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The Ontological Foundation of Economic Theory

– A Post Keynesian inspired Comment

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Abstract
A core element of evolutionary economics is processes of change. Therefore, according to Kurt Dopfer the focus when you do economics has to be on irreversibility, non-ergodicity, non-repeatability, non-periodicity or path dependence. In arguing along these lines, there seems to be a good deal of similarities between evolutionary and Post Keynesian economics.

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Comment to the presentation made by Professor Kurt Dopfer on ***The ontological foundations of economic theory*** as discussant presented at *A theory of economic evolution – Pivotal questions – An international conference at Aarhus University*, Centre for Business History, 13th and 14th June 2013.

In what follows, I will present some Post Keynesian inspired comments on Dopfers paper and his statements about the content of evolutionary economics.

Being an economist who for many years has found inspiration in the writings of Keynes in order to try to understand the complex way in which macroeconomic phenomena unfold themselves, I have in general no difficulties in accepting most of the core elements of an evolutionary thinking as described by Dopfer (2005):

> "Looked at through evolutionary lenses, we see a world of continuous change and creative advance that incessantly unfolds into new forms. This process is inherently *historical*. Evolutionary theory is principally a *historical theory* … During the process of generalization a historical theory employs criteria such as irreversibility, non-ergodicity, non-repeatability, non-periodicity or path dependence"; Dopfer (2005:16)[1].

I find such a statement in very good accordance with both the economic understanding of Keynes and that of many Post Keynesians. As Davidson (1996:482) points out:

> "Keynes' uncertain future involves a creative economic reality in the sense that the future can be permanently changed in nature and substance by actions of individuals, groups (e.g., unions, cartels), and/or governments, often in ways not completely foreseeable by the creators of change … In a nonergodic environment … this existing market information does not, and cannot, provide reliable data for forecasting the future".

[1] Therefore, as pointed out by Galbraith (1987:1-2): "economic ideas are always and intimately a product of their time and place; they cannot be seen apart from the world they interpret. And that world changes – is, indeed, in a constant process of transformation – so economic ideas, if they are to retain relevance, must also change".

People acting on their free will to change their mind, if needed, up to the very last moment when they decide what to do economically often make mistakes. Although they plan the best they can, taking use of all the relevant information they can get hold on, they don't actually act as individuals with perfect rationality as both their expectations and their information in general are not perfect. Households and firms of real life are, seen from a Post Keynesian perspective, therefore bounded in their rationality, as stated above by Davidson. Most often households and firms act economically on 'rules-of-thumb', or as stated by Dopfer et al. (2004a:263) summarising in one sentence what evolutionary economics is fundamentally all about: "For us, the central insight is that an economic system is a population of rules, a structure of rules, and a process of rules". And such complex structure of rules that govern the way the economic system works have evolved over a long period of time, as pinpointed by Dopfer et al.. That is, to evolutionary minded economists, there is a huge gap between the theoretical focus in neoclassical and in evolutionary economics:

> "What is exogenous in the neoclassical model in fact comprises the endogenous core of evolutionary economics. In this sense, the broad scope of evolutionary economics constitutes a return to classical economics. The latter, too, made such variables as technology, institutions or preferences central to the model. In evolutionary economics, as in classical analysis, stasis is only a 'time slice' through an inherently open and dynamic process"; Dopfer (2004:178).

Not that many Post Keynesians, I think, would oppose to this conclusion.

As such, as I have argued elsewhere – see Olesen (2010) – in my opinion Keynes tried throughout all of his life to understand how a modern monetary economy is continuously in a process of change as society in general develops. As a consequence of this, Keynes, in opposition to views held by the mainstream economic understanding then as now, did not accept that the macroeconomic system is a closed, stationary and mechanical working system that in general follows the rules of ergodicity. Rather it should be seen as an open, social and changeable path dependent system. Therefore, to Keynes and the Post Keynesians, ontological concerns has to be taken seriously when you as an economist deals with economic theory and economic policy advising activities. In the real world, economic units be it households or firms act in an environment of fundamental or ontological uncertainty. As a consequence of this, they act economically on expectations (or rational beliefs) that are not perfect as their rationality is bounded due to the existence of this kind of uncertainty which cannot be overcome cognitively by processes of 'learning by doing' of the individual

household or firm. As an economist you have to acknowledge this fact if you want to understand the real world the right way[2]. Or as Keynes (1936:149-150 & 162-63) said it himself:

> "we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing; or even five years hence … We are merely reminding ourselves that human decisions affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectation; since the basis for making such calculations does not exist; and that it is our innate urge to activity which makes the wheels go round, our rational selves choosing between the alternatives as best we are able, calculating where we can, but often falling back for our motive on whim or sentiment or chance".

In his struggle for realism – an effort to get economic theory to be in better accordance with real life phenomena – Keynes was for many years on the search of an alternative to the mainstream economic understanding both theoretically as well as methodologically. As it is known he succeeded in 1936 by the publication of *The General Theory*. Or as Paul Davidson (2007:26 & 185) has said it:

> "In developing his general economic theory analog to non-Euclidean geometry, Keynes threw over three restrictive classical axioms … Keynes argued that in a money-using entrepreneur economy where the future is uncertain (and therefore could not be reliably predicted), money (and all other liquid assets) would always be nonneutral as they are used as a store of savings. In essence, Keynes viewed the economic system as moving through calendar time from an irrevocable past to an uncertain, not statistically predictable future. This required Keynes to reject the ergodic axiom".

In doing so it became important for Keynes (and the Post Keynesians) to focus on 'time, money, and uncertainty'. Therefore, as stated in a letter to Roy Harrod written in the summer of 1938, the mathematician Keynes understood economics primarily as a qualitative rather than as a quantitative science:

[2] With Kregel (1976:221 & 223): "Instead of assuming that the future was known (or that there were sufficient future markets and that all future prices could be taken as known) he maintained the assumption that it was in the nature of a monetary economy that the future could not be known … Keynes recognised that the essence of the problems of uncertainty and expectations is that time elapses between the taking of a decision and the ultimate outcome of the decision and further that the outcome itself may occur through a passage of time".

> "It seems to me that economics is a branch of logic, a way of thinking … ***Progress*** in economics consists almost entirely in a progressive improvement in the choice of models … Economics is a science in terms of models joined to the art of choosing models which are relevant to the contemporary world. It is compelled to be this, because, unlike the typical natural science, the material to which it is applied is, in too many respects, not homogeneous through time … In chemistry and physics and other natural sciences the object of experiment is to fill in the actual values of the various quantities and factors appearing in an equation or formula; and the work when done is once and for all. In economics that is not the case, and to convert a model into a quantitative formula is to destroy its usefulness as an instrument of thought"; CW (XIV:296 & 299).

To me, this statement seems also to be in good accordance with the views of evolutionary thinking as presented by Kurt Dopfer.

Likewise, I, as many other Post Keynesian inspired economists I think, would fully agree on the distinction made later on in the paper between *Homo sapiens oeconomicus* and *Home oeconomicus*[3]. Or as stated in Dopfer (2004:180): "The traditional *homo economicus* fails in crucial ways with respect to the demand for realism".

An instrumental kind of methodology as adopted by many mainstreamers would hardly do the job the right way if the aim of the economist is to try to understand how a complex modern economy functions in a globalised context; see e.g. Olesen (2010a). Rather, the likelihood of success is almost certainly much greater if the belief of Dopfer is adopted. That is, it seems likely, as stated by Dopfer (2005:21):

> "that *empirical groundwork* along *interdisciplinary* lines will indeed contribute to the reconstruction of a more valid economic theory"[4].

[3] For more details on this discussion, see the presentation given in Dopfer (2004) on the nature of *Homo sapiens oeconomicus*.

[4] Therefore, Dopfer (2005:22) states: "We thus conceive of *Homo sapiens* as a *rule-making and rule-using animal. Homo sapiens oeconomicus* is, accordingly, *Homo sapiens* as a *rule-making and rule-using animal in economic contexts*, such as production, consumption and transaction. The subject matter of evolutionary economics is the analysis of the evolution of economic rules".

Seen from a Post Keynesian perspective, macroeconomic phenomena are not just a simple kind of aggregation of various microeconomic outcomes[5]. On the contrary, the interaction between these two levels is of a rather complex nature, and difficult to depicture correctly.

Or as Paul Davidson has pointed out:

> ”Now, if you know the future’s is uncertain, what does that mean? It means basically … that humans have free will. The human system isn’t deterministic or stochastic … Humans can do things to change the world … they create institutions”; King (1995:21).

However, it should not come as a surprise to economists that an instrumental kind of methodology is troublesome to use in general in economics, especially if they know of both the writings of Adam Smith and of Keynes[6]. Sadly, however, at least in a Danish context, when we teach economics to students it is mostly always without any information, not even the most basic one, of the history of economics. And not that many students get acquainted with non-mainstream economics neither of a Post Keynesian nor of an evolutionary kind of nature.

[5] Therefore, Post Keynesian inspired economists would in general have no problems in accepting the presented view on the neoclassical model made by Dopfer (2005:33-34): “The neoclassical model does talk about firms and households, but it actually assumes that individuals and socially organized entities are identical. The cortical and the social organization govern homologously microeconomic operations. Human cortex and social body are indistinguishable with respect to their rational course of action, their determining variables and their consequences”.

[6] As Keynes for instance expressed himself in his biographical note on Alfred Marshall: ”the master-economist must possess a rare **combination** of gifts. He must reach a high standard in several different directions and must combine talents not often found together. He must be mathematician, historian, statesman, philosopher – in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man’s nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician”; CW (X:173-74).

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