

THE CONCEPT OF UNCERTAINTY IN POST KEYNESIAN THEORY AND IN INSTITUTIONAL ECONOMICS

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“There seems to me to be no other economist with whose general way of thinking I feel myself in such genuine accord”

Keynes to Commons (1927)

ABSTRACT

The objective of this article is to show that there are some similarities between the Post Keynesian and Institutional Economics theories in terms of their concept of uncertainty, which allow us to understand not only the instability of contemporary economies but, above all, the relevance of institutions in coordinating them.

KEY WORDS

Uncertainty; Institutional Economics; Post Keynesian Theory.

JEL CLASSIFICATION

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INTRODUCTION

Keynes and the Post Keynesians demonstrate that, in an uncertain and unknown world, economic agents prefer to retain money rather than make investment decisions. The consequence of this rational preference is the possibility of unemployment resulting from insufficiency of effective demand. Institutionalists believe that the “economic environment” has nothing to do with the notion of “equilibrium”, as well as money is a fundamental institution of the capitalist system because it affects the preferences and actions of economic agents. In both schools of thought, we can observe at least two essential aspects of the dynamic of contemporary economies. These are, first, that the economy is a historical process (it means that uncertainty matters) and, second, that

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institutions, both political and economic, are indispensable to the task of “modeling” economic events.

Considering the idea above, the Post Keynesian and Institutional theories try to answer the following questions: How do economic agents make rational decisions? How do they form expectations? Why do they retain (or decide not to retain) money? Can the institutional environment influence the economic decisions? If so, in what way? The answer to these questions lies in the concept of uncertainty linking the two schools of thought.

As is commonly known, uncertainty is the fundamental element of Keynes’s theory. As Minsky (1975, 57) writes, to comprehend Keynes “*it is necessary to understand his sophisticated view about uncertainty, and the importance of uncertainty in his vision of the economic process. Keynes without uncertainty is something like Hamlet without the Prince*”. For the Institutionalists, in a world of incomplete and imperfect information, institutions are necessary to enforce economic agents, with limited insights, to adopt strategies characterized by conventions.

This article aims at exploring the concept of uncertainty in the Post Keynesian and Institutional Economics theories. The concept of uncertainty is very important because it allows us to understand not only the instability of contemporary economies but, above all, the relevance of institutions in coordinating them. This implies that the article also analyzes the theoretical similarities between Post Keynesians and Institutionalists on the social institutions related to money and the essential properties of money in an entrepreneur economy.

The article is divided into three sections. The first presents the concept of monetary economy developed by Keynes and the Post Keynesians. The idea is to show that individual expectations, so crucial to decision-making, are directly related to a favorable institutional environment. The next section examines the idea of uncertainty in Institutional theory. It also shows that, for Institutionalists, money is an essential institution in the economic system. Finally, the third section, in terms of conclusion, links the two schools of thought, emphasizing the concept of uncertainty and the relevance of institutions.

1. MONEY AND UNCERTAINTY: THE ESSENCE OF KEYNES'S MONETARY ECONOMY

Keynes's primary legacy consists in demonstrating the logic of a monetary economy¹. In such an economy, fluctuations in effective demand and employment occur because, in a world in which the future is uncertain and unknown, individuals prefer to retain money, postponing consumption and investment decisions. As Keynes says (1973b, 411, emphasis added), “*booms and depressions are phenomena peculiar to an economy in which ... money is not neutral*”.

Why, in Keynes's economy, is money not neutral? In other words, how does retaining money protect against uncertainty regarding individual transaction and production plans? The explanation is in Keynes's *The General Theory of Employment, Interest and Money* (referred to below as *GT*).

In Chapter 17 of *GT*, Keynes showed that money differs from other assets due to the following properties: first, the elasticity of money production is zero – that is, money is not produced by the quantity of labor the private sector employs in the productive process. Second, the substitution-elasticity of money is also zero. Third, the carrying cost of money is zero. These properties illustrate that money has two purposes in a monetary economy: it is a means of circulation – it facilitates exchanges – and it is a store of wealth.

Due to these properties, Keynes (1964, 235) argues that “[*u*]nemployment develops, that is to say, because people want the moon; – men cannot be employed when the object of desire (i.e. money) is something which cannot be produced and the demand for which cannot be readily choked off”. In other words, unemployment occurs because, when the demand for money increases, the price of money is greater than the price of other producible assets.

Thus, by providing security against uncertainty, money links the past, present and future, and, as a result, coordinates economic activity. In this sense, as Davidson (1994, 87) writes, “*in a world where people cannot reliably predict future ... the ... existence of money and money contracts over an uncertain future ... [are the bases] of a monetary system*”. In other words, in a monetary economy, money is not neutral.

The principle of effective demand, essential to the Keynesian revolution, is based on the idea of non-neutrality of money. The insufficiency of effective demand occurs

because individuals, in conditions of uncertainty, prefer to hold money or other liquid assets² instead of acquiring goods produced by labor. Thus, the liquidity preference – that is, money as an asset – inhibits economic agents spending decisions, and as a result, it affects economic activity. In sum, by the principle of effective demand, economic crises come about because money is an alternative form of wealth.

The central question in Keynesian theory, therefore, concerns to the relationship between uncertainty and money. Post Keynesian theory recovers this fundamental Keynesian insight: fluctuations in effective demand are related to the liquidity preference of individuals seeking safeguards against uncertainty. It is for this reason that Post Keynesians develop a theoretical structure in which the Keynesian revolution is studied within the context of a monetary theory of production (see, for example, Cardim de Carvalho 1992). In Keynes's words, in a monetary production economy, "*money plays a part of its own and affects motives and decisions and is, in short, one of the operative factors in the situation, so that the course of events **cannot** be predicted, either in the long period or in the short, without a knowledge of money between the first state and the last*" (1973b, 408-409, emphasis added).

This quote not only illustrates the importance of money in monetary economies, but also shows the relationship between money and uncertainty. In a monetary production economy, the concept of money's non-neutrality has to do with the decision process of economic agents amidst uncertainty.

But what is uncertainty? In his 1937 article, entitled *The General Theory of Employment*, Keynes, responding to critics of the *GT*, offered the following definition of uncertainty:

*By 'uncertain' knowledge, let me explain, I do not mean merely to distinguish what is known for certain from what is only probable. The game of roulette is not subject, in this sense, to uncertainty ... Or ... the expectation of life is only slightly uncertain. Even the weather is only moderately uncertain. The sense in which I am using the term is that in which the prospect of a European war is uncertain, or the price of copper and the rate of interest twenty years hence ... About these matters there is no scientific basis on which to form any calculable probability whatever. We simply **do not know** (1973c, 113-114, emphasis added).*

On the one hand, when Keynes said that roulette is not uncertain, he meant that for uncertain events probability cannot be obtained from relative frequencies. On the other hand, as an example of uncertainty, Keynes wrote that the price of copper twenty years from now is something *nobody knows*. From our point of view, Keynes argued that social, economic and political conditions change radically over a twenty-year period, making it impossible to extrapolate future events based on the events of today. In other words, Keynes defined as uncertain a phenomenon whose probability cannot be calculated, leaving people ignorant about the future.

The passage above provides us with the distinction between risk and uncertainty, suggested both by Keynes in *A Treatise on Probability* (referred to below as *TP*) and by Knight in *Risk, Uncertainty and Profit*. Risk is a situation in which a decision must be made concerning a certain event and the probability distribution of this event is known. Uncertainty, on the other hand, characterizes a situation in which the probability distribution of the event does not exist³.

The 1937 article also illustrates the relationship between uncertainty and money: uncertainty is the main reason for the occurrence of liquidity preference and investment fluctuations. Keynes explains (1973c, 116, emphasis added) that “*our desire to hold money as a store of wealth is a barometer of the degree of our distrust of our calculations and conventions concerning the future ... The possession of actual money lulls our disquietude; and the premium which we require to make us part with money is the measure of the degree of our disquietude*”.

If uncertainty cannot be modeled in a deterministic way in a monetary economy, the decisions of economic agents will be made according to conventions. Keynes writes (1964, 148) that “[i]t would be foolish, in forming our expectations, to attach great weight to matters which are very uncertain⁴ ... The state of long-term expectation, upon which our decisions are based, does not solely depend, therefore, on the most probable forecast we can make. It also depends on the **confidence** in which we make this forecast”.

In view of the future being uncertain, individuals, more specifically entrepreneurs, follow their instincts, characterized by what Keynes described as *animal spirits*. In other words, the state of confidence of individuals depends on conventions. Therefore, the adoption of conventions by economic agents is a partial solution to the problems of uncertainty.

This idea is related to the concept of probability developed by Keynes in his *TP*. In this work, Keynes shows that intuitive knowledge is important for the formation of a rational belief. Probability is thus defined as a logical relation in which “*we are claiming, in fact, to recognize correctly a logical connection between one set of propositions which we call our evidence and which we suppose ourselves to know, and another set which we call our conclusions, and to which we attach more or less weight according to the grounds supplied by the first*” (Keynes, 1973a, emphasis added).

Taking the passage above as a reference, Keynes discussed probability as a type of knowledge obtained by arguments in which the terms *certain* and *probable* describe degrees of rational belief. In other words, Keynes’s theory of probability is based on a logic in which the degree of rational belief is sustained under specific circumstances. Probability is part of a learning process.

On this point, Dequech (1998) argues that there is a parallel between the *TP* and the *GT*: in the former, we have the binomial probability-weight, while in the *GT* Keynes emphasized the binomial expectations-state of confidence. In this sense, uncertainty and decision processes under conditions of uncertainty, which are fundamental to Keynes’s theory, are discussed in both the *TP* and the *GT*⁵.

How do economic agents form expectations in the real world? For Post Keynesians, in a context in which time is historical, economic agents do not decide future actions on the basis of statistical series analyses or beliefs justified by past experience. To the contrary, decision-making is classified as an environment of true uncertainty. Davidson (1994), for example, in classifying expectations as being determined by ergodic and non-ergodic processes, emphasizes the nature of immeasurable (incalculable) uncertainty. An ergodic process is one in which the expected value of the probability distribution can always be estimated on the basis of past observations. In this process, Davidson (1994, 90) writes that “*the future is merely the statistical reflection of the past*”. For non-ergodic processes, on the other hand, the laws of probability do not apply. That is, uncertainty, in non-ergodic situations, is immeasurable. In sum, risk, under a probabilistic hypothesis, can be reduced to certainty, while uncertainty cannot.

Using Davidson’s taxonomy, in a non-ergodic world in which there is uncertainty, monetary contracts⁶ and liquidity demand are fundamental for decision-

making amidst uncertainty. The decisions of economic agents, under uncertainty and in a non-ergodic world, do not lend themselves to any kind of probabilistic solution.

The existence of uncertainty explains the volatility of investment, and, consequently, the rationality of liquidity preference. This, in turn, causes fluctuations in effective demand and unemployment. For Keynes, the decision to invest involves both intuition, characterized by *animal spirits*, and convention.

Thus, in the Post Keynesian view, in a world under uncertainty, money – as the object that liquidates contractual commitments denominated in the money account – can be held as a safety asset in moments of greater uncertainty by its characteristic of transporting purchasing power over time. So liquidity preference can grow if economic agents have contractual obligations and there is some *degradation* in confidence.

The decision of holding money, also a convention, allows investors to maintain liquidity and postpone irreversible investment decisions. Uncertainty, therefore, is the reason by which people retain money. The greater the uncertainty surrounding the expectations of economic agents, the more these will be inclined to postpone spending decisions (the greater the liquidity preference). Thus, *animal spirits* and liquidity preference are intimately and inversely related.

In chapter 12 of the *GT*, Keynes showed that individual expectations are not determined by long-term fundamentals related to the expected return of an asset, since the information necessary to form such expectations may not exist. For Keynes, economic activity is operationalized according to a calendar of historical time: the decisions of economic agents are made using as references the irreversibility of the past and the unpredictability of the future. In the words of Keynes (1964, 152): “*philosophically speaking, it cannot be uniquely correct, since our existing knowledge does not provide a sufficient basis for a calculated mathematical expectation. In point of fact, all sorts of considerations enter into the market valuation which are in no way relevant to the prospective yield*”.

Thus, the future scenario, upon which investors must make decisions, is inferred from a state of confidence. According to Keynes (1964, 148), the long-term expectation “*upon which our decisions are based, does not solely depend, therefore, on the most probable forecast we can make. It also depends on the **confidence** with which we make this forecast*”. This state of confidence, which Keynes in the *TP* relates to the probability

relation, appears to constitute, in the *GT*, a convention whose “*essence ... lies in assuming that the existing state of affairs will continue indefinitely, except in so far as we have specific reasons to expect a change. This does not mean that we really believe that the existing state of affairs will continue indefinitely*” (1964, 152).

The passages above explain the difference between *ex ante* decisions and *ex post* results, which, in the end, show that in a monetary economy expectations can be frustrated. Keynes explained that in a world in which individuals cannot predict the future,

previous expectations are liable to disappointment and expectations concerning the future affect what we do to-day. It is when we have made this transition that the peculiar properties of money as a link between the present and the future must enter into our calculations ... Money ... is, above all, a subtle device for linking the present to the future; and we cannot even begin to discuss the effect of changing expectations on current activities except in monetary terms ... So long as there exists any durable asset, it is capable of possessing monetary attributes and, therefore, of giving rise to the characteristic problems of a monetary economy (1964, 293-294).

Therefore, once again, we return to the central point of the Keynesian theory: monetary economies are inherently unstable because economic agents must make decisions in a context of uncertainty. Thus, according to the Keynesian theory and Post Keynesians, in a monetary economy there is a tradeoff between decisions involving the accumulation of wealth and the possession of liquidity. In this sense, the expectations of economic agents change constantly through time.

But how should economic agents generate and act on expectations in a context in which uncertainty cannot be eliminated? How to make expectations, based on both conventional behavior, as well as “*animal spirits*”, less unstable? Keynes argues that the

State will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest ... Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself

*to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive **socialisation of investment** will prove the only means of securing an approximation to full employment* (1964, 378, emphasis added).

The quote above can be interpreted in two ways: some theoretical approaches, both those supportive as well as those critical of an economy regulated by the State, believe that Keynes's only proposal for stimulating effective demand is state intervention. For others, the idea of "*socialization of investment*" concerns the creation of endogenous institutional mechanisms, such as the existence of a *state organization*, to mitigate the uncertainty of individual decisions. In *The end of laissez-faire*, written in 1926, Keynes (1972, 292-293) points out:

I believe that some coordinated act of intelligent judgement is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investments, and whether the present organisation of the investment market distributes savings along the most nationally productive channels. I do not think that these matters should be left entirely to the chances of private judgement and private profits, as they are at present... These reflections have been directed towards possible improvements in the technique of modern capitalism by the agency of collective action.

Going in the direction that the second interpretation is more in tune with Keynes's argument, Post Keynesians believe institutions are important to determine events and economic results in the interests of economic stability and social justice. Davidson (1994, 102), for instance, writes that "[i]n a world of uncertainty, the existence of a State organization ... is essential in providing the public with assurances of the continuity of contractual arrangements between the present and the future".

Thus, concluding this section, for the Post Keynesians, "*institutions matter*".

2. AN INSTITUTIONAL APPROACH FOR MONEY AND UNCERTAINTY

As is well known, the existence of a process of structural transformation in monetary economies is fundamental to the Institutionalist framework. This process, in fact, characterizes the economic system, defining what an economy is and how it

changes. According to Institutionalists, because economies operate in historical rather than logical time, economic agents take decisions under conditions of genuine uncertainty and, as a result, the outcome of the decisions they make cannot be predicted. Thus, money, as an essential institution, and uncertainty play a crucial role in the capitalist economy.

This section is divided in two parts: the first one, bringing back the contributions of Commons, an author associated with the “Old” American Institutionalists, presents, *en passant*, the institutional approach to money. It means that, in a context where decisions are irreversible and uncertainty matters, the liquidity preference shapes the behavior of economic agents. In other words, in a monetary economy, money is not neutral. The second part, taking three contemporary Institutionalists as a reference, Hodgson, Dugger and Samuels, examines the treatment given to “uncertainty” in the Institutional theory.

Before continuing, it is important to mention that, on the one hand, the Institutionalists have in common a concern for identifying points of agreement that can allow for the creation of a true “Institutionalist theory”⁷. On the other hand, although New Institutional Economics (*NIE*) has assumed today a prominent role within Institutional thought, this article does not present the *NIE*’s theoretical framework because it is closer to the analyses of the theory of the firm⁸ than to the theories elaborated by the “Old” American Institutionalists and the three authors mentioned above. This, however, does not mean that Coase, Williamson and North, among others, do not take into account uncertainty as a central concept to a firm’s strategies and decisions.

2.1. MONEY AS AN ESSENTIAL INSTITUTION: A BRIEF NOTE

The original ideas of the “Old” American Institutionalists, such as Commons and Veblen, relate the concept of institutions to habits, rules and to the evolution of Institutionalism itself, perceiving a strong relationship between historical specificities and an evolutionary perspective. In this sense, defining the concept of money – also an institution – and explaining its evolution, Commons, for instance, argued that money changes the preferences and way of thinking of economic agents in monetary economies.

As is well known, in monetary economies, money performs basic functions, such as standard of value, unit of account, means-of payment and store of value. These functions are essential to allow the use of money to establish contracts between

entrepreneurs and workers and investors and financiers. In other words, monetary contracts are fundamental in a monetary economy to stabilize economic agent's expectations under uncertainty.

The idea above poses one question: how can money affect the economic system? For instance, Whalen (1993), presenting and analyzing the main Commons' contributions on money, shows that money, for Commons, is a source of instabilities in the economic system. In Whalen's words (1993, 1169, emphasis added): "*the role Commons gave to money ... in his economics was a central one ... he viewed it as essential to the production process of modern capitalism. Without money, which transfers purchasing power from the future into the present, few twentieth century establishment could operate ... then, money is a **fundamental** element of our economy even before we consider the question of macroeconomic fluctuations*".

Considering the quote above, Commons' analysis on money is, implicitly, related with the notion of liquidity preference⁹.

Moreover, according to Whalen (1993, 1157), the Commons' attempt to understand the problems of macroeconomic fluctuations, led him to conclude that "*bank credit [play] an important role in modern capitalist economies*", because it connects financial and industrial circulation. As Commons (1934, *apud* Whalen, 1993, 1160) wrote:

Money, in its modern meaning, is the social institution of the creation, negotiability, and release of debts arising out of transactions. If payment is made without a lapse of time worth measuring, we name it a purchase or sale, and it differs from the short-time and long-time debts only in that the intervening stage of negotiability of the debt is omitted. Thus money is secondarily a medium of exchange – it is primarily a social means of creating, transferring, and extinguishing debts.

Based on these points, for Commons, the conception of money, an institution, is strongly related with expectations and confidence. In this sense, he developed a monetary theory in which the liquidity preference is affected by expectations and confidence – there is a process of downward causation between liquidity preference and expectations and confidence – and, as a result, the economic agent's preferences changes.

To sum up, in Commons' analysis, the more economic agents are confident, the less they retain money. Moreover, the acceptance of money depends on trust, but trust is stability of the social relations and state power. Thus, in other words, conventions and *institutions* are important, because they shape the behavior, habits and preferences of economic agents concerning expectations and confidence.

2.2. THREE POINTS OF VIEW ABOUT “UNCERTAINTY”

2.2.1 VEBLEN AND THE “BLINDNESS” OF THE EVOLUTIONARY PROCESS: THE HODGSON’S ANALYSIS

Hodgson (2002, 113) defines institutions as “*durable systems of established and embedded social rules that structure social interactions. Language, money, law ... firms (and other organizations) are all institutions*”. Thus, the “Economic Theory of Institutions” is related to institutions, human activity and the evolutionary nature of economic process. Moreover, if there is a “general theory” of Institutionalism, its generality would be in developing varied and specific analyses of a particular phenomenon¹⁰.

According to Hodgson (1993, 13) the “Old” American Institutionalism of Veblen, Commons and Mitchell focus on the importance of institutions, demanding a genuine evolutionary economics. For him, what characterizes this analysis is the rejection of the ontological and methodological assumptions of classic liberalism.

Well, this is precisely the point at which the Institutionalists become evolutionaries, since the negation of thinking about economics in terms of equilibrium (or marginal adjustment) is necessary to understand the economic changes and transformation in the capitalist system. For Hodgson (1993), the Veblen's thought¹¹ goes in this direction, because it has three central points: (i) the inadequacy of neoclassical theory in dealing with innovation; (ii) the concern with how change and growth occur rather than with “stable equilibrium”; and (iii) the emphasis on the process of economic evolution and technological change. In this sense, institutions are defined as the result of a present situation, as well as the process is guided by the way people see things (“see” future), which alters or strengthens their points of view.

According to Hodgson, Veblen presents an “evolutionary economic theory” where instincts, habits and institutions exert a role in economic evolution analogous to the role of genes in biology (Veblen, 1899, *apud* Hodgson, 1993, 17). In other words,

habitual lines of action define “points of view” through which facts are perceived. For this reason, modern anthropology and psychology have suggested that institutions have a fundamental role in the definition of cognitive structures to interpret data, habits and routines in the transformation of information into useful knowledge¹². Therefore, what unites Evolutionaries and “Old” Institutionalists is not so much the emphasis on institutions as a “unit of analysis” – as in *NIE* – but on the “body of knowledge”, defined as similar theoretical concepts centered on a vision of the economy as a *process* of *dynamic evolution*¹³.

In sum, this process of selection or institutional coercion implies that institutions change, which, even if the change is gradual, pressures the system through explosions, conflicts and crises. This leads to changes in attitudes and actions. In any social system there is a permanent tension between rupture and regularity, demanding constant reevaluation of routine behaviors and volatile decisions of other agents. In this sense, the Veblen’s idea is intimately associated with the concept of “blindness of the evolutionary process”. Such concept, for us, *is* the notion most comparable to the uncertainty of Keynes.

2.2 HISTORY AS A BLIND DRIFT AND THE INEXISTENCE OF OPTIMAL EQUILIBRIUM: THE DUGGER AND SAMUELS CONTRIBUTIONS

The analyses succeeding Veblen, Commons and Mitchell assumed different conceptual and methodological forms, not all of which are compatible. Samuels (1995) organizes the various methods into the following groups: the “Old” American Institutional tradition, the “New” Neoclassical Institutionalists, the “Young” American Institutionalists and the European institutionalists (Evolutionaries, Regulationists and the Austrian tradition).

For Dugger (1998), the principal points of Veblen’s work are: (i) a vision of the economy as a process, rather than a search for “equilibrium”; (ii) the existence of a certain “socialized irrationality” that often subjugates a virtual “solidarity of the exploited classes”; (iii) the idea that power and status combine with myth and authority to sustain tyranny; (iv) the concept of equality as the essence of a dignified life, and values and ideology as upholders of “participatory democracy”; and (v) a preference for radical transformation above incremental adjustment.

According to Dugger, Veblen restored the historical, methodological, conceptual and political origins of the term “Institutionalist”. The author perceives in Veblen clear theoretical and conceptual similarities with Marxism and observes a strong divergence with the so-called “New Institutionalism”¹⁴.

The proximity to Marx and the critique of the *status quo* is the main reason the mainstream ignores the contribution of the radical Institutionalists. Veblen, as Marx, believed that a fundamental change in capitalism was necessary to create equality among men. This equality would only arise when a system based on communal control of the economy, especially production, substitutes one based on private profit. This change, however, would not be possible in the short term, making Veblen, contrary to Marx (who believed historical transformation could come about through social revolution), a profoundly pessimistic author. For the former, history evolves as an “absurdist process”, following a “blind” trajectory. There exists, for Veblen, no such thing as a dialectical movement leading to pre-established (or redemptive) ruptures. In other words, Veblen’s work does not allow for any deterministic notions of “progress”.

This fact, however, does not impede the Institutionalist tradition that follows Veblen, commonly referred to as “Old” Institutionalism, from reiterating that the differences between Veblen and Marx concerning the historical process (absurdist or dialectical) does not imply that the two schools are incompatible. Though Veblen rejected the Marxist theory of value and the notion of dialectic as a way of interpreting history, it is possible to reconcile the differences between the two by comparing their critiques of classical and neoclassical orthodoxy.

Observe that the term *blind drift* corresponds to the “evolutionary” expression “blindness of the natural evolutionary process” (Hodgson, 1993). In reality, the “blindness” is part of the process of permanent change and adaptation, due to uncertainty. The idea of *process* involves an understanding of economic development as something not driven by or convergent with any pre-established situation or ideal of equilibrium. The Institutionalists oppose the notion of process to that of equilibrium, intending to delimit different theoretical fields. In Veblen, process is always associated with “circular causation”, which together constitute the basis of economic activity. Such characteristics allow us, at least on this point, to draw comparisons between Veblen and Marx, Keynes and Schumpeter.

Contemporary Institutionalists, such as Samuels and Dugger, affirm that an Institutional (or process) paradigm centered on the notion of process is currently being developed¹⁵. Therefore, for Veblen, the process of cumulative change in the social structure occurs through a “cumulative sequence” of causation, always non-teleological and not necessarily implying progress.

The radical Institutionalists, by thinking within the “process paradigm”, reject the definition of economics as a science concerned with the way in which human beings utilize scarce resources to satisfy their unlimited needs. Instead of this, they define economics as a “science of social supply”, where human needs and resources are a product of *social processes*, historically determined and qualitatively dependent on technological progress. Contrary to the orthodox tradition, the radical Institutionalists reject defining economics from the perspective of “scarcity” and “unlimited desire”. Neither of these conditions can be declared as “given” (that is, they are produced by social, historical and cultural circumstances).

The concept of *absurdity*, central to Veblen’s analysis, has the following implications for his view of history: history is opaque and absurd, and the future offers no guarantees of improvement or “progress”; thus, the course of human action resembles more a “blind drift” than a project to be followed. Therefore, since history has no meaning, humans can or cannot make their own history, though they normally are unable to do so. The absence of a divine or dialectical project, to counter history’s inherent “opaque” and “absurd” sequence of cause and effect, allows for the existence of “imbecile institutions”¹⁶.

The radical Institutionalists defend radical change irreconcilably opposed to neoclassical equilibrium analysis. They observe the economy as a “continuous process”, and reiterate the need for economic analysis to be tied to an economic program. In other words, there is a need for both theory and action, involving the restructuring of capitalism rather than acquiescence with the automatic mechanism of the market. Since the market does not serve the population’s well-being, humans must have a plan of action to create something that does. The rejection of the automation of the market and of equilibrium implies more than simply institutional (incremental) adjustment. What is needed is institutional substitution, replacing the market with something else.

Another concern of the institutionalists is with the organization and control of the economy as a broader and more complex system than the market. This implies a

recognition of the importance of: (i) the distribution of power in society; (ii) the way markets operate (as complex institutions interacting with others); (iii) knowledge formation (or how knowledge is formed in a world in which the future is radically indeterminate); and (iv) the allocation of resources (level of aggregate income, income distribution, organization and control), where general culture is both a dependent and independent variable (Samuels 1995, 571).

For the Institutionalists, the principal flaw of neoclassical thought is its “methodological individualism” that treats individuals as independent, self-sufficient beings with given preferences, while in reality individuals are culturally and mutually interdependent. This implies an analysis of the market from the point of view of “methodological collectivism”. This opposition to “methodological individualism” is rooted in the belief that such approaches ignore the complex, dynamic and interactive reality of an economy, which has little to do with the optimizing rationality of equilibrium. In criticizing the static nature of the neoclassical models¹⁷, the Institutionalists reaffirm the importance of theories emphasizing the dynamic, evolutionary nature of the economy.

Given these observations, Samuels proposed the “institutionalist paradigm”, centered on the following: (i) critique of the organization and performance of pure market economies, considering these mere abstractions; (ii) the generation of a substantial “body of knowledge”¹⁸ concerning a variety of topics; and (iii) development of a multidisciplinary approach to solve problems.

These three categories define, to a large extent, the Institutional field of research. What is the link between these categories? They have one point in common: the negation of the idea that the economy is something static and regulated by the market in search of optimal equilibrium. The response of mainstream theorists to the Institutional critique is that in the absence of mainstream analysis, the field of research would be empty, with no consistent theoretical content (Atkinson and Oleson, 1996, 1998). Institutionalists respond claiming important advances in the direction of an alternative to the mainstream. This alternative does not emphasize equilibrium, and it is understood that economic decisions, whether made by firms or within institutions, are made under uncertainty. The evolutionary current is an example of these advances.

3. FINAL CONSIDERATIONS

Without underestimating the contributions of other authors, Minsky offered one of the most influential contributions to the Post Keynesian thought by linking institutions and the “institutional environment” to the theoretical principles of the *GT*. As is well known, Minsky emphasizes the financial character of contemporary capitalism, in which institutions are fundamental in providing continuity and credibility to the system. Institutions, however, can also become subordinate to certain behavioral standards. Such subordination generates instability and increases uncertainty. Consequently, although institutions are fundamental to the “normal” functioning of the system, they are inherently subject to periodic, systematic crises¹⁹.

Perhaps this is the fundamental point associating Post Keynesian thought with the Institutionalists. Both schools of thought reject the idea of stability subordinated to the cannon of long-term equilibrium. The “institutional environment” is culturally and historically conditioned and is subject to permanent alterations and rearrangements. The existence of a process of structural transformation in economies is fundamental to the Post Keynesian and Institutional framework. This process, in fact, characterizes the system, defining what an economy is and how it changes.

Well, this article tried to demonstrate that although differing in important ways, both Post Keynesians and Institutionalists believe that the concept of uncertainty is fundamental to understanding the capitalist dynamic. As shown above, this concept, though not as explicit as in Post Keynesian thought, is implicit in Institutional analysis. The message of Keynes’s analysis is that, in a context of uncertainty about the future (outcomes concerning the calculation of long-term expectations), economic agents postpone spending decisions. According to the Institutional Economics, the concept of uncertainty is related to the notions of evolutionary “blindness” and blind drift, as well as the rejection of optimal equilibrium. Despite the existence of (healthy) differences with Post Keynesian thought, each of these elements of Institutional analysis is opposed to the idea that economic activity can be described in terms of “stability” or convergence to some kind of long-term equilibrium. These conditions are only possible in the absence of *uncertainty*. That is, the existence of such conditions are only comprehensible in a logical or theoretical sense, in a world devoid of historical content.

Taking into consideration the idea of the epigraph, in *Am I a liberal?*, an article written by Keynes in 1925, and in *Myself*, a book written by Commons in 1934, it is

possible to recognize the link between Keynes – and (Post)Keynesian theory – and Commons – also Institutionalists – when both authors expressed their points of view about the future of the economic system. Bringing back the Commons’ idea of period of stabilization, Keynes

(1972, 306, emphasis added) points out that “*we must find new policies and new instruments to adapt and control the working economic forces ... to proper in the interests of social stability and social justice*”. In his book, Commons (1934, *apud* Whalen, 1993, 1170, emphasis added) writes that “[t]his nearly thirty of my experience ... I have written up in my *Institutional Economics*, I was trying to *save capitalism by making it good*”.

Notes

¹ According to Keynes (1964, vii), a “*monetary economy ... is essentially one in which changing views about the future are capable of influencing the quantity of employment and not merely its direction*”.

² Assets with low carrying costs that are traded in the financial markets.

³ In the Keynes-Knightian vision, uncertainty is an unknown “probability” while risk is a calculable probability.

⁴ According to Keynes (1964, 148), “‘*very uncertain*’ [does not] mean the same thing as ‘*very improbable*’”.

⁵ Dequech (1998, 22) emphasizes the relevance of the notion of *weight* in Keynes’s theory of probability: “*Weight has to do with the evidence on which the probability relation is based ... Weight represents either the amount or relevant evidence (as opposed to probability, which depends on the balance of favourable and unfavourable evidence) or the evidence’s degree of completeness*”.

⁶ Davidson argues (1994, 17) that without contracts, a monetary economy would not exist, since contracts reduce uncertainty concerning the future values of nominal variables.

⁷ The multiplicity of analyses and focuses confer significant diversity to such works, which, as Samuels (1995) argues, is a theoretical strength rather than a weakness. For this reason, uniting the different perspectives under a single theoretical framework goes against the very nature of institutionalism, which has in diversity its most powerful element.

⁸ It is necessary to emphasize that the *NIE* presents a non-conventional approach to the theory of the firm.

⁹ For instance, Tymoigne (2003) explores this relationship.

¹⁰ For Hodgson (1998, 169), an economic theory must demonstrate how specific groups of common habits are *embedded* and reinforced through specific social institutions. In this sense, Institutionalism moves from the abstract to the concrete. Contrary to the standard theoretical models, more specifically, neoclassical models, in which the rationality of individuals is given, Institutionalism uses psychology, anthropology, sociology and other areas of research dealing with the question of how people behave.

¹¹ According to Hodgson (1993, 15), Veblen was looking for a theory of how innovations occur, rather than a theory of equilibrium conditions after the technological possibilities have been determined. For Veblen (1934, *apud* Hodgson, 1993, 15), “*the question is not how things stabilize in a ‘static state’, but how they incessantly grow and change*”. Veblen explored both the process of economic evolution and technological transformation and the way in which action is molded by the circumstances.

¹² The idea that routines in firms are analogous to genes in biology was developed by Nelson and Winter (1982). Although these authors make no reference to Veblen, their work is theoretically closer to the “Old” Institutionalism than to the “New”.

¹³ Veblen’s classic article, “*Why is economics not an evolutionary science?*”, written in 1899, shares much in common with the ideas discussed here. For him, “[t]he economic life history of the individual is a cumulative process of adaptation of means to ends that cumulatively change as the process goes on, both the agent and his environment being at any point the outcome of the last process” (Veblen, 1899, *apud* Hodgson, 1993, 17). Science itself, for Veblen, had a non-static connotation, with a strong methodological identity with Evolutionism. In 1899, he wrote: “*The life of man in society, just as the life of other species, is a struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions*” (Veblen, 1899, *apud* Hodgson, 1993, 17).

¹⁴ For Dugger (1988, 1): “Radical institutionalism, though not as developed as its cousin, Marxism, is also a profoundly critical theory of industrial capitalism. Radical institutionalism is based on the works of Thorstein Veblen and, to a much lesser extent, on the works of John R. Commons. (...) Radical institutionalism is not based on the labor theory of value, but does share with Marxism certain critical points in relation to neoclassical economic theory. (...) It has nothing in common with the so called “new institutionalism” of Oliver E. Williamson. The radical institutionalism of Thorstein Veblen is a full-fledged paradigm, one which stands on its own as an independent school of thought”.

¹⁵ According to Dugger (1988, 4), the Institutionalists constructed a “process paradigm” to explain human behavior in economic systems embedded in existing cultural circumstances. Such circumstances and processes may or may not generate beneficial results for society. What Veblen was trying to construct was a theory of economic process based on nothing more than “opaque facts”.

¹⁶ For Commons, history does not follow the “absurd” trajectory characterized by Veblen. History, rather, is a continuous sequence of human actions and reactions, resulting from its very nature of action and reaction. Thus, history is the product of human action, generating a cumulative effect of action, conflict and change. In sum, according to Commons, human history is a permanent process of planning and reform.

¹⁷ Samuels (1995, 572) affirms that “the categories of neoclassical analysis are largely formally logical and therefore substantively empty, and cannot properly be applied to the real world without additional assumptions, assumptions which willy nilly determine how markets form, operate, and generate results”.

¹⁸ The institutionalist “body of knowledge” consists of eight items, such as the socially activist role of institutions, social control of the market economy, emphasis on technology as the major force of economic transformation and the dual role of culture in a process of “cumulative causation”. Additional focus is placed on the recognition that the power structure generates social relations marked by inequality and hierarchy. For a discussion of these points, see Conceição (2000).

¹⁹ Minsky’s article (1996) specifies various points in common between Keynesian theory and Institutionalism.

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