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John R. Commons and Wesley C. Mitchell: On a Model of Human Behavior

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Introduction

In the history of American economic thought, it was at the end of the nineteenth century that the "New School" of economists, who had returned from studying in Germany, appeared. In contrast to the "Old School" of traditional, classical, and liberal laissez-faire economics, this school advocated a new liberalism, in which the government would actively protect the freedom of workers and farmers at the mercy of industrial interests. They founded the American Economic Association, which was modeled after the Social Policy Association (Verein für Sozialpolitik) of Germany. However, in 1886, the Haymarket Affair broke out in Chicago, leading to increased criticism of socialist tendencies, including even Christian socialism, and mainstream economics shifted to focus on abstract theories. In response to the marginal revolution in Europe, mainstream American economics became the theory of marginal productivity, which focuses on the factor of production based on marginal utility theory.

A series of "intellectual movements" that attempted to explore the possibility of controlling the American economy and society during World War I took a critical attitude toward this mainstream economics. This intellectual movement came to be called "institutional economics" in a joint debate at the thirty-first meeting of the American Economic Association organized by Walton Hamilton, John M. Clark, and Harold Moulton at the end of December 1918. At this conference, Hamilton proposed five requirements for an economic theory. According to him, an economic theory must: (1) unify the economic sciences; (2) be relevant to the problems of control; (3) be relevant to institutions; (4) be relevant to the problems of process; and (5) be based on an acceptable theory of

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human behavior.[1] He believed that only "institutional economics" could satisfy all these requirements. Hamilton's fifth requirement on human behavior is noteworthy as a criticism of the mainstream economics of the time. This problem began with a scathing critique of hedonistic psychology, the premise of marginal utility theory developed at the end of the nineteenth century by Thorstein B. Veblen, a leading thinker of the "generative period" of institutional economics. The question that continued to be asked was, what kind of model of human behavior should be used to reconstruct economics?

John R. Commons (1862–1945) finally called his economics "institutional economics" in the 1930s. Since the end of the nineteenth century, he had focused his analysis on human will, especially the institution of "transactions" based on the "will-in-action," which economists had dared to ignore because of its irregularity and variability. His major concern was that institutional factors, such as laws and practices, played a prescriptive role in economic activity and provided factors that promoted smooth economic activity. He described the process of the historical development of Anglo-American common law in the rapid changes in American society from the end of the nineteenth century to the 1920s, especially in the legal activities of creating and revising the working rules of various industrial transactions. Wesley C. Mitchell (1874–1948) also began to advocate institutional economics in the 1920s, after the joint debates of the American Economic Association. He developed a critique of the "economic man" model of orthodox economics from the 1910s, referring not only to Veblen, but also to William James, a proponent of pragmatism, and William McDougall (1871–1938), a social psychologist.

Several studies on institutional economics have proven the positive significance of historically and culturally accumulated institutions, rather than those formed on an ad hoc basis.[2] There has also been progress in the study of the draft of Commons's late major work, *Institutional Economics*, which was published in 1934.[3] Few studies have attempted to clarify what is unique about

1. Walton H. Hamilton, "The Institutional Approach to Economic Theory," *The American Economic Review*, March 1919, vol. 9, no. 1, Supplement, Papers and Proceedings of the Thirty-First Annual Meeting of the American Economic Association (March 1919): 311–16. For more details on these five requirements, see Malcolm Rutherford, "Institutionalism between the Wars," *Journal of Economic Issues*, vol. 34, no. 2 (June 2000a): 291–303; Rutherford, "Understanding Institutional Economics: 1918–1929," *Journal of the History of Economic Thought*, vol. 22, issue 3 (September 2000b): 277–308.

2. Malcolm Rutherford, *The Institutionalist Movement in American Economics, 1918–1947: Science and Social Control* (New York: Cambridge University Press, 2011); John Dennis Chasse, *A Worker's Economist: John R. Commons and His Legacy from Progressivism to the War on Poverty* (London and New York: Routledge, 2017).

3. Uni Hiroyuki, ed., *Contemporary Meanings of John R. Commons's Institutional Economics: An Analysis Using a Newly Discovered Manuscript* (Singapore: Springer, 2017).

Commons's and Mitchell's models of human behavior in contrast to the mainstream models of the economic man in American economics at the time.

To address this issue, this article is structured as follows: section I examines Commons's volitional theory of value and institutional evolution, especially the economic theory and transaction model based on a realistic understanding of human beings acting voluntarily, as opposed to the mainstream economics of the early twentieth century. Section II elaborates on Mitchell's discussion of the rationality of economic activity. In order to consider the relationship between psychology and economics, this section deals with Mitchell's analysis of McDougall's social psychology, which was the mainstream of psychology at the time. The final section clarifies the place of the model of human behavior assumed by Commons and Mitchell in early twentieth-century American economics.

I: Commons's Volitional Theory of Value

1. Three Categories of Human Behavior Models and "Will-in-Action"

From the end of the nineteenth century, Commons was concerned with the fact that institutional factors, such as laws and practices, played a prescriptive role and provided the factors that facilitated smooth economic activity.[4] In *Legal Foundations of Capitalism*,[5] Commons attempted to describe the legal process of constructing and changing the working rules of various industrial "transactions" brought about by the expansion of governmental authority and large corporations or labor unions in the late nineteenth century and the 1920s in the process of the historical development of Anglo-American common law. A distinctive feature of Commons's thought is the pursuit of social practices that are appropriate to the new society as "institutions governing the market" or "practical rules" within the traditional framework of common law. He also proposed a volitional theory of value concerning the asymmetrical structure of the parties in the labor market, and anticipated the nature of a "reasonable" market.

According to Commons, traditional economic theory has dealt with two concepts, "value" and "economy," based on three mathematical concepts:

4. See John R. Commons, "A Sociological View of Sovereignty," *American Journal of Sociology* 5 (July-November 1900): 1–15, 155–71, 347–66; 5 (January-May 1900): 544–52, 683–95, 814–25; 6 (July 1900): 67–89. For a detailed discussion of the structure of this series of articles and the relevance of sociology and economics to Commons's early thought, refer to Richard A. Gonce, "The Identity and Significance of Commons's 'A Sociological View of Sovereignty,'" in *The Founding of Institutional Economics: The Leisure Class and Sovereignty*, ed. Warren J. Samuels (London and New York: Routledge, 1998), 76–96.

5. John R. Commons, *Legal Foundations of Capitalism* (New York: The Macmillan Co, 1924).

"quantity, time, and energy."[6] The three mathematical concepts include "statics," or the quantitative relationship of energy, which deals with the problem of the relationship between the whole and its parts, and "dynamics," or the time relationship of energy, which deals with the relationship between past, present, and future processes.

(1) Quantity: "Value" is simply the sum of the parts with similar properties, abstracted as prices to make any commodity calculable. In contrast, "economy" is the proportion of dissimilar "values," in which the whole is a multiple of more than just the sum of its parts. Economic theory involves a quantitative relationship between the part and the whole: "A sum of prices is the total business assets of a firm, but a proportioning of land, labor, capital, and management is a going concern."[7] The good or bad of this "economy" is judged by proportion, that is, whether the whole is greater or lesser than the parts. But traditional economic theory has taken for granted the "good economy," which is the unintended consequence of Adam Smith's invisible hand.

(2) Time: François Quesnay, David Ricardo, Karl Marx, and others found the cause and substance of value in the accumulated energy of the past. The hedonistic economists sought value in the pains and pleasures of the present, based on calculations of the future. Commons discovered "value in the hopes, fears, probabilities and lapse of time of the future, depending on the will of persons existing in the present."[8] Therefore, his theory can be regarded as an expectation theory, whereas traditional economic theories are quantitative theories.

(3) Energy: With this change in the concepts of quantity and time, the concept of energy, which is the substance of "value" and the cause of "economy," comes to mean "human will."

Commons, of course, noted the necessity of constructing an economic theory based on this human will. He saw previous economic theories as theories of commodity and machinery, similar to the natural sciences, in that they considered the human will as something irregular and elusive. The development of psychology, ethics, law, and political science at the beginning of the twentieth century has opened up the field of human nature with regard to "the relations of man to man," and the existence of "human will" in human behavior has been recognized. Commons claimed that economic theory should not merely deal with the relations of man to nature but also with value and economy based on the relations of man to man. He then proposed three very unique classifications that differentiate how various economists have viewed models of human behavior.

(1) Quesnay, Smith, Ricardo, Marx, and Pierre-Joseph Proudhon: They took the "relations of man to nature," or the "engineering economy," as the starting

6. Ibid., 1–2.

7. Ibid., 1–2.

8. Ibid., 2.

point of their theories, and dealt mainly with the production, exchange, and consumption of commodities.[9] The principle of the commodity has much in common with the mechanical principle established by Sir Isaac Newton, which attempts to explain all-natural phenomena and human activities in terms of physical laws. The difference in emphasis gave rise to the distinction between physiocrats, classical economists, socialists, and anarchists in that the "commodities" they dealt with included, for example, notions of human nature, use-value, utility, scarcity, exchange value, labor, savings, expectations, private property, freedom, politics, and economics.

(2) Jeremy Bentham, Nassau William Senior, Hermann Heinrich Gossen, William Stanley Jevons, Carl Menger, Léon Walras, Eugen von Böhm-Bawerk, and John B. Clark: They inherited the lineage of (1), but focused more on the subjective aspect of human beings. The starting point of their theory was human "feelings" such as pleasure, pain, satisfaction, and sacrifice, and they interpreted the concept of "value" from the approach of diminishing and marginal utility. Their explanatory principle was the "scarcity principle" proposed by David Hume and Thomas Robert Malthus.

(3) Hume, Malthus, Henry Carey, Frédéric Bastiat, Gustav Cassel, Benjamin McAlester Anderson, and the Supreme Court of the United States: They used "transactions" between two or more people seeking the purpose of the future, rather than "commodities" or "feelings" as the starting point of their argument. Their distinctive feature was that they regarded human will as the human will-in-action[10] that we find "in human behavior, and this behavior begins to be formulated into natural laws of its own."[11] The principle that explained "transactions" was the "principle of the working rules of going concern,"[12] such as common law, statutes, business regulations, and ethics, which existed in the various interferences of corporations, trade unions, associations, or governments, such as tax collection or the exercise of police power.

Mainstream economics at the time believed that each economic unit would prefer a pattern of satisfying its desires as a passive response under given external

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9. Ibid., 3–4.

10. This "will-in-action" of human beings is the will to act while considering future possibilities and expectations of the future. Commons had in mind the contrast with the "will-in-vacuo" of John Locke's *An Essay Concerning Human Understanding* (1690). Commons explained this behavior of human beings with "will-in-action" using the legal concepts of "performance," "avoidance," and "forbearance." Performance is the power demonstrated in the actual action. Avoidance means that the action is not actually chosen and is not executed, while there are several alternative options for performance. Forbearance is a limitation imposed by oneself or a higher authority on the extent of one's power to act, and a withholding of the exercise of a right. See Commons, *Legal Foundations of Capitalism*, 78.

11. Ibid., 3.

12. Ibid., 5.

conditions. Commons thus regarded the categories (1) and (2) as mechanistic theories of value and cost, analogous to the natural sciences, which viewed human will as agnostic and capricious and not subject to law. Commons therefore placed his own "volitional theory," which emphasized the intentional workings of human beings, in the line of (3), which analyzed the human will-in-action and transactions including its evolutionary aspects.

2. Transactions and the Role of the Arbitrator

Commons gave the following reasons for using transactions by human will-in-action as the starting point for economic theory.[13]

> In fact, transactions have become the meeting place of economics, physics, psychology, ethics, jurisprudence and politics. A single transaction is a unit of observation which involves explicitly all of them, for it is several human wills, choosing alternatives, overcoming resistance, proportioning natural and human resources, led on by promises or warnings of utility, sympathy, duty or their opposites, enlarged, restrained or exposed by officials of government or of business concerns of labor unions, who interpret and enforce the citizen's rights, duties and liberties, such that individual behavior is fitted or misfitted to the collective behavior of nations, politics, business, labor, the family and other collective movements, in a world of limited resources and mechanical forces.[14]

Transactions are not the relation of man to nature, but a conflict or dependence of the minds and wills of human beings on each other in their social relationships. However, transactions by parties with will-in-action do not always take place peacefully. Even if a final agreement is reached between parties who do not have legal relationships such as rights and duties, it may still lead to disputes or conflicts because they cannot force the other party to fulfill their own expectations. Commons considered the existence of a "fifth party," equivalent to a so-called third party, to be essential in settling this dispute. The role of this "fifth party" is as significant in wage bargains in the labor market as it is in price bargains in ordinary transactions.

For example, suppose there are two groups of workers and employers who

13. There are several studies focusing on Commons's transactions. For example, the evolutionary aspects of property rights are examined in detail in Richard A. Gonce, "The New Property Rights Approach and Commons's *Legal Foundations of Capitalism*," *Journal of Economic Issues*, vol. 10, no. 4 (December 1976): 765–97; and Giorgos Meramveliotakis and Dimitris Milonakis, "Surveying the Transaction Cost Foundations of New Institutional Economics: A Critical Inquiry," *Journal of Economic Issues*, vol. 44, no. 4 (December 2010): 1045–71, which reevaluates Commons in terms of contemporary concerns.

14. Commons, *Legal Foundations of Capitalism*, 5.

cannot agree on a wage level. Mainstream American economists of the time, such as J. B. Clark, assumed that prices (wages) would always be in equilibrium by balancing supply and demand in one-to-one transactions between parties based on a uniform human image with given desires. In contrast, Commons developed a model of transactions that incorporated legal relationships outside of the usual economics discussion. It considered volitional workings, including coercion, duress, and persuasion, of parties with will-in-action. At the actual transaction, if the bargaining between the employer (actual buyer: B) and the worker (actual seller: S) makes it difficult to find a wage level, the possibility of a potential transaction with the next best employer (next best buyer: B') and worker (next best seller: S') may increase, or the transaction itself may not take place in the first place depending on the bargaining. If the wage level proposed by the employer is low and the worker refuses to sign the employment contract, there will be potential workers who are willing to work even under such inferior employment conditions. This may lead to a further reduction in the initially proposed wage level. If the contract between the employer and the worker does not allow both parties to agree on the terms and conditions of the employment and its environment (e.g., skills, willingness to work, understanding of workplace practices, etc.) as well as the wage levels, the business plan may have to be abandoned. There may also be problems with employers replacing current workers with new ones who have no understanding of the workplace practices but are willing to work at lower wage levels. In such a case, both parties may benefit from finding a level at which they can maintain their existing employment relationship. Commons had suggested a landing point by bringing in a "fifth party" as a force outside the market, including wage levels and other ancillary conditions of employment and environment. This "fifth party" is known as the "arbitrator." In order to clarify the role of the arbitrator, let us examine his view of the due process of law, which is the rule-making process.

3. Due Process of Law

In the context of American law, since the end of the nineteenth century, the Supreme Court has developed the jurisprudence of "substantive due process." It emphasizes the real aspects in addition to the due procedure of law, on the due process clause of the Fourteenth Amendment (1868) which is parallel to the provisions of the Fifth Amendment (1791) regarding the federal government. In the field of labor law, the Supreme Court has interpreted this doctrine of substantive due process to include "freedom of contract" and has ruled a lot of labor legislation unconstitutional.[15]

15. For details on the evolution of precedents on this economic freedom and due process, refer to Noah R. Feldman and Kathleen M. Sullivan, *Constitutional Law*, 20th ed. (St. Paul, MN: Foundation Press, 2019).

Commons considered that by the end of the nineteenth century, the due process clause had been extended not only to criminal proceedings but also to civil judicial and administrative proceedings, and that it was well established to require proceedings to be based on notification and hearing. He saw the due process clause as having changed to mean "the due purpose of law," that is, that the due process clause is not merely a requirement for the procedural propriety of the law, but also guarantees the proper content of the law (substantive rights). He examined this new substantive concept of due process as it relates to the events of the late nineteenth century. Commons found that the meaning of property and liberty had shifted from use-value to exchange-value in the Supreme Court's opinion, and that the interpretation of due process now guaranteed the inclusion of freedom of contract (freedom to approach the market). Thus, the due process clause has come to mean not only "due procedure of law," which requires the procedural propriety of the law, but also "due purpose of law," which protects the proper content (substantive rights) of the law.

The role of the courts has been expanded to include determining what is important in light of the purposes of the state, along with a change in the interpretation of the due process clause. Traditional common law was concerned only with physical and objective procedures, leaving the purpose behind them out of consideration of the subjective, in other words, the working rules governed the purpose. However, a working rule that determines the direction that leads to the collective action of going concern is not only a procedure of a transaction, but also a concrete ideal that includes the purpose behind the transaction. The courts authorized the purpose of the transaction if it was beneficial and discouraged it if it was harmful. The purpose of the transaction came to determine the working rules. This new interpretation of the due process clause as the protection of the proper purposes of the law had, of course, major implications for the working rules of the political going concern of the state.

The issue that needs to be considered is the method of thinking and the quality of the arbitrator who determines the purpose of the state and derives the working rules. Commons considered that working rules should be determined according to the sevenfold process of thinking, which is an inseparable attribute of human-will: (1) habit; (2) idea; (3) definition; (4) classification; (5) investigation; (6) evaluation; and (7) choice.[16] The purpose of achieving future expectations in the present is discerned through this sevenfold process of thinking. All human behavior is composed of this sevenfold process of thinking. According to

16. Commons, *Legal Foundations of Capitalism*, 349–51. Among the articles Commons cited as premises for this argument are John Dewey, *How we think* (Boston: D.C. Heath & Co., 1910) and Nathan Isaacs, "How Lawyers Think," *Columbia Law Review*, vol. 23, no. 6 (June 1923): 555–56. Dewey categorized the process of thinking into five logical stages based on his awareness of the problem of the difference between "legal thinking" and "ordinary thinking."

Commons, the thinking necessary for an arbitrator is none other than the "due process of thinking." Due process of thinking is "proper thinking" that can only be acquired by repeating the sevenfold process of thinking. It is not a process of thinking that is stimulated by sympathy for others or limited by duty, but a process for determining appropriate human relationships. This process is coercive and authoritative in that the arbitrator's decision has the purpose of determining the authority to repress or release individuality. Based on this due process of thinking, the arbitrator decides on new working rules, expressed in legal terms of rights, duties, liberties, and exposures, in order to achieve more reasonable values.

The working rules determined by the arbitrator bind the participants in the transaction into a legal relationship. Commons considered a transaction to be an "authorized transaction" if it is based on a working rule set by an arbitrator who is higher than the actual parties to the transaction. Commons stated that "even these authorized transactions must prove to be empty and ineffective if the superior authority is not at hand with power and willingness to make good on its promises and commands."[17] Rather, he emphasized the need for the collective power of concerns to ensure the maintenance of legal and economic correlations in "authorized transactions."

Commons focused on the transactional relations of the political concern of the state, particularly the power to determine the extent of the state's physical power exercised by the legislature, the courts, and the executive. The rights determined in this transaction are not only the absolute and unchanging rights of the property owner to physical things, but also the relative and limited rights constituted by abstract legal relations. Commons explains, for example, this power to determine the dual legal correlations and limits between citizens and citizens, as well as between officials and citizens, in the debt-credit relationship of actual transactions, by means of a "legal and economic compass"[18] consisting of the following eight basic legal concepts.[19]

17. Commons, *Legal Foundations of Capitalism*, 100.

18. Wesley N. Hohfeld of Yale Law School was a major influence on the "Legal Realism" that developed in the 1920s and 1930s. This compass can be thought of as Commons's refinement of the "Hohfeld System" devised by Hohfeld, which consists of the "legal opposition concept" and the "legal correlation concept." Refer to Wesley N. Hohfeld, "Some Fundamental Legal Conceptions as applied in Judicial Reasoning," *Yale Law Journal*, vol. 23, no.1 (November 1913): 16–59.

19. Commons, *Legal Foundations of Capitalism*, 91–100.

← Correlatives and Equivalents →

	Official	*Citizen A*		*Citizen B*	*Official*
↑	Power	Right	B B’	Duty	Liability
Limits ↓	Disability	Exposure	S S’	Liberty	Immunity

In order to construct a more realistic model, Commons showed the existence of not only buyers (B) and sellers (S) in actual transactions, but also the next best buyers (B’) and sellers (S’) who are willing to participate in the transaction depending on the conditions. If there is only a relationship between Citizen A (creditor) and Citizen B (debtor) in an actual transaction, then Citizen B, who has not complied with his “duty,” can be “liberty.” In this case, Citizen A would be in a state of “exposure.” Therefore, the government gives Officials the “power” to protect the “rights” of Citizen A and the “liability” to enforce the “duties” of Citizen B. So “right,” “duty,” “power,” and “liability” are correlated. If the Official does not fulfill his “power” or “liability,” Citizen B will neglect his “duty” and increase his “liberty,” and Citizen A will be in a state of “exposure” without the ability to exercise his “right.” The official will be “disabled” to do anything against Citizen A, and will be “immune” not to enforce the law against Citizen B.

The relationship between Citizen and Citizen, and between Citizen and Official, is determined by these legal and economic correlations. These correlations are nothing more than a pragmatic process that, under new conditions, leads to new and different results each time. In this regard, Commons cited the words of Oliver Wendell Holmes, “illusion of certainty.”[20]

Commons pointed out that the essence of due process lies in “what is to be done.” Therefore, the role of the arbitrator is only to realize the “public purpose.” Commons saw the inclusion of guarantees for workers as a public purpose through the due process of thinking, just as the interpretation of the legal concept of “freedom” has expanded from freedom from physical restraint, or “freedom of the slaves,” to freedom of access to markets, or “freedom of the property owners.” The public purpose of judges as arbitrators in the era of American industrialism was to ensure that workers had sufficient legal security, just as manufacturers and merchants had once been given security of property and freedom in the common law. The remaining task is to clarify the content of the “public purpose” of Commons’s volitional theory through an examination of the “principles of classification.”

20. Ibid., 124.

4. Classification and Public Purpose

Commons saw the change in the content of the due process clause in the context of the historical change of the "principle of classification" in Anglo-American law.[21] As mentioned above, the content of the due process clause included not only the procedures of the law, but also its substantive content. Commons pointed out that it was essential to deal with the facts in an appropriate manner.

> Some facts are important, others are not. Each fact does not count for one. Some of them count for much more than one, some for much less than one. Facts are the qualities, the faculties, and transactions of persons and things. There is no thinking without classification, for classification is the sorting out of qualities, faculties, or acts that are similar and distinguishing them from others that are dissimilar. And the reason for sorting them out is in order to value, choose, and act.[22]

When a dispute or conflict arises between parties to a transaction, the arbitrator (the fifth party) considers how similar cases were once decided by researching precedents. But a new case will never be a perfect match to a past case. The arbitrator plays the role of classification, making new comparisons in accordance with the facts. Classification is the inclusion of facts that are similar, the exclusion of facts that are dissimilar, and the weighing of each fact to determine the degree of similarity. The principle of classification is that the arbitrator proportions the various components toward the goal of expanding the common wealth of nations. If the balance is right, the common wealth expands; if it is wrong, the common wealth shrinks.

According to Commons, Adam Smith's intention was not to interfere with the natural economy by the collective power of the collective will of the state, but to mechanically induce the elements by divine providence to increase the power of individual will. Smith considered private and common wealth to be identical in that producers, led on by the "invisible hand," are "proportioning the factors by equalizing the incomes of individuals towards a 'normal' or 'natural' or harmonious standard of wages, interest, or profits for each class."[23] Smith's idea meant a return to the days of a natural economy, when private and common wealth were one and the same, from William I to the Act of Settlement of 1701. In that era, the king's sovereignty and property were considered integral, and the individual will and the collective will were identical, that is, private and public

21. Ibid., 321–31.
22. Ibid., 344.
23. Ibid., 323.

purposes were the same. It was the Act of Settlement that separated the king's sovereignty from his property. This separated the realm of the individual will of private wealth from the realm of the collective will of common wealth. The former was a mere private purpose, while the latter came to be considered as a public purpose of "common good," "weal public," "common right," and "public policy."[24]

Commons's aim in taking up Smith's argument was to show the impracticality of a theory based on the natural law of mechanically inducing elements in the age of American industrialism. Commons argued that in the Big Business era, the collective power of the state was being used to artificially induce elements to achieve private purposes. This resulted in inappropriate outcomes that were not based on the public purpose of the natural economy. Instead of rejecting Smith's theory, Commons emphasized the importance of the principle of classification, which proportioned new constituencies to work toward the public purpose of expanding the common wealth itself. The aim of political economy is to select the limiting factor with the highest value and to expand that factor by limiting the domain of other limiting factors in order to achieve the maximum result. Both high-value limiting factors and low-value supplementary factors are essential to the overall outcome, but of course how they are handled varies from time to time.

Commons regarded the growth of the common wealth as a public purpose, but argued that "the question always is, not, *What* is a private purpose over against a public purpose? but, Is the private purpose *also* a public purpose, or *merely* a private purpose?"[25] In other words, public purpose is not an absolute purpose, but only a relative purpose. Commons viewed the inducement of components to public purposes considered important at the national level as a process of political economy.[26] The arbitrator is responsible for recognizing the "will-in-action" of the parties to the transaction, and for establishing working rules that expand the collective behavior of individuals, families, and corporations when appropriate to the public purpose, and inhibit it when not, in order to generate new and surprising outcomes of a higher and different kind. In short, the working rule in the going concern of the state was a new practice in the age of American industrialism that promoted certain businesses and jobs as valuable, but restricted them if they were damaging, in order to achieve the public purpose of expanding the common wealth as a whole by extending the sphere of transactions by people and groups with "will-in-action," eliminating conflicts of interest, and further increasing individual freedom of transaction.

24. Ibid., 325.
25. Ibid., 326–27.
26. Ibid., 43.

II: Mitchell and the Rationality of Economic Activity

Institutional economics, which began to take shape in the early twentieth century as a theory for explaining the institutional functions and processes of change in the American economy and society, was an intellectual movement that reconsidered social issues from a different perspective. Mitchell entered the University of Chicago in 1893 and was influenced by the economists Veblen and James L. Laughlin, and the philosopher Dewey.[27] He had been interested in the monetary controversy concerning the bimetallic standard system even before he entered the University of Chicago. Mitchell began his research on the Greenbacks[28] during the Civil War while at the University of Chicago, and received his PhD in 1899.[29] In 1903, he moved to the University of California and began to study business cycles, focusing on the evolution of the money economy and the cyclical readjustment of various prices, and published a book on it.[30] During his time at Columbia University (1913–1944), he was engaged in the establishment of the New School for Social Research and the National Bureau of Economic Research (NBER), and continued to work consistently on empirical studies of business cycles. Mitchell was interested in the spillover and cumulative interaction of many factors behind the business cycle as a phenomenon unique to modern capitalism, and believed that an institutional analysis of the economic system was essential to its clarification.

In previous studies of American economic history, Mitchell has usually been regarded as one of the founders of institutional economics and primarily as a scholar of business cycle theory. However, as Rutherford also points out, Mitchell

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27. For a detailed biography of Mitchell, see Lucy Sprague Mitchell, *Two Lives: The Story of Wesley Clair Mitchell and Myself* (New York: Simon and Schuster, 1953).

28. Greenbacks were the common name for paper money issued by the United States government in 1862 during the Civil War as a temporary measure to raise money for the war effort. The name comes from the fact that the reverse side of the bills were printed with green ink. Congress authorized the Treasury Department to issue $150 million of these bills in February 1862, and authorized additional issues of $300 million in July 1862 and January and March 1863. Greenbacks were fiat money, with no reserves of gold or silver, and were only declared legal tender. See Henry W. Brands, *Greenback Planet: How the Dollar Conquered the World and Threatened Civilization as We Know It* (Austin, TX: University of Texas Press, 2011).

29. The title of his doctoral thesis is *History of the Legal Tender Act* and it was published in 1903. See Wesley C. Mitchell, *A History of the Greenbacks, with Special Reference to Economic Consequences of Their Issue: 1862–65* (Chicago: University of Chicago Press, 1903).

30. Wesley C. Mitchell, *Business Cycle* (Berkeley CA: University of California Press, 1913).

had been arguing for a model of human behavior that had played an important role in his institutional approach since 1910, when he was at the University of California.[31] The two-part article entitled "The Rationality of Economic Activity,"[32] which is discussed in this section, provides a useful clue as to how Mitchell was thinking about the nature of economics with psychological elements.

Mitchell regarded the principles of human nature assumed by mainstream economic theory, from classical and neoclassical economics to early twentieth century American economics, as "borrowed from psychology,"[33] such as functional psychology. The social scientists during this period tended to be more closely connected with psychology. They include Graham Wallas, a British political psychologist, Jane Addams, an American social worker, Edward A. Ross, an American sociologist, and Adolph Wagner and Gustav von Schmoller, German economists. Mitchell focused on a new field of psychology called "social psychology."

The psychological trends in the United States at that time included the comparative psychology of humans and animals, which emerged at the end of the nineteenth century under the influence of Charles Darwin's theory of evolution.[34] It had a major impact on American philosophy and psychology, and led to the birth of pragmatism and functionalist psychology. There was also a movement toward social psychological research on human social behavior by Dewey and others. In 1908, E. A. Ross published *Social Psychology*,[35] which was influenced by Gustave Le Bon's crowd psychology and Jean Gabriel de Tarde's fundamental force, imitation. McDougall, a British psychologist, hypothesized that if humans are the product of evolution, then various instincts must be innate. In 1908, he wrote *An Introduction to Social Psychology*,[36] in which he discussed innate human instincts as the driving force behind all mental activity. According to McDougall, from an evolutionary standpoint, human social behavior can be explained based on the concept of a dozen or so "instincts" and their associated "emotions," covering personal and social behaviors such as flight, refusal, struggle, curiosity, sex, gregariousness, sympathy, and imitation. However, McDougall's emphasis

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31. See Malcolm Rutherford, "Wesley Mitchell: Institutional and Quantitative Methods," *Eastern Economic Journal*, vol. 13, no. 1 (January-March 1987): 63–73.

32. Wesley C. Mitchell, "The Rationality of Economic Activity: I," *Journal of Political Economy*, vol. 18, no. 2 (February 1910a): 97–113; Wesley C. Mitchell, "The Rationality of Economic Activity," *Journal of Political Economy*, vol. 18, no. 3 (March 1910b): 197–216.

33. Wesley C. Mitchell, "The Rationality of Economic Activity: I," 97.

34. See William Douglas Woody and Wayne Viney, *A History of Psychology: The Emergence of Science and Applications*, 6th ed. (New York: Routledge, 2017).

35. Edward A. Ross, *Social Psychology: An Outline and Source Book* (New York: The Macmillan Company, 1908).

36. William McDougall, *An Introduction to Social Psychology* (London: Methuen & Co., 1908).

on innate instincts was antipodal to the behaviorist psychology of John B. Watson, an American psychologist who emphasized objectively observable acquired learning and environments. With the development of machine-based industry symbolized by automation technology in the United States, the objectivist position advocated by Watson's behaviorist psychology permeated all subsequent fields of psychology and became the premise of modern psychology. In contrast, "social psychology" based on McDougall's theory of instincts, although it had a great impact on the social sciences at the time, was increasingly criticized as a subjective and unscientific psychology, and subsequently fell into decline in the 1920s.

1. Principles of Human Nature as Assumed by Economists

Mitchell understood that the subject of McDougall's *An Introduction to Social Psychology* was the study of instinct, the most important driving force of all human activity. The assumptions of the social sciences at the time were based on a false understanding of their common premise, the science of the human mind (psychology). For example, the arguments of classical economics, which were based on hedonistic psychology (utilitarian ethics), assumed that good and pleasure were the same thing and that humans were rational beings, even though humans are anti-intellectual and have many irrational aspects. They derived false theories from these false psychological assumptions. According to McDougall, this false psychology should be turned into an "empirical science of behavior," or as he put it, "an evolutionary natural history of mind" based on objective observation.[37] Mitchell believed that the empirical science of this behavior, as the study of instinct, was essential to reconcile the theory of economics with reality. McDougall discussed instincts in three parts: afferents, central nerves, and centrifugal nerves. Particular emphasis in his research on instincts was placed on the central nervous system, which serves as a link between stimuli from receptors common to all humans and effectors such as muscles. He classified the central nervous system into a dozen or so instincts and their associated emotions.[38]

In McDougall's discussion, Mitchell was particularly interested in habit, the emotion that controls our instinctive behavior. McDougall, who took the position of instinct theory, of course believed that habits are also formed from innate instincts, but he included certain habits in "modes of activity of acquisition."[39] Therefore, Mitchell paid attention to McDougall's point that pleasure and pain, the basis of hedonistic psychology (utilitarian ethics), partially influence the formation of habits. Pleasure and pain, which are nothing more than aimless

37. Mitchell, "The Rationality of Economic Activity: I," 100.
38. Ibid., 101.
39. Ibid., 103.

movements, are hardly recognized as driving forces for behavior, but the forms of behavior associated with pleasure are promoted and become established as habits, while those associated with pain are suppressed and decline. That is, McDougall recognized that obscure instinctive behaviors are modified and standardized into definite behaviors. However, McDougall himself only addresses pleasure and pain in terms of their influence on the formation of these habits. In this regard, Mitchell argued that "in studying human behavior, we should first discuss habits and instincts."[40] Mitchell was reading McDougall's intent, which was to show that the driving force behind the complex activities that make up society as a whole is not pleasure and pain, but instinct and habit formed by the modification of instinctive behavior.

McDougall's social psychology of instinct theory had an impact on the field of psychology at the time, but eventually disappeared as it was thought unscientific. However, Mitchell's focus was more on the relationship between economics and psychology that McDougall worked on. Conventional economists had assumed a false form of psychology called hedonistic psychology. It viewed as "rational" the sensible self-interested behavior of people who seek pleasure and avoid pain. Mitchell's aim was to raise the issue of economics based on such a psychology.

2. Economists and Psychology

This section begins with Mitchell's view of the psychological assumptions of classical economists since Adam Smith.[41] In his *The Theory of Moral Sentiments*, Smith made a psychological assumption about the homogeneous nature of human beings to strive to better their own condition. Mitchell determined that this assumption was based on Smith's natural freedom. On the other hand, Malthus's psychological premise was a sexual instinct between the two sexes, accompanied by suppression by poverty and vice, as well as by moral restraint. Following the Malthusian principle of population, Ricardo connected the irrational aspect of increasing offspring with the minimum cost of survival and the rational aspect of a human being as a calculable animal. James Mill was the one who combined Ricardo's concept of economic activity with Bentham's hedonism. N. W. Senior's understanding of human nature as pursuing the acquisition of additional wealth at the cost of less was merely inherited from Smith and Ricardo, not from psychologists. Mitchell pointed to John Stuart Mill as the person who showed that the humanity of political economy is an arbitrarily defined "economic man." He was the one who revealed the essence of political economy as an abstract science, abstracting from emotions and motivations that aim to acquire the maximum amount of goods with the least amount of work and restraint.

40. Ibid., 103.
41. Ibid., 104–7.

This is followed by Mitchell's views on economists since the marginal revolution.[42] Jevons used Bentham's calculus of pleasure and pain to advance the abstraction of the principle of human nature in economics. He excluded the sexual instinct between the two sexes from the principles of human nature, and dealt only with the static field of utility and self-interest. Maffeo Pantaleoni further developed this static field. He referred to human nature as driven by desire fulfillment, based on the premise of psychological hedonism. Mitchell reconsidered the relationship between Pantaleoni's humanity and McDougall's humanity as a real being in relation to non-Euclidean geometry and the assumptions of Euclidean geometry. He believed that if an unproven, artificial premise can be considered academically valid as a theorem, then it is nothing but "truth." In order to achieve their mission of simplifying and explaining complex economic phenomena, Pantaleoni and other neoclassical economists consciously assumed factually incorrect assumptions, such as perfect competition.[43]

Mitchell suggested that this assumption of rational human nature as a self-interested person was shared by American economists such as Irving Fisher and J. B. Clark. However, Mitchell focused on the attempt to bring economics closer to economic life rather than on the attempt to pursue the logical accuracy of economics as a science. It was Alfred Marshall who successfully reconciled the psychological assumptions of classical and neoclassical economics with the realities of economic life. Marshall saw the attempt to abstract economics symbolized by the "economic man" as incomplete; rather, he tried to build economics on the basis of the behavior of calculating "entrepreneurs." However, as Mitchell pointed out, Marshall was merely expressing economic phenomena mathematically, using mechanistic methods such as consumer surplus and producer surplus, with pleasure and pain or satisfaction and loss as the basis of his economic theory.

Finally, Mitchell discussed economists such as Schmoller, Werner Sombart, Sidney and Beatrice Webb, and Veblen, who took an evolutionary perspective on human nature itself as the subject of their inquiry.[44] According to Mitchell, they must be the ones who considered the knowledge of the human mind and its mode of action, an essential psychological premise for economics as pointed out by McDougall. They focused on the institutions to standardize individual behavior, which Mitchell described: "Institutions are themselves conceived as psychological entities—habits of thought and action prevailing among the communities under observation."[45]

Mitchell's findings in reflecting on the relationship between economists and

42. Ibid., 107–11.

43. Ibid., 109.

44. Ibid., 111–13.

45. Ibid., 112.

psychology since Smith is that "economists began their neglect of psychology by taking human nature for granted."[46] Classical and neoclassical economists have implicitly built their theories on the assumption of a homogenous rational human nature, and have neglected psychological concepts in favor of making progress in the abstraction of economics. Economists who adopted the evolutionary hypothesis finally made the principle of human nature a subject in itself, and attempted to create a psychological concept that could be used for economic inquiry. As McDougall had pointed out, evolutionary arguments were essential to scientific thinking, and therefore psychological knowledge was necessary for all those who study the social sciences. This is exactly the point with which Mitchell sympathized with McDougall.

3. Social Concepts and Institutional Evolution

Mitchell regarded the wise self-interested rational human model assumed by earlier economists as unrealistic. They have committed "the intellectualist fallacy"[47] in that their "rationality" of human beings was limited to the fact that they possessed the intelligence to recognize and act on facts common to most human beings. For example, the desire to consume goods and obtain satisfaction, the desire to avoid the hassle of labor, and the desire to have new desires once current desires are satisfied. Human behavior has been explained by economists as the marginal utility of goods, the disutility of labor, and so on, using formulas and diagrams because they are "useful tools for illustrating the main features of processes that are too complex to describe reality."[48]

But it was the content of rationality that Mitchell took up as the problem. McDougall's theory of instinct emphasized that instinct, the driving force behind all behavior, determined the purpose of all human activity. Mitchell saw economics as dealing with the means to achieve the ends of human economic activity. He considered rationality from the following three aspects.

First, the production of goods as an industrial aspect of economic life. The Big Business period was characterized by the application of natural science to the production of goods, as well as by a wide range of advanced industrial organization and management techniques. Mitchell considered the standardization of production techniques for goods to be rational.

Second, on making money as a business aspect of economic life. Mitchell saw that the accounting techniques used to ascertain the financial condition and business performance of companies were also being rationalized. This rationalization of the economic activities of industry and business, that is, the

46. Ibid., 112.
47. Mitchell, "The Rationality of Economic Activity," 197.
48. Ibid., 197–98.

rationalization of the production of goods and the making of money, was achieved by the successful combination of the people who designed the work plans and the people who executed those plans with machine-like regularity. Mitchell suggested that the psychological principles of those who faithfully follow these instructions should be the subject of analysis of actual human behavior—for example, human behavior such as "facts of habits, amenability to suggestion, tendency toward imitation, and the instinct of construction"[49] based on McDougall's instinct theory.

Third, the consumption of goods. People tend to behave irrationally towards personal consumption. For example, it is a well-known fact that humans make purchases that are ignorant and careless of the prices, and that they consume on a passing whim. Mitchell pointed out that McDougall's terms, such as habit, suggestibility, and the instincts of emulation and imitation, should be incorporated to explain the rationality assumption about human consumption behavior.

Through a consideration of Mitchell's arguments, it is suggested that traditional economics has focused solely on economic rationality, ignoring the habits and instincts addressed by other sciences such as sociology, ethnography, and psychology. The rationality of human behavior has various aspects, such as the production of goods, making money, and consumption. Economic rationality, which is an acquired aptitude, should be included in the scope of economics, as should habits and instincts. In short, there was a division of labor between the other sciences and economics.

The downside of economics' focus on this narrow field, Mitchell said, was that economists misunderstood the social origins of the social concept and its core, social institutions. According to Mitchell, social concepts are cumulative concepts that each ethnic group has uniquely inherited in its own way.[50] By being taught, understanding, and using these social concepts by the group to which they belong, human beings save much of their mental effort and increase their individual abilities. Thus, social concepts have a great impact on individual thinking and behavior, leading to "a marked standardization of thinking and of acting."[51] Mitchell pointed out that this standardization became an entrenched habit and formed a common pattern of thought and behavior for the members of the group to which it belonged; in other words, social institutions as habits of thought became norms for guiding the behavior of individuals. But it is impossible for the current members of the group to have the same habits of thought as their ancestors. Mitchell described the evolutionary aspects of social institutions themselves as follows:

> Unforeseen logical developments, unforeseen conflicts between different elements,

49. Ibid., 200.
50. Ibid., 202.
51. Ibid., 203.

> and unforeseen results of acting along the lines laid down, all occur from time to time and react upon the communities in which the institutions prevail, much as personal habits react upon their practicers.[52]

Mitchell thought that economists had missed the evolutionary aspects of these social institutions in that they had misinterpreted the nature and influence of economic concepts. The essence of economic rationality in economic theory is nothing more than a model of the "economic man" constructed by specializing in an analysis of the motives that dominate human beings in industry and business, that is, by artificial methods that remove the other various aspects of human nature. According to Mitchell, by focusing on such a narrow field of analysis, economists have failed to grasp even the true nature of the phenomena themselves, and regarded social concepts, especially pecuniary concepts, as nothing more than "empty symbols." The issue that remains is how economists have handled the concept of money.

4. Economics and Rationality

Smith, Walter Bagehot, and J. S. Mill regarded money as a superficial phenomenon and did not take it up as a major issue compared to the discussion of value and distribution. In addition, the non-Euclidean or mechanistic economic theories after Jevons, who used hedonistic calculus, focused on the acquisition of pleasure rather than the use of money. Marshall, an eclecticist, attempted a realistic explanation of the business process around the "entrepreneur" involved in making money, but he did not attempt to clarify the hedonistic basis of his theory of economic rationality from the monetary argument.

That is why Mitchell pointed out that economic rationality, simplified by hedonism, was essentially a product of money, and argued for the need for an evolutionary consideration of economic problems from the perspective of functional psychology.[53] This claim can be seen as a criticism of the classical economists' view of money as superficial. It can also be taken as an emphasis on the role of money in defining the current economic regime: "During the long centuries that men have been gaining their mastery over the use of money, pecuniary concepts have been gaining a subtler mastery over men."[54] For example, the expansion of the financial system, including credit lending, financial management, fiscal policy, and securities markets, has resulted in the standardization of individual thinking and behavior, as people learn to improve their economic efficiency through the use of money, thereby restraining their

52. Ibid., 204.
53. Ibid., 208.
54. Ibid., 208.

instinctive impulses. These are the results of the dominance of money over human beings. The behavioral norms associated with the concept of money, in which financial success is praised and failure is despised, deeply dominate our lives.

Mitchell considered the previous explanations of human behavior by economic theory, which were based on hedonistic calculations dealing with marginal increments of goods and labor instead of ignoring monetary concepts, to be artificial in two respects.[55] First, when goods were considered in terms of money prices and labor in terms of money wages, money itself was not considered, even though business transactions were a highly organized field. Second, by ignoring the evolutionary aspects of monetary concepts and equating uncivilized, barbaric humans with those involved in modern business, the characteristics of the modern economic regime were overlooked. As these two points make clear, the "economic man" of conventional economic theory has to be superficial, ignoring the institutional foundations accumulated by our ancestors and imperfect traits such as irrational behavior. Artificial and superficial economic theory excludes the process of the monetary economy, which is the dependency of industry and business.

But Mitchell observed that classical economists and their successors did not just ignore the monetary concept, they exaggerated its spirit of monetary rationality and absorbed it into the assumptions of hedonistic psychology. In the world of a highly organized monetary economy, the norms of conduct of gaining monetary profit and avoiding monetary loss become so pervasive that people, especially those who are eager to make money, have become machines that calculate their monetary consequences with great precision. Mitchell said, "Every interest of his life should be reducible to terms of one common denominator—the dollar."[56]

Mitchell thought that the rationality implicitly assumed by classical and neoclassical economists was constructed through the similarity of the rationality of monetary and psychological concepts, and completed by paraphrasing monetary terms into psychological terms in Bentham's hedonism. They replaced accounting with hedonistic calculus, and interpreted self-interest as the maximization of net pleasure rather than net profit, so that it could be rephrased from the monetary units of profit and loss to the emotional units of pleasure and pain. The reason for the harmony between the facts of the monetary economy and explanations of human behavior that rely on hedonistic rationality and ignore the concept of money is that the behavioral norms created in the development of the financial system have worked strongly to bring rebellious human nature in line with monetary rationality. Non-Euclidean or mechanistic economics attempted to

55. Ibid., 209.

56. Ibid., 213.

explain the rationality of all of human economic life, including non-business issues such as the consumption of wealth and the dynamics of economic activity to which hedonistic rationality, which is similar to monetary rationality, could not be successfully applied. The unreality of rational human beings assumed by economic theories, which Mitchell called "the intellectualist fallacy," arose from the exaggeration of the hedonic calculus employed by those economists.

What Mitchell focused on was a new, scientific type of economic theory that would "account for the actual human types which are found in every nation"[57] and explore human nature itself, based on the psychological knowledge that McDougall saw as essential to economics. Mitchell emphasized the importance of explaining not only the economic regime of the moment, but also its own changes. It was an economic theory based on evolutionary theory, not artificial, superficially abstracted human rationality. For Mitchell, economic rationality was not a given attribute of human behavior, but simply "man's rationality is usually exhibited by a sensible acceptance of an established routine proven by experience to be effective."[58] That is, it was the result of a monetary system that routinized what worked empirically in the monetary realm.

Conclusion

The points discussed in this article clarify the features of the view of the model of human behavior assumed by Commons and Mitchell. In the early twentieth century, mainstream American economics at the time of the emergence of institutional economics was dominated by J. B. Clark's theory of marginal productivity, which was a mixture of marginal theory after Jevons and the Austrian theory of subjective value. The economic unit assumed in this theory is considered to choose a pattern that satisfies its desires as a passive response to the external conditions surrounding it at the time.

In the three types of models of human behavior presented at the beginning of *The Legal Foundations of Capitalism*, Commons placed himself in a line which took as its starting point the transaction of the "will-in-action" of two or more people seeking a future. In his volitional theory, Commons assumed a legal economic transaction relationship that includes not only actual transactions but also potential transactions. It attempted to model a human being with "will-in-action" in which four parties actively choose more desirable prices and conditions based on the ruling of the fifth party, rather than the passive economic agents with given desires assumed by orthodox economics. The arbitrator finds in the practices and customs of the transaction parties the concept of property rights and the legally-based social rules for governing human behavior, the working rules of

57. Ibid., 216.
58. Ibid., 199.

the going concern. It was a distinctive feature of Commons's theory that the arbitrator induces the behavior of the participants in the transaction to socially realize "reasonable value" according to due process.

Mitchell's criticism of the utilitarian model of the economic man, as assumed by orthodox economics, was that its assumptions of human rationality were derived from a faulty psychology, and were therefore inconsistent with the facts of economic society. The evolution of social institutions is a cumulative change in the norms produced by human beings who operate actively with diverse purposes. Mitchell called the standardization of human thought and behavior by such internalized norms "economic rationality." In order for economic theory to be based on "economic rationality" in this sense, it was essential to incorporate new psychological knowledge, as McDougall pointed out, and to change social institutions.

Economic theory should not be based on the assumption of a passive and unrealistic human being who satisfies given desires, but on an active human being based on the fact that human understanding changes with the cumulative development of social institutions. It should be emphasized that this was precisely the new model of human behavior advocated by Commons and Mitchell.