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Abstract

A brief statement on the customary foundations of economic processes and institutions and a review of theoretical approaches to custom.

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Custom. The term ‘custom’, or ‘social custom’, refers to the set of habits, attitudes, and convictions prevailing in a society, as inherited from the past. Used in another sense, custom refers to the forces which shape those habits, attitudes, and convictions. Thus it may be said that the forces of custom mold the prevailing conventions, mores, usages, manners, and habits as well as the prevailing preferences, behavioral inclinations, moral attitudes, and social norms.

Phrased differently, the term ‘custom’ refers to the tacit elements of →culture, that is, to those parts which are not formalized or institutionalized but emerge and stabilize spontaneously, and to the forces that govern these regularities. The formalized and institutionalized parts of culture – formalized law, religious organization, and other cultural conventions, institutions, and artifacts – rely on elements of custom, and are often shaped by the same behavioral tendencies which give rise to custom.

Social and economic structures and processes are thoroughly permeated by elements of custom - customary ways of behaving, of thinking, and of evaluating all kinds of actions and events. The economic and social institutions in any given society rely in a fundamental way on prevailing customs. Yet custom cannot be taken as a given for purposes of long-term analysis because it is molded, bent and shaped by the very social and economic processes which build on it.

Custom as a system. The amalgam of habits, attitudes, and convictions to which we refer as ‘custom’ forms an interlocking complex, where each element stabilizes the others. Consider customary attitudes which link social status

to skin color. These prejudices will give rise to various rationalizations reconfirming and stabilizing discriminatory attitudes and habits. As a result, the discriminatory habits, values, preferences and cognitions mutually reinforce each other. Further, customs are mutually dependent upon each other. The custom of greeting by raising one's hat cannot be maintained without the custom of wearing a hat, for example and has vanished more recently along with the custom of hat wearing. Typically, each custom depends on many others. The system of habits, behavioral inclinations and associated convictions must be conceived as a system – not in any mechanical sense, but rather as a very comprehensive net of mostly weak and vague interdependencies.

Custom as an agent of production. Regarding the effect of custom on economic performance, both its constraining and its enabling effects have been stressed. Many economists emphasise that custom often presents an impediment to economic change and social development. The economist Alfred Marshall (1842–1924) spoke of the 'yoke of custom' as 'hindering the method of production and the character of producers from developing themselves freely', and the economist John Stuart Mill (1806–73) saw competition and custom as two alternative mechanisms of economic coordination, with competition carrying progress, and held that the sphere of competition would expand while the sphere of custom would shrink over time and in the course of economic and social modernization.

On the other hand, custom is an important agent of production, easing or even enabling production and social coordination in many important ways. Alfred Marshall has

emphasized this positive aspect of custom as well. He observed that businesses, as organizational forms, rely on specific elements of business morality and would not be feasible without it. Contracting – a prerequisite of all kinds of economic coordination – is largely of a relational nature and not usefully enforceable in court (→ relational contracts). Instead it relies on the presence and mutual acceptance of business practices. In the old days, a businessman's handshake was worth more than a written contract, and cognate practices survive in modern specialized markets. This is of obvious advantage for easing economic transactions (→ transaction cost economics).

Further, custom and competition are not mutually exclusive, as Mill thought, but often mutually complementary. Business morality is a case in point. As another example consider gratuities. A custom of giving, say, 10% as a normal gratuity for certain services may enhance economic performance. The customer may give less if dissatisfied, and give more if satisfied. In this way, an effective incentive for maintaining the quality of the service is established which would be absent without the custom, entailing the problem of quality deterioration.

Inadequacy of functionalistic and individualistic explanations. This is not to say that customs – such as tipping – form 'optimally' in the sense of establishing themselves such that economic efficiency is optimized for the relevant transactions. Empirically, tipping practices in similar countries like the US and Australia differ significantly. Given the similarity of these societies, we would expect roughly similar standards from an efficiency point of view, but actual

practices diverge. Further, other customs – ownership in human beings in slave societies, or caste systems, to name just two – seem not to foster economic or other types of efficiency. Their possible positive side effects in terms of efficiency – if there are any – can usually be taken care of by alternative and preferable arrangements. The →functionalist position that custom forms ‘optimally’ seems problematic. Custom is neither fully ‘optimal’ nor entirely detrimental. In some ways it is an impediment, in others an important productive asset (→social capital). In both senses it is an important agent of production.

The example of tipping – relating to a widely observed custom in modern economies, which contributes significantly to income in some occupations – illustrates also the other point that custom cannot be explained in terms of self-interest, often identified with →methodological individualism. This approach falls short of accounting for the giving of gratuities in non-repeated exchanges. Even if the individuals are assumed to prefer conforming to the social norm of giving gratuities, or are fearing social sanctions by not conforming, each individual will find that there is scope for cornering the custom in a self-seeking way, for instance by rounding downward rather than upward in cases of doubt. This would drive average gratuities down over time and would thereby extinguish the custom. Most customary practices are beset by such problems of erosion.

Reciprocity. Customs like giving gratuities seem to rely on reciprocity, i.e., on a desire of the individuals to reciprocate gifts with counter-gifts, and to retaliate offenses with

counter-offenses (→ reciprocity, →social exchange). Consider a market where gratuities are not customary. The customers may pay, however, more than the stated price if satisfied, simply by leaving five Dollars to cover a bill of \$ 4.73, but they cannot pay less, even if dissatisfied. Customers who are reciprocators will behave this way. As a consequence, tipping may occur occasionally, gradually making it acceptable and customary. There will emerge an average positive level of gratuities in the market. Customers, motivated by reciprocity, will start giving some gratuities even for average service and will deviate in the one or the other direction, according to the quality of the service provided.

Many aspects of economic interaction can be understood in this manner. →Relational contracting, i.e. the reliance on tacit mutual obligations in contract interpretation and execution, relates to this class of phenomena. Other economically important instances are provided by the widespread practice of firms to pay wages in excess of what would be required to attract workers, and the worker's preparedness to work better than strictly 'by the rules'. Firms can thrive on these behavioral propensities by creating a strong corporate culture. Further, the keeping of promises and the faithful execution of contractual obligations – fundamental to economic performance - may be understood in terms of reciprocity.

Reciprocity builds on certain standards of entitlement and obligation, as reciprocation is prompted by deviations from what is considered the norm. The norm itself is a matter of custom, with normality generating the norm. In this sense,

reciprocity builds on custom. The desire to reciprocate itself can be traced to a desire of humans to establish regularities and outbalance deviations from those regularities by appropriate counter deviations.

Conventions. Conventions are important elements of custom. Typical conventions relate to greeting, expressing agreement, holding market days, or using certain commodities rather than others as means of exchange. The essential aspect of a convention is that it is reasonable for everybody to follow it if the others comply. (In terms of →game theory, a convention is a →Nash equilibrium.) An obvious example is provided by the convention of driving on the right-hand side of the road in some countries, and driving on the left-hand side in others. Given that everybody drives on the right-hand side, it is most expedient for everyone to do the same.

Many approaches to problems of social interaction seek to understand all kinds of social regularities, including institutions, as conventions. The prototype argument has been developed by the Austrian economist Carl Menger (1840-1921) with regard to the evolution of money: In an exchange economy, individuals will accept certain commodities for pay even if they have no use for the commodity, as long as they can expect to find others who accept it in exchange for something they need. If a commodity is widely used for exchange purposes, everybody will accept it, and it will turn into →money. (Some primitive moneys provide counter-examples to this logic, however.)

Generalization. Consider the convention of driving on the right-hand side of the road. If a traveler, arriving at a foreign country, observes that people drive on the right-hand side of Harbor Street and Broadway, he will conclude that this is the prevailing custom. This inference is, logically speaking, not defensible because there is no evidence that the rule applies to other roads. Yet the custom is grasped by this kind of quick and superficial induction. Many customs which are not formally transmitted rely on such spontaneous generalization which is a precondition for tacit transmission.

Generalization is not only important for the transmission of a custom; it entails behavioral generalization, too. The custom of driving on the right hand side of the street, for instance, usually generalizes to walking on the right hand side of sidewalks and stairs, and the custom to discriminate according to skin color in business transactions generalizes to discriminating in other spheres of social life. The converse is also true: If market forces bring about a racial integration of the workforce in a discriminatory society, this will weaken discriminatory attitudes and practices in other spheres of life: Equality and equal treatment at work weaken the belief that the groups differ in any fundamental way. The theories which seek to depict all customs as conventions neglect this important motivational force arising from generalization.

Private customs and social conventions. The custom-as-convention view neglects also some other behavioral tendencies beyond generalization. This is readily seen if we consider private habits and customs. The term 'private custom' refers to the amalgam of habits, convictions, attitudes and preferences entertained by individuals not

facing social interaction. Arguments relating to social interaction are inappropriate here, as there is no interaction. Still we find that individuals develop behavioral habits, emotional and cognitive attitudes ('habits of the mind'), and preferences in a given setting and do carry these over to new situations. These regularities seem often related to 'ownership effects' and 'commitment effects', a class of phenomena studied by psychologists. Custom seems to rely as much on these psychological regularities as it relies on the logic of conventions – a point very clearly stated already by David Hume (1711-76) in his thoughts about the customary origins of property.

Custom as inertia. Custom is sometimes portrayed as a force of inertia, maintaining everything as it is as long no other forces come into action. (Alfred Marshall has expressed this view, for instance, and evolutionary economics with its emphasis on 'routines' governing economic interaction suggests a similar stance.) The 'inertia view' is misleading because customs may grow and spread, change over time, or erode. The forces governing the growth and decay of customs are, in this sense, active forces and not merely forces of inertia. As an example, consider the arguments about the emergence of gratuities from reciprocity in conjunction with the argument about generalization. Taken together, they may explain the spreading of the custom of giving gratuities in markets where quality can be observed on the spot. We may even speculate that new technologies like the Internet render new modes of transaction dominant, bringing about supporting customs. These new customs and etiquettes may then spread to traditional modes of transactions. It is

misleading to depict such processes of growth and generalization as instances of inertia.

Custom as friction. A related view, also developed by Alfred Marshall, is that custom amounts to friction in the sense of slowing down all processes which would run faster otherwise. Eventually, however, custom will adapt to new exigencies. If it is expedient to honor promises, honesty will spread; if it is profitable to cheat, honesty will be eroded. In the long term, custom would be molded entirely by economic and other incentives. As an upshot of this argument, custom would not matter in the long term and could be entirely disregarded for purposes of analysis. It would amount to friction, but could not provide an active force generating some kind of structure and development. Although such an argument points to important phenomena which render custom adaptive in many ways, this view entirely neglects the active elements of custom. Because of its active elements, custom exerts an important influence on its own, and the adaptive view of custom is often inadequate.

Custom as preference. Custom may also be understood as a force which molds the preferences of the individuals in a given society, making them prefer customary ways of behavior. The customary part of their preferences is, however, not idiosyncratic but rather shared by many individuals in society. In this, it relates directly to →social norms. These customary preferences can be taken as relatively stable givens to be fixed under a →*ceteris paribus* clause for purposes of short-run analysis. In the long term, the adaptive and active aspects of custom formation interact with economic processes, however, and it is misleading to

hypothetically fix customs, or social norms, under a *ceteris paribus* clause when dealing with issues of long-term historical change.

Custom as a constraint. Given that people foster certain customs and associated preferences, habits and convictions, these givens can be considered as constraints for each individual's action. Everybody faces the reactions of the other members of society, as molded by custom. In this sense, custom can be viewed as a constraint for purposes of partial analysis.

Custom as a situational force. It is customary to analyze economic action by assuming that individuals act according to their preferences, subject to certain constraints. As custom may be viewed as affecting both preferences and constraints, all behavioral effects of custom could be couched in these terms, yet this may be misleading. While it is true that all action can be framed as determined by tastes and constraints, this is a theoretical perspective which complicates matters unduly, and thereby hinders rather than helps in understanding. A direct approach of viewing customary action as prompted by the interpretation and perception of the situation, and by a desire of the individuals to live up to what 'the situation demands', is often preferable.

Custom usually requires certain actions, as prompted by certain situations. The behavior elicited in this way may not be brought about by fear of formal or informal sanction; it may not be prompted either by a preference for the required action as such. A customer may resent leaving a gratuity on the restaurant table upon departure because doing so would

leave him without the fare for going home by bus. He thinks, however, that the waiter deserves a tip because he has served him well. If he does not give the gratuity, he will feel uneasy, even if he personally condemns and dislikes the custom. The choice between giving the gratuity and going home by bus differs from his earlier choice between fish and meat because it involves an obligation which is prompted by the situation and by the custom which prescribes that type of behavior in this situation. In this sense, behavior does not reflect a simple preference, even if it can be theoretically rephrased in such terms.

The pervasiveness of custom. Custom is a pervasive element in social and economic organization. The example of gratuities provides a very clear instance of an economically relevant custom which can be theoretically detached from the underlying transaction. Customs which cannot be theoretically isolated as nicely from the ‘purely economic’ aspects are much more common and much more important. When customary features are tightly integrated with economic incentives, institutions, and laws, custom is particularly important and remains, at the same time, almost invisible. Comparing economies across time and space may render these customary influences visible, and help explain how some customs have supported certain developments and frustrated others, and how the ensuing developments have molded those customs in turn.

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