Darwinian and post-Darwinian economics, summed up as follows:

From what has been said it appears that an evolutionary economics must be the theory of a process of cultural growth as determined by the economic interest, a theory of a cumulative sequence of economic institutions stated in terms of the process itself (Veblen, 1898b, p. 393).
This emphasis on a theory of sequence ‘stated in terms of the process itself’ is characteristic of the Darwinian view of describing evolutionary processes devoid of all preconceptions based upon uncaused causes. The Darwinian metaphysic imputed by Veblen is one of cause and effect. This involves a preconception of an evolutionary process of change through environmental adaption by biological organisms motivated by inherited instinctual drives, and culture in the case of humans, resulting in unceasing adaptation to conditions which are themselves in a state of flux. This is a recursive process driven entirely by interactions endogenous to the system in question, and not an exogenous divine power. The preconception of the ‘Darwinian scheme of thought’ is one where ‘the continuity sought in and imputed to the facts is a continuity of cause and effect. It is a scheme of blindly cumulative causation, in which there is no trend, no final term, no consummation’ (Veblen, [1907] 2007a, p. 304). This, then, is the central metaphysical preconception of a modern economics theory for Veblen, and one that distinguishes an evolutionary economics from a non-evolutionary one.

2.4. Agency, Structure and Instinct-Habit Psychology

A defining innovation in Veblen’s social theory was his utilization of instinct-habit psychology as developed by pragmatist William James (1890b). Veblen found the conceptual need for instinct-habit psychology within his social theory after reviewing an 1896 book by Max Lorenz, Die Marxistische Socialdemokratie, which critiqued an aspect of Marxist theory (Veblen, 1897). Veblen considered Lorenz to have identified an important critique of 19th century Marxism, arguing that it presented an over-socialized view of agents as primarily mediums of social structure:

While the materialistic interpretation of history points out how social development goes on – by a class struggle that proceeds from maladjustment between economic structure and economic function – it is nowhere pointed out what is the operative force at work in the process. It denies that human discretion and effort seeking a better
adjustment can furnish such a force, since it makes man the creature of circumstances [i.e. social structure]. This defect reduces itself ... to a misconception of human nature and of man’s place in the social development. The materialistic theory conceives of man as exclusively a social being, who counts in the process solely as a medium for the transmission and expression of social laws and changes; whereas he is, in fact, also an individual, acting out his own life as such. Hereby is indicated not only the weakness of the materialistic theory, but also the means of remedying the defect pointed out.

With the amendment so indicated, it becomes not only a theory of the method of social and economic change, but a theory of social process considered as a substantial unfolding of life as well (Veblen, 1897, pp. 136-137).

Hodgson argues that Lorenz’s critique applies to some of the ‘less sophisticated Marxism prominent at around the end of the nineteenth century’ (1998c, p. 418), and not Marxism in general. The importance of Veblen’s reaction to Lorenz’s critic is in terms of the impetus it provided Veblen to seek a conceptual framework for connecting social structure to individual agency, but without viewing agents as simply ‘mediums’ of the former. In this task Veblen was strongly influenced by the instinct-habit psychology of William James (1890b). Twomey points out that James’ work represented a model of human psychology that ‘stressed the active and multi-tiered nature of the mind in which instincts, habits, and conscious reasoning are all significant for understanding human behaviour’ (Twomey, 1998, p. 437).

Following Darwin’s illumination of biological evolution, James sought to integrate human biological and evolutionary endowed instinctive responses to environmental interaction, with the fact that humans are also conscious, thinking agents who generate culture that is not reducible to instinct. Regarding evolution, James wrote that ‘[O]ur various ways of feeling and thinking have grown to be what they are because of their utility in shaping our reactions to the outer world’ (James, 1890b, p. 34). These ‘ways’ have evolved over the course of millions of years of species evolution, and for James refer to the human species biological endowment of instincts, including imitation, emulation, predatory instincts, sympathy, fear,
playfulness, curiosity, sociability and shyness, shame, love and maternal love (James, 1890a, pp. 404-441). These instincts impart a shared quality to all human life, irrespective of historical time or place, and for James are essential to any explanation of human psychology and social life more broadly.

However, James absolutely rejected any biologically reductionist account of human agency (Friesen & Cresswell, 2017). James’ discussion of instinct is illuminating of this point. For much of human history it has been common to distinguish humans from other animals by categorising the former as rational animals, meaning humans consciously decide what actions they wish to take, and the latter as creatures that are slaves to unconscious instinct (Friesen & Cresswell, 2017). As Friesen and Cresswell point out, James rejected this view, both in relation to higher cognitive animals and humans. James argued that:

*Nature implants contrary impulses to act on many classes of things,* and leaves it to slight alterations in the conditions of the individual case to decide which impulse shall carry the day…‘experience’ in each particular opportunity of application usually deciding the issue. *The animal that exhibits them* [numerous instincts] *loses the ‘instinctive’ demeanor and appears to lead a life of hesitation and choice, an intellectual life; not, however, because he has no instincts—rather because he has so many that they block each other’s path* (James, 1890a, pp. 392-393, emphasis original).

James makes an important point here. He argues that increasing numbers of instincts, combined with an increasingly complex nervous system and a capacity for memory results in an ever greater ability for higher cognitive animals to make decisions that over-ride instinctual impulses, based upon their past experiences. Thus he notes that ‘the mythical view of an instinct would make it invariable’ but that extended studies of actual animal behaviour, and here James references Darwin’s *Origin of Species*, show that instincts refer ‘only to a tendency to act in a way of which the average is pretty constant’ (James, 1890b, p. 391). These studies also show that animals adapt their behaviour over the course of their lives based upon their experiences.
A greater array of instincts are tend to run into contradiction due ‘to the possible entrance of the same stimuli into several of them’ (James, 1890, p. 391). Consequently, even from a purely physiological point of view, James argues that higher cognitive animals cannot act with blind invariance in accordance with their drives, since they must always act after assessing the numerous instinctive impulses that any situation can trigger. Humans, of course, have the highest cognitive capacities, and the most complex instinctive endowment, and this is why for James they display the greatest degree of intellectual control and adaptation of instinctive life.

James therefore proposed two more levels of human psychology beyond instinct, the second being habituated mental processes, and the third being conscious thought. His comments on how these three interact are crucial to understanding instinct-habit psychology, and the fact that it absolutely does not purport to explain culture as strictly determined by biology. James uses an imaginary example of coming late to a train platform to illustrate his understanding of the dynamic interactions within his multi-level view of human psychology (James, 1890b, pp. 12-13). Upon entering a train depot, James states he hears the conductor shout ‘All aboard!’ He explains his immediate response to ‘the air-waves falling on my tympanum’. First his heart ‘stops, then palpitates’, while his legs quicken their pace in response. James describes that, if he stumbles in his rush, then the sensation of falling results in his hand coming up in an attempt to break the fall. Likewise, he notes that if a splinter of wood from the platform enters his eye, the lid closes and tears begin to flow to cleanse the splinter out. Next James points out that these three responses to environmental stimulus are different in many respects. The eyelid closure, the ‘lachrymation’ (tear flow) and the heart beating faster are all involuntary reflexes. These are biologically endowed responses that have been retained through evolutionary selection due to their fitness-enhancing characteristics.

James points out that the movement of the arm to break the fall is also an involuntary reflex, since it occurs ‘too quickly to be deliberately intended’ (James,
However, he points out that this latter reflex is not of the same sort of reflex as the others, since it is a learned reflex acquired through ‘the pedestrian education of childhood’. Furthermore, James notes that one can learn to fall more skilfully, with the new skill becoming reflexive once learned and repeated enough times. Or, he notes, the response could be repressed altogether. He therefore notes ‘actions of this kind, into which instinct and volition enter upon equal terms, have been called ‘semi-reflex’’. But the most revealing comment relates to the trigger stimulus that started the whole process, the conductor signalling the train’s departure. On this James points out:

The act of running towards the train, on the other hand, has no instinctive element about it. It is purely the result of education, and is preceded by a consciousness of the purpose to be attained and a distinct mandate of the will. It is a ‘voluntary act.’ Thus the animal’s reflex and voluntary performances shade into each other gradually, being connected by acts which may often occur automatically, but may also be modified by conscious intelligence (James, 1890b, p. 13).

What James has succinctly illustrated in his example, is the means by which instinct, habit and culture are utterly intertwined in a prosaic moment of everyday life. Furthermore, what is noteworthy here is that the trigger for the entire sequence is cultural in origin. It is the words ‘All aboard’, given in a specific cultural and technological context that no genetically inherited capacities could alone have possibly provided knowledge of, that set in motion the instinctual and habitual responses that follow. In this instance instinct and habit are in the service of achieving a cultural act determined by conscious choice.

Thus, when James argues that habit ‘diminishes the conscious attention with which our acts are performed’ (James, 1890b, p. 114), he does not mean that base biological instincts are then in command of human action, or that consciousness or culture have played no role. Actions that were originally a consequence of conscious choice and within a cultural context ‘may grow so automatic by dint of habit as to be apparently unconsciously performed’ (James, 1890b, p. 5). He gives examples such
as ‘buttoning and unbuttoning, piano-playing, talking, even saying one’s prayers, may be done when the mind is absorbed in other things’ (James, 1890b, p. 5). These particular habits are all a direct consequence of socialization, and not genetically inherited instinct.

James outlines that in learning complex tasks, for example piano-playing, intense conscious effort is required to learn each separate step, and also to learn their interrelations. However, once the task is learned the only conscious impulse required ‘is the initial impulse, the command to start’ (James, 1890b, p. 116), after which the rest of the activity is automatically engaged. Nevertheless, James is also clear that it is our evolved biological capacities, particularly the plasticity of our nervous system and brain functions, that allow for highly flexible cognitive habituation of complex cultural and social activities (1890b, p. 105). Furthermore, he argued that such plasticity was functional precisely because it entailed both a degree of flexibility and a degree of inflexibility, or resistance to change:

*Plasticity*, then, in the wide sense of the word, means the possession of a structure weak enough to yield to an influence, but strong enough not to yield all at once. Each relatively stable phase of equilibrium in such a structure is marked by what we may call a new set of habits (James, 1890b, p. 105, emphasis original).

In a remarkable early figuration of brain plasticity, James argued that cognitive association of sequences of thought become habitual, meaning they are controlled by brain functions that do not require conscious control, by changing the structure of neural pathways within the brain through repetition of certain experiences\(^1\). The evolutionary advantage of such plasticity is clear. Activities, including social responses, that are constantly engaged become highly efficient, and require little conscious control once learned, thereby saving on the high energy required by conscious thought (1890b, p. 112). Crucially, James’ conception of habit refers not

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\(^1\) In a recent review of brain plasticity Kolb and Whishaw (1998) trace the concept of brain plasticity to a paper by Tanzi in 1893. However, James *Principles of psychology* precedes this work by three years.
only to sequences of automated responses to cues such as the decision to play a musical score, but also sequences of action and feelings triggered during socio-cultural situations.

For example, habitual responses can relate to sequences of feeling that will be triggered by stimuli that include a national flag, a physical characteristic such as skin colour or biological sex, status symbols of social wealth, all of which once learned will be triggered without any conscious effort. Furthermore, many such responses are not in fact consciously chosen to be learned by agents, but are a result of being born in a specific history in a specific place, with habits being absorbed unconsciously. Through habituation ‘we find ourselves automatically prompted to think, feel, or do what we have been accustomed to think, feel, or do, under like circumstances, without any consciously formed purpose, or anticipation of results’ (James, 1890b, p. 112). It is for this reason that James views habit as ‘the enormous fly-wheel of society, its most precious conservative agent’ (1890, p. 121). However, the effectiveness of the human cognitive process of habituation is a double-edged sword, since habits once formed can become largely invisible to the conscious thoughts of an individual, and are difficult to undo due to effect of plasticity.

Veblen was deeply influenced by James’ work, taking from him the idea that instinct, and habit, played a significant role in the development and stabilization of social relations. Like James, Veblen rejected reductive biological causal relationships (Hodgson, 2004b, pp. 163-164). His most detailed discussion of instincts indicates this point clearly (Veblen, 1898a, 1914, [1899] 1970). Veblen argued that instinctive drives provided all humans with a general orientation and motivation for purposeful action, given as ‘an objective end of endeavour’ (Veblen, 1914, p. 3). In that sense Veblen suggested that instinctive action is ‘teleological’, since it involves a purposive drive aimed at some given end, with Veblen discussing in his work the instincts for social emulation and predatory instincts (Veblen, [1899] 1970), and idle curiosity, a parental bent, and an instinct for workmanship (Veblen, 1914, pp. 27, 31-35, 85-89). Veblen argued that excluding ‘the instinct of self-preservation, the
propensity for emulation is probably the strongest and most alert and persistent of the economic motives proper’ (Veblen, [1899] 1970, p. 110).

Veblen acknowledged that no precise definition of instinct was possible, because the concept could feasibly be linked in some way to actions that ranged from tropismatic responses such as an eyelid blinking, to complex cultural activities such as purchasing a status object (Veblen, 1914, p. 5). Therefore, he restricted the term to refer to general universal orientations to life found in all humans, across time and across societies, and which make specific activities worthwhile. Following James, he argued that instinctive drives ‘cross, blend, overlap, neutralise or reinforce one another’ (Veblen, 1914, pp. 9, 11), such that in situations where contradiction arises active intelligence would be required to engage any particular activity. Veblen argues that instincts and instinctive behaviour must be distinguished, since ‘[i]nstinct, as contra-distinguished from tropismatic action, involves consciousness and adaptation to an end aimed at’ (Veblen, 1914, p. 4). Tropismatic responses are fully automated. Insects are generally viewed to operate entirely through tropisms. Instinctive behaviour, on the other hand is a phenomenon of higher cognitive animals, and involves decision-making.

Veblen noted that in human life the ‘working out of the instinctive proclivities of the race is guided by an intelligence to a degree not approached by the other animals’ (Veblen, 1914, p. 6). For Veblen, instinctive behaviour is not simply mindless automated responses, but involves degrees of intelligence relative to a particular species’ cognitive capacities. For humans ‘a more or less extended logic of ways and means comes to intervene between the instinctively given end and its realisation’ by means of culture (Veblen, 1914, p. 6). Furthermore, given that the whole complex of instincts in humans could ‘neutralise’ one another, or be creatively blended through application of intelligence, it should be clear that like James, Veblen viewed human capacities for conscious thought as emphatically involving a novel power of creativity that was itself unexplainable in terms of any instinctive drive.
This does not mean instincts play no role in cultural development, only that they clearly play a smaller and reducing direct role once culture begins to accumulate and proliferate, which is dated to around 50,000 years ago (Sapolsky, 2017, p. 556). Otherwise how else could we explain the fact that anatomically modern humans have remained the same for the last 200,000 years (Mithen, 1998; Sapolsky, 2017), while the development of culture has seen the rise of agriculture, large fixed settlements and a veritable explosion in cultural variation between societies (Diamond, 1998; Fried, 1967; Mann, 2012b), including differing ideologies, religions, languages, poetry, music, literature, philosophy and more. Given that the human biological organism has not fundamentally changed during this time, biology cannot alone explain this radical amassing of cultural variation, as put by Veblen:

If ... men universally acted not on the conventional grounds and values afforded by the fabric of institutions, but solely and directly on the grounds and values afforded by the unconventionalled propensities and aptitudes of hereditary human nature, then there would be no institutions and no culture (Veblen, 1909a, p. 300).

Elsewhere Veblen argued that there is incessant change in the institutions, laws, norms and habits of thought, as well as in technology that determine the detailed nature of social life, while simultaneously ‘change comes rarely—in effect not at all—in the endowment of instincts’ (Veblen, 1914, p. 35). Veblen’s point was that evolution had moved from a genetic basis to an epigenetic basis, with culture and institutions playing an increasingly central role in variation, selection and replication of successful adaptations that fulfil the needs of human societies. Therefore, Hodgson is right to argue that Veblen emphatically broke with any form of biological reductionism (2004b, p. 162).

Regarding habit, Veblen argued that ‘the accustomed ways of doing and thinking not only become an habitual matter of course, easy and obvious, but they come likewise to be sanctioned by social convention, and so become right and proper and give rise to principles of conduct’ (Veblen, 1914, p. 7). Here Veblen is
pointing to what later economists have called ‘endogenous preferences’ (Bowles, 1998). That concept refers to the fact the given set of incumbent institutions and cultural norms into which individuals are born ‘influence the evolution of values, tastes, and personalities’ of those individuals (Bowles, 2004, p. 75). These influences impart a particular social psychology and way of acting on agents which must then be internalized to any model of behaviour (Bowles, 1998, 2004; Bowles & Gintis, 1993).

Proponents for endogenous preferences reject the standard neoclassical position that argues for the opposite, that preferences are exogenous, such that all human agents share the same rational, utility-maximizing preferences irrespective of historical time and place. Consequently, Veblen foreshadowed an important critique of neoclassical economics made later (Etzioni, 1988; Hodgson, 1988). Veblen also made the observation that dominant institutions within a society could result in the spread of habits of thought from their originating sphere to other spheres of action, thus further strengthening the perceived naturalization of those institutions. He noted that ‘pecuniary institutions induce pecuniary habits of thought which affect men’s discrimination outside of pecuniary matters’ (Veblen, 1909b, p. 632). It is this ‘positive feedback’ effect of institutional life in constituting the interpretive horizon of agents, as well as resulting in a set of unconscious habituated responses to specific stimuli that powerfully reinforce the naturalness of a given historical period from the perspective of agents living within those social relations (Hodgson, 2004c, p. 656). In this light, habit is indeed the ‘enormous flywheel of society’ and a conserving force. But it is not an iron cage, but more akin to a bronze cage, malleable to extent that habits can be broken, and new ones formed, but resistant enough that this process requires effort.

In summing up this section, Veblen, following James, proposed a multi-level relationship between instincts, culture, institutions and individual agency. Instincts provide all humans with a basic underlying predisposition to act, with Veblen stating ‘the ends of life, then, the purposes to be achieved, are assigned by man’s
instinctive proclivities’ (Veblen, 1914, p. 5). The means for seeking such general ends, are given specific content by culture. Furthermore, both James and Veblen viewed the high degree of intelligence acquired by humans as allowing cultural development to achieve a degree of autonomy in the manner that instinctive ends are sought, and also to seek ends that have no immediate instinctive correlate. Likewise, the concept of habit is deeply concerned with socialization, and in assessing the biological conditions under which such socialization occurs.

As has been shown, neither James nor Veblen argue that instinct directly causes habituation, rather the biological capacity for habituation means that socialization of habits must occur under the conditions laid down by our biologically endowed cognitive capacities. However, the detailed content of such habituation is filled by the interactive experiences of the agent with the external world. If this world is primarily cultural, then habits will be primarily cultural in nature. If culture then becomes institutionalized, individual agents will become habituated to institutional life. However, individuals have causal forces impinging on their behaviour other than institutions. They have an evolutionary-endowed motivation structure that means no agent’s behaviour is fully explainable solely in terms of the social structure in which they have been socialized. Secondly, and in a correlate to the potential for conflict between multiple instincts, every society is composed of multiple institutions, which will also entail conflicting demands. For example, a society’s dominant religion might conflict with its economic system, as do Christian teachings against greed versus the capitalist celebration of profit. Most societies have opposing political ideologies on offer, and there will typically be ongoing emergence of non-institutional ideas and social movements contesting incumbent norms and institutions. In short, even relatively stable societies have ongoing dynamic change, social conflicts and emerging non-institutional relations (Mann, 2012b, p. 15). Thus, all socialized agents must continually and actively choose between available options, although this is not a purely voluntarist affair, precisely because prior socialization
creates bias and attachment to one social fact or institution over another. But the fact remains that social structure alone cannot account for the behaviour of agents.

Chapter four will further elaborate on the illuminating insights provided by instinct-habit psychology on how socialization produces cognitive habituation. In that chapter I discuss recent research on priming that strongly corroborates James’ psychology. I finish here by indicating how Veblen understood societal change in light of his admixture of a Darwinian evolutionary theory, institutionalism, and instinct-habit psychology. Veblen tied these various components together to produce a novel theory of institutional evolution. One of the clearest summaries of this theory is stated in his 1899 work *The Theory of the Leisure Class*:

The life of man in society, just like the life of other species, is a struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions. The progress which has been and is being made in human institutions and in human character may be set down, broadly, to a natural selection of the fittest habits of thought and to a process of enforced adaptation of individuals to an environment which has progressively changed with the growth of the community and with the changing institutions under which men have lived. Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection. So that the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions (Veblen, [1899] 2007c, p. 125).

This paragraph carries the full force of the theoretical innovation contained within Veblen’s thinking. In particular, identification of institutions as units of selection was a ‘substantial theoretical leap’ (Hodgson, 2004b, p. 140) that made the critical jump from evolution of complex natural systems through a biological, gene-inheritance
process, to one that can also be driven by culture and institutional diffusion. However, Veblen was missing some crucial theoretical elements in his theory.

First, while rejecting biological reductionism, he failed to adequately theorize how and why culture and institutions could not be traced back to human biology using the reductionist method. Veblen’s theory was missing the philosophy of emergence (Hodgson, 2004b, p. 225). An emergent property is one whose ‘existence and nature depend upon entities at a lower level, but the property is neither reducible to, nor predictable from, properties of entities found at the lower level’ (Hodgson, 2004b, p. 32). The concept of emergence is vital to fully dispense with the reductionist fallacy which arises when biological causes are given as total explanations of social life (e.g. Becker, 1976; Robson, 2001; Tullock, 1979; E. O. Wilson, 1975). Modern proponents of evolutionary theory have built on the idea of emergence to develop a ‘generalized Darwinism’ (Aldrich et al., 2008; Beinhocker, 2011; Breslin, 2010; Buskes, 2013; Hodgson & Knudsen, 2010), referring to a theory for explaining change in complex systems composed of goal-seeking entities. Both the philosophy of emergence and ‘generalized Darwinism’ are crucial to the reconstruction and furthering of Veblen’s project. I will discuss both in detail in chapter five.

**Conclusion**

In this chapter I outlined the rise of Veblen’s evolutionary economics at the turn of the twentieth century. I discussed Veblen’s prescient grasp of the philosophical ramifications of Darwin’s work for the wider sciences, and his Darwinian-inspired critique of classical and neoclassical economics. Critique involved analysis of the flawed preconceptions held within both classical and neoclassical theory, showing how these then affected analysis. Veblen argued that these preconceptions prevented economics becoming a fully modern science to the extent that they involved imputing teleological forces of an animistic bent. Likewise, Veblen critiqued the
neoclassical conception of *Homo economicus* as being an unrealistic model of the typical human agent and admonished its aping of physics’ theory of static systems as unsuitable for modelling a dynamic economy. These critiques are still important today because traditional neoclassical ideas continue to hold sway in mainstream economics.

Veblen offered a positive critique in the form of a proposal to transform economics into an evolutionary science founded in institutionalism, thereby rounding off a major intervention within the discipline. He developed a non-teleological, non-ethnocentric process of social change in which cumulative causation, cultural sequence and means-ends goal orientations that themselves change through historical time are the crucial elements driving evolution (Mayhew, 1987: 976; O’Hara 2000; Hodgson 1995, 2004; Rutherford 1984). In effect he developed a Darwinian social theory of institutional evolution. As the next three chapters will show, this theory was not without flaws or detractors. I have not critiqued Veblen’s work in this chapter, aiming instead to provide a detailed reading of his innovative contribution. However, chapters four and five will engage a critique and reconstruction of his theory. In chapter three I outline how and why Veblen’s novel system of theory fell into obscurity.
This chapter discusses the direction American institutionalism takes under John R. Commons and Wesley Mitchell Clair in the two decades after Veblen’s initial successful impact. Commons was a contemporary of Veblen’s, while Mitchell was one of Veblen’s graduate students in 1897 (Hodgson, 2004b). Of the two Mitchell was significantly impacted by Veblen’s work, and initially sought to develop his innovative ideas. Commons on the other hand, shared with Veblen an institutionalist approach and a rejection of the naturalisation of any prevailing social order, but was critical of Veblen’s Darwinism, which he understood as denying the possibility of intentional social change. Such views still abound today, and are one important reason why Veblen’s evolutionary theory was largely ignored throughout the twentieth century, even while other aspects of his work were celebrated. Over time Veblen’s most innovative contributions were largely abandoned by his own followers, marking the early demise of institutional-evolutionary economics by the 1940s.

Here I outline the reasons why Veblen’s system fell out of intellectual favour. I argue this historical work is important for contemporary reconstruction, in order to acknowledge and meet the ongoing arguments against biology and Darwinism within the social sciences, which can be traced back to this period early in the twentieth century. The chapter will proceed with the following four sections. Section one discusses the work of John R. Commons, highlighting his major contribution to the theory of collective action, and his continuation with Veblen’s project of
critiquing the individualist, rational-choice model of neoclassical economics. Section two will outline Commons’ critique of Veblen, and argue that Commons developed a version of American institutionalism that had more in common with the contemporary ‘institutional turn’ (Hall & Taylor, 1996; Jessop, 2001), and in particular ‘historical institutionalism’ (Thelen, 1999), than with Veblen’s evolutionary approach. Section three turns to Wesley Mitchell, who initially attempted to develop Veblen’s system, but ultimately was to give up the project of furthering Veblen’s evolutionary theory. Instead Mitchell made significant and lasting contributions to macroeconomics. The last section concludes.

3.1. John R. Commons and a Non-Darwinian Approach to Institutionalism

Commons is regarded as a foundational figure within American institutionalism (Hodgson, 2004b; Rutherford, 1983). He absorbed many of the advances in social sciences that influenced Veblen. Commons is viewed as having a less developed grasp of the theoretical and philosophical issues at stake in the shift to institutional economics than did Veblen (Hodgson 2004), but as holding a much deeper practical experience of institutional development, and it is this latter aspect that emerges in his work. For example, Commons worked extensively as a researcher for trade unions, government and political parties, was deeply enmeshed in the legal and institutional developments of his time, and was elected as president of the American Economic Association in 1917. In addition, Commons was involved in drafting legal documents for the State of Wisconsin in relation to labour and industrial bargaining (B. E. Kaufman, 1998). Such was Commons’ practical influence that one commentator has claimed that ‘no institutional economist in the 20th century has had a greater impact on the actual structure of the American economy than has John R. Commons’ (Tool, 2000, p. 122). Later influential economists, Gunnar Myrdal and
Herbert Simon, as well as the ‘new’ institutionalist Oliver Williamson, all claimed to have been significantly influenced by Commons (Hodgson, 2004b, p. 285).

Commons’ approach to institutional economics was to focus on the political economy of collective action and how this worked itself out as legal formalization, thus forging a form of legal institutionalism (Commons, 1924, 1931, 1950). In taking this approach he critiqued classical economics in a manner that is clearly influenced by Veblen. For example, Commons objected to theoretical application of various preconceptions that explained and predicted certain outcomes as ‘necessary’ or ‘natural’, through usage of terms such as ‘nature’s harmony, natural law, natural order, natural rights, divine providence, over-soul, invisible hand, social will, social-labor power, social value, tendency towards equilibrium of forces, and the like’ (Commons, 1924, p. 2). In making this criticism Commons is following Veblen and moving decisively away from all types of teleological preconceptions within theory, an approach common to pre-Darwinian science. Commons also broke decisively with the neoclassical synthesis, critiquing assumptions about the motivations of agents, and the fact that the theory ignored the institutional relations shaping those agents. As Commons puts it:

[T]heir individualistic point of approach required certain notions, expressed or implied, of ethics, law, private property, liberty, society, government, which the hedonists either took for granted without investigation, or avoided as being “non-economic” or “anti-economic,”’ (1924, p. 4)

This critical reference to the neoclassical ‘individualistic point of approach’ and the presumptions underlying it exhibits Commons’ rejection of methodological individualism. ‘Methodological individualism’ in broad terms involves privileging the individual over social structure when explaining social phenomena (Hodgson, 2004b, p. 16). Elster defines it as ‘the doctrine that all social phenomena (their structure and their change) are in principle explicable only in terms of individuals – their properties, goals, and beliefs’ (Elster, 1982, p. 453). This approach is fundamentally at odds with Commons’ institutionalism, which recognised the
centrality of institutions as forms of ‘collective action in control, liberation and expansion of individual action’, wherein motivation results from ‘unorganized custom’ and ‘organized going concerns’ (Commons, 1931, p. 648). Custom cannot be explained in terms of single individuals, but rather emerges as unintended consequences of interactions between many individuals over time. The institutional and sociological view is that established customs have causal power to shape the preferences and beliefs of individuals living under those customs (Durkheim, [1895] 1982; Veblen, [1899] 2007c). It was Durkheim who described customs as ‘social facts’ to indicate they had an existence independent of any single individual (Durkheim, [1895] 1982, p. 70).

Commons sought to analyse and explain the role of custom and social structure through the concept of ‘transaction’ as the basic unit of observable social interaction between two or more individuals, or between groups of individuals (Commons, 1924, pp. 4-5; 1931, p. 648). Transactions are forms of bargaining governed by both informal and formal rules of interaction, and may occur between equals, or between members embedded in hierarchical relations (e.g. employee-manager), and between groups acting in mutual dependency or in conflict. For Commons, a transaction is always actualized within and through cultural, historical and physical bounds that determine the constraints and possibilities of the interaction, since a transaction is ‘the meeting place of economics, physics, psychology, ethics, jurisprudence and politics’ (1924, p. 5). All these elements play a role in determining the outcomes of transactions as collective bargaining, the general process by which Commons argued economic institutions developed and evolved. In addition, Commons examined how this process manifested in the concrete development of law.

These are the general theoretical underpinnings of Commons’ legal institutionalism. Next I discuss the affinities with contemporary historical institutionalism, and then outline the way in which Commons breaks with core aspects of Veblen’s work.
3.2. Collective Bargaining and Institutional Development

A central focus of historical institutionalism is to understand how institutions ‘emerge from and are embedded in concrete temporal processes’ (Thelen, 1999, p. 369), with a major focus on the role of institutional construction as a means to resolve collective action issues (Rothstein, 1996, p. 159; Streeck, 1997, 2009). I argue that this contemporary historical institutionalist approach follows a theoretical line laid by the concept of ‘transaction’ and collective bargaining as outlined by Commons. The point can be highlighted through a discussion of Streeck’s analysis of the ‘German model’ of capitalism (Streeck, 1997, 2009). The German model came to be highly regarded in the decades after the Second World War, due to its high international competitiveness at high wages and with low inequality of income and living standards. Germany was by far the most successful major world economy at the time of unification with East Germany, achieved through a high degree of institutional caging of the logic of capital, relative to Anglo-Saxon economies, in order to serve wider social needs (Streeck, 1997). Streeck’s historical institutional analysis of the formation of the German corporatist model follows a similar line of analysis as outlined by Commons’ concept of collective bargaining in action. Streeck notes that the German model reflects ‘a complex historical compromise between liberal capitalism…two different countervailing forces, Social Democracy and Christian Democracy’ along with a mix of traditionalism, two currents of modernism, liberalism and socialism and compromises made between capital and labour (1997, p. 34).

On the latter, Germany has been noteworthy for the ‘near universal’ coverage of workers by collective wage bargain agreements during most of the post-war era (Streeck, 2009, p. 38). Streeck outlines how these agreements were the result of negotiation between industrial managers and powerful, highly centralized national worker unions. These agreements were successfully enforced by a system of councils
run by elected workplace representatives that had ‘quasi-statutory’ powers. The outcomes secured for labour were comparatively good relative to labour across the OECD. For example, Germany has traditionally had one of the highest D1:D5 wage ratios in the OECD, referring to the ratio of income for the poorest 10 percent compared to the median wage. During the 1980s and 1990s this ratio increased further from 61 to 64 percent, whereas most other OECD countries saw a decline, with Streeck highlighting that the ratio in the United States dropped from 45 to 40 percent (2009, p. 38).

This unique national-level collective bargaining has been codified formally in German law, institutions and organizations, as well as informally as norms and societal expectations, and has made German capitalism a unique inscription of a globally common capitalist relation. To elaborate, German capitalism is the same as other national ‘varieties of capitalism’ to the extent that it shares essential characteristics that justify the nominal descriptor ‘capitalist’ for such economies. These characteristics include legal rights to buy, sell and own private property, an economy based on commodity exchange, private ownership of the means of production, and paid labour defined by employment contracts (Hodgson, 2015, p. 259). On the other hand, German capitalism is unique because of the process outlined by Streeck’s historical institutional analysis, whereby the basic institutions of capitalism are made concrete within unique nationally-bounded relations. Those specific relations in Germany, as elsewhere, are a unique consequence of German history. Thus global sameness, in the form of the basic capitalist institutions, and national difference, given as the unique institutional enactment of capitalist relations within a specific country, are the intertwined components that result in varieties of capitalism.

As discussed above, Commons’ concept of transaction outlines theoretically the relations and processes discussed by Streeck, and therefore it is clear that Commons developed key concepts that pre-empted the research agenda of contemporary historical institutionalism. However, in developing this trajectory he
explicitly failed to develop the most unique and innovate aspects of Veblen’s institutionalism, its Darwinian theory of social evolution, and instinct-habit psychology (Anderson, 1933, p. 598; Hodgson, 2004b, p. 307; Rutherford, 1998, p. 465). Hodgson (2004b) reflects that Commons’ theoretical agenda increasingly took on the flavours of the shifting intellectual currents wherein behaviourist psychology and positivism were increasingly ascendant in American social science during the interwar period. In line with the latter trends, Commons became inclined to view human psychology as something of a tabula rasa, which the incumbent culture and environmental stimuli of a period then moulded fully. In thinking this way Commons opted for a primarily volitional theory of human motivation (Hodgson, 2004b, p. 294), and argued that Darwinism in social theory was unacceptable since it ‘attempted to get rid of the human will and to explain economic phenomena as the working out of natural forces’ (Commons, 1924, p. 376).

This point of view expressed Commons’ long-standing critique of Veblen’s views on the natural selection of institutions. Veblen had argued that the ‘evolution of social structure has been a process of natural selection of institutions’ (Veblen, [1899] 1970, p. 188). Commons (1897, p. 295) had previously claimed: ‘The term ‘natural selection’ is a misnomer, as Darwin himself perceived. It means merely survival. ‘Selection’ proper involves intention, and belongs to human reason. Selection by man we call artificial’. Commons, of course, is right to stress the role of human agency in social development, but wrong to disavow the role played by unintended natural selection. Darwin did distinguish, but never in a mutually exclusive manner, between natural and artificial selection (Hodgson, 2004b, p. 296). Rather, the latter was viewed as a special case of the former, a point understood by Veblen. ‘Selection’ does not always entail intention, and social outcomes are not always intended, as was the view argued by Commons.

By ‘natural selection’ of institutions Veblen is referring to the fact that that no agent or agents designed the overall outcome of any given society, even though agents do clearly design aspects of society. A society taken in total at any given
moment is an unintended outcome of the interactions of human agency, historical path dependency and environmental conditions (Buskes, 2013). Humans may plan, but the mix of factors involved in determining what institutions are selected and retained over time mean that artificial selection is itself only a component of a wider process of change. This is why Veblen argued that the process of social change taken in total was best termed a case of ‘natural’ selection of institutions, since institutions that solve certain problems within this general matrix of history, path dependency and environment tend to diffuse amongst societies, such that institutions become ‘efficient factors of selection’ (Veblen, [1899] 2007c, p. 125). The mechanisms by which this occurs are discussed in theoretical detail in chapter five, section four. In addition, Part III of this thesis will provide an original account of the evolution of bank bailout policy in response to financial crises, and argue that it represents a case of institutions acting as a factors of selection. As a result I argue across chapters eight and nine that the global diffusion of bank bailout policy highlights the clear limits of human agency in managing complex, open systems, as is a social system.

Commons’ critique of evolutionary concepts is important because it expresses concerns about applying Darwinism to social life. These concerns relate to the view that Darwinism denies a role for human agency in determining outcomes, or that competition and survival of the fittest is natural, where the latter then implies moral justification for any actions that ensure survival. None of this is held true either by Darwin, or contemporary understandings of Darwinism. Darwin himself stated: ‘I use the term Struggle for Existence in a large and metaphorical sense, including dependence of one being on another, and including (which is more important) not only the life of the individual, but success in leaving progeny’ (Darwin, [1859] 2008, p. 51). In elaborating this point he further stated: ‘a plant on the edge of a desert is said to struggle for life against the drought’ (ibid, p. 51). Consequently, Darwin never suggested that the struggle for existence implied free will was inconsequential, or that competition between individuals was inevitable.
Evolution selects for genes or institutionalized cultural traits that allow a species to flourish over time. Intention and cooperation, as well as competition may all impact outcomes. Darwin’s point was that species must engage in a struggle for survival. Some species compete individually between members of their own species, as well as against the wider environment, to ensure progeny. Others, such as eusocial insects form vast collectives to cooperatively ensure reproduction. Human societies that have survived for long periods of time have developed institutions that facilitate cooperation on ever greater scales. This cooperation has often facilitated successful competition through war against other societies. But war is neither inevitable, nor does evolution theory present is it normatively superior to other strategies.

In economics, capitalist markets entail competition between collectivities of cooperating individuals, some of which are composed of millions of agents. We call these corporations. Walmart alone employs around two million workers. The modern corporation is one of the most highly developed forms of social planning in human history (Lazonick, 1991). The most successful economies in the world have the largest corporations, the most amount of regulation and the most bureaucratic states (Commons, 1924; Hodgson, 2015; Sklar, 1988). Evolution tehn, does not mean that individualistic competition automatically ensures the best outcome. As Hodgson points out, natural selection ‘implies neither optimality nor lack of human involvement…it does not mean that all other possibilities are unnatural’ (Hodgson, 2004b, p. 295). Social planning and intention can be factors shaping evolutionary processes.

Commons, therefore misunderstood what Veblen meant by natural selection of institutions, with this misinterpretation arguably a central reason why he decided not to carry on with the Veblenian project. On other fronts Commons made significant and lasting policy contributions to American institutionalism. He ultimately sought to develop an institutionalism on different grounds to Veblen, and made a sustained attempt to do so in a systematic fashion (Hodgson, 2004b, p. 307).
However, the theoretical aspect of his work was less successful, with Boulding later arguing that his ‘theoretical structure remains today exactly where he left it: a tangled jungle of profound insights’ (Boulding, 1957, p. 8). Overall, his greatest impact was not theoretical, but practical, with his work influencing institutional policy-making and social bargaining processes of his time.

3.3. Wesley Mitchell: From Darwinism to Macroeconomics

Wesley Mitchell was a student of Veblen, and set to have a major impact in his own right on economics. Hodgson (2004, p. 251) provides the following biographical information. Mitchell was a graduate student of Veblen during the latter half of the 1890s, having finished undergraduate studies in the University of Chicago in 1896, with Veblen having a significant and enduring impact on his thought. Mitchell also studied with Carl Menger in Vienna, having received a travel fellowship to Europe during 1897. He was a deep reader of the German historical school, and developed a keen interest in psychology, monetary theory and the business cycle. This theoretical pluralism, along with the influence of Veblen, meant Mitchell held a deep scepticism of the concept of ‘rational economic man’. Rather than providing a foundation on which to build a theory of economic life, the concept of economic rationality was perceived as posing a problem in need of explanation. As Mitchell states:

As such it [economic rationality] is the central problem of economics—not a solid foundation upon which elaborate theoretical constructions may be erected without more ado. Even if economists are justified in starting with it as an assumption, they are not justified in stopping before they have made it a problem. And when they treat it as a problem they will find themselves working back to habits, and from habits back to instincts (Mitchell, 1910, p. 201).

As well as making economic rationality a problematic rather than an assumption, it is clear that Mitchell initially linked the sought-for theoretical solution into an evolutionary framework, one that considered the role of instinct and processes of habituation as central to explaining modern economic agents.
Mitchell’s central critique of *homo-economicus* is that it significantly ‘overestimates individual powers of understanding and analysis’ (Hodgson, 2004, p. 252) and undertheorizes the importance of social knowledge inherited culturally, and overplays the assumed power of individual rationality on which the theory is based. Mitchell makes the point as follows:

These [social] concepts are the focal points in that organization of ideas which is one of the fundamental requisites of thinking. From one point of view, the race’s stock of concepts is its most valuable asset; the summation of its cultural achievements. But, unlike the instincts, these concepts are not part of the mental equipment which the individual inherits at birth; rather they are something which he must acquire in the course of experience (Mitchell, 1910, p. 202).

Mitchell goes on to note that no individual works out for themselves all the social concepts which they acquire through life, nor could hope to do so. Rather, social progress is dependent upon the saving in time and energy gained by inheriting knowledge and practices already worked out and perfected by previous generations. Institutions are the means through which such inheritance is possible. For Mitchell the passing on of institutional knowledge involved a dynamic mix of deterministic and volitional elements. It is in the development and preservation of institutional knowledge that Mitchell sees the social foundations of capitalist rationality, not some pre-social universal rationality as prescribed by traditional economics:

…the [historically inherited] concepts supply the basis for rationality. As logical formulations of ideas proved valid by long experience, their acquisition trains the individual in reflection, marks out the lines of his own planning, and makes possible a far more intellectual control over activity than he could attain without their use (Mitchell, 1910, p. 203).

Mitchell is arguing that it is the cultural transmission of previous habits of thought and practices that have solidified to form enduring institutions that determine an individual’s orientation to life. On this ground Mitchell viewed *homo economicus* not as a universal being, but rather a recent and historical emergent social agent, or as
Young pointed out in following Mitchell: ‘[m]odern business is conducted by men who have learned to think in terms of money’ (Young, 1911, p. 415, emphasis added).

While Mitchell clearly was attracted by Veblen’s evolutionary scheme, he made his most significant contributions to non-Darwinian theories of macroeconomics. The most important being that he ‘developed the foundations of a system-wide, macroeconomic level of analysis’ (Hodgson, 2004, p. 309). Mitchell’s impact on macroeconomics stems from his work with the National Bureau of Economic Research (NBER), which Mitchell set up with Edwin Gay in 1920. The Bureau’s ‘pioneering work’ on macro-level income statistics in the twenties is regarded as ushering a ‘revolution in the economic information system’ (Boulding, 1957, p. 8). This revolution was especially important due to its effect on national economic planning. The NBER under the guidance of Mitchell was central to the establishment of modern macroeconomics, and as a result is seen as a precursor and significant influence on the later work of Keynes (Mirowski, 1989, p. 307). The extent of this influence can be read in arguments made by Mitchell long before Keynes’ (1936) General Theory of Employment, Interest and Money hit the book press, including arguing for ‘the long-range planning of public works, with intent to get a larger part of such undertakings executed in periods of depression’ (Mitchell, 1922, p. 26).

Mitchell (1927, 1941) also did extensive work on documenting and theorizing a dynamic understanding of the capitalist business cycle. Here he broke decisively with Walrasian static general equilibrium theory underpinning neoclassical macroeconomics. Mitchell developed an endogenous theory of the business cycle, meaning regular capitalist boom and busts were an outcome of capitalist dynamics, and not only the result of external shocks as neoclassical theory claims to this day, as chapter six outlines when discussing traditional economics view of the causes of the 2008 financial crisis. Neoclassical economist Koopman attacked Mitchell as having no theory of the business cycle and being empirical without being theoretical (e.g. Koopmans, 1947). The reason for this critique was that Mitchell rejected the neoclassical approach of deriving macroeconomics from microeconomics based
upon methodological individualism. Instead, one of Mitchell’s innovative arguments was to propose the reverse must also be considered, that is, there is a macroeconomic foundation for microeconomics (Hodgson, 2004b, p. 314). Mitchell argued rightly that institutions imparted a standardising effect on individual agency (Mitchell, 1925, p. 8), a process during which individual behaviour and beliefs are formed.

This process has been discussed in chapter one as referring to the ‘constitutive role of institutions’ (Chang, 2002, p. 554) or ‘reconstitutive downward causation’ (Hodgson, 2001, p. 295). It refers to a fundamental mechanism of socialization, and is one of the most important concepts of institutional theory (see also Heilbroner, 1986, ch 3; Hodgson, 2000, 2007b; Sperry, 1991). Consequently, the real issue, as concisely stated by Sherman, is that Mitchell’s theory rejected in resounding terms neoclassical theories of the business cycle based on methodological individualist principles:

Whereas all neoclassical theory is stated in terms of eternally true laws, Mitchell stated an evolutionary theory. Whereas all neoclassical business cycle theories are exogenous, relying on external shocks to the economy, Mitchell stated an endogenous theory, based on the internal dynamics of capitalism. Whereas neoclassical theories are deduced from unproven psychological axioms, Mitchell builds his theory from inductive generalities gained from empirical research (2001, p. 85).

In sum, Mitchell’s important insights on the business cycle was that it was strictly a capitalist phenomenon, it arose only in an economy which was pecuniary in nature and organized through capitalist institutions of market exchange, production for profit and financial money-credit. In doing so he generated a historical theory of the business cycle that actually comports with real history, in contrast to neoclassical theory based on equilibrium which comports only with itself. However, much as did Commons, Mitchell developed a line of institutionalism that shed core elements of Veblen’s project, with again Darwinism and instinct-habit psychology left largely undeveloped, even as Mitchell made major progress on the evolution of the business cycle.
Conclusion

In taking stock, Veblen, Commons and Mitchell were significant foundational thinkers in American institutional economics. Each of the three made significant and lasting impacts on the development of the field. Veblen developed a cutting critique of the neoclassical synthesis emerging during the turn of the twentieth century, and proposed in its place a Darwinian theory of institutional evolution that synthesized insights from psychology, anthropology, political economy and the wider social and natural sciences. Commons recognised that economics is not simply a matter of governance, but also a question of power, expressed as domination and acquiescence between interest groups during the formation of rules of conduct and policy and the legitimation of goals (Elliott, 1978). Mitchell developed major advances in business cycle theory, as well as in macroeconomic theory. He proposed policy solutions such as counter-cyclical spending to ameliorate recession before John Maynard Keynes (1936) had published The General Theory in Employment, Interest and Money.

However, it is important to note that the ‘old’ American institutionalism consisted of a broad research agenda, rather than an integrated system of economic theory. In contrast, in a perceptive essay Anderson (1933, p. 599) rightly made note of the fact that ‘Veblen attempted to forge an integrated system of economic theory along entirely original lines’. Anderson goes on to argue the following:

Most interpretations of Veblen’s economics have sadly misconceived him. Neither the proponents of the "orthodox" tradition nor Veblen's followers of the "institutional" school have grasped the full significance of his work. In the folklore of economists he has been variously labelled a satirist of present-day society, a philosopher of history, a censor of the economic machine and a severe critic of orthodox theory. All these designations are correct; but they are not important. Pre-eminently, he is the creator of a new system of theory (Anderson 1933: 622).

However, this integrated system was not followed up by later institutionalists, or even by Veblen’s own students (P. A. O’Hara, 2002). Instead, early followers of
Veblen ultimately followed the wider intellectual currents in the social sciences of the post-war twentieth century that eschewed Darwinian theory and instinct-habit psychology (Camic & Hodgson, 2011a). Consequently, major American institutionalists who followed Veblen in taking a political economy perspective in challenge to orthodox economics, people such as John Commons, Wesley Mitchell, Clarence Ayers, Gunnar Myrdal and John K. Galbraith, also departed from the most distinctive aspects of Veblen’s approach.

Veblen shares responsibility for the falling into obscurity of his system. This is because while his works provide the basis for an integrated theory of socio-economic change, Veblen never developed a clear and systematic presentation of his ideas (Rutherford, 1998). Instead, those inclined to follow Veblen’s ideas have had to ‘extract them, like precious metal, from the veins of glittering insight that run sporadically throughout his works’ (Hodgson, 2004b, p. 9). It has been the case that up to the early 2000s Veblen’s work remained largely left as it was upon his death (P. A. O’Hara, 2002), however since this time major efforts have been established to synthesize and critically rebuild Veblen’s efforts into a modern theory of institutional-evolutionary economics. In that light, chapters four and five will engage this literature. Chapter four critiques a number of Veblen’s theoretical failings, but also highlights recent evidence that validate innovations such as his application of instinct-habit psychology to social theory.
Chapter 4. Reconstructing
Institutional-Evolutionary
Economics

In a prescient early assessment, Anderson (1933, p. 618) argued that Thorstein Veblen had developed ‘an integrated system of economic theory’. In acknowledging the potential offered by Veblen’s approach Anderson further stated: ‘It is no compliment to the institutional economists that as a rule they have not taken the trouble to attempt a consistent statement of the doctrines of Veblen’ (ibid, p. 598). The tragedy for Veblen’s legacy during the twentieth century is that no institutionalist following approximately in Veblen’s footsteps tried to reconstruct and develop his work as an integrated model for analysis of socio-economic change (Hodgson, 2004b; P. A. O’Hara, 2002; Rutherford, 1998). I outlined a number of reasons for this in chapter three, including major intellectual shifts in the social sciences post-1945 that rejected Darwinism and instinct-habit psychology. However, Veblen’s own shortcomings must be included in the reasons for the demise of his system. While his theory was integrated it was far from complete (Anderson, 1933; Hodgson, 2004b). Furthermore, given the scope of Veblen’s incomplete project, reconstruction would require a major and systematic effort.

Over the past three decades Geoffrey Hodgson has engaged the project of reconstructing and developing Veblen’s work (Hodgson, 1992, 1993, 1995a, 1995b, 1998c, 2001, 2002, 2004a, 2004b, 2004c, 2007a, 2007c, 2009, 2010). Others have also added to Veblen’s contemporary revival (Dugger, 1989, 1995, 2006; P. A. O’Hara, 2000, 2002; Rutherford, 1984, 1998; Twomey, 1998). However, it is Hodgson who has by far contributed the most rounded contribution, seeking to fully trace out the
origins of Veblen’s thought in its historical context, outline its developmental arc, its strengths and weaknesses, and lastly, seeking to fortify a number of half-built ramparts holding up Veblen’s theoretical edifice. This has involved wide-ranging recourse to contemporary developments in philosophy, as well as across the social and natural sciences. Hodgson’s work will provide the major source for this chapter and the next. The goal here is to outline and respond to a number of important criticisms laid against Veblen’s theory, and argue for the continuing relevance of his key contributions. Building on Hodgson, this chapter develops original links between Veblen’s work and recent major statements in evolutionary psychology, particularly the work of Daniel Kahneman (2012) on priming. I also contribute to current debates on the place of biology in the social sciences.

This chapter proceeds through four sections. Section one argues that Veblen eliminates purposive action when arguing a form of ‘technological determinism’ as the primary source of social change (Hodgson, 2004b, p. 287; Rutherford, 1984, p. 346; 1998, pp. 475-476), and that this aspect of Veblen’s theory must be rejected. Section two rejects claims that instinct-habit psychology is unsuitable for contributing to an explanation of cultural change (e.g. Anderson, 1933; Beckert & Streeck, 2008; Rutherford, 1984), and argues that recent developments in cognitive science vindicate Veblen and James view on instinct-habit psychology. Section three builds on Veblen’s understanding of ‘habit’, arguing that it is a crucial concept for understanding agent socialization. A final section summarizes the chapter.


Rutherford (1984) argues that Veblen had a particular interpretation of Darwin that led him to increasingly formulate all social change in terms of blind causation, meaning non-teleological and as a result of a process of habituation to technological change. The problem, suggests Rutherford, is not the notion that much social change is unintended, nor that technology impacts how humans behave. Rather, he suggests
that in rejecting teleological explanations Veblen then proceeded to reject all ‘explanations that involve intelligent or thoughtful decisions concerning the goals of action on the part of individuals confronted by new circumstances’ (Rutherford, 1984, p. 346). Consequently, Rutherford is following a line of critique discussed in the previous chapter in relation to John R. Commons. Whereas Commons is critiquing Veblen’s views on institutional selection, Rutherford is concerned with another aspect of the theory. He view Veblen as overstating the role of technology in directing social change, and with theorizing a process of passive adaption, or a process of ‘blind habituation’ by agents to new technology (1984, p. 346; 1998), essentially outlining a form of technological determinism. Hodgson (Hodgson, 2004b, pp. 206-221) also provides a detailed analysis and critique of Veblen’s understanding of technology and social change on similar grounds.

‘Technological determinism’ refers to the view ‘that social structure and social change are ultimately to be explained as adaptations to technological progress’ (Miller, 1981, p. 91). As will be shown below, Veblen does exhibit an unwarranted technological determinism by arguing across a number of studies that technology imparts a linear socializing effect on agents, one that affects their habits of thought and action (Veblen, 1904, 1914, [1906] 2007). Thus, even if elsewhere Veblen does repeatedly emphasise the role of agency in the unfolding of institutional life (Veblen, 1898a, p. 188; 1898b, p. 243; 1909b, p. 391), Seckler is correct in arguing that Veblen ‘teeters between free will and determinism’ (Seckler, 1975, p. 56). This confusing position needs to be resolved during reconstruction of Veblen’s ideas. The problem to be critiqued in this section is as follows: by over-emphasizing the unintended effects of technology on behaviour Veblen fails to satisfactorily outline the purposefulness of human action ‘as a category distinct from mechanical causality’ (Hodgson 1998: 424). Given the importance of technology in Veblen’s system I will critically assess his arguments in detail.

In the *Theory of the Business Enterprise* Veblen (1904) develops a line of thought which argued that financial crises were a consequence of financial institutions that
fostered speculative activity on the part of investors. In doing so ‘brilliantly’
foreshadowing the theory of economic instability found in Keynes’ (1936) work
(Hodgson, 2004b, p. 207). However, in what Hodgson regards as a fatal misstep for
his theory of institutional change, Veblen failed to follow this avenue of analysis,
and instead followed up a theory of cultural change in response to technological
development. It was a misstep because of unfounded assumptions concerning the
existence of a direct and determinate causal relationship between technology and
habits of thoughts of agents using the technology.

Veblen’s choice at the beginning of the twentieth century to analyse the social
consequences of the machine process occurs in the context of burgeoning
industrialization across America. He gives his first major statement indicating a
growing focus on technology towards the end of the Theory of the Business Enterprise
(Veblen, 1904, pp. 302-373). Veblen argued:

The machine process pervades the modern life and dominates it in a mechanical sense.
Its dominance is seen in the enforcement of precise mechanical measurements and
adjustments and the reduction of all manner of things, purposes and acts, necessities,
conveniences, and amenities of life, to standard units (Veblen, 1904, p. 306).

Veblen argued that this permeation of daily life with mechanization ‘inculcates a
habit of apprehending and explaining facts in terms of material cause and effect’
(ibid, p. 67), thereby he drew a direct line of causation between technology and how
agents who interact with that technology think. He argued that the growing
dominance of industrial processes in the daily lives of workers meant that ‘it is not
too much to say they have become the chief force in shaping men’s daily life, and
therefore the chief factor in shaping men’s habits of thought’ (Veblen, [1906] 2007, p.
17). The manner in which it shapes their habits of thoughts, argued Veblen, was to
induce an ever greater tendency to have a ‘matter-of-fact’ approach to the world, by
which he means a ‘greater resort to the mechanical or dispassionate method of
apprehending facts’ (Veblen, [1899] 2007a, p. 105). The term ‘matter-of-fact’ is
Veblen’s terminology for modern science, envisioned by him as replacing animism, religion and political ideology as the driver of social change.

Veblen placed this growth in the matter-of-fact habit of thought within an evolutionary framework, arguing that institutions that promoted such scientific and technologically-minded thinking would be selected and reproduced on an ever greater scale:

A civilisation which is dominated by this mater-of-fact insight must prevail against any cultural scheme that lacks this element. This characteristic of western civilisation comes to a head in modern science, and finds its highest expression in the technology of the machine industry (Veblen, [1906] 2007, p. 2).

This statement imparts a progressive and linear character to the growth in the mechanistic habit of thinking within technologically progressive nations. Writing in an era when colonialism is in full swing, Veblen is arguing that once a nation adopts the scientific approach, the resultant material resources that will accrue will result either in either forcing non-scientific societies to adopt a similar approach, or face threat of more forceful displacement. Either way the scientific approach would steadily increase. The importance of this shift towards scientific-based social reproduction is the effect on the habits of thought of agents, who would be socialized into a matter-of-fact viewpoint. According to Veblen’s theory of institutional change, this technological determinism on agent cognition and behaviour would undermine explanations based on ‘natural rights’ and social conventionalities. The relevance of this effect for the capitalis system would, argued Veblen, be to undermine property rights based on claims of natural right and convention:

The ultimate ground of validity for the thinking of the business class is the natural-rights ground of property – a conventional, anthropomorphic fact having an institutional validity, rather than a matter-of-fact validity such as can be formulated in terms of material cause and effect … Arguments which proceed on material cause and
effect cannot be met with arguments from conventional precedent (Veblen, 1904, p. 318)

Veblen is arguing here that there are no scientific grounds for the ratio of distribution of capitalist surplus, nor for modern property rights more broadly, and that it is only a matter of convention that the capitalist gets the larger share. Thus, in a manner reminiscent of Marx (1990) and Schumpeter ([1942] 2008), albeit for different reasons, Veblen argued that the successful development of capitalism would undermine the ongoing reproduction and institutional legitimacy of the system. For Marx (1990, pp. 927-930) capitalist development sows its own seeds of destruction by centralizing both the means of production and labour, whereby the latter can easily organize itself due to proximity. Motivated by shared class-interest workers would logically seek to overthrow the social relations dominating them. Schumpeter’s position is remarkably close to Veblen’s, since he also argued that increasing rationality akin to Veblen’s matter-of-fact habit of thought would destabilize property conventions, stating: ‘the bourgeois finds to his amazement that the rationalist attitude does not stop at the credentials of kings and popes but goes on to attack private property and the whole scheme of bourgeois values’ (Schumpeter, [1942] 2008, p. 143). Veblen thus argued that ‘the machine discipline acts to disintegrate the institutional heritage, of all degrees of antiquity and authenticity…It thereby cuts away that ground of law and order on which business enterprise is founded’ (Veblen, 1904, p. 214).

Veblen’s argument is summed up as follows: when agents use technology it transforms their habits of thought to correspond with the type of thought he argues is required to engineer such technology, which is rational-objective; secondly, that this new matter-of-fact habit of thought would come to singularly dominate an agent’s interpretive horizon, such that they would no longer accept the validity of social relations based upon natural rights and social conventions that are unsupported by this matter-of-fact viewpoint. Thus, a matter-of-fact way of thinking would come to replace the previously dominant subjective-conventional way of
thinking. On the face of it there is a logic to this argument. Nevertheless, Hodgson is right to argue that it fails utterly ‘to stand up to even moderate theoretical and historical scrutiny’ (Hodgson, 2004b, p. 217).

Hodgson finds acceptable the point that living with, and using, technology daily will impact and condition how agents think and behave. But exactly how, and to what effect, is far less clear than Veblen proposes. Hodgson calls into question what it means to take a ‘matter-of-fact’ view to the world. Veblen understood it to mean a ‘dispassionate method of apprehending the facts’. But as Hodgson notes, this is a rather vague and questionable claim, and seems to imply that facts speak for themselves, whereas an interpretive framework must always be utilised (2004b, p. 217). Furthermore, as Hodgson points out, the fact that workers learn how to build or use machines ‘does not provide a specific and detailed understanding of causal ontology’ (Hodgson, 2004b, p. 217), echoing a similar point made by Max Weber on this same question of the effects of modern technology on its users (Weber, 1946). It is therefore dubious to argue that their habits of thought would by causal necessity be deeply penetrated and transformed on the grounds Veblen argued.

For example, young children who believe in Santa Claus and adults who believe in various religions, find little problem in using one of contemporary society’s most advanced technologies, the smart phone. Using a smart phone requires knowledge that pressing certain icons with your finger makes certain things happen, and nothing more. And the same can be said for many industrial technologies from the perspective of those who use such technologies, be they workers or consumers. Likewise, Hodgson (2004b, p. 217) points out that technologies are often developed by engineers and scientists even when there are large unknowns regarding the central processes at hand. He notes that the steam engine was developed well in advance of the laws of thermodynamics being well-understood, while false theories of heat were accepted well into the 19th century, even as industrial processes involving heat-based transformations were developed. Many metal alloy discoveries were trial and error, absent full apprehension of the
underlying chemical processes, while to this day scientists have competing explanations of key concepts such as gravity and electricity. Newton and Einstein created very different theories of gravity, both of which are still used to make predictions.

If technology is often not fully understood by its inventors, then how can we assume, as Veblen does, that it will impart a particular habit of thought on its users. What technology does and how it works is one thing; how agents perceive and feel about that same technology is another. Hodgson (2004b) highlights two studies by past pupils of Veblen that critiqued his view of technology and change on such grounds. Mumford noted that: ‘The direct reaction of the machine was to make people materialistic and rational; its indirect action was often to make them hyper-emotional and irrational’ (Mumford, 1934, p. 284). The latter consequence is due to the social dislocations often associated with machines. A well-known example being the machine-breaking movement of the early 19th century Luddites in response to the development of mechanical looms that made their hand-skills redundant.

Likewise, Hoxie’s study of trade unions gave grounds to reject Veblen’s thesis, since once organized into unions, workers who came into contact with industrial processes on a daily basis did not then come to view property rights as illegitimate, but instead sought to increase their own property claims, i.e. their wage share, on the economic surplus (Hoxie, 1917). Contemporary America is the most technologically advanced of the developed countries, and also one of the most religious (Hodgson, 2004b), while more generally it is clear that even after centuries of global industrialization, traditional modes of thought such as nationalism and religion have survived and often thrived (Haugaard, 2010, p. 68). In 2017 a representative sample of US adult residents polled by the Gallup Organization found the percentage of the population holding a creationist viewpoint at thirty
eight percent. The poll also found the same percentage believe humans evolved, but that God guided the process, while fifty seven percent of respondents believe in evolution of some form, either God-driven or by a Darwinian process.

On the other hand, the American Academy of Arts & Sciences report on the American public’s perceptions of science found that a ‘majority of Americans view scientific research as beneficial’ (*Perceptions of Science in America*, 2018, p. vii). Thus contradictory viewpoints of the world may be held simultaneously, a psychological state termed ‘cognitive dissonance’ (Egan, Santos, & Bloom, 2007), giving strong reason to question Veblen’s thesis. The view that a unitary ‘matter-of-fact’ habit of thought is likely to become dominant within people’s interpretive horizons as a result of using technology is unlikely in the extreme. Instead, contemporary social theory highlights that agents are capable of utilising and maintaining multiple and contradictory interpretive horizons during everyday life, or as Haugaard notes in repurposing Marx’s well-known phrase to make the point: ‘it is possible to be a scientist in the morning, a nationalist in the afternoon and a religious believer in the evening’ (Haugaard, 2010, p. 68). All that in the era of the machine process.

In summary, across a number of major works Veblen (1904, 1914, [1906] 2007) placed a significant emphasis on the role of technology in generating institutional change. While such a proposition is undoubtedly true at a general level, Veblen’s model of technological change is theoretically flawed and empirically refuted. Veblen did occasionally qualify his position on technology, for example noting that conditions could arise which would ‘dispel the effects wrought by habituation to the ways and means of modern industry and the exact sciences’ (Veblen, 1915, p. 237). However, he ultimately developed an extensive argument for technological determinism. As Hodgson rightly points out, viable reconstruction of his theoretical system must reject this element of Veblen’s argument (Hodgson, 2004b).

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4.2. The Modern Revival of Instinct-habit Psychology

As discussed in chapter three, the rejection of instinct-habit psychology by Veblen’s immediate followers coincided with the rise of behaviourism, and a strict separation of biology from the social sciences during much of the twentieth century (Twomey, 1998). In fact, debates regarding the applicability of biological findings to social science continue to abound (Beckert & Streeck, 2008; Brooke & Larsen, 2014; Brown, 2012; Cooter, 2014; Meloni, Williams, & Martin, 2016). This debates turn on issue of what role, if any, our biology plays in shaping cultural evolution. Cooter (2014) fears that using biological categories from cognitive science in explaining history will make brain processes central, thereby stripping historical change of agency. In a similar vein Beckert and Streeck argue:

we believe the attempt to trace regularities in social action to psychological universals or even neurological endowments to be fundamentally mistaken, as individualistic or biologicist explanations cannot do justice to the crucial role of social structures, socialization, and cultural evolution in coordinating human activities (Beckert & Streeck, 2008, p. 16)

This latter position is common to social scientists who argue for a strict dualist approach to the natural and social worlds (e.g. Brown, 2012; J. B. Foster, 1997), entailing that explanations of the latter require little or no insights from the former, and that social science ought to focus exclusively on culture as the central causal mechanism.

This dualist position is untenable. Humans are biological animals, and biology is fundamental to any complete explanation of the how and why of human behavior, and processes of socialization. This statement does not entail reducing the importance of culture. Veblen developed William James’ instinct-habit psychology to provide a theory of socialization that connects biology to institutions and how they impact individual agents. Rutherford (1984) has critiqued instinct-habit psychology, arguing it has no role in explaining cultural evolution. However, growing numbers
of studies during the latter half of the twentieth century have sought to place human
cognition and socialization within an evolutionary framework (Buss, 2007; Friesen &
doing so these studies support the multi-tiered view of mind as an outcome of
millions of years of biological evolution as developed by James (1890b) and Veblen
(1898a, 1914, [1899] 1970). This section will contribute to these important ongoing
debates on biology in the social sciences, through arguing for the relevance of
instinct-habit psychology as part of a viable reconstruction of Veblen’s
institutionalism.

Veblen argued that the ‘dichotomy between physiological and psychological
activity be abandoned’ (Veblen, 1914, p. 30), and in developing James’ (1890) ideas
he argued that instinct-habit psychology provided important insights into human
behaviour, and the mechanisms by which socialization occurs. Modern proponents
of institutional-evolutionary economics have developed these ideas. Habituation
refers to a learned propensity ‘that is moulded by environmental circumstances’
(Hodgson, 2004b, p. 164). Camic defines habit as ‘a more or less self-actuating
disposition or tendency to engage in a previously adopted or acquired form of
action’ (Camic, 1986, p. 1044; see also Hodgson, 2015, p. 388). Regarding self-
actuation Hodgson argues that: ‘The mechanisms of habit are largely unconscious,
but they may press on our awareness. Habits are submerged repertoires of potential
behaviour; they can be triggered or reinforced by an appropriate stimulus or context’
(Hodgson, 2004c, p. 652). This self-actuation is due to their establishment within
‘subliminal areas of our nervous system’ (Hodgson, 1997, p. 664). Thus, it is crucial
to note that habits have an automatic quality and remain latent when not in use (see
also Kahneman, 2012; Kilpinen, 2000; Wood & Neal, 2007).

To expand on this point a distinction between the potential and the actual is
important. Hodgson draws upon realist philosophy (Bhaskar, 1975) in explaining
this difference. Science, he notes, is about identification of causal laws, the latter of
which are not events but rather ‘generative mechanisms that can under specific
conditions give rise to specific events’ (Hodgson, 2004c, p. 653). This highlights the requirement to distinguish between ‘observed empirical regularity and any causal law that lies behind it’ (ibid, p. 253). Hence habit is understood as a disposition for certain behaviour, and which continues to exist even when behaviour is not engaged, or when other factors prevent the disposition being acted upon.

Studies on consumer behaviour as early as the mid-twentieth century had shown that many purchases are habitual rather than the result of extensive forethought and investigation of available options (Katona & Mueller, 1955). Katona argued that ‘to understand business life, both habitual and routine acts and their abandonment through making genuine decisions must be studied’ (Katona, 1951, p. 52), and suggested that the degree of conscious engagement with a decision to make a purchase was correlated with the relative importance of the given purchase. Meaning that an agent is more likely to habitually keep buying the same brand of tea without investigating the price or quality of other brands, but less likely to habitually keep buying the same brand of car without considering price and quality of competitors. Habit is therefore viewed by Katona as a conserving tool, whereby conscious effort that requires high levels of mental energy is saved for important decisions. Katona is following a similar line developed by James’ view, discussed in chapter two, on the role of habit as societies ‘great flywheel’ and ‘most precious conservative agent’ (James, 1890b, p. 121).

Habits may be unconsciously acquired or consciously acquired. For example, much of our socialization is acquired unconsciously during life. As children we don’t consciously choose to acquire a feeling of pride or a sense of belonging when confronted with symbols of our nation of origin, such as flags, anthems or country name. Nor do we consciously choose which God to worship. But the majority of people are socialized with some degree of nationalism and religious affiliation. As children we don’t initially reflect on the validity of society’s demand of deference to specific historical forms of authority invested in institutional roles such as the teacher, the police officer or the employer. Nationalism, praying to a God or Gods,
and authority deference are all examples of unconsciously acquired culturally-specific habitual responses to given stimuli.

Agents are constantly accumulating habitual responses while learning to navigate their social environment. This view of habit has clear similarities with Bourdieu’s concept of ‘habitus’, defined as ‘[s]ystems of durable, transposable dispositions’ that act ‘as principles which generate and organize practices and representations that can be objectively adapted to their outcomes without presupposing a conscious aiming at ends’ (Bourdieu, 1990, p. 53). Hodgson (Hodgson, 2004b, p. 187) points out that Bourdieu acknowledges his debt to the pragmatist concept of habit in developing the concept habitus (Bourdieu & Wacquant, 1992, p. 122). However, while the concept of habitus is widely used in sociology, it is not acknowledged that the concept is in fact grounded in biological evolution and pre-cultural drives. In ways such as this sociology has become unmoored from a logical and necessary grounding in biology, as a complementary explanation rounding out its social theories, theories which concern biological animals who can generate culture because of their biology. Instinct and habit are both prior to conscious cultural attainment, and serve as its foundation.

As discussed in chapter five, Veblen argued that instinctive drives involve a fundamental intelligence. For example, without instincts a newborn would have no means to ‘structure its interaction with the world’ (Hodgson, 2004b, p. 163), since amongst other things instincts allow a newborn to suckle, clutch, and communicate its needs to others prior to attaining any cultural abilities. Kahneman (2012, pp. 21-22) makes a similar point, noting that we are born with a whole host of priming instincts that allow us to recognize objects, potential danger, react to sounds prior to consciously processing the stimuli, comprehend spatial relations and more. These basic instincts are crucial for initial survival.

Studies in evolutionary biology and cognitive science provide further support for instinct-habit psychology. Twomey (1998, pp. 441-444) points to Franklin’s (1995) work on the nature of mind as elaborating modern themes previously developed by
Veblenian institutionalism and pragmatist psychology. Franklin argues that ‘[m]ind is better viewed as continuous as opposed to Boolean’ (Franklin, 1995, p. 17), referring to a concept of degrees of mind, rather than a view of a single degree, often considered to be fully conscious. Instead of a single rational level of mind, the hypothesis is that ‘mind is aggregate rather than monolithic’ (Franklin, 1995, p. 17). This view is the product of a growing consensus that the human mind is a composite product based on integrated activity between older ‘automated’ functions and newer higher cognitive brain functions (Edelman, 1992; Minsky, 2007; Ornstein, 1991; Sapolsky, 2017). In making this argument Sapolsky argues that ‘automatic aspects of behavior’ are not separable from higher cognitive functions such as emotion and conscious thought (Sapolsky, 2017, p. 23).

Kahneman’s (2012) landmark text in evolutionary psychology reinforces these points. Kahneman’s (2012) work distils his own lifetime of study, and a critical synthesis of the priming literature (Aarts, Gollwitzer, & Hassin, 2004; Bargh & Williams, 2006; Zhong & Liljenquist, 2006) in outlining the roles played by unconscious and conscious aspects of mind in decision-making. I argue that Kahneman’s study directly supports the conceptualization of mind given by instinct-habit psychology. He describes two systems, System 1 and System 2, through which the mind operates in negotiating life.

System 1, which conforms with the instinct-habit conceptualisation used by Veblen, is described as operating ‘automatically and quickly, with little or no effort and no sense of voluntary control’; System 2, the self-conscious part of the mind, takes care of ‘effortful mental activities…associated with the subjective experience of agency, choice, and concentration’ (Kahneman, 2012, pp. 20-21). Crucially, Kahneman argues that ‘[a]lthough System 2 believes itself to be where the action is, System 1 is the hero of the book’ (Kahneman, 2012, p. 21). It is the hero because System 1 puts into action James’ ‘great flywheel of society’, the highly efficient automated responses that effectively deal with enormous amounts of information experienced daily. Some of System 1’s abilities are inherited biologically, some are
acquired unconsciously as tacit knowledge, and many are learned through conscious effort. But once various forms of tacit knowledge and practices are acquired by whatever means, these abilities become reflexive responses triggered by environmental stimuli.

Thus, System 1 can handle enormous amounts of environmental responses with relatively little input from System 2, under the condition that these responses generally align with what System 2 has been socialized to view as normal. The latter deals with all tasks requiring conscious attention, and can also be deliberately activated by an agent at any time. However, as Kahneman notes, ongoing application of System 2 is highly taxing, can only be used for a small number of tasks for limited periods of time. If the task is highly complex, then only one task can be attended to (Kahneman, 2012, pp. 31-32). The most important insight of this research is that most of the time System 2 operates on the constant suggestive flow of impressions provided to it by System 1, rather than by active attention to the world. Kahneman notes that this ‘division of labor between System 1 and System 2 is highly efficient: it minimizes effort and optimizes performance’ (ibid, p. 25). James made this same point, arguing that in freeing up conscious attention, habit ‘diminishes fatigue’ (James, 1890b, p. 112). Furthermore, System 1 cannot be turned off, although it can be overridden by System 2 (Kahneman, 2012, pp. 25, 56). Allocation between systems has been finely honed through a ‘long evolutionary history’ (ibid, p. 35) and works effectively most of the time. However, System 1 has important limitations and biases, systematic errors, visual and cognitive, that are made in specific circumstances, and it does not deal very well with formal logic and statistics (ibid, p. 25). Kahneman systemically outlines analysis of the enormous experimental evidence supporting this argument, but which I forego here.

The above studies do not advocate the argument that higher cognitive functions are determined fully by lower cognitive, automatic functions, but rather seek to understand how they relate, and how this relationship impacts human behaviour. This was precisely the task set by James (1890) and taken up by Veblen
(Veblen, 1898a, 1914, [1899] 1970), as outlined in chapter five. The position argued is not that culture can be fully explained in terms of instinct, cognitive processes or habit, but rather of explaining human cultural behaviour in its full evolutionary development. Consequently, the revival of instinct-habit psychology is part of a wider intellectual shift which Hodgson summarizes as follows:

The rehabilitation of instinct and habit was part of a movement to situate the mind in its evolutionary, biological, material and social context. The interactions involved cross the boundaries between the biological and the social, the mental and the material. Accepting that reductionism is generally unattainable, multiple levels of analysis are involved (Hodgson, 2004b, p. 403).

Multiple levels of analysis involves drawing out causal relations and interactions between elements that are biological and cultural, and rejecting the argument for biologically reductionist explanations of social and cultural behaviour as directly caused by genes or human biology. Such a reductionist approach was evident in the arguments made during the 1970s by ‘socio-biologists’ (Alexander, 1979; Symons, 1979; E. O. Wilson, 1975, 1978), as well as by some evolutionary economists (Becker, 1976; Robson, 2001; Tullock, 1979). Critics of sociobiology argue that early approaches to ‘Darwinize’ cultural evolution were flawed because they attempted to map biological processes and categories directly onto the socio-cultural domain in a reductionist manner, thereby stretching invalid analogies across levels of analysis, rather than building level-specific theory (Buskes, 2013; Hodgson, 2004b, pp. 46-49).

4.3. ‘Habit’, Institutions and the Making of a Social Agent

The institutional-evolutionary understanding of habit must be distinguished from other concepts of habit within economic thought. Hodgson (2004c, 2010) points out that the institutional-evolutionary view contrasts with versions of economic behaviourism, since the latter understands habit as derived from sequentially correlated rational behaviour (Becker, 1992; Becker & Murphy, 1988; Philips & Spinnewyn, 1984). In this view habit is simply a rational act that is repeated, thus
retaining the rational actor model intact and central to explanations. Furthermore, such a habit can be easily ‘kicked’ once it becomes rational to do so. This understanding of habit is of a surface-level phenomena ultimately caused by a deeper unchanging psychology that is fundamentally rational. This is the rational actor model central to neoclassical agent modelling. The model has previously been critiqued on the impossibility of its assumptions that all necessary information for a fully rational choice is available, and also on grounds that agents don’t possess the enormous computational power that would be required to process such volumes of information (Beinhocker, 2006; Shackle, 1972). This critique is important. Here I develop a different critique, based on the discussion of habit developed thus far.

Critique begins with the observation that rationality is simply assumed, and taken as the normal state of mind, rather than explained in traditional economics. Cosmides and Tooby (1994) point to the fact that rational behaviour is not the normal state of things, but rather quite abnormal in a universe populated almost entirely by non-self-conscious entities and inert matter. Their point, shared by others (Hodgson, 1998a, 2004c, 2010; Mitchell, 1910) is that rational behaviour cannot be assumed, but must be explained in causal terms. Hodgson (Hodgson, 2004b, 2004c) outlines the difference between the institutional-evolutionary view of habit as a propensity versus the behaviourist position viewing habit as a belief, preference or behaviour. The former understands habit as referring to a deeply embedded psychological conditioning that acts largely unconsciously, and is a result of the moulding of agents within an institutional order. Institutional life fundamentally shapes the character of agents on both conscious and unconscious levels. It provides them with the specific historical habits that become internalised within their cognitive framework, and through which they orientate themselves to life in a process of ‘reconstitutive downward causation’ (Hodgson, 2000; 2001, p. 295; 2004c, p. 656; 2007b).

As discussed in chapter one, the latter concept marks a fundamental difference between Veblenian institutionalism with both traditional economics and
the ‘new’ institutional economics (Coase, 1992; North, 1989, 1990; O. E. Williamson, 1985) based on a ‘rational-choice’ version of institutionalism (J. L. Campbell, 2004). Rational-choice institutionalism follows neoclassical marginalism in viewing agents as fundamentally self-interested, which in an economic context means actions are a consequence of a ‘decision-making logic based on an interest in maximizing benefits relative to costs’ (J. L. Campbell, 2004, p. 14). This instrumental economic rationality is considered universal, meaning irrespective of historical context. The emergence of institutions are then viewed as rational attempts by individuals to overcome issues such as transaction costs (Coase, 1937, 1992). Once formed these institutions then enable and/or constrain agents. But while agents strategically adapt their behaviour to the institutional context they operate in, their core preference for economic maximization is still the underlying assumption concerning behaviour.

Against that rational-choice view, downward causation involves the much stronger claim that institutions ‘have a capacity to change aspirations, instead of merely enabling or constraining them’ (Hodgson, 2007b, p. 107). Instrumental rationality, insofar as it may exist, would then be viewed as the result of living under certain institutional conditions, for example a society organised around pecuniary gain. This constitutive role of institutions is ‘a central hallmark of a truly ‘institutionalist’ approach’ (Chang, 2002, p. 554). It refers to the fact that institutions play a major role in shaping agents habits, and therefore are central to explaining socialization. As Veblen argued: ‘The situation of today shapes the institutions of tomorrow through a selective, coercive process, by acting upon men’s habitual view of things’ (Veblen, [1899] 2007c, p. 126).

This institutional approach does not fall into the trap of the over-socialized individual as discussed by Wrong (1961). Wrong came at the problem of over-socialized accounts of human agency from a Freudian perspective, viewing ‘man as a social though never a fully socialized creature’ (1961, p. 183). The reason given for this gap in socialization is the fact that every human is endowed with a set of biological drives, which while having evolved under the context of millions of years
of humans living as a social species, thus the drives being necessarily adaptive to socialization, these drives are never in exact agreement with the specific demands of historical society and its culture. Thus, drives and culture are symbiotically entwined, but always partially out of tilt with one another, generating a degree of conflict between the two. This general point that biology gives each human agent drives apriori to socialization, and which motivate agents in ways that can both conflict and conform to a given social structure is consistent with the view from instinct-habit psychology.

Hodgson provides four propositions shared by other theorists, including Bhaskar’s (1989) critical realism and Giddens’ (1984) structuration theory, that reject the over-socialized agent. These are: (1) social structures depend upon individuals because ‘individuals through their actions may create, confirm, reproduce, replicate, transform or destroy social structures, either intentionally or unintentionally’ (Hodgson, 2004b, p. 179); (2) social structures are not explainable ‘entirely in terms of individuals and their relations’; (3) individuals depend on social structures to socialize them in ways that allow ‘survival and interaction’ in a given historical period, and much of their behaviour is a consequence of this socialization; (4) individuals cannot be entirely explained in terms of the social structures in which they have been socialized (ibid, p. 179).

Thus, while they are interdependent phenomena, individuals and social structures are also ontologically different entities. Further underscoring this point is the fact that ‘any given agent is preceded by historically given social structures. Hence agency and structure are not different aspects of the same thing but are separable in time’ (Hodgson, 2004b, p. 228). Likewise, a given social structure can collapse or disappear during the lifetime of an agent, and it is agents who creatively produce new social practices that may eventually become social structures if widely adopted. Consequently, agents cannot be solely explained in terms of structure, nor structure explained solely in terms of individuals. No reductionist explanation is possible from one to the other.
Allowing that a degree of conflict always exists in society, and that society is not an inviolable ‘iron cage’ dominating over individuals, it should nevertheless be emphasized that the institutionalist view is one where social structure is understood to exert a powerful and stabilizing effect on individual subjectivity. Veblen viewed this as a consequence of a society being pervaded by a ‘certain characteristic logic and perspective, a certain line of habitual conceptions having a degree of congruity among themselves, a “philosophy,” as it would once have been called’ (Veblen, 1915, p. 267). The view that stable, dominant and enduring institutions of a given historical era impart a relatively dominant shared ‘philosophy’ and mode of practice is a central component of institutional analysis (Heilbroner, 1986; Hodgson, 2015, pp. 54-57; P. A. O’Hara, 2000). The relative coherence of a historical lifeworld imparts a significant source of shared agent habituation.

Veblen further argues that the habits of thought and practice of the dominant institutions of a society tend to become the points of reference for other institutional spheres to one degree or another (Veblen, 1914, pp. 50-51); and that under capitalism this results in a situation whereby ‘pecuniary institutions induce pecuniary habits of thought which affect men’s discrimination outside of pecuniary matters’ (Veblen, 1909b, p. 632). A similar observation has been made by studies in cultural political economy, without using the concept of habit, on the spread of financial logics to non-financial spheres (Jones, 2014, 2016; Martin, 2002, 2009). The argument is that the growing centrality of financial institutions in contemporary economic life results in the transformation of our psychological categories for understanding reality in subtle ways. Jones argues that ‘finance goes unseen and unregistered as it becomes the basis for seeing and registering what is’ (Jones, 2016, p. 123), which ‘involves coding social situations in terms of the categories of finance’ (Jones, 2014, p. 46), so that for example traditionally non-pecuniary social spheres such as education become viewed as an ‘investment in oneself’.

While these observations highlight how dominant institutions create dominant habits of thought, what is missing is an explanation of how that occurs.
Much like Bourdieu’s conception of *habitus*, it is simply assumed that socialization happens, but the ‘how’ is left as a black box, indicating a wider problem in sociology due to its disconnection from biology. Instinct-habit psychology provides an explicit conceptualisation of the mechanisms by which dominant institutional logics are internalised by agents, becoming habitual responses that can be activated in activities outside of the originating institutional context. Agents can decide to consciously reflect upon their habits at any time, but the default evolutionary position is not to, unless there appears to be good reason for doing so. Consider that to establish a habit to begin with an agent must repeat an action multiple times, thus habits are the result of actions that recurrent in an agent’s life. Likewise, priming studies reveal that unless System 2, our conscious decision-maker, is alerted by something unusual to examine a habitual situation, it simply follows along with the prompts from System 1. This is in order to save on the taxing energy efforts involved in using conscious deliberation, and it is why Kahneman (2012, p. 39) names our capacity for conscious deliberation the ‘lazy controller’, due to its default position to save on effort.

This section has argued that habits are the economising foundation of higher cognitive processes: ‘habits are foundational to all thought and behaviour. All deliberations, including rational optimisation, themselves rely on [apriori] habits’ (Hodgson, 2004c, p. 653). This is the basic evolutionary relationship of antecedence argued broadly by contemporary studies taking a non-reductionist Darwinian evolutionary approach to social science study (Buss, 2007; Hodgson, 1997, 2007b, 2010; Kahneman, 2012; Vanberg, 2002; Wright, 1994). In bringing together the arguments in this and the above section, I return to the critiques by Rutherford (1984) and Beckert and Streeck (2008). First, I argue that Rutherford’s (1984) critique that instinct-habit psychology is a form of unwarranted psychologism is wrong. On the contrary, the theory has been vindicated by modern cognitive science and experimental psychology, and provides crucial theoretical explanation of a central aspect of human cognitive capacities, as well as the capabilities and limits involved.
These capabilities and limits are the result of a multi-level mind arising through evolutionary processes. While conscious agency emphatically exists as one capability of human cognition, it is not the master of the house as has been assumed during much of the twentieth century, to repurpose Freud’s phrasing of things.

I further argue that Beckert and Streeck (2008) are wrong to cast out ‘biologistic’ explanations from social theory, on the basis that they ‘cannot do justice to the crucial role of social structures, socialization, and cultural evolution in coordinating human activities’ (2008, p. 16). On the contrary, biology is the foundation out of which culture emerges, so that biology and social science overlap with one another. Where such overlapping occurs the findings of the sciences must concur with one another, or be reconciled if they do not (Beinhocker, 2006, pp. 72-73). The stultifying ‘disciplining’ of science that has occurred during the twentieth century has been contrary to this crucial point (Mann, 2012b, p. xii; Ollman, 2003, p. 3; Samman, Coombs, & Cameron, 2015, p. 4; Schumpeter, [1942] 2008, p. 45). It is time to take a less disciplined path to knowledge.

**Conclusion**

In this chapter I critiqued Veblen’s technological determinism, arguing that the evidence shows he was guilty as charged in several of his works. I argue that Veblen’s position on the effect of technology on habits of thought is theoretically flawed and empirically false. This aspect of theory is rejected by the reconstruction of his work here. Veblen’s use of instinct-habit psychology has been criticised by numerous studies, and was dropped by his immediate followers during the post-war period. Sections two and three argue that the recent evidence from evolutionary psychology, experimental psychology and cognitive science confirms Veblen’s and James’ pioneering work in this area. A key argument is the claim that the mind should be viewed as a multi-level phenomena, wherein instinct and habit are prior to, and provide the basis out of which, consciousness emerges.
A further argument is that instinctive behaviour is highly adaptable and involves intelligent application in light of specific and changing environmental conditions, leading to habits. The latter refer to conscious and unconscious dispositions to act in certain ways, which are triggered by environmental stimuli. For humans, the content of habits are largely filled with intended and unintended consequences of culture and institutional life. Habituation is a conserving mechanism, it cannot be turned off, but it is not an iron cage. Agents can critically reflect on their situation, they do develop moral and logical critiques, and they do consciously create new institutions to which later agents then become habituated to. Next, chapter five builds on arguments that Veblen’s theoretical system was incomplete.
Chapter 5. An Incomplete Theory

The viable reconstruction of institutional-evolutionary economics entails not only critiquing weaknesses in Veblen’s original formulation, but also identifying and developing theoretical gaps. Building on the work of Hodgson (2004b) this chapter identifies a number of missing elements in Veblen’s theory. I discuss recent theoretical developments in evolutionary theory that can fill these gaps. This chapter provides two original contributions. First, sections one through four each treat an important theoretical component of institutional-evolutionary economics, bringing together elements that are otherwise scattered across the literature. I argue each component is vital to the systematic theoretical development of institutional-evolutionary economics.

Second, section two contributes to a major debate in political economy regarding whether focusing on institutional commonalities of across capitalist economies, or variation between these economies is more important for modelling global capitalism. Marxist-based studies attack the varieties of capitalism approach as inferior to their focus on capitalist commonalities (Bruff, 2011; Coates, 2000; Jessop, 2014; Streeck, 2010). I argue that excessively focusing on either commonalities or variation is detrimental to analysis, and that the Darwinian concept of ‘population thinking’ provides a theoretical solution by integrating commonalities and variation into a single theory of dynamic change.

Population thinking is a methodological principle originally developed out of the observation that natural selection in biology works upon variation, such that variation is central to how change in species essence over time (Hodgson 2015, p. 31; Mayr, 1982, p. 46). Thus variation is a key component of change. This chapter also outlines the importance of moving from ‘analogy to ontology’ (Hodgson, 2002) when developing suitable domain-specific mechanisms of evolution in the social realm. In
the past, Darwinism has been destructively applied in social science through use of analogous principles drawn directly from biological theory (e.g. Symons, 1979; Wilson, 1975, 1979). Such mistakes can be avoided by realizing that generalized Darwinism is based on shared ontological features across system, rather than similar evolutionary mechanisms.

The chapter proceeds through five sections. Section one outlines Veblen’s failure to develop a philosophy of emergence necessary to overcome reductionist causal accounts running from biology to culture. Section two develops an account of population thinking, and discusses its relevance for theories of social evolution. Section three outlines ‘generalized Darwinism’, which is the argument that Darwin identified key elements of a universal theory of change in complex systems. Section four develops a theory of domain-specific mechanisms explaining processes of evolution within the social domain.

5.1. The Philosophy of Emergence

Hodgson (2004b, pp. 225-247) argues that one crucial gap in Veblen’s theoretical system was his failure to develop a philosophy of emergence. Hodgson argues that the latter is required to adequately explain the nature of the relationship between interdependent entities existing at different ontological levels. For example, where higher level entities depend on lower level entities for their existence, but have capacities that are not fully explainable in terms of those lower entities. Emergentism is a crucial explanatory theory to overcome reductionist approaches when integrating relevant biology findings into social theory, as well as explaining relations between agency and structure that preserves both their interdependence and their status as ontologically different entities. Veblen attempted to achieve such a resolution, but failed to engage with the proto-emergentism developed by a number of his contemporaries, such as Emile Durkheim (1895) and Lester Ward (1903). Their contributions will be discussed shortly. Reconstruction of his system
requires the addition of the philosophy of emergence. The goal of this section is to outline the fundamental aspects of emergence, discuss some early pre-figurations of the concept by contemporaries of Veblen and argue for the necessity of the concept for institutional-evolutionary economics.

The theory of emergent properties was initially developed in philosophy and psychology as a way to explain the mind-body problem, and has also been developed to explain the relationship between agency and structure (Archer, 1995, 1996; Elder-Vass, 2007a, 2007b; Hodgson, 2004b). Emergence is about explaining the relationship between wholes and parts. Specifically, an emergent characteristic is a consequence of a specific structural relationship between a set of entities, and refers to a capacity which does not exist in any of the composite parts taken singly (Elder-Vass, 2005, p. 316; 2007a, p. 28; P. Lewis, 2012, p. 369). Furthermore, the emergent characteristic is not predictable by understanding the characteristics of the component entities, and therefore emergentism is a response to ‘eliminative reductionism’ as an adequate method for explaining reality.

‘Eliminative reductionism’ is a scientific method for studying relations between entities in which the causal power of emergent characteristics becomes redundant to explanation (Elder-Vass, 2007b, p. 412). For example, methodological individualism is a type of eliminative reductionism, because it explains away the causal powers of social structure by stating all outcome in terms of the causal powers of individual agents. Similarly, sociobiologists during the 1970s and 1980s explained away culture as a deterministic outcome of biology, thus requiring no explanation of culture in its own right (e.g. Wilson, 1975). Emergentism aims to show why such explanations are inadequate. In doing so it is important to distinguish between ‘emergent’ properties and ‘resultant’ properties. Where emergent properties involves new characteristics, a resultant property is where the properties of wholes are also held by the parts in isolation (Elder-Vass, 2007a, p. 29). Elder-Vass gives the example of mass as a resultant property because the combined weight of all the atoms that make up a body’s mass are the same value whether
structured within that body, or existing in isolation. Consequently, a resultant property is one which involves no new capacities or characteristics arising out of a structural relationship formed between lower entities.

Emergent characteristics, on the other hand, can be illustrated through a classical physical example of water. In its smallest possible unit, a water molecule is a product of a structural relationship based on a chemical bond involving two hydrogen atoms and one oxygen atom. Water is a ‘higher’ level emergent entity than either of its constituents because some properties of this relationship are emergent capacities. These include the fact that water can quench thirst and extinguish fires, something neither hydrogen nor oxygen can achieve in isolation. Water’s liquidity on the other hand is a resultant property, since both hydrogen and oxygen can take liquid forms. Thus an emergent entity may have a mix of emergent and resultant capacities. Elder-Vass (Elder-Vass, 2007a) points out that classing entities with emergent capacities as ‘higher’ level elements holds no normative implication, but simply indicates the emergent, as opposed to resultant component.

In the social sciences, the idea of emergent properties dates back to at least the nineteenth century. Hodgson (2004b, pp. 225-247) outlines an earlier ‘proto’ development of the concept in the work of Emile Durkheim (see also Sawyer, 2005) and Lester Frank Ward, the latter an American sociologist and contemporary of Veblen. Hodgson points to a passage in the Rules of Sociological Method where Durkheim discusses emergent properties of water as not belonging to the two gases of which it is composed but as arising out of ‘the complex substance which they form by coming together’. In the same passage Durkheim argues for applying this insight to society:

…every society gives rise to new phenomena, different from those which occur in consciousness in isolation, one is forced to admit that these specific facts reside in the society itself that produces them and not in its parts - namely its members. In this sense therefore they lie outside the consciousness of individuals as such, in the same
way as the distinctive features of life lie outside the chemical substances that make up a living organism (Durkheim, [1895] 1982, pp. 39-40)

Durkheim is arguing that when living socially, collective customs emerge between individuals that could not exist for individuals living in isolation. These customs, with Durkheim giving examples such as moral and legal codes, religious values, literary standards, political ideologies and common aphorisms, pre-exist the birth of any particular individual, have causal powers over that individual to the extent that they inform their thoughts, habits, and daily practice in the community, and also have an ontological stability independent from their application by individuals at any given moment. For example, social customs such as marriage, inheritance, Christmas dinner, nationalism, and religion, continue to exist even when not in use at any given moment.

Thus Durkheim says of institutional life: ‘None of these modes of acting and thinking are to be found wholly in the application made of them by individuals, since they can even exist without being applied at the time’ (ibid, p.55). This shows that social facts cannot be explained fully in terms of the individuals reproducing them in any given moment, given that customs also exist outside of this reproductive action. Social structures, therefore, cannot be explained solely in terms of the actions of individuals. Likewise, and as discussed in chapter four above, this does not mean social structure provides a full explanation of individual behaviour. Individuals cannot be fully explained in terms of custom and social structure because they have a biologically endowed motivation structure, psychology and causal power independent of any historical social order. This endowment means agents are never fully socialized, and can create new ideas and engage practices that conflict with incumbent custom and institutions. Neither institutions and culture nor individuals and biology provide a full explanation of social life. For these reasons proponents of the philosophy of emergence reject eliminative reductionism as an adequate theory for explaining social reality (Archer, 1995; Bhaskar, 1989; Elder-Vass, 2007a; Hodgson, 2004b; P. Lewis, 2012).
While Durkheim developed a nascent conceptualization of emergence, he also developed sociology in strict separation from psychology and biology, thereby taking a different direction than Veblen and other American social scientists of the time. Amongst Veblen’s American peers interdisciplinary synthesis was forthcoming by people such as Lester Frank Ward (Hodgson, 2004b, pp. 228-232). Hodgson argues that Ward (1903) published one of the great works of twentieth-century sociology, *Pure Sociology*, but one that has since been largely uncited. Ward argued that the sciences must ‘grow out of one another’ rather than operating in isolation; he also argued for the ‘biologic origin of the subjective faculties’ (Ward 1903, quoted in Hodgson, 2004b, p. 231). Ward is arguing for placing human cognition within an evolutionary framework, much as did James and Veblen, so as to understand the evolved capacities that have made culture possible to begin with, and which continue to influence the process of socialization in important ways. Consequently, Ward shared the wider attitude to inter-disciplinary work that appears to have been predominant in American social sciences of the time.

Hodgson argues that Ward generated a number of important innovations. First, Ward described emergent capacities using the concept of ‘creative synthesis.’ This involved detailed arguments for novel properties that arise when components are brought together in certain types of relations. Second, Ward was one of the earliest social theorists to develop a multi-layered ontology (Hodgson, 2004b, p. 230). In its basic form this consisted of the physical comprising matter, the vital comprising living organisms, the psychic comprising complex nervous systems and consciousness, and the social made up of culture-based interactions between conscious organisms. Sociology operated at this last and most complex level. Part of the explanation for each new higher level involved understanding the lower level, as well as addressing new capacities, thus indicating the need for sociology to be inter-disciplinary.

Third, Ward stressed that institutional evolution involved both spontaneous, or unintended elements, and intended, or consciously planned elements. As a result
Ward did not view spontaneous order ‘as an excuse for minimising government intervention in the economy’ (Hodgson, 2004b, p. 231). On the contrary, and in the tradition of the early American institutionalists, Ward argued that the best method to ensure optimal social results is the judicious application of government intervention. Finally, Ward argued that institutions and structure were both a constraint on agency and ‘an essential springboard for dynamic behaviour’ (Hodgson, 2004b, p. 231), indicating the positive aspect of culture as an emergent capacity. In sum, Hodgson argues that given Veblen’s project, Ward offered resources holding ‘enormous’ potential. Unfortunately, for Veblen, who reviewed Ward’s Pure Sociology (Veblen, 1903) he failed to observe this potential to the detriment of his own theoretical development.

Hodgson (2004b, p. 232) argues that any viable reconstruction of Veblen’s theory requires a central place for the philosophy of emergence. Absent a theory of emergence he argues three unsatisfactory choices arise (2004b, p. 243). First, social sciences could be developed using eliminative reductionism and working back to biological and psychological categories. But this begs the question of how to explain capacities arising from institutions and culture that do not readily fit such categories. Hodgson notes that within economics Alfred Marshall and Gary Becker amongst others have attempted versions of this approach. Second, theory could develop along the lines of Austrian subjectivism, focussing on individual choices and feelings. But this involves agents and their beliefs and preferences being taken as given, thereby ignoring millions of years of biological evolution that preceded the few tens of thousands of years of institutional and cultural development. As a result, Hodgson argues that such an approach is ‘illusory’, being achieved ‘only through partial abandonment of causal explanation’ (Hodgson, 2004b, p. 243).

A third choice is to overcome individualistic and subjectivist positions by moving analysis entirely up to the level of social structure, with Hodgson pointing to the work of Talcott Parsons and Clarence Ayers as indicative of this approach. The flaw here is to ‘downplay or ignore’ the biological and psychological foundations of
human agency, thereby again reneging on causal explanation of a significant component affecting social evolution (Hodgson, 2004b, p. 243). The argument from the institutional-evolutionary economics proposed here is that none of those options are adequate.

5.2. Population Thinking

Darwin’s work was devastating for natural science understood within teleological frameworks grounded in animism or theology. A second major revolution in natural science thinking resulting from Darwin’s work was the replacement of ‘typological essentialism’ grounded in the work of Plato and Aristotle with ‘population thinking’ (Hodgson, 2015, p. 31; Mayr, 1982, pp. 44-47; Sober, 1980, p. 360). Typological essentialism involves studying classes of entities by identifying essential shared qualities of a class of entities to create an ideal or proto-typical representative of the type in question based upon identified essential qualities. These qualities are identified by abstracting from variation exhibited by those entities. For example, the proto-typical humans is mammalian, with ten fingers and toes, two arms, two legs, a torso, neck and head and so forth. The variation in exact dimensions of all these biomechanical parts is deemed irrelevant.

According to the typological essentialist view, variation is ‘nothing but “errors” around the mean values’ (Mayr, 1982, p. 47), and therefore largely irrelevant for theorizing how species change. Darwin on the other hand, showed that it is precisely variation upon which evolutionary selection works, and that variation is a key element required for evolution to occur. While Darwin’s work provides the basis for ‘population thinking’, it is biologist and philosopher Ernst Mayr who building on Darwin’s work formalizes the term theoretically during the twentieth century (Mayr, 1978, 1982). This section outlines typological essentialism and argues that it cannot adequately conceptualize the significance of variation within classes of entities; that population thinking overcomes this weakness, and in so doing provides powerful
tools for conceptualizing processes of change within a class of entities. I further argue that population thinking is valid for application to classes of entities beyond the biological domain, for example in conceptualizing variation between national capitalisms, and is a crucial conceptual addition to institutional-evolutionary theory.

Aristotle developed his ‘natural state model’ based on the typological essentialist principle of abstracting from variation to provide an ideal representative. Sober outlines the model as follows:

Aristotle’s hypothesis was that there is a distinction between the natural state of a kind of object and those states which are not natural. These latter are produced by subjecting the object to an interfering force…Variability within nature is thus to be accounted for as a deviation from what is natural (Sober 1980: 360).

Consequently, the concept of a class of species developed using the natural state model was fundamentally a concept of species ‘type’ based on ‘an average, typical, or representative individual that served as a surrogate for the whole species’ (Hodgson, 2015, p. 31). The problem for the practising naturalists during Darwin’s time was that it seemed nothing could ever be found that was in its ‘natural’ state. Instead, they were continually struck by the fact that when collecting specimens of the same species they never found two exactly alike (Mayr, 1982, p. 46).

Consequently, while each species had defining essential characteristics that individuals had to share in to be members of a particular species, it was also clear that variation between members within a species was also a fundamental phenomenon that needed explanation. Theory based on the natural state model was incapable of such an explanation (Mayr, 1982; Sober, 1980). Darwin’s great breakthrough was to realize ‘that this diversity itself constituted an invariance, obeying its own law’ (Sober 1980: 365). It was by thinking through the implications of fundamental and ongoing variation within a species that was to allow the breakthrough for population thinking and a theory of evolution. This is because natural selection cannot function without variation to work upon (J. M. Smith, 1993, p. 133). During Darwinian evolution it is those variants that are best adapted to
environmental conditions that are selected and retained genetically (Darwin, 1859; Mayr, 1978, 1982). Hodgson summarizes the importance of population thinking for conceptualizing change within complex systems:

In Darwinian evolution the idea of variation encapsulated in population thinking is of paramount interest because it is upon variety that selection operates. This means that we cannot model an evolutionary system simply by focusing on the average or representative features of a population. Summarizing a complex system in terms of average or representative components neglects the variety that is essential to system behaviour and evolution (Hodgson, 2004b, p. 91).

Population thinking does not involve rejecting the philosophical notion of essence, but rather involves developing an enriched account of essence and variation interacting dynamically (Hodgson, 2004b, p. 96). Sober makes a similar point, arguing that population thinking is not ‘fatal’ to essentialism, but only to the way it is deployed within the natural state model (1980, p. 350). In fact, without some concept of essence there would be no way to define a species, or class of objects to begin with (Hodgson, 2015, p. 28).

Species essence is therefore understood to refer to a causal mechanism, or mechanisms, that makes a species entity the type of thing that it is, such that essence is not simply a list of attributes (Hodgson, 2015, p. 32; Sober, 1980, p. 354). In biology genetics cause an individual to be a member of a group of species. In social systems, dominant institutions cause a society to be a particular type of society, be it capitalist, communist, feudalist or some other type. At the heart of each of these societal forms is a set of central institutions that all societies of that type must have to be that type of society (Heilbroner, 1986; Hodgson, 2015). Defining the cut-off point for species membership can sometimes be difficult, and run towards vagueness on the periphery such that the doctrine of essentialism is ‘consistent with the existence of insoluble line-drawing problems’ (Sober 1980: 359). Change can occur without changing a species essence, for example a mammal species gaining an extra finger, or a capitalist society introducing new institutions for regulating labour, statutory
rights or social welfare provisions that other capitalist societies do not have. Likewise, at a certain point change leads an entity to become ‘another kind of thing. But this does not mean the thing in question never had an essence’ (Hodgson, 2015, p. 33).

Hodgson argues that population thinking is a powerful method for theorizing change in a situation of multiple coexisting capitalisms (2015, p. 32). Hodgson has developed the insights of population thinking into a wider historical proposition regarding social system analysis, termed the ‘impurity principle’ (Hodgson, 1988, 1993, 1996, 2015). This principle states that ‘every socioeconomic system must rely on at least one structurally dissimilar subsystem to function’ (Hodgson, 2015, p. 40, emphasis original). Consequently, even if one structure, economic or otherwise, is dominant within a society, other structures are still required for functionality. Furthermore, due to historical path-dependency each society is likely to have some unique subsystems, alongside having a set of dominant institutions that are common with other societies.

It is also the case that the social and political logics of these supporting subsystems can causally impact the development of dominant institutions. This helps to explain why there is so much variation in global capitalism. The degree of causality flowing between institutional spheres at any given moment is a matter for ongoing empirical investigation (Baccaro & Pontusson, 2016). Hodgson argues that the family and the state are two vital impurities without which capitalist economics could not proceed. There is a large degree of variation in how the family or the state is arranged globally, with consequences for how capitalism is regulated and organized.

Streeck (2016b, p. 61) has argued that the impurity principle is functionalist in the Parsonian sense, meaning it justifies and explains the existence of any substructure based upon it simply existing, and thereby necessarily having a function. Functionalism is in this way tautological, and explains away rather than explaining dysfunction or deviation as a result. Hodgson, however, has rejected the
functionalist critique, arguing that the impurity principle is not functionalist since it
does not purport to explain why any particular subsystem exists, and is subject to
falsification if an institutional system is found existing independent of any
supporting subsystems (2015, p. 40). Instead, he argues that the claim is based on
ontological considerations supported by historical observation. The impurity
principle indicates that to understand any given social system, analysis cannot
confine itself to the most powerful structure or relation in that system.

There is now a vast literature highlighting the existence of varieties of
capitalism that populate the global economy (Albert, 1993; Amable, 2000; Aoki, 2010;
Deeg & Jackson, 2006; Dore, 1997, 2000; Hall, 2007; Hall & Thelen, 2009; Hodgson,
Whitley, 1999; M. Witt et al., 2017). This literature highlights the unique forms of
capitalist development globally as a consequence of path-dependent development
arising from unique institutional, cultural, and environmental conditions. This
literature shares the basic point that capitalist societies do not develop solely under
the influence of capitalist institutions. If they did, there would be no variation, given
that each society would have the same causal force, capitalist institutions, directing
its development.

A couple of examples will illustrate this outcome. In his classic study on
capitalist variation Albert (1993) outlined a number of distinct branches across the
leading economies. Branches include what he terms the Rhine model dominant in
Northern Europe countries such as Germany, Switzerland, Sweden and the
Netherlands, and also to some extent Japan, and the neo-American model
exemplified by the United States, and to a lesser extent Britain. Albert argues the

3 These studies all share a concern with studying capitalist variation. However, there are also major
differences in underlying theoretical approaches within this literature, including but not limited to
rational-choice institutionalism (North, 1990), game theory (Aoki, 2010; Hall and Soskice, 2001),
historical institutionalism (Streeck 1997, 2009) and legal institutionalism (Hodgson, 2015), and therefore
this selection of studies represent a shared research agenda, but with considerable theoretical diversity
therein.
Rhine model has a commitment to long-term economic outcomes that affects investment and savings, and a stakeholder model of economic bargaining based on cooperative labor-management relations and extensive social welfare. The neo-American model by contrast, is based on rugged-individualism, corporate short-termism and a winner-takes-all competitive mentality that results in low social welfare and more combative labor-management relations.

Studies using a comparative approach assessing the Anglo-Saxon liberal model of capitalism versus Japanese capitalism are further illustrative. Dore (1997) characterised the Anglo-Saxon economies as based upon the ‘property view’, which involves a corporate legal structure that states a company is set up to further the material interests of its owners and that shareholder value is the predominant norm. In comparison Japanese capitalism is founded on the ‘entity/community view’, referring to an institutional matrix in which a business is viewed as a community akin to a nation, and where the firm is a community of members bound together in mutual interest through cooperation and sharing of risk. The community view is also a strong norm undergirding post-war Germany’s economic development (Streeck, 1997).

Differences between CEO-worker pay gaps in the USA and Canada, representing the property view, and Japan representing the community view, indicate the substantial material outcomes that result from differing cultural norms. In 2003 the ratio of CEO to worker pay was 24.5 in Canada, 44 in the USA and 9.5 in Japan (Salazar & Raggiunti, 2016, p. 732). This study further notes that in 2003 CEO’s in Japan received on average 20 percent of the pay of American CEO’s, while Japanese workers received 94 percent of the wage of American workers. In 2012 Japan’s highest paid CEO did earn a high enough wage to break into the top 200 list of best paid American CEO’s, with this consistent lower wage inequality linked to ‘informal tying of executive pay to worker welfare in the context of a culture of intolerance to excessive executive compensation’ (Salazar & Raggiunti, 2016, p. 724). In that light, it is hardly surprising that labor income inequality as measured using
the Gini coefficient is significantly lower in Japan (0.329) than in the USA (0.453) (Aizawa, Dekle, & Helble, 2017).

A major study (M. Witt et al., 2017) on variation in global business systems assessed the institutional structure of 61 major economies representing 93.5% of 2013 global GDP. This study identified nine main types of business system, each of which has particular implications for wealth distribution, investment levels, innovation, labor-management relations, type and degree of government intervention, firm size and inequality amongst other outcomes. Capitalist variation is ‘the outcome of social and political conflicts that are embedded in a specific society for a given historical period’ (Boyer, 2005, p. 548). On the other hand, there has been global convergence since the eighteenth century on capitalist institutions as the basis on which all nation-states today base their economic reproduction.

Consequently, essence and variation must both be considered when analysing the global political economy. Unfortunately, this important point is lost on some of the participants in the ‘end of capitalism’ debate critiqued in chapter seven, and also on a number of political economy studies that have recently critiqued the varieties of capitalism literature (Bruff, 2011; Coates, 2000; Jessop, 2014; Streeck, 2010). Here I assess the argument by this latter group. These studies claim that the commonalities, meaning the capitalist institutions common to all societies today, ought to be the focus for analysis of global capitalism, and that variation between nation-states is far less relevant (Bruff, 2011, p. 482; Coates, 2000, p. 142; Jessop, 2014, p. 248; Streeck, 2010, p. 35). For example, Jessop argues that the concept of ‘variegated capitalism’ is superior to assessing variety at the nation-state level. ‘Variegation’ for Jessop ‘involves complementarities and tensions among types (varieties) of capitalism in a tendentially singular, yet still incomplete and unevenly integrated, world economy’ (Jessop, 2014, p. 248). Such a statement seems to be splitting hairs at best, or theoretically empty at worst. Jessop’s concept of variegation is a simple derivative of the word ‘variety’, and one that essentially holds the same meaning.
The main difference for Jessop is that his concept of ‘variegation’ places analysis primarily at the level of global processes between states and regions within a single world economy, rather than within nation-states. In shifting the analysis to a single capitalist world economy, Jessop then argues that variation is less relevant for understanding global economic change, and instead the focus must be on capitalist institutions. But the question begged here is: why is global capitalism ‘variegated’? For example, given that Jessop acknowledges that global capitalism is ‘variegated’ then the source of this variegation must be a crucial causal factor. Furthermore, it is clear that it can only be non-capitalist institutions located in nation-states that are exerting a causal power that generates variegation. But it is precisely the latter which Jessop seeks to downplay in leaning towards a typological essentialist account of the global economy. On the other hand, the vast comparative capitalism literature shows in detail that global variegation is due to the interactions between capitalist states that have different views and norms about how trade should be conducted and have different existing institutional frameworks in which they are invested politically, socially, and culturally (Hall, 2007, p. 63). Furthermore, each nation-state tries insofar as it can, to shape global trade conditions in a way that most benefits its own variety of capitalism and its social and political goals (Ruggie, 1982).

In that light, accepting the importance of global processes and capitalist commonalities does not mean that national variation is less important. Understanding processes within nation-states is crucial to understanding economic evolution at the global level, as an analysis of international trade deals highlights. Ruggie’s (1982) study on the development of a post-war international trade regime based on the World Trade Organization and the General Agreement on Trade and Tariffs, termed ‘embedded liberalism’, is instructive. The latter is Ruggie’s term for the post-war consensus of the governments participating in the negotiations that certain social goals should be institutionally secured, even if it cost some economic efficiency. Ruggie argues that transnational regimes are an outcome of the interactions of numerous actors with varying social and political purposes, whose
interaction determines those regimes. He illustrates the point in his study of the post-war negotiations as follows:

Once negotiations on postwar commercial arrangements got under way seriously, in the context of preparations for an International Conference on Trade and Employment, the principles of multilateralism and tariff reductions were affirmed, but so were safeguards, exemptions, exceptions, and restrictions—all designed to protect the balance of payments and a variety of domestic social policies. The U.S. found some of these abhorrent and sought to limit them, but even on so extraordinary an issue as making full employment an international obligation of governments it could do no better than to gain a compromise. The U.S. Senate subsequently refused to ratify the Charter of the International Trade Organization (ITO), as a result of which a far smaller domain of commercial relations became subject to the authority of an international regime than would have been the case otherwise.

Ruggie highlights that even so dominant a hegemon as the post-war United States could not dictate all the terms of the international regime that was created between the U.S. and Europe. Furthermore, that regime ended up being rather more limited than initially proposed due to a number of conflicting and ultimately irreconcilable positions. The agreement that did result was a compromise for each nation-state, based on what they wanted and how much influence they had within the negotiations to get it. The point made by Ruggie is that the degree of difficulty in establishing such regimes should not be underestimated, as the recent history of the Trans-Pacific Partnership further highlights. Twelve countries, representing 40 percent of global GDP and 20 percent of global trade began negotiations in 2008. The three largest economies in the group were the United States, Japan and Canada. A decade later negotiations were still not complete, which is evidence in its own right of the conflicting views on what capitalist trade should involve. In 2017 newly elected president of the United States, Donald Trump, pulled his country out of the negotiation. Canada did the same in 2018 and the entire process unravelled thereafter.
Thus, true to view of population thinking, global capitalism comprises of commonalities and enduring variation. Understanding global processes requires an understanding of the institutions and economic practices found in nation-states that produce capitalist variation. Likewise, global processes are beyond the control of any single nation-states and causally impact on how a nation-state structures its economy, as is recognised within the comparative capitalism literature. Hall and Soskice argue that international regimes ‘have a substantial impact on national societies’ (Hall & Soskice, 2001, p. 51). Similarly, Hall observes that ‘the effectiveness of domestic institutions depends on the character of international regimes’ (2007, p. 52). Consequently, comparative capitalism provides extensive research for understanding the relationship between global and national capitalism through the concept of population thinking.

Adequate population thinking requires a sound definition of the essential characteristics that make a class of entities the type of entity that they are, alongside data on existing variation between constituent members of a class (Hodgson, 2015, p. 25). Hodgson provides an account of six characteristics that he argues must be present for an economy to be considered capitalist. He derives the first five of these characteristics directly from Karl Marx’s work (Marx, 1990, 1991, 1992), and the sixth from Joseph Schumpeter (1934). The characteristics are as follows: 1) ‘A legal system supporting widespread individual rights and liberties to own, buy, and sell private property’; 2) ‘widespread commodity exchange and markets involving money’; 3) ‘widespread private ownership of the means of production by firms producing goods or services for sale in the pursuit of profit’; 4) ‘much of production organized separately and apart from the home and family’; 5) ‘widespread wage labor and employment contracts’; and 6) ‘a developed financial system with banking institutions, the widespread use of credit with property as collateral, and the selling of debt’ (Hodgson, 2015, p. 255).

With a clear definition of the essential elements of capitalism, alongside the varieties of capitalism literature, we have the components for engaging in
population thinking. Furthermore, population thinking provides a conceptual resource to productively link the above noted studies focussed on the commonalities existing between nation-state economies globally, and those which assess the significant variation in the way capitalist economies are institutionalised at the level of the nation-state. Population thinking is one of the most important concepts for an institutional-evolutionary theory of social change. Next I discuss generalised Darwinism, which is the over-arching theoretical framework within which cultural evolution is understood.

5.3. Generalized Darwinism and Cultural Evolution

Across a broad and well-developed literature there is now a major consensus that Darwin’s core trinity of variation-selection-retention refers not only to a biology-specific process, but also to an over-arching meta-theory that can be generalized to explain change in open, complex systems that share certain ontological features (Aldrich et al., 2008; Beinhocker, 2011; Breslin, 2010; Buskes, 2013; Dawkins, 1999; J. Foster & Metcalfe, 2012; Hodgson, 2002, 2004a; Hodgson & Knudsen, 2010; Hodgson & Knudsen, 2012; Metcalfe, 1998; Nelson, 2007). The consensus across this literature is that Darwin’s trinity can be generalized to form the foundation of an evolutionary theory that is applicable to multiple domains. This consensus is based on the argument that Darwin identified an evolutionary ‘algorithm’ that ‘is neutral with respect to the medium or substrate of evolution, and neutral with respect to the ‘entities’ that evolve’ (Buskes, 2013, p. 665). This section argues that generalized Darwinism is valid.

As discussed by Hodgson and Knudsen (2010, pp. 33-34) and Lewontin (1970, p. 1) conditions needed for an evolutionary process to occur include: (1) a source of ongoing generation of variation between members of the population involved, referred to as phenotypic variation; (2) these entities experience differential rates of success in different environments through a process of selection of fit characteristics;
(3) these environmentally fit characteristics must be retained and passed on somehow, either through direct inheritance of characteristics as occurs in biological gene-based reproduction, or by some other mechanism, with the end result being a change in the average characteristics of the population of entities in favour of the successful characteristics. It is only when this process of variation-selection-retention results in changes to the average characteristics of a population that a Darwinian evolutionary change can be said to have resulted. In this way Darwinian evolution disciplines the direction of change of the essential characteristics of the entities involved, meaning evolutionary process are ‘non-random because selection is not a blind lottery’ (Buskes, 2013, p. 664).

The late-twentieth century renaissance of universalized evolutionary theory was led by Lewontin (1970), who noted the potential ‘generality’ of Darwin’s trinity. He pointed out that ‘any entities in nature that have variation, reproduction, and heritability may evolve’, and that ‘no specific mechanism of inheritance is specified’ (Lewontin, 1970, p. 1). This idea was to animate later proponents of cultural evolution (Boyd & Richerson, 1988; Durham, 1991; Laland, Odling-Smee, & Feldman, 2000; Mesoudi, 2011; Richerson & Boyd, 2006), with Metcalfe capturing the emerging zeitgeist: ‘That evolution is a core concept in biology does not mean that it is an inherently biological concept. Evolution can happen in other domains providing that conditions for an evolutionary process are in place’ (1998, p. 21). Similarly, Hodgson argued that ‘Darwinism includes a broad theoretical framework for the analysis of the evolution of all open, complex systems, including socio-economic systems’ (Hodgson, 2002, p. 259). Thus, the argument is that at a high level of abstraction Darwin’s trinity can be generalized.

However, such high-level abstraction also means that Darwin’s central evolutionary process explains very little about the detailed mechanisms of change in any given domain to which it may be applicable. Consequently, while it is argued that universal Darwinism is necessary for building a theory of change in complex, open systems, it is also argued that this general framework is not sufficient, and that
domain-specific mechanisms must then be identified to complete the explanation (Aldrich et al., 2008, p. 585; Buskes, 2013, p. 672; Hodgson & Knudsen, 2010, p. 40). This crucial point brings into relief why initial attempts to explain social evolution using Darwinian ideas, such as sociobiology (Alexander, 1979; Symons, 1979; E. O. Wilson, 1975) were a failure. These studies used unsuitable biological analogies as mechanisms for explaining change in the social domain.

Consequently, one of the major theoretical developments in the project to generalize Darwinism has been to move from analogy to ontology (Breslin, 2010; Hodgson, 2002; Hodgson & Knudsen, 2010). For Hodgson this marks a shift in his position, given that in an earlier study he argued that Darwinism in the social sciences ought to proceed on the ground of analogous principles (Hodgson, 1992, p. 286). Hodgson (2002, p. 264) critiques this earlier view by insisting that shared ontological characteristics of complex systems ought to be the grounds for theory-building. This latter position argues that Darwin’s trinity is ‘logically independent of specific apparatuses of reproduction and selection, such as those involving genes and DNA’ (Hodgson 2002: 264). This view set the grounds on which the literature has since developed, arguing that Darwinism should not be based on analogy but on identification of common ontological features of complex systems (Aldrich et al., 2008; Breslin, 2010; Buskes, 2013; Hodgson & Knudsen, 2006a, 2010). Specifically, ‘Darwinian principles in social evolution does not imply that the detailed mechanisms of selection, variation and inheritance are analogous or similar to biological evolution’ (Aldrich et al., 2008, p. 585). For this reason Darwin’s trinity must always be supplemented ‘with auxiliary explanations specific to each scientific domain’ (Hodgson, 2002, p. 270, emphasis original).

Consequently, social evolution is not viewed as analogous to biological evolution. Rather, it is argued that they both evolve through a Darwinian process operating at a specific level of ontological commensurability. Across systems where universal Darwinism applies, one can expect different domain-specific mechanisms by which the process of variation, selection and retention operate. As a result, the
goal should not be to import biological categories to explain social evolution, or vice versa, the goal is rather to fill out at increasingly more concrete levels of theory the mechanisms specific to the relevant domain.

This theoretical development defuses criticism of universal Darwinism based on a strict dualistic understanding of the nature of the social and biological domains that rejected the validity of any analogous processes of evolution (J. B. Foster, 1997; U. Witt, 1999). For example, Witt (1999, p. 22) argued that ‘serious objections may be raised as to whether analogies to natural selection and genetic adaptation are, indeed, a reliable basis for developing the evolutionary approach in economics’. Generalized Darwinism does not deny the validity of this point. Instead, it is argued that so long as change can be said to occur under conditions where variation is generated across a population of entities, where environmental conditions result in selection of certain characteristics and not others, and retention of those characteristics by some method is possible over the long-term, then Darwinian evolution can be said to have occurred. I argue in this thesis that such conditions do apply to the social domain. Chapters nine and ten will provide a historical analysis of the evolution of bank bailout policy in support of this position. The next section of this chapter identifies the mechanisms by which social evolution occurs.

5.4. Domain-Specific Mechanisms of Institutional Evolution
This section develops a middle-range theory of domain-specific mechanisms by which institutional evolution occurs. To understand how crisis has impacted the evolution of capitalist institutions in Part III we need to identify mechanisms generating institutional variation, a process by which some institutions are selected and retained, but not others, and the means by which institutional knowledge is retained. There is ongoing debate within the field on identifying the specific mechanisms for building a middle-range evolutionary theory of institutional change that are particular to the
social domain. Here I build on specific concepts and mechanisms for social evolution that have strong support in the literature.

As discussed in chapter two, Veblen (Veblen, [1899] 2007c) argued that institutions were units of selection within the process of socio-economic evolution. Veblen, however, did not make clear the mechanisms by which selection and retention would occur in the social domain. Here I begin by briefly contrast between domain-specific theorizing of Darwin’s trinity within biological and social systems, and then proceed to a developed account of the latter. In biological systems population variation within a species is generated through genetic recombination and gene mutation. In social systems institutional variation involves imitation, innovation and planning (Aldrich et al., 2008, p. 584; Hodgson & Knudsen, 2010, p. 35). This involves ‘artificial selection’ when agents consciously innovate and plan institutional change. However, artificial selection is a special case of Darwinian natural selection, the latter referring to the fact that complex systems taken in total, even in the social realm, are not the product of conscious design. As Buskes points out, despite societal development obviously involving goal-directedness ‘cultural (and scientific) evolution remains essentially Darwinian because humans are fallible creatures: our greatest collective achievements are not due to some mysterious foresight but to the hindsight of a cumulative winnowing process’ (Buskes, 2013, p. 688).

Humans agents must work with what history bestows upon them when seeking to engage novel changes in society, including incumbent institutions, norms and technologies, all of which limit what can be achieved at any given moment through path dependency. Biological evolution is also path dependent, since variation occurs through small changes to the existing genetic endowments of a species (J. M. Smith, 1993). Human agents and wider society must also deal with unintended consequences of social life, from environmental pollution to traffic jams. In illustrating Buskes above

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point, no agent or group of agents foresaw or planned the increasingly devastating effects of industrialisation on the Earth’s biosphere, yet these effects, which Matthewman calls ‘manufactured uncertainty’ (Matthewman, 2017, p. 7), are now one of the central issues of our time, shaping the way we live materially and impacting local and global politics (Hamilton, Gemenne, & Bonneuil, 2015). The uncertainty of the future consequences of these effects is driving variation in national and global responses.

Variation is reduced by ‘selection’ pressures, which refer to ‘the mechanisms that bring about the survival of some variations rather than others, often reducing variety’ (Aldrich et al., 2008, p. 584). Selection pressures arise from incumbent environmental conditions, including climatic conditions, available food sources, levels of competition or cooperation between individuals and/or groups, and in the case of social life power must also be considered as a key selection mechanism (Tang, 2017, p. 605). Selection mechanisms reduce variety by selecting some but not other character variations. For example, war, and the threat of war, has been a major selection mechanism in the evolution of institutions shaping human history (Feld, 1975; Hodgson, 2015; Mann, 2012a; Turchin, 2006). It has resulted in generation of variation in terms of social organization, but selection pressures have reduced this variation, explaining why armies throughout recorded history have been constituted by a mix of three core elements, infantry, cavalry and artillery (Mann, 2012a). It is hardly the case that military planners throughout history consciously selected this same formulation of infantry, cavalry and artillery by chance. Rather, the selection was forced upon groups once it became clear that it was the most successful organization of armed forces, whether for defence or aggression.

Recent European history further illustrates how selection pressures forces reduction in variety, even when this conflicts with the wishes of social agents. Feld credits the Dutch state of the sixteenth century with creating the first truly modern professional standing army and ‘earliest rationalized form of military administration’ (1975, p. 419). This allowed the Dutch to become a first rate power for a century, in a
European context of constant war between states, many of which were much larger in terms of population and better resourced than the Dutch. Feld argues that the Dutch army ‘was perhaps the most efficient and certainly the most widely imitated force of its age’ (ibid, p. 421). The point about wide imitation is noteworthy, given the cultural context. During the sixteenth century the aristocratic concept of war still dominated in Europe. For the nobility, a ‘soldier fought for glory’ and a ‘sense of duty to his sovereign’ (ibid, p. 422). Reward for fighting was a mix of plunder and the valor gained through victory, while pay was usually haphazard and discipline of soldiers outside of wartime was non-existent. Feld points out that for the aristocracy, war was a gentleman’s occupation. Consequently, for the aristocratic elites of other European countries the Dutch system of war management was anathema to their own noble ethos.

The Dutch merchant class upended this model by applying ‘sound management’ principles and employing duty to contract rather than sovereign or God (ibid, p. 422). They institutionalised a regularly paid army, under full-time professional management, an army engaged in year-round drill-training and rationalization of technique and discipline. In doing so they turned a potential weakness, an army composed of mercenaries, into a strength. As Feld points out, it was an army that ‘destroyed the aristocratic ethos’ (ibid, p. 423). Yet the aristocratic nation-states of sixteenth century Europe could ill afford to ignore the Dutch innovations, despite the fact that its organizational culture and general ethos conflicted so severely with their own. The Dutch came up with an effective institutional solution to solve an environmental problem of war in Feudal Europe. Other nations were forced to imitate that solution irrespective of how it clashed with ruling ideology, or face the prospect of defeat. This, I argue, is a useful example to illustrate how institutions become units of selection. Chapters nine and ten argue this point in detail in relation to banking institutions.

The question for now is how are institutions selected and diffused? Selection pressures force ‘interactors’ to acquire or develop new ‘replicators’. Hodgson and
Knudsen (2010, p. 15) define an ‘interactor’ as ‘a relatively cohesive entity that hosts replicators and interacts with its environment in such a way as to lead to changes in the population of interactors and their replicators’ (Hodgson & Knudsen, 2010, p. 15). Interactors can be organizations, such as business firms (Aldrich et al., 2008; Hodgson & Knudsen, 2004b), or individuals and groups (Hull, 1988; D. S. Wilson, Van Vugt, & O’Gorman, 2008). A ‘replicator’ refers to ‘program-like bits of information, held by an entity [interactor], that can represent adaptive solutions to problems and guide its development’ (Hodgson & Knudsen, 2012, p. 13). In the natural world a gene is a biological replicator; in the social domain individual habits, organizational routines and ideas are equivalent replicators (Aldrich Howard & Ruef, 2006; Hodgson, 2015; Hodgson & Knudsen, 2004a, 2004b, 2010).

Here we come to a crucial difference between biological and social evolution. In biological evolution genetic replicators spread vertically, meaning from parent to offspring, through replication by reproduction. During this process replication is a mechanism referring to a causal relationship between interactors, where a high degree of fidelity exists between original and replicated entities, and where information relating to characteristics for environmental adaptation are passed directly between entities (Aldrich et al., 2008, p. 586; Godfrey-Smith, 2000). Whereas in the social domain, while vertical replication does occur when individual humans reproduce sexually, thereby passing on their replicators (genes), this process is not an important source of evolutionary change for humans living in agricultural-based settlements for the past 8,000 or so years. Genetic selection is not viewed as important for humans because of the consequences of a history of ever greater within-group cooperation (Bowles & Gintis, 2002; Gintis, Bowles, Boyd, & Fehr, 2005). As Bowles and Gintis point out: ‘cooperation is based in part on the distinctive capacities of humans to construct institutional environments that limit within-group competition and reduce phenotypic variation within groups’ (Bowles & Gintis, 2002, p. 8).

Within co-operative groups ‘levelling institutions’ such as redistribution of resources reduce within-group reproductive competition, thereby making gene
selection redundant as a mechanism of evolutionary change for humans. But simultaneous to this growing cooperation, the historical record shows increasing between-group competition (Gintis et al., 2005; Mann, 2012b; Turchin, 2006), and thus the growing importance of institutions over genes as units of selection shaping the character of social life (Bowles & Gintis, 2002, p. 8; Veblen, [1899] 2007c, p. 125). Institutions that successfully organize societies in ways that ensure large-scale cooperation, and the ability to rebuff violent attacks, or be successful in such attacks on other societies, are the institutions that are retained and increasingly imitated over time, while unsuccessful institutions fall into disuse, or the societies using them are annihilated.

Institutionalization of social life involves ‘niche construction’ (Buskes, 2013; Laland et al., 2000). This refers to a process of ‘organisms creating and changing their own environments, and thereby altering the sources of natural selection and the direction of evolution’ (Buskes, 2013, p. 669). Humans build socio-cultural institutional environments with complex hierarchies and artificial environments. These built environments with their related cultural milieus, themselves become factors that shape behaviour. During institutional change there is no process of vertical replication, since institutions do not directly pass on information in the sense defined for sexual reproduction. Rather, for institutional evolution ‘diffusion’ of replicators (habits, routines and ideas) is one of the most important mechanisms by which information is passed on horizontally (Buskes, 2013, p. 672; Hodgson, 2015, p. 322). Diffusion is defined as ‘the process by which an innovation is communicated through certain channels over time among members of a social system. It is a special type of communication, in that the messages are concerned with new ideas’ (Rogers, 2003, p. 5). A similar definition states: ‘Diffusion is here the successive transmission of a property—involving information and the capacity to use it—from one entity to another, through time and space’ (Hodgson & Knudsen, 2010, p. 105). In further clarifying the crucial difference between biological and social mechanisms of evolution, Hodgson and Knudsen (2010, p. 27) note that ‘diffusion is regarded as a
type of inheritance where a copy of a replicator is established in a second interactor, but without the copying of interactors’. Here the concept of ‘social learning’ is significant.

Social learning is defined as: ‘A general capacity to acquire information from others, regardless of the nature of the information, its function, or the sensory modality involved’ (Laland et al., 2000, p. 141). Social learning becomes central to human evolution under conditions where culture can be accumulated using language and writing (Buskes, 2013). Cultural diffusion spreads horizontally between interactors, under influence of a selection pressure, natural or artificial, or a mixture of both. This horizontal diffusion of information and practices can occur at a speed that is far greater that the slow turn of vertical, population reproduction that occurs within biological evolution of a species. It is this comparatively vaster speed that makes cultural evolution so dynamic in comparison (Buskes, 2013).

While institutional diffusion is a major mechanism in social evolution there are some important limitations to this process as outlined by Hodgson (2015, pp. 324-325). First, successful transmission of knowledge and practices depends on the adaptive abilities of receiving organizations. Here the role of tacit knowledge is paramount, and it is impossible to transfer all such knowledge. Thus experimentation and repetition of new routines is required. Second, what works in one institutional environment may not work in another context, due to the effect of ‘institutional complementarity’ (Hodgson, 2015, p. 325). The latter refers to the effect whereby ‘the co-existence (within a given system) of two or more institutions mutually enhances the performance contribution of each individual institution’ (Deeg, 2007, p. 611). In an environment where a complementary institution is missing, the diffusion of an institution that is successful in its original environment may fail in the new one. Consequently, effective institutional diffusion may not be as simple as replicating a successful institution from one environment into another.
Conclusion

This chapter argues that Veblen’s theoretical system requires a significant amount of critical reconstruction to deal with issues and gaps in his work. I have discussed a number of these criticisms, and where relevant sought to connect issues to wider debates in the social sciences concerning the relationship between social and natural science. I support Hodgson’s (2004b) argument that reconstruction of Veblen’s legacy must integrate the philosophy of emergence into its theoretical system. Emergence involves a theoretical explanation for why free will, institutions, and culture cannot be reduced and explained away as direct consequences of biological causes. Emergence also explains why biology must form part of the explanation of free will and culture, since the latter are possible only as a result of the human species distinct biological capacities. These capacities determine the conditions and limits under which culture and free will is possible, and must be understood in their own right to fully comprehend the process of socialization.

I also argued for the relevance of the concepts of ‘population thinking’ and the ‘impurity principle’ for understanding cultural evolution, as well as for productively linking analysis of essential characteristics of capitalism with studies focussed on variation between units of capitalism at the nation-state level. Both of these concepts will be essential for Chapter 8. In that chapter the concepts will be deployed to critique studies that develop a Western-centric model of capitalist decline, including analysis of the Chinese Communist Party as a significant ‘impurity’ causally impacting the character of China’s distinct variety of capitalism. Returning to this chapter’s summary, I also outlined the theory of Generalized Darwinism, arguing that it provides a crucial framework for developing a theory of social evolution. However, it was argued that a crucial step in using Generalized Darwinism in a legitimate way was to develop domain-specific theory that is then placed within this evolutionary framework.
Lastly, in section four I discussed theory outlining such domain-specific theory for understand cultural change, and provided a number of examples where institutions acted as units of selection. In Part III of the thesis Generalized Darwinism buttressed with a domain-specific theory of cultural evolution will play a critical role in conceptualizing institutions as units of selection during historical change in the financial sector precipitated by banking crises. One aim here is to exhibit the analytical power of institutional-evolutionary theory for analysing system evolution. This will be done by providing analysis of the slow emergence of bank bailout policy, first as a speculative solution to banking crises that threaten to collapse national financial sectors, then eventually becoming a defacto global institutional response to such crises. Next, however, the analysis turns to Part II of the thesis, where institutional-evolutionary theory is utilized to critically engage studies assessing the future of capitalism in light of the 2008 global financial crisis.
Part II: Debates on the Future of Capitalism
Chapter 6. The Traditional Economic View: Capitalism Forever

The global financial crisis of 2008 saw some of the world’s oldest and largest financial institutions collapse, others nationalized to prevent collapse, and yet more saved from collapse or nationalization through enormous injections of public money (Helleiner, 2011). While the crisis originated in the United States, and most severely impacted the developed economies of North America and Europe, the scale and breadth of the crisis was such that it had global consequences. Global investment flows collapsed by almost three quarters between 2007 and 2009 so that during this period the World Bank delivered ‘record levels of financial support’ to nation-states suffering severe fiscal financing gaps (World Bank, 2009, p. v). Global growth plunged into negative territory, falling to -1.734 for 2009, its lowest level since World War II.

Along with a creaking economic system, global protests in the form of the Occupy movement broke out (Van Gelder, 2011), motivated by the fact that private banks had been bailed out with billions of dollars of public money, while citizens were left facing increasing economic hardships of the Great Recession (Seefeldt & Horowski, 2012). A global protest movement, negative global growth, and the largest economic crisis since the Great Depression all combined to shake the capitalist world at its foundations. A crisis on this scale called into question not only the legitimacy of capitalism, but also its ability to reproduce itself economically. The 2008 crisis opened up an debate on the future of capitalism (Blinder, 2013; Calhoun, 2013; Choate, 2009; Collins, 2013; Crotty, 2008; Dutt, 2015; Kaletsky, 2011; Mann, 2013; Pomfret, 2010; Reich, 2010; Roberts, 2016; Streeck, 2014a, 2014b, 2016b; Wallerstein, 2013). Within this literature there are at least three major themes: 1)
capitalism will continue without end; 2) capitalism is ending; 3) global capitalism is unlikely to collapse soon. Each theme represents a common view shared across a number of studies investigating what the 2008 crisis means for capitalism’s future prospects.

Theme one is identified as a common idea expressed across a number of mainstream economic studies (Blinder, 2013; Choate, 2009; Kaletsky, 2011; Krugman, 2012; Pomfret, 2010; Taylor, 2009). This cohort have an implicit ‘end of history’ assumption (e.g. Fukuyama, 1989) built into their theory of capitalism, viewing it as the universal endpoint of economic evolution. Themes two and three are grounded in political economy, and will be outlined and critically assessed across chapters seven and eight. This chapter will provide an assessment of theme one, the mainstream economic view. In reviewing the literature I note that if theory can tell us something about crisis, the reverse is also true, crisis can tell something about theory, about its strengths and limits. This chapter highlights the weaknesses in mainstream economics. I argue that it provides an inadequate theory for understanding capitalist society as a historical social system evolving according to its institutional logic. This chapter will proceed through three sections. Section one, reviews studies that take the view that ‘capitalism will continue without end’. Section two applies institutional-evolutionary theory to critique the mainstream economics approach to studying capitalism. The final section summarizes.

6.1. Capitalism Will Continue Without End

From the viewpoint of traditional economics, the crisis was not seen as a potential sign that capitalism was, or even could be ending, but simply as a sign it required a regulatory revamp (Blinder, 2013; Choate, 2009; Kaletsky, 2011; Krugman, 2012; Pomfret, 2010; Reich, 2010; Stiglitz, 2010; J. B. Taylor, 2013). The 2008 crisis was according to these studies the result of factors that had nothing to do with “normal” market operations. Thus, the financial crisis was primarily a result of either failed or
excessive regulation, putting governments at fault (Pomfret, 2010; J. B. Taylor, 2013) or crony capitalism, putting moral failure of individuals at fault (Reich, 2010; Stiglitz, 2010), or a mixture of both regulatory and moral failure (Blinder, 2013; Choate, 2009; Kaletsky, 2011; Krugman, 2012). A detailed overview of these analysis will now follow.

First, all the studies assessed below refer primarily to events in the United States during 2007/08, and references to ‘capitalism’ in this chapter are primarily in reference to American capitalism. Pomfret’s analysis of events in America is paradigmatic of traditional neoclassical understanding of capitalist development. The account, therefore, turns on accepting as an article of faith the view that markets are largely self-regulating mechanisms that tend towards stable equilibria, and if left alone self-regulating markets generate the highest possible economic efficiency. These assumptions are expressed in Pomfret’s framing of the crisis as a result of factors he argues are exogenous to the market:

In a market-based economy in which prices largely capture social costs and benefits, any impediment to financial intermediaries directing funds to those borrowers willing to pay the most will have economic costs and because these costs are largely in the form of a suboptimal capital stock they will result in reduced long-term growth (2010, p. 24).

Based upon this view, he argues that in the years leading up to the crisis in the United States, market-distorting state intervention was rife, as ‘public policies, such as deposit insurance, with moral hazard implications increased the likelihood of crises, and cheap money exacerbated the situation by encouraging highly leveraged investments’ (2010, p. 22). Consequently, government and Federal Reserve policy is claimed to be the primary causal factor of the financial crisis, understood as an ‘impediment’ to otherwise self-regulating financial markets. It follows from this claim that absent government policy interference unimpeded market activity would not have resulted in a crisis of such a large scale. In arguing that financial innovation is crucial for economic growth, Pomfret does acknowledge that a degree of
instability is concomitant with this: ‘crises are something to be minimized but not eliminated, because financial liberalization is desirable in order to enable financial intermediation to work as well as possible’ (ibid, p. 24). A ‘natural’ amount of market-generated instability, for Pomfret, is the price of financial innovation.

In that light, market discipline that wiped out Lehman Brothers was a good tonic for curing excess risk-taking by financial actors. Pomfret argues that financial crises cause the ‘real economy’ to contract, but that once market discipline cleanses the system of failed firms the economy ‘will emerge stronger’ (ibid, p. 35). Thus Pomfret views smaller crises that are claimed to result from truly liberalised markets are revitalising of capitalism, and it is only state interference that generates the type of large crisis of 2008. Pomfret is sceptical of ‘cataclysmic’ scenarios, arguing that ‘closure of banks is not a disaster’ (2010, p. 35), a point also made by Kaletsky (2011). Both argue that the crisis was just another of the many financial busts during the 20th century, with the difference being that this one was exacerbated by gross policy error.

Pomfret’s view that financial crises are unavoidable if financial innovation is desired is an important one. In fact, I argue a similar point in chapter ten, but in the context of a different causal analysis. Pomfret views state regulation as a primary causal factor. I argue that regulations are secondary causal factors in the unfolding of economic crises, and that historically they have had a rather different effect that Pomfret claims. Historically, regulations have successfully dampened the business cycle, and reduced the severity and frequency of crises (Sewell, 2008, p. 520; Sklar, 1988). Against that, it is the profit-seeking behaviour incentivised by capitalist institutions that are the primary causal factor in crises (Veblen, 1904), because this motive results in financial firms and agents seeking to avoid regulations by creating new products, also known as financial innovation. Chapters nine and ten develop this argument in detail. The point I make at this stage is that Pomfret has only identified the symptom, and not the cause.
Furthermore, and true to the preconceptions of traditional economics, Pomfret fails to consider how a crisis on the scale of 2008 might impact political stability and capitalist legitimacy. In history, many periods marked by social revolution and historical change have been triggered by economic crises (Sewell, 2012). During the 2008 crisis mass protests broke out across America and globally, in the form of Occupy (D. Taylor, 2017; Trudell, 2012). Yet for Pomfret, an economic crisis only has economic ramifications, and the latter are only stated in term of market efficiencies. Consequently, while there is acknowledgement that equilibrium is not the only outcome of a market, the causes of this are poorly understood, and the consequences too narrowly framed to gain traction on capitalism’s political economy and historical dynamics.

Taylor (2013) has a similar monetary-based line of critique as Pomfret, arguing the ‘easy money’ hypothesis. Taylor argues that because the Federal Reserve kept the interest rate below the level that ‘historical conditions would suggest policy should be’ during the 2000s, the central bank created the conditions for an asset boom to occur (Taylor, 2013, p. 2). He argues that had the Federal Reserve followed the ‘Taylor rule’ (J. B. Taylor, 1993), a rule Taylor himself proposed in 1993, and which is influential in central bank policy thinking in the United States, then the crisis would not have occurred. The Taylor rule is his guide for setting rates based on past conditions. It proposes a relatively high interest rate (i.e. tight monetary policy) under conditions where inflation is above its target, or when output is above its full-employment level, in order to reduce inflationary pressure. Taylor points out that these conditions were exhibited in the United States in the years running up to 2008, yet monetary policy was kept too loose. Consequently, for Taylor, the causal story of the global financial crisis is all about ‘monetary excess’, further exacerbated by Government policy in the mortgage lending market, through under-writing mortgages for subprime borrowers. For Taylor, subprime lending bid up the price of houses beyond their ‘true’ market value (ibid, p.11), subsequently creating the conditions for a price crash.
Another term for ‘subprime’ borrowers is ‘working poor’, a concept used to define the growing cohort of American workers in full-time employment but suffering low income due to real wage-stagnation since the 1980s (Apel, 2015). This wage-stagnation has been further exacerbated by widespread underemployment, as well as a major structural shift away from well-paying, blue-collar employment towards precarious, low paying contract work (Katz & Krueger, 2016; Standing, 2011). Presumably, in Taylor’s neoclassical model of economics, if large numbers of citizens cannot gain access to private mortgage credit then they should wait until the market can meet their demands, however long that may take. They ought not make political demands for government policy that will resolve that issue, but by “distorting” the market.

This view is premised on the false notion that markets never become depressed or otherwise dysfunctional absent non-market interference. But market dysfunctionality does occur (Keynes, 1936). Furthermore, is it realistic economic theory to assume that the economy should be, and can be, organized without any influence from the political and social demands of citizens whose life chances are fundamentally determined by the structure of economic distribution within that economy? Such a de-politicised view is fundamental to traditional economics. For example, Taylor simply assumes the market on its own will ensure maximum marginal efficiency, and therefore the cheapest supply of the goods people want without market volatility. However, unregulated markets are highly volatile. The most unstable period of American capitalism was its least regulated period during the 19th century (Sklar, 1988). Furthermore, government-backed mortgages in the United States, which Taylor views as the cause of the 2008 crisis, have their origins in market failure during the Great Depression. Fannie Mae was chartered in 1938 to stimulate a depressed construction sector by providing reliable and affordable mortgages nation-wide, and Freddie Mac was chartered in 1970 to support that mission (Green & Wachter, 2005). Capitalism must be politically legitimate as well as economically functional, and finding the balance between both requirements is an
ongoing dynamic, due to market structures and political demands constantly shifting. Politics cannot be separated from economics.

Both Taylor and Pomfret illustrate this latter fallacy. What follows from their analysis is that the crisis has no negative ramifications for capitalism qua capitalism, since the free market works perfectly well in their alternative reality where politics either doesn’t exist, or doesn’t ever interfere in economic processes. To the extent that some policy intervention is accepted to be unavoidable, for example Central Banks acting as lenders of last resort, Taylor advocates a rule-based policy framework (J. B. Taylor, 1993) that ought to be conducted according to ‘a set of sound market principles with minimal deviations and interventions’ (Taylor 2013, p. 62). Here again the assumption of market equilibrium is the basis for this claim of action based upon ‘sound market principles’. Yet, Taylor own ‘Taylor rule’, as well as acknowledgement of the need for lenders of last resort contradict the theory of equilibrium. Thus paradoxically, Taylor and Pomfret’s analysis argues that the 2008 financial crisis signals the wrong kind of regulatory intervention, despite the fact that they also accept as axiomatic the traditional economic model of self-stabilising markets.

Blinder (2013) and Choate (2009) both present analysis based upon a critique of regulatory failure along with moral failure. Blinder (2013) highlights seven ‘villains’ that caused the crisis: inflated asset prices, excessive leverage, slack financial regulation, fraudulent lending practices, unregulated securities and derivatives built on mortgage securities, poor performance of the rating agencies, and compensation schemes disconnected from outcomes in many financial institutions. This time it is argued that too little, rather than too much intervention is the problem, with Blinder arguing that excessive financial de-regulation relative to some financial instruments, such as derivatives can be dangerous. Orthodox economists who make this type of analysis are influenced by Keynes’ (1936) model of capitalism as a system that emphatically requires state regulation and policy intervention to ensure economic reproduction over time.
This theoretical position is a significant improvement on mainstream economics, since it acknowledges the role of government and policy as fundamental to the effective operation of markets (e.g. Krugman, 2012; Stiglitz, 2007, 2010). Stiglitz and others have critiqued neoclassical equilibrium models that are based on the assumption of perfect information and complete markets (Greenwald & Stiglitz, 1986; Stiglitz & Weiss, 1981). These studies highlight that during real-world market transactions markets are often incomplete, information is always imperfect and agents have asymmetric access to this information, providing some agents with significant advantages over others. In applying this approach to the 2008 crisis Stiglitz argues that: ‘Agency issues and externalities mean that there is a role for government [regulation]. If it does its job well there will be fewer accidents’ (2010, p. 17). As Galbraith points out, the limitations of this type of ‘New Keynesian’ critique is that it still views economic crises as accidental rather than as the result of structural effects of capitalism’s institutional logic (J. Galbraith, 2014, p. 73). The market is still considered as capable of at least tending towards equilibrium growth in the long-run. Consequently, although some frictions are acknowledged to exist that can unsettle this tendency, ‘New Keynesians have not been prepared to abandon equilibrium’ (Beinhocker, 2006, p. 167). Critics of traditional neoclassical theory, such as Stiglitz, are still proponents of the core elements of the traditional model, albeit with a few imperfections for which government action is required.

In following a similar New Keynesian line of analysis, Choate (2009) argues that state-led capitalism, referring to economies such as China and Japan, is superior to America’s market-led capitalism, with the crisis proving as much. The ‘tragedy’ of market versions dominating over state capitalism for Choate, is that when effectively managed by the state ‘the market is the most efficient means in the world to allocate scarce resources and stimulate economic innovation and growth’ (Choate, 2009, p. xiv). Again, like Stiglitz and Krugman, for Choate the crisis indicates that the future of American capitalism should involve developing stronger regulatory intervention. While agreeing with this prognosis, I argue that this analysis fails to grasp that there
are also limits to the role of secondary institutional regulation of primary capitalist institutions, due to the nature of how these latter institutions work, and the behaviour they impart upon agents. Thus, the analysis falls short of a fuller understanding of capitalist institutional evolution, as Part III of the thesis will show.

In sum, there is a degree of slippage from a strong neoclassical position that the market is infallible, failing only when unnecessary and unwarranted regulations interrupt market operations (Pomfret, 2010; J. B. Taylor, 2013), to a New Keynesian-influenced neoclassical position that the market is the best institution for securing material prosperity, but still requiring a mix of public and private regulation to function at its most effective (Blinder, 2013; Choate, 2009; Kaletsky, 2011; Krugman, 2012; Reich, 2010). The strong neoclassical position is theoretically blind to the necessity of institutional regulation for a functioning and relatively stable modern market economy. For this reason traditional economists always have a scapegoat to blame for market failure, namely whatever regulations operate at the time of a crisis are the reason for the crisis. New Keynesian-leaning approaches offer a more developed account of why regulation is required, but still fall short on a sociological explanation of how capitalist institutions shape behaviour and habits on a deep level. The next section provides a detailed theoretical critique of traditional economics conceptual limitations.

6.2. How to Study Capitalism: the need for a political economics

In this section I discuss what the literature reviewed so far tells us about how to study capitalism. The aim is to illustrate why economics must be political economics in order to generate realistic analysis. Here I draw upon the theoretical resources developed in Part One of the thesis. I argue that one of the fundamental differences between mainstream neoclassical economics and institutional approaches to political economy is that the latter are committed to ontological holism, and that this commitment is essential for studying capitalism.
In chapter one, I argued that the broad tradition of institutional political economy is connected at a fundamental level by a shared commitment to a holistic understanding of social life. This entails that economic theory remains open to the possibility, and indeed likelihood, that causality runs between distinct social domains, and that economic life may be impacted by non-economic cultural norms and values; or conversely, that cultural and political relations of non-economic origin will be affected by outcomes in economic life.

Foundational thinkers of political economy understood economic and non-economic domains as interacting dynamically. As discussed in chapter two, Veblen argued that for economics ‘the subject of inquiry is the conduct of man in his dealings with the material means of life, the science is necessarily an inquiry into the life-history of material civilization’ (Veblen, 1909b, pp. 627-628). Veblen argues that economic science is rightfully focussed on material reproduction. However, Veblen follows with the argument that since economic life intersects and depends to some degree on non-economic social relations in order to function, the study of it must not be isolated ‘from all other phases and bearings of human culture’ (ibid, p. 628). This is why economic is a study of the “life-history of material civilization”.

In discussing the commonalities between Marx and Veblen’s work, O’Hara (2000) argues that their approach to studying capitalism stems from a commitment to ontological holism. From the perspective of holism, single observed effects always have multiple causes, with Myrdal arguing ‘[t]here is no one basic factor; everything causes everything else. This implies interdependence within the whole social process’ (Myrdal, 1978, p. 774). In similar vein, Schumpeter states ‘[t]he social process is really one indivisible whole’ (1934, p. 3). In relating this principle to the economy, it has been noted that for a capitalist economy to function a multitude of ‘actions that are not “economic”…must be performed’ (Heilbroner, 1980, p. 83). These necessary non-economic actions include things such as child rearing, provision of law and order, establishment of a legally guaranteed universal equivalent (money), third party arbitration of economic and other disputes, legal

As discussed in chapter five, institutional-evolutionary economics based on Veblen’s work theorizes this inter-dependence using the concept of the ‘impurity principle’ (Hodgson, 1988, 1993, 1995b, 2015). This argues that socio-economic systems always rely on a mix of central institutions that define the type of system in question, and supporting subsystems necessary for overall reproduction. Capitalist markets rely on the family for labour power, however children are not conceived with a view to selling labour power as a market commodity. Capitalism also relies on the state to reproduce the conditions for a stable and functioning society, but the state does not exist solely to serve capital, nor does it solely serve capital. In all societies the state discharges numerous non-economic duties. Both the family and the state as institutions pre-exist capitalism, and vary in nature from society to society, providing a key source of capitalist variation. What all this means is that the economy cannot be realistically abstracted from all other social relations (Lawson, 1997; Myrdal, 1978).

Veblen originally argued across numerous works that neoclassical economics does exactly this, founding its approach on theoretical preconceptions concerned with a theory of market prices, a marginal analysis of resource allocation efficiency, and the impact of utility-maximizing behaviour on prices and allocation (Veblen, [1899] 2007b, pp. 143-144; [1908] 2007, p. 193). Hodgson has developed more recent institutional-evolutionary critiques that build on Veblen’s criticism regarding the lack of holistic and historical grounding of neoclassical theory (Hodgson, 1988, 2001). Hodgson (2001) makes a sustained argument against the dangers of “general” or “universal” theory in social science at the cost of historical specificity.

For Hodgson, “universal” theory describes theory that is used ‘to understand every kind of circumstance within its broad domain of application. Specific circumstances would enter the theory merely as data. Particular theories would no
longer be required’ (2001, p. 3). Universal theories purport to explain all things
within their given range, providing a unified explanation of reality. However, if the
theory is based on an unfounded universal claim, as is the neoclassical view of *homo
economicus*, then it becomes blind to historical conditions. While it is reasonable to
accept that every human being has some degree of self-interest influencing their
behaviour, as a basic survival instinct would necessitate, problems arise when such a
proposition is over-extended to explain every sort of outcome. Hodgson argues that
neoclassical theory’s universal account of human motivation, given as ‘everyone is a
utility maximiser’, is an example of universal theory that is non-falsifiable.

It cannot be falsified because even altruistic and other-directed activity are
viewed as rational utility-maximising by conferring psychic pleasure on the
individual. In this way the concept of utility-seeking stretches to ‘cover every
eventuality or behaviour’ (Hodgson 2015: 68). In forcing non-self-interested acts to
be compatible with its theory of individual utility-seeking, neoclassical economics
generates universal concepts that are ‘impoverished in terms of their concreteness,
relevance and practical application’ (Hodgson, 1996, pp. 382-383). As Fukuyama
puts it in making a similar critique, the theory becomes ‘a tautology that robs the
model of any interest or explanatory power’ (Fukuyama, 1995, p. 19).

The marginal revolution of the 19th century is the source of this tautological
approach. Veblen’s critique of marginalism in chapter two was that it involved
delimiting the scope of economics to a mathematically tractable theory of individual
preferences based on assumptions of individual rationality and utility-seeking. Thus
while classical economics was essentially ‘political economy’, its neoclassical
replacement was to ‘drop the adjective and become “the relationship between given
ends and scarce means . . .”’ (Bowles & Gintis, 2000, p. 1411). In taking this
theoretical juncture, neoclassical economics cast as strange and aberrant, what had
previously been fundamental to economics as the science of material life, namely
politics.
For mainstream economics the political claims of millions of Americans struggling to own a home which inspired the creation of Freddie Mac and Fannie Mae is relegated to the part of inefficiencies distorting market prices. It is a theory where ‘abstract theoretical problems’ tend to dominate over ‘real world’ considerations (Deane, 1978, p. 99), a critique recently restated by heterodox economists (Bowles & Gintis, 2000; Keen, 2011; Lee & Keen, 2004). Leading figures of marginalism, such as Stanley Jevons and Leon Walras, sought to develop a theory of value that hinged ‘on marginal utility as the determinant of the ratios at which goods were exchanged’ (Deane, 1978, p. 95). Marginal analysis seeks to identify which allocation of scarce resources with competing alternative uses will produce the most utility for users. If all resources are available to all consumers in a free market, prices then become a measure of utility. In that circumstance, the law of supply and demand, diminishing returns and utility maximising by agents ensure, theoretically speaking, the most efficient allocation of goods at the margin.

Conceptualised thus, Walras defined economics as the ‘theory of the determination of prices under a hypothetical regime of perfectly free competition’ (Walras, [1874] 1954, p. 40). While Walras mathematically described the possibility of a general equilibrium, Alfred Marshall developed an analysis based on partial equilibrium of prices for individual firms and individual markets (A. Marshall, 1961[1890]), which he viewed as adding realism to Walras’ assumption of full knowledge by market participants of all market prices at their equilibrium. The assumption was made to allow a mathematical description of market prices.

The consequences of mainstream economics being built upon the foundations set by the neoclassical marginal revolution are manifold. By narrowing down the scope of the subject matter ‘so as to be almost exclusively concerned to a study of market processes’ (Deane, 1978, p. 99; Heilbroner, 1970; O’Boyle & McDonough, 2017), while other important factors were permanently discounted. The result: no consideration of the question of wealth distribution, or of the role of politics, power, and a whole host of other important non-economic factors in the determination of
economic outcomes. Likewise, and against the weight of historical evidence that shows capitalist economics are prone to regular business cycles and crises rather than sustained equilibrium (Aliber & Kindleberger, 2015; Mitchell, 1941; Reinhart & Rogoff, 2009; Schumpeter, 1927; Sherman, 1991), mainstream neoclassical economics to this day still has no theory of the endogenous causes of capitalist crises, as the studies reviewed above illustrate. And as Sewell points out as a rebuttal to a typical mainstream response, even if we were to somehow believe that such crises were in every instance the result of an exogenous shock, it would still have to be explained why economies always respond the same way to such shocks (2008, p. 521). That explanation can only be developed by assessing the institutional order itself.

I argue that a commitment to ontological holism common to the tradition of institutional political economy allows for a more sophisticated and realistic account of socio-economic life. Myrdal sums up the difference in approach as follows:

In calling the holistic approach the fundamental principle of institutional economics, I imply that our main criticism of ordinary economics is that it works with narrowly closed models, limiting the analysis to too few conditions...Confining the variables to only a few that can be quantified permits the use of impressive mathematical models, which regularly presuppose a sharp restriction of vision. Almost the entire social system is kept out of sight. This methodology should at least require a clear statement of assumptions with respect to conditions and determinants not considered. Such an account is regularly not given. Most of the time the need is not consciously perceived (Myrdal, 1978, p. 775).

Myrdal’s critique concisely summarizes the core of the argument made by Thorstein Veblen outlined in chapter two. Veblen’s critique continues to hold relevance today. Based on these critiques, mainstream economic analysis will be dropped from further consideration on the question of the future of capitalism.
Conclusion

So what does crisis tell us about mainstream economic theory? Instead of assessing what role the normal operation of capitalist institutions played in leading the economy towards the Great Recession, the analysis turns on arguments about economic regulation that produces market distortions. Studies debate if there was too much or too little regulation, or whether individual moral failings were to blame. These are important, but secondary questions. The primary question is to first assess what role capitalist institutions play in generating economic crisis. It is these institutions that generate the risk-taking behaviour of actors and firms within the financial sector. The narrow framing of the problem by mainstream economics follows from the fact that neoclassical theory is based upon a narrow ontological foundation that ignores a large number of factors central to outcomes in the global political economy. Based on the evidence provided in this chapter, I argue that mainstream economics provides an inadequate framework for studying capitalism as a historical social system. The historical question of capitalism’s ongoing reproduction must, if to be realistic, be approached from a political economy perspective. The next chapter turns to the political economy debate on the future of capitalism.
Chapter 7. The Political Economy

Debate: Two Views

This chapter outlines prominent arguments within the political economy literature on the future of capitalism post-2008. Within this literature two prominent themes have emerged, representing opposing positions. One set of studies argue that ‘capitalism is ending’; a second group argue that ‘capitalism is unlikely to end soon’. This political economy debate contains disagreement on the future of capitalism. However, in getting to those opposing views the studies share important methodological principles for studying social systems. Analysis is based on the view that study of capitalism must involve focus on the operation of capitalist institutions over time, assessing how these institutions operationalize a distinct logic and set of practices that give capitalist society a distinct structure and historical trajectory. In the context of assessing possible futures, the goal of political economy is to therefore identify social patterns of change that are caused by capitalism’s dominant institutions.

Consequently, the studies below all propose a form of structural theory in arguing that capitalism is either in terminal decline as a consequence of the system’s normal logic of development; or, the opposing view that it is potentially heading into a period of renewal or enduring low growth. Each theme arises from a view of capitalism’s institutional relations as the primary causal factor for analysis, rather than regulatory conditions or individual moral failings. This chapter now proceeds in three sections. Section one reviews the studies arguing that ‘capitalism is ending’. Section two reviews studies that claim ‘capitalism is unlikely to end soon’. Section three summarizes.
7.1. Capitalism is Ending

A number of studies view the 2008 financial crisis as a symptom of deeper structural problems. Roberts (2016) argues that Marx’s law on the tendency for a falling rate of profit threatens global growth. Collins (2013) offers a ‘stripped-down’ Marxist theory of technological unemployment eviscerating the middle class in all economies within the next four decades or so. Wallerstein provides a structural argument for why growing economic stagnation is the new normal in developed economies, arguing that the global system is in a ‘terminal stage’ (Wallerstein, 2013, p. 10). Monopoly-finance capitalism theorists (J. B. Foster & Magdoff, 2009; J. B. Foster & McChesney, 2012) view economic stagnation as the normal condition of a developed capitalist economy dominated by monopolistic corporations, due to the relationship between increased worker exploitation and monopoly profits on the one hand, and a lack of new investment opportunities and declining growth due to underconsumption on the other. They argue that monopoly-finance capital is caught in an ‘endless crisis’ of stagnation for which no escape is now possible.

Other studies share much with this latter analysis on the role of finance as a means for substituting wage growth with debt (Brenner, 2009; Lapavitsas, 2009; Polanyi Levitt, 2013), which increases consumption-based growth for a time, but also increases debt-levels. When the latter become saturated, such that new debt can no longer be added, then economic recession will result. As a result, debt-based growth ultimately leads to long-term volatility and recession. This is why Brenner argues that the 2008 crisis resulted from ‘unresolved problems in the real economy that have been literally papered over by debt for decades’ (Brenner, 2009, p. 1). Streeck (2014a, 2014b, 2016a, 2016b) tells a similar story, applying a synthesis of institutional and Marxist insights to argue that economic stagnation is now the future of capitalism because growth is stalling and debt is too high.

While utilising different theoretical frameworks, all of the above studies share a central proposition: that the 2008 financial crisis was a symptom of a deeper,
structural outcome of capitalist development. The consensus is that global capitalism is in a period of long-term stagnation and decline due to endogenous causes relating to capitalist institutions. This economic breakdown is argued to affect the entire global capitalist system, such that a number of these studies argue that we are now within a few decades of terminal breakdown (Collins, 2013; J.B. Foster & McChesney, 2012; Streeck, 2014a, 2014b, 2016a, 2016b). The rest of this section focusses on these studies, outlining their arguments that capitalism is ending.

Collins bases his argument on a Marxist framework, which he describes as a ‘stripped-down’ Marxism describing economic collapse caused solely by the effect of technological displacement of the middle class (2013, p. 38). This argument goes beyond traditional claims that automation displaces manual labour, arguing that artificial intelligence means that more complex white collar professional jobs are now also under threat. Collins argues that this effect on its own will end capitalism by no later than the end of the 21st century, but ‘very likely will bring capitalism to an end within the next thirty to fifty years’ (Collins, 2013, p. 38). Collins de-emphasizes other typical Marxist theories of collapse, including a falling profit rate, business cycle volatility, and current neo-Marxist theories of secular stagnation and financial speculation. Instead, he argues that middle class technological unemployment is the key factor threatening a global capitalist crisis. While his argument is not original in form, he provides an updated perspective on the impact of technology on labour which contains a novel focus on middle-class unemployment.

Here I outline two of Collins central arguments, which if they held true, would indeed spell disaster for global unemployment rates, especially in the most advanced economies. One argument concerns the ability of new technologies to generate entire new sectors and employment opportunities even as they displace older sectors in a process of Schumpeterian ‘creative destruction’. The second concerns the effects of offshore outsourcing on the advanced economies. Beginning with the effects of creative destruction, it has been the case previously that while
new technology has displaced large numbers of jobs, for example in agriculture, it has also compensated those losses through generation of entire new sectors of employment in manufacturing and later in services. Collins thus begins by admitting that fears of technological unemployment have been overstated in the past. This time, however, he argues a number of points mean the threat is real. He argues that ‘computerization of the middle class is not being compensated by the creation of new jobs at an equal rate’ (Collins, 2013, p. 41). Collins argues that artificial intelligence and information technology advances are now displacing service sector employment in advanced economies such as the United States, where service jobs now account for 75% of employment (2013, 41). He points out that sales jobs are either being automated or made redundant by online selling, and retail clerks are being replaced by electronic scanners. These effects are occurring, argues Collins, without new sectors emerging with replacement jobs. He argues that artificial intelligence will eventually even displace higher managements positions such that ‘the displacement of middle-class labor will be nearly complete’ (Collins, 2013, p. 41).

Collins second argument concerning offshore sourcing claims that this indicates a further significant squeezing of middle class workers in advanced economies. Here he argues that advances in internet technology mean that the geographical spread of markets is no longer a barrier to competition for almost any type of service. The well-established process of offshore outsourcing involves firms contracting foreign-based companies to provide services at lower cost that their domestic economy (Yang, Wacker, & Sheu, 2012). Collins points out that white collar workers in low-wage economies can now easily and directly compete with similarly skilled workers in high-wage economies at a fraction of the cost (Collins, 2013, p. 44), thereby structurally displacing those workers in advanced economies. Collins finishes with the following cataclysmic prediction: ‘It is clear that the rate of technological displacement has accelerated in the last fifteen years. We could well reach 50% structural unemployment by the year 2040, and 70% not long after that’ (Collins, 2013, p. 57). This would, of course, be disastrous. But the question is
whether such extrapolations are realistic. The next chapter will attempt to answer this, placing Collins argument as part of a growing debate on technological unemployment (Brynjolfsson & McAfee, 2012; Frey & Osborne, 2017; Mokyr, Vickers, & Ziebarth, 2015; Walker, 2014). Here I continue with a review of studies supporting the ‘end of capitalism’ hypothesis.

Another Marxist take on the ‘economic decline’ view is elaborated by Foster and McChesney (2012). They build on the analytical tradition of the Monthly Review analysis of ‘monopoly capitalism’ (Baran & Sweezy, 1966; J. B. Foster, 1986, 2006; Magdoff & Sweezy, 1987). This approach argues that ‘the normal state of a mature capitalist economy dominated by a handful of giant monopolistic corporations is one of stagnation’ (Foster & McChesney, 2012, p. viii; see also Baran & Sweezy, 1966, p. 108). The general argument runs as follows: the concentration and centralization of capital that occurs over time due to competition winnowing out smaller and less effective firms results in an economy dominated by giant monopolistic corporations. These corporations are able to generate super profits due to factors that include massive economies of scale, highly effective marketing and branding, well-organized political lobbying, informal agreements to reduce price competition, and heightened exploitation through high price mark-ups on unit labour costs. However, this apparent capitalist utopia generates a new internal contradiction in the form of structural stagnation through underconsumption. Monopoly prices are a form of rent that reduces labour’s share of surplus, and which therefore reduces potential consumption and shrinks available new investment opportunities for the growing super-profits of monopolistic corporations.

The result is a breakdown in the circuit of capital that Marx outlined in volume two of Capital (Marx, 1992), located within the sphere of circulation rather than in production pace Roberts (2016), resulting in a massive over-accumulation of capital. Growing monopolization of the economy is argued to be the cause of slowing growth rates in the United States, European Union and Japan. Growth rates for these three regions between the 1960s and 2000s have dropped by 50% on
average for both the US and European Union, and a dramatic 90 per cent reduction for Japan, albeit starting from an usually high rate of almost 10 per cent in the 1960s (Foster & McChesney, 2012, p. 4). The response to falling growth is to boost consumption through debt, leading to the growth in power of the financial sector since the 1970s onwards (J. B. Foster, 2006, 2007).

Foster and McChesney (2012) argue that financialization is an institutional response to stagnation in the goods-producing sector of the economy (see also Giovanni Arrighi, 2010; Lapavitsas, 2013), with this monopoly-derived stagnation within the developed economies appearing as stagflation during the 1970s. Finance offered a solution both to underconsumption, through consumer debt, and the lack of investment outlets in the productive economy, through asset speculation. In Foster and McChesney’s account, financialization is a solution that allows ongoing and increasing consumption. For this reason ‘stagnation and financialization are increasingly interdependent phenomena’ (J. B. Foster & McChesney, 2012, p. 4). However, they argue that this relationship is highly volatile. Debt can only boost consumption for so long, since increasing debt loads also mean increasing the interest that must be paid out of disposable income. At a certain point of indebtedness, interest payments become so large that the debtors have no more capacity to service new debt. Once the debt-issuance-for-more-consumption chain breaks down, a wave of debt-defaults that become self-reinforcing occurs, as happened during the subprime crisis of 2008 in the United States (Aalbers, 2008).

Consequently, the argument is that debt as a solution to a reduction in the share of surplus going to blue collar employees works very well early in a business cycle when debt levels are relatively low, but becomes an increasingly self-strangling process as the cycle progresses, one that creates conditions for ever greater recessions when the cycle turns. Foster and McChesney see conditions since the 1970s in the leading economies as representing an ‘endless crisis’ of monopoly-finance capital, and furthermore, that ‘there is no way of historically transcending the growing contradictions of capitalist maturity within the context of the system’
(2012, p. 183). Their view is that economic stagnation in the United States, Europe and Japan will result in global stagnation and economic collapse. In making this point they discount the possibility of a China-led Asia driving global growth (2012, pp. 155-183). They end their analysis with a call for a ‘revolutionary reconstruction of society’ (2012, p. 183), but unfortunately provide no indication as to how to achieve such a task.

Streeck (2014a, 2014b, 2016a, 2016b) offers an admixture of Marxism and historical institutionalism in generating his analysis of global capitalism post-2008. He argues that analysis of contemporary political economy cannot proceed without a theory of capitalism, that Marxism provides one of the best theoretical accounts of capitalism, and therefore recourse to Marxist insights are essential. In a narrative similar to the one presented by Foster and McChesney (2012), Streeck (2014a, 2016b) views the period from the 1970s onwards as one long crisis for American and European capitalism, due to the cascading effect of slowing growth rates resulting in a turn to debt-fuelled stimulus, which creates the potential for bigger crises when debt levels reach their limit. Streeck contrasts this situation with the three decades after World War 2. Prior to the 1970s a booming United States and postwar rebuilding in Europe generated high growth rates in the Western economies. Economic stability was further facilitated by an institutionalised postwar agreement between capital, labour and the state, also described as the Keynesian compromise (Duménil & Lévy, 2005). The latter involved institutionalizing the economy based on a commitment to a more comprehensive welfare state, graduated high taxation, high-waged full employment and an extensively regulated financial system.

However, Streeck (2014a) argues that by the 1970s the war-reconstruction boom had run its course, slowing economic growth. Simultaneously, growing international competition for capital and the gradual breakdown of the Bretton Woods system of monetary management contributed to the development of a structural crisis marked by declining profit rates in the developed economies. Streeck (2014a, p. 21) notes that declining profits present a legitimation crisis for
capitalists. He argues that the global liberalization of capital was a successful strategy to undo the constraints which capital ‘had to endure in order to become politically acceptable’ in a post-war era haunted by fascism and war (2014a, p. 4). He argues that ‘the history of capitalism after the 1970s, including the subsequent economic crises, is a history of capital’s escape from the system of social regulation imposed on it against its will after 1945’ (2014a, p. 19). For this reason, the crisis of capitalism from the 1970s onwards should be viewed as ‘an unfolding of the old fundamental tension between capitalism and democracy’ and the destruction of the postwar shotgun marriage between the two (2014a, p. 4)

Nevertheless, while capital has temporarily gained increased power to exploit labour and arbitrage national tax rates lower, for Streeck this only buys some respite until the threefold and self-reinforcing conditions of declining growth rates, increasing debt levels, and inequality combine to generate a total economic breakdown. In dating capitalist decline from the 1970s Streeck states: ‘What we are seeing today, however, appears in retrospect to be a continuous process of gradual decay, protracted but apparently all the more inexorable.’ (2014b, p. 38). The three strategies that have held terminal decline at bay are debt-fuelled consumerism, monetarism and debt-fuelled public spending, and each have been used to their maximum potential (Streeck, 2014a, p. 4). On this basis Streeck argues that global capitalism is in terminal decline. Like Foster and McChesney (2012) he develops his entire analysis of global capitalism on conditions in Western economies, and in doing so Streeck rejects the relevance of China and Asia (Streeck, 2016b, p. 37).

To sum up, the above studies argue that the global capitalist system is entering terminal decline. Studies here seek to understand capitalism on its own terms, investigating how the institutions of capitalism generate specific logics, contradictions and outcomes which are fundamental to the normal operation of those institutions, and therefore unavoidable. Furthermore, these studies all seek to connect the economics of capitalism with the politics of capitalist societies in line with the broad tradition of political economy. Studies by Collins (2013), Streeck
(2014a, 2014b, 2016a, 2016b) and Foster and McChesney (2012) each provide structural arguments that global capitalism is going to collapse for economic reasons. These arguments all share a Marxist focus on the contradictions of capitalism. In addition, arguments by Streeck and Foster and McChesney share a methodological principle of focusing analysis on Western economies, based on the view that global economic reproduction is dependent on these economies. The next section reviews political economy studies that are critical of some of the claims undergirding the ‘capitalism is ending’ theme.

7.2. Capitalism is Unlikely to End Soon

A number of political economy studies have developed analysis that is critical of the type of argumentation undergirding the ‘capitalism is ending’ theme (Calhoun, 2013, 2016; Mann, 2013). The critiques identified by Mann and Calhoun are twofold. The first is a totalizing conception of global capitalism as a single system evolving on a relatively homogenous developmental path. This is a form of typological essentialism, as discussed in chapter five. The second flaw is a one-sided account of the crisis-aspects of the capitalist business cycle that forgoes analysis of the stabilizing aspects that are produced by the growth phase of a business cycle. In reference to the type of arguments found in the ‘capitalism is ending’ cohort of studies, Calhoun makes the following point:

Much critical engagement with capitalism has focussed on its internal contradictions and potential collapse. Contradictions are real and collapse is possible, but the language is misleading. We speak of the collapse of the Roman Empire, but this took 300 years of decline, instability and conflict. We speak of the collapse of feudalism, but it would again be more accurate to see a long process of transformation as feudal structures were less able to organize social, economic and even military life, and less able to reproduce key elements of their power structure while gradually states and what we now call capitalism grew (Calhoun, 2016, p. 171).
Calhoun argues, as does Mann (2013), that the decline of any centuries old socio-political system that is deeply embedded culturally and materially across numerous societies will likely occur over an order of centuries rather than decades. Furthermore, any decline is argued to likely involve a gradual displacement of existing relations, as new practices are trialled. There is unlikely to be a global collapse because nation-states will change at differential rates in accordance with their own specific cultural and political path-dependent processes. Calhoun is critical of Western-centric approaches that treat the pressures and crisis of legitimacy faced by Western capitalism during the post-2008 recession, as threatening a global economic collapse. Against Western-centrism, Calhoun argues that capitalist legitimacy is robust in many parts of Africa, Asia and Latin America. Likewise, while a crisis in two of the major trading regions, the United States and Europe, will obviously impact aggregate global trade, it is unlikely to be detrimental for all other regions. For example, Calhoun points out that after a brief slowdown in 2008/2009 much of Asia rebounded to high growth rates, especially China and India. Capitalist legitimacy in Asia can viewed as an outcome of the fact that the region is the location of a booming middle class (Kharas, 2010). Growth in the region has been the major driving force behind a milestone in global development reached in 2018. It was at this time that half the world’s population entered the middle class (Kharas & Hamel, 2018), which for the authors means having disposal income for consumer durables, entertainment and vacations, and some savings for periods of financial distress. Therefore, economies at different developmental stages and enacting particular variations of capitalism relations have different growth potentials, and different admixtures of social costs and gains within the possible range afforded by capitalist institutions – all of which affects legitimacy and prospects for ongoing capitalist reproduction.

For such reasons Calhoun (2013, 2016) is critical of the ‘capitalism is ending’ thesis, and instead argues that global capitalism may just as likely be heading into a period of renewal. He points out that ‘capitalism is not always the same across space.'
In the first place, it always exists in social and political contexts, not in a “pure”, abstract or average form. In the real world, capitalism is always shaped by state support, regulation and mediation of conflicts’ (2016, p. 171). Consequently, the success or failure of any given capitalist economy over time depends in large part on a number of factors, including the competencies of the state managing any given economy (Albert, 1993; Shonfield, 1965), the existence of cultural traits that either complement or retard capitalism’s commercial logic (Fukuyama, 1995; Goudzwaard, 1979; Weber, 2001 [1930]), the political success of labour movements to increase workers’ share of the surplus (Silver, 2003), as well as a state’s ability or willingness to ameliorate capitalism’s social ills through development of social welfare (Dore, 2000; Kaufmann, 2013).

It is for these reasons that focusing excessively on economic contradictions arising from the logic of capitalism, an approach common to the Marxist approaches discussed above, cannot provide an adequate analysis for understanding the future evolution of capitalism. Economic contradictions only occur when there is growth. If there is growth this means capitalism is functioning reasonably well from an economic viewpoint. Furthermore, where there is growth and contradictions, there is also a state regulating that growth and its contradictions. This is a crucial factor, since capitalist contradictions such as overproduction, inequality, underproduction, recessions, and banking crises can, and have been, institutionally managed with increasing success as knowledge of the economic system has grown over the past two centuries (Sewell, 2008, p. 520). Chapters eight, nine and ten develop this point further. The point here is that contradictions must ultimately be understood in their real form, which involves varying degrees of institutional management of the economy, as well as non-market distribution of economic wealth through the welfare state, which stabilize capitalist economies over the long-term.

Mann (2013) is also critical of those who regard capitalism as being in terminal decline within a few decades. Like Calhoun, Mann argues that any collapse will be on a time scale of a century or more, and uneven across space. Mann is
critical of analysis of global capitalism understood as a tight-knit singular system whose development is largely determined by the laws of motion of capital. Against that type of theory, Mann has developed a relational and non-systemic conception of social change as an outcome of interacting networks of power (Mann, 2012b). While noting there are potentially many such networks, he argues that the most important historically are ideological, economic, military and political networks of power.

These networks operate ‘as multiple, overlapping networks of interaction’ that constitute different social dynamics which typically operate orthogonally to one another. Or as Mann puts it, ‘they interact but not in a systematic way’ (2013, p. 72). Consequently, Mann is sceptical of analysing any society’s development in terms of a single dominating logic. Mann elaborates his position as follows:

This means that we can only identify up to a certain degree “internal” dynamics within a power source, since each is not absolutely autonomous from the others, and the development of each affects the development of the others. Once we admit the importance of such interactions we are into a more complex and uncertain world in which the development of capitalism, for example, is also influenced by ideologies, wars and states (2013, p. 72-3).

Mann does not deny the importance of economic power in the era of capitalism, but rejects its singular domination over all other networks of power. Consequently, for Mann the end of capitalism cannot simply be a question whose answer is sought only in reference to capitalism’s economic institutions, and only in relation to a select few economies within the global economy. Rather, the question must involve consideration of other networks of power which operate according to a relatively autonomous logic of their own, and how these might bolster or negate ongoing capitalist reproduction.

Conclusion

The above literature review has outlined two prominent positions within political economy debating the prospects of a collapse in the global capitalist system in the
coming decades. These studies emerged in response to the crisis of 2008/2009. Two main themes are evident within political economy: (1) ‘capitalism is ending’ and (2) ‘capitalism is unlikely to end soon’. In contrast to mainstream economic studies discussed in chapter six, the studies falling within political economy have engaged the future of capitalism debate through a socio-historic approach. I have identified a number of debates and points of contention between proponents of both political economy themes. Specifically, the literature review highlights important debates on technological unemployment, the growth potential of the world economy, the significance of the rise of Asia, and lastly, to what extent can the logic of capitalism be institutionally managed. These arguments will be critically assessed in chapter eight.
Chapter 8. No End to Capitalism in the Asian Century

This chapter takes up the key debates identified in chapter seven. The prospect of technological unemployment is investigated. In addition, debates over methodological principles regarding the importance of economic contradictions versus institutional regulation when assessing capitalism, as well as the viability of a Western-centric analysis of global capitalism, are theoretically critiqued. Regarding Western-centric analysis, this entails projecting the conditions in major Western economies post-2008 as representative of the state of the global economy. Here the role of a China-led Asia in boosting world growth is the key point of contention, and will be critically assessed here. This chapter draws upon secondary empirical evidence and institutional-evolutionary theory to critique the structural arguments underpinning the ‘capitalism is ending’ thematic.

The chapter will proceed in five parts. Section one takes up the argument concerning technological unemployment made by Collins (2013). Section two critiques the Western-centric view of capitalism’s demise outlined in the previous chapter. Section three critiques the discounting of a China-led Asia as a central driving force of global growth in the 21st century. Section four draws on institutional-evolutionary concepts of population thinking and the impurity principle to outline the theoretical flaw inherent in the ‘end of capitalism’ arguments based on Western-centric analysis. The final section summarizes.

8.1. Technological Unemployment

Collins (2013) argues that global capitalism faces total system breakdown within a few decades on the basis of a ‘technological unemployment’ hypothesis. This
hypothesis is a long-standing hauntology on capitalism’s demise (Mokyr et al., 2015), and has recently re-emerged within a narrative predicting an automation-driven collapse in global employment (Walker, 2014). As Walker notes on the recent re-emergence of automation anxiety: ‘It seems that hardly a week goes by when there is not some headline about robotics taking jobs’ (2014, p. 8). Historical anxieties about technological unemployment stretch back to 18th century industrialization, with Mortimer fearing that machinery would ‘exclude the labour of thousands of the human race, who are usefully employed…’ (Mortimer, 1772, p. 104). Others viewed the effects of technology on labour as separable into short-run and long-run effects, where the former were typically viewed as negative, while the latter as positive. For example, Ricardo saw technology as benefitting the three main economic classes, landlords, capitalists and workers in the long run. Benefits would accrue because landlords and capitalists would gain cheapened input costs on which a portion of their return on capital depended, while workers would receive cheaper living costs under conditions where increased productivity would expand income and investment and grow the economy, thereby ensuring high demand for labour (Ricardo, 2001 [1821], p. 283).

However, in the short run Ricardo argued that technological displacement ‘is very often injurious to the interests of the class of labourers’ (Ricardo, 2001 [1821], p. 284), since those displaced may not find immediate employment, and may find their skills no longer relevant. Other influential analysts had more radical views regarding the long-term effects of technology. In an essay titled ‘Economic Possibilities for our Grandchildren’ written in 1928, John Maynard Keynes took a more sanguine view of things, arguing that the working week would be a brisk 15 hours within a couple of generations due to economic efficiency (Keynes, [1930] 2010). Keynes viewed technological displacement as the process leading to a new political economy where work would be slowly abolished. Marx had another view again, providing an influential statement on technological unemployment through his law of the tendency for a rising organic composition of capital (Marx, 1991, pp. 317-338).
This law argued that competition required capitalists to constantly replace variable capital (labour) with constant capital (machinery). This causes a reducing total profit rate, since profit (surplus value) is generated by paying labour a wage less than the value it generates. As labour is replaced by machinery, profit levels drop across the economy and unemployment increases (Marx, 1991, p. 343). Unemployment was viewed as generating the grounds for a proletarian revolution that would likely end of capitalism before the falling rate of profit did (Marx & Engels, [1848] 1994). History has thus far failed to match any of the above predictions regarding the impact of technology on unemployment or the profit rate. The question is whether there are legitimate causes for concern this time around?

As discussed in the previous chapter, Collins (2013) analysis draws upon a ‘stripped-down’ Marxism that forgoes the profit rate element in Marx’s theory of technological displacement of labour, in order to focus solely on the effect of technological disruption upon middle class jobs. Collins extrapolates unemployment trends over the past fifteen years in the OECD to develop future trends over the coming decades, predicting an unemployment rate of 50 per cent by 2040. I argue that this is a highly questionable trend extrapolation, for reasons now discussed. First, typically predictions of unemployment have been based on linear extrapolations of existing conditions, and therefore always prone to be disproved by an economic system driven by ‘creative destruction’ (Schumpeter, [1942] 2008, pp. 81-86). The latter refers to the incessant process under capitalism of the continual displacement of old sectors, products and methods of production and the creation of entire new sectors, products and methods of production in the search for temporary monopolies and super profits that are the spoils for creating a new market. As a result of creative destruction there is no long-term linear evolution of existing sectors. The historical evidence shows that new technology combined with entrepreneurial activity has resulted in more new jobs being created than have been made redundant (Bisello, Fernández-Macías, & Hansen, 2018; Mann, 2013; Stewart, De, & Cole, 2015).
Mann (2013, p. 89) points to a number of statistics to illustrate this point. First, Mann notes that between 1950 and 2007 global job growth was almost 40% greater than population growth. During this time it has also been the case that large numbers of women have joined the workforce, vastly increasing labour supply. As a result, while employment has outpaced population growth, the global unemployment rate has hovered around a relatively constant 6 percent (figure 1, below). Mann notes that employment fell in the developed economies post-2008, but increased in all other global regions. His central point is that unemployment in 2013 was a Western economic problem, not a global issue (Mann 2013, p. 89). However, even in the few years since Mann made this statement, unemployment rates in Western economies have recovered significantly (figure 2). For example, unemployment levels after the 2008 financial crisis peaked by 2009 for Japan, 2010 for the United States, and 2013 for the Eurozone, and have since then steadily recovered in all three economic regions.

![Global Unemployment Rate, 1991-2017](image)

*This dataset is harmonized and may, therefore, differ from nationally reported data. Data for 1991-2017 are estimates while data for 2018-2019 are projections. Source: International Labour Organization, Trend Econometric Model (ILO.org/unstatsdata)*

*Figure 1: Global Unemployment Rate, 1991-2017. Source: International Labour Organization*
Contemporary global employment trends show that global employment creation is strong, despite two centuries of technological revolution. Stewart, De and Cole examine how technology has changed the composition of jobs between 1871 and 2011 in England and Wales. Their study reveals that technology has typically displaced ‘muscle power’ jobs, while simultaneously generating higher cognitive and less routine jobs. To illustrate their point they compare employment trends of labour-intensive versus non-routine caring jobs as a percentage of total employment in Wales and England since 1871. In 1871 muscle power jobs accounted for 23.7% of all employment, while caring professions represented approximately 1.1%. By 2011 the respective figures are 8.3% and 12.2% (Stewart, De & Cole, 2011, p. 5). They point out that ‘technology is highly complementary to cognitive, non-routine tasks’ (ibid, p. 5).

This point is illustrative of a recent Eurofound report on the ‘future of manufacturing’ in Europe (Bisello et al., 2018). This report assesses how manufacturing in advanced economies is changing in ways that mean traditional blue collar jobs are becoming white collar. Increased standardisation, regulatory requirements and quality control, all implemented using complex digital systems
across industries such as car assembly, chemical plants and machine operators, meat processing and hand packers has resulted in higher skilled workers, more autonomy and safer jobs. In assessing car assemblers new roles the report states: ‘intellectual tasks are becoming more relevant in areas such as quality control and the use of sophisticated, digitally controlled equipment’ (ibid, p. 17). What this report illustrates is that technology does not necessarily make even blue collar jobs redundant, let alone white collar jobs, but instead makes the most onerous or labour-intensive components of such jobs redundant, while upskilling other aspects of work.

The technological trend has been to reduce routine manual jobs, and increase skilled jobs (Hodgson, 2015, p. 329-330). This point is elaborated in the World Economic Forum’s 2018 ‘Future of Jobs Report’ (Leopold, Ratcheva, & Zahidi, 2018). The Report builds analysis on a survey of predictions of technology impact on work by business executives of 313 companies representing a wide array of industries and 15 million employees. According to business leaders the ‘augmentation of existing jobs through technology is expected to create wholly new tasks…opening up opportunities for an entirely new range of livelihoods for workers (ibid, 2018, p. v). This prediction is supported by Schumpeter’s theory of creative destruction, as well as past historical evidence. The report argues that ‘technology may free up workers from the majority of data processing and information search tasks—and may also increasingly support them in high-value tasks such as reasoning and decision-making’ (ibid, p. 3). This prediction is already a reality in the car assembling work discussed above. Technology is therefore viewed as complementing labour, and setting humans free to engage in higher cognitive functions. History and theory refute the Marxist technological deskilling thesis originally argued by Marx (1990, p. 549, 788), later by Braverman (1974), and now by Collins (2013).

What about Collins second argument concerning offshore outsourcing on the middle classes in the advanced economies? This argument is equally suspect when one examines the dynamics at play in outsourcing and the changing global costs of
production. First, it is true that advances in IT and transport logistics mean that offshore outsourcing has become an established option for cost-cutting for advanced economy firms, especially on labour costs (Cusmano, Mancusi, & Morrison, 2010; Yang et al., 2012). Outsourcing began during the 1970s, with a major acceleration during the 1990s. Furthermore, while the trend began with repetitive and low value production and product assembly, offshore outsourcing then moved towards services and knowledge-based tasks, including R&D (Leiblein, Reuer, & Dalsace, 2002). Thus, Collins is correct in stating this structural change has impacted both blue and white collar workers in advanced economies. But this has not had any clear negative impact on the quantity of employment globally, as the above statistics on global and national employment show, even if it may have impacted groups of workers within a particular economy; for example, displacing some skilled jobs from advanced to developing economies.

However, displacing jobs from economy to economy has no overall effect on global employment, only national employment, whereas Collins predicts a global crisis of employment. Furthermore, there are issues with offshore outsourcing, which alongside recent shifts in factor costs within national markets are resulting in important changes in the practice (Cusmano et al., 2010; Dolgui & Proth, 2013; Pearce II, 2014; Yang et al., 2012). First, it is now recognised that much offshore outsourcing leads to failure (Yang et al., 2012, p. 4462). Issues include the quality of work and ability of buyers to quality control production in vendor economies, difficulties in managing cross-cultural decision-making, and the fact that cost differentials are falling between advanced economies and offshore vendor economies. As low-cost economies become venues for outsourcing they receive large foreign investment flows which boosts growth and development, which in turn increases costs, including labour costs, reducing the competitive gap between developed economies (Pearce II, 2014).

Labour costs, have been rising in economies that are major vendors of outsourcing. For example, labor costs in China are on track to have risen by 750%
between the year 2000, while cost savings of outsourcing to India have dropped to 10% from around 40%—50% (Pearce II, 2014, p. 29). As Pearce points out, these changes have resulted in a shift towards domestic outsourcing, or ‘reshoring’ in the United States: ‘Domestic outsourcing is a fast-emerging strategy among U.S. firms. It involves a company relocating primary and support activities to America that were previously performed outside the country in pursuit of competitive advantage’ (Pearce II, 2014, p. 27). Reshoring is arguably one factor helping to explain the resilience of the U.S. jobs market in recent years. What these trends in offshoring-reshoring highlight is that Collins arguments are based upon a static cost model of global labour costs, whereas such costs are in fact dynamic and shifting constantly.

In a further blow to his thesis of a globally declining middle class, and which links to rising wages in China and other developing economies with large FDI inflows, is the fact that globally the trend for the middle class is exactly opposite to what Collins is arguing. Growth in Asia has been the major driving force behind a milestone in global development reached in 2018. It was in this year that half the world’s population entered the middle class (Kharas & Hamel, 2018), which for the authors means having disposal income for purchasing consumer durables, entertainment such as movies and vacations, and having some savings for periods of financial distress. The Asian economic region currently accounts for 9 out every 10 entrants to the ‘new middle class’ (Kharas & Hamel, 2018, p. 3), a trend that Kharas (2010) predicted in earlier research.

To sum things up, currently the empirical evidence shows that global employment is the highest it has ever been, despite the fact that the information technology revolution that Collins places so much emphasis upon is two decades old. Globally the middle class is larger than ever, and predictions of its growth trend by Kharas (2010) have been born out thus far, with further growth expected in the

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5 See Kharas (2010) for detailed discussion of data collection methodology and how the definition of ‘middle class’ was derived.
coming decade. All the evidence seems to suggest that as has been the case over the past two centuries, technology will continue to be utilised for complementing existing work and entrepreneurial-led creative destruction, resulting in displacement of existing sectors and jobs and the creation of new ones. Of course, perhaps Collins is right and soon no one will be able to think of new ways to use AI to generate new types of work for humans.

However, history shows us that capitalist agents have continually generated new ways of employing labour even as old jobs are made redundant, precisely because profit-making is dependent upon such innovation. Collins fails to provide reasons why this process is now doomed within decades. His analysis hinges exclusively on his own ‘crystal ball’ prediction of the impossibility of future economic innovation. Such a prediction of the future is purely speculative, and runs against Schumpeter’s historically proven theory of creative destruction, as well as current trends in global employment and middle class expansion. Thus as others have suggested in reviewing the literature on technological anxiety, ‘[m]aking specific predictions about the future of technology or the economy is almost always imprudent’ (Mokyr et al., 2015, p. 46). Collins offers nothing to change that view, and much to support it.

8.2. Low Growth and Sovereign Debt

On the question of growth, Mann is critical of studies (e.g. J. B. Foster & McChesney, 2012; Roberts, 2016; Streeck, 2014a, 2016b) which see capitalism’s future demise as a consequence of poor prospects for future economic growth. To the contrary, Mann is right to argue that there is much room for capitalist expansion globally. He points out that only a portion of China and India’s enormous populations have been industrialized, while Africa and Central Asia have hardly begun this process at all. Taking China as a paradigm, Mann notes that the country has already undergone more than thirty years of liberalization and still has significantly cheaper wages than
the West. For these reasons, Mann argues that there is potential for far more than another thirty years of primitive accumulation and industrialization ahead in the world system.

However, even if the more pessimistic predictions regarding potential for global growth are correct, Mann argues one of two possibilities are likely. First, more exploitative and oppressive capitalism could develop in advanced economies, undoing the gains of social democracy over time. A second option, which Mann thinks is quite likely, is that economies will be able to stabilize into ‘enduringly low-growth capitalism’ (Mann, 2013, p. 90). This view is based on the historical observation that low growth was the normal state of Britain for most of the 18th and 19th centuries, when it was the leading centre of industrialization. Mann notes that during capitalism’s big breakthrough in Britain growth never exceeded 2 per cent in any one year, and usually settled around the 1 per cent mark (2013, p. 91). It was only in the twentieth century that growth sped up. Contemporary evidence from Japan’s political economy provides empirical support for Mann’s proposition of the possibility for an enduring low-growth economy. Japan’s so-called ‘lost decades’ between 1990-2010, so named because of low GDP growth averaging at 1.22 per cent annually (World Bank, 2018) has hardly led to what could be described as an economic catastrophe.

Japan is the world’s number three economy measured by GDP, has some of the largest global corporations, and is a technological leader. Unemployment over the ‘lost decades’ period averaged 3.9 per cent, with the highest unemployment rate of 5.4 percent coming in 2002. Inequality between rural and urban regions has decreased during the ‘lost decades’ (Lützeler, 2017), while overall inequality, which is low in Japan relative to other developed economies, has been relatively stable during the 2000s (McKenzie, 2013). Given the close relationship between economics and politics, one might reasonably expect that if low growth was an economic catastrophe there would also be political upheaval in Japan during this period. There was significant electoral reform in 1994 in response to the property market crash of
1992 and ensuing stagnation. However, this was an evolutionary modification of Japan’s post-war politics. Reform was designed to boost political legitimacy by creating a ‘more responsive political system’ for the median voter through stricter political financing rules that reduced the political leverage of big business on politicians (Rosenbluth & Thies, 2010, p. 131). All in all, by early 2018 Japan has experienced almost three decades of low growth with no indication of an impending systemic collapse of its economic system, its political system or its social system. Japan’s low growth decades support Mann’s hypothesis on the feasibility of enduring low-growth.

The historical evidence, for contemporary Japan and a rising 18th century Britain is that low growth of around 1-2% can be sustained for long periods of time. At the very least, that should call us to question the thesis shared by Streeck (Streeck, 2014a, 2014b, 2016b) and Foster and McChesney (2012) that capitalism in the leading economies of the United States, Europe and Japan have been in an ‘endless crisis’ since the early 1970s due to falling growth levels. As outlined in the previous chapter, this argument states that financialization was a response to low growth, with credit being used to boost consumption and debt replacing wage gains for workers. However, once debt increases beyond some unstated level, financialized consumption becomes unsustainable, consumption-led demand collapses and the economy falls into recession (J.B. Foster & Magdoff, 2009; J.B. Foster & McChesney, 2012; Streeck, 2016a).

Streeck sums up the claimed death spiral process as follows: ‘low growth contributes to inequality by intensifying distributional conflict; inequality dampens growth by curbing effective demand; high levels of existing debt clog credit markets and increase the risk of financial crises; an overgrown financial sector both results from and adds to economic inequality’ (Streeck, 2016a, p. 164). Early 1970s to present day is almost fifty years of crisis. One might reasonably wonder whether any society could sustain such a prolonged period of ongoing crisis without extensive political volatility. Yet Western economies have been remarkably stable over this time period.
These studies have focussed exclusively on the economic issues that develop during a business cycle, but ignored the economic benefits that also arise during the same period. In doing so they have presented a misleading and partial account of capitalist development.

Understood as a totality, the capitalist business cycle is one of growth followed by recession. As French business cycle theorist Clément Juglar succinctly put it, ‘the only cause of depression is prosperity’ (Schumpeter, [1954] 2006, p. 1090). In assessing this statement by Juglar, Schumpeter argues that ‘depressions are nothing but adaptions of the economic system to the situations created by the preceding prosperities’ (ibid, p. 1090). Consequently, it is the case that the path to a capitalist crisis is paved with the bricks of economic success, and it is economic success that is the minimal requirement undergirding the political legitimacy of the capitalist state.

The problem with the economic narrative of ‘endless crisis’ since the 1970s found in Streeck (2014a, 2016b) and Foster and McChesney (2012) is that Western capitalism has not experienced one long recession since the 1970s, but rather a number of business cycles, including both growth and recession. This point is supported by a number of studies critiquing claims that the American economy has stagnated since the 1970s (Basu & Vasudevan, 2013; Crafts, 2008; Hossein-Zadeh, 2014). Crafts (2008) points out that the period from the 1980s to 2007 is known as the ‘Great Moderation’ in U.S. macroeconomic literature due to exceptionally low volatility in GDP growth, in tandem with low inflation. He acknowledges that growth slowed down after 1973 in leading European economies, and to a lesser extent in the United States. But a closer look at the United States shows this trend is not catastrophic, and also includes significant periods of reversal. Craft provides evidence of falling productivity in Germany and France since 1973, however, for the United States falling productivity between 1973 and 1995 was strongly reversed during 1995-2004, reaching levels higher than the boom period of 1950-1973 (Craft, 2008, p. 52).
Craft further points to the fact that during the period 1995-2004, the growth of capital for every hour worked increased by 4.3 per cent per year. This figure again beats the 1950-73 period, and reverses the decline during 1973-1995. On the profit rate, he notes that ‘econometric analysis showed that, although profitability experienced highs and lows, there was no downward trend in the net rate of return on capital in the United States in the period 1947–98’ (2008, p. 54). In sum, Crafts argues that talk of an ongoing economic stagnation is ‘seriously misleading when used for the United States to describe the whole period since 1973’ (2008, p. 55). In an extensive review and critique of the literature on the relationship between the rate of profit and economic crisis in the United States based on data going back to the 1940s, Basu and Vasudevan (2013) come to a similar conclusion as Crafts. In doing so, they highlight that ‘the current crisis [2008 Great Recession] was preceded by a period of rising profitability, buoyed by favourable trends in both the profit share and technology (Basu, Vasudevan 2013: 83).

Foster and McChesney (2012) and Streeck (2014a, 2016b) base their predictions for global capitalist decline on developments within the leading economies of America, Western Europe and Japan. What I have shown so far is evidence that Japan has been politically stable under conditions of low growth for almost three decades, while the United States has experienced both low growth periods and high growth periods in the past few decades, rather than prolonged stagnation. Another central argument in the ‘capitalism is ending’ thesis is that many states are now dependent upon debt to maintain growth levels. Japan is the paragon example here, with OECD data showing a debt-to-GDP ratio standing at 237% in 2015, followed by Greece at 183%, and Italy at 157% (OECD, 2018). The history of sovereign debt defaults shows that large national debt piles are indeed unsustainable (Reinhart, 2010), and therefore Streeck (2014a) and others are right to suggest this debt burden will likely result in a debt crisis for some countries in the medium term. Nonetheless, other major economies are far less indebted, for example the United States at 125% cent, and Germany at a paltry 79%. But the more
important question to ask is as follows: Why should unsustainable debt result in the end of capitalism? The fact is that a simple and oft utilized solution exists to unsustainable debt – debt restructuring. Debt restructuring is part and parcel of capitalist economics (Cumming & Fleming, 2015), and is another form of value destruction that occurs during all periods of the business cycle when, for example, firms go into receivership, individuals apply for bankruptcy or when either corporations or individuals seek debt restructuring or write down in negotiation with their creditors.

The concern here is strictly with state debt. Sovereign debt default is a well-established and historically frequent process (Reinhart & Rogoff, 2009; Winkler, 1933). One of the earliest defaults on record is by English ruler Edward III after military defeat in 1340, an act which cost his Florence-based lenders dearly, as the city was hit with a bank run soon after (Reinhart & Rogoff, 2009, p. 69). In fact England was something of a serial defaulter between the 14th and 17th centuries, while France defaulted eight times prior to the twentieth century and Spain thirteen times, with Reinhart and Rogoff pointing to the ‘near universality of [sovereign] default’ (2009, p. xxxi).

While a state will almost certainly pay higher borrowing costs for a time after default, temporary sovereign bankruptcy does not have enduring effects on a state’s ability to borrow, nor are the costs of default as high as one might expect. The Financial Times coverage of Argentina’s state bond auction in 2017 is illustrative of this point:

This week, Argentina startled the markets by issuing $2.75bn worth of century bonds, with an effective yield of 8 per cent. You might have thought this would be a hard thing to sell. After all, Argentina has defaulted on its debts eight times in its 200-year history, with no less than five defaults in the past century alone (Tett, 2017).

The report continues that the auction was over-subscribed due to high demand. In light of the above, and given the historic universality of sovereign debt default,
should the current high levels of debt for countries such as Japan really indicate a coming cataclysm? Japan has reneged on its debt payments once in its modern history, and that during the Second World War. Given the historical evidence on the rather benign effects sovereign bankruptcy has had on countries such as Argentina, if or when Japan does default/restructure its national debt, it is unlikely that the sky will fall down on Japan’s capitalist economy.

Debt is an integral part of capitalist economics. It fuels the business cycle, and allows for the use of future income to drive current development, thus vastly increasing the scope of economic development. When individuals, firms or states take on excessive debt there are mechanisms by which this can be resolved. Debt restructuring is another part of the business cycle, a process that entails value creation during growth and value destruction during recession as the system adjusts to its previous growth. Value destruction during a recession is also the process by which a renewed cycle of growth will eventually emerge. It is the reason that Postone argues that the limit to capital is ‘an asymptotic curve, you get closer and closer to an absolute limit but you never reach it’ (Hamza, Ruda, & Postone, 2016, p. 504). The business cycle is a self-regenerative mechanism, but the Marxist studies assessed above focus on the processes leading to value-destruction, while ignoring or downplaying the processes of renewal. Foster and McChesney (2012) and Streeck’s (2014a, 2014b, 2016a, 2016b) analysis of debt and growth fail to take this regenerative dynamic into full account. This omission compounds the next issue to be discussed, a typological essentialist view of the global economy.

8.3. Global Growth in the ‘Asian Century’

Mann (2013) critiques a view found in the ‘capitalism is ending’ literature that the global economy can be neatly defined as a single global capitalist system evolving primarily according to the logic of capital. In supporting his rejection of the single global system viewpoint, Mann discusses outcomes of both the Great Depression of
the 1930s, and the 2008 Great Recession. Both are often viewed as impacting global economic conditions, notes Mann. However, while the Great Depression devastated Western Europe and the Anglophone economies, Mann points out that China was barely affected, while the Soviet Union, Eastern Europe and much of South East Asia maintained economic growth (2013, p. 77). Mann makes a similar case regarding the financial crisis of 2008, which is often termed the Global Financial Crisis. However, it was Western Europe and the Anglophone economies that were by far worst affected by this crisis. The crisis began in the United States and spread to Europe due to the fact that European banks had bought significant amounts of the fraudulently rated Collateralized Debt Obligations that were at the heart of the crisis (M. Lewis, 2010).

Mann is not denying that the global financial system is highly interlinked. It is, which is why he points to World Bank GDP data showing that ‘almost every country had a difficult 2008 or 2009’ (2013, p. 81) as a result of American and European financial difficulties. However, World Bank data shows that by 2010 many major economies, such as India, Indonesia, Brazil, Mexico, Turkey, Nigeria, Canada, Malaysia, Korea, and Singapore bounced back to all-time GDP growth highs, while China dropped from 14 per cent growth in 2007 to 9.6 per cent growth in 2008, and back up to 10.6 per cent in 2010. In explaining the differential global effects of the 2008 Great Recession Mann argues that ‘many countries got out quickly because they had different structural arrangements, some economic, some political, some ideological.’ (Mann, 2013: 81). Mann’s analysis supports the institutional-evolutionary concept of the ‘impurity principle’ discussed in chapter five, and which will be used for theoretical critique in section four below.

In making these points, Mann illuminates what I argue is a major flaw in studies contributing to the ‘capitalism is ending’ theme. Some of these studies construct a Western-centric model of global capitalism literature (e.g. Foster & McChesney, 2012; Streeck 2014a, 2014b, 2016). In these studies there is a complete discounting of the overwhelming evidence that global capitalism’s growth engine will increasingly be a China-led Asia. Whereas others argue that the 21st century will
be the ‘Asian Century’ due to the region’s rapid economic development since the 1970s (Giovanni Arrighi, 2007; Mahbubani, 2008; Prestowitz, 2005). China has emerged as the central driving force of this development. However the role of Asia and China in boosting twenty-first century economic growth is dismissed out of hand by Streeck (2016b). Highlighting a weak grasp on a key trend in global political economy, Streeck states: ‘Western capitalism will decay, but non-Western capitalism will not take its place, certainly not on a global scale…China will for many reasons not be able to take over as capitalism’s historical host’ (Streeck, 2016b, p. 37). Streeck fails to provide an account of his reasons for saying this. Foster and McChesney (2012) also argue China and Asia will not support global capitalist growth in the coming decades. Unlike Streeck, they spend a chapter developing this position, which I will now review. Following that I provide arguments for why both studies are emphatically wrong in discounting China and Asia as drivers of global growth in the 21st century.

Foster and McChesney (2012) begin their assessment of China by noting that the country’s high rate of growth is dependent on high debt levels, including a $585 billion government stimulus package in 2008 to offset the effects of the Great Recession. They note that this stimulus was mainly invested in fixed capital, and has resulted in dangerous levels of overcapacity. They argue that ‘[f]ew informed economic observers believe that the current Chinese growth trend is sustainable; indeed, many believe that if China does not sharply alter course, it is headed toward a severe crisis’ (2012, p. 156). Next they argue that China’s export-led economy is excessively dependent upon the EU and the United States. One might reasonably wonder what is excessive about the second largest economy in the world, China, having the bulk of its trading relations with the largest economy, the U.S., and largest economic region, the EU. It seems a rather logical outcome. Foster and McChesney argue that China is dangerously over-reliant on a low-wage export model, and that ‘hundreds of thousands of mass incidents’ are now common in China (2012, p. 156), indicating political unrest threatens Chinese capitalism. They
never tell us, however, what exactly these protests are aimed towards. Is it to get rid of capitalism, or is it to get better conditions as capitalist workers? The reference provided to support their claim is from a Chinese newspaper article discussing a local taxi strike, but which also states:

According to official statistics, 280000 “mass incidents” (petitions, demonstrations, strikes) occurred in 2010, against only 87,000 in 2005. These movements, often spontaneous and poorly organized, almost always based on economic demands (China Times, 2011)

Protests for better working conditions and wages are not necessarily a threat to capitalism. Historically such protests have been part and parcel of the dynamic tension between capital and labour over their respective share of economic surplus (Polanyi, 1944; Silver, 2003). Political protests based on economic demands are as old as capitalism, and have served to reinforce capitalism’s political legitimacy when these demands have resulted in improved conditions for labour and the welfare state. Consequently, the existence of mass protests cannot, in and of themselves, be viewed as a threat to Chinese capitalist development.

Foster and McChesney further predict that because current Chinese development is unsustainable and heading for a crisis. This view of impending crisis has regularly resurfaced since Capital, volume one was published in 1867, and wherein a theory of capitalism breaking down due to its internal contradictions was elaborated (Marx, [1867], 1990, pp. 927-930). Critics of political economy that focuses on economic contradictions have argued that proponents tend to overstate the likelihood of economic crisis, conflict and instability while ignoring evident growth and stability (Galbraith, 2014, pp. 76-77; Heilbroner, 1970, p. 21). Heilbroner points out that the Monthly Review predicted six recessions for the United States during 1954-1963, during a period when only two recessions actually materialized. Writing in 1976, Mandel argued that it was unlikely capitalism could survive another fifty years of the continual contradictions and crises it has generated (Mandel, 1976, p. 86). Studies reviewed here predict a similar timeframe of fifty years, but starting
from the 2010s (e.g. Collins, 2013, p. 38). Others such as Streeck provide histrionics but no specific timeline: ‘What is to be expected... is a long and painful period of cumulative decay’ (2014b, p. 64). Whether ‘long’ refers to a matter of decades, centuries, or millennia, Streeck never states. As argued in this thesis, the focus on recession and contradictions is misleading when done without due consideration of how the economic system can return to growth after a downturn turn.

For example, in returning to Foster and McChesney’s claim that China is heading for a recession, their point can be made in a more mundane way in the context of business cycle theory. What they are predicting is that after GDP growth averaging 10 percent annually since Deng Xiaoping began reforms in 1978, Chinese capitalism will have a recession at some point in the future. All they have predicted is what is already long-established theoretically in business cycle theory (Burns & Mitchell, 1946; Mitchell, 1941; Joseph A. Schumpeter, 1934; Sherman, 1991), and which is evident in capitalist history. As discussed earlier the system develops through cycles of growth, followed by a downturn. It is a historical fact that capitalism develops through ongoing series of business cycles. Therefore, the flip side of arguing that a cycle of growth is unsustainable is the equally true claim that capitalist recessions have thus far also proven to be unsustainable. Why should China be any different than Germany or the United States or Britain, all of whom have had numerous recessions in their economic history, after which they entered another growth phase.

This point is important, and thus worth a brief excursion into business cycle history. I noted earlier that the frequency and amplitude of downturns has been reduced over time in the leading economies. Sewell (2008) argues the weakening of the downturn cycle is due to increasingly effective institutional regulation of economic processes. Historical evidence on the business cycle in the United States provides compelling evidence for this point. According to the National Bureau of Economic Research, America’s economy has experienced 33 business cycles between 1854-2009 (NBER, 2012). The structure of these cycles in terms of the length of
expansion periods versus contraction periods has changed substantially over time. The average contraction phase has shortened from 21.6 months in the 1854-1919 period to 11.1 months by the 1945-2009 period. At the same time the average expansion phase has grown from 26.6 months in the first period, to over double that at 58.4 months by the third period, as highlighted in figure 3.

<table>
<thead>
<tr>
<th>Period</th>
<th>Contraction average (months)</th>
<th>Expansion average (months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854-1919 (16 cycles)</td>
<td>21.6</td>
<td>26.6</td>
</tr>
<tr>
<td>1919-1945 (6 cycles)</td>
<td>18.2</td>
<td>35</td>
</tr>
<tr>
<td>1945-2009 (11 cycles)</td>
<td>11.1</td>
<td>58.4</td>
</tr>
</tbody>
</table>

*Figure 3: Breakdown of NBER Business Cycle Data: source NBER (2012)*

It is clear from this data that it is possible to learn to regulate and manage capitalist business cycles so as to decrease the duration of the downturn phase, while extending the growth phase. Statistics on some other major economies are instructive in this regard. World Bank GDP data shows that China has not had a recession between 1976 and 2018, Australia has experienced continuous growth between 1992 and 2018, Poland has seen continuous growth between 1992 and 2018, the Republic of South Korea experienced only one year of recession between 1981 and 2018, while India has experienced only three years of negative GDP growth since 1963 (World Bank, 2018).

Prominent Marxist scholar Ernst Mandel (1970) explains how governments have attenuated the down phase of the business cycle. He points out that expanding social security payments and an ever expanding public sector have reduced the amplitude and duration of capitalist downturns during the twentieth century. Both are ‘anticyclical’ relative to the business cycle (1970, p. 66). As Mandel points out, social welfare and general state expenditure on goods and services puts a floor under the fall in demand arising from unemployment. Likewise, governments may opt to boost spending to replace falling private demand during recessions (Keynes,
1936). By the late twentieth century in developed economies anywhere between 30 to 60 percent of GNP was filtered through government programs (Pierson, 1993, p. 595). This is still the case in 2018. In the OECD state spending as a share of GDP averages 43.7 percent (OECD, 2018b). Spending ranges from a low of 25.2 percent in Chile, to a middle range of 37.6 percent in the United States, to a high of 57.1 percent in Finland. While fluctuating over time in reaction to economic fortunes and ideological tides, this spending is nonetheless relatively permanent, and is in effect a permanent Keynesian-style, anti-cyclical demand-management stimulus, since unlike private investment, the majority of government spending continues during economic downturns as it did prior to the downturn.

In returning the analysis to China, in light of business cycle theory there is no reason why a Chinese recession should mean China’s economy is doomed. Capitalist history shows conclusively that recovery and a new period of growth is the normal follow-on. Likewise, China’s government is highly interventionist in its capitalist economy, showing little qualm about using large-scale Keynesian stimulus policy during economic downturns, as its post-2008 policy intervention highlights. Recession is not an existential threat to China’s economic development. Furthermore, the Chinese state has a proven track record of effectively managing economic development in ways that dampen business cycle volatility.

Another argument made by Foster and McChesney in rejection of China’s ability to sustain its economic development is that China is ‘dangerously’ reliant on a low-wage export economy, and therefore cannot assume the mantle of global economic leadership. Two points are relevant here. First, this claim assumes that China’s economy cannot develop into a high-wage, high-value-added economy. It can. Second, China is already making significant inroads towards this goal, as I now outline. China’s leadership is aware of many issues raised by Foster and McChesney (2012). At the National People’s Congress in March 2007, the Premier at that time, Wen Jiabao, warned that ‘the biggest problem with China’s economy is that the growth is unstable, unbalanced, uncoordinated and unsustainable’ (Ignatius, 2010).
The government has sought to rebalance the economy since then, with three key approaches being central.

The first is to move up to the top of the value-added chain, as indicated in the Chinese Government’s ‘Made in China 2025’ developmental plan (Li, 2017). This government-backed initiative aims to invest billions in R&D to ensure Chinese firms are global leaders in technology, design and high-end manufacturing. The second strategy is its ‘Belt and Road Initiative’ designed to develop its own Asian hinterland as an export outlet (Deepak, 2018), connect China to Europe by land, and project geopolitical influence. The third strategy is to move towards a high-wage, skilled economy based on a balanced export/domestic consumption model. There is much evidence that these plans are bearing fruition. In 2015 a major report on China’s economic development set out to grade it’s progress as a leader in global innovation across four categories: (1) consumer-focussed: ‘involves solving consumer problems through advances in products, services, and business models’; (2) manufacturing focussed: ‘aimed at improvements to reduce cost, shorten production time, and enhance quality in manufacturing’; (3) science-based innovation: ‘involves the development of new products through the commercial application’; (4) engineering-focussed: ‘involves the design and engineering of new products’ (McKinsey Global Institute, 2015, pp. 30-31). This report found China to be a global leader in the first two areas, but needing further development to catch up with the West in the second two areas.

Since 2008 Asian economies have continued to grow strongly, and as noted in a Bloomberg article China’s GDP has surpassed the Eurozone’s in 2018:

In another sign that the “Asian century” has arrived, China is on course to overtake the euro area in the size of its economy this year. China’s gross

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6 In January 2017 the first commercial train arrived in London, having set off from Yiwu in East China 16 days earlier. As The Guardian noted: ‘Faster than a ship, cheaper than a plane… the journey marks a new departure in the 21st-century global economy’ (The Guardian, 2017).
domestic product is forecast to reach about $13.2 trillion in 2018, beating the $12.8 trillion combined total of the 19 countries that use the euro (Jamrisko, 2018).

While China’s growth rate has slowed between the years 2010-2018, this is a relative slowdown, since it has gone from an average of 10 per cent throughout the 2000s to stabilize around 6.5 per cent during 2015-2018. The Asian economic region was responsible for 50 per cent of global growth during 2000-2010 (Huang & Wang, 2011), accounted for 60 per cent of world growth in 2016, and has seen growth rates hovering just shy of 6 per cent each year between 2015-2017, with a forecast of 5.7 per cent growth for 2018 (Asian Development Bank, 2017). The Financial Times reported in early 2017 that average wages in China’s manufacturing sector have trebled in the past decade and ‘have soared above those in countries such as Brazil and Mexico and are fast catching up with Greece and Portugal’ (Steve Johnson).

China is producing growing numbers of global corporate behemoths, including world e-commerce and entertainment firms Alibaba Group and Tencent Holdings, and Huawei Technologies, which in early 2018 is the world’s largest maker of telecommunications equipment and third largest smartphone manufacturer (Bloomberg, 2018). In 2015 China overtook the United States as the world’s largest e-commerce market (Chandler, 2017). Chinese capital is now a global force in mergers and acquisitions, and is now the second biggest spender after American capital (Avendano, Melguizo, & Miner, 2017). China has sponsored the creation of a new global investment bank, the Asian Infrastructure Investment Bank (AIIB), as an alternative to the World Bank, invests more in Latin American and Africa that the United State, and despite its status as a ‘developing’ economy ‘is emerging as the world’s largest investor’ (Dollar, 2017, p. 3).

China, with its internal market of 1.3 billion citizens, a single-party government with enormous experience in creating and successfully implementing national development plans (Li, 2017), a new and growing global presence through foreign investment, and global institutions such as the AIIB, is realizing its potential
to become the world’s biggest economy in absolute quantitative terms, and in qualitative terms as a technological leader in many sectors. China is the economic engine driving the Asian Century. Theory and history both support Foster and McChesney’s (2012) prediction that there will be an economic downturn, recession or even crisis in China sometime in the future, but in and of itself that is hardly much of a prediction for the future of any capitalist economy. Studies which dismiss China and Asia as irrelevant for the future of global capitalism, are profoundly out of touch with the political economy of that region.

8.4. Population Thinking, Impurities and Global Capitalism

From the perspective of institutional-evolutionary economics, conceptualizing the global economy in terms of a representative model where a part stands for the whole is a form of typological essentialism. The latter represents theory that abstracts from variety in a population in order ‘to concentrate instead on an average, typical, or representative individual that served as a surrogate for the whole species’ (Hodgson, 2015, p. 31). In the analysis presented by Streeck (2014a, 2016) and Foster and McChesney (2012) the economies of the United States, Western Europe and Japan stand as a surrogate for the entire global political economy. This section now draws on the concepts of population thinking and the impurity principle, discussed in chapter five, to bring into relief the central theoretical flaw in Streeck and Foster and McChesney’s analysis.

In making their arguments, Streeck (2014a, 2016) and Foster and McChesney (2012) build a model of global capitalism that abstracts from global capitalist variation, both at the level of economic development, and at the level of the political systems regulating economic life in nation-states. This sort of abstraction is a valid and normal strategy in science when seeking insights on parts of a system. However, to understand the whole requires that other elements are brought back in to the model at a later stage (Hodgson, 1995b, 2015). If the wider system under study is a
complex system of multiple, interacting entities, each of which wield some degree of causal force over total system outcomes, as is the case with the global political economy, then isolation of only some of the system is unlikely to be adequate to characterise the whole. Unless the abstracted elements are of such little influence that they can be safely ignored. This is not the case with China and the Asian economic region when modelling global capitalism.

In the case of Streeck (2014a, 2016) and Foster and McChesney (2012) we see a construction of a representative cohort of economies which are then claimed to stand for the whole global economy, resulting in the suppression of variation across the world economic system. The model hides the fact that many large and important economies are experiencing high growth rates, and have substantially different socio-political models of regulation which at any given moment generate differential levels of political legitimacy and growth potential (Bohle, 2018; Carney, Gedajlovic, & Yang, 2009; Johnston & Regan, 2018; M. Witt et al., 2017). Hodgson argues that if existing variation is not brought back into a theoretical model at a later point after initial abstraction occurs, then representative modelling is destructive of analysis of the evolution of complex systems (2015, p. 31). This is because it is variation across a population of entities that provides the energy by which evolutionary change occurs (Hodgson, 1993; D. D. Johnson, Price, & Van Vugt, 2013; Nelson, 1991).

The argument then follows that the existence of multiple forms of capitalism globally must be conceptualized in terms of population thinking, and not in terms of representative modelling. In addition, as discussed in chapter five the ‘impurity principle’ conceptually supports the need for population thinking in understanding global economic variation. The principle outlines why it is the case that socioeconomic systems always rely on other, structurally dissimilar subsystems, in order to reproduce themselves over time (Hodgson, 1988, 1993, 1996, 2015). Two important institutions which all national capitalist reproduction relies upon, but which are structurally dissimilar to the market institution, are the family and the
Here I consider the role of the Chinese state and its role as an impurity determining significant aspects of the development of China’s variety of capitalism. China’s development highlights the significant successes of its state-led economic liberalization programme, which have allowed it to become the leading economic power in Asia, and a geo-economic rival to the United States. Such has been this success that studies on China’s state-led economic development view the nation’s rise as a significant challenge to Western models of market-led economic development (Arrighi, 2007; Campbell, 2008; Strange, 2011; Hui, 2006). Arrighi has provided the most developed and sustained argument for this view. He argues that some of the most important factors shaping China’s unique form of capitalist development are the Mao-era Cultural Revolution and the Communist Party’s response to that revolution (2007, pp. 367-378). Mao’s Cultural Revolution occurred during the ten years of 1966-1976. The Deng reforms that initiated market liberalization began in 1978.

Arrighi argues that Deng’s economic reforms were a reaction to the chaos of the Cultural Revolution years, and had wide support ‘inside and outside the Chinese Communist Party’ (2007, p. 368). However, as Arrighi points out, while the Communist Party fully repudiated the Cultural Revolution, it maintained its support for the Chinese Revolution, the socialist values underpinning the revolution, and even Mao Zedong thought. Arrighi points to Hui’s analysis of two significant consequences of this political history for later development:

First, the socialist tradition has functioned to a certain extent as an internal restraint on state reforms. Every time the state-party system made a major policy shift, it had to be conducted in dialogue with this tradition... Secondly, the socialist tradition gave workers, peasants and other social collectivities some legitimate means to contest or negotiate the state’s corrupt or inegalitarian marketization procedures (Hui, 2006, pp. 44-45).

Regarding the first point, the socialist tradition is still central to the Party’s ideology, as the most recently updated Communist Party’s Constitution (2017) highlights. The
section titled ‘General Programme’ opens with the claim that ‘The Communist Party of China is the vanguard of the Chinese working class, the Chinese people, and the Chinese nation. It is the leadership core for the cause of socialism with Chinese characteristics’ (General Programme, 2017, p.1). The document is replete with similar referrals to revolutionary socialism as the final goal of economic reform. In real policy terms, adherence to this tradition during capitalist development has meant that the Chinese state has taken a ‘far more selective’ approach, and on its own terms, to market liberalization that other developing countries (Arrighi, 2007, p. 356).

Even when negotiating entry in the World Trade Organization during the early 2000s China resisted pressure by other leading members to liberalize on Western terms, and while some compromises were required was able to continue with its own model, as a World Bank report noted: ‘While the agreement will involve widespread reductions in protection, it cannot be represented as a move to free trade or a simple proportional cut in protection as many studies have tried to do…China will still be far from fully open after the reforms’ (Ianchovichina & Martin, 2001, pp. 1, 2). The Chinese state has remained highly interventionist in planning and executing largescale economic planning both alongside private activity, and to direct it (Li, 2017). Arrighi notes that worker’s rights during China’s liberalization have been comparatively ‘more generous’ than rights in nation’s at similar or higher levels of development (2007, p. 360). Wei and Price point out that worker’s rights and employment matters have been a central concern for the Party, and are an area where extensive legislation has occurred (Wei & Price, 2014). Both Arrighi and Wei & Price view comparatively favourable workers’ rights as a direct consequence of the Chines State’s socialist tradition.

As noted above, a second outcome of the Party’s continued legitimation of, and its own legitimacy through, the nation’s socialist revolutionary tradition, is that it emboldens the citizenry to politically contest issues they are unhappy with (Hui, 2006, Amin, 2005, p. 274). In 2006 increasing unrest at growing inequality between rural and urban regions was successful in forcing the Party to expand benefits such
as healthcare, education and social welfare for farmers (Arrighi, 2007, p. 16). Similarly, a new Labour Contract Law that came into effect in 2008, was a direct result of increasingly large-scale protests by migrant workers (Wei & Price, 2014, p. 123). A further conclusion one might reasonably draw here, is that a lack of widespread anti-capitalist protests indicates general satisfaction amongst the population with the economic path the country is on.

The unique political history of twentieth century China, and the Chinese Communist Party, have coincided to generate a unique impurity in the form of Chinese state regulation and planning of its capitalist market development. Chinese capitalism has generated a distinctive model of capitalism, one that has met with unparalleled development successes. China’s model offers other states options for imitation in the policy arena, for example, on how to use economic planning effectively in combination with private-sector development. From an evolutionary perspective, policy variation that is tested in the environment across nation-states is the crucial element upon which selection processes operate. The impurity principle helps us to conceptualize why such variety in global capitalist development is unavoidable, because each nation has unique aspects within its subsystems. Population thinking provides a means through which we can conceptualize the dynamic relationship between variety and essence in the evolution of a complex system such as the global economy.

This chapter has focussed attention on sources of variation that cause capitalism to be different across space. However, it is important to keep in sight the fact that all capitalist economies do share the same basic set of institutions, what can be accurately termed as analogous to a species essence. This means that alongside the dynamic generation of ongoing innovation and wealth, these economies share a similar set of fundamental issues and political tensions connected to the way capitalist institutions work. In chapter five we saw that some studies make the argument that these capitalist commonalities across national economies are more
important than capitalist variation in determining political economic outcomes and evolution (Bruff, 2011; Jessop, 2014; Streeck 2010).

I have critiqued this either/or position as a false dichotomy, one that is destructive of a theory that can capture the actual conditions of the global political economy, its distinct national spaces of regulation and their impact on global economic evolution. The argument from institutional-evolutionary theory is that both commonalities and variation must be considered for an adequate theoretical explanation of contemporary economic conditions, and to generate a realistic theory of economic change.

**Conclusion**

This chapter has engaged a critique of the political economy studies that argue global capitalism is in terminal decline over the next five decades. One argument is the prediction of extensive technological unemployment for the middle classes. I provided evidence to show that there are weak grounds, empirically and theoretically, to assume an employment apocalypse is eminent. A second argument is that Western capitalism has entered a period of irreversible low growth and stagnation that will result in the breakdown of world capitalism. The necessary addendum to this argument is that developments across a China-led Asia are irrelevant to the future prospects of the global economic system. Likewise, I find the argument that China and Asia are irrelevant to the future of global capitalism to be astonishingly out of touch with developments in the region, and what they portend for the future of global economic development. The empirical evidence supports the view that at the global level capitalism is in robust shape, and that the 21st century with be the Asian century, from an economic perspective.

Based on the evidence in this chapter, there are no convincing grounds to predict a global economic breakdown in the coming decades. A central issue undermining the ‘end of capitalism’ analysis is its failure to account for increasingly
effective institutional regulation of the business cycle. Critical political economy tends to focus on economic instability and crisis, and to underplay or discount altogether the ways in which a crisis only arises after sustained growth has occurred. Furthermore, crises can be either amplified or ameliorated through a wide variety of institutional frameworks in which national capitalisms have developed historically. Data on business cycles in the United States and elsewhere, show that growth phases of the business cycle have become longer and contraction phases shorter and less severe during the past century.

Part III of this thesis argues that effective forms of institutional regulation of capitalism have tended to diffuse across capitalist economies over time, thereby reducing variation and resulting in convergence. A crucial area where institutional regulation has grown in effectiveness over the past two centuries is the financial system. Finance, banking and credit-creation are at the heart of all functioning capitalist economies (Hodgson, 2015; Joseph A. Schumpeter, 1934). For this reason a full-blown banking crisis threatens the entire economy. In Part II of the thesis I argue that bank bailout policy developed since the 18th century has been crucial to preventing the most dangerous type of banking crisis, a crisis of systemic risk where bank runs, a loss of confidence in banking money and a full breakdown of the payments system occurs.

In the following chapters I outline how financial regulatory institutions have evolved under the duress of economic crises, and how initial variation in policy addressing systemic risk has reduced and institutionalized over time to a single policy that today is a global bank bailout standard. Consequently, Part III is about institutional convergence and capitalist commonalities. I identify the structural logics at work in driving this institutional evolution, the domain-specific mechanisms through which evolution has occurred, as well as the limits that political agency faces when attempting to regulate or negate undesired aspects of a given social system. In sum, Part III argues that the development of bank bailout policy is a case of Darwinian institutional evolution, where institutions act as
efficient units of selection within a process of variation-selection-retention. Understanding how the financial sector and its regulatory institutions have evolved provides insights into the possibilities for regulating the financial sector, and by extension the wider economy.
Part III: Crisis and Institutional Evolution
Chapter 9. Financial Crisis and ‘Too big to fail’ policy

This chapter assesses the future of capitalism through a case-study on the institutional evolution of bank bailout policy. Drawing on the theoretical resources from Part One of the thesis, this chapter will provide an institutional-evolutionary analysis of what I argue is the most significant global institutional response to financial crises and systemic risk, the policy of bank bailouts, colloquially known as ‘Too big to fail’ (Acharya, Beck, Evanoff, Kaufman, & Portes, 2014; Gup, 2004a, 2004b; G. Kaufman, 1990; Moosa, 2010; Sprague, 1986; Stern & Feldman, 2004). The first recorded bank bailout of a modern financial system was in the United States in 1792 (Sylla, Wright, & Cowen, 2009). Fast-forward to the Global Financial Crisis of 2008 and bank bailout policy has diffused globally to become an institutionalized response to banking instability (Gup, 2004b; Mishkin, 2006; Stern & Feldman, 2004).

I argue that this global diffusion of ‘Too big to fail’ over the past two centuries provides a prime example of institutional evolution in action. A process of variation, selection and retention has winnowed down initial variation in historical responses to possible financial sector collapse to one policy option, a state-backed guarantee to bail out the financial system. Understanding the past is a prerequisite for gaining insight into possible futures. Consequently, historical study of bank bailouts will contribute to understanding the future evolution of capitalism by providing insight into the historical evolution of institutional resilience to the most dangerous type of financial crisis, a crisis of systemic risk.

This chapter will proceed through six sections. Section one discusses definitions of banking crises, in order to develop a clear account of these events, their
causes, and their implications. Section two traces out two centuries of institutional innovation and variation in how various governments solved the risks of bank failure during crisis, beginning in 1792 and the first financial crash in the United States of America. Section three looks at the modern origins of today’s state-managed bank bailout policy. Here the development of bank deposit insurance in response to the Great Depression laid the grounds for the formal institutionalization of modern bailout policy during the 1980s. Section four examines the U.S. banking crisis of 1984, when Continental Illinois became the largest bailout in history, at $41 billion, dwarfing previous bailouts. In the aftermath of Continental it was officially acknowledged that the eleven largest U.S. banks were considered ‘Too big to fail’. Section five argues that this history of bailout policy exhibits a dynamic of variation, selection and retention, and therefore is a case of Darwinian institutional evolution. The final section summarizes.

9.1. Defining a Banking Crisis

Many institutional innovations have occurred during crisis moments. Grossman documents four elements he considers to have been central to ‘banking evolution’ as ‘crises, bailouts, merger movements, and regulation’ (Grossman, 2010, p. xviii). In this and the following chapter I focus on crises, bailouts and regulation. Furthermore, where Grossman uses the term ‘evolution’ according to its common usage of implying general change or development, I will use the term in its strict Darwinian sense of referring to change disciplined by a process of variation-selection-retention. Financial crises have been a recurrent theme throughout the history of capitalism (Aliber & Kindleberger, 2015; Reinhart & Rogoff, 2009). Kindleberger and Aliber (2015) document over fifty major financial crises since the early 17th century. Reinhart and Rogoff (2009) catalogue an even greater number of financial crises, including sovereign debt-defaults, banking crises and currency crises going back to the 13th century. Laeven and Valencia (2012) identify 147 banking
crises globally between 1970–2011. These crises have shaped the development of banking institutions globally (Grossman, 2010).

A financial crisis need not lead to a banking crisis, since the latter is a narrower category of the former. However, a banking crisis will always result in a financial crisis because of the crucial functions of a banking systems in a modern economy. This is due to a number of factors. First, the majority of all legal payments go through the banking system; second, banks provide short-term operating credit for businesses and for consumer credit, and provide long-term credit for business development and housing mortgages. If these functions suddenly breakdown then a full-blown financial and economic crisis will occur. Banking is fundamental to a modern economy.

But what exactly does a banking crisis entail? A good start is to first identify a stable banking system. One definition of a sound banking system is where ‘most banks (those accounting for most of the system’s assets and liabilities) are solvent and likely to remain so. Solvency is reflected in the positive net worth of a bank, as measured by the difference between assets and liabilities’ (Lindgren, Garcia, & Saal, 1996, p. 9). Thus, a banking crisis arises when the banks that account for the majority of assets and liabilities become insolvent for whatever reason. Friedman and Schwartz (1963) argue that the defining feature of a banking crisis is a large increase in the currency-to-deposit ratio in favour of currency as a result of withdrawals, but with the exact level at which this ratio must be for a crisis to exist is not specified. This definition falls under the more general solvency definition of Lindgren, Garcia and Saal (1996), since large withdrawals of deposits from a banking system would be one means by which bank solvency would be severely reduced.

Sudden, largescale withdrawals of deposits from banks are called ‘bank runs’ (Grossman, 2010, p. 56), and are highly dangerous to financial stability. These occur when there is a loss of confidence in a bank, or the entire system, the result of which threatens financial collapse. It is important to briefly discuss here how the financial structure of modern based on a fractional reserve system is susceptible to bank runs.
In fractional reserve systems a large portion of a modern bank liabilities are payable on demand, for example demand deposit accounts, whereas most of a modern bank’s assets are illiquid and thus not easily convertible to cash, for example mortgage loans (Grossman, 2010). Modern retail banks are typically required to have a cash reserve as a percentage of total liabilities in order to cover current on-demand payments, while the remaining funds can be loaned out, hence the name fractional reserve lending. In the United States banks with deposits over $123 million are Federally stipulated to hold ten percent in reserve (Federal Reserve, 2018). The specific amount of legally required reserve has varied historically across national jurisdictions (Zardkoohi, Kang, Fraser, & Cannella, 2018). The rest of the bank’s deposits are used to fund less liquid investments such as short and long-term lending.

The benefits of the fractional reserve system is that it allows banks to engage in extensive credit-creation (Joseph A. Schumpeter, 1934). For example, if the reserve is set at ten percent, banks can lend out nine tenths of all deposits. Loaned out money used as payment and which then ends up as the receiver’s bank deposit can also be lent out fractionally, thereby massively multiplying base deposits into a far larger superstructure of credit. This banking money provides the basis for entrepreneurial credit and capitalist growth (Joseph A. Schumpeter, 1934). The risk inherent in fractional reserve lending, however, is that when some banks fail during a crisis, mass panic can ensue and depositors, who typically do not know which banks are sound and which are not, begin withdrawing their deposits from all banks. This results in a ‘bank run’ due to ‘substantial deposit withdrawals from sound institutions’ far beyond their available fractional reserves (Grossman, 2010, p. 84). Withdrawals cannot be fully met, causing more panic, threatening the entire banking system and wider economy in a self-amplifying feedback loop (Mishkin, 1991). Solving bank runs through the policy of deposit insurance has been a key development in stabilizing capitalist banking systems (Goodhart, 1999; Mishkin, 2006), and will be discussed further in section three.
Grossman points out that an ‘isolated bank failure does not constitute a banking crisis’, unless that bank is of such systematic importance that it would lead to contagion’ (2010, pp. 58-59). Building on the above definitions of a banking crisis, Grossman defines a crisis as a situation that includes the following three elements: 1) ‘A high proportion of banks failed’, 2) ‘an especially large or important bank failed’, and 3) ‘failures of the type described in (1) or (2) were prevented only by extraordinary and direct intervention by the government or some other actor’ (Grossman, 2010, p. 59). He goes on to note that intervention may include declaring a public holiday to temporarily close the banking system, or major reorganization or nationalization. Similarly, Laeven and Valencia view a crisis as systematic if there are widespread signs of financial distress indicated by ‘significant bank runs, losses in the banking system, and/or bank liquidations’ (Laeven & Valencia, 2012, p. 4). It is under such conditions that typically leads to major government intervention.

9.2. Initial Variation in Bank Rescue Policy

This section will trace the rise of modern banking regulations as a result of institutional innovations in response to crises during the 18th and 19th centuries. The first crisis discussed is the U.S. financial panic of 1792. This crisis is recorded as America’s first financial crash, and the crucible in which the country’s modern financial system was forged by Alexander Hamilton, the country’s first Treasury secretary (D. J. Cowen, 2000a, 2000b; Sylla et al., 2009). The crisis came at a crucial period for the newly formed country. Republican anti-Federalists were critical of Hamilton and others who sought to develop federal institutions, including a central bank (Grossman, 2010, p. 225). Hamilton has gained Congressional approval in 1791 to establish the Bank of the United States (BUS) as a tool for implementing Federal goals for national economic development, and for improving the fiscal capacities of the nascent federation. While these goals were ultimately successful, with the bank playing a seminal role in American economic development during the twenty years...
after its incorporation in 1791 (D. J. Cowen, 2000b), it almost backfired spectacularly in the first year of the bank’s life.

Hamilton’s BUS was heavily involved in creating the conditions that triggered the 1792 crisis (D. J. Cowen, 2000a). During the first two months after it opened its doors in December 1791, the bank flooded the market with credit, which was used by speculators who tried to corner the market in U.S. debt securities and BUS stocks (D. J. Cowen, 2000a, p. 1043). When Hamilton tried to quell what he viewed as excessive speculation, the bank sharply restricted credit in February of 1792 and in doing so inadvertently triggering a market crash. If the crisis had not been resolved quickly it would have been a political disaster for the Federal government.

According to Sylla et al. (2009), Hamilton’s goal with the BUS was to develop a robust market for U.S. government debt, in order to provide the Federal government with reliable funding. Thus, the incorporation structure of BUS was devised with this in mind. The Federal government took a 20 percent stake, and private investors were offered the remaining shares, ‘one-quarter of which was payable in specie (gold or silver), and the remainder to be payable in the new U.S. debt securities’ (Sylla et al., 2009, p. 67). By requiring three-quarter payment in U.S. debt securities Hamilton’s goal was to generate an initial market for government securities. By late 1791 he got more than he bargained for as markets for bank shares and government bonds became volatile and speculative bubbles:

The BUS direct public offering led to six weeks of heated financial speculation, the likes of which had never before been witnessed in America. Bank scrips purchased at $25 quickly doubled in price…In early August, they soared, reaching a bid of 264-280 asked in New York on August 11, and reportedly more than 300 in Philadelphia the same evening. Then they tumbled, in Boston from 230 on August 12 to 112 on August 14, to 154-59 in New York on August 16, and to 125-37 in Philadelphia the same day, before rallying later that month. Government bonds also rallied, sixes jumping from 90
in early July to 112.50 in Philadelphia on August 13. Then they fell to 100 by August 17, prompting Hamilton to swing into action (Sylla et al., 2009, p. 71).

Hamilton began government-backed open-market operations using the private Bank of New York, because the BUS was not yet fully functional, to steady the market. This initially had a calming effect during the latter months of 1791, however by March 1792 a collapse of 25 percent in the price of government bonds called ‘sixes’, (paying 6% interest), heralded a new phase of panic threatening to derail Hamilton’s financial revolution. Hamilton stepped up his response, beginning ‘a series of lender-of-last resort operations that would last for several weeks’ (Sylla et al., 2009, p. 78). This involved channelling loans to support banks under pressure due to the depreciation in bonds, as well as ‘authorizing a further $100,000 of open-market purchases of sixes at par’ (ibid, p. 79), thus paying above the going market rate and putting a floor under speculator losses. Hamilton also involved the New York bond dealers, getting them to ‘collateralize U.S. bonds at the prices Hamilton had suggested’ (ibid, p. 81), thus utilizing a novel mix of government and private institutions.

His approach worked, and the financial panic receded by mid-April 1792. Hamilton also avoided political rancour that would have arisen if it were known his efforts involved a bailout of private banks and investors by protecting them from further losses. Hamilton framed his purchases of bonds as actions aimed at reducing government debt, which anti-Federalist Republican’s supported (ibid., p. 84).

Hamilton restored market confidence and a period of stability followed that was not breached again until 1819 (D. J. Cowen, 2000a). His legacy was to leave America with a modern financial system, characterized by ‘stable public finances and debt management; stable money; an effective central bank; a functioning banking system; active securities markets; and a growing number of business corporations, financial and nonfinancial’ (Sylla et al., 2009, p. 62). He also devised strategies such as open-market operations and lender-of-last-resort that have become mainstay responses to financial panic.
Grossman (2010, pp. 86-96) identifies the next four 19th century bank crises and bailouts to be discussed. First I turn to Australia 1826, and the bailout of Bank of New South Wales in Australia (Grossman 2010, p. 87-88). The bank had a virtual monopoly in New South Wales during the 1820s boom in the region. It was highly profitable, paying dividends as high as 53.5 percent in 1826. In attempting to further increase this rate of profit, the bank ‘began to over-issue notes’ while simultaneously new competition from Bank of Australia entered the lucrative market (ibid, p. 88). This led to a drain on deposits, as investors bought shares in the new bank. Cash drain threatened the banks solvency and forced it to apply for government support. Given the extent of the banks operations in the state, and the threat its collapse posed to the economy, the government approved the loan. However, the bank had to accept a number of conditions. These included the government gaining authority to appoint three directors, the bank reducing its lending by one quarter over nine months, and the bank having to call up its unpaid capital to support its solvency (ibid, p. 88).

The reasons for these stipulations was to avert the moral hazard the precedent might otherwise generate (Grossman 2010: 90). ‘Moral hazard’ is a term that originates from the insurance literature, and refers to situations where insurance prompts the insured to act more reckless than they would without insurance (Grubel, 1971). In banking, it refers to the danger that bankers confident of a bailout will behave in ways that cause the need for a bailout. Moral hazard has been a major concern and point of political contention for authorities engaging in banking sector rescues since at the late 18th century (Grossman, 2010; Sylla et al., 2009).

Next is the bailout of the Bank de Belgique. This bank became a candidate for bailout in 1839 after it was put under pressure to redeem large amount of its notes by another large financial institution, Société Générale, which had sought the redemptions for political reasons. As Grossman discusses, the politics revolved around the Dutch King William of Orange-Nassau’s refusal to acknowledge Belgium as a sovereign state. The Bank de Belgique had been established shortly after the
Belgian Revolution of 1830 as a ‘counterweight’ to the King William-backed Société Générale. The latter sought to use financial tactics to collapse the Bank de Belgique by presenting large redemption claims. The Belgian government had initially refused to help prior to suspension of payments, but quickly changed its approach when the economic effects became clear:

The bank’s suspension soon began to affect commerce and industry: companies were not able to obtain funds to meet payrolls and other current expenses, and pressure began to mount for politicians to do something about the crisis. By December 22, the Minister of Finance brought a proposal to Parliament to assist the bank…In reporting back to Parliament, the commission of inquiry appointed by the government acknowledged that moral hazard might be engendered by such a precedent, but that the danger of not dealing with the threat was even more dangerous’ (Grossman, 2010, p.89)

This case highlights the centrality of major banks to a capitalist economy, as well as indicating the political motivating factors that can act as drivers of public assistance for private banks, despite the moral hazard and conflict with free market principles.

In Germany 1848 the Schaaffhausen Company, the largest private bank in the Rhineland at the time faced collapse during a national financial crisis, when the bank became illiquid (Grossman, 2010). This occurred, despite the fact that the value of its assets exceeded the value of the bank’s liabilities. However, the assets could not be converted to cash due to the national crisis. Moral hazard was a major concern of the Prussian state authorities engaging the bailout. They therefore specified relatively onerous conditions and limitations on any support. The bank was to be re-structured in such a way that its creditors were made shareholders, making them directly liable for the bank’s ongoing activities. Half of the share total was guaranteed by the Prussian authorities an annual dividend of 4.5 percent, with back payments of 10 percent per year for a decade. The remaining shares had no guarantee, and were limited to 4 per cent payments per annum. The shares left in the hands of the original owners, who had in effect being stripped of that ownership by being
demoted to part-shareowners, and were not to receive more than 2 percent per annum through to 1858. The Prussian authorities were given power to choose one of the bank’s three directors. Lastly, the fiscal cost to the Prussian Treasury was strictly limited to paying the agreed dividends. These strict stipulations were aimed squarely at ameliorating the politically contentious effects of public authorities helping private institutions, as well as averting moral hazard.

Next we turn to France 1889, and the Comptoir d’Escompte, a Paris-based bank founded in 1848 that had become central to France’s developing financial sector. The bank lent large sums to a metals company that tried to corner the copper market during the 1880s. This strategy failed when copper prices collapsed in March 1889. Knowledge of the bank’s exposure to this collapse led to a bank run. With a large possibility for contagion the Bank de France guaranteed 100 million franc loan to short-circuit the run. But the Bank de France only did so on the condition that a number of private banks subscribe to the guarantee and share liability with the authorities. The private bankers refused initially, until the government threatened to make public their unwillingness to support the general interest alongside the government in resolving the crisis. Here Grossman notes: ‘The government’s role, then, was to encourage, and, if necessary, threaten the bankers to subscribe to the guarantee for the Comtoir’s debts’ (Grossman, 2010, p. 92) This strategy appears to have provided the necessary motivation, since the private banks subsequently agreed to support the plan.

A bailout in 1890 of Baring Brothers occurred under similar conditions of coercion. The rescue plan involved ‘dragooning’ the wider private financial community into accepting part-liability for the rescue, which would involve liquidation of the bank’s assets, ‘along with the personal fortunes of a number of its directors’ (Grossman, 2010, p. 94), and using the sales to pay off claims against the bank, which was re-incorporated as a limited-liability company. The guarantors would be liable for the difference sold assets and the bank’s total liabilities due.
Instances of large banks that were refused bank bailouts during the 19th century are also instructive of the political economy through which bailout policy has evolved. The City of Glasgow Bank was denied a bailout by the Committee for Scottish banks on for more pragmatic reasons in 1878. The bank had expanded aggressively in the decades prior, and was one of the largest in Scotland by 1878. During that year the bank ran into major solvency difficulties and requested help from the Committee. They refused ‘on the grounds that the bank’s affairs were in a terrible state’ (Grossman 2010: 96), and that no viable rescue was possible. In fact, the directors were later tried and sentenced to prison for fraudulent accounting and falsifying bank statements (Grossman 2010, p. 96). Two large French banks were denied help during the 19th century, Crédit Mobilier in 1868 and Union Générale in 1882 (Aliber & Kindleberger, 2015; Grossman, 2010). Refusal this time was also on the grounds that both banks were completely insolvent, with Union Générale accused of falsifying its books during aggressive expansion during the French railway boom of the 1870s.

Kindleberger and Aliber also note that during the 19th century the French authorities were resolutely against financial bailouts on the ideological grounds that the policy encouraged moral hazard (2015, p. 261). Thus, the French approach was to let banks fail, and let losses fall as they should in a policy of non-intervention. Nevertheless, as discussed earlier, the French authorities did bailout the Comptoir d’Escompte in 1889. Why the change in policy? Kindleberger and Aliber suggest that the French authorities recognised the limits of their non-interventionist approach and acknowledged that ‘a second large bank failure in seven years might have completely destroyed the French banking system’ (2015, p. 265). This point highlights the growing recognition by state authorities of the need for credibility and general confidence in a financial system in order for it to function, and with that recognition a growing view that the costs of non-intervention could be greater.

The last example in this section, and our first twentieth century banking crisis further highlights this point. Between May 1918 and February 1923 Norway had the
most devastating financial crisis of its history, with the main index at the Oslo Stock Exchange falling 73.6 percent during the period (Grytten & Hunnes, 2010). It was the effect of this crisis that led the Foreningsbanken, Norway’s largest bank of the day with total assets equivalent to 16 percent of national GDP, to request a government bailout in 1923. The request was initially refused by Governor of Norges Bank, Nicolai Rygg on grounds that the bank was insolvent and an unviable prospect (Nicolaisen, 2015). Soon afterwards Foreningsbanken was placed under public administration, followed by two banks, Centralbanken for Norge and Handelsbanken, a few days later (Nicolaisen 2015: 2). This cascade effect threatened to implode the entire economy, not only because the banks involved were large, but because their failure destroyed confidence in all banks, even those in good standing. By the time the Handelsbanken faced collapse the government was ready to intervene and rescue the bank. The reasoning for the intervention was explained by Governor Nicolai Rygg after the crisis in testimony to a banking commission:

The very foundations of confidence, the nation’s confidence in its own credit institutions had been shaken … The most important objective was therefore to prevent an avalanche, seek to contain the damage, hang on and hold back. That was the dominant thought, to prevent total collapse, for the danger of this was indeed present… and the general atmosphere of nervousness manifested itself in the most peculiar ways. In the blind panic that ensued, unreasonable attacks were made on institutions that were more than deserving of their depositors’ confidence’ (reported in Gjedrem, 2009, Norges Bank report).

Rygg is referring to the psychological effects of a bank run, whereby a loss of confidence in a single or small number of banks becomes contagious, threatening the whole system, and exposing the structural vulnerability embedded in the fractional reserve lending system underpinning modern finance. It was precisely this negative ‘run’ loop which the Norwegian government sought to short-circuit by reversing their non-intervention policy and support the banking system.
While government intervention did avert the worst of the 1923 Norwegian banking crisis, there still existed no formal policy to solve the ‘bank run’ problem. It was to take the Great Depression and a series of banking crises during the 1930s in the United States before a permanent solution was found to this issue. The next section will turn to developments in the United States since the 1930s which led directly to the innovation of deposit insurance policy to solve the run problem. By 1984 the United States had also formally institutionalised ‘Too big to fail’ policy.

9.3. The Historical Origins of ‘Too big to fail’

The Great Depression beginning in 1929 and continuing into the 1930s, ultimately led to a major policy breakthrough in dealing with one of the most dangerous effects of financial panic, a banking run, and which in turn laid the grounds for the institutionalisation of ‘Too big to fail’. The policy was deposit insurance, and will be discussed in more detail shortly. Eichengreen has described the Great Depression as ‘the great economic catastrophe of modern times’ (1992, p. 2), and while the crisis originated in the United States, it had global consequences. Grossman identifies some of the headline economic statistics that illustrate this impact. During the years 1929-1933 real GDP fell in the United States and Canada by over 20 percent, in Austria by 20 percent and Germany and France by 15 percent. Unemployment in the USA reached 25 percent, while industrial unemployment there hit almost 40 percent, while in Germany this latter figure was just shy of 44 percent by 1932 (Grossman, 2010, p. 245).

In the United States the effects of the crisis were particularly devastating on the country’s financial system. The famous stock market crash of 1929 was just the beginning, as the country experience a succession of three banking crises through to 1933 (Eichengreen, 1992). Grossman provides figures for the dramatic increase in bank suspensions, whereby banks refuse to converting deposits into cash withdrawals, during the crisis. During the 1920s national banks suspensions,
whereby banks temporarily stop paying out on-demand deposits, averaged around 85 per year, with the average shooting up to 580 annually between 1930-33, with 1,475 occurring in 1933 (Grossman, 2010, p. 245). During the banking crises large numbers of banks failed. For example, in November 1930 a full 256 banks holding almost $200 million of deposits failed; while in December of the same year 352 banks holding more than $370 million failed (ibid, p. 246). High rates of bank failures continued until 1933. There is broad agreement that these rolling bank failures significantly prolonged and deepened the Great Depression (Eichengreen, 1992; Friedman & Schwartz, 1963; Grossman, 2010).

I argue that cases such as the Norwegian experience in 1923 along with the Great Depression that have resulted in a global ‘Too big to fail’ policy in the early 21st century. It is now acknowledge as policy that no government will allow its largest national banks to fail out of fear of contagion and systemic risk (Goodhart, 1999, p. 356; Gup, 2004a, p. 31; Mishkin, 2006, p. 989). These historical cases clarify why governments are not willing to risk the immediate and catastrophic economic damage of systemic banking failure, despite the economic costs and potential political problems that moral hazard poses. It is the differential time-structure between potential long-term consequences versus short-term system collapse that results in the paradox of bank bailouts. Nicolaisen describes this paradox as the fact that ‘Banks should not be bailed out, but they must be bailed out nevertheless’ (Nicolaisen, 2015, pp. 4, emphasis original). Under such conditions the history of banking rescues has inexorably inched towards the global institutionalization of ‘Too big to fail’.

One of the most important policy responses to these banking failures during the Great Depression was the establishment of federal deposit insurance through incorporation of the Federal Deposit Insurance Corporation (FDIC) under the 1933 Banking Act (Aliber & Kindleberger, 2015; Grossman, 2010; Zardkoohi et al., 2018). The aim of deposit insurance was to short-circuit bank runs by providing a federal guarantee of all deposits up to a maximum amount, covering the majority of savers.
The amount covered initially was $2,500, which was raised to $5,000 six months later (Grossman, 2010). Structuring the insurance this way was meant to protect the general saver, who could not reasonably be expected to treat their savings as investments and thus monitor their banks risk profile (Goodhart, 1999). Large depositors, on the other hand, would not be covered since they were knowledgeable investors with the means and the motive to ‘monitor risk-taking behaviour’ (Zardkoohi et al., 2018, p. 222), and should be responsible for losses as well as profits.

This innovative policy solution had the benefits of securing everyday savers thus preventing panic withdrawals during a crisis, while simultaneously allowing normal ‘market discipline’ continue to apply to everyone else. According to Friedman and Schwartz: ‘Federal insurance of bank deposits was the most important structural change in the banking system to result from the 1933 panic…and…the structural change most conducive to monetary stability’ (Friedman & Schwartz, 1963, p. 434), a view shared by Grossman (2010, p. 247).

The success of deposit insurance in virtually eliminating bank runs has resulted in its global diffusion as a policy in almost all national financial systems (Goodhart, 1999; Mishkin, 2006; Nicolaisen, 2015). However, since its inception deposit insurance policy has continually transformed in ways that set the grounds for the ‘Too big to fail’ policy. The fact that the insurance limit kept rising over time is crucial in this respect. From the initial $2,500 limit, the bar raised to $5,000, then $100,000, and then $250,000 by 2008 (Aliber & Kindleberger, 2015). The decisive step was removing limits altogether under certain circumstances:

When large banks got into trouble, the FDIC deliberately removed all limits on the amounts of deposits covered by the guarantee to halt imminent runs and in practice it established that banks with significant deposits over $100,000 were ‘too big to fail’ (Aliber & Kindleberger, 2015, p. 255).
The bailout of Continental Illinois National Bank in 1984 is a seminal moment in the institutionalization of ‘Too big to fail’ policy. This crisis will now be discussed in detail.

9.4. The Banks that were ‘Too big to fail’

The formal legal authority to provide bank bailouts was added in 1950 to the original Banking Act of 1933 used to incorporate the FDIC. It was to take twenty one years before that authority would be utilized. Between 1950 and 1971 no bank bailouts were granted in the United States (McKinley, 2011). During the decade starting in 1971 three bank bailouts were granted (Sprague, 1986). In 1971 Unity Bank and Trust Company of Boston was bailed out at a cost of $11.4 million; in 1972 Bank of the Commonwealth of Detroit followed with a $1.5 billion bailout; then, in 1980 First Pennsylvania Bank of Philadelphia cost $9.1 billion to rescue. However, it was the case of Continental Illinois in 1984 that represented a key juncture in the history of bank bailout policy.

Prior to the financial crisis of 2007/08, Continental Illinois National Bank stood as the largest bank failure in the history of the United States. Costing $41 billion to save, the rescue dwarfed the combined value of the three bank bailouts during the previous decade. More noteworthy than the cost was the fact that Continental’s bailout marked the first time in financial history when specific private banks were explicitly acknowledged to be ‘Too big to fail’. The policy was officially acknowledged in 1984 when in testimony to Congress on the Continental Illinois rescue, the Comptroller of the Currency declared that the eleven largest banks would not be allowed fail under any circumstance due to their importance to the financial system (D. P. Morgan & Stiroh, 2005; M. O’Hara & Shaw, 1990). The term ‘Too big to fail’ was coined by Congressman Stewart McKinney in 1994, as a way to frame the logic of this new approach to bailout policy (Gorton & Tallman, 2016). I now provide a detailed analysis of the political economy driving the decision to
rescue Continental Illinois, and following this, the decision by the Comptroller to publicly acknowledge that some banks were no longer subject to the law of the market.

Irvine H. Sprague’s (1986) study is a primary source for the analysis below. Sprague was either the director or the chairman of the FDIC for all four bailouts running from 1971 to 1984, and provides an illuminating insider’s account of the institutional logic that determined whether or not to grant bailouts during bank failures. The caveat here is that Sprague is discussing major political-economic decisions in which he played a central role. Thus while Sprague is best placed to explain the institutional logic at work, he also has a personal interest in justifying the FDIC’s actions during the bailouts. However, since there is independent corroborating evidence to support key claims made by Sprague regarding his and the FDIC’s motives and methods for implementing a rules-based process for bailout implementation, his study provides a credible and valuable source.

Sprague (1986, pp. 22-32) outlines the legal framework under which the FDIC operated during the first four bailouts spanning 1971-1984 in which he played a role. The FDIC’s three person board had full authority to grant a bailout, so long as two the three members voted in favour. Bailout was one of three options for dealing with troubled banks. The other two options were to pay off a failed bank, meaning that insured depositors get paid, or sell the bank with assistance by the FDIC (ibid, p. 22). Sprague points out that bailout was the least used, with payoffs and sales covering 99 percent of all cases through to 1986. He outlines the general outcome of each of the three options when implemented. With a payoff insured depositors get promptly paid, the bank is liquidated, the community loses its banking services and creditors and uninsured depositors ‘are at the mercy of the liquidation results’ (ibid, p. 22). By contrast, if the option of selling the bank is taken, insured and uninsured depositors and creditors are fully protected, while banking services are maintained in the community. During both payoffs and bank sales the FDIC assumes all bad loans for liquidation and covers deposit liabilities, however stockholders in the bank typically
lose all or most of their asset value, as they fall to the bottom of the queue for any returns from liquidation.

The final option is a full bailout, which means ‘the bank does not close, and everyone—insured or not—is fully protected, except management which is fired and stockholders who retain only greatly diluted value in their holdings’ (ibid, p. 23).

Thus, during this period of the FDIC’s history bailouts have outcomes that clearly reduce moral hazard, including firing of management and shareholders facing major losses if the bank requires rescue. However, Sprague does acknowledge that with a bailout it is ‘impossible to structure a transaction that does not provide at least the possibility of some residual value to stockholders and creditors of the failing institution’ (ibid, p. 29) in a situation where they would otherwise face total losses if the bank failed. Consequently, moral hazard cannot be totally avoided. As a result, the FDIC’s ‘preferred’ option historically during Sprague’s reign was to sell a failing bank, due to the fact that this option involves least disruption to the community’s services and lowers levels of moral hazard. Analysis will now focus on the final option, the bailout.

The rule governing whether or not the FDIC approves a full bailout is termed the ‘essentiality doctrine’. Sprague outlines the doctrine as follows: ‘The board need only make the finding that the insured bank is in danger of failing and is “essential to provide adequate banking service in its community”’ (Sprague 1986: 27). As Sprague himself points out, this entails a large degree of discretion, since no detailed directions are provided for deciding ‘essentiality’, nor is the term ‘community’ defined. Any decision ultimately ‘boils down to a judgement call by the FDIC board’ (ibid, p. 28), requiring two out of three members to be in favour. Nevertheless, Sprague argues that the institutional approach of the FDIC has been to view bailouts as a nuclear option, and that board members have traditionally been reluctant to apply the essentiality doctrine unless ‘they perceive a clear and present danger to the nation’s financial system’ (ibid, p. 28-29).
The statistics on FDIC approved bailouts support Sprague’s claim in this regard. During the 1970s only three banks were approved under the essentiality doctrine. Of eighty cases requiring FDIC assistance during 1984, sixteen were payoffs, sixty-three involved sales, and one bailout was approved. In the following year the FDIC was required to resolve 120 bank failures, with 29 payoffs and 91 sales. In 1986 there were 108 cases, with 75 sales and 30 payoffs (ibid, p. 22-23, 35).

Continental was deemed essential to the national banking system due to both its size and level of inter-connectedness with the wider financial system making its failure likely to crash the entire system (Sprague, 1986; Zardkoohi et al., 2018).

The bank had grown aggressively throughout the 1970s and early 1980s, so that by December 1983 it was the largest bank in the Midwest, and the eighth largest bank in the United States, with assets of $42.1 billion (Swary, 1986). However, issues began to arise with the quality of the loan portfolio upon which this growth was built. Sprague documents an article in the American Banker in 1981 which observed the following: ‘It can be said that Continental’s spectacular loan growth in recent years is less a matter of sharp pricing that it is of finding customers to whom the bank has been willing to lend more than the competition’ (Sprague, 1986, p. 150). This observation was later proven to be well-founded. During assessment of Continental’s risk profiling by the FDIC in preparation for providing financial assistance, it was revealed that the bank had systematically assigned high credit ratings to customers its shared with that two other large banks, whereas the latter two banks had assigned much lower credit scores (ibid, p. 170).

This build-up of bad debt would prove to be the ultimate cause of Continental’s failure, however, a series of financial shocks in 1982 were the proximate cause. Penn Square bank failed in 1982, followed by a securities trading agency Lombard-Wall. There was also international financial turmoil in 1982, with Mexican and Argentine debt crises, as well as a number of corporate bankruptcies, all of which Continental had exposure to. By the second quarter of 1984 the bank reported bad loans totalling $2.7 billion. As bad news followed more bad news,
foreign uninsured depositors began withdrawing large amounts of money, and the ten days starting May 9th 1984 saw $6 billion in withdrawals (ibid, p. 153). The writing was on the wall for the bank, unless help was forthcoming.

Help was forthcoming from the FDIC. Sprague goes through the options the board discussed in coming to the decision that Continental met the essentiality doctrine and a full bailout would be provided (Sprague 1986, p. 155-160). As discussed earlier, the preferred option for the FDIC was to seek a sale of the troubled institution. However the scale and speed of the Continental crisis meant there was no time to set up a sale. Another factor that militated against a sale was the sheer size of Continental, and the complexity of its accounts. In the circumstances and time pressure sale was ruled out by the board. The next option was to provide a payoff of insured depositors and let losses fall where they may. This option would have cost $4 billion, but covering only 10 percent of Continental’s funding base. Sprague notes this ‘seemed a temptingly cheap and quick solution’ (ibid, p. 155). The problem, he argued, was the relationship of those losses to the rest of the banking system, and whether or not it would result in a cascade failure. The FDIC made its initial estimate of Continental’s integration with the wider system. They estimate that ‘more than two thousand correspondent banks were depositors in Continental’ and that ‘fifty to two hundred might be threatened or brought down by Continental’s collapse’ (ibid, p. 155).

Sprague points out that when more precise figures were available after the FDIC had time to go through the books, they showed that 179 banks had 50 percent capital in Continental, while 66 banks had 100 percent. These banks would have been decimated by its failure. Furthermore, the FDIC board were certain in light of historical evidence that a massive loss of confidence would follow the failure of Continental and its dependent banks, and this would threaten the funding lines of the entire nation’s banking system, sound and unsound alike. The decision was taken by the three-member board of the FDIC to provide all assistance needed to ensure Continental did not fail. This began as a $2 billion emergency assistance,
comprised of $1.5 billion FDIC funding and $500 million from seven large private banks, given as a subordinated loan to Continental (ibid, p. 160). The cooperation of the private banks was designed to indicate private sector confidence in the rescue, and provide time to assess the requirements of a final rescue solution. When the costs of a permanent solution were tallied total FDIC funding support would reach a further $3.5 billion paid for discounted bad loans, as well as $1 billion in stock purchases, totalling $6 billion assistance (ibid, p. 209-210).

Continental Illinois stands as seminal moment in the institutionalization of ‘Too big to fail’ policy in the United States. In September 1984, during the political aftermath of Continental’s rescue, the Comptroller of the Currency declared before Congress that ‘some banks were simply "too big to fail" and that for those banks total deposit insurance would be provided’ (M. O’Hara & Shaw, 1990, p. 1587). The Comptroller went on to identify the eleven largest banks at the time as qualifying for limitless insurance (D. P. Morgan & Stiroh, 2005). The legal and institutional norms were set, and ‘Too big to fail’ had become a publically acknowledged official policy of the leading capitalist economy, setting a precedent for a policy that would diffuse globally by 2008.

9.5. ‘Too big to fail’: a case of Darwinian institutional evolution?

I argue that the historical evidence in this chapter indicates that ‘Too big to fail’ policy is a case of Darwinian institutional evolution. This implies the policy is a case of evolutionary change governed by variation, selection and retention resulting in the natural selection of some institutions over others. This can be illustrated by discussing the argument so far using theory developed in Part one of the thesis, particularly chapter five on generalized Darwinism and domain-specific mechanisms of evolution.

The regular crises that engulf capitalist economies are not a designed outcome of conscious planning by business agents or governments. This means that agents
are not acting out their roles within the capitalist economy with the goal of generating a financial crisis. Such crises are instead an unintended consequence of agents seeking to make as much profit as possible under the conditions given by capitalist institutions. As such, recurrent capitalist crises are a developmental phenomenon peculiar to the workings of capitalist institutions, as is well-established in business cycle theory (Mitchell, 1941; Mullineux, 1990; Joseph A. Schumpeter, 1934; Sherman, 1991). Banking crises are one particularly dangerous type of recurrent crisis that are common to the history of all capitalist economies. The development and retention of some but not other social responses to those recurrent crises is an evolutionary process. In assessing historical responses to banking crises, the history of bank bailouts exhibits initial institutional variation. The latter can involve imitation, innovation and planning (Aldrich et al., 2008, p. 584; Hodgson & Knudsen, 2010, p. 35), and therefore ‘artificial selection’ of specific policy responses.

However, as shown above there has been considerable reduction in variation in how governments respond to banking crises from the 18th century through to the 21st century. During the 18th and 19th centuries variation included engaging bailouts, letting banks fail, variation in different combinations of public and private institutions providing support, and variation in what stipulations, if any, would be attached to offers of help with regard to reducing moral hazard. Private institutions such as the New York clearing houses and the Bank of New York played a major role in supporting Hamilton’s response to the 1790 crisis in the United States. Many 19th and 20th century bailouts had a mix of private and public institutions acting as guarantors of liabilities, examples here are the bailouts in 1889 of Comptoir d’Escompte, the 1890 Baring Brothers bank rescues and the 1984 Continental rescue, all of which involved private banks acting as part-guarantors for government-led recues. In other rescues the public authorities were solely responsible, for example in the 1839 Bank de Belgique rescue, and 1848 Schaaffhausen Company rescue.

In a number of instances the institutional response was to refuse to bailout banks altogether, as in France with Crédit Mobilier in 1868 and Union Générale in
1882, City Bank of Glasgow in 1878, and again in Norway with Foreningsbanken in 1923. Likewise, during the Great Depression in the United States the authorities allowed banks to fail, with 608 banks holding half a billion in deposits failing in the last two months of 1930 alone (Grossman, 2010, p. 246). There has also been variation regarding stipulations attached to bailouts. The authorities of New South Wales gained authority to appoint board directors and dictate a number of operational practices upon rescuing the Bank of Australia. The Prussian authorities guaranteed dividend payments for selected shares, while also ensuring major costs were born by shareholders and creditors. In the Baring Brothers bailout a number of directors had their fortunes liquidated when the bank was rescued and reorganized as a limited liability company. Likewise, with Continental Illinois’ rescue some losses were imposed on shareholders through share dilution and senior management was fired.

All of this variation involves considerable institutional innovation by actors responding to financial crisis. Alexander Hamilton’s work during the 1792 crisis is perhaps the most resounding example of innovation, given that he ‘formulated and implemented “Bagehot's rules” for central-bank crisis management eight decades before Walter Bagehot wrote about them in Lombard Street’ (Sylla et al., 2009, p. 61). The latter work penned by Bagehot in 1873, who was also one-time editor of The Economist, is considered to be a landmark text on banking crisis resolution. It covers institutional policy that is today standard in Central Bank operations, such as lender-of-last-resort functions and open market purchases for stabilizing asset prices (Bagehot, 1873). While Hamilton added novel elements, he also was limited by path dependency regarding the financial tools available to him. He had no central bank, thus Hamilton had to rely on cooperation by private institutions to implement his plan. He also had to be careful to frame his intervention so as to reduce political opposition due to anti-Federalist opposition.

Variation is reduction by ‘selection’, which refers to ‘the mechanisms that bring about the survival of some variations rather than others, often reducing variety’ (Aldrich et al., 2008, p. 584). Selection mechanisms evident in the above
account of capitalist financial crises arise from both technical and political sources. On the technical side, government responses to a banking crisis seek to resolve the crisis in a manner that ensures ongoing capitalist reproduction. Any solutions which fail this in this goal are not likely to be retained in the long-run. Bank bailouts do ensure ongoing reproduction, but at a cost. The problem with rescues is that they involve moral hazard, which can itself lead to the very problems that authorities are trying to avoid by encouraging banks to take excessive risk in the view they will be bailout out. Aside from potentially creating the conditions for a banking crisis, moral hazard is also politically contentious because as the next chapter highlights in more detail, it is fundamentally contrary to capitalist ideology that argues profit-taking is justified by risk-taking. As a result, moral hazard creates both technical and political problems, whereas a commitment not to rescue failing banks resolves both of these issues. Furthermore, letting banks fail aligns with capitalist ideology that the state should not intervene in economic outcomes, and that profits and losses are a private affair.

Thus one might reasonably have expected institutionalization of a policy of non-rescue to have emerged over time as the selected response of authorities. However, two outcomes have prevented this. The first and most important outcome is the technical danger that a full-blown banking crisis represents to the functioning of a capitalist economy. Authorities ultimately have to ‘weigh the benefits of preventing panic now against the cost of reducing riskier activity later’ (Goodhart, 1999, p. 353). The second is that moral hazard can be reduced by stipulating onerous conditions as part of a rescue, thereby reducing both the economic effect of excessive risk-taking by agents who believe they will be bailed out, and also reducing political rancour. It is worth discussing each of these issues in turn.

During the 19th century we saw that for a time the French authorities were resolute in their determination to let market forces govern, and thus refused to intervene during banking crises. However, the frequency of these crises, and their effect on confidence led the French authorities to change course and begin
participating in bank rescues. Similarly, the Norwegian government refused to rescue the Foreningsbanken, which led to a growing panic during which the Norwegian government reversed course and began bailing out banks. Another case of policy reversal resulted from the Great Depression in America, when thousands of banks were allowed to fail. In the aftermath these failures were recognised as significantly deepening and prolonging the crisis. Furthermore, the Great Depression posed a major threat to capitalist legitimacy in America, indicating that the costs of letting banks fail was greater that the risks involved in saving them. Furthermore, risks accruing from bailouts such as moral hazard and political discontent could be reduced using policy measures. Goodhart (1999) points out that the issue of moral hazard has been recognized from early on in the history of bailouts. The cases discussed above support that view. Authorities have typically imposed losses on shareholders and owners, demanded the right to appoint directors and stipulate commercial strategy, as well as firing responsible managers.

I argue that the selection pressure arising from the need of governments to ensure economic reproduction in the face of a full-blown banking crisis has resulted in bailouts being selected as the favoured response. A banking collapse will bring a modern economy to a stand-still (Grossman, 2010; Nicolaisen, 2015). Selection is the mechanism by which variation is tested and reduced in a given environment (Buskes, 2013; Hodgson & Knudsen, 2010). In the case of bank bailouts, letting systematically important banks fail is no longer considered to be a viable option by authorities in any modern economy. ‘Too big to fail’ is now a globally adopted policy (Baker & McArthur, 2009; Goodhart, 1999; Gup, 2004a; Mishkin, 2006), highlighting a winnowing selection process over time.

Selection pressures force ‘interactors’, for example institutions such as central banks, to acquire or develop new ‘replicators’. Replicators are bits of information relating to adaptive solutions to problems. Replicators can diffuse through a variety of mechanisms, some of which can be identified as likely candidates for the spread of ‘Too big to fail’. As discussed in chapter five, cultural evolution occurs through
horizontal diffusion of habits, routines and ideas. For early bank rescues it is difficult to specify the exact channels of diffusion, although some potential avenues can be identified. With early rescues during the 18th and 19th centuries a large amount of variation regarding bailout implementation, and the stipulations attached when the policy was used, indicate much ad hoc innovation by authorities faced with bank failure, based on little or no existing policy examples or theoretical guidelines. However, Goodhart (1999) points out that the first major and systematic theoretical treatise on how to deal with banking crises was published by Henry Thornton in 1802. Following that, Walter Bagehot published *Lombard Street* in 1873, with a French version printed a year later (Bagehot, 1874).

These publications, both of which argue for lender-of-last-resort operations, indicate that intellectual ideas on solving banking crises were circulating since the turn of the nineteenth century in Britain and Continental Europe. They dates of publication also indicate that Alexander Hamilton was a true innovator during the crisis of 1792, which predates both Thornton’s and Bagehot’s publications. Further diffusion of replicators for banking regulation across societies is found in the spread of banking laws (Grossman, 2010). The free banking law passed in Canada during the 1850s was based on a similar U.S. law, while ‘certain aspects of English banking were influenced by the banking systems of Sweden, Scotland, Hamburg, Amsterdam, and Italy’ (Grossman 2010, p. 170). Japan adopted a version of the United States National Banking Acts on which to base its first banking code (Grossman 2010, p. 169). In the twentieth century there emerged clear institutional means by which replicators relating to banking regulation could diffuse. Post-WW2 a number of major global financial institutions were created, including the World Bank and International Monetary Fund in 1945, and the Bank for International Settlements (BIS) in 1930. This last institution is especially relevant to global diffusion of banking policy.

The BIS is owned by 60 central banks accounting for 95 percent of global GDP, and its stated mission is ‘to serve central banks in their pursuit of monetary and
financial stability, to foster international cooperation in those areas and to act as a bank for central banks’ (BIS, 2018). Westermeier argues that the bank ‘operates like a think tank in the field of financial policy-making’ (Westermeier, 2018, p. 1), and provides researchers and policy-makers with regulatory knowledge. As such, the BIS is a major institutional channel for diffusion of knowledge and policy relating to all aspects of banking. Banking policy developed in the leading capitalist countries has diffused globally, with the OECD model becoming the global standard (Caprio & Vittas, 1997). Likewise, where only six countries emulated the FDIC’s deposit insurance scheme in the first three decades after it was established in 1933, today the policy is now a global norm (Mishkin, 2006; Nicolaisen, 2015). Consequently, by various means, it is clear that there has been significant global diffusion and convergence upon a set of shared banking institutions and solutions to banking crises.

Conclusion

The institutionalization of ‘Too big to fail’ bailout policy is not an outcome of foresight and planning, but rather of reaction and experimentation to another unintended outcome, the capitalist business cycle. Furthermore, it is not by statistical chance that deposit insurance and bank bailout policy are today a global norm, while market-based policies that ideologically align with capitalist norms, such as letting banks fail, have been consigned to the financial dustbin. Such outcomes are indicative of an evolutionary trend, in which social systems evolve according to their institutional logic, and in doing so present unexpected problems for social agents. Under such conditions agents engage institutional innovation, which, if successful are likely to be copied by others facing the same problems, which Veblen identified as ‘a process of natural selection of institutions’ (Veblen, [1899] 2007c).

I argue that the global diffusion of bank bailout policy is such a case of the natural selection of institutions. Initial variation to a specific problem, banking
failure, was disciplined by selection pressures comprising technical and political requirements to ensure the economy could reproduce itself. Bank bailout policy has emerged as the best solution thus far to systemic risk during a banking crisis. However the solution comes at a cost, since by socializing private losses its presents an ideological contradiction that threatens the social legitimacy of capitalism. Nevertheless, in view of the costs of not bailing out banks, the gains outweigh the losses, and the policy has diffused globally. The next chapter will provide further compelling evidence to support this argument, and also to refine it in important ways. I discuss significant recent political efforts in the United States to end ‘Too big to fail’, first through the 1991 Federal Deposit Insurance Corporation Improvement Act, and again in the 2010 Dodd-Frank Act. The political economy out of which both these pieces of legislation arise highlights both the possibilities and limits of regulating the financial sector. It also highlights the limits of agency to determine how a complex, open system evolves. I show that ‘Too big to fail’ is an evolutionary sub-optimal outcome that is ‘locked-in’ to the development of all capitalist economies. There is no regulatory solution that can fully ensure a total negation of the possibility of systemic risk in the context of a capitalist economy.
Chapter 10. Bank Bailouts and Evolutionary Lock-In

Capitalism without failure is like Christianity without hell – Warren Buffett, (2008)

[T]hose responsible for a bank’s problems or its failure should pay. After all, they are the ones who make the profits when things go right – Irvine Sprague, former chairman of the FDIC, (1986)

The American taxpayer does not want their government in the business of picking winners and losers – Chairman McHenry, U.S. House of Representatives (2011)

Bank bailout policy is today a vital tool for stabilizing the financial system and the broader economy during the most dangerous category of financial crises, events that threaten systemic risk. The policy has been selected and retained over centuries of financial crises which have proven its effectiveness. Nevertheless, despite the policy’s success in solving one economic problem, use of the policy generates another set of problems, both economic and political. Key issues in the political economy of bailouts are as follows. First, it is widely recognised that bank bailout policy generates moral hazard (Afonso, Santos, & Traina, 2014; Bhagat, 2017; Graham, 2010; Gropp, Hakenes, & Schnabel, 2010; G. Kaufman, 1990; Moosa, 2010; Nicolaisen, 2015; Skeel, 2010; Stern & Feldman, 2004). These studies show that the consequences of this moral hazard are that big banks which are perceived to be systemically important are willing to operate more riskily than smaller banks not classed as being of systemic importance. Another line of critique is that bank bailouts distort market competition. This is because banks
perceived to be ‘Too big to fail’ get cheaper market funding, and higher equity valuation than would otherwise be the case (Baker & McArthur, 2009; Brewer & Jagtiani, 2013; Hughes & Mester, 1993; M. O’Hara & Shaw, 1990; Santos, 2014).

As a result, these effects of ‘Too big to fail’ policy involve ‘a substantial taxpayer subsidy for the TBTF banks’ (Baker & McArthur, 2009, p. 2), one that impacts the functioning of the banking sector in fundamental ways. The policy leaves smaller banks at an unfair disadvantage as a result of government regulatory designation, rather than market competition, thus opening up the critique that government is ‘picking winners’, compounding the undermining of capitalist ideology and market norms. Rosenblum sums up the situation as follows: ‘In essence, dealing with TBTF financial institutions necessitates quasi-nationalization of a private company, a process antithetical to a capitalist system’ (Rosenblum, 2011, p. 10). He further states: ‘If allowed to remain unchecked, these entities will continue posing a clear and present danger to the U.S. economy’ (Rosenblum, 2011, p. 3).

The political dangers, the economic costs, and the violation of capitalist norms have historically made bank bailouts a topic of intense political controversy, and no less so in modern times. In this chapter I focus on the United States, as the nation with the most recent historical experience in applying bank bailouts. In the United States there has been two major regulatory attempts to solve the ‘Too big to fail’ problem in recent times, both with significant bi-partisan support: the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, and the Dodd-Frank Act of 2010. Both failed, but not for lack of political will or effort.

A 2014 House of Representatives hearing opened with the following statement: ‘Dodd-Frank codified too-big-to-fail into law, and it is now demonstrable 4 years later that the big banks have gotten bigger and the small banks have gotten fewer’ (Assessing the Impact of the Dodd-Frank Act Four Years Later, 2014, p. 2). The question asked in this chapter is: Why does ‘Too big to fail’ banking persist when there is political will to end it? I argue that ‘Too big to fail’ is an example of sub-optimal evolutionary lock-in (Beinhocker, 2006, p. 440; Bowles, 2004, p. 12; Hodgson,
2004b, p. 44). As Hodgson points out: ‘It is a serious misconception to see evolution as always leading to either static or optimal outcomes’ (2004, p. 44; see also Hodgson, 1993; Veblen [1899] 1970). Sub-optimal outcomes are possible.

Evolutionary systems are path-dependent, working with existing structures, including their possibilities and limitations through a process of adaptation and selection. This can result in lock-in, whereby a sub-optimal solution is the best possible one in the given conditions. I argue that bank bailouts are an evolutionary sub-optimal lock-in outcome for capitalist economies. This means that within a capitalist system, bank bailouts are the best available solution to a financial crisis that generates systemic risk, despite the significant economic and political problems that the policy generate. The bailout issue is fundamental to capitalist development, and cannot be regulated away.

The chapter proceeds with five sections. Section one assesses the first modern effort to end ‘Too big to fail’, the 1991 Federal Deposit Insurance Corporation Improvement Act. Section two turns to the trigger event of the 2008 crisis, the political decision to let the market operate as normal when Lehman Brothers failed, and outlines the political forces driving the debate prior to that decision over whether the bank should be rescued. Section three turns to analysis of the second major political effort to end ‘Too big to fail’, the 2010 Dodd-Frank Act. Section four outlines why the call to ‘break up the banks’ is not feasible. Nor is it possible to regulate away all risk so as to prevent bailout situations occurring. Section five argues that ‘Too big to fail’ is a permanent feature of capitalist development, and represents a case of sub-optimal, evolutionary lock-in.

10.1. FDICIA, and the First Effort to End ‘Too big to fail’
The 1980s was not a good decade for U.S. banking. In fact it was easily the worst decade since the 1930s due to large numbers of failures across both the commercial banking sector and the savings and loans thrift industry (Benston & Kaufman, 1997).
Thus, along with ‘Too big to fail’ bailouts of First Pennsylvania Bank of Philadelphia in 1980, and then Continental Illinois in 1984, there was also the ‘savings and loan’ crisis that continued throughout the entire decade (Barth, 1991; Barth, Trimbath, & Yago, 2004; Curry & Shibut, 2000). I will outline the key elements of this crisis, because along with the ‘Too big to fail’ bailouts, the savings and loan debacle provided the political momentum to try and resolve permanently the problem of systemic risk and bailouts through major new legislation, the 1991 Federal Deposit Insurance Corporation Improvement Act. After outlining the savings and loan crisis I will discuss the regulatory response.

The American savings and loan system has its origins in the tail end of the Great Depression (Benston & Kaufman, 1997; Calavita & Pontell, 1990). Set up in the early 1930s, savings and loan institutions were established to promote home ownership and thereby home construction which would help stimulate the economy. Savings and loan deposits were federally insured to prevent bank runs, which had ravaged the banking sector during 1929-1933. While the 1933-established Federal Deposit Insurance Corporation covered retail banking deposit insurance, the thrift industry received its own insurance corporation, the Federal Savings and Loan Insurance Corporation, as a result of the 1934 National Housing Act. The system worked well until the 1970s, when the entire thrift industry began suffering growing losses.

The initial trigger for the crisis was an abrupt increase in interest rates towards the end of the 1970s. The savings and loan institutions were providing long-term fixed mortgages using short-term deposits, making them vulnerable to major swings in interest rates. When rates rose substantially, the discounted value of their assets (fixed-mortgages) quickly became less than the value of their liabilities (deposits) (Benston & Kaufman, 1997, p. 140). This had a disastrous effect, to the extent that by the early 1980s almost the entire industry comprising around 4,000 institutions was loss-making and essentially ‘insolvent from an economic viewpoint’ (Barth et al., 2004, p. 181).
During 1986-1995 the U.S. government had to take a direct hand in orderly closing or otherwise resolving by merger or sale 1043 thrift institutions holding $519 billion in assets (Curry & Shibut, 2000, p. 26). The Federal Savings and Loan Insurance Corporation, which had an insurance fund generated through annual premiums charged to the institutions, was overwhelmed by the scale of losses, and itself became insolvent. As a result, taxpayer money was required to honour total claims against deposit insurance, ultimately costing an estimated $123.8 billion, with the private sector contributing an additional $29.1 billion to resolve the crisis (ibid, p. 31). The savings and loan crisis was a major political issue that was amplified by the fact that large levels of fraud were uncovered, whereby thrift owners took advantage of insurance protection for self-enrichment. The crisis is viewed as one of the biggest white collar crime events in American history, with government reports stating that as much as 70 to 80% of insolvencies had criminal activity as a central contributing factor (Calavita & Pontell, 1990, p. 310). It was also one of the largest prosecutions of white collar crime in U.S. history, with over 1,000 bankers at all levels of seniority prosecuted for fraud (Cohan, 2015).

As Curry and Shibut (2000) point out, the government assistance provided during the savings and loan crisis was technically not a bailout, since troubled institutions were either allowed to fail, or otherwise resolved through mergers and sales. Government funds were only used to return savers’ deposits, as required by insurance legislation. However, the point of setting up the deposit insurance corporations and requiring the banks and thrift institutions to pay annual premiums was to ensure the taxpayer would not have to pay for any ensuing failure. The system was supposed to be self-sufficient. Consequently, occurring during a decade of multi-billion dollar bank bailouts, the savings and loan crisis contributed to an already fraught political debate on assistance to the banking sector (Graham, 2010, p. 118). The outcome of that debate was the Federal Deposit Insurance Improvement Act of 1991.
This act was aimed squarely at ending the problem of ‘Too big to fail’, preventing future taxpayer support to deposit insurance costs, and ending regulatory compliance issues within banking. Some assessments of the Act have argued that it largely succeeded in its goals (Mishkin, 2006; Wall, 1993), while others have argued that ‘Too big to fail’ was still as likely an outcome after as before the Act (Graham, 2010; Stern & Feldman, 2004). The contours of this debate illuminate the problem posed by big-bank failure post-2008, and the later debates around Dodd-Frank to be discussed in section three.

Wall (1993) provides a detailed analysis of the key provisions in the FDICIA legislation, which sought to strengthen and refine the original FDIC legislation of 1933, rather than radically overhaul it. Wall argues the legislation’s significant elements are that it provides banking agencies a clear mandate to minimize losses, and ‘sets up an incentive system to encourage compliance’ (1993, p. 3). To begin with, the Act requires regulators to take far stronger action if a bank’s capital ratios decline. Two actions are required in the case of the latter: first, undercapitalized banks must outline a credible plan to restore their capital to the required levels; second, regulators must act within 90 days of a bank’s capital ratio becoming dangerously low, such that absent restoration a ‘least cost’ resolution must be undertaken (ibid, p. 4).

Next, Wall identifies Sections 141 and 142 as crucial provisions reducing the likelihood of ‘Too big to fail’ bailouts occurring. Section 141 still allows for a ‘systemic risk’ exception to justify a bank bailout, but significantly increases institutional and political accountability over decisions made to invoke that clause. As discussed in the previous chapter, a 1950 amendment to the original 1933 FDIC legislation granted bailout authority to the board of the FDIC if two of the three board members agreed to do so. Whereas under the FDIC Improvement Act a two thirds majority of both the FDIC board and the Federal Reserve board, along with the Secretary of the U.S. Treasury ‘must all agree that an institution’s ill-health poses a systemic risk’ (ibid, p.4). Section 141 also requires the Secretary of the Treasury to
provide detailed evidence that indicates that the systemic risk clause was
legitimately applied (Graham, 2010, p. 133; Mishkin, 2006, p. 995), increasing the
transparency and accountability of decision-making.

Finally, the Act stated that if a bank is bailed out, and the costs exceed
available insurance funds, the rest of the industry is required to provide emergency
funds to the FDIC to cover the shortfall at a rate that is proportional to each bank’s
total assets (Wall, 1993, p. 4). This last provision is aimed at encouraging the banks to
enforce compliance upon each other. Section 142 reduces the Federal Reserve’s
ability to act as a lender of last resort to undercapitalized banks. This was done to
prevent access to the Fed’s discount window being used to allow the bank to borrow
funds until all uninsured deposits could be withdrawn. In summing up his analysis,
Wall finds that the provisions indicate the serious political will in Congress to
prevent future bailouts (ibid, p. 11), concluding that: ‘Although FDICIA does not ban
the too-big-to-fail doctrine, it has substantially reduced the likelihood of future large
bank bailouts’ (1993, p. 11).

Stern and Feldman (2004) take a different position on the effects of the
FDICIA. They discuss the ‘firewall’ argument that policy makers use to justify bank
bailouts. This argues that bailouts prevent a domino effect occurring due to the
interconnected nature of modern banking. The reciprocal flows of credit and debt
between institutions means that the failure of one will lead to the failure of many,
precipitating a major economic recession. Thus the cost of saving one, or even a
number of banks, will always be smaller than the cost of a full-blown systemic crisis.
Stern and Feldman accept this argument, but focus on the moral hazard which this
creates.

Their view is that when creditors of big banks believe the government will
protect their loans, they have reduced incentives to monitor the bank’s risk
management practices. Likewise, big banks know their creditors are not monitoring
them for this very reason, incentivising them to take ever greater risks in the search
for profits. This leads to more ‘misallocation’ of resources, leading to more bad
loans, so that when banks know they are viewed as ‘Too big to fail’ they acts in ways which create the very conditions wherein the policy will be required. Consequently, and as other studies have also argued, deposit insurance and bailout policy create moral hazard incentives that lead to big banks taking on more risk than they otherwise would (Afonso et al., 2014; Graham, 2010; G. Kaufman, 1990).

Stern and Feldman (2004) conclude their assessment of the FDICIA by arguing that moral hazard will continue as before because the Act contains a ‘systemic risk’ loophole that may be exercised even when no such risk is present. This means that there will be no ‘significant change in the incentives that policymakers face when confronted with the bailout decision’ (Stern and Feldman, 2004, p. 79). Mishkin is critical of their position on this latter point (2006, p. 995). He notes that the debate over the ‘systemic risk’ clause is a classic example of the ‘rules vs discretion’ conundrum. Proponents of a rules-based approach argue that even when discretion is used in an optimal manner initially, it is likely to be followed by sub-optimal abuses of discretion later. Therefore, if the discretionary ‘systemic risk’ clause is kept, it will be used in inappropriate ways in the future. Also, the banks will expect it to be used in the future, and act accordingly.

The argument against the pro-rules view is that rules are too rigid for situations marked by unpredictable circumstances, therefore use of discretion is vital. Mishkin takes this latter view, pointing out: ‘Financial crises and systemic risk stem from events which are highly unpredictable and which have highly unpredictable consequences’ (2006, p. 995). Furthermore, Mishkin and others (Bernanke & Mishkin, 1997) argue that assuming a sharp dichotomy in the ‘rules vs discretion’ debate can be misleading. So long as users of discretion are made accountable as to why they acted, and that the path to the act of discretion is itself rule-based, then discretion is not by default open to abuse (Mishkin, 2006, p. 996). Mishkin views the high levels of required consent and accountability legislated by FDICIA for using the systemic risk clause as sufficient to ensure the measure is used appropriately (2006, p. 996).
Do the events of 2008 support either side of the debate on the effectiveness of the FDICIA? Graham argues that because bailouts were used to resolve the 2008 crisis the FDICIA was a failure (2010, p. 134). This, however, is a simplistic answer which fails to understand the goal of the FDICIA. The proponents of the Act did not claim the legislation would ensure that bailouts could never happen again, even if the underlying goal was indeed to end ‘Too big to fail’. Rather, the legislation sought to reduce incentives that would lead to their need, and also sought to increase political accountability and widen the consensus needed to implement them. At the same time, the legislation maintained a ‘systemic risk’ clause in case future unpredictable events meant that a bailout might be more desirable than a full-blown banking collapse. In the next section I argue that the case of Lehman Brothers indicates that the FDICIA legislation was successful in providing strong disincentives to implement bank bailouts. I further argue that the financial contagion set off by Lehman Brother’s bankruptcy indicate why maintaining a systemic risk clause for implementing bailouts is appropriate.

10.2. To Bail, or Not to Bail? Lehman Brothers and the Contagion Effect

Lehman Brothers’ collapse was the trigger event that transformed an economic downturn into a crisis of systemic risk, threatening the global financial system (Eichengreen, Mody, Nedeljkovic, & Sarno, 2012, p. 1299; Swedberg, 2010, p. 91). Lehman Brothers filed for bankruptcy on September 15, 2008. Prior to that it had requested assistance from the United States government to avoid bankruptcy. Yet despite being the 6th largest U.S. bank by total assets at the end of 2007, no financial bailout was forthcoming. It was the largest bankruptcy in American history (McKnight, 2018), the consequences of which were to be felt globally. The panic generated by Lehman’s failure resulted in immediate volatility and contagion. So strong was the effect that within two days of denying Lehman assistance the U.S.
Treasury engaged an abrupt reversal and provided the insurance firm AIG an $85 billion bailout. Soon after ‘Sunday announcements concerning bailout deals became the new business-as-usual’ (Graham, 2010, p. 119).

Writing in the New York Times, economist Alan Blinder explained the effect that Lehman’s collapse had as follows: ‘After Lehman went over the cliff, no financial institution seemed safe. So lending froze, and the economy sank like a stone. It was a colossal error, and many people said so at the time’ (Blinder, 2009). While it may have been an economic error, there were strong political pressures at play during the Lehman Brother’s crisis which militated against bailing out private institutions, even systemically important ones. I argue that the political pressures in the run up to the Lehman event are indicative of the continuation of an anti-bailout political environment that had originally driven the FDICIA legislation of 1991. Prior to the Lehman situation of September 2008, the U.S. government had provided assistance to resolve issues in financial institutions. First the Federal Reserve assisted the sale of Bear Stearns to J.P. Morgan in March 2008 to prevent bankruptcy (Graham, 2010). This type of financial assistance falls under the ‘least cost’ resolution of the FDICIA, and the cut-price deal involved Bear Stearns shareholders losing most of their value (Mollenkamp, Whitehouse, Hilsenrath, & Dugan, 2009). Next to receive assistance were Fannie Mae and Freddie Mac. These are government-sponsored enterprises founded in 1938 and 1970 respectively. They were originally developed with a social purpose in the spirit of the ‘New Deal’ ethos, with their goal being to broaden and stabilize the U.S. mortgage market and increase affordable housing. Both institutions guaranteed around $1.5 trillion in mortgages, and on September 7 both were nationalized by the Treasury and given a $200 billion infusion (Swedberg, 2010, p. 86).

By this stage of the unfolding crisis the only bailouts forthcoming were for the two government-sponsored entities. No private bank had yet been bailed out. However, difficulties were growing at Lehman Brothers, with the institution announcing a large loss of $2.8 billion for its second quarter in June 2008. The bank’s size and importance made it a suitable candidate for ‘Too big to fail’ status. By early
September the bank was looking for a buyer, making overtures to Citigroup (McDonald, 2009, p. 281). However, upon announcing a further massive loss of $3.9 billion on September 10, the likelihood of a private buyer evaporated (Swedberg, 2010, p. 86). On September 12, the Federal Reserve organized a meeting at the New York Fed with senior Wall Street CEO’s to come up with a plan to resolve the Lehman problem.

According to Swedberg ‘there was strong confidence at the time that the U.S. state would not let a big bank go under’ (2010, p. 87). This was understandable given history, and the ‘systemic risk’ clause that was kept in the FDICIA legislation. As the sixth biggest bank by assets, there was little doubt that Lehman could be considered systemically important. However major economic matters are never far from political machinations, and it appears that politics, ideology and accountability all played a role in the decision by Secretary of the Treasury Henry Paulson to refuse Lehman assistance. On the weekend of September 13-14, when Lehman’s fate was being decided, Treasury Secretary Henry Paulson was in a conference with Ben Bernanke and Timothy Geithner, chairman of the Federal Reserve and President of the New York Fed respectively. Paulson is recorded as stating unequivocally that there would be no bailout (Wessel, 2009, p. 16). He let his staff leak that position to the general public. In a manner illuminative of the rules vs discretion debate, Geithner was highly critical of Paulson’s action, because ‘what was needed in a situation like this was a flexible approach, not locking yourself into a position’ (Swedberg, 2010, p. 88).

Paulson, however, was under political scrutiny after supporting assistance to Bear Stearns and the two government-sponsored entities, Freddie Mac and Fannie Mae. The general political climate in Congress was anti-bailout (Sorkin, 2009, pp. 283-285). On Friday September 12 at a meeting discussing what to do about Lehman Brothers, Paulson told the attending Wall Street CEOs that they would have to come up with a market-based solution. He informed them that: ‘There is no political will for a federal bailout’ (Wessel, 2009, p. 16), so one should not be expected. Recall that Wall (1993) argued that the FDICIA represented a major attempt to change incentives and
behaviour through increased political accountability for bailout implementation, and that the legislation itself was the product of significant anti-bailout sentiment in Congress. The lack of political support for bailing out Lehman Brothers is suggestive both of the legislation’s effectiveness in that regard, and also of continuing anti-bailout sentiment. The wider intellectual climate was also against bailout policy, with economists and publications such as the Wall Street Journal arguing publically that the market should be left to deal with any failures (Swedberg, 2010, p. 88).

On September 14 the last potential buyer of Lehman Brothers, Barclays of the UK, pulled out of any potential deal, and the decision was made that Lehman would have to declare bankruptcy. Harry Miller, Lehman’s head bankruptcy lawyer, made the following prediction of what would ensue: ‘It’s going to have a disabling effect on the markets and destroy confidence in the credit markets. If Lehman goes down, it will be Armageddon’ (quoted in Swedberg 2010: 90). As it turned out Miller was ‘on the money’, to use an appropriate idiom. Swedberg (2010, p. 91-93) provides an account of how financial contagion quickly spread throughout the American and global financial system through ‘direct’ and ‘indirect’ effects. Direct effects are the result of losses incurred by other institutions due to direct financial interactions with Lehman. These kinds of effects are relatively easy to quantify. Indirect effects refer to outcomes ‘that were caused by the fear that was unleashed by Lehman’s collapse, by rumours that now began to circulate’ (2010, p. 91), and with that a collapse of confidence in the financial sector.

On this latter point Swedberg highlights the special role of confidence in the banking system, drawing on the pioneering work of Walter Bagehot to argue that indirect effects pose the true danger in a financial crisis. Bagehot assessed the role of confidence during crisis as follows:

We should cease ... to be surprised at the sudden panics [in the banking system]. During the period of reaction and adversity, just even at the last instant of prosperity, the whole structure is delicate. The peculiar essence of our banking system is an unprecedented trust between man and man; and when that trust is much weakened by hidden causes,
a small accident may greatly hurt it, and a great accident for a moment may almost
destroy it (Bagehot, 1873, pp. 151-152).

Lehman was the great “accident” that triggered the 2008 global financial crisis. To
give a sense of the scale and interconnections involved, Swedberg notes that the
bankruptcy was valued at $613 billion, and involved 80 subsidiaries across the globe.
Declaration of bankruptcy caused immediate freezing of millions of transactions,
and was quickly followed by other banks announcing Lehman-related losses. These
‘direct effects’ include Japanese institutions losing $2.4 billion, Royal Bank of
Scotland expecting between $1.5 billion to $1.8 billion losses, and a combined $2
billion of losses for cities and counties across the United States who had invested in
Lehman bonds (Swedberg, 2010, p. 92). In England retail investors lost $160 million
on Lehman investment products, while in Hong Kong 43,000 investors stood to lose
$1.8 billion invested in Lehman bonds. In Germany Sachsen Bank, which was state-
owned lost $500 million, and hedge funds in London had around $12 billion frozen
assets upon Lehman declaring bankruptcy (ibid, p. 92).

These figures indicate not only the vast scale of direct losses caused by a
single large bank, but the extent of the global web of claims characterising modern
finance. However, as Swedberg goes on to illustrate, it was the indirect effects that
were even more threatening. Why? Because of the consequences for confidence. It is
the perception of indirect, or ‘hidden losses’ and the ensuing ‘contagion’ that is
catastrophic for agent confidence in the financial system (Swedberg, 2010, p. 92; see
also Scott, 2016). Financial actors in the modern money markets know the extent of
interconnectedness, but typically no single actor knows at any given time who
exactly is connected to whom, and to what extent. For example, a large money
market fund called the Reserve Primary Fund held Lehman bonds, also known as
‘commercial money’, with a face value of $785 million (Swedberg, 2010). Lehman’s
bankruptcy instantly discounted that value to 20 cents on the dollar (Mollenkamp et
al., 2009).
As Swedberg explains, the sudden collapse in value of the Reserve Primary Fund led investors to assume that it was possible that ‘other money market firms might have Lehman bonds or Lehman-related assets (”hidden losses”). Direct links to one actor, in short, led to a belief that all of the actors in the market might have similar holdings’ (2010, p. 92). During September 2008 this belief resulted in panic by short-term bank creditors who withdrew funds from the market (Ivashina & Scharfstein, 2010). The money markets are particularly important to the broader economy because companies sell commercial paper to fund short-term borrowing for expenses such as wages and materials (Mollenkamp et al., 2009). The panic set off by Lehman’s bankruptcy on Monday September 15 froze the money markets within hours, and as good as shut down global commercial lending.

But that was only the beginning of the indirect losses stemming from the spreading contagion. That same Monday insurance against bond defaults saw its largest single-day increase in history. This dramatic rise resulted in knock-on losses for sellers of bond insurance, including banks, hedge funds and insurance companies. As Mollenkamp et al (2009) explain, these sellers also had to increase their insurance funds to guarantee they could meet their obligations, with Monday’s insurance rise alone requiring a margin call of an estimated $140 billion by insurance sellers. In London the inter-bank offered rate (LIBOR) which sets the global rate of inter-bank lending, shot up over 100% between Monday and Tuesday, from 3.11% to 6.44%, but still failed to prevent a collapse in bank-to-bank lending, as fear of hidden losses grew (ibid). On Tuesday market agents began to speculate on which bank would be next to fall, focussing first on Goldman Sachs and J.P. Morgan, with the latter suffering a share price plunge of 28% within hours. With markets in freefall, rumours spread that increased the panic. On September 16 it was reported in financial news that UBS AG stood to lose $4 billion through Lehman exposure, with UBS subsequently suffering a 19% fall in share price. However, later it turned out that the real figure was $300 million (Mollenkamp et al., 2009).
With financial collapse underway, the U.S. government did a full U-turn on its bailout policy. The first big institution to be bailed out was not a bank, but an insurance company, AIG, which had been hit by a massive margin call on its bond insurance obligations. The government provided $85 billion to shore up AIG, taking a 79.9% equity stake (Graham, 2010). Over the next six months the U.S. financial sector became dependent upon government assistance to stay afloat. On the 3rd of October 2008 the Troubled Asset Relief Program (TARP) was brought into effect, authorizing a $700 billion fund for buying up toxic assets from the financial sector. It took until August 2009 to fully stabilize the financial markets in the United States (Swedberg, 2010).

The events around Lehman Brothers share much in common with the 1923 Norwegian crisis discussed in chapter nine. As in 2008, the Norwegian government was opposed to bailing out private finance. And like in 2008, a large bank, Foreningsbanken, was allowed fail. The effect of a large bank failure in both instances was to act as a trigger for an ensuing financial contagion, with growing prospects for a total financial meltdown. The only way to short-circuit that contagion was government intervention to support ailing banks. Some studies, however, claim that ‘Too big to fail’ is a ‘myth’ (e.g. G. Kaufman, 1990; Moosa, 2010). These studies argue that there is no historical evidence that a collapsing large bank represents systemic risk. I argue that events in Norway in 1923, and in the United States in 2008 provide counter-points to this view. The historical evidence shows that ‘Too big to fail’ is a hard fact of capitalist financial development.

10.3. Dodd-Frank and the Second Effort to End ‘Too big to fail’
In the political aftermath of the bailouts of 2008/2009 there was significant political pressure on the U.S. government to deal conclusively with the ‘Too big to fail’ problem (Acharya, Cooley, Richardson, Sylla, & Walter, 2011; Carpenter, Cooley, & Walter, 2011; Prasch, 2012; Skeel, 2010). The 2010 Dodd-Frank Act was intended to
restore public faith in the American financial system, and perhaps even in capitalism itself. With such a profound task, major reform was required and was forthcoming, with the Act ‘widely described as the most ambitious and far-reaching overhaul of financial regulation since the 1930s’ (Acharya, Cooley, Richardson, Sylla, et al., 2011, p. 1). The importance of Dodd-Frank is such that it has generated a major academic debate on its value and achievements (Acharya, Cooley, Richardson, Sylla, et al., 2011; Acharya, Cooley, Richardson, & Walter, 2011; Anand, 2011; Barth, Dearie, Skeel, & Wilmarth, 2014; Krainer, 2012; Prasch, 2012; Rosenblum, 2011; Scott, 2016; Skeel, 2010). There has also been two major Congressional Hearings on Dodd-Frank (Assessing the Impact of the Dodd-Frank Act Four Years Later, 2014; Has Dodd-Frank Ended Too Big to Fail?, 2011). I will discuss both the academic and political debates in turn.

The 2010 Dodd-Frank runs to over 2,300 pages and has been subject to intense scrutiny. The Act builds upon the approach taken in the 1991 FDICIA legislation, in that it seeks to significantly reduce the possibility of bank bailouts, while maintaining a systemic risk clause. Title I of the Act is central to dealing with systemic risk, and therefore the bailout problem. In addressing this systemic risk the Act created two new regulatory bodies, the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR). The FSOC is tasked with identifying systemic risk, while the OFR’s responsibility is to provide the Council administrative and technical support (Anand, 2011, pp. 1-2). Section 113 of Title I provides the FSOC the authority to designate nonbanks as systemically important financial institutions, with the result that these firms are then subject to stricter supervision by the Federal Reserve, and subject to higher capital requirements (Scott, 2016, p. 62).

Along with nonbank firms designated as ‘systemically important’ by FSOC, section 165 of Title I provides for “enhanced prudential supervision” for all bank holding companies with assets of $50 billion or greater. The enhanced supervision includes higher standards in relation to ‘capital, leverage, liquidity, asset
concentrations, and single counterparty exposures’ (Barth et al, 2014, p. 84). The trade-off here is that the institutions classified as systemically important and therefore subject to stricter regulatory oversight, are also more likely to receive government assistance during a crisis, thus resulting in moral hazard that increases risk-taking by these designated firms.

To counter the moral hazard effect, the Dodd-Frank Act contains substantial new authority vested in regulating agencies to require ‘funeral plans and orderly liquidation procedures for unwinding of systemically important institutions’ (Acharya, Cooley, Richardson, Sylla, et al., 2011, p. 5). The ‘funeral plan’ refers to the ‘living will’ provision in Dodd-Frank. This provision requires ‘that all large institutions prepare living wills that serve as a detailed blueprint of the organization and its plan for a rapid and orderly liquidation under the Bankruptcy Code in the event of its failure’ (Barth et al., 2014, p. 84). Barth et al. acknowledge that this annually renewed document is an ‘arduous and expensive’ requirement, but argue it is highly valuable, as it forces bank management to have a clear view of their corporate structures and of all business lines and inventory, thus reducing risk through ignorance (ibid). Others point out that the cost of regularly producing a living will is ‘a tax on complexity’ (Acharya, Cooley, Richardson, Sylla, et al., 2011, p. 8), and therefore represents a disincentive for becoming ‘systemically important’ that can partially counter incentives for achieving that status, such as cheaper funding costs and higher equity valuations.

In providing an up-to-date overview of a systemically important bank, the living will can provide regulators with an early warning alert of a bank that is becoming excessively risky, allowing for pre-emptive intervention. If an institution gets into trouble the living will provides a roadmap for orderly liquidation as a least-cost solution. This last point is particularly important in the context of supporting Dodd-Frank’s goal of ensuring bankruptcy rather than bank bailout occurs if a systemically important institution fails. The ‘living will’ overcomes the ‘too complex
to fail’ issue (G. G. Kaufman, 2014, p. 215), by negating the barrier of complexity that could prevent an orderly unwinding during a crisis.

Dodd-Frank also established the Consumer Financial Protection Bureau to protect citizens from financial fraud and deliberately misleading financial products. A further provision is the Volcker Rule, which reinstates a limited form of Glass-Steagall. The Volcker rule limits the amount of proprietary trading a bank holding company may engage in, and does not allow for any bailout of these activities. The amount allowed is restricted to $8 billion under the de minimus threshold provision. The threshold is designed to allow smaller nonfinancial companies to avoid the regulatory requirements aimed at large banks. These smaller entities use proprietary trading to hedge risk (Bryan & Rafferty, 2006), and at the de minimus threshold pose no systemic risk. These are some of the most significant changes to the regulation of the financial system. I now turn to assessments of the impact of Dodd-Frank.

A number of studies view Dodd-Frank as falling short on actual effectiveness due to the political lobbying power of the financial sector (Simon Johnson & Kwak, 2011; Moosa, 2010; Prasch, 2012; Rosenblum, 2011; Skeel, 2010). According to this analysis, the banks have the lobbying power, political connections and the resources to stop legislation contrary to their interests, and have used this influence to water down Dodd-Frank. Skeel (2010) offers a critique of Dodd-Frank for its double crime, first of failing to comprehensively deal with the central problem of moral hazard and market privilege which TBTF banks claim, and second, for reinforcing some of the major causal factors that led to the crisis. These include a relationship of crony corporatism between the political establishment and big finance in the USA, aided and abetted by a policy framework based on opaque discretion rather than transparency and rule of law. In providing the strongest reading of the ‘lobbying power’ position, Prasch argues that the ensuing financial reform post-2008 was a case of politicians giving the ‘appearance of “doing something”’ to placate public anger but that in actuality it is business as usual on Wall Street (2012, p. 550). His
biggest point of supporting evidence for this claim is the failure to outlaw a ‘systemic risk’ clause for allowing future bailouts.

While there can be little doubt that Wall Street has influence in Washington, and that the big banks influenced the final version of Dodd-Frank, the argument that the legislation is a continuation of pre-crisis practices is misleading. It underplays the significant changes the Act entails and the fact that many of which are contrary to Wall Street’s desires, as I highlight now. For example, the ‘living will’ provision entails significant costs, it allows regulators to keep better track of risks, and increases the likelihood that an orderly liquidation of a failing bank can be achieved, obviating the need for a bailout. Clearly, the Volcker Rule is also against the wishes of the large banks, placing an $8 billion threshold on proprietary trading that effectively locks them out of any significant trading. Furthermore, the fact that the Consumer Financial Protection Bureau ‘has faced dogged, and at times vitriolic, opposition from some in the financial industry’ prior to, and since its inception (Peterson, 2015, p. 1061) is good evidence that it is contrary to Wall Street’s wishes. As indeed are the hefty fines the Bureau has levied against institutions, with one example being Wells Fargo receiving a fine of $500 million in 2018 for applying fraudulent insurance charges to customers (Borak, 2018). Other analyses of Dodd-Frank are also critical of the view that little has changed (Acharya, Cooley, Richardson, Sylla, et al., 2011; Barth et al., 2014; Krainer, 2012).

Krainer points out that ‘it is important to remember that Dodd–Frank is a political Act subject to all the political infighting fuelled and greased by an intense and well financed lobbying effort on behalf of the financial services industry’ (2012, p. 122), but continues on to note that it was ‘surprising’ to see how much of the suggestions for serious reform were taken on board by Congress. Another study shares this viewpoint. Barth et al (2014, p. 82) outline what they view as four legitimate critiques of Dodd-Frank: (1) the Act is too complex; (2) it is too difficult to implement, with only 40 percent of provisions implemented by 2014; (3) the Act was silent on some of the most important causes of the crisis, which they view as the
moral hazard and government-sponsored entities; and (4) the Act failed to outlaw bank bailouts. However, while acknowledging these points, they argue these failures have been used to generate a misleading narrative that nothing has changed. Whereas for Barth et al (2014) the Act is responsible for significant changes in U.S. finance. The financial sector is in a far stronger position than prior to the crisis, as evidenced by the fact that ‘capital and liquidity are at nearly twice the levels they were in 2009’, while tier 1 common equity capital provided by banks’ shareholders and which acts as loss-absorbing buffer capital, has increased more than 90 percent, rising from $420 billion in 2009 to over $800 billion in 2014 (Barth et al, 2014, p. 83). They further note that leverage has been reduced by half over the same period. Increased capital and liquidity requirements reduce the banks’ ability to maximise earnings by tying up capital as an insurance buffer that could otherwise be invested, while tier 1 capital is first in line for absorbing losses if a bank fails. Both measures are contrary to the profit-maximising interests of investors.

Acharya et al (2011) see Dodd-Frank as a partial success, but also a work in progress. They ‘applaud the Dodd-Frank Act’s ambition and its copious attempt to rewrite financial sector regulation’ (2011, p. 29). They view its successes as including the ‘living will’ provision, the Volcker Rule, and the centralization of derivatives clearing which make a formerly opaque activity transparent and as a result easier to regulate. They also applaud the requirement of enhanced supervision for nonbank firms designated as systematically important. However, on the minus side the authors argue that Dodd-Frank fails on a number of grounds (Acharya et al., 2011, p. 8-9). It is overly complex, requiring as it does ‘over 225 new financial rules across 11 federal agencies’ (ibid, p. 8). It fails to fully overcome moral hazard generated by the ‘systemic importance’ designation, and which distorts market pricing of bank insurance and inter-bank lending. The Act has provisions to make large banks bear their own losses during failure, but does not make them bear losses they impose on other connected banks in the event of failure, thus still leaving the taxpayer liable for those. They also point out that the final version of the Volcker rule is ‘a highly
diluted version of the original proposal’ (ibid, p. 7), and that Dodd-Frank ‘fails to recognize that there are systemically important markets’ as well as individual institutions (ibid, p. 8), thus leaving open another avenue by which government support may be required in the future.

Scott argues that Dodd-Frank solves the wrong problem, in that some of the most important provisions address risks arising from asset ‘connectedness’ (Scott, 2016, p. 59), whereas ‘contagion’ was the real issue in 2008. Asset connectedness relates to the direct losses that one bank’s failure imposes upon another financial institution. Recall that when Lehman collapsed it imposed direct losses on banks, pension funds and other institutions globally. While Scott views addressing this issue as important, he argues as does Swedberg (2010) that indirect losses are more dangerous than direct losses in causing systemic crises, and that it was therefore ‘contagion’ rather than ‘connectedness’ that was the source of systemic risk during 2008 (Scott, 2016, p. xv). Scott argues that while Dodd-Frank solves the risks of connectedness by requiring banks to have large capital buffers to absorb losses, it fails to adequately solve the problem of contagion.

Both Scott (2016) and Acharya et al (2011, p. 28) agree that power to stop contagion is severely restricted as a result of Dodd-Frank removing authority from the Federal Reserve to act as lender-of-last-resort to individual nonbanks. During 2008 this power was essential to avert contagion when used to support AIG two days after Lehman Brothers failed. The political will to reduce lender-of-last-resort authority is a direct outcome of the politics and public outrage over ‘Too big to fail’, with Scott elaborating: ‘These powers were attacked after the crisis as undesirable bailouts and were either restricted or eliminated, leaving us vulnerable to future contagion’ (2016, p. 65). The Federal Reserve still has the capacity to act as lender-of-last-resort, but only as part of a broad programme and not to individual institutions, and assistance must be supported by the Secretary of the Treasury. Scott argues this is too rigid, and argues strongly for the need for discretionary authority in times of crisis.
To sum up, it is worth noting that there are a number of similarities between the Federal Deposit Insurance Improvement Act of 1991, and the Dodd-Frank Act of 2010. Both pieces of legislation were in response to a major period of financial crisis. Both were formulated and passed in Congress during a period of political agitation and public outrage over government assistance to private finance, resulting in strong political will to develop a genuine response to the problem. Both Acts effected genuine change in how the financial sector is regulated, and both maintained a ‘systemic risk’ clause that provides the authorities discretion to provide bailouts under dire circumstances. I reject as simplistic the view that the Dodd-Frank Act is ‘business as usual’. The main criticism levelled at both the FDICIA and Dodd-Frank in their aftermath was that they did not provide an outright ban of ‘Too big to fail’. But this critique is misguided. The next section will argue that the institutional logic and operation of a capitalist financial sector is such that there can be no final regulatory solution to the problem of ‘Too big to fail’.

10.4. ‘Break up the banks’, and other non-solutions

The most enduring and heavily politicised critique of the Dodd-Frank Act is that the legislation was meant to end ‘Too big to fail’ but instead legally codified the practice. In the first major political hearing one year after implementation, Chairman McHenry opened the hearing as follows: ‘Dodd-Frank has only reinforced the bailout culture, perpetuated the moral hazard of government intervention, and tipped the economic scales for a few at the expense of growth and competition’ (Has Dodd-Frank Ended Too Big to Fail?, 2011). In another hearing three years later, Chairman Hensarling declared in his opening statement: ‘Dodd-Frank codified too-big-to-fail into law, and it is now demonstrable 4 years later that the big banks have gotten bigger and the small banks have gotten fewer’ (Assessing the Impact of the Dodd-Frank Act Four Years Later, 2014, p. 2). Bhagat (2017, p. 117) documents prominent public officials who have recently argued for breaking up the banks as
the only solution to the bailout problem, including Paul Volcker, former Chairman of the Federal Reserve, Thomas Hoenig, member of the Board of the FDIC and former President and CEO of the Federal Reserve Bank of Kansas City, Richard Fisher, President and CEO of the Federal Reserve Bank of Dallas, and Neel Kashkari, President of the Federal Reserve Bank of Minneapolis.

The academic literature is also replete with calls to break up the banks as the solution to the bailout problem (Graham, 2010, p. 154; Moosa, 2010, p. 329; Prasch, 2012, p. 552; Rosenblum, 2011, p. 21). Rosenblum argues that this approach is the only way to ‘restore faith’ in market capitalism (2011, p. 21). However, for a number of reasons to be outlined below I argue that there is no feasible way to reduce the size of the large banks to an extent that would prevent systemic risk. One problem in any proposal to break up the banks is the difficulty of specifying what the right size threshold that is both bailout safe and economically viable (Bhagat, 2017, p. 118; Rosenblum, 2011, p. 21). So what size makes a bank ‘Too big to fail’?

Penas and Unal classify a bank as TBTF if its assets exceed two percent of assets of all depository institutions in a given year (2004, p. 157). Brewer and Jagtiani (2013) estimated the TBTF threshold during 1991-2004 was $100 billion. They base this definition on banking merger data over that period, during which time they argue that banks paid $15 billion in premiums across eight deals that ensured the merged entity would break the $100 billion mark, which was viewed as the bailout threshold. The Dodd-Frank Act classes bank holding companies that have assets of $50 billion or more as systemically important. Therefore, large banks would have to be reduced in size to below this threshold to end ‘Too big to fail’.

To assess the feasibility of this proposal we first need to compare the ‘too big’ threshold with the actual size of large banks today. The financial crisis made large banks larger, as smaller banks were merged with bigger ones to stabilize the sector, so that by 2010 six banks accounted for ‘two-thirds of the assets of the banking system’ (Moosa, 2010, p. 322). In the second quarter of 2018 the top six U.S. banks total assets were as follows: (1) J.P. Morgan $2.6 trillion; (2) Bank of America Corp. $
2.3 trillion; (3) Citi Group Inc. $ 1.9 trillion; (4) Wells Fargo $1.9 trillion; (5) Goldman Sachs $970 billion; (6) Morgan Stanley $875 billion (Tariq & Haider, 2018). J.P. Morgan alone represents a multiple of 52 times over the $50 billion threshold. In the fourth quarter of 2017 the top 38 U.S. banks were all above the $50 billion Dodd-Frank threshold. What would the economic costs be of breaking up all those banks? How would you keep them all below that level thereafter? While calls for break up are abundant, answers to these questions are not. Rosenblum ponders, but without answering, if the policy could be implemented without major economic damage (e.g. Rosenblum, 2011, p. 21).

But this is not the only issue at stake in break-up. Concentration within the financial sector is not unique, or especially high, rather it is reflective of the general concentration levels in all sectors of the economy (Heilbroner & Milberg, 2012, p. 80). In that light, opponents of calls to break up the banks argue that economies of scale mean that the banks must maintain a size relative to the wider economy in which they operate, both to remain competitive and to be functional (Barth et al., 2014). National competitiveness and functionality is only one concern when considering the implications of bank size. Another consideration is geopolitical. American banks are global operators, breaking them up would deprive U.S. finance of globally significant operators. In a capitalist world system ‘geoeconomic’ power (D. Cowen & Smith, 2009; Luttwak, 1990) is crucial to a state’s geopolitical power.

Geoeconomic power entails exerting control and influence over economic flows beyond the territory of the nation state. The United States has immense geoeconomic power through the dollar as global reserve currency, and by having large numbers of sector-leading multinational corporations. The economic rise of China is challenging the U.S. on some of these fronts, one of which is finance. Four state-owned Chinese banks currently hold the top four spots in the 2018 global bank rankings by assets (Mehmood & Chaudhry, 2018). The Industrial and Commercial Bank of China ranks number one with $4 trillion in assets, while the top American bank, J.P. Morgan, ranks 6th place globally. A $50 billion bank would not count as a
global contender. Will any American government undermine the ability of its leading financial institutions to be competitive in the global market? American geopolitical history would strongly imply not (N. Smith, 2003).

These are substantial grounds as to why calls to break up the big banks are likely to go unheeded. However, even in the unlikely event that banks were broken up, it still would not solve the problem of systemic risk. As two proponents of break up acknowledge, contagion can make size irrelevant (Graham, 2010, p. 122; Rosenblum 2011, p. 19), since instead of ‘Too big to fail’ you get ‘too many to fail’. In addition, it is also the case that many smaller firms perform critical processes so that their failure poses ‘significant systemic risk’ (Bhagat, 2017: 118). A further point that cuts to the core of the problem, and provides another powerful reason why ‘Too big to fail’ cannot be ended is that ‘[s]ize is not the problem. The problem is excessive risk regardless of size’ (Barth et al, 2014: 88). Indeed, and in a capitalist system there can be no final regulatory solution to excessive risk in the financial sector.

In finance, risk is the fundamental commodity on which profits are made, one that is constantly being traded, packaged, measured, priced, insured, sold, resold, reinsured, spliced and re-constituted in ever more novel ways. Pushing the boundaries of risk management in order to generate new lines of profit is one aspect of financial innovation. Likewise, more ways to manage risk means more ways to increase leverage, which increases the productivity of financial assets, and again profits. Risk in finance is the goose that lays the golden eggs. This primary relationship between risk and profit is why there is a ‘dialectic of regulation’ (Goodhart, 2014, p. 4). Regulations are designed to negate risk, or at least that level of risk that could be systemically dangerous. As Goodhart explains, effective regulations prevent the ‘regulated from doing what they want to do. So they will attempt to avoid it. Usually they succeed, though perhaps only after a time’ (ibid, p. 4). This is also known as ‘regulatory arbitrage’, whereby financial actors seek to develop new organizational practices and product innovations that ‘circumvent the regulatory apparatus designed to contain bank risk taking’ (Acharya et al, 2014, p. 3).
The effect of such arbitrage is a dialectic wherein crisis leads to new regulations, which leads to avoidance and erosion, leading to crisis, and more regulation, and so on. Meltzer further illustrates this process through his two laws of regulation:

[M]y first law of regulation. Lawyers and bureaucrats regulate. Markets circumvent regulation. My second law of regulations says: Regulations are static. Markets are dynamic. If circumvention does not occur at first, it will occur later. Regulation then often misleads the innocent (Meltzer, 2012, p. 9).

Regulation misleads the innocent when it is thought of as being able to provide a final solution to the problem of excessive risk. A final solution to excessive risk-taking in the financial sector would only be possible by regulating so tightly that no risk-taking at all would be possible, simply because the line between ‘reasonable’ risk versus ‘excessive’ risk is impossible to draw on a regular basis. And here the differential morphology of markets versus regulatory frameworks is crucial: markets are dynamic, whereas regulations are static for long periods of time. The latter can never keep up with the former. Likewise, nobody knows how risky a new financial innovation is until it is tested through use, and there is always a powerful incentive for financial agents to push risk to the limit, in fact doing so is part of its raison d’être.

Profit is the fundamental incentive for entrepreneurial activity in every sector of the capitalist economy. But it is only in finance that the externalities of this risk-taking may be imposed upon the rest of the economy in potentially catastrophic ways. Nevertheless, so long as finance is capitalist in nature, innovation will involve pushing the frontiers of risk-management. Does that mean regulations are pointless? Absolutely not. Regulations are important, because depending on how well formulated they are, they can either ameliorate or aggravate the trend, increase or decrease the frequency and amplitude of crises. What they cannot do is remove or negate the trend altogether, because the trend is structural and fundamental to the capitalist institutional order.

What the weight of evidence shows is that the chances of breaking up the big banks to a sufficient degree that they would no longer be ‘Too big to fail’ are remote.
Even if this could occur, it would not prevent the possibility of systemic risk, due to financial connectedness and the effects of contagion. It is also the case that risk cannot be fully regulated out of the financial sector, because risk is fundamental to capitalist activity. In addition, the line between “safe” levels of risk and “excessive” risk is at best many shades of grey and typically only clear in hindsight. Finally, the effect of reconstitutive downward causation on agents operating within capitalist institutions is such as to impart powerful profit-seeking modes of behaviour, driving financial innovation to constantly test the limits of risk. The life of a firm, and the success of an agent within it, is positively connected with successful accumulation. This is why ‘financial crises are recurring phenomena, just like the business cycle’ (Acharya, Cooley, Richardson, Sylla, et al., 2011, p. 13). In short, there can be no regulatory solution to ‘Too big to fail’.

10.5. Sub-Optimal Evolution and System Lock-In

Bank bailouts will remain the policy solution to avert catastrophic systemic risk in the future for three reasons. One, there is no feasible way to reduce banks to a size where they no longer pose systemic risk. Two, there is no way to simultaneously have a capitalist economic system and to fully and finally solve the problem of risk arising from financial innovation. Three, no government is willing to allow contagion take hold of their financial system (Baker and McArthur, 2009; Gup, 2004; Wilmarth, 2004; Mishkin, 2006; Goodhart, 1999), despite the high costs involved in bailing out banks to avert this effect. The evidence shows that ‘Too big to fail’ is an evolutionary outcome, a process within which politics and agency play a role, but which is an unintended outcome of a wider set of structural factors over which no agents have full control. Furthermore, there has been clear efforts by powerful actors to end ‘Too big to fail’, but to no avail. Importantly, it is also a sub-optimal outcome. This outcome has consequences both for a debate within evolutionary theory, and for the future of capitalism.
Within evolutionary theory there is debate concerning the type of outcomes possible through an evolutionary process. A number of studies argue that sub-optimal evolutionary lock-in is one possible outcome for an evolutionary system (Beinhocker, 2006, p. 440; Bowles, 2004, p. 12; Hodgson, 2004b, p. 44). Here natural selection is not understood as implying either moral or just outcomes, nor does it imply optimality or progression on the previous state of affairs. Refinement, is simply refinement relative to the given environment, and need only be ‘just enough’ of a refinement to ensure survival (Aldrich et al, 2008, p. 585; Hodgson and Knudsen 2010, p. 36, 90). This was the original view offered by Darwin, who pointed out: ‘we are apt to look at progress as the normal rule in human society; but history refutes this’ (Darwin, [1981] 1871, p. 166). The position on sub-optimality can be summed up as follows: ‘Darwinism does not assume that selection brings about globally efficient or (near) optimal outcomes, and in certain instances, selection can even lead to systematic errors or maladaptions’ (Aldrich et al, 2008, p. 585). This is because evolution never starts from scratch, but must work with the structures endowed by past development, thereby setting limits on adaptability under constantly changing conditions.

Yet many studies understand evolutionary processes as automatically resulting in optimality (Brown, 2012; Poirot Jr, 2008; Ridley, 2015; Tang, 2017). Following that, these studies argue that if existing social outcomes are not optimal, it therefore stands that they are not Darwinian either. Poirot, for instance, discusses Veblen’s criticism of institutions that persisted but which did not ensure maximum welfare for humans. Poirot claims: ‘In arguing that maladaptive institutions could persist Veblen abandoned a strict Darwinian view of social evolution’ (2008, p. 412). On similar grounds, Tang states: ‘This ontological fact that not all aspects of human society are welfare-optimizing (i.e., Pareto-optimal) or even welfare-improving (i.e., Pareto-improving) makes a Darwinian approach inadequate (if not misleading) for understanding human society’ (2014, p. 605). These views indicate a failure to fully grasp the nature of an evolutionary process, and its fundamental limitations.
Generalized Darwinism as discussed above in chapter five only claims that solutions to problems need be adequate, or slightly better than the next best available solution to become selected and retained within complex systems that have the suitable mechanisms for variation-selection-retention to occur. Furthermore, it is claimed that in such circumstances, over time this process will discipline the developmental arc of such systems, making them evolutionary in the Darwinian sense of the term. As Marx rightly said: ‘Men make their own history, but they do not make it as they please; they do not make it under self-selected circumstances, but under circumstances existing already, given and transmitted from the past’ ([1885] 2001, p. 7). Institutional-evolutionary theory argues those circumstances are transmitted through institutional evolution.

Within a social evolutionary process, political agency faces limits to action set by the nature of the system at hand, its inherited structural path-dependency and the evolutionary trend generated by the dominant institutions of a society. The evidence from the comparative capitalism literature shows unequivocally that there are many possibilities for capitalist evolution, with variation itself an outcome of the unique histories and cultures of different societies, as well as political agency. But variation has its limits, and there are also important commonalities across all capitalist economies. The last two chapters have focussed on one such commonality, financial crisis. This leads into the second point to be discussed, sub-optimal lock-in and the future of capitalism.

Based on the evidence in this chapter, I argue that the structure of a capitalist financial sector is such that risk is fundamental, and therefore cannot be fully regulated out of the operation of finance. This means that future crises are more or less a certainty, as is being increasingly recognised in the literature (Acharya, Cooley, Richardson, Sylla, et al., 2011, p. 13; Krainer, 2012, p. 125; Sewell Jr, 2012, p. 304). At the same time, there is no way to fully resolve the ‘Too big to fail’ issue within a capitalist institutional order, despite all the problems that are connected to it. These include it being antithetical to capitalist ideology, its high economic costs and the
political rancour it generates. It is locked-in to the evolution of finance capital, and therefore the politics of bank bailouts will play a role in the future of capitalism, and indeed bailouts have played a major role in recent political history.

Bank bailouts post-2008 in European countries such as Ireland, Greece and Spain resulted in these states running very high debt-to-GDP ratios to pay for the bailouts. To regain fiscal positions that comply with European Union rules these states adopted severe cuts to public spending, otherwise known as ‘austerity’ (Blyth, 2013; McDonagh, forthcoming 2019; Mylonas, 2014). In analysing Ireland’s political economy post-2008, I argue that bailouts of Irish banks added further political tension to a socio-political distribution crisis that emerged as the country’s property boom collapsed (McDonagh, forthcoming 2019). A capitalist recession can generate a socio-political distribution crisis as different economic classes each seek to maintain their pre-crisis share of income (McDonagh, 2019, p 9). During recessions government income decreases in correlation with declining tax receipts, while welfare spending increases in correlation with rising unemployment. Some groups in society must suffer a reduction in their income as a consequence of the state adjusting its taxation and spending to reflect the new fiscal reality. During 2008 the Irish state’s income dropped drastically as recession developed (Drudy & Collins, 2011), while simultaneously unemployment and welfare spending increased. With significant fiscal adjustment already on the horizon, the state had to spend a further €64 billion on bank bailouts in 2009/10 to prevent systemic contagion, with the cost amounting to a quarter of annual GDP for 2010 (McDonagh, 2016, p. 89). It was this additional debt that led the government to simultaneously increases taxation while engaging ‘austerity’, ‘referring to drastic cuts in public spending’ (McDonagh, 2019, p.1). Major political volatility ensued as social groups contested cuts in spending and new taxation (Charalambous & Lamprianou, 2016), in a manner similar to events that played out across other European countries that implemented bailouts and austerity.

In Greece and Spain austerity politics resulted in two new left-wing socialist parties, Syriza and Podemos respectively, emerging and going on to have significant
electoral success (Orriols & Cordero, 2016; Stavrakakis & Katsambekis, 2014). The successes of these new left wing parties directly reflects a delegitimising of capitalism amongst the Greek and Spanish citizenry. The bailouts have ‘provoked social conflict, political controversy and academic disputes’ (Clarke & Newman, 2012, p. 299). The social consequences of austerity have been linked with the rise of extreme forms of populism across the Continent (Kriesi & Pappas, 2015; Stavrakakis & Katsambekis, 2014; Vasilopoulou, Halikiopoulou, & Exadaktylos, 2014). The costs of bailouts have major political consequences.

Bank bailouts also pose questions that have the potential to unsettle capitalist legitimacy in other ways. In the aftermath of 2008 on of the most significant global social movements of the 21st century, Occupy Wall Street, emerged (D. Taylor, 2017; Van Gelder, 2011). The principle factor driving Occupy was anger at Wall Street banks being bailed out. The movement also made a political demand for a ‘people’s bailout’, a point echoed by academics (W. C. Marshall & Concha, 2012; Martin, 2010). Martin argues that the mutualisation of risk at play in bank bailouts could provide ‘the basis for a reenchantment of socialism’ (2010, p. 187). One of the more enduring and significant splinter organizations that emerged out of Occupy, ‘Strike Debt’ (Aitken, 2015; Ross, 2014) offers a nascent realization of that suggestion. Strike Debt is a movement of activists, writers and academics in the United States that organizes debt resistance and have produced for free dissemination a Debt Resistors Manual that provides strategies for dealing with common debt enforcement. Strike Debt also organizes an online fund called ‘rollingjubilee’ that raises money through donation to purchase debt for pennies on the dollar in order to strike it out. To date, the site claims to have raised $700,000 used to strike out $31 million in debt, targeting medical and student debt (Strike Debt, 2018).

Another social movement birthed out of the turmoil of 2008, and one that has been more politically significant in the U.S., is the Tea Party (Arceneaux & Nicholson, 2012; Madestam, Shoag, Veuger, & Yanagizawa-Drott, 2013). The Tea Party emerged as an anti-federalist grassroots movement in early 2009. Like Occupy, its early
participants were incensed by government assistance to Wall Street. However, the similarities end there. The Tea Party’s objective is to reduce all forms of government assistance, whether that be to Wall Street, Main Street or social welfare, with 85% of Party supporters in favour of cutting domestic spending as the best way to reduce the national budget deficit (Arceneaux & Nicholson, 2012, p. 702). The Tea Party is recognised as having revitalized a flagging Republican Party after Obama’s 2008 election win, and also with shifting the Republican Party even further to the right (V. Williamson, Skocpol, & Coggin, 2011).

These political reactions to bank bailouts post-2008 are illustrative of the radical upheavals which have emerged across the United States and Europe. These events provide evidence of the destabilizing effects of financial crises solved through bank bailouts. To that extent, bank bailouts offer a ‘Damned if you do, and damned if you don’t’ conundrum. The consensus view of governments since the Great Depression has been that the high cost of bailing out the financial system is less than the cost of letting it face systemic collapse. Consequently, bailouts will almost certainly occur again in the future, and the way in which these future bailouts are managed will play a significant role in the politics of capitalism.
Conclusion

This thesis has investigated the institutional evolution of capitalism in the context of the 2008 Global Financial Crisis. The latter was the most significant economic crisis since the Great Depression, and posed an existential question regarding the future of the economic system. To investigate the question of capitalism’s future Part I of the thesis outlined institutional-evolutionary theory, an approach argued here to be a preeminent theoretical framework for understanding social evolution. In Part II, I reviewed mainstream economics and political economy debates on what the 2008 crisis portends for the future. Here I identified the empirical weaknesses and theoretical limits of many of these studies. It was argued that global capitalism is dynamic, and that a China-led Asia will drive global growth in the 21st century. In Part III of the thesis, I refined the investigation into capitalism’s future by focussing on the evolution of the institutional policy at the center of 2008, ‘Too big to fail’. Bank bailouts have been used to avert the most dangerous type of financial crisis, systemic risk, since the 18th century. Analysis of the evolution of this policy has revealed important insights into how capitalism evolves, how the business cycle is managed, and also the limitations of institutional regulation of capitalist dynamics.

In drawing out further the lessons of this thesis for understanding capitalism’s future, I return briefly to an earlier famous thesis on the subject, Joseph Schumpeter’s *Capitalism, Socialism and Democracy*. In 1942, and in light of the Great Depression and the emergence of state socialism as an alternative economic system, Schumpeter developed his thesis on the future of capitalism (Schumpeter, [1942] 2008). It is a classic study of the capitalist economy as a system whose institutions impart a specific direction to social change, and wherein economy and politics are understood as deeply intertwined. Schumpeter viewed capitalism as an economic success but a sociological failure, arguing that social issues generated by capitalist
development were a grave danger to the system’s ongoing reproduction. Regarding economic prospects, Schumpeter predicted ‘there are no purely economic reasons why capitalism should not have another successful run’, adding that ‘in these things, a century is a “short run”’ ([1942] 2008, p. 163, emphasis original).

There are important echoes of Schumpeter’s analysis in this thesis nearly 80 years later. Based on the evidence weighed up in chapter eight, I argue that there are still no purely economic reasons to predict the end of capitalism. The argument that global capitalism is in terminal decline does not stand up to scrutiny. Global growth has been strong during the post-2008 recovery. The United States has recovered from 2010 onwards, and on 22 August 2018 recorded the longest bull run in history for the S&P 500. By that date the index had gone 3,453 days without a ‘correction’, which involves a drop of 20% or more. The Eurozone has also recovered, albeit more slowly, while Japan can be seen as a case of what Michael Mann terms ‘enduring low growth’, discussed in chapter seven. Elsewhere, capitalism is booming. A China-led Asia continues to grow at high rates, and if an economic downturn occurs in China or elsewhere in the coming decade or so, well that will hardly be a new, or unexpected turn in capitalist history. Furthermore, any economic model that discounts the importance of Asia as an emerging center of global capitalism is inadequate in the extreme.

I also argued in chapter eight that renewed predictions of an old capitalist haunt, technological unemployment, are empirically ungrounded and theoretically suspect. World employment is at a record high. Throughout the history of capitalism new technologies that have saved on manual and unskilled labour, have also opened up new markets and new forms of employment. It is in the entrepreneur’s brief to generate precisely such outcomes. Technology has generated more jobs than it has extinguished, and these jobs have continuously required higher skilled and more educated workers, not less. From an economic perspective, global capitalism is as dynamic as ever, and there are no convincing grounds to see an end to creative
destruction and economic dynamism within three to five decades, the range predicted by contributors to the ‘capitalism is ending’ theme.

Thus, I follow Schumpeter and engage in a bit of one-upmanship. I predict there are a few more runs left in global economic growth. In that context, I further argue that Marxist political economists should give up the ghost of Marx on the particular issue of capitalism’s contradictions resulting in its economic breakdown. Capitalism is not going to fail through economic stagnation, whatever else may unfold. As I have argued, the development and application of institutions that manage capitalist reproduction have been central to stabilizing the business cycle. Nevertheless, and as also discussed, issues still persist, such that I concur with Schumpeter’s second point, that social and political consequences flowing from capitalist development may pose the real trouble.

Here I have argued that bank bailouts are one issue that pose political and social trouble. They present a paradoxical situation: a policy designed to save the economic system, but one which cuts fully against that system’s moral grain, as well as its practical operation. Bank bailouts suspend the capitalist market’s operations, socialize its private debts and nationalize private corporations, all in the name of the common good. In doing so they destabilize capitalism’s ideological moorings. For this reason, they have invoked political rancour throughout history, along with significant political will to end ‘Too big to fail’ through regulations.

I argue that institutional-evolutionary economics offers concepts that explain this paradox, by illuminating the structural forces at play in the diffusion of banking institutions, that have over time led to the institutionalization of ‘Too big to fail’. The theory was applied to assess the institutional nature of capitalism, and how this imparts an evolutionary arc to the history of finance capital. This arc is disciplined by a complex of interactions arising between the unintended outcomes of agents seeking profit under capitalist institutions; the intended actions of agents seeking to prevent such crises; and the logic through which finance operates. In short, the interaction between crisis, regulation and risk, within a process governed by a
further factor, path-dependency. This complex of relations has produced institutional variation, which in turn has been reduced down through a Darwinian process of variation-selection-retention over centuries, resulting in the global institutionalization of ‘Too big to fail’ today. I argue that this outcome is a prime example of evolutionary lock-in, a result that is sub-optimal but the best solution nonetheless for governments seeking to avoid financial contagion during crisis.

The utility of institutional-evolutionary theory is that it provides a means to conceptually grasp the nature of these interactions. One benefit to this is that it allows for identification of limits to action. For example, understanding the institutional logic of finance provides insights of the sort ‘if X then Y’. To elaborate, chapters nine and ten argue that if you have a capitalist financial system then you cannot fully regulate away risk. Thus, if ‘capitalism’ then ‘risk’, or if C then R. Risk is fundamental to how finance works. Furthermore, the behaviour of financial agents is influenced by reconstitutive downward causation to be pro-risk, because this is how these agents can engage financial innovation, with the goal of creative destruction and high profits. It is the institutions of finance that impart behaviour that continually seeks to engage regulatory arbitrage. As discussed in chapter ten, effective regulations prevent financial agents from engaging practices they are otherwise incentivised to engage in, which is why they innovate their way around such regulations. The primary cause of financial crisis, then, is the logic of finance and the practices demanded by capitalist institutions. This is why financial crises have repeated throughout history, despite the continually changing contextual factors, such as regulatory environments, or varying cultural and political environments across the globe.

Does this mean regulations are pointless? Absolutely not. The evidence shown in this thesis is that increasing regulatory sophistication, and better knowledge of fiscal management and the nature of the business cycle has dampened the frequency and intensity of these cycles over time. Good regulations decrease the frequency and amplitude of economic crises. Bailout policy has been an important
tool in this regard. But Sewell makes an important observation on this dampening
effect: ‘Although governments have learned over time to dampen the cycles by
instituting unemployment insurance schemes and manipulating monetary and fiscal
policies, the business cycle has proved impossible to abolish’ (Sewell, 2008: 520).
Thus, financial regulations have their limits. The business cycle is fundamental to the
working of capitalist economics. Regulatory management of this cycle is possible,
full command over it is not.

There is no way to fully regulate for the causes of future crises, even if some
pre-emptive actions can be postulated. Nevertheless, the most successful and stable
economies over the past two centuries are those with the most developed set of
regulating institutions (Sklar, 1988). This does not imply that more regulation is
automatically best, rather it is a question of the quality of regulations rather than
quantity. In that light, chapter ten shows why governments ought to keep a
‘systemic risk’ clause in their policy arsenal for dealing with financial volatility. Just
because discretion can be abused is not a reason to deny discretion in situations that
demand it. A rules-based use of discretion is possible. Calls to outright ban the
policy are based on a flawed understanding of the capitalist economy.

To return to Sewell’s point, the business cycle and economic crisis has been
impossible to abolish because it is an outcome of the nature and logic of the capitalist
institutional order. While critical political economy has long pointed out as much,
this is only part of the story. It is also the case that an economic contradiction only
arises if there has been successful economic development to begin with. Thus, if it is
ture that the contradictions of capitalist development cannot be negated entirely,
history also proves they can be effectively managed in ways that thus far have vastly
increased long-term economic stability to a level acceptable to citizens and
governments.

Effective institutional management of capitalism has marshalled the
contradictions of the system to a large degree. I have shown as much here, using
institutional-evolutionary theory to highlight how banking history has evolved to
reflect this dynamic. I have also shown that social systems have an evolutionary life of their own, determined by a process of institutional evolution which may be influenced by agents, but whose outcomes are beyond the design or control of any group of agents. For this reason, and more, Thorstein Veblen argued a century ago that economics must be an evolutionary science.


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