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Was Frank Knight an Institutionalists?

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**Abstract** - This paper critically examines Geoffrey Hodgson's recent provocative claim about Frank Knight as being a member of American institutionalism in the interwar years. In the first section of the paper the authors attempt to provide a definition of institutionalism and to emphasize its meaning from a historiographic point of view. The second and third sections analyze the two main methodological struggles between Knight and the institutionalists, namely, the debate during the early 1920s over the use of instinct theory as an explanation of economic behavior, and the subsequent campaign led by Knight in the late 1920s and early 1930s against the behaviorist wing of American institutionalism à la Copeland and Ayres. The fourth section deals with Knight's own brand of institutionalism. Our main conclusions are that, even if Knight's approach to the study of economic behavior shows some significant affinities with American institutionalism, he was not – both sociologically and in terms of his philosophical premises - an institutionalist.

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Not only was Knight an institutionalist, he was also one of the greatest institutionalists after Veblen (Hodgson 2004, 344).

Knight is no institutionalist in any ordinary sense of the term. (Gonce 1971, 555 n67).

## 1. The Issue

Geoffrey M. Hodgson's *The Evolution of Institutional Economics* is not a history of American institutionalism in the proper sense of the term<sup>1</sup>. As the author himself explains in the introduction, the aim of the book is rather "to look at its [American institutionalism's] conceptual, philosophical and psychological foundations". (Hodgson 2004, 7). Accordingly, Hodgson presents an articulate and well documented historical reconstruction of institutionalist methodology. A strong – although by no means exclusive – emphasis is addressed on how the leading figures of the movement developed their ideas on the functional relationship between individual agents and social structures.

With this article we do not mean to provide a general appraisal of Hodgson's book –quite a challenging task that would require a more comprehensive review essay. More modestly, we would like to focus the reader's attention on a single chapter, namely chapter fifteen, where the author decides to enroll Frank H. Knight inside the ranks of American institutionalism<sup>2</sup>. Two main features are put forward by Hodgson as justification for such a rather controversial pronouncement. First, "he [Knight] accepted the impact [of] social and institutional factors on human wants and behavior." Secondly, Hodgson relies on self-identification: in his writings, Knight "repeatedly described himself as an institutionalist" (Hodgson 2004, 344). In our account, it is the first point that really matters and this article is (almost entirely) devoted to its critical evaluation.

In order to sustain his position, Hodgson offers an elaborate and insightful presentation of Knight's thoughts on five key theoretical and methodological issues: a) neoclassical utility theory (325-328); b) given preference functions and fixed technological possibilities (328-330); c) methodological individualism (330-332); d) the possibility of a synthesis between neoclassical economics and institutionalism (332-334); and e) the place and value of institutional economics (338-344). In each case, the author finds important traces of affinity between Knight and American institutionalism. For instance, in discussing one of the most problematic matters – namely, utility and the neoclassical theory of prices – Hodgson appropriately shows how Knight accepted it more as a source for normative considerations, than as the dominant explanation underlying human conduct in economic decisions. Hence, Hodgson arrives to the conclusion that "Knight thus distanced himself from the neoclassical economists who typically rely on utility theory to model, explain or predict human action" (327). Other instances of detachment between Knight and neoclassicism are explored for each one of the residual key theoretical and methodological issues. To put it briefly, Hodgson sees Knight as rejecting the "rarified deductive theory" which is today's synonym for neoclassicism – i.e. the paradigm of a given, abstract, pure, *a*institutional conceptual model of the economy – as well as a follower of institutionalism as an epistemological complement for neoclassicism. It should also be noted that Hodgson acknowledges some fundamental differences between Knight and the institutionalists – especially those, like Ayres and Copeland, who embraced the positivistic climate which pervaded American social sciences since the late 1920s. Accordingly, he devotes a whole section (334-338) to discuss in some detail Knight's criticisms of behaviorism and empiricism, particularly in the version which was elaborated by Morris Copeland. Still, in spite of these divergences, Hodgson's verdict is quite categorical: "Not only was Knight an institutionalist, he was also one of the greatest institutionalists after Veblen". (Hodgson 2004, 344).

With this article we wish to present some further reflections upon Knight's contentious connections with American institutionalism. We shall try to provide a different – although not necessarily conflicting – point of view from Hodgson's by revisiting two debates on method in the interwar years: the former was occasioned by a brief but intense exchange of views on the role of instincts in human actions; the latter instigated a protracted campaign on the pros and cons of behaviorism and, more generally, of experimental methods in economics. On both these frontiers Knight and the leading institutionalist economists firmly stood on opposite camps.

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<sup>1</sup> Hodgson himself repeatedly admits: "This present work is in part a history of American institutionalism, but in many respect it is incomplete". (2004, xviii); "This work is not intended to be a rounded history of American institutionalism". (2004, 7).

<sup>2</sup> It should be noted that chapter 15 of Hodgson (2004) draws heavily on a previously published essay by the same author (Hodgson 2001).

There are five further sections in this paper. In Section 2 we offer a few preliminary comments on the very nature of American institutionalism and the possibility of arriving at an acceptable definition of its main contours. The third and fourth sections deal with the two most significant methodological debates between Knight and the institutionalists during the interwar years. The fifth section discusses Knight's own approach to institutionalism. The last section presents some concluding remarks.

## 2. Questions & Definitions

The title of this article seems to reveal that we are facing no problems whatsoever in defining American institutionalism as an historical category and that, consequently, we would have no difficulty in measuring Knight's writings and epistemology against some fixed yardstick which is called "American institutionalism". However, this is not the case and such impression would be misleading. Readers will find out that we do have an answer to the question "was Frank Knight an institutionalist?" but our verdict will be based on a very pragmatic and primitively empiricist – that is, on a very institutionalist – way to discover similarities as well as points of dissent between Knight and an established group of people which we assume away as belonging to "American institutionalism".

To put it in another way, our considerations on Frank Knight and institutionalism are rather loosely connected to our capacity to provide unambiguous answers to the following general set of questions: What definition – or, better, what description – of American institutionalism do we want to apply as the historiographic standard against which an economist's adherence to the movement can be critically gauged? How far – or how thin – must the line of demarcation be in order to allow this economist to be identified as a member of American institutionalism or to some of its multifarious strands? In this case, should we need to specify what "Knight" we are considering as belonging to institutionalism? The theorist? The philosopher? The dissenter? The teacher? His whole production? His early writings?

Some of these questions have been hotly debated in the past ten years or so by distinguished historians of economic thought, and should be of interest to us in this context. However, they are possibly not.

In fact, despite Malcolm Rutherford's meritorious efforts of systematization, it looks as though the profession has not yet provided conclusive answers in this respect. Many interpreters agree that a clear definition of institutionalism is a rather problematic undertaking and, what is more important, some go on to argue that – unlike other "schools" of thought – Institutionalism is by no means a useful historiographic category. As Dan Hammond (2004), Steve Medema (2004) and others have pointed out, such widespread scepticism can be justified with two main explanations: first, institutionalism seems to be lacking of a coherent, distinctive and uniform set of core ideas; secondly, at a more political or applied level, institutionalism definitely does not have a common policy orientation which could be taken as a model or as a unifying principle or as a systemic vision. Most importantly, with Frank Knight, these difficulties appear even more pronounced. His self-identification as an institutionalist notwithstanding, he certainly had some of the attributes which Malcolm Rutherford elaborated to define the list of prerogatives to be part of the movement. But then again, as many interpreters have correctly pointed out, how much of institutionalism one needs to accept to become an institutionalist? Interwar institutionalists were dissenters on marginalism and many other things, and so was Frank Knight. But is it enough? And is self definition meaningful? Or is it not?

Now if we go back to Rutherford, in order to sign up a new member to the group, five major prerequisites are needed: "i) a clear recognition of the *central* analytical importance of institutions and institutional change [...]; ii) a desire to base economics on a social psychology consistent with this emphasis on the role of institutions, and a related rejection of hedonistic psychology [...]; iii) the adoption of a view of a correct scientific method in social science as empirical and 'investigational' [...]; iv) an emphasis on the *critical* examination of the functioning of existing institutions [...] and a related belief in the need for new forms of 'social control' [...]; v) the adoption of a pragmatic and humanistic approach to social value" (Rutherford 2004, 183, both emphasis in the original).

Moreover, to this list of arguments we may want to add a further criteria which is quite crucial in our story on Frank Knight. In fact, what remains rather undisputed from Malcolm Rutherford's general interpretation is the idea that Institutionalism can be understood and, most importantly, "used" as an historiographic category, if we think of it not as a school, not as a clear-cut paradigm, but as an intellectual movement, as a network of people working on loosely related research programmes, with at least two main streams. The former comprises a *humanistic* soul, with John Maurice Clark and John R. Commons as its most authoritative proponents, which can be characterized by a distinctive research bent towards an

institutional analysis of market structures and the legal intricacies of modern economic systems. The latter can be identified with a so-called *scientist* wing, far more populated, with Copeland, Mitchell, Tugwell, Wolfe and the NBER guys as its most important affiliates, which can be in its turn characterized by an inner drive toward quantitative and experimental methods and by their application to the explanation of business fluctuations and other macroeconomic issues. As we will attempt to show below, it was this second group within the movement which Knight referred to as “the institutionalists” and which attracted his harsh criticisms during the 1920s and 1930s.

Thus, following Rutherford’s taxonomy and this review of the troops, our starting point is that one of the innovative features of American Institutionalism is the attempt to elaborate a new theory of human behaviour particularly fit for these new research projects. In contrast with neoclassical economics, both the scientific and the humanistic strand of Institutionalism did so through a process of cross-fertilization or contamination with some major achievements of modern psychology. It is along these rather narrow perspectives that it may not be meaningless to ask: “was Frank Knight an institutionalist?” Our negative reply has not been influenced by the reading of Hodgson’s very valuable book whose conclusions on this matter deserve, in our opinion, to receive new justifications and a different emphasis.

Anticipating some of our conclusions, we believe, with Hodgson, that Knight agreed on some core ideas and beliefs and rejected others. Knight was part of institutionalism since most of his works were not conceived in pure, a-institutional conceptual terms, and that institutions did matter in terms of process confrontation and social evolution. Knight recognized the central analytical significance of institutional change and shared with institutionalism the idea that economics ought not to be confined to theories of value and distribution or to the elegant sophistication of market equilibrium. However, one of the points that we wish to emphasise with regard to Hodgson, is that Knight strongly denied the need to base economics on a social psychology consistent with the emphasis on the role of institutions together with the adoption of empirical and investigational methods. True, as Hodgson shows, Knight can not in any way be associated to methodological individualism. However, while discussing motives, forces, instincts, habits and the ultimate determinants of human behaviour he strongly and openly dissented with what the leading American institutionalists were arguing and trying to fabricate as viable alternatives to methodological individualism. As long as Knight drastically rejected instinct theory first and behaviourism later, he rejected *the* core ideas of institutionalism as a sociological entity à la Rutherford. Along these lines, he was never part of the movement but what he wrote worked against its unity – and rather successfully.

### 3. The First Debate: Instinct Theory

A lot of research efforts have been done to investigate the psychological foundations of American institutionalism from its beginning to the interwar years<sup>3</sup>. They all put strong emphasis on a common starting point: the emergence during the second half of the nineteenth century of instinct-based theories of human agency. Although various authors had already acknowledged the role of impulses and proclivities, it was not until Darwin’s introduction of biological explanations into behavioral analysis that instincts entered the rhetoric of the social sciences in a rather systematic way. William James, William McDougall and C. Lloyd Morgan gave instinct theory its greatest refinement, and deeply influenced those economists who were looking for a viable alternative to hedonism. At the beginning of the century, early institutionalists like Thorstein Veblen, Robert F. Hoxie, Wesley C. Mitchell and Carleton Parker widely employed it in their analysis of economic behavior. Their attention was drawn by the multiple layers of interaction between instinctive motivation and intentional economic behavior. As we have shown elsewhere (Asso and Fiorito 2004a), debates on the role of instincts in economics were not confined to the different souls of American Institutionalism, and even some orthodox figures, like Irving Fisher or Frank Taussig, paid attention to the utility of instincts for a better understanding of the evolution of the American economy.

The success of instinct theory, however, was short-lived. Roughly within a decade from the publication of McDougall’s influential treatise, psychologists and social scientists drastically began to reject the idea of innate patterns of behavior. By the late 1910s and early 1920s, following the attacks of the so-called social psychologists, instinct theory in its different formulations was largely replaced by the modern idea of culture and cultural determinism (Cravens and Burnham 1971, 642).

At about the same time this anti instinct revolt was also and quite inevitably creeping into the field of economic studies. Frank Knight was an absolute protagonist of this revisionist campaign. Although he was in good company with some of the leading figures of the emerging empiricistic and behavioristic wing of

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<sup>3</sup> Hodgson 1999; Lewin 1996; Rutherford 2000a; 2000b; Asso and Fiorito 2003a; 2004a; 2004b.

institutionalism – such as Clarence Ayres and Morris A. Copeland (Asso and Fiorito 2003a)<sup>4</sup> – Knight used different arguments. We can roughly assemble them into two different groups.

A first line of criticism focused on the perceived tautological content of instinct theory. In 1922 Knight noted that:

“If instincts are to be scientifically useful, it must be surely possible to get some idea of their number and identity. But there has always been substantially unanimous disagreement on this point. Logically the choice seems to lie between a meaningless single instinct to do things-in-general and the equally meaningless hypothesis of a separate instinct for every possible act” (Knight 1922).

Knight thus strongly rejected the usefulness for economics of any working taxonomy of instincts, pointing out that it would always be possible to find ad hoc justifications for any kind of human behavior simply by adding one new instinct to the existing set. “Instinct” as an analytical category to explain human behavior was therefore devoid of any predictive power: “It is not practically helpful” – Knight wrote in 1924 – “to be told that some one of the possibilities of a situation will eventuate, though it may have a power, somewhat difficult to account for, of satisfying – after the event – a certain type of craving for a reason why” (Knight 1924, 248).

Secondly, Knight criticized instinct theory on the ground that too much emphasis was placed on the purely biological determinants of human behavior while no adequate consideration was given to the cultural and environmental factors as a primary cause of human activity and motivations. Following instinct theory, Knight conceded that the biological nature of the human organism provides an important part in explaining human behavior, for man is subject to hunger, thirst and the need for sex like any other animal. Accordingly, all these “general” activities have to be considered as innate and largely unlearned. “Yet” – he continued – “it is most essential to observe that these are not specific activities, that the concrete content of all of them, what is eaten and how, the forms of courtship and family life, the language spoken and so on – are after all acquired, and within astonishingly wide limits one type of content is acquired as readily as another”. (Knight 1924, 248).

However critical towards instinct theory, Knight curiously maintained an open door about the future developments of social psychology. In his caustic review of Lionel Edie’s institutionalist textbook, *Principles of New Economics* (1922), Knight admitted to be under the impression that “the tendency of the more careful students in this domain [social psychology] is already strongly away from the use of ‘instincts’ to explain everything in the field of human contact” and observed with approval that “the movement is toward a real ‘psychology’, viewing behavior as the expression of conscious attitudes toward values *whose content is largely an institutional product*”. (Knight 1923, 155; emphasis added). This last passage shows that, in spite of his attack against the institutionalist use of instinct theory in economics, Knight was not adverse to the study of how values shape and direct human behavior. Interestingly, in the last sentence Knight affirms that the essence of values is largely “an institutional product”. This point is particularly relevant and will be taken up below.

#### **4. The Second Debate: Knight’s Crusade Against Behaviorism and Empiricism**

After the turn of the century, the professionalization of psychology occurred in overlapping phases involving different theoretical orientations and methods (Degler 1991). By the end of the War, John Watson’s behavioristic and conditioning theory and Edward Thorndike’s conception of learning by reinforcement began to gain momentum within the discipline, soon displacing instinct psychology and leading to the emergence of a reasonably coherent set of intellectual commitments to which the name *behaviorism* gradually became attached. Its main tenets were the removal of introspection in psychological theory, a dedication to the use of objective methodology in research, and a strong concern for the practical application of psychological knowledge to the prediction and control of human behavior.

Behavioristic psychology soon attracted considerable interest among those institutionalists who – unsatisfied with instinct theory – were looking for a viable alternative to the hedonistic explanation of human behavior. This perception is confirmed by the large number of references to behaviorism that, since the mid

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<sup>4</sup> In their anti instinct campaign, Knight, Ayres and Copeland seem to have been influenced by the work of J. R. Kantor, perhaps also because for some time their presence overlapped at the University of Chicago. See also Asso and Fiorito (2004a).

1920s, can be found in the “institutionalist” literature<sup>5</sup>. A few examples may help to clarify this point. In 1930 Morris Copeland made an explicit plea on behalf of establishing closer connections between institutionalism and behaviorism. Both approaches, he wrote, were based upon the common concern that their epistemology must conform to two important canons: first, “that they shall be consistent with hypotheses in other fields, especially with the natural-evolutionary hypotheses in geology and general biology”; and second, “that they shall leave the door open to the solution of all psychological problems by methods of scientific observation and scientific reasoning” (Copeland 1930, 13). A few years later Clarence Ayres defined institutionalism and behaviorism as “parallel and coincident” movements (Ayres 1936, 235), while, in comparative terms, Rexford Tugwell wrote:

“If our institutions are our activity experiences, which is a statement often used for definition, the theoretical position is exactly analogous to the behaviorist one. If the behaviorist would say that men are what they do, the institutionalist would say that society is as it acts. Behaviorist throws over the paraphernalia of consciousness, institutionalism has no use for it either in its other forms – group consciousness for instance”. (Tugwell 1937, 418).

As many authors have pointed out, such an enthusiastic approval of behaviorism was also due to the growing favor toward the introduction of positivism in the social sciences<sup>6</sup>. Hence, behaviorism seemed to be consistent with the positivist belief that the only domain for achieving scientific knowledge – i.e. knowledge based on direct, systematic and neutral observation – was the domain of natural science. Natural science, with its mixture of formal analysis, empirical investigation into cause-effect relationships, and resulting theories capable of prediction and control over nature, became the paradigm against which all other forms of knowledge ought to be measured. Accordingly, society was seen as an objective reality whose constituents, structure and functioning obey regularities. Behaviorism, with its central idea that all human behavior could be explained in term of observable stimulus-response patterns, fitted perfectly into this framework.

Knight fiercely and directly reacted against the institutionalist campaign on behalf of behaviorism and empiricism in economics. His first response occurred as early as 1925, with an essay published in the *American Economic Review* (Knight 1925a)<sup>7</sup>, but his participation to this methodological controversy continued, in a scattered and fragmented fashion, in several other essays (1925b; 1935b; 1935c), encyclopedia entries (Knight 1931; 1935a), book reviews (Knight 1932; 1934a; 1934b; Knight *et al.* 1931), and in his private correspondence<sup>8</sup>.

Knight developed his critique of behaviorism along what may be defined as a neo-Kantian perspective<sup>9</sup>. He began by denying the possibility of demarcating observation from inference. Empirical facts, he argued, are constructed in view of well defined theoretical or rhetorical interests. Objects and events are not automatically *facts* because of the kind of inherent and objective properties they possess, rather they are defined in advance of empirical work: “[t]he answer at the end of every line of inquiry is instrumentalism” (1925b, 94). This is true for all disciplines belonging to the natural and social sciences. For Knight what they had in common in their pursuit of scientific values was the precise specification of the categorical forms of the fact they study. Moreover, he added, selection of facts as potential objects of analysis implies not simply a choice of studying A or B, but a value-oriented construction of A and B:

“[...] [T]he most critical perception is never entirely free from a volitional, or interest, element, even abstracting from the wish to be free from bias, which is also a wish, a value. Allowance for

<sup>5</sup> See Asso and Fiorito (2003a; 2004a) for a more detailed survey of the literature.

<sup>6</sup> See also Asso and Fiorito (2003a; 2004a; 2004b), Mirowski (1987), Rutherford (2000a; 2000b).

<sup>7</sup> Knight’s essay “Fact and Metaphysics in Economic Psychology” was written as a polemical reaction to two articles by Lawrence Kelso Frank (1924) and Adolph Snow (1924), overtly supporting the use of behaviorism in economics. The very same years Knight wrote to Viner: “We have to do exactly what Snow and Frank try to get away from doing, namely talk in terms of such things as ideals or purposes, and urges toward their realization. I admit it isn’t ‘scientific’ that behaviorism represents the ‘scientific’ point of view. But you can never keep a purely scientific point of view in any science!”. Frank H. Knight to Jacob Viner. Iowa City, September 9, 1925. Jacob Viner Papers, Seely G. Mudd Manuscript Library, Princeton University. The letter is reproduced in Asso and Fiorito (2003b).

<sup>8</sup> See in particular Knight’s correspondence with Clarence Ayres (Samuels 1977), J. M. Clark (Fiorito), Copeland (Asso and Fiorito 2003), Mitchell (Fiorito 2000), and Viner (Asso and Fiorito 2003b).

<sup>9</sup> Hodgson (2004, 334) correctly observes: “Kant influenced Knight, like many others at the time, including Marshall, Veblen and Weber”.

the ‘personals equation’ is an indispensable part of the strictest laboratory technique, and approximation to laboratory technique is a matter of degrees over most of the field of science. ‘Scientific truth’ is itself a theoretical ideal, a limiting concept, impossible of literal realization. And finally, ‘Truth’ itself is as clearly a value as Beauty or Goodness, its fellow members of the famous trinity”. (Knight *et al.* 1931, 150).

To put it in modern jargon, for Knight facts are selective assertions about reality. Empirical statements cannot describe events and objects exhaustively. The infinite complexity of reality is unknowable in the absence of epistemic norms that designate one-sided principles of selection. Facts are therefore, *selectively* constructed. Theoretical interests and values formally specify principles that justify and guide the construction of different types of facts (Asso and Fiorito 2003a; 2003b).

The next step for Knight is to disparage the behaviorist requirement that consciousness – including self-consciousness – must be excluded as an object of scientific inquiry. In Knight’s opinion the ineludible assesment of attitudes and perspectives that tend to bias scientific inquiry or push it in one direction rather than another is incompatible with the behavioristic banishment of consciousness from the realm of science: “[...] a ‘motive’ is meaningless unless thought of as a phenomenon of consciousness”. (1922, 24). For instance, Knight argued, any attempt to explain in terms of environmental pressures to sensory stimuli the reasons why an author is actually writing a scientific article, would lead to an infinite explanatory regress. As he wrote in a letter to Morris Copeland:

“If you try to work out a drive or action-pattern which will ‘explain’ your writing the article at all, and writing one leading to this particular conclusion instead of some other, you will only set yourself (if you succeed) the new question of working out an action-pattern to explain why you did that, and so on without end. In the intellectual life itself (if not elsewhere) you cannot get away from real interests, which look forward and not backward for their explanation. This tendency to place the investigation, inquiry or argument itself outside the universe of discourse, is very interesting to me. But the fact remains that inquiry and argument are also behavior, and their characteristics have to be taken account of in any discussion of behavior which pretends to completeness”<sup>10</sup>.

Thus in his defense of introspection, Knight attaches great relevance to the communication. While Watson and his followers proposed and attempted to incorporate the major aspects of linguistic behavior within a behavioristic framework, Knight held that our ability to relate to one another through language – but also through shared meanings, traditions, norms – cannot be reduced to the logic of mechanical action patterns. In his view, communication between individuals is essentially communication between minds: “Peoples are personalities, characters; the biggest part of social relations consists of conversation, the interest residing in feeling and thought communicated and not in behavior and its physical results”(Knight 1925a, 260). It is through communication and social intercourse that people infer other people’s (and their own) consciousness and recognize it as real. The very logic of language thus becomes purposive and eludes any behavioristic attempt to reduce it to a stimulus-response pattern<sup>11</sup>.

Knight’s last step was to reject the behavioristic conception of social control as it was openly endorsed by many institutionalists of the time. The mechanistic interpretation of human nature is again under his critical lenses. While the behaviorists stressed the relevance of behavioral mechanisms as an instrument for social control, Knight emphasized the role of persuasion through communication. To Knight, social control appeared to be more a matter of “art” rather than of mechanical technique or of science: “Art, after all, is ‘expression’ – of ideas and emotions; and the potency in human relations of sympathy, anger, personal

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<sup>10</sup> Frank H. Knight to Morris A. Copeland: November 9, 1926. Knight Papers, Regenstein Library, Department of Special Collections, University of Chicago. The letter is reproduced in Asso and Fiorito (2003a).

<sup>11</sup> This point is treated extensively in his 1925 article on “Economic psychology and the value problem” from which this quotation is taken: “Speech in particular cannot without absurdity be treated as mere physical behavior, and the behavioristic term ‘language habit’ does grave injustice to the richness and variety of life. The notion of habit is of possible applicability to the utterance of words used in a purely literal sense – if any language outside of mathematical symbols ever is strictly literal, an assertion open to doubt. It will not fit at all the other type of language, which is more important and more common in cultural intercourse, the figurative, suggestive use. Language as an artistic medium must not be confused either with the mere tool of factual communication or with mechanical incitement to action. Actual speech almost always contains a considerable admixture of the first element”. (Knight 1925b, 90).



force, and feeling attitudes generally, is not to be gainsaid". (Knight 1925b, 90-91)<sup>12</sup>. Thus, Knight argued that any attempt to influence or manipulate society through the laws of response to stimuli, however consistent with the "scientific" point of view, is doomed to be ineffective:

"The man who expects to influence others must work more through their feelings and his own than through explicit physical stimulus and response. The interpretation of human conduct in terms of 'behavior patterns', inherited or acquired, in relation to 'situations' may be metaphysically correct, but it will not work". (Knight 1925b; 90).

To summarize, Knight criticized institutionalists like Copeland, Frank, Mitchell or Tugwell for holding that the significance of social behavior can be derived from the nature of their antecedents causes and their causal implications for subsequent events. Establishing causal uniformities, he argued, does not fulfill the functions of explanation, prediction and control. Knight conceded that social theorists set the point of departure for causal analysis by constructing empirical facts, by interpreting the social significance of events. However, the process of causal explanation in social science is not identical with the search for universal and causal laws in natural science. As Knight put it in a critical review-article of Slichter's *Modern Economic Society* (), the notion of uniformity of sequence is antithetical to that of social control "by the behaving material itself". Although in social and economic phenomena there is "considerable uniformity of sequence", Knight concluded, such a uniformity "runs in terms of meanings and values rather than physically described events". (Knight 1932, 440).

## 5. On Knight's institutionalism

The previous two sections have dealt with Knight's methodological debates with the institutionalists. Especially in the case of his anti behavioristic campaign, Knight found himself in open disagreement with many of the leading figures of the movement who, in their turn, were attacking the methodological foundations of the emerging neoclassical paradigm. Nevertheless, as Hodgson correctly emphasizes, Knight was by no means a staunch defender of orthodoxy.

The most convenient starting point to solve this apparent contraddiction is an essay Knight contributed to Tugwell's *The Trend of Economics* (1924) with the rather emblematic title "The Limitations of the Scientific Method in Economics". As Knight himself wrote in a letter to Wesley Mitchell, this article was intended to be a "presentation of the claims of the old-fashioned theory as against institutional economics"<sup>13</sup>. In the first three sections, Knight elaborated, in a rather rudimentary way, many of the above mentioned anti-positivistic claims which were to be fully developed in the two subsequent decades. In particular, Knight critically focused on the empiricist insistence that claims must be assessed on the basis of observational evidence and on the alleged possibility of cleansing the study of motives from social science. It should be noted, that in some cases, his discussion, albeit anti institutionalist in the author's intent, acquired a strong anti "neoclassical" flavor<sup>14</sup>. In one crucial passage, Knight (1924, 108-109) asserted: "[i]t is one of the philosophic assumptions of this essay [...] that neither man nor his world can be understood in terms of categories derived from the exigences of adapting means to given ends".

Having assessed the limitatons of the scientific method in economics, Knight goes on to discuss a rather authoritative statement: "In spite of all the foregoing, there is a science of economics, a true, and even exact science, which reaches laws as universal as those of mathematics and physics" (1924, 134). Such laws define the *form*, even though not the *contents* of human activity. All this means that "scientific" economics cannot predict which goods will an economic agent desire, even though is able to describe, within reasonable limits, in which way the agent distributes his/her expenditure among several alternatives: "We do not know what specific things will be wealth at any given place and time, but we know quite well what must be the attitude of any sane individual toward wealth *wherever a social situation exists which gives the concept meaning*". (Knight 1924, 135; emphasis added). To put it differently, instead of implying courses of action that actively manipulate the routines of daily life in behalf of a definite set of social values, "economic"

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<sup>12</sup> "[...] [T]he method of social prediction and control is as closely akin to the method of art and of aesthetic criticism as to the method of laboratory science". (Knight 1925b, 98).

<sup>13</sup> Frank H. Knight to Wesley C. Mitchell, May 18, 1923. The letter is reproduced in Fiorito 2000, 291-292.

<sup>14</sup> Similarly Hodgson observes: "However, Knight's [1924] essay is much closer to institutionalism than he suggested, and if his stance is old-'fashioned' is nearer to a dynamic version of Marshall than to any static neoclassicism". (Hodgson 2004, 328).

rationality accepts motives as “factual desires” and calculates the most expedient means of dealing with the difficulties which their fulfillment present<sup>15</sup>. For Knight, this type of rationality exists as a manifestation of man’s tendency for means-end rational action and is deeply non-institutional in character.

“Nor are the general laws of economics ‘institutional’. They work in an institutional setting, and upon institutional material; institutions supply much of their content and furnish the machinery by which they work themselves out, more or less quickly and completely, in different actual situations. Institutions may determine the alternatives of choice and fix the limits of freedom of choice, but the general laws of choice among competing motives or goods are not institutional—*unless rational thinking and an objective world are institutions, an interpretation which would make the term meaningless*”. (Knight 1924, 137; emphasis added).

And again, in the same context, Knight sees “a close analogy between theoretical economics and theoretical physics”. (Knight 1924, 138).

Here Knight clearly distanced himself from the institutionalists’ claim that economic rationality is itself a product of the pecuniary institutions of capitalistic societies. In his later writings, however, these assertions are somewhat rephrased in a more cautious fashion. In spite of the universal nature of economic laws, the Chicago economist pointed out that any supposed analogy between utility maximizing economic agents and Newtonian mechanics should be taken *cum grano salis*. Causal analysis in natural science – especially in mechanics – is subject to verification and is not affected by the vicissitudes of value-relevance. While the criteria of causal adequacy are universal, the criteria of social significance depend on the values of the social agent. As a consequence, mechanical causality is inapplicable to social events because the range and meaning of empirical *objects* in social science vary with changes in the values of the behaving *subjects*. This is why – and this is Knight’s central theme – although useful instrumentally, at closer examination economic rationality breaks down into a higher level of rationality which involves an urge to achieve a set of values. Such an “urge,” he wrote, cannot be reduced into factual desires, in the sense that it “has no literally describable object” (Knight (1935a, 244).

The role of value oriented behavior is present in Knight’s works, at least since his first methodological essays. The most lucid statement about how such a higher form of rationality enters the economic discourse is perhaps contained in the entry “Value and Price” for the *Encyclopaedia of the Social Sciences*. Values, Knight argued, enter the realm of economic behavior in two different ways. First, he insisted on the fact that “what is chosen in an economic transaction is generally wanted as a means to something else” – a point reminiscent of Dewey’s denial of the means–end dichotomy<sup>16</sup> – and this in turn implies “a judgment that is a means to the result in question”. Second, as already implied in earlier statements, “what is ultimately wanted for its own sake can rarely, if ever, finally be described in terms of physical configuration, but must be defined in relation to a universe of meanings and values” (Knight (1935a, 246-247).

From this perspective, the main deliberative problem implied by human behavior is the evaluation of those “ends” that economic rationality must necessarily capture in their empirical aspect or, as Knight called them, the evaluation of “factual desires”. Here the similarity with Weber’s analysis of value-rational behavior (*Wertrational*), is quite evident and has already been pointed out by many interpreters<sup>17</sup>. What Knight seems to assume is the existence of another form of rationality directing human behavior, not on the basis of means-end calculation, but in relation to a past, present or potential set of values. Accordingly, values represent a unique standard against which reality’s flow of unending empirical events may be selected, measured, and judged. In this connection, it is extremely significant to note that Knight accused both institutionalism and neoclassicism – or at least some of their versions – for neglecting the role of value-oriented behavior in their methodological writings. Two passages taken from Knight’s correspondence can be usefully reproduced to emphasize this point. The first is addressed to the most convinced supporter of behaviorism among American institutionalists, Morris Copeland:

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<sup>15</sup> More specifically, “the ‘patterning’ of interests does not invalidate the principles of utility analysis at all, so long as substitution is possible through varying proportions; and that is clearly the fact over a considerable field, whatever its precise extent may be”. (159).

<sup>16</sup> As noted by Asso and Fiorito (2003a) and Hodgson (2004, 330).

<sup>17</sup> See asso and Fiorito (2003a) for references and a more detailed discussion of this point.

“I submit that no man, however well-educated or critical, or scientifically biased, can carry on five minutes of ordinary conversation about any topic of human interest connected with human relations, without repeatedly and distinctly recognizing (a) that human actions are largely caused and inevitably interpreted in terms of wishes or desires, in a sense categorically different from mechanical estimation, and (b) furthermore, that they are similarly caused by and inevitably interpreted in terms of (to a lesser but important degree) value judgment in a sense categorically different from wishes or desires”<sup>18</sup>.

The second is part of a more general comment on Robbins’ *The Nature and Significance of Economic Science* which Knight wrote to the author:

“I am inclined to think that the fundamental judgment stressed so much in your book, of an absolute contrast between judgments of facts and judgments of value, is actually the basic error in the theory of nineteenth century liberalism. Stating it another way, I am inclined squarely to reverse the maxim *De gustibus non disputandum*, in this regard, and hold that only judgments of value can be discussed, facts as such not at all. That is, when we disagree about a fact it seems to me we disagree about the validity of observation or evidence, and that every disagreement is essentially a difference in evaluation”<sup>19</sup>.

Knight’s dissatisfaction with both “orthodox” and “unorthodox” approaches is also reflected on his tripartite partition of economics. According to Knight, within economics, three distinct and equally necessary “methods of treatment” can be distinguished. The first is “economic theory in the recognized sense”, which Knight mainly identifies with marginalism and defines as “a study, largely deductive in character, of the more general aspects of economic cause and effect, those tendencies of a price system which are independent of the specific wants, technology, and resources” (Knight 1924, 144). The second method is “applied economics”, which “should attempt a statistical and inductive study of the actual data at the particular place and time, and of the manner in which general laws are modified by special and accidental circumstances of all sorts” (Knight 1924, 144). The third method is the most relevant in connection with our discussion:

“The third division of economics is the philosophy of history in the economic field, or what some of his votaries have chosen to call ‘historical’ and other ‘institutional’ economics, studying the ‘cumulative changes of institutions’. In so far as it aspires to practical utility it will endeavour to predict long-period changes in the factors which applied economics accepts as data and attempts to observe and use as bases of inference. As far as can be seen now, this third division, even more than the second, is a field for the exercise of informed judgment rather than for reasoning according to the canons of science. The movement of history are to be ‘sensed’ rather than plotted and projected into the future”. (Knight 1924, 144).

The latter approach may appear, at first sight, as an important concession made by Knight to the institutionalist movement. However, Knight’s version differs substantially in its philosophical foundations from the empiricist approach of people like Copeland and Frank or from Veblen’s evolutionary economics, having rejected, albeit with different motivations, both behaviorism and instinct-habit psychology. It is certainly true, as remarked by Hodgson, that Knight acknowledged in more than one occasion the role of habits in shaping human conduct. For instance, Knight wrote in 1942: “Our behavior is largely of the type variously designated as social habit, custom, tradition, usage, or institutions. Such behavior forms are perpetuated by processes which sociologists call imitation and suggestion, acculturation and the like, and often refer [*sic*] to as social inheritance, in contrast with the biological inheritance of instincts”. (Knight 1942, 259-260). In the passage immediately below, however, Knight added an important remark:

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<sup>18</sup> Frank H. Knight to Morris A. Copeland: January 25, 1927, emphasis added. Knight Papers, Department of Special Collections, University of Chicago. The letter is reproduced in Asso and Fiorito (2003).

<sup>19</sup> Knight to Robbins, February 17, 1934. Knight Papers, Department of Special Collections, University of Chicago. See also Knight’s review of Robbins’ *The Nature and Significance of Economic Science* in the *International Journal of Ethics* (Knight 1934b).

“But traditional-imitative or institutional *behavior* is theoretically reducible to the mechanism of conditioned response, in contrast with *activity*, and is not social in the distinctively human sense, though institutions are nearly as distinctive of human society as is deliberative group action”. (Knight 1942, 260; both emphases added).

Interestingly, we can discern here an implicit distinction between institutional *behavior* and institutional *activity*. While institutional behavior can be reduced to some form of mechanical pattern of action, purposive institutional activity is identifiable only by reference to “meanings” and “valuations”<sup>20</sup>. This is what Knight meant when he asserted that values’ content is largely “an institutional product” (1923, 155). For Knight, at its institutional level, social reality is understood as the outcome of efforts to implement values; and this reality is logically comprehended by the methodology of historical research. Here, again, the gap between Knight and the empiricist wing of institutionalism becomes wide. While institutionalists like Copeland saw institutionalism as an application of the natural science methods to economics<sup>21</sup>, Knight conceived it as a sort of philosophy of history in the economic field which is subject to very same limitations of the historical method<sup>22</sup>. Historical research, for Knight, was never to develop explanatory laws of social evolution, but always to account for unique configurations of phenomena by reference to antecedent conditions which were held to be socially significant to their emergence. As Knight put it:

“[...] the usefulness of history is not in giving us rules which can be made the basis of inference and prediction; it is not in this respect a science, but rather an art. The study of history works in a quite different way, through training the judgment, giving insight into human life. The useful knowledge of history is chiefly unconscious knowledge and its application will also be unconscious. As we have remarked of the interpretation and prediction of human situation in general, the basis of the inference is not consciously known. Often, indeed, the premises can be discovered and put into words *afterwards*, but that again is more history, but not science”. (127: emphasis added).

In history – as in institutional economics – the necessary orientation to “values” not only influences the objectivity of historical study but it becomes the very principle which makes this objectivity possible. It acts, Knight thought, as a (chiefly unconscious) principle of selection whereby fragments of the succession of social events are endowed with a form of objectivity – becoming, as a result, material for historical analysis. So “theoretical relation to values” – to put it in Weberian terms – rather than interfering with the acquisition of objective knowledge, becomes for Knight the only precondition which allows the social scientist to acquire objective historical (and *institutional*) knowledge.

## 6. Conclusive remarks

Knight was not an institutionalist, and this for two main reasons. First, he was not “sociologically” associated with the network of individuals who, during the interwar years, actively promoted institutionalism and used to consider themselves as full members of the movement. Second, as we have attempted to show, Knight took part in (at least) two important methodological controversies with the institutionalists. In the early 1920s, he criticized those economists – like Edie and Veblen – who employed instinct theory in their analyses of human behavior. Since the mid 1920s, Knight engaged in a personal crusade against the more

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<sup>20</sup> “Activity is an attribute of a purposive individual, a subject, or self” (Knight 1942, 253).

<sup>21</sup> Copeland once wrote to Eveline Burns: “I regard Institutionalism as an attempt to apply the natural science point of view in economics. According to this view economics seems to me to be a branch of biology”. M. A. Copeland to E. Burns, November 14, 1930. Morris A. Copeland Papers, Rare Book and Manuscript Library, Columbia University.

<sup>22</sup> “The great fact which makes economic theory so vague and so difficult is the confusion already referred to as the relations between cause and effect and or the interpretation of ‘given’ conditions, or in scientific terms, the separation of the constants and independent variables, from the dependent variables. This problem underlies the crude distinction often drawn between ‘static’ and ‘dynamic’ economics, and between short-time and long-time views of the price problem. It is also central to the issue between the conceptions of economics as deductive theory and as ‘institutional’ economics. All these contrasted notions, are purely relative, matters of degree; at one extreme we might have a discussion limited to the abstract theory of markets, at which point indeed some of the mathematical treatments virtually stop; at the other extreme we should have the philosophy of history (in the economic field, however defined) and that is what institutional economics practically comes to. It should go without saying that all are useful and necessary.” (141: emphasis added).

“scientific” wing of institutionalism which advocated the application of natural science methods to economics. He critically argued that institutionalist economists had downplayed the “metaphysical” and “evaluative” dimensions of human behavior, by focusing instead on the economic actor as a mechanical agent, merely responding to external stimuli. Our reconstruction has also considered Knight’s attempt to promote a new form of institutionalism which would complement both “pure” and “applied” economics. Knight’s own brand of institutionalism was built upon the concepts of values and value-oriented rationality. In his own schema, value-oriented rationality is the only type of rationality that allows to introduce institutional analysis into economics and, more generally, social science. Although economic rationality is also capable of direct conscious mastery of reality, it does not introduce consistent attitudes towards life. For Knight, instrumental rationality, characterized by a means-end rational calculation of interests, lacks the methodical element called forth when values, particularly those reaching the status of ethical standards, regulate action by providing meaning to economic “ends”.

Hodgson is absolutely correct in pointing out the so many affinities between Knight’s work and that of some institutionalists – mainly Veblen. If, however, the term “institutionalism” is to maintain a certain degree of historiographic significance, it becomes necessary to distinguish clearly between those economist who were directly associated with the movement and, on the other hand, those figures who were external to the movement and shared many of the institutionalists’ concerns about received economic doctrines. Therefore, if, in our opinion, Knight does not properly belong to institutionalism, then, a final puzzle still remain to be solved, namely, why he occasionally defined himself as such. A possible and plausible answer can be found in Knight’s polemical rhetorics and in his love for argument. However, concerning this very last issue, there is nothing better we can do, than leave to Knight himself the concluding words:

“When I am talking with an orthodox economist who expounds all these economic principles as gospel, I am a rip-roaring institutionalist, and when I am talking to an institutionalist who claims the principles don’t make any sense at all, I defend the system, the ‘orthodoxy’ that is treated with so much contempt by followers of Veblen and others who wear the institutionalist label”. (Knight 1960, 82).

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## **Was Frank Knight an Institutionalism?**

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### **Abstract**

This paper critically examines Geoffrey Hodgson's recent provocative claim about Frank Knight as being a member of American institutionalism in the interwar years. In the first section of the paper the authors attempt to provide a definition of institutionalism and to emphasize its meaning from a historiographic point of view. The second and third sections analyze the two main methodological struggles between Knight and the institutionalists, namely, the debate during the early 1920s over the use of instinct theory as an explanation of economic behavior, and the subsequent campaign led by Knight in the late 1920s and early 1930s against the behaviorist wing of American institutionalism à la Copeland and Ayres. The fourth section deals with Knight's own brand of institutionalism. Our main conclusions are that, even if Knight's approach to the study of economic behavior shows some significant affinities with American institutionalism, he was not - both sociologically and in terms of his philosophical premises - an institutionalist.