AUSTRIANS AND POST KEYNESIANS: THE QUESTIONS OF IGNORANCE AND UNCERTAINTY

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What makes Austrian economics distinctive in relation to other schools of thought? Various aspects such as subjectivism, praxeological method, and the absence of modeling have been put forward as "defining characteristics" of the school. And, since they are not mutually exclusive, each has considerable merit, for each is an attempt to grasp the essence of a "core" concept that distinguishes the Austrian approach from the formulaic, deterministic, and positivist approach of the mainstream. In this article, we will attempt to demonstrate that the Austrian method of dealing with both theory and history is informed by its perspective on uncertainty as the core concept uniting the various characterizations of Austrian thought. Furthermore, we will argue that the Austrian School, among modern schools of thought, possesses the most realistic perspective on uncertainty and its role in the functioning of the economic system.

The occasion for this article is a review of *Uncertainty in Economic Thought*, edited by Christian Schmidt (1996). The book is a collection of articles, primarily by continental economists, presented at a 1993 symposium of the Charles Gide Association for the Study of Economic Thought. Austrian scholars interested in the subject matter will benefit not only from its discussion of the shortcomings of mainstream economics in this area, but even more so from articles that present the essential elements of the two most prominent non-mainstream approaches: those of the Austrian and Post Keynesian Schools. It is the relationship between these two non-mainstream approaches that will be the focus of this article.[1]

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[1]Other economists of Austrian orientation have researched the Post Keynesian school in some detail. See, for example, Bellante (1992). Hoppe (1997) summarizes Mises's analysis of the risk-uncertainty distinction.

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Such an emphasis is justified, from an Austrian perspective, because of numerous suggestions made that the two schools would benefit from some sort of "increased intellectual trade." For instance, no less an authority than John Hicks has "made a case for increased integration" of the viewpoints of John Maynard Keynes and F.A. Hayek (Snowdon, Vane, and Wynarczyk 1994). The Austrians and Post Keynesians, in addition to their criticisms of orthodoxy on the issue of uncertainty, also share non-mainstream perspectives on the importance of monetary institutions (as opposed to strict money neutrality) and transitional states (as opposed to static equilibrium). However, despite their shared recognition of important factors such as ignorance, money, and time, the two schools remain far apart on the nature and significance of these factors within the economic system.

APPROACHES TO UNCERTAINTY: DEVELOPMENT AND EVOLUTION

In the first chapter of *Uncertainty in Economic Thought*, Mark Perlman and Charles McCann consider the "bundle of ideas" that make up the modern conception of uncertainty. Their chapter serves as a useful summary of the development of the uncertainty concept in the history of thought. The authors note, for example, that Richard Cantillon, considered one of the forerunners of the subjectivist approach later adopted by the Austrians, was among the earliest economic thinkers to stress the entrepreneurial decision of committing known costs against unknown (i.e., future) prices. In discussing the ability of the entrepreneur to account for future contingencies, J.H. von Thünen held that profit accrues as a payment for the willingness of the entrepreneur to take on uncertainty beyond that which is discountable (i.e., measurable risk, which corresponds to knowledge of a probability distribution of future outcomes).[2] Thus, the term uncertainty applies to cases where it is not known whether any such distribution exists (p. 12).

Augustin Cournot also wrote extensively on the problem of uncertainty. Perlman and McCann summarize Cournot's view of uncertainty as stemming from two sources: (1) faulty perceptions and (2) the specificity of events (p. 13). The first of these two sources may be seen as the rationale for an approach based on "subjective" probabilities, i.e., the notion that, although the "true" probability distribution of outcomes may not be known to a decisionmaker, he nonetheless forms a subjective distribution of outcomes based upon the set of information available at the time of choice. The second source, on the other hand, corresponds closely to von Thünen's view and to modern, non-mainstream conceptions of uncertainty.

In essence, mainstream economics has followed the lead of neoclassical theorists John von Neumann, Oskar Morgenstern, Leonard Savage, and others (including, arguably, Robert Lucas, Jr.) in classifying uncertainty as merely

[2]Von Thünen is popularly credited with formally distinguishing "true" uncertainty from risk (p. 12).

unidentified risk (pp. 11, 14–15). Non-mainstream schools such as the Austrians and Post Keynesians, on the other hand, have insisted on the theoretical distinction between the two. An important result of these different approaches is that the mainstream position has proven especially conducive to the "strong" form of rational expectations, whereby the subjective and objective probability distributions of all economic outcomes are identical, while the non-mainstream positions have allowed significant scope for the "non-convergence" of subjectively formed expectations and objectively determined outcomes.

Almost all non-mainstream approaches to uncertainty draw heavily from Frank Knight (1921). Several chapters in *Uncertainty in Economic Thought* are devoted to further illumination of Knight's treatment. Knight "mostly repeated von Thünen," say Perlman and McCann, but then added to von Thünen's analysis the concept of entrepreneurial insight. The reward, says Knight, for correct (in hindsight) entrepreneurial decisions in the face of "unforeseen risks" is profit (p. 13). This perspective on uncertainty fits well with the Austrian emphasis on the entrepreneur and the division of knowledge. Indeed, the Post Keynesian Paul Davidson, in the book's second chapter, includes Knight among the Austrians in relation to the treatment of uncertainty and risk (p. 22). Other articles examine the interpretation of Knight's treatment and its relation to corresponding developments in the work of Keynes, Hayek, Hicks, and G.L.S. Shackle.

APPROACHES TO UNCERTAINTY: AUSTRIAN AND POST KEYNESIAN

To its credit, *Uncertainty in Economic Thought* gives the Austrians their due in regard to the treatment of uncertainty in economic life; the introduction notes, for instance, that "uncertainty is a logical implication of the methodological options of the Austrian School" (p. 3). Attention is given to Hayek's emphasis on the diffusion and incompleteness of knowledge as well as to Menger's analysis of how the use of money is both a response to and a generator of uncertainty.[3] The best discussion of Austrian ideas in the collection, however, is Pierre Garello's chapter examining the link between subjectivism and uncertainty in Austrian thought.[4] Garello uses Mises's *Human Action* (1949) as his basis for a discussion of the role of uncertainty in Austrian economics, a role that is found to be fundamental. Indeed, Mises himself writes

> The uncertainty of the future is already implied in the very notion of action. That man acts and that the future is uncertain are by no means two independent matters. They

[3]On Hayek, see Omar Hamouda and Robin Rowley, "Ignorance and the Absence of Probabilities" (pp. 38–64). On Menger, see Thierry Aimar, "Money and Uncertainty in the Economic Thought of Carl Menger" (pp. 100–11). Aimar's portrayal of Menger's thought lends support to the view, shared by the present author, that Menger was much more eclectic in his approach to economic science than many modern-day Austrians seem to realize (or, perhaps, care to admit).

[4]"Uncertainty and Subjectivism: The Role of Uncertainty in the Austrian School" (pp. 87–99).

> are only two different modes of establishing one thing . . . If man knew the future, he would not have to choose and would not act. (Mises 1949, p. 105)

A key to understanding uncertainty in an Austrian context is that it is not merely the ends toward which actions are directed that are subjectively determined, but the means as well. Neoclassical economics accepts the subjectivity of ends (i.e., tastes and preferences), but has no truck with the subjectivity of means. By contrast, as Garello points out, the Austrians insist that

> only *ex post* can we be sure that the use of such and such means enables us to reach our ends. At the time the decision is made, the results are uncertain because they will occur in the future, even if it is the very near future. (p. 89)

Thus, it is "because economic phenomena are the consequences of actions, which themselves rest on subjective bases, that uncertainty naturally turns into a fundamental element of economic life and therefore of economic analysis" (p. 88). As economic scientists, we must realize that we cannot, with certainty, identify either the goals of economic actors or even the means by which they perceive those goals may be met.

This does not imply that neither economists nor the economic agents that are the focus of their attention have any method by which to proceed in their analysis of future possibilities. Economists can make use of their understanding of human action and corresponding market processes to study "events (past actions) in their uniqueness, their specificity" (p. 91). The goal of such historical (as opposed to praxeological) research is to address the "quantitative problems" in the field of action. Says Mises,

> Quantitative problems are in the field of human action open to no other elucidation than by understanding. . . . Understanding, by trying to grasp what is going on in the minds of the men concerned, can approach the problem of forecasting future conditions. (Mises 1949, p. 118)

Economic agents, too, make use of their understanding of human action. Garello quotes Mises:

> Understanding is not a privilege of the historians, it is everybody's business. In observing the conditions of his environment everybody is a historian. . . . Acting man looks, as it were, with the eyes of a historian into the future. (ibid., p. 58)

In fact, it is in this role as an economic actor that the scientist gains insight into the "quantitative problems" of economic relations.

Of particular relevance to the Austrian perspective on uncertainty is the role of the entrepreneur. As Garello states, the "concept of entrepreneurship is at the root of the Austrian theory of market processes" (p. 92). And it is here, where entrepreneurship enters the picture, that the Post Keynesian treatment of uncertainty may be usefully introduced and contrasted with the Austrian approach. For while the two schools agree essentially on what uncertainty *is* (vis-à-vis the neoclassical mainstream), they are quite far apart in terms of what uncertainty *means* for economic actors and for the scientists who try to make sense of their actions. The point of departure rests on the role of the entrepreneur or, more correctly, on the lack of entrepreneurial function (in the Austrian view) within the Post–Keynesian framework.

How, in a world of uncertainty and change, do economic actors somehow manage to achieve a reasonable degree of coordination among their individual plans? The means–ends framework that characterizes human action provides the answer to this question, and it is the entrepreneur that is the driving force behind the coordinating process. Successful entrepreneurs are those who, through alertness and insight, are able to detect the presence of discoordination (or, if you prefer, disequilibrium) in markets and act upon this insight in order to make profits. This insight is defined by Hayek as "a capacity to find out" based on the (local) knowledge of the particular circumstances of time and place "which kinds of things or services are wanted, and how urgently they are wanted" (Hayek 1978). The test of whether such decisions are, in fact, coordinating (or equilibrating) is to be found solely in the *ex post* disposition of profit and loss. And it is entrepreneurial decisionmaking in the face of uncertainty and in the hope of profit that leads to the very possibility of coordinating market processes.[5]

Post Keynesian writers such as Davidson implicitly deny the importance of this coordinating aspect of entrepreneurship.[6] His entry in *Uncertainty in Economic Thought*[7] is an attempt to clearly distinguish the Post Keynesian position on uncertainty from other positions. Quoting Keynes, Davidson defines uncertainty as the absence of any "scientific basis on which to form any calculable probability whatever" (p. 23). And lest we mistake this to be merely an assertion that economic scientists are incapable of knowing beforehand the means and ends on which subsequent human actions are based, Davidson clarifies:

> For Keynes and the Post Keynesians, on the other hand, uncertainty involves situations where decisionmakers believe that no relevant probabilities (no external reality) exist today that can be used as a basis for scientifically predicting future events. As John Hicks has put it "One must assume that people in one's models do not know what is going to happen, and know that they do not know what is going to happen." . . . This Keynes–Post Keynesian view permits human "free will" to create future outcomes (or future states of the world) . . . It is truly a revolutionary way of looking at the entrepreneurial market system. (pp. 24–25)

[5]Garrison (1986) demonstrates the importance of particular institutional arrangements, i.e., those that reward "correct" expectations and penalize "incorrect" expectations, in bringing about market coordination.

[6]Perhaps a caveat applies here. Post Keynesian writers are a diverse lot, as much or more so than the Austrians, although sharing a basic emphasis on the imperfection of knowledge as well as markets. We, therefore, do not presume to imply that all Post Keynesians share the views of Davidson, the writer critiqued in this chapter. As a leading figure in Post Keynesian thought, however, Davidson can be fairly considered a "representative agent" of the school.

[7]"Some Misunderstandings on Uncertainty in Modern Classical Economics" (pp. 21–37).

In contrast to this Post Keynesian approach, Davidson characterizes the Austrian approach as one in which "external reality is determined by Mother Nature in a manner similar to the way nineteenth-century physicists viewed the working of the physical world" (p. 24). As such, the Austrian approach fails to provide "room for human free will and the creative aspect of human nature and entrepreneurship" and, instead, posits a world where the "economic play is already written in the laws of economic nature that determine the economy's structure, just as the future paths of the planets are predetermined by the laws of physics" (p. 26).

Given that Davidson does not provide even a single reference to writings of an Austrian economist that actually attest to his characterization of their approach, we will not bother to refute it here.[8] In essence, the question of whether the future is predetermined is irrelevant from an Austrian standpoint; it is enough to know that "to acting man the future is hidden" (Mises 1949, p. 105). The more fundamental conflict between the two schools concerns competing visions of what entrepreneurs actually do. Austrians will agree that if "entrepreneurs have any important function in the real world, it is to make crucial decisions" (p. 32). Davidson fails to speculate, however, as to just how entrepreneurs might go about making such decisions in the face of an uncertain future. As noted before, the Austrian approach is explicit about the role of alertness and insight, based on localized knowledge, in driving the entrepreneurial decisionmaking process. By contrast, the most Davidson can find to say about entrepreneurial decisionmaking is that entrepreneurs "will sensibly disregard available market price signals" if they believe that conditions "will cause the future to differ in a nonpredictable (uncertain) way" (p. 29).

Now, certainly the very fact that an entrepreneur acts is enough to inform us that he is not disregarding price signals. To the contrary, the acting entrepreneur is one who has come to the decision that available market prices are signaling an opportunity for profit, a temporal disequilibrium that may be exploited to the gain of the one who correctly appraises the situation and acts accordingly. Of course, there need be no presumption on the part of the economic scientist that entrepreneurs will have, on balance, expectations that correspond to the reality that unfolds (as the "strong" form of rational expectations predicts). We can be certain only of the fact that those who prove (from hindsight) to have made incorrect decisions will incur economic losses, while those who prove to have chosen correctly will reap economic gains. Thus, the market systematically and impartially "weeds out" errors and coordinates the plans of individuals who hold widely disparate expectations of the future. The very essence of entrepreneurship

[8]Let it suffice to say that this characterization of the Austrian approach is, well, amusing. Compare with Mises:

> from the human point of view action is the ultimate thing. We do not assert that man is "free" in choosing and acting. We merely establish the fact that he chooses and acts and that we are at a loss to use the methods of the natural sciences for answering the question why he acts this way and not otherwise. (Mises 1949, p. 105)

is to act on the basis of "available market price signals" that indicate discoordination.

Davidson does not spend any time discussing why entrepreneurs would act if market prices were to be completely disregarded, but we can perhaps look to the traditional Keynesian diagnoses of "animal spirits" and the "propensity" to consume and save for answers. In a Keynesian world, there need be no particular insight, even of the localized and subjective sort, for action on the part of entrepreneurs. To the contrary, entrepreneurs are assumed to act on the basis of expectations that they know themselves to have no good reason to hold apart from some obscure collective psychology, naively assuming that the best guide to action is what everyone else is doing. Thus, while both the Austrians and Post Keynesians stress the importance of entrepreneurship in an explanation of economic phenomena, the Post Keynesian emphasis appears to be an entirely negative one, acknowledging the place of action without seriously considering the impetus for that action. And in emphasizing action without reference to the perceived knowledge that brings that action about, the Post Keynesian analysis actually undermines the "free will" to which it proposes to give place.

These very different views on the nature of entrepreneurship give rise to corresponding differences in policy prescriptions. For an Austrian economist, it is the presence of the entrepreneur that ensures a competitive "discovery process" in which economic actors attempt to change the current state of affairs, thereby "systematically contributing to the coordination of plans" (p. 93). The absence of the entrepreneurial function in the Post Keynesian framework, however, leads to the recognition of uncertainty in economic life without its market-based solution. It is unsurprising, therefore, that dealing with this rampant uncertainty becomes the foremost problem for Post Keynesian policy to solve. Their solution, which they naturally attribute to the brilliance of Keynes, is that government must step in with policies that reduce uncertainty and/or mitigate its effects.[9] Says Davidson,

> Government should be continuously seeking to develop, where possible, adaptable economic institutions that attempt to reduce uncertainties by controlling the economic environment to limit future time outcomes to those that are closely compatible with full employment and reasonable price stability. Economists should strive to design various institutional devices that can produce legal constraints on the infinite universe of events that could otherwise occur as the economic process moves through historical time. (p. 34)

In other words, although the market is itself unable to deal with the fundamental problem of uncertainty, society is, through government, "capable of producing policies that intelligently control and improve the performance of the economy compared to what would occur under laissez-faire competitive market conditions" (p. 25).

[9]Thus, Davidson quotes Keynes in his insistence on "a somewhat comprehensive socialization of investment" as the means for "securing an approximation to full employment" (p. 26).

Thus, Post Keynesian policy recommendations involve limiting the legal ability of individuals to bargain in the marketplace. Such recommendations include traditional demand management and "incomes" policies designed to stimulate expenditures while stifling free wage bargaining (Snowdon, Vane, and Wynarczyk 1994, pp. 367–82). However, a glaring omission in Davidson's chapter is that the link from the Post Keynesian position on uncertainty to the possibility of government action to "improve the performance of the economy" is never made. Even if one accepts the view of an economy plagued by an all-encompassing uncertainty and entrepreneurs that act without any good reason for doing so, it still does not follow that government is capable of improving upon the results of this economic process.[10] In fact, the Post Keynesians' own vision of pervasive uncertainty would seem to lean against such conclusions, for how, in a world of such uncertainty, could the government possibly form policies that are compatible with full employment and price stability? Under uncertainty, there can be no perfect *ex ante* knowledge of the relationship between actions and particular outcomes. To claim that government can improve upon free-market outcomes by reducing uncertainty, one must somehow infer that the government is able to obtain information that is unavailable to market participants in regard to future prospects. If Davidson has some reason to believe that government does indeed have access to such information, it is not stated here.

CONCLUSION

We do not wish to imply that there is nothing of value in Davidson's presentation of the Post Keynesian approach to uncertainty. Nor do we believe that there is no possibility of fruitful dialogue on various aspects of the uncertainty problem between Austrians and Post Keynesians. Credit is certainly due to Davidson for his ability to frame the risk-uncertainty distinction in the language of modern, neoclassical theories of stochastic processes.[11] And, apart from the omissions we have discussed, most Austrians will find little to disagree with in his discussion of entrepreneurship and "crucial" decisions. Unfortunately, those omissions are of fundamental relevance to the whole issue of uncertainty. The strength of the Austrian approach is demonstrated in its close attention to the entrepreneurial function that other traditions, including the Post Keynesians, tend to ignore.

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[10] Mises makes a case for the opposite conclusion:

> All varieties of interference with the market phenomena not only fail to achieve the ends aimed at by their authors and supporters, but bring about a state of affairs which—from the point of view of their authors' and advocates' valuations—is less desirable than the previous state of affairs which they were designed to alter. (1949, p. 854).

Indeed, there are very credible arguments and evidence that intervention will tend to increase, rather than decrease, uncertainty. See, for example, Koppl and Yeager (1996).

[11] Austrians could, we think, take a cue from Davidson's treatment in this regard. The inability of Austrian economists to correspond with the mainstream via a "common dialect" is an often overlooked but important hindrance to the transmission of valuable ideas throughout the profession.

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