**HISTORICAL SCHOOL AND INSTITUTIONALISM**

They developed as a reaction against the classical and neoclassical schools: the first developed in Germany against classical school and the second, influenced by the former, was born in the USA and was aimed at criticizing the neoclassical approach. They have some common features

* Their **rejection** of the idea of **universal law** (general truth applicable in all places and times) in favour of complexity
* Their idea of a **constantly changing economic system** (difficult to identify well defined patterns 🡪 historical generalization of classical school is a heroic exercise because there are different generalizations in different times of observation)
* Their use of **inductive method** to produce theoretical results. Neoclassical school uses the hypothetical deductive method (unique time t) and classical school uses the historical deductive one (different times *t* and *t + 1*), yet both lead to the same conclusions in different times and places. For these two schools, the starting points are particular facts observed in time t for a specific country (country A). From these particular facts we can derive some regularities (conclusions) in time t for country A. In country B, other particular facts are observed in time t and other regularities are derived and linked to that specific country in a specific time. This implies that different countries have different regularities. In time *t + 1*, a particular fact is observed in country A and regularities are derived for country A in time *t + 1*. The facts observed in country A in time *t* and *t + 1* may differ and, as a result, the regularities derived from these facts may differ as well. The inductive approach is used to explain something that evolves over time and space, so **generalizations** are **impossible** because economic systems are composed by agents (firms and consumers) whose behaviour may change continuously over time and space. This is a **relativistic approach** which implies that the economic aspects observed in a country in a particular time may differ with respect to another period and to another country.

**GERMAN HISTORICAL SCHOOL**

German historical school is characterized by some points:

* **Relativistic approach**
* Emphasis on the **role of government**
* **Inductive approach**
* Suggestion of the usage of **social reforms**, needed to help the workers to increase their living condition in an unequal society (reduce inequality).

German historical and economic background was very different from the English one, seedbed for classical doctrine. In fact, England had a well developed industrial sector that allowed the use of free competition and *laissez faire*, which could improve the growth of the economy; however, other countries, characterized by a low level of industrial sector, international competition would be disastrous. So the idea of German school is that classical economic ideas work only for economies with a well developed industrial sector: this is linked to the idea that different contexts produce different regularities.

The **forerunners** of this school are the **cameralists**, German mercantilists of the 18th century that suggested the importance of the state, central focus of the economy. Moreover, **Romantic** **economists** influenced historical school with their refusal of rationalism and mathematics in the economic analysis. Another forerunner is **Friedrich List** (1783 – 1846), who cannot be considered a member of this school because he has different influences, such as classicism and romanticism. In particular, he criticizes Smith’s approach and defines it as cosmopolitan (the idea of free trade and commerce generates a sort of universal republic where different countries are united by trade; however, this is possible only if all countries exhibit the same level of industrialization and civilization) and individualistic (the nation is just a sum of different individuals pursuing their self-interest mitigated by sympathy). The appropriate policy intervention can be individuated only if we study the history of a country (**historical analysis** at a **country level**), which is different from the ones of other countries. In particular, free trade does not work in Germany and the only way to stimulate its industrial sector is the usage of **tariffs** (**infant industry protection**).

Historical school is divided into two eras, an older and a younger one. The **older historical school** (1840 – 1860) comprises the figures of **Hilderbrand**, **Roscher** and **Knies**, supporting a strong **criticism** of **classical** school (generalizations applied to different countries are impossible) and the application of **historical patterns** to identify the policy intervention needed to stimulate the growth of the country. The **younger historical school** attacked also the **neoclassical** school and used the same concepts to do so. In this context we find the contribution of **Von Schmoller** (1838 – 1917), famous for his controversy with Merger (neoclassical) about the method (deductive vs inductive). Von Schmoller identified the key elements in the study of economics in a given country: land, population, technology, social order, market conditions and other aspects. Since these elements differ among countries, it is impossible to use the deductive method suggested by Merger. He is also famous for supporting public intervention (reforms) for reducing inequality in worker conditions. The most important member of the younger German school is **Max Weber** (1864 – 1920), considered the father of sociology together with Durkheim and Marx. He is famous for his contribution about the **origin of capitalist system** and its **evolution** and for introducing a **method of comparison between different cases** (ideal times). As for the origin and evolution of capitalist system, Marx considered it to be related to material conditions (pursuit of profit, capital concentration, proletarization of workers 🡪 conditions of economic reproduction) that generate capitalism and influence its evolution, as well as generating institutions and culture. Instead, for Weber the **causality** is **reverted**: the **material conditions** of production are the **result** of **culture** and **institutions**. Capitalism and material condition of production are the result of the **rationalization process of institutions** (well-defined organization of factories, bureaucratization in government organization and rational behaviour of capitalists 🡪 profit-maximizing behaviour), with a consequent increase of middle class, and **religious culture** (Protestantism played an important role in the evolution of capitalist system because it did not condemn the pursuit of profit like Catholic Church, yet it supported the commitment to produce profits).

Weber’s method is based on ideal types, mental constructs of individuals used to compare different concrete cases: when we make a comparison, we build ideal types (conceptual categories) in our mind, which vary among individuals. For example, if we have case A and case B and we want to compare them, first of all we build the ideal type of each of them and then compare them. This model follow the tradition of historical school: we need to construct ideal types because cases are too different to be compared in themselves.