

Judicial Decision and Joint Bargaining: Two Methods of Institutional Reform in the *Institutional Economics* of John R. Commons

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Abstract

An additional method of institutional reform is presented by comparing John R. Commons' *Institutional Economics* (1934) with his 1927 manuscript "Reasonable Value" (Commons 1927), newly discovered in Japan in 2013. The 1927 manuscript stresses that by settling disputes, a higher authority, "judicial decision," plays a role in institutional reform. In contrast, *Institutional Economics* (1934) discusses a "joint bargaining system," essentially the creation and amendment of working rules through negotiations between interest groups, joint administration of those rules, and enabling institutions via sovereignty. The entire picture of Commons' theory of institutional reform is clarified and contemporary impacts of his theory highlighted.

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1. Introduction

Discussions of institutional reform are a core component of the value theory in John Rogers Commons' major work *Institutional Economics* (Commons 1934) (hereafter IE). Institutional reform is the method that brings about the three requirements of "reasonable value," that is "equality of opportunity," "fair competition," and "equality of bargaining power." When we compare two descriptions of institutional reform, that is (1) additional descriptions from his 1927 manuscript "Reasonable Value" (Commons 1927), newly discovered in Japan in 2013,¹ with IE and (2) his earlier theoretical works, *The Legal Foundations of Capitalism* (Commons 1924) (hereafter LFC), we find that a different method of institutional reform is described in the additional descriptions in the 1927 manuscript. This paper clarifies his two methods of institutional reform. The first method was captured in LFC and the 1927 manuscript, and the second method was captured in additional descriptions in IE (discussed in sections 2 and 3). By articulating these two methods, this paper presents an overall picture of Commons' theory of institutional reform (section 4). In addition, the paper shows some contemporary impacts of his theory of institutional reform (section 5).

2. The Method of Judicial Decision Described in LFC and the 1927 Manuscript

The method Commons focuses on in both LFC and the 1927 manuscript is institutional selection by “judicial decision,”² where a superior selects an institution (a custom) from competitive institutions (customs) in the process of deciding a dispute of inferiors (Commons 1927, CH. 1, 25-26). The term that captures this process is “artificial selection” (Commons 1924, 376). The Supreme Court stands at the pinnacle of this process of artificial selection. What is the purpose and the thinking behind the Supreme Court’s selection of a custom? The Supreme Court is based on the “public purpose,” in other words, “justice,” which is comprised of the increase in the commonwealth and the achievement of ethical principles, namely, security of expectations, freedom, and equal treatment (Commons 1924, 327, 345, 351-352). The public purpose is not a priori purpose (Commons 1924, 321). The meaning of public purpose has been changed historically, especially by the Supreme Court itself. For example, the Supreme Court expanded the meaning of freedom from the freedom of the human body, to the property of an individual, to the property of a corporation (Commons 1924, 325).

The Supreme Court makes decisions based on advantages and disadvantages to the public purpose resulting from its decision (Commons 1924, 356). Concretely, the Supreme Court considering the public purpose and being strongly affected by its

internalized customs, classifies facts, gives different weights to them, and, finally, makes a decision, which sorts out the conflicting customs (Commons 1924, 349–351). The internalized customs³ are and will be affected significantly by the dominant customs of the time and place. For this reason, the Supreme Court itself is affected by the evolving customs of society.

3. The Method of Joint Bargaining Described in IE

3.1. Joint Bargaining System

In chapter 10 of IE, “Accidents and Unemployment-Insurance and Prevention,” (Commons 1934, 840) Commons retraces the deliberation process of the Wisconsin Workmen’s Compensation and Accident Prevention Law of 1911 and the Wisconsin Unemployment Prevention Law⁴ of 1932, and their administration after passage and describes the “joint bargaining system” (Commons 1934, 858) in detail.⁵ This system is the different method of institutional reform in LFC and the manuscript 1927. In this system, three parties, the Wisconsin State Industrial Commission, employers’ association, and trade union, jointly and quickly amend the working rules of the system⁷ that relate to special and conflicting issues.

The following three points of the system are essential. First, creation and amendments

of the working rules of the system are created through negotiation between the interest groups. Each interest group, which is set up voluntarily, selects its representative(s) and sends the person (persons) to be part of the system. Second, “administration” of the rule is voluntarily performed by the interest groups. Third, workability of the system is supported by a “sovereign power” given by the government. In this system, on the one hand, the interest groups take over a part of the power from the sovereign government or sovereignty. The groups receive greater authority from the sovereignty, as they play a role creating rules that are recognized by society as reasonable. On the other hand, the sovereignty can enhance “progressive” private practice, which means more reasonable practices in a wider-ranging and semi-public system. By this method, the sovereignty guides the groups to play a part in social governance.

Through the joint experiences of administering the system for about 20 years (Commons finished writing IE in November 1933), the mutual understanding between the conflicting interest groups is enhanced and shared belief is built. Mutual understanding means that one participant recognizes the motivations that drive other participants, and uses these motives for his/her own aim or the aims of the system (Commons 1934, 859–860). The motivations of the labor union are wage increases, reduction of working hours, safety, and guarantee of employment, among others. The

motivation of a firm is the pursuit of profit. On the one hand, the trade union tries to bring the firm into the system, giving an incentive to the firm; in other words, the union tries to connect the profit motive of the firm with welfare improvement. On the other hand, the employers' association tries to increase efficiency, and build management-labor cooperation by offering the progressive job environment employees want. Based on these mutual understandings and mutual manipulation of motives, a shared belief is built. The belief is that to enact or amend the working rules of the system, if the concerned parties negotiate, compromise, and make an agreement, then every party can jointly administer the working rules. Owing to this belief, a new rule avoids becoming a dead letter and the workability and penetration of the new rule are ensured.

3.2. Roles of Sovereignty in the Joint Bargaining System

The first role is "investigation." Through investigation, sovereignty determines the factual progressive business and labor customs. The progressive practices are more fitting to the public purpose than the prevailing practices, such as practices contributing to increased efficiency, stable employment, safety improvements, stabilized prices, and that ensure "reasonableness," for instance, ensure the equality of bargaining power between negotiators, fair competition, and equal opportunity. In other words, sovereignty acquires

ideas of novel behaviors through investigation. The second role is to give sovereign power. Through involving interest groups, the sovereignty institutionalizes the ideas in the joint bargaining system. Thus, sovereignty involves private groups in the social governance that sustains order and obtains public purposes.

3.3 Reasons Why the Different Method was Newly Described

In order to rebuild from the Great Depression, which started from a plunge in the New York stock market in 1929, each advanced country embarked on a “managed recovery” (Commons 1934, 611). The reason Commons added a detailed explanation of the joint bargaining system in IE is that he was concerned not only with the rise of fascism in Germany and Italy and communism in Russia, but also with the need for a quick recovery in the American political economy. In May 1933, the American political economy started to move rapidly towards totalitarianism in the name of the New Deal. Considering this rapid development, Commons wanted to show how a managed recovery could hold the line against fascism and communism. According to IE, the defense against fascism was to keep legislatures alive, and the means of this was to resolve legislature functional failures by using commissions. According to IE, the role of the legislature is to approve and protect voluntary associations, and, in some cases, give authority to them; and the

role of the voluntary association is to send its own representatives to the advisory committee and work to resolve complicated conflicts.

Another reason that Commons gave detailed explanations in IE of the joint bargaining system after his manuscript 1927 was that he was deeply confident in the workability of the system when he saw the process of the passage of the Wisconsin Unemployment Prevention Law of 1932.

4. Articulation of the Two Methods of Institutional Reform

This section tries to show the larger picture of institutional reform described in IE as IE does not specifically state how these two institutional methods of reform relate. Through this challenge, this section attempts to understand the composition of social progress.

The two methods of institutional reform may be integrated through the following two approaches. In the first, the emphasis is on the participation of actors mainly belonging to lower-level institutions and their influence on higher-level institutions. The second involves the implementation of a collective sanction from certain higher-level institutions on lower-level institutions.

In the first approach, Commons assumes that citizens try to: (a) capture the collective power by participating in various going concerns⁷ (Commons 1924, 105–106); and (b)

change the working rules by exercising collective power. In IE, Commons argues that citizens establish a higher institution through concerted actions. Examples of such institutions are the establishment of agreements between corporations, employer associations, or trade unions (Commons 1934, 54, 70). Multiple conflicting interest groups construct an institution, called “collective bargaining” (Commons 1934, 759). The interest groups build such institutions voluntarily or they are constituted through guidance by the state and federal commissions. The latter represents the joint bargaining system with both private and public characteristics. In the process of instituting such working rules, economic, political, and ethical principles are coordinated. The mixture (compromised body) of the various principles is finally expressed by the working rule.

Direct participation is not the only way to affect higher institutions; there are two other ways available to citizens. First, by launching legal action, citizens turn to a supreme institution with proper jurisdiction to justify their claim, which is rooted in private organizations, by ethical principles. Second, the citizens’ collective opinion (public opinion) affects the judges’ “habitual assumptions,” or code of conduct because habitual assumptions consist not only of judicial precedents but also of public opinion and social customs. Based on the clarifications established in IE, judges’ habitual assumptions are driven by different principles; for example, “economic assumption” refers to scarcity and

efficiency, while “ethical assumption” reflects universalistic ethical principles (i.e., security, freedom, equality, and fairness; Commons 1934, 698).

In the second approach for exercising the collective sanction and inducement from certain upper institutions to lower institutions, the judicial branch weighs and evaluates various aspects of a case in accordance with the habitual assumptions. Then, the judicial branch makes a decision about the case, such as its legality and whether it violates the Constitution. As a result, one institution (custom) is selected from competing institutions in the case. This decision should conform to various (ethical) principles that differ from standard economic principles. In shifting our attention from the judicial branch to the legislature, we see that legislatures concede part of their sovereign power to private going concerns through the arrangement of a commission (Kitagawa 2016). In doing so, legislatures allow private going concerns to contribute to social governance.

The above descriptions are illustrated in Figure 1. In this figure, we observe visually the following two points.

Insert Figure 1 here.

First, we observe that economic, political, and ethical principles are coordinated and

translated into working rules through a cyclical structure of participation, projections, coercions, and inducements. In this cyclical structure, the “reasonableness” of the political economy is gradually enhanced; in other words, the three conditions of a reasonable transaction—equal opportunity, fair competition, and equality of bargaining power—have been and will be developed. As noted in section 3.3, on one hand, the standard of reasonableness created by the judicial branch’s artificial selection means the “ordinary,” that conforms with customs; on the other hand, the standard of reasonableness created by the joint bargaining system means “the best practicable.” This cycle of institutional reforms developing reasonable conditions for myriad transactions is not a closed one because the economic, political, and ethical situations evolve via complicated multiple causations, thus, institutions and agencies should continuously adapt to the changing situations (Commons 1934, 705).

Second, the joint bargaining system is the area of overlap of public and private activities. Institutions are being constituted socially through which citizens participate in going concerns, the going concerns become participants in collective bargaining, and in negotiations. In the dynamics of pluralistic and hierarchic institutions, the joint bargaining system is the area where socially constituted private institutions assume the character of the public. Compared with the 1927 manuscript, the additional descriptions in IE

elucidate how the concerted governing systems are both socially and governmentally constituted.

5. Contemporary Impacts of Commons' Theory of Institutional Reform

Commons' theory of institutional reform has two contemporary impacts. First, it is a strong reminder that we should (re-)recognize that we have a method of empowering institutions by transferring a part of sovereign power so that the bargaining system becomes workable and acceptable. In modern times, when society's direction is under pressure, we should consider the policy challenges of supporting the construction and management of joint bargaining systems (Kitagawa and Uemura 2015). This is because the joint bargaining system is the method that uses institutions that have been privately and socially constituted for governance. Moreover, it is the method that redefines acceptable and workable goals by members of a community.

Second, there is a different drawing of institutions than our common drawing at the micro, meso, or macro level. The uniqueness of his theory of institutional changes, which covers not only judicial sovereignty but also legislatures, the joint bargaining system, interest groups, and going concerns, is that it dynamically draws the concerted actions of these groups towards creating progressive rules. What he shows is how the process of a

problem created by participants of a transaction at the micro-level is socialized, then brought to the joint bargaining system, a local court, a higher court, and, ultimately, the supreme court. Moreover, the solution for the problem is also diffused to all of society and broadly institutionalized through imitation of the rules of the joint bargaining systems and the decisions of courts.

Commons' way of drawing institutions so that he can capture the process where various going concerns take concerted actions over a certain concrete economic dispute reveals his analytic flexibility as he readily shifts his analysis from the micro- to the macro-level. Consequently, this can be seen as a fresh lens for those of us hung up on distinctions between micro, meso, and macro levels.

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Footnotes

¹ It was newly discovered by H. Uni in 2013 in the Kyoto Prefectural Library (Uni 2017).

² This method is repeatedly explained by previous studies such as J. E Biddle, (1990), Y.

Ramstad (1994), and S. G. Medema (1998).

³ For expressing the internalized customs, IE references the term “institutionalized mind,” which consists of “intellect” and “habitual assumptions” (Commons 1934, 697–699).

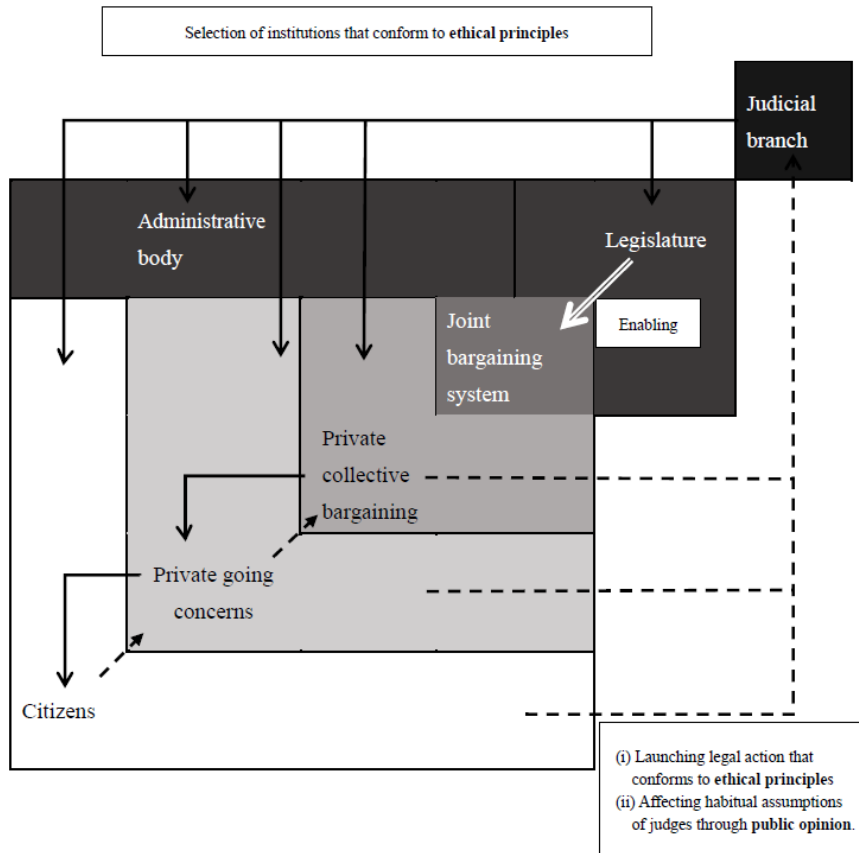
⁴ It can be restated as unemployment insurance or unemployment compensation law.

⁵ While J.D. Chasse (1986) and L. Bazzoli (1999) stress that Commons considered the joint bargaining system an effective method of reforming institutions, they do not comment on why the system was effective, and on what grounds Commons created a fairly detailed explanation of the system after the 1927 manuscript. This paper answers these two points in section 3.

⁶ Commons sees the working rules of a going concern as an “institution” (Commons 1934, 69). In this case, the going concern is the joint bargaining system.

⁷ LFC and IE imply that each citizen has “constituent power.” The power inside every citizen reflects and affects social structure. From the perspective of constituent power, K. Kitagawa (2013) compares Commons with Antonio Negri. While Negri focuses on the constitution in the productive sphere, he cannot show a concrete momentum and constituent processes. On the contrary, Commons shows these as economic conflicts, negotiation, and the two methods of institutional reform.

Figure 1. Articulation of the Two Methods of Institutional Reform



The *solid arrows* indicate that a going concern self-servingly and artificially selects an institution within its jurisdiction. If the organization is a judicial branch (especially the Supreme Court), it selects the institution artificially and in conformance with certain public purposes (ethical principles). The *dashed arrows* reflect that a citizen or a going concern affects the rule-making process of an upper going concern to seize collective power for their own benefit. Economic, political, and ethical principles are coordinated and translated into working rules through participation in an upper going concern and by affecting the rule-making process.

Source: Kitagawa (2017, 94).