

Is capitalism really capital-ism?

Hodgson, Geoffrey M: Conceptualizing capitalism: institutions, evolution, future. University of Chicago Press, Chicago and London. x+495. pp.

The economists I look on as the greatest are those who can convince by using only simple language. One can learn by reading them even when they do not apply the sophisticated mathematical and econometric tools characteristic of economists; when they apply only the fine but commonsense logic of economics. In my estimation this club of the greatest includes names such as F. A. Hayek, James Buchanan, Ronald Coase, Amartya Sen, and Peter Thomas Bauer. With this new book Geoffrey Hodgson has become a member of this club. Just like these great economists, Hodgson does not pretend to know the facts better than economic historians do. He doesn't pretend to do mathematics better than mathematicians do. He does not build a new model, neither does he uncover new facts or new statistical methods to examine old facts. What he does is simply a kind of a refined common sense. Yet, this wise approach helps him shed new light on the old question: Is the rapid economic development of the past 250 years the result of a new system of institutions?

Some institutional economists, such as North (1990) or Acemoglu and Robinson (2012) have thought hard about this question and say 'yes'. Other institutional economists and economic historians (Clark 2007; McCloskey 2010) have thought about it even harder and say 'no'. As this book reveals, Geoffrey Hodgson, a brilliant institutional economist, has thought about it the hardest I have ever seen and says 'yes'. But his 'yes' is a complicated one; it takes a book-length analysis of the definitions of such difficult concepts as money, property, contract, and above all, capital.

The most surprising discovery of the book is that economists' knowledge of the institutions they are supposed to be scientifically studying is insufficient to understand the nature of these institutions. Through a serious and balanced analysis of the fundamental institutions of the market economy Hodgson arrives at a definition of "capitalism" which is a union of the Marxian and the Schumpeterian sets of the characteristics of capitalism. But the concepts of these two authors must first be refined and examined over 250 pages so that the author can conclude the first part of the book with a definition of capitalism.

What may surprise many economists reading Hodgson's definition and understanding of capitalism is that for him capitalism is more than just a market economy. In his view, capitalism must be defined as a historically new set of institutions which are only characteristic of the past two hundred or so years of humanity. Markets and certain other

“conservative” elements of economic freedom are too old to be the only defining feature of an institutional structure of such novelty as capitalism. Markets and freedom of exchange are not enough to describe modern institutions.

There is a common theme running through Hodgson’s major and most provocative claims about capitalism that can be briefly expressed as follows: law is not custom; money has not spontaneously evolved; a property right is not the same as possession; the market and the firm cannot be mixed to make a “hybrid”; and we should only refer to assets as ‘capital’ if they can be collateralized. The common theme may be the proposition that government enforcement of institutions cannot be replaced by an alternative mechanism; neither can markets. Therefore, markets and government complement each other, and to understand capitalism we must understand that complementarity. This book is, however, not just another attempt to ride the new wave of interventionist thinking. Rather, this is a serious attempt to examine the institution we are living with.

Hodgson’s ‘legal institutionalism’ means that he places the concept of law at the centre of the understanding of institutions. He argues with the claim that law is derived from custom alone. Modern law is too complex to be seen as the result of people following its rules as a matter of habit. Rules and customs do evolve and they are not independent of law, but without the state as an enforcer we cannot have law. Government authority and our inclinations to accept that authority are crucial in understanding institutions.

Similarly, and this is another provocative proposition of the book, without the state we cannot have property rights because property rights are not the same as possession. With this proposition Hodgson argues against the ‘property rights approach’ (Alchian – Demsetz 1973) which defines property rights as “socially recognized rights of action” (ibid.: 17). According to Hodgson, this is a definition of possession which is not to be confused with property rights. However, property rights, as well as possession, are older than capitalism. Although he agrees with the claim that secure property rights are not as new as is usually claimed, he does not conclude, as McCloskey (2015: 59) does, that “[c]apitalism has always been with us, since the caves”. Capitalism is more recent than secure property rights because it is not only secure property rights that makes capitalism.

What makes capitalism – beyond property rights and freedom of exchange – is, first of all, capital. That is why chapter seven, the chapter criticizing the use of the concept of capital, is the key chapter of the book. First, because it identifies capital in a different way from what is typical among economists today. His definition of capital as “either money or the realizable money value of an asset” (p. 189) which is “tied up with the capitalist system of debt” (ibid.)

is not unique or new in the history of economic thought, as he clearly explains, but it is certainly a minority view. The best way to demonstrate this is to point out that he rejects the term ‘human capital’. It is clear that when applying his definition of capital humans cannot be capital within a capitalist system. It seems to be a fair summary of Hodgson’s view of money and capital that he thinks of them as systems of rules. That is why he concludes that money, and especially capital, is not universal; instead they are dependent on the institutional rules we follow. Outside this context they lose their meanings.

Hodgson’s legal institutionalist view contrasts clearly with the new institutionalist one in the case of the theory of the firm. Since in his approach law as enforced by the state has a central role, he is arguing very clearly against the view that there is a continuum between the firm and the market in which different kinds of “hybrids” can be found. The legal form of a firm is key, says Hodgson (pp. 207-208), because “it establishes [the firm] as a locus of legal liability”. Legal personality is a transaction cost-decreasing institution, and therefore, it is at the heart of the firm. Since legal personality is not a question of degree, neither are the boundaries of the firm. Hodgson, therefore, argues strongly against a view which considers the border between the firm and the market as of little importance.

Finally, Hodgson arrives at a rich understanding of our commercial society and of its essential institutions, which has several implications for today’s big questions such as the evolution of capitalism, the understanding of inequalities, and even for economic policy, all of which is dealt with in the second part of the book. This part, as may be expected, is more driven by the values and policy views of the author than the first, although it is still well-researched, clear, and honest.

Take just one example of this slight bias: his treatment of the Austrian school economists. Reading his rich understanding of the market and firm in chapter eight I concluded that his view had very much common with the Austrians. My conjecture was confirmed in chapters eleven and twelve where he explicitly refuses the mechanistic view of the economy and knowledge, praising the Austrians for their more organic view of the economy and their understanding of the nature of tacit knowledge.

On the other hand, he distances himself from the Austrians for reasons which seem false to me. First, he says that Hayek “overlooked the differences between information and physical commodities” (p. 307). He did not. Hayek was very much aware of this difference and was very much concerned about the concept of intellectual property and patents about which he (Hayek 1988:36) concluded that “it is not obvious that such forced scarcity [the one created by the property rights over immaterial goods] is the most effective way to stimulate the

human creative process”. Second, Hodgson says that the Austrians do not really analyse the knowledge problem inside the firm. This may be right for Hayek and Mises but certainly wrong for the Austrian school as such (Sautet 2000:98-107).

Third, he rejects Hayek’s (1944:31) argument about the inefficiency of the mixture of planning and competition. Hayek’s conclusion is, however, concerned only with “planning against competition” and he accepts that “planning for competition” is possible (ibid.). The crucial question is, of course, what kind of “planning” is against and what is for the market. Since Hodgson seems to think that the kinds of “planning” modern welfare states are doing are necessary to preserve market competition, but market competition itself is not the root of the problem of inequality, he is not as far from Hayek’s views as he wishes to show. This planning for competition attitude of the book makes it hard to understand the easy way in which Hodgson dismisses the ordoliberalists, claiming that they are “redolent of Hayek” (p. 80) in their failure to differentiate between law and custom.

In this second part of the book the author is sometimes less rigorous with definitions than he is in the first one. For example, in chapter fifteen, which is otherwise full of insights, exploitation is defined as “disadvantages or injustices that apply to one group rather than another” (p. 353), which is next to being nonsensical, since it means that anything good or bad happening to some but not all of the groups of society implies exploitation. But if one group is not made better at the expense of another, who exploits whom? It is not even clear why the concept of exploitation is needed to discuss inequalities, which Hodgson discusses in the wise and balanced manner which characterizes the whole book. His conclusion is that the root of inequality of income and wealth is not the market but the nature of capital: the fact that receiving the return on human wealth is much more time-consuming than doing the same with Hodgsonian capital, and the non-collateralizable nature of human wealth. These two, says Hodgson, create the possibility for ever growing inequalities of income and wealth.

Despite the minor biases that characterize the second part of the book and which, indeed, may only be visible because of my own biases, this book is a treasure for any economist who is interested in the nature and origin of different specific institutions in today’s market economy. It is a book you usually go back to read through certain arguments again or to understand the history of an economic idea related to institutions. The author is obviously aware of this since he provides a glossary of the main terms, including – and this illustrates well the approach of the book – the definition of a definition.

The approach and the tone of the book are unique for an economics book. First, because the author’s primary aim is to understand the nature of certain key institutions. His first aim is

not to understand the causality between these institutions and economic development, even if it sometimes seems to be the case. He presumes that the historically new set of institutions he calls capitalism was the key to economic development, because the primary cause of economic growth must be institutions. The second unique aspect of the approach of the book is the author's knowledge and his seriousness about philosophy; he can hardly be accused of the philosophical poverty found in some economics (text)books (McCloskey 1998: 139-154). Third, Hodgson's knowledge of the history of economic thought is amazing: he knows, of course, institutional economics, old and new; but he knows the Austrian school, and he knows the Marxian economists and non-economists. Synthesizing all these thoughts is not easy and the result is not an easy read. But reading it will enhance your wealth, even if it may not enhance your capital.

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