2 Post Keynesian methodology

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Introduction

Methodology is concerned with the choice of methods of analysis, and the means of choosing between competing theories. For neoclassical economists, the method of analysis is mathematical formalism, and they choose those theories that predict best. Mathematical formalism is appealing because it makes what is being analyzed clear and precise; it also allows theories to be easily compared. Good theories predict well and become accepted; other theories are bad theories.

One drawback to this view of methodology is that it discourages consideration of alternative schools of thought. Any methodology developed outside the neoclassical framework inevitably fails by neoclassical criteria. It is therefore important that Post Keynesians not just explain their methodology; they must also use methodological arguments to justify considering something broader than neoclassical methodology. Post Keynesian methodology needs to make clear that its approach to economics can be justified, and also make the case that its methodology provides a better understanding of how the economy works.

This chapter discusses what methodology means for Post Keynesian economics and how its views on methodology have developed. For Post Keynesians, methodology is a matter of discussing not only how models are chosen, but also what is meant by empirical assessment and how the real world is understood. Methodology also provides a basis to critique mainstream economics and a mechanism to mark out Post Keynesian territory.

Today, methodologists know that there is no universal set of methodological principles. Each school of thought is characterized by its own methodology; the specification of that methodology comes from inside the school. By observing what Post Keynesians do, the methodologist can rationally reconstruct practice as conforming to a set of methodological principles. These principles can then be discussed and, if need be, questioned or updated.

The next section discusses the philosophical foundations of economic methodology. The third section considers the different aspects of the Post Keynesian methodology and argues that these are mutually compatible. The fourth section considers some unresolved methodological issues. The final section summarizes the Post Keynesian approach to methodology and discusses some of its policy implications.
Philosophical foundations

Early methodological statements of Post Keynesianism emphasized the importance of historical time, and the theoretical implications of taking historical time seriously. Key figures, such as Robinson (1978) and Kaldor (1972), emphasized that conducting economic analysis in terms of historical time means that we have to do without equilibrium in the mainstream sense of the term. They questioned conventional supply and demand analysis (which requires pure competition and the independence of supply and demand) because it did not correspond to real world conditions. This raised issues about what types of lack of realism we are prepared to accept (all theory being in some sense unrealistic).

Neither Robinson nor Kaldor was explicit about methodology in the traditional sense. They focused on theoretical differences rather than questioning the whole basis for theory appraisal. At that time, the field of methodology was dominated by Popper’s (1934, 1950) ideas about testing hypotheses. Reference to “the facts” was central. According to Popper, while confirming instances could not prove a theory true, contradiction by the facts could prove it false. Theory testing should thus be designed to narrow the range of what was true and what could be shown to be false. Implicit in Popper was the view that empirical testing was the best way to appraise a theory.

Friedman (1953) reduced the issue of empirical testing to a question of predictive success. The structure of a theory and the realism of its assumptions were not important. Instead, we should choose that theory which predicts best. It was not just Post Keynesians who reacted against such a methodology by arguing for the merits of explanation as an alternative to prediction and a means of generating better predictions. And it was not just Post Keynesians who argued for more realistic theories.

But the critique had particular force for Post Keynesians, for whom the starting point of theory was the nature of the real world. Post Keynesians thought it crucial that there be some correspondence between a theory and the real world, something that Friedman denied.

Meanwhile, the philosophy of science was undergoing a major transformation. Previously, the goal had been to identify the best method for science, and the best way to choose theories. But, drawing on the work of Thomas Kuhn (1962), in the 1960s philosophers of science began to raise questions about whether it was possible to identify one best method of theory appraisal. Kuhn observed, through a study of the history of science, that theory choice was not a simple matter of testing a theory against the empirical evidence, as suggested by traditional philosophy of science. Instead, science proceeded within communities of scientists, each with a shared paradigm.

A paradigm consists of a disciplinary matrix based on a particular world view and communicated by exemplars (Kuhn, 1974). The world view determines core beliefs about the nature of the subject matter and the questions asked, whereas the disciplinary matrix provides the theoretical and empirical tools
used to answer these questions. There are no universal, external criteria by which to judge which is the best paradigm. Each paradigm has its own set of criteria for theory selection, and there is no basis for applying these criteria to other paradigms.

In practice, scientists operate within a scientific community, so that the range of world views, and thus paradigms, is limited. Within each social grouping of scientists, conventions are shared about how to proceed. Contrary empirical evidence is not sufficient grounds for giving up a paradigm; evidence is understood differently depending on the paradigm. For example, a paradigm that precludes involuntary unemployment would interpret high unemployment as evidence of high voluntary unemployment. There is no conflict with the presumption of market clearing.

Based on the work of Kuhn, Dow (1985) argued that economic schools of thought are most effectively identified at the methodological level as paradigms. Methodological differences had to be understood if communication between schools of thought was to succeed. A corollary of this is that ideology is part of the world view that defines a school of thought and its methodological principles.

Kuhn thus opened the door for developing a methodology that would explain the Post Keynesian world view and its disciplinary matrix as a coherent whole. These methodological underpinnings were expressed in different ways by different Post Keynesians. The next section explores some of these specifications.

**Post Keynesian methodology**

Joan Robinson (1975) worked with Keynes at Cambridge and was perhaps the first to use the term "Post Keynesian." She highlighted the role of ideology in theory; but she also reflected the times by taking the stand that the ideology of different schools of thought could be separated from theory, so that, as long as ideological differences were made explicit, arguments could be settled by reason (Salanti, 1996).

Paul Davidson (1972) continued to highlight methodological issues and the role of ideology. He emphasized the significance of conducting analysis in terms of historical time, rather than the logical time used by orthodox theory. Historical time is distinctive in being irreversible – something precluded by most orthodox analyses. Davidson also highlighted the uncertainty of expectations with respect to an unknown future. If economic relationships were not determinate and timeless, it was impossible to analyze equilibrium in the same way as orthodox theory. So equilibrium for Post Keynesians came to refer to stable states, rather than the market clearing and satisfaction of expectations that characterize the orthodox concept of equilibrium. Relying on this foundation, Davidson (1972) built a theory of money in historical time. It showed money to be integral to economic relations because of its role as refuge from uncertainty.

Alfred Eichner (1978), also in the US, provided the first general account of Post Keynesian economics. He put great emphasis on its methodological distinctiveness. In particular, he emphasized that a methodology emphasizing
historical time will have to be applied to industrial structures that are not perfectly competitive. This means that the conditions for orthodox supply and demand analysis will not be met. (For example, the supply curve is not defined in the absence of perfect competition.)

In the UK, Victoria Chick (1983) drew attention to the distinctive methodological aspects of The General Theory, and argued that understanding the methodology of The General Theory was necessary for understanding its economics. Keynes focused on a monetary production economy, rather than a real exchange economy, because he was trying to understand such an economic system. This led to a focus on time, uncertainty, and money. This, in turn, required a combination of partial and general analysis, including his use of different time horizons and his notion of equilibrium as a state of rest where no one had the power to effect change (even if they had the desire to do so). From all this Keynes could explain unemployment equilibrium.

Reissue of the Treatise on Probability (Keynes, 1973) made clear the philosophy behind Keynes's methodology. In the Treatise, Keynes developed a theory of how we (as economists and as economic agents) establish reasoned grounds for belief under conditions of uncertainty. Following Hume ([1739-40] 1978), Keynes thought that, as mere humans, we could not know with any certainty the causal forces underpinning complex relationships. We could only draw on experience, the human faculties, reason (as opposed to rationality), and intuition. Hume emphasized the importance of beliefs. Our belief system, in turn, reflects our social nature, so that social convention plays a part. Keynes (1937) talked of people relying on conventional opinion of what would happen in financial markets because they lacked any other guidance. The remaining gap is filled by what Hume termed "the imagination" and what Keynes termed "intuition." These are combined with reason and conventional judgment in order to form a view on the basis of available evidence.

A rich literature on the philosophy of Keynes followed, which demonstrated the coherent methodological underpinnings of his economics (building on Lawson and Pesaran, 1985; Carabelli, 1988; O'Donnell, 1989; Davis, 1994). There is still much debate over whether, at what level, and how far Keynes changed his mind over time. Particularly controversial is the understanding of Keynes's view on the organicism (interrelatedness) of individuals and of social systems (i.e. the nature of the subject matter as a basis for the design of theory). But whether or not Keynes started as an atomist, there is general agreement that he ended as an organicist.

Although much methodological discussion focused on Keynes, Post Keynesian economics was originally much broader in scope. The early development of Post Keynesianism in North America, and in the Trieste summer school, included a range of non-mainstream approaches (Lee, 1998). While aiding in the institutional development of Post Keynesianism, the resulting pluralism (in the absence of explicit methodological justification) created difficulties when it came to classifying Post Keynesianism in a positive sense, rather than as a critique of the mainstream. An early definitive account of Post
Keynesianism (Hamouda and Harcourt, 1988) presented it in terms of three strands (following the traditions of Keynes, Sraffa, and Kalecki/Robinson). This raised the issue of whether Post Keynesianism was methodologically coherent and whether there was a Post Keynesian methodology.

Several attempts have been made to identify the methodological principles implicit in Post Keynesian economics.

For Davidson, methodology requires a concern with realism, also taking into account the real world implications of historical time when doing economics. Davidson (1994) went on to develop an account of Post Keynesian methodology that emphasizes its generalizing nature. He understood Keynes as offering a general approach, of which neoclassical economics was a special case. He characterized Post Keynesianism as rejecting three neo-classical axioms - the axiom of the neutrality of money, the axiom of gross substitution, and the ergodic axiom. By rejecting these axioms, Davidson argues, Keynes was able to develop a more general theoretical framework that could be applied to particular circumstances.

Money is crucial because there is no close substitute for it and because it is not neutral (i.e. it affects the real world) in a world of uncertainty. An asset with a relatively stable and certain value is necessary for times of high uncertainty and, more generally, as the denominator of contracts.

Systems are ergodic if their structure remains stable over time, so that extrapolation from the past is a good guide to the future. Ergodic systems lend themselves to mathematical representation and econometric testing, as in orthodox economics. Non-ergodic systems imply uncertainty in the real world, so that formal equation systems cannot capture the complexity of reality. Put another way, non-ergodic systems are those where historical time generates structural change, whereas in ergodic systems historical time can be represented satisfactorily by logical time. Some economic relations may be ergodic. For these, neoclassical methodology is appropriate, but this requires special justification as an exception to the norm of non-ergodicity. Thus, while not rejecting mainstream economics, Davidson contains it (Chick, 1995a), arguing that it is only a good theory for special circumstances.

Lawson (1994) is even more skeptical about neoclassical methodology. He advocates that Post Keynesians adopt critical realist foundations. Critical realism holds that the purpose of science is to uncover causal structures. For the critical realist, what we observe as empirical events is only a surface manifestation of the real underlying causal forces that we cannot directly observe. Consequently, the orthodox focus on econometric testing of models is limited because it only looks at surface characteristics. A critical realist account of inflation would seek to identify the forces at work underlying both changes in monetary conditions and changes in the general price level, rather than specific predictions about how monetary changes affect the general price level.

For critical realists, social systems are regarded as complex, structured, and transformable. This corresponds with Keynes's understanding of social systems as organic and Davidson's understanding of them as non-ergodic.
Understanding the social structure is the first step to transforming it. This supports the reformist stance of Post Keynesian economics.

What follows is open-system theorizing. In an open system one does not know all the relevant variables. Post Keynesians understand the economy as an open system. The social system, with its institutions and conventions, evolves and human agency can generate surprises. Open systems can also be transformed by human agency. In contrast, mainstream economics views the real world as a closed system. This view justifies its representation by a single formal model that can be tested empirically with econometric techniques. Relevant variables are fully specified, and they are used to analyze a wide variety of contexts over time and space.

The notion of an open system approach has numerous affinities with the idea of a Babylonian mode of thought. Dow (1985; 1996) developed this latter notion to capture a different way of understanding complex systems. Like critical realism, it does this by approaching a question from a range of angles and using a variety of methods (in contrast with the mathematical method of orthodox economics). This approach also corresponds to Keynes’s (1937) view on how we establish reasonable grounds for belief under uncertainty — knowledge is built up by means of conventions and intuition as well as ordinary logic applied to all available evidence. It also provides a coherent rationale for a methodology that employs a range of methods, taking various starting points.

The Babylonian mode of thought has been accused of advocating “anything goes,” similar to postmodernist ideas and the rhetoric approach, which seem to be putting forward the view that there is really no methodology. However, this characterization is not accurate. The Babylonian approach occupies a middle ground, between one set of rules and no rules. It advocates a set of methodological principles corresponding to a set of schools of thought. Rather than the pure pluralism of postmodernism, this is a pluralism modified and structured according to principles peculiar to Post Keynesianism (see Dow, 1997). Critical realism also occupies a middle ground, recognizing the impediments to establishing truth with respect to a complex social system. The objective is to seek, as far as possible, true knowledge. But recognizing that this is an unachievable goal, a variety of approaches to establishing (fallible) knowledge becomes necessary.

Chick (1995b) further develops the idea of Post Keynesianism as a distinctive way of thinking. This approach stresses the primacy of the problem at hand for deciding on the theory and method to use. Like critical realism, the goal is to transform society, and, like the Babylonian approach, different aspects of the social system are analyzed in different ways, depending on the context.

While there have been several accounts of Post Keynesian methodology, sufficient common ground exists to identify something approaching a consensus position.

The general methodological approach is an open system approach, involving collections of partial analyses that aim to build up a (fallible) knowledge of different aspects of the socioeconomic system. Rather than relying on a single,
formal method, a range of methods are employed (formal, institutional, and historical, for example) that draw on different types of evidence (case studies or published data series, depending on the problem at hand). As a corollary, there is no single set of axioms from which all theories are drawn.

It should not be surprising that Post Keynesian methodology has developed in the same way that methodology suggests theory should develop – following different chains of reasoning, taking different starting-points (depending on context), but unified by a shared vision of reality (see Dow, 1990). This vision includes a focus on production rather than exchange, a focus on imperfect competition, and a focus on distributional questions. A further important element of the view of methodology outlined above is that methodology itself is an evolving body of knowledge. Debate on these foundations therefore continues.

Unresolved issues

As we noted above, Post Keynesian methodology is still evolving; so the above summary should be regarded as only provisional. In fact, changing methodological principles may be seen as one aspect of an open system. Several issues remain under debate and comprise part of an evolving Post Keynesian methodology.

First, there is the question of the role of econometrics. Lawson (1997) takes a strong position against using econometrics on the grounds that the conditions for its application are virtually never met (namely, that the subject matter conforms to a closed system). But many Post Keynesians find that econometrics is a useful tool for understanding the real economic world. There are several ways to deal with this issue. One possibility is to give up critical realism; another is to give up econometrics. But intermediate possibilities are being explored (see Meirman, 1998) for justifying the use of econometrics under certain carefully specified conditions.

Another unresolved methodological issue concerns expectations. There is a broad spectrum of opinion here. At one extreme are followers of Shackle (1972), who emphasize the subjectivity of expectations. At the other extreme are those who analyze expectations in terms of reason. Finally, some Post Keynesians choose to give expectations and uncertainty a very minor role. For example, horizontalists focus on credit creation and downplay the relevance of liquidity preference theory, which is built on the view that money takes its role from the existence of uncertainty (see Cottrell, 1994, for a review of Post Keynesian monetary theory which explains the different approaches). Since Post Keynesians stress the importance of uncertainty, a Post Keynesian theory giving diminished attention to uncertainty may raise problems of inconsistency. This is currently a matter under active debate.

The importance of uncertainty reflects a more general difference of opinion between the Sraffian strand of Post Keynesian economics and the rest, since Sraffian long-run analysis explicitly abstracts from uncertainty in order to
identify structural tendencies. It is difficult, therefore, to reconcile the methodology specified above with the Sraffian approach. Indeed, it has even been suggested that attempts to identify the Sraffian approach with Post Keynesianism should be discontinued (see Roncaglia, 1995).

This issue raises a more general issue, which is the relation between Post Keynesian economics and other non-mainstream approaches. To the extent that all share an open-system approach to economics, there is much common ground. The literature demonstrates the fertility of this common ground, with ideas bouncing back and forth between Post Keynesians and other non-mainstream economists. Neo-Austrians, Institutionalists, Marxians and Post Keynesians, for example, can profit from reading each other's work. But what they make of it will depend on the school of thought to which they belong.

Socially and institutionally, such cooperation helps build knowledge and understanding. Nevertheless, it is useful to have an idea of the 'representative' Post Keynesian. Kuhn's idea of scientific revolutions did not fit economics well, because ideas change gradually and many economists fail to fit neatly into categories. Indeed, many non-mainstream economists prefer not to take on the label of a particular school and like operating in these middle grounds. But the idea of a paradigm or school of thought is still a useful organizing principle, reflecting a set of ideas that guide practice within an otherwise uncharted open-system approach. Just as conventions provide stable reference points for economic activity, institutionalized schools of thought provide stable reference points for economic analysis.

Conclusion and policy implications

One of the most important contributions that methodology can make is to spell out how economists appraise theories. Post Keynesians embrace a multi-strand and multi-method approach to questions and issues, depending on the particular context. They justify such an approach as a good way of building up (fallible) knowledge of the real world.

This approach is coherent because Post Keynesians share a common view of the world. This view determines the kind of questions asked, the methods used, and points to the underlying purpose of economics as a means of employing policy to improve economic performance. It is important that there be alternatives to the single, formal method of neo-classical economics and that these alternatives can be fully justified by philosophical and methodological foundations. Post Keynesian economics provides such an alternative.

The approach is also practical because Post Keynesian thought is well suited for applying economics to policy issues. Policy-making requires an understanding of underlying structure so that we can understand the effects of policies applied to a changing structure, and also the effects of policies designed to change structure itself. The advantages of neoclassical formalism (namely the precision and certainty of the conclusions) depend, among other things, on the ceteris paribus clause being satisfied. What Post Keynesianism gives up in terms of
precision and certainty, it more than makes up for in its understanding of the causal mechanisms underlying the real economy and its ability to draw on a range of methods.

Post Keynesian methodology is based on its particular world view and leads to its distinctive policy approach. This approach has five main elements.

1. The economic process is seen as being ordered to a considerable degree because of institutions and conventional behavior, rather than because of market coordination. However, there is always the potential for disorder due to creative, profit-seeking behavior and the revision of expectations under conditions of uncertainty. Economic structures are not inherently stable, either because institutions and conventions may change, or because expectations may change discretely or the degree of uncertainty itself may change.

2. There are inevitable limits to knowledge. This means that, in general, knowledge of economic relations is held with uncertainty. Uncertainty is the norm since social systems transform themselves unpredictably.

3. Money is the social institution devised to address uncertainty. It serves as the denominator of labor and debt contracts, and allows capitalist economies to function.

4. There is a focus on production rather than exchange as the driving force in the economy. Demand and supply are understood to be interdependent, and imperfect competition is seen as the normal structure in product and factor markets.

5. Income distribution and, more generally, the distribution of economic power are perceived as significant social issues for economics to address.²

Notes

1. She persisted in attempting to communicate ideas with orthodox economists in spite of differing methodologies. The lack of understanding among mainstream economists of the feasibility of different methodological starting points led to the confusions of the Capital Controversies; see Dow (1980).

2. This chapter has benefited from comments and suggestions from Geoff Harcourt and the editors.

References


