THE CONCEPT OF UNCERTAINTY IN POST KEYNESIAN THEORY AND IN INSTITUTIONAL ECONOMICS: A POSSIBLE CONCILIATION?

Fernando Ferrari Filho[*]
Octávio Augusto Camargo Conceição[**]

"*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 similarities between the post Keynesian and institutionalist theories that allow us to understand not only the instability of contemporary economies but, most of all, the relevance of institutions in coordinating them.

KEY WORDS

Uncertainty; Institutional Economics; Post Keynesian Theory.

JEL CLASSIFICATION

B15, B25, D81 and E12

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 insufficiency of effective demand. In a similar vein, institutionalists believe that the "economic environment" has nothing to do with the notion of "equilibrium". In both currents 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 and, second, that institutions, both political and economic, are indispensable to the task of "modeling" economic events. The post Keynesian and

[*] Full Professor of Economics at Universidade Federal do Rio Grande do Sul/Brazil. Financial support from the National Research Council of Brazil (CNPq) is gratefully acknowledged. E-mail: ferrari@ufrgs.br.
[**] Associate Professor of Economics, Universidade Federal do Rio Grande do Sul and Economist, Fundação de Economia e Estatística/Brazil. E-mail: octavio@fee.tche.br.

institutionalist theories try to answer the following questions: How do agents make rational decisions? More specifically, how do agents form expectations concerning saving or investment? Why do they retain (or decide not to retain) money? Can the institutional environment influence the decisions referred to above? If so, in what way? The answer to these questions lies in the concept of uncertainty linking the two schools of thought.

Uncertainty is the fundamental element of Keynes's theory. As Minsky (1975: 57) wrote, 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, uncertainty is related to the notion of bounded rationality described by Simon (1983). According to Simon, agents faced with incomplete information adopt strategies characterized by conventions.

Well, despite the fact that some authors have analyzed the theoretical similarities between post Keynesians and institutionalists exploring the characteristics and functions of money in an entrepreneur economy, such as Minsky (1996), Stanfield (1999), Atkinson and Olesson Jr (1998) and Tymoigne (2003), the objective of this article is to explore one of these similarities – that is, the concept of uncertainty. In the Keynesian and post Keynesian theories, the concept of uncertainty appears so clearly, while in the institutionalist theory it is implicit in the theoretical approach. Why the concept of uncertainty is so important? It allow us to understand not only the instability of contemporary economies but, most of all, the relevance of institutions in coordinating them. This is the point that this article will focus on.

The article is divided into three sections. The first explores the concept of monetary economics 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 discusses the idea of uncertainty in institutionalist theory. Finally, the third section offers brief concluding remarks, discussing the points of convergence between the two theories.

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

Keynes's primary legacy consists in demonstrating the logic of a monetary economy[1]. 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 put it (1973b: 411, boldface 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 chapter 17 of Keynes's *General Theory of Employment, Interest and Money,* referred to below as *GT*.

In this chapter, Keynes shows that money differs from other assets in the following ways: 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 nil, meaning that no other asset, non-liquid, functions as a store of value, a unit of account and a medium of exchange, as does money.

These properties of money illustrate the central role it has in a monetary economy: by providing security against uncertainty, money, through monetary contracts, links the past, present and future, thus coordinating economic activity. As Davidson (1994: 87) explains, "*in a world where people cannot reliably predict [the] future ... the ... existence of money and money contracts over an uncertain future ... [are the bases] of a monetary system*". In this sense, contracts denominated in monetary units characterize the institution of a monetary economy.

The principle of effective demand, essential to the Keynesian revolution, is based on the idea of monetary non-neutrality. There exists a possibility of insufficient demand due to individuals using income in the form of non-reproductive wealth, instead of using it to

[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*".

acquire goods produced by labor. In other words, the liquidity preference inhibits individual spending decisions, thus affecting 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 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. In this sense, in investigating the principle works united in Keynes's *Collected Writings*, the post Keynesians develop a theoretical-analytic structure in which the Keynesian revolution is analyzed within the context of a monetary theory of production[2]. 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, boldface added).

The quote above illustrates not only the importance of money in monetary economies, but also the relationship between money and uncertainty. In a monetary production economy, the concept of the non-neutrality of money has to do with the decision process of individuals amidst uncertainty.

But what is uncertainty? In a 1937 article entitled *The General Theory of Employment*[3], Keynes, responding to critics of the *GT*, offers 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*

[2] An interesting analysis of the principles and dynamic of the monetary theory of production is offered by Cadim de Carvalho (1992, chapter 3).

> *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*** (Keynes, 1973c: 113-114, boldface added).

On the one hand, when Keynes says roulette is not uncertain, he means that for uncertain events, probability cannot be obtained from relative frequencies. On the other hand, as an example of uncertainty, Keynes argues that the price of copper twenty years from now is something **nobody knows**. From our point of view, Keynes argues 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 defines 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* (*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 exist[4].

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 (Ibid.:116, boldface added):

> *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.*

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[3] Reproduced in Keynes (1973c).

[4] In the Keynes-Knightian vision, uncertainty is an unknown "probability" while risk is a calculable probability.

If uncertainty cannot be modeled in a deterministic way in a monetary economy, the decisions of agents will be made according to conventions. Keynes writes (1964:148),

> *It would be foolish, in forming our expectations, to attach great weight to matters which are very uncertain*[5] *... 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*.

Because the future is uncertain, individuals, more specifically investors, 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 agents is a partial solution to the problems of uncertainty.

This idea is related to the concept of probability Keynes developed in *TP*. In this work, Keynes shows that intuitive knowledge is of the utmost importance 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, 1973: 6, boldface added).

Taking the passage above as a reference, Keynes discusses 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 determinate 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 emphasizes the binomial expectations-state of confidence. In this sense, uncertainty and

[5] According to Keynes (1964: 148), *"'very uncertain' [does not] mean the same thing as 'very improbable'"*.

decision processes under conditions of uncertainty, which are fundamental to Keynes's theory, are discussed in both the *TP* and the *GT*[6].

How do agents form expectations in the real world? For post Keynesians, in a context in which time is historical, 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 generated 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 explains (Ibid.: 90), "*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 contracts[7] and liquidity demand are fundamental for decision-making amidst uncertainty. The decisions of 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.

The decision of holding money, also a convention, allows investors to maintain liquidity and postpone irreversible investment decisions. Uncertainty, therefore, is the reason 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

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[6] 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*".

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

liquidity preference). Thus, *animal spirits* and liquidity preference are intimately and inversely related.

In chapter 12 of the *GT*, Keynes shows 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 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 (Ibid.: 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[8], 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*" (Ibid.: 152).

The passages above explain the difference between *ex ante* decisions and *ex post* results, which, in the end, shows that in a monetary economy, expectations can be frustrated. Keynes explains 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* (Ibid.: 293-294).

Therefore, one more time, we return to the central point of Keynesian theory: monetary economies are inherently unstable because agents must make decisions amidst uncertainty. In this context, the expectations of economic agents change constantly through time.

But how should 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 ... [on the] optimum rate of investment ... [Moreover] a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment* (Ibid.: 378).

The passage above, in our opinion, can be interpreted in two ways: some analysts, both those supportive as well as those critical of an economy administered and regulated by the State, believe that Keynes's only proposal for stimulating effective demand is state intervention. For others, the idea of "*socializing investment*" concerns the creation of endogenous institutional mechanisms so that individual decisions can be made in the least adverse manner possible. Believing the second interpretation more in tune with Keynes's argument, post Keynesians believe institutions are important to determine events and economic results. In other words, for the post Keynesians, "*institutions matter*".

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[8] See Runde (1990).

2. UNCERTAINTY AND THE INSTITUTIONALISTS

If institutions matter, how do the institutionalists fit into this discussion? Is there an affinity between institutionalist research and the post Keynesian perspective? In this section we argue that there is indeed affinity between the two schools, though the first does not dispose of an established economic theory of its own[9], as Keynes achieved with the *GT*.

Without underestimating the contributions of other authors, Minsky offers one of the most influential contributions to post Keynesian thought by linking institutions and the "institutional environment" to the theoretical principles of the *GT*. 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 crises[10].

Perhaps this is the fundamental point associating post Keynesian thought with the institutionalists. Both schools 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, foreign to orthodox schools of thought, is fundamental to the post Keynesian and institutionalist frameworks. This process, in fact, characterizes the system, defining what an economy is and how it changes. To ignore this element is to suppose a static institutional environment, with rules stripped of their historical nature. The affirmation that Keynesian and institutionalist thought are opposed to such hypotheses does not imply that the two schools are similar, but that the basic critiques of the capitalist economy and its functioning are very similar[11].

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[9] This point is made explicit in various institutionalist works, which call for an "institutional economic theory". See Hodgson (1998) and Samuels (1995).

[10] Minsky's article (1996) specifies various points in common between Keynesian theory and institutionalism. He begins with Keynes's letter to Commons, which illustrates his affinity with the American institutionalists. Keynes (*apud*, Minsky, 1996: 357) affirms: "*There seems to me to be no other economist with whose general way of thinking I feel myself in such genuine accord*". And where is this similarity? To answer this question requires an understanding of the following: "*The current crisis of performance and confidence in the rich capitalist countries makes it necessary, once again, to think about the institutional prerequisites for successful capitalism*" (Ibid.: 357).

[11] Minsky (1996: 357) emphasizes: "*relevant theory is not a compendium of propositions derived from axioms assumed to be universally true: theory is not a subdivision mathematics. Relevant theory is the result of the*

Though Minsky's ideas discussed above cannot be characterized as genuinely institutionalist, they cannot be seen as altogether foreign to the latter. The similarity between Minsky and the institutionalists is in the critique of capitalism as inherently unstable, subjected to a process in which economic decisions must be made amidst uncertainty. The original ideas of the American institutionalists such as Veblen, Commons and Mitchell adopt the same analytical perspective. Veblen, recognized as the precursor of institutionalist thought[12], relates the concept of institutions to habits, rules and to the evolution of institutionsalism itself, perceiving a strong relationship between historical specificities and an evolutionary perspective. The institutionalists have in common a concern for identifying points of agreement that can allow for the creation of a true "institutionalist theory"[13].

Taking three contemporary institutionalists as a reference, Geoffrey Hodgson, Warren Samuels and William Dugger, who sought to rescue institutionalist theory as characterized by Veblen, examine the treatment given to uncertainty in the latter's writing. This article does not attempt to review Veblen's original writings in search of "his" notion of uncertainty, but to analyze how the authors above incorporate, through their interpretations of Veblen's thought, the concept of uncertainty. Hodgson associates Veblenian thought with the evolutionary current. Samuels's work is very similar to Hodgson's, although he does not believe the theories of New Institutional Economics (*NIE*) – elaborated by Coase, Williamson and North – are incompatible with Veblen's work. As for Dugger, he is considered the best example of "radical institutionalism".

Although *NIE* has assumed today a prominent role within institutionalist thought (with some considering *NIE* the school's "only" representative), it will not be evaluated in

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exercise of imagination and logical powers on observations that are due to experience: it yields propositions about the operation of an actual economy." Minsky (Ibid., p.357) adds that "[*t*]*he current methodological fashion, where artificial economies are first specified, then simulated and finally deemed satisfactory (unsatisfactory) if it can be said that the general characteristics of the simulation are similar (dissimilar) to the general characteristics of a time series of constructs based upon observations (such as GNP), would most certainly have been anathema to both Keynes and to the institutionalists of his day. In today's terminology, Keynes's 'beliefs' are mental models that lead to propositions about the behavior of the 'real world' economy. This approach makes 'real world' outcomes dependent upon institutions*".

[12] Geoffrey Hodgson (1998b), for example, affirms they the foundation of the Institutionalist School cannot be found in Veblen's writings, and even less so in the work of Commons and Mitchell.

[13] The multiplicity of analyses and focuses confer significant diversity to such works, which, as Warren Samuels argues (1995), 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.

this text. This is because *NIE* is theoretically closer to the analyses of industrial organization and theory of the firm than to the theories elaborated by the three authors mentioned above. This, however, does not mean that Coase, Williamson and North do not take into acount uncertainty as a central concept to a firm's strategies and decisions. To simplify things, we suppose below that the contributions of *NIE* are implicit in Samuels (see section 2.3).

2.1 HODGSON AND THE "BLINDNESS OF THE EVOLUTIONARY PROCESS"

For Hodgson (1998b), if institutionalists manage to define an "Economic Theory of Institutions", such a definition should relate instititutions, human activity and the evolutionary nature of economic processes. Once associated with other specific economic institutions, they will be able to define different types of economies. If there existed a "general theory" of institutionalism, its generality would be in developing varied and specific analyses of a particular phenomenon[14].

The old American institutionalism of Veblen, Commons and Mitchell focused on the importance of institutions, demanding a genuine evolutionary economics. These institutionalists, however, developed a more descriptive line of analysis, relegating theoretical questions to a second plane. This has led some sympathizers, such as Gunnar Myrdal, to characterize the school of thought as "naive empiricism"[15]. 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 to think in terms of change and transformation, both inherent to Veblen's thought[16]. Veblen's analysis has three

[14] This contrasts with neoclassical economics, which possesses a universal theoretical structure related to behavior and rational choice, which in turn leads to price theory, economic welfare and so on. Institutional economics, to the contrary, does not assume that the habits of human activity are theoretically irrelevant. An economic theory, according to institutionalists, 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, 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 (Hodgson, 1998b: 169).

[15] For Hodgson (1993: 13), the old institutionalism emphasizes the importance of institutions and declared the need for a genuine evolutionary economics. The school, however, became ever more descriptive in its analysis, leaving many core theoretical questions unanswered. What characterizes this analysis is the rejection of the ontological and methodological assumptions of classic liberalism.

[16] According to Hodgson (1993: 15), Veblen was looking for a theory of how innovations occur, rather than a theory of equilibrium conditions after the technolgical possibilities have been determined. For Veblen (1934, *apud* Hodgson, 1993: 15), "the question is not how things stablize in a 'static state', but how they incessantly

central points: the inadequacy of neoclassical theory in dealing with innovation; the concern with how change and growth occur rather than with "stable equilibrium"; and the emphasis on the process of economic evolution and technological change. In this sense, institutions are defined as the result of a present situation, which molds the future through a selective and coercive process. This process is guided by the way people see things, which alters or strengthens their points of view.

The critique of neoclassical thought centers on the assumption of a false conception of human nature. The individual in neoclassical theory is wrongly seen in hedonistic terms, being a passive, inert and unchangeable social entity (Veblen, 1919: 73, *apud* Hodgson, 1993). Veblen rejects the hypothesis that individuals can be taken as given, and offers as an alternative an "evolutionary economic theory" where instincts, habits and institutions exert a role in economic evolution analagous to the role of genes in biology (Veblen, 1899, *apud* Hodgson, 1993: 17). In Veblen's thought, 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 knowledge[17]. 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 using similar theoretical concepts centered on a vision of the economy as a *process* of *dynamic evolution*[18].

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

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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.

[17] The idea that routines in firms are analagous to genes in biology was developed by Nelson and Winter (1982). Alhough these authors make no reference to Veblen, their work is theoretically closer to the old institutionalism than to the new.

[18] 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: "*The 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).

crises. This leads to changes in attitudes and actions. In any social system there is a permanent tension between rutpure and regularity, demanding constant reevaluation of routine behaviors and volatile decisions of other agents. The idea of evolution in Veblen is intimately associated with the process of "circular causation", implying that Veblen could be, according to Hodgson, the precursor of studies undertaken by Gunnar Myrdal, Nicholas Kaldor and K. William Kapp. The breadth and complexity of Veblen's ideas put him along with Marx, Marshall, Keynes and Schumpeter as one of the great figures of economic thought. For the purposes of this article, the "blindness of the evolutionary process" is perhaps the notion most comparable to the uncertainty of Keynes.

2.2 DUGGER AND HISTORY AS BLIND DRIFT

The analyses succeeding Veblen, Commons and Mitchell assumed different conceptual and methodological forms, not all of which are compatible. Samuels (1995) organized the various methods into the following groups: the old American institutionalist tradition, the "new" neoclassical institutionalists, the young American institutionalists and the European institutionalists (evolutionaries, regulationsts and the Austrian tradition). William Dugger views *NIE* as fundamentally different from the institutionalism of Veblen, Commons and Mitchell.

For Samuels, there is much room for comparison between Veblen and Marx and virtually none between these two authors and the neoclassicals. Samuels argues that the institutionalist tradition is not only totally compatible but can at times be confused with both the Marxist and neoclassical traditions. Dugger labels the institutionalism of Veblen and Commons as "radical institutionalism" while Samuels refers to their line of thought as "old American institutionalism".

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

According to Dugger, Veblen restores 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"[19].

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 (Hodgson, 1993), 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 rejects 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, occuring amidst uncertainty. The idea of **process** involves an understanding of economic development as something not

[19] 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* ".

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 institutionalist (or process) paradigm centered on the notion of process is currently being developed[20]. 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[21].

Veblen's explicit concern was with an "absurd theory" capable of creating institutions that impede the "advance" of the process in some or various segments (imbecile institutions). This could result in a "process of change for the worse" [22]. Gunnar Myrdal reformulated this argument in his "theory of cumulative causation", where a certain process ends up aggravating the situation of weaker segments of society. An example of this is the "vicious cycle of poverty".

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 satisy 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

[20] 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".

[21] For Veblen (1919, *apud* Dugger, 1988: 4)): "*... a concept of a process of cumulative change in social structure and function; but this process, being essentially a cumulative sequence of causation, opaque and unteleological, could not, without an infusion of pious fancy by the speculator, be asserted to involve progress as distinct from retrogression or to tend to a "realisation"or "self-realisation" of the human spirit or of anything else*".

[22] For Veblen (1964, *apud* Dugger, 1988: 4): "*But history records more frequent and more spectacular instances of the of imbecile institutions over life and culture than of peoples who triumph have by force of*

from the perspective of "scarcity" and "unlimited desire". Neither of these conditions can be declared as "given" (that is, they are produced historically, that is, 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".[23]

The radical institutionalists defend radical change irreconciliably opposed to neoclassical equilibrium analysis. They see 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.

2.3 SAMUELS AND THE INEXISTENCE OF OPTIMAL EQUILIBRIUM

Warren Samuels sees "institutional economics" as a non-marxist alternative[24] to the neoclassicism dominant in mainstream theory. According to Samuels, institutional

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instinctive insight saved themselves alive out of a desperately precarious institutional situation, such as now (1913) faces the peoples of Christendom".

[23] For John R. 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. For Commons, human history is a permanent process of planning and reform.

[24] Though reiterating the non-marxist character of institutionalist thought, Samuels (1995: 570) believes the theories are not mutualy exclusive: "*Some institutionalists consider their approach to be mutually exclusive with neoclassicism, whereas others, including this writer, consider institutionalism and neoclassicism to be supplementary. Some institutionalists consider their approach to be mutually exclusive with Marxism, whereas others, including this writer, consider institucionalism and Marxism as having significant areas of overlap.*

economics is characterized by various frameworks with several points in common. The notion of an "institutionalist paradigm" aims to identify common elements and beliefs without ignoring the key differences among the various branches of the school. The first similarity among the institutionalist theories is the role of the market as a guiding mechanism for the economy, or, more broadly, the concept of the economy organized and oriented by the market. For the institutionalists, the allocation of resources in society is determined by the society's organizational structure; in other words, by its institutions. The market simply carries out the instructions of the predominant institutions (Samuels, 1995: 571).

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 (Ibid.: 571).

A third aspect is the existence of various institutionalist critiques of neoclassicism, although Samuels argues the two are supplementary, and believes the latter has made substantial contributions concerning the functioning of the market. 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 rationalisty of equilibrium. In criticizing the static nature of the neoclassical

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There has been considerable diversity within institutional economics. Such heterogeneity is not pathological. It is a sign of richness and ferment".

models[25], the institutionalists reaffirm the importance of theories emphasizing the dynamic, evolutionary nature of the economy. As neoclassical thought tends to minimize any possibility of institutional change, it opposes itself to the institutionalists, who do not accept the "panglossian conclusion" that "whatever it is, it is optimal". For the latter school of thought, the structure of power affects the formation and performance of markets as well as governmental action[26].

Given these observations, Samuels proposes 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"[27] concerning a variety of topics; and (iii) development of a multidisciplinary approach to solve problems.

These three categories define, to a large extent, the institutionalist field of research. Despite nuanced differences, 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 institutionalist 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). 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

[25] Samuels (1995: 572) affirms: *"... 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*".

[26] Samuels (1995: 572) emphasizes that institutional analyses incorporate markets, institutions as well as the analysis of social forces that condition the formation and exercise of individual choice. The economy, therefore, is understood as a system encompassing more than just the market, incorporating systemic evolution, implicit in institutional and technological change.

[27] The institutionalist "body of knowledge" consists of eight items, such as the socially activist role of institutions, social control of the market economy, empasis 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).

This article tried to demonstrate that although differing in important ways, both post Keynesians and institutionalists believe 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 institutionalist analysis through 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 institutionalist analysis is opposed to the idea that economic activity can be described in terms of "stability" or convergence to some kind of long-term equlibrium. These conditions are only possible in the absence of **institutions** and **uncertainty**. That is, the existence of such conditions are only comprehensible in a logical or theoretical sense, in a world devoid of historical content.

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