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Is There an Institutional Theory of Distribution?

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Income distribution is a primordial question. “Who gets what” is a universal, unremitting source of resentment and social discord. Economic science is nominally concerned with the “positive” aspects of the problem. That is, what forces regulate the apportionment of the social dividend? Or, what assumptions must be made about the nature of reality to logically demonstrate that a given distribution of income is Pareto optimal?

Does institutionalism offer a coherent and surpassing alternative to the standard model of distribution? The issue is clouded by several factors. For one thing, there is no single piece of scholarship that can be pointed to as the authoritative or definitive institutional treatment of the subject. The problem of relative rewards does figure materially in the works of Thorstein Veblen, John R. Commons, and Clarence Ayres. However, with the exception of Veblen’s critique of John Bates Clark’s marginal productivity theory (Veblen 1908), the views of these economists with regard to distribution are nested within their respective analyses of related phenomena such as the nature of technology, the evolving substance of property, or the meaning of capital. An extensive literature has accumulated in the past three decades wherein specific institutional sources of rising income inequality have been identified and explicated.[1] Though this scholarship is not lacking for “models of inequality,” it is frequently difficult to determine if a particular inquiry is linked to, or constitutes an extension of, an overarching theory grounded in institutional principles. Other authors have performed an exegesis of seminal institutional works and in the process contributed valuable insights about the social and/or technological factors that shape distribution.[2] Yet none of these presents a comprehensive view of the subject. In summary, if there is an institutional theory of distribution, it presently exists as a hard-to-descry constellation of mutually consistent ideas distributed through a broad space of literature.

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This article endeavors to make the institutional view of distribution more coalescent and intelligible. It aims first to put the essential points of divergence between institutional and standard economics concerning relative rewards in sharper relief. The argument is made that the fundamental source of disagreement concerns a critical premise of the standard theory of distribution—that is, the supposition that resources have "intrinsic worth." The view of distribution that emerges from the institutional literature goes well beyond critique, however. The objective here is to identify and explain the salient aspects of this collective opinion. Achieving this goal will require a defragmentation of the scholarship as well as an examination of how several of the core theorems of institutional thought intersect with, or impinge on, the problem of distribution. Among these core ideas are (1) production is a social activity; (2) folk views or belief systems assist in the maintenance of power relationships; (3) market outcomes are often predetermined by the rules governing transacting parties; (4) the institution of property is not static; and (5) the pursuit of pecuniary interest can upset the delicate balance among vertically arranged activities vital to modern production and distribution methods.

The following section contains a critique of the standard (marginal productivity) theory of distribution. Next an institutional interpretation of the factors which regulate income distribution is discussed. Concluding remarks follow.

Do Resources Have Intrinsic Worth?

The concept of intrinsic worth is fundamental to the standard theory of distribution. The term "intrinsic worth" is used here to convey the idea that resources are like vessels that contain so many units of productive energy or potential exchange value. These vessels are emptied into semifinished or finished goods and services, the market value of which must be equal to the sum of values transferred by the land, labor, capital, and entrepreneurship necessary to produce them. It is not the incorporation of privately owned resources within a social process which endows them with usefulness. Rather, the productive energy or potentiality of an electrician, a tool, or an acre of land is thought to reside in, or belong to, the thing itself. Hence it is possible to determine (if not directly, then at least indirectly through factor prices) the contribution of a specific factor to exchange value.

The standard, or "marginal productivity," model of distribution has been alternatively classified as an application of partial equilibrium analysis to the problem of "factor" prices or as a generalization of David Ricardo's theory of rent to other inputs—that is, labor and capital. The theory is concerned with two principal problems: (1) the factors that determine the intrinsic worth or the true value of a productive resource and (2) the conditions under which incomes or distributive shares are forced into (or deviate from) parity with intrinsic worth.[3] Clark, the founder of the modern theory, had this to say about the second issue:

> [W]e may now advance the more general thesis . . . that, where natural laws have their way, the share of income that attests to any productive function is gauged by the actual product of it. In other words, free competition tends to give to labor what labor creates, to capitalists what capital creates, and to entrepreneurs what the coördinating function creates. (1908, 13)

Clark's thesis has a clear normative dimension—specifically, the distributive share that ought to accrue to any resource owner is given by the exchange value that would be lost if, ceteris paribus, that resource were withheld from production. In other words, the question of who gets what can be, in theory at least, resolved by appeal to objective or technical factors. The standard model makes the just price of resources equivalent to their inherent value. Defenders of the marginal productivity theory concede that, in any collaborative economic activity, direct measurement of the proportion of exchange value attributable to the miscellany of factors employed is not feasible.[4] It is left to the invisible hand to put remunerative shares in proximity to intrinsic values. Setting aside the problem of "imperfections" (monopsony or oligopsony, wage legislation, legal restrictions on entry to occupations, and so forth), the market mechanism guarantees that income received by resource owners via factor market transactions accurately measures the value contributed by resources at the margin of production.

The attack launched against marginal productivity by Pierra Sraffa (1951, 1960) and Joan Robinson (1953–1954) initially focused on the problem of measuring capital. Sraffa's 1951 preface to Ricardo's work was aimed at the marginal productivity theory of distribution, whereas Robinson's 1953 article concerned the measurement of capital in the aggregate production function. Sraffa and Robinson showed that it was impossible to find an index number measuring capital that could be determined independent of distribution of income between wages and profits. G. C. Harcourt noted that

> such independence is necessary if we are to construct an iso-product curve showing the different quantities of labor and capital which produce a given level of national output. . . . The slope of this curve plays a key part in the determination of relative prices of capital and labor and therefore of factor rewards. However, the curve cannot be constructed and the slope measured unless the prices it is intended to determine are known beforehand. (Harcourt 1969, 371)

Robinson commented in a retrospective on the Cambridge capital debates that "nearly the whole argument . . . has circled around this question of measurement. But it is a superficial problem. The real issue is not about the measurement of capital but about the meaning of capital" (1980, 114–115). Ayres asserted that the percept of capital which forms the basis on modern economic theory in fact has a dual meaning. *Capital* is commonly apprehended to designate tangible instruments of production (machinery, buildings) as well as intangible or institutional phenomena (money or "finance"). Ayres' genealogy of the modern idea of capital laid bare the importance of this dual concept in dissolving social resistance to the transfer of economic and political

power to the money-controlling, interest-receiving classes (1944). The efficacy of the standard notion of capital in serving this specific ideological purpose is explained by two factors: (1) it establishes a causal link between the "critical activity" of the interest-earning classes (that is, waiting or sacrifice) and the accumulation of those things upon which the welfare of the community ultimately depends—"the physical materials and instruments of trade and manufacture" (42) and (2) it attributes magical productive potency to "capital equipment."

That the source of productive power is the piling up of liquid claims to goods is a myth that goes far in explaining social acquiescence to gross disparities of income and wealth. As Ayres made plain:

> That growth was a function of the industrial equipment of the community, as anybody could see even in earlier times. To identify that function with the accumulation of money was to attribute the whole thing to the men who made money. This is what we accomplish by calling both things "capital." (1946, 10)

The idea summarized under point (1) above is formally expressed by the "loanable funds" or, what is the same thing, "time preference" theory.[5] This theory is based on the supposition that credit or finance materializes only when intermediaries make unexercised claims to goods (saving) available to borrowing agents. John Maynard Keynes pointed out that, ceteris paribus, decisions by agents to spend or not to spend have no effect on the capacity of banks (or other intermediaries) to make new loans:

> Saving has no special efficacy, as compared with consumption in releasing cash and restoring liquidity. . . . [T]here is, therefore, just as much reason for adding current consumption to the rate of increase of new bank money in reckoning the flow of cash available to provide new "finance," as there is for added saving. (1973, 233)[6]

Technology is the "total stock of human know-how applicable to physical facts" (Ranson 1987, 1267). The arrowhead, the oxbow, the air conditioner, the rice harvester, the machine tool—all these constitute evidence of an accumulated body of knowledge and skill. At the same time, effective deployment of these tangible things (effective in the sense of producing consumer or producer goods) is knowledge and skill contingent. A fishhook is useless by itself—it requires knowledge and skill for its usefulness. The same principle applies to spreadsheets, earthmoving equipment, aircraft, pasta makers, or natural resources. The value of topsoil, bauxite ore, or gutta percha was manifest only when sufficient understanding of agriculture, aluminum production and uses, and undersea cables (respectively) was achieved. Veblen, in a critique of Clark's "productivity of capital," reasoned that a sudden loss of tangible capital goods

> would entail a transient inconvenience. But the accumulated, habitual knowledge of the ways and means involved in the production and use of these appliances is the outcome of long experience and experimentation, and given this

body of commonplace technological information the acquisition and employment of the suitable apparatus is easily arranged. (Quoted in J. Robinson 1980, 116)

Institutionalists reject the axiom of immanent worth or "value in severalty" with respect to labor, knowledge, machines, or gifts of nature. The economic value of "factors of production" is contingent upon, and may be nonexistent without, their inosculation with other factors of production. Organizations, viewed as both as a repositories of know-how and as amalgams of rules, practices, or policies that produce correlative or complementary actions, are often a decisive factor in making tangible things, or knowledge, useful. The work of the toolmaker, the surgeon, or the farmer draws on the knowledge of best practices gained by the countless number of trials of other practitioners past and present. Moreover, their labor is enabled by instruments, software, equipment, chemicals, genetically modified seeds, or pharmaceuticals—things that embody stored-up understanding and for which the machinist, the surgeon, or the farmer can take little credit. Perhaps most importantly, resources, whether human or nonhuman, derive their usefulness by their integration into a process which "presupposes the proper working of many other processes" and requires the "running maintenance of interstitial adjustment between the several sub-processes" (Veblen [1904] 1975, 7, 8).

Economic activity is cooperative and interdependent, and it "free rides" on the hard work, suffering, and imagination of a countless number of persons both living and dead.[7] The high degree of coordination essential in modern economy would be impossible without a vast institutional infrastructure. Productive power resides in "systems"—not in labor, land, or capital.

The standard theory of distribution, which appoints the market as diviner of the value inhering in factors of production, endures in spite of what seems to have been a fatal assault on its logical foundations mounted by Sraffa, Robinson, and others. The crude form of the theory, which can found in expressions like "people get what they are worth," is often invoked by noneconomists to explain income disparities. The view implicit in statements such as the one just quoted is that distribution results from "natural" forces that, like gravity, are not subject to repeal by human agency. Therefore political action to redress inequality seeks to pervert natural economic laws. The key implication of the "no intrinsic worth" position is that ethical or moral claims to the social dividend, whether filed by individuals or groups, have no corporeal or natural basis to sustain them.[8]

Power, Institutions, and Distribution

Power is the capacity to "give effect to the will." Wills inescapably come into conflict when goods, land, or opportunities are not freely available. Individuals and groups struggle to increase their share of the (scarce) social product and to shift the burdens of production to other individuals or groups. The expansion of the agent's liberty or "free-

dom to choose" often must come at the expense of a restriction of another's power or liberty. The employer and the employee, the landlord and the tenant, the giant discount retailer and the small business enterprise, the livestock producer and the meatpacking company—all have opposing interests. The range of possible outcomes resulting from the face-off of contending interests cannot stray outside the limits imposed by the condition of scarcity. The contest of interests is infrequently a winner-take-all affair. Power is rarely absolute—it exists in degrees.[9]

Interests prevail to a lesser or greater extent, depending on the degree of power held vis-à-vis those with inimical interests. The employee with an attractive offer from another employer holds a greater degree of power against her current employer than an employee with no such offer. Domestic automakers gain power against unionized workers when production can be shifted to *maquiladora* plants, or to China. Hog farmers gain power at the expense of packers when bargaining cooperatives are made legal. Recording artists lose economic power when music can be downloaded for free. A shift in the degrees of power possessed by the Yakima Indians and Oregon and Washington farmers occurred when the U.S. Department of the Interior authorized the diversion of water from the Columbia River for irrigation.

As power is a decisive factor in accounting for disparities in material rewards, a theory of distribution should be indistinguishable from a theory of power. A satisfactory theory of power would, beyond defining what power is, elucidate principles to explain how power is established, enlarged or diminished, protected and perpetuated, redistributed, exercised, and rendered legitimate or illegitimate.

The inseparability of distributive mechanisms from habits, customs, working rules, laws, and belief systems is a salient aspect of institutional thought. Distribution is an instituted process. The term "institutions" refers to the complex of organizations (for example, households, churches, schools, corporations, stock markets, trade organizations, or labor unions) that produce correlated patterns of behavior and define the parameters of acceptable conduct in human affairs.[10] Institutions are clusters of "working rules" specifying limits and opportunities, what the agent "may, must, can, or cannot do" (Commons 1924, 68).

Self-interested behavior is especially disruptive in modern economic systems—that is, systems in which production is impossible without an "extended order of human cooperation" (Hayek 1988, 119). Institutions are algorithms that direct individuals with contrary objectives toward a common purpose. Nearly every action of an economic character is governed by canons of behavior, the contravention of which may bring opprobrium, or worse. The canons may make negotiation over the price of a particular item permissible, or they may forbid it. They may grant rights to a copyholder to cultivate land but create a corresponding duty to supply the manorial lord with labor or crops. The rules may proscribe, or allow, compulsory union membership. Or they may confer upon individuals or corporations the right to withhold land, machinery, or knowledge from those in need.

When an individual repeatedly behaves in accordance with prevailing norms of conduct, that person becomes habituated or "acculturated." Appropriate behavior in a given situation becomes less a function of conscious forethought and more the result of a conditioned reflex. The "people doing" dimension of institutions means that, before long, the customs or rules regulating economic behavior become a kind of collective social habit and thus, like all habits, have a tendency to persist.[11] A similar phenomenon is manifest with respect to peoples' thinking about rules that guide their everyday life. People are predisposed to cast their thoughts with the use of pre-existing mental or ideological templates. Competing templates are usually in circulation, and there is a tendency to select those which have widest currency within one's social group or economic class. Folk views, when they have achieved the status of "collective habits of thought," exert a powerful influence on behavior.[12] This factor explains why the inculcation of youth with folk views approved by authority is a basic function of "education."[13] Educators have done their job well if a "representative citizen" would, when called upon to explain some aspect of society's rules, deliver a spontaneous, pat response that is nonthreatening to elites.

The dynamic interaction of habit with customs caused John Dewey to describe institutions as "embodied habits" that display "permanence and inertia" and as such impose a "force of lag in human life" (1922, 108–109). Institutions bring order, routine, stability, and predictability. Institutional inertia makes it likely that the complex social algorithms that solve the "who gets what" problem today will be deployed in the future.

In endeavoring to give effect to the will, individuals or "going concerns" are constrained, but also empowered, by the rules of society. Institutions "constitute the arenas in which people try to accomplish their aims. Institutions imply 'you may' as well as 'thou shalt not,' thus creating as well as limiting choices" (Neale 1987, 1179).

The Market "Process" is Man-Made

The transaction is the ubiquitous interface of opposing wills. For Commons the transaction is "the ultimate unit of economics, ethics, and law. It is the ultimate but complex relationship, the social electrolysis, that makes possible the choice of opportunities, the exercise of power, and the association of men into families, clans, nations, business, unions, or other going concerns" (1924, 68). Individuals, groups, or business organizations will fare well or poorly according to the terms they receive in transactions. Every transaction is a test of power, and the value of what is given up in relation to what is gained is an implicit measure of the power possessed by the transacting agent.

> We measure the degree of power by the ratio of exchange. . . . I sell a bushel of wheat for 2 bushels of oats. The ratio is 1 bu. = 2 bu. I sell it for bushels—the ratio is 1:3. . . . The ratio of exchange measures the degree of power because it measures the ratio between what I give up and what I get back in the exercise of power. (Commons 1924, 30)

The working rules of transactions give evidence of power asymmetries. The rules also furnish the social machinery that brings the terms of transactions into agreement with the (prior) distribution of power. So what is the role of the "market" or "market forces" in the division of total output? The standard mode of thinking has income-producing exchanges occurring "within," and facilitated by, markets. One aspect of the market idea is largely taxonomic and atheoretical. That is, the universe of potential or actual transactions can be subdivided into classes called markets based of the relatedness of sellers' wares as well as close substitutability of buyers in the estimation of sellers.

The term market also connotes a process or "field of force" that pushes, pulls, or prods agents to the resolution of terms. As price theory is to this day expounded with concepts borrowed from nineteenth century celestial mechanics, it should come as no surprise that many continue to conceive of the market as a force of nature which, like all forces of nature, is capable of operating "unfettered"— meaning, without human design, control, or intervention. According to this view, things like taxicab medallions, rent controls, professional credentialing, or buyers cooperatives merely alter the parameters within which generic market energy exerts its influence. The ideological implications of the "market as natural force" notion are potent. For if the scheme of relative prices is established by the reaction of natural market energy with self-interested agents, the same must hold true for relative rewards. Just as water will flow to its "natural place" without dams, levies, drainage, or other man-made devices, so too will incomes adjust to their natural level absent social contrivances like the minimum wage, exclusive franchises, or right-to-work laws. *Rent seeking* is thus alternatively defined as any attempt to raise income above its "natural level" by political means.

The institutional view is different. Markets are co-extensive, or wholly contained within, institutions. More precisely, markets are clusters of working rules that guide conduct in transactions. Working rules "operate by placing certain limits or by opening up certain enlargements for the choices and powers of the individuals, who are parties to the transactions" (Commons 1924, 68). The rules that apply in most transactional settings, whether they are a matter of custom or formal law, have the backing of authority—meaning that agents anticipate that a third party would perform its duty to enforce the rules if required.[14] Market forces are not natural or "supra-cultural" but rather materialize as the effect of institutionally conditioned behavior. Yngve Ramstad explained that "the 'price mechanism' is mentally inseparable from the instituted working rules of which it is but an active description. Indeed, without an understanding of the specific rules themselves, one cannot understand how the 'mechanism' functions" (2001, 258–259). As such, the "outcomes of markets should be seen as a social product, an expression of an underlying social order" (Clark 1996, 198).

The institutions of provisioning do not count all interests as equal. The rank ordering of (opposing) interests is encoded in the working rules of society. For example, the (relatively) high priority attached to the interests of mine owners would be evident from laws that permit the issue of strike-breaking injunctions. The Consumer Goods Pricing

Act of 1975 (which outlawed the practice of resale price maintenance) aggrandized high-volume, discount (big-box) retailing but at the same time deprived a decent-to-excellent livelihood to a vast number of small merchants of hardware, clothing, sporting goods, electronics, auto parts and tires, music, lawn and gardening equipment and supplies, flooring and wallpaper, prescription drugs, eyeglasses, books, cosmetics, jewelry, appliances, groceries, and other items.[15] A system that authorizes Medicare to leverage its oligopsony power against pharmaceutical companies clearly weighs the interests of senior citizens more heavily than a regime which forbids it. Some critics charge that the Bayh-Dole Act of 1980, which enables universities and private firms to obtain proprietary claims to discoveries from research funded by National Institute of Health or National Science Foundation grants, has resulted in artificially inflated prices for many new drugs and windfalls for shareholders (prior to 1980, discoveries arising from publicly funded research were in the public domain).[16] Major League Baseball's reserve clause tilted the balance of negotiating power in favor of club owners at the expense of players. The legal minimum wage cannot be raised without simultaneously downgrading the interests of small business owners. Customs, laws, or working rules (and the folk views which validate them) are the "cause" of economic inequality as well as its social reproduction.

Power of Property

Because they produce outcomes advantageous to specific interest groups on a recurring basis, working rules are instruments of power. Efforts to reshape the rules to fit a vested interest may therefore garner a high payoff.[17] This leads to a singularly difficult question—that is, what is the nature of the process that selects which working rules shall have the force of authority? On one hand, it is conceivable that particular customs or working rules gain social traction because they are instrumental in eliciting the necessary human coordination and/or in making disputes manageable.[18] It should be noted that rules adopted according to "efficiency" criteria may nevertheless cause power to be shared unequally. It is also possible that institutions owe their present configuration to past (successful) attempts to gain privilege or advantage.[19] That is, institutions are the object as well as the tool of the powerful. History records that the creation of laws, statutes, or regulations is a topmost priority of power elites.

Case histories of institutional development are instructive. Commons argued that the modern institution of property took shape in a series of Supreme Court decisions in the late nineteenth century. The majority ruled in the first Slaughter House case that property should be defined to include only "use-values"—so that state actions which deprive agents of the *exchange value* of their assets do not constitute a "taking" of property.[20] "Liberty" therefore meant the absence of restrictions to the expected uses of tangible things—labor, machinery, or land. The court redefined *property* in the Minnesota Rate case "from things having only use-value to the exchange value of *anything*" (Commons 1924, 14 italics added). Owners of tangible and *intangible* or incorporeal things

(e.g., knowledge, debts, or goodwill) enjoy "pecuniary liberty," meaning not only freedom of access to markets but more importantly the right to apply the full degree of pressure or coercion *in exchange* that derives from the control of property—where "capacity to withhold" is subsumed under "control."[21] As rights are empty without a third party to enforce them, the state incurs a duty to protect persons from diminution of the expected exchange values of their properties arising from, for example, the appropriation of proprietary knowledge or the failure of other parties to perform on contracts.

The nineteenth century metamorphosis of property as an institution is partly explained by the changing facts of economic organization as well as the emergence of big business as the dominant force underpinning authority. At the same time, court opinions of the era reveal the lingering influence of the Lockean or "natural rights" theory. Veblen explained that "the scheme of natural rights grew up and found secure lodgement in the common sense of the community, as well as its lawgivers and courts, under the discipline of small industry and petty trade," a regime wherein "both [in] trade and industry . . . man met man on a *somewhat equable footing*" ([1904] 1975, 270, italics added). The court's extension of the traditional logic of property to the new realities facilitated a revolutionary shift in the locus of economic power:

> Just as the scales of the reptile become the feathers of the bird when the environment moves from land to air, so exclusive holding for self becomes withholding from others when the environment moves from production to marketing. The transition was hardly noticeable as long as the merchant, the master, the laborer, were combined under small units of ownership, but becomes distinct when all opportunities are occupied and business is conducted by corporations on a credit system which consolidates property under the control of absentee owners. Then the power of property . . . comes into its own. (Commons 1924, 53)

Economic inequality in modern capitalism arises from the concentration of "the power of property." How did the power of property come to be so tightly controlled? A key explanation is found in the difficulty of achieving the "running maintenance of interstitial adjustments" between the "interlocking detail processes" of modern industry by the method of pecuniary transactions (Veblen [1904] 1975, 10). The vertical separation of ownership or control of raw materials, industrial equipment, organizations, or proprietary knowledge vital to a highly articulated production process creates fertile ground for opportunism. The power to withhold from market exchange means the power to disrupt, to derange, to coerce, and to inflict economic damages in the pursuit of purely business objectives.[22]

The emergence of the corporation as the transcendent form of economic organization is powerful evidence of the weakness of market institutions in maintaining the degree of coordination among specialized resources indispensable to modern production methods. The corporation is, after all, an entity which sharply limits the scope of market exchange. Ronald Coase, in explaining the systematic displacement of market

exchange by organization, assigned highest important to the resulting savings in transactions costs associated with using the market mechanism (i.e., search, negotiation, contracting, and compliance) (1937). The transactions cost approach fails to take due account of the dichotomy between the pecuniary aims of business and the imperatives of modern technology.[23] Internalization of the interstices of an elaborated production system makes it less vulnerable to hold-up by businessmen who "are not necessarily best served by the unbroken maintenance of industrial balance" (Veblen [1904] 1975, 28). The cardinal virtue of the vertically integrated, bureaucratized corporation is that it

> [removes] the pecuniary element from the interstices of the system as far as may be. The interstitial adjustments of the industrial system at large are in this way withdrawn from the discretion of rival business men. . . . The heroic role of the captain of industry is that of a deliverer from an excess of business management. It is a casting out of business men by the chief of business men. (Veblen [1904] 1975, 48–49)

The supplanting of markets with organizational hierarchies proved effective in forcing the necessary measure of cooperation among self-interested parties and thus gave impetus to the diffusion of new knowledge. The structural transformation of the U.S. economy in the period after 1870 effectively placed control of society's vital production systems in the hands of a comparatively miniscule peerage of business elites. Veblen ([1923] 1964) and others placed particular importance on the institution of "absentee ownership" or passive property in bringing immense agglomerations of assets under centralized control.

As a matter of law, the corporation is a "person."[24] Corporate officers therefore have reign to wield the coercive power that derives from the "right" to withhold vast production systems—systems upon which livelihoods of many thousands of individuals depend. Extant institutions make attempts to bring corporations under social control exceedingly difficult.[25] As such, they pose formidable obstacles to greater economic equality. Creating a society in which the benefits of production are more widely shared remains a remote possibility without an eradication of belief systems pertaining to the sanctity of private property and/or the natural laws of distribution.

Concluding Remarks

In appraising the "goodness" of the systems which regulate distribution, we are obliged to ask: what ends should these institutions be instrumental in achieving? Is it simply a matter of rationing scarce goods? A large component of society's incentive structure, its complex system of rewards and punishments, is circumscribed within the field of transactions or contracts by which people obtain their incomes. Achieving the "extended order of human cooperation" might be impossible without at least some degree of inequality in the distribution of rewards. Superior achievement in business,

science, athletics, entertainment, or other fields can be of great value to society but typically entails extraordinary risk taking and/or sacrifice by the individual. Regimes of equality can be assailed on grounds they fail to properly incentivize risk taking, hard work, and deferred gratification.[26] Moreover, such regimes are ill suited to contain the human propensity to shirk or free ride.

Even if it is allowed that a modicum of inequality is unavoidable or even desirable, the argument that substantially greater income inequality cannot be achieved without inflicting serious damage to the structure of incentives guiding behavior is spurious. This view is partly informed by a misguided notion of "the market" as a supra-institutional coordinating mechanism that works uniformly across activities. As was discussed earlier, markets are man-made clusters of rules that are idiosyncratic with respect to specific trading situations. A useful microeconomics begins by cataloging rules peculiar to specific real world production and exchange activities and then proceeds to an analysis of the linkage of rules to pattern of incentives, resource allocation, and the distribution of power. Inquiry along these lines is useful because, among other things, it uncovers institutions which have no real social purpose but merely serve to maintain economic power in the hands of the few. Economic progress will partly depend on the casting off of obsolescent modes of distribution—obsolescent in the sense of limiting the use of society's accumulated knowledge and productive power to improve lives. James Peach has written that "[p]overty occurs, not because of resource constraints or a lack of technical knowledge, but because institutional (distributional) arrangements have not been adjusted to the productive potential of the modern society" (1994, 170).

Distribution has implications for effective demand in systems in which purchasing power accrues in intangible money (and thus can be withheld from the expenditure stream).[27] Firms' disbursements and receipts are interdependent in the global sense, since it is the continuous recycling of factor incomes that sustains spending for goods and services. Business decision makers pay no respect to this principle, however, because they (correctly) perceive that the incomes dispensed by an individual firm have little, if any, connection to its sales revenues. Similarly, decisions to employ new technologies or offer new products are conditioned strictly on business principles—though the cumulative effect of such decisions on the structure of job occupations, the locus of power, and the distribution of income may be profound.

A highly skewed distribution of income is detrimental to the development of the type of broad-based consumerism that buoyed the United States economy in the post-1945 era. It is questionable whether the "golden age" (1945–1972) expansion of output and productive capacity could have been achieved without the ameliorative effects of the minimum wage, unionism and collective bargaining, progressive taxation, and income transfers.

Notes

1. Recent examples include Freeman 1993, King 1988, Crayo and Cormier 2000, and Waddoups 2002.
2. This group includes Hodson 2003, McIntyre and Ramstad 2002, Bush 1983, and Rutherford 1981.
3. See Bronfenbrenner 1971, chapter 6, for a detailed exposition of the theory.
4. Bertrand Russell stated the problem this way: "Consider a porter on a railway. . . . What proportion of the goods carried can be said to represent the produce of his labor? The question is wholly insoluble" (quoted in Bronfenbrenner 1971, 183). F. A. Hayek wrote, "Nobody can ascertain, *save through the market,* the size of the individual's contribution to the overall product" (1988, 119, italics added).
5. A restatement by Robert Barro: "In a closed economy accounting identities imply that national saving must end up equal to domestic investment. Therefore, the decline in desired national saving means that the real interest rate has to rise (With fall in desired national saving, there is an insufficient supply of funds to provide for an unchanged quantity of domestic investment demand). The higher real interest rate restores an equilibrium by reducing investment demand and raising desired private saving" (1991, 134).
6. For more detailed elaborations on this point, see Brown 1993, Davidson 1986, and Terzi 1986–87.
7. Thorstein Veblen, for example, observed that "[t]he greater part of the industrial arts is a heritage out of the past, a knowledge of the ways and means hit upon and tried out by past generations and from them handed on to posterity. . . . [A]ny addition, extension, advance, or improvement in technology is a rearrangement or refinement upon the elements of such knowledge so handed down from the past" (1923, 64–5).
8. The reader will note the contrast with Marxian theory of this point. Specifically, Marxian theory asserts that the contribution of the individual worker to total output is measurable by the ratio of the expenditure of (homogeneous) labor time by the worker to the aggregate expenditure of labor time. Distribution on this basis would give rise to inequality, given differences in skill or productivity among workers: "The first phase of communism, cannot yet provide justice and equality: differences, and unjust differences in wealth will still persist. . . . [T]he mere conversion of the means of production into the common property of the whole of society . . . does not remove the defects of distribution and the inequality . . . which continues to prevail so long as products are divided 'according to the amount of labor performed'" (Lenin, State and Revolution, chapter 5, paragraph 3, quoted from *Lenin: On Politics and Revolution,* New York, 1968, 222–23).
9. Commons defined liberty as the "absence of restraint, or compulsion, or duty, and is equivalent to the exercise of power and the choice of opportunities which it permits. But the choice of opportunities is, in fact, but a choice between two degrees of power. If I can sell the use of my labor for $3.00 a day, that is one degree of power over my employer. If I can sell it for $3.50 a day, that is another degree of power. . . . The economic equivalent of liberty, therefore, is the freedom to choose between two degrees of power over other persons" (1924, 28–9).
10. Walter C. Neale wrote that "[a]n institution is defined by three characteristics. First, there are a number of people doing. Second, there are rules giving the activities repetition, stability, predictable order. Third, there are folkviews . . . explaining or justifying the activities and the rules" (1987, 1182).
11. Commons distinguished between habits and customs as follows: "Habit is repetition by one person. Custom is repetition by the continuing group of changing persons" (1934, 155). Geoffrey Hodgson (2003) argued that Commons did not clearly establish a causal link of custom to habit, as did John Dewey: "[C]ustoms persist because individuals form their personal habits under the conditions set by prior customs" (Dewey 1922, 58).

12. Jerry Ravetz argued that economic science can play a key role in the formation of folk views among society's elites. The "folk" are defined as "a particular clientele, with its particular world view that needs to be buttressed by the body of learning in question." For example, Marxism served the function of folk science for the nomenclatura: "[T]he socialist system needed its ideological legitimation in Marxism, and so Marxism became an elite folk science for the apparatus, providing formulas and clichés that were retold and memorized in varying degrees in various institutional settings" (1994–95, 166, 177).
13. Bertrand Russell asserted that "[a]lmost all education has a political motive: it aims at strengthening some groups, national, religious, or even social, in the competition with other groups. It is this motive, in the main, which determines the subjects taught, the knowledge offered and the knowledge withheld, and also decides the mental habits the pupils are expected to acquire" (1961, 403).
14. Commons wrote that "there are an indefinite number of possible disputes between the parties to the transaction that may arise. . . . Consequently, if transactions are to go on peaceably . . . there must always have been a fifth party to the transaction, namely, a judge, a priest, chieftain, paterfamilias, arbitrator, foreman, superintendent, general manager, who would be able to decide and settle the dispute" (1924, 67).
15. Resale price maintenance (RPM), whereby a manufacturer (or wholesaler) stipulates a minimum resale price for retailers, is designed to prevent intrabrand price competition—thus protecting retailers' margins on goods sold. RPM protects against "retail free riding" because it "creates property rights in the information services provided by the dealers who carry their products" (Boyd 1997, 224). The Consumer Goods Pricing Act of 1975 is viewed as a critical factor underpinning the success of the Wal-Mart business model—"Buy it low, stack it high, sell it cheap" (Walton 1992, 12—quoted in Ghemawat et al. 2003, 4). For an examination of the impact of Wal-Mart on small town retailers, see Wall 1998 and Peterson 1999.
16. See Angell 2004 and "Paying Twice for the Same Drug" by Peter Arno and Michael Davis in *The Washington Post,* March 27, 2002, A27.
17. Neale stated that "[p]eople do consciously manipulate the rules and values of their institutions in their efforts to achieve their ends" (1987, 1179).
18. Veblen believed Charles Darwin's theory was transferable to the problem of institutional selection and used the term "natural selection of institutions" (1899, 188). Commons distinguished between "natural" and "artificial" selection, the latter term referring to a process guided by human will or volition (1934, 45). Hodgson opined that "Commons failed to incorporate the insights and attitudes of Darwinism. He did not appreciate that 'artificial selection' was no more than a special case of 'natural selection' and not an alternative to it" (2003, 570).
19. The public choice literature is filled with examples of how "rent-seeking" agents expend resources to obtain special economic privileges (government licenses, quotas, exclusive franchises, for example) which create artificial scarcities and thus yield windfalls to the privileged. James Buchanan has commented that "[t]he analysis of rent-seeking is . . . properly designated as institutional economics in the very real sense" (1980, 14). Affiliates of the "old" institutionalism will agree the activity of institution molding is a critical area for study (in fact, it is nearly equivalent to the study of economy itself). The classification of this activity of "rent-seeking" is based on the neoclassical view that resources have an intrinsic worth so that "rent" is an unwarranted premium above "true" value.
20. *Butchers' Union v. Crescent City Co.,* 111 U.S. 746, 751 (1884).
21. The recognition that economic power is a dimension of property came in the *Munn v. Illinois* (1871) decision, according to Commons. Prior to this decision, the common law principle that charges must be "reasonable" applied only to cases where economic power derived from special grants or franchises (to operate a public ferry or bridge, for example). In these cases the source of power was not property but rather "sovereignty," so that restrictions on prices did not abridge property rights.

22. Janet Knoedler explained that "for Veblen, the interstices were pecuniarily important junctures in the orderly flow of the technological aspects of production. Goods and services traveled through these junctures, or interstices, by means of interstitial adjustments, and interstitial adjustments were accomplished by means of transactions—transactions that could also be used to interrupt this orderly flow. . . . Veblen saw these firms as operating in a commercial system where business strategies were aimed at manipulation and control of the interstices for pecuniary and not industrial gain; thus, business leaders will circumvent or even 'sabotage' industrial efficiency if their pecuniary gains are greater when employing such strategies" (1995, 387, 389).
23. J. K. Galbraith has argued that the most important (economic) consequence of technology is "in forcing the division and subdivision of any . . . task into its component parts. Thus, and only thus, can organized knowledge be brought to bear on performance" and "the inevitable counterpart of specialization is organization. . . . [C]omplex business organizations are the tangible manifestation of advanced technology" (1967, 12, 16).
24. Corporate franchises were issued in the United States in the early nineteenth century "mainly for undertakings involving a direct public interest; the construction of turnpikes, bridges, canals, the operation of banks and insurance companies, and the creation of fire brigades" and were strictly regulated. The modern legal status of the publicly owned corporation came about "by a long process of grant of management powers piecemeal. . . . [T]he various accretions of power appear partly in statutory amendments over more than a century, partly in decisions purporting to declare the common law, partly in statutory enactments which purport to recognize or declare the common law; partly in clauses inserted in charters (such as proxy voting); partly in powers merely assumed by lawyers and management which, becoming traditional, work their way into the system" (Berle and Means 1967, 11, 119).
25. Galbraith commented that "[w]hen the modern corporation acquires power of markets, power over the state, power over belief, it is a political instrument, different in form and degree but not in kind from the state itself" (1973, 6).
26. Recall Joseph Schumpeter's argument that extreme inequality is useful in bringing forth a large number of business "trials" (and thus innovation): "Spectacular prizes much greater than would have been necessary to call forth a particular effort are thrown to a minority of winners, thus propelling much more efficaciously than a more 'just' or equal distribution would, the activity of that large majority of businessmen who receive in return very modest compensation or nothing or less than nothing, and yet do their utmost because they have big prizes before their eyes and overrate their chances of doing equally well" (1942, 73–4).
27. J. M. Keynes commented that "[s]ince I regard the propensity to consume as being (normally) as such as to have a wider gap between income and consumption as income increases, it naturally follows that the collective propensity for the community as a whole may depend . . . on the distribution of incomes within it" (1939, 129). David Hamilton noted that "[o]ne of the difficulties in the industrial economy is the failure of its ceremonial system of distribution, based on imputed productivities, to redistribute sufficiently to keep the reciprocal flow goods and money at a constant or increasing rate. It was precisely this aspect of the industrial system to which J. M. Keynes addressed himself" (1991, 944–45).

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