

# FORGING A SOCIAL SCIENCE: THE CONTRIBUTION OF VEBLLEN, COASE AND KEYNES TO THE ROLE OF INSTITUTIONS IN ECONOMICS

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## ABSTRACT

This article aims to analyze the contribution of three authors who gave rise to the emergence of original schools of thought in Economics and dealt with the role of institutions in the economy. The authors chosen to the debate suggested in this paper have in common the interest in the role of institutions in the economy. Two of these authors are directly associated to Institutional Economics: Thorstein Veblen (1857-1929) and Ronald Coase (1910-2013). Although from distinct institutionalist schools of thought, they had the intention to bring the institutional dimension of life to the economic analysis. Outside the specialized institutionalist debate, John Maynard Keynes (1883-1946) gave the first steps to inaugurate a new branch in Economics, giving birth to Macroeconomics and engendering the emergence of many schools of thought in this new field of research. In Keynes' work we may find issues concerning institutions, mainly when he considers conventions as a relevant concept to understand macroeconomic results. In this paper we intend not only to observe the contributions of Veblen, Coase and Keynes to Economics, but also to draw some similarities, and important distinctions, between these authors.

**Keywords:** institutions; economic science; Thorstein Veblen; John Maynard Keynes; Ronald Coase.

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## 1 Introduction

This article aims to analyze the contribution of three authors that gave rise to the emergence of original schools of thought in Economics and dealt with the role of institutions in the economy. Chronologically, the first contribution to be considered is Veblen's institutionalism. Thorstein Veblen (1857-1929) is considered the father of Institutional Economics, later known as Original American Institutionalism or, like the new institutionalists have called it, Old Institutional Economics. Ronald Coase (1910-2013) contributed to the field of transaction cost economics; he published articles considered the first steps to the so-called New Institutional Economics. Outside the institutionalist debate, John Maynard Keynes (1883-1946) gave the first steps to inaugurate a new branch in Economics, giving birth to Macroeconomics and engendering the emergence of many schools of thought in this new field of research.

Veblen's seminal article, "Why is Economics not an Evolutionary Science?", was published in 1898. In this article, Veblen pointed out that the existing economic theory was non-evolutionary, outdated, in a nutshell, an orthodox theory that needed to be modernized. No one escaped Veblen's critique, which hit Adam Smith, Karl Marx, Austrian economics, the German Historical School, and many others, including John Bates Clark, an American economist that represented the orthodoxy in the US, being named by Veblen as an apologist of the orthodox theory<sup>1</sup>. According to Backhouse (1985), at the turn of the nineteenth to twentieth century it was in course the consolidation of the ideas of equilibrium and maximization brought by the so-called "Marginalist Revolution", having a more pronounced character of a Kuhnian revolution in the English academy than in the north American academy. In fact, between the years of 1820 and 1920, Herbst (1965) states that about nine thousand North Americans went to German universities - a smaller number went to other European universities. In this sense, Backhouse (1985, p.126-127) highlights the more plural nature of the training of American economists at the end of 19th century, who drew from varied European sources.

Still in the field of institutionalist thought, we find Coase's contribution, but from another perspective: the New Institutional Economics he helped to forge had no conceptual

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<sup>1</sup> Veblen was Clark's student at Carleton. But he was a rebel student that made fundamental critiques to his professor's theories. In the article "Professor Clark's Economics", Veblen (1908) dedicated some time to offer a critical appraisal of Clark's ideas.

or ontological continuity with Veblen's Original American Institutionalism. In 1937, Coase published the article "The Nature of the Firm", in which he criticized the lack of realism in existing economic theory, which treated the firm as a mere production function. To bring more realism to the understanding of the role of the firm in the economic world, he suggested the consideration of a contractual dimension and the idea of transaction costs (later refined by Oliver Williamson). But realism must come together with tractability, and to match this second requirement Coase appealed to substitution at the margin mechanism. Therefore, Coase does not suggest, like Veblen, a radical break with the existing economics theory; instead, he aims to contribute to a tradition in Economics embedded in the theory of choice.

Only one year before Coase's seminal work, Keynes published a book that became a landmark in Economics, "The General Theory of Employment, Interest and Money". Keynes's book engendered not only the emergence of Macroeconomics, but also a plurality of macroeconomic schools of thought. Looking at the ontological commitments of the aforementioned institutionalist authors, we may find some Keynesian schools closer to the new institutionalism (like old and new Keynesians), but also the Post-Keynesians, more identifiable with the Original American Institutionalism. In which measure the Keynes of the "General Theory" is closer to Coase or Veblen is a matter of investigation and we intend to provide some insights into this topic in this article.

In common, Veblen, Coase and Keynes had the intention to build new approaches in the economic theory of their time. In different ways, the three economists also attributed a relevant role for institutions (though in different senses) in the study of real-world economies. Veblen gave birth to the first originally American school of thought. His critique of what he called the economic orthodoxy resulted in an original comprehension of the economic world based on instincts and habits of thought, or institutions. Coase, with one foot in the London School of Economics and the other in the American academy, created an institutionalist perspective on firms based on transaction costs and marginalist principles. Keynes, from Cambridge-England, aimed to overcome the limits of what he called the Say's Law to build a theory capable of explaining the economics' most pressing problems of his time. Each in their own way – and seeking to answer different questions – they set out to reformulate the economic theory of their time. Therefore, we have two objectives in this article: first, to present the theories, concepts and authors which were the target of Veblen, Keynes and Coase's critiques. Secondly, based on the critical reading of the economic theory

of their time, we compare the contributions of Veblen, Coase, and Keynes regarding the role of institutions in Economics.

## 2 Veblen's Radical Critique of the Economic Theory

Veblen was an American theorist versed in several fields of social science, developing original ideas and concepts later known as Institutional Economics<sup>2</sup>. He influenced some American economists of his time, like Wesley Mitchell, John Commons, Clarence Ayres, amongst others. Throughout his academic life, Veblen published a bunch of papers and books, but the article “Why is Economics not an Evolutionary Science?”, published in 1898, is considered the seminal work of the original tradition of Institutional Economics. In this paper, he criticizes what he denominated as orthodox economy based on three ideas: animism, hedonism, and taxonomy. All theories committed with one or more of those ideas were considered non-evolutionary.

Animism is a tendency of some theories to presuppose a final cause or goal in social processes - it is a teleological conception of history. Veblen identified this animistic conception in the Smithian idea of invisible hand, which suggested that self-interested individuals interacting in markets would lead to economic well-being. Likewise, Marx's suggestion that the capitalist society would meet an end, like feudalism did, implied a teleological conception of social processes. For Veblen, the result of human actions and thoughts are unpredictable and cannot be known by the theorist *a priori*. This resembles Keynes' idea of an unpredictable open future, or radical uncertainty.

Taxonomy is the tendency to create and organize lists of abstract concepts, categories, and social events. Examples of this type of theoretical construction are the concepts of “*homo economicus*” and “perfect competition”. This is a way of doing science that puts the theoretical construction prior to the observation of the object of study. First the world is theoretically cataloged in concepts, then the economist tries to fit these theories into reality. This way of knowledge construction could be identified with deductivism, a defect that Veblen saw in the Classics and Marginalists. But if deductivism is not a good way of doing science, neither is its opposite, inductivism, proposed by the German Historical

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<sup>2</sup> This denomination was suggested by Walton Hamilton, in the paper “The Institutional Approach to Economic Theory”, published in 1919, two decades after Veblen's seminal article. Nowadays, with the advent of New Institutional Economics, the so-called Institutional Economics now encompasses Veblenian tradition, named as Original American Institutionalism, and the new institutionalism of Ronald Coase, Oliver Williamson and Douglass North.

School. Veblen escaped the *Methodenstreit* by suggesting *abduction*, an alternative method consisting in picking concepts, ideas, and insights from other sciences in order to build a richer economic theory.

The third mistake of orthodox economics, hedonism, can be understood as a way of understanding economic agents as calculating creatures, or, in Veblen's terms, as "lightning calculators of pleasures and pains". Thus, we should not postulate *a priori* that individuals are driven by rational calculation without looking at how and why people think and act the way they do. In this sense, the author suggests that we look at how human beings evolved subjectively and materially throughout history. In doing so, Veblen has built an original comprehension of human action and social evolution based on a transdisciplinary approach. That is what we will present in the following paragraphs, based on "The Theory of the Leisure Class", a book published by Veblen in 1899.

For Veblen, a modern, or evolutionary, theory should consider the latest discoveries in evolutionary biology and instinct psychology, amongst other branches of science. Based on instinct psychology, Veblen suggests that human instincts are the engine of human action, instead of rationality. We act, leaving inertness, because we need to understand the world around us (idle curiosity), we need to build useful things, like tools, to satisfy our needs (workmanship instinct) and we need to protect the group we belong to (parental bent). However, there is a more basic instinct, which is the one that inclines us to preserve our life (survival instinct). Therefore, we leave the state of inertia moved by instincts, linked to our biological nature, that put us into action. Instincts not only move us in the world, but also state the purpose of action.

When acting in the world, individuals end up creating patterns of behavior. This is what Veblen called habits of thought, defined as ways of being, feeling, thinking and doing things in the world. If instincts provide the purpose of action, habits of thought are responsible for building the means to achieve these purposes in society. The way that a European assured his survival in 16th century society is distinct from the way an American guaranteed his survival in the USA at the end of the 19th century. The instinct to stay alive is the same; what changes is the way this purpose is achieved in society, or what habits of thought are acceptable and/or effective to achieve the purposes set by instincts. In other words, the way in which instincts are satisfied is determined by the habits of thought prevalent at a given historical moment in each society.

Instincts drive individual action out of inertia and provide a purpose for their action. Institutions are habits of thought that evolve over time. Once established, certain habits of thought begin to guide human action, and may become an end in themselves, contradicting instincts. For example, a certain socially accepted behavior may start to engender actions that threaten the life of an individual, as in the case of aesthetic standards that go against the survival instinct: people may fail to eat properly so as to become very thin. Aesthetic standards influence what is socially considered beautiful and desirable, shaping ways of thinking and acting, engendering patterns of behavior shared by social groups - the habits of thought, or institutions.

Mental habits convey a conception of what is considered beautiful, of what is appropriate, what is right. Subjects tend to meet the requirements of certain habits of thought, using emulation to be accepted and/or identified with specific social classes. Emulation is related to the need for recognition and social belonging that people have in societies divided in social classes. If an individual wants to be recognized as a sophisticated individual, he or she will seek to demonstrate that he knows sophisticated beverages, international dishes, music considered of good taste by the social group to which he or she belongs, amongst other behaviors and products that show that this individual has a sophisticated taste. Thus, Veblen is stating that social groups have specific habits of thought that must be observed by people who want to be associated with these groups.

It is important to note that habits of thought are engendered by the initial engine of action, provided by instincts, in which this human action is always guided by socially shared and concrete practices. This means that mental habits emerge from subjects' own concrete lives and reflect, to a certain extent, their environment, and their way of life. In this sense, Veblen recognized the existence of two habits of thought in the economy he lived (end of the 19th century, beginning of the 20th century): mechanical processes and business enterprise. Mechanical processes are the habits of thought specific to workers, whose daily tasks in the factory involve routine, cause-and-effect activities. The capitalists, the owners of factories, think in finalistic terms, their habit of thought is targeted to profit seeking. These two habits of thought tend to cause class conflict, based in distinct ways of thinking and doing things in society.

An important aspect of Veblenian theory should be noted. For Veblen, class conflict is based on the idea that distinct habits of thought lead to disagreement between groups that think differently, while in Marx, class conflict emerges from capitalist production relations

and can only be solved by transforming those relations. In Veblen, class conflict could be solved within the framework of institutions capable of regulating this class struggle. In a way, this is what another American institutionalist, John Commons, intended with the idea of a “reasonable capitalism”. The idea that capitalism could and/or should be regulated through institutions and/or economic policy is shared by Keynes and some Keynesian schools of thought. In new institutionalism, mainly in North’s proposal, instead of institutions regulating capitalism we have the idea of institutions providing an environment shaping incentives to individual choices.

In the article “The Instinct of Workmanship and the Irsomeness of Labor”, also published in 1898, Veblen analyzes the orthodox conception of labor as a disutility and the idea of a trade-off between labor and leisure. Another article published in 1898 by Veblen, "The Beginnings of Ownership", brings an analysis of how the idea of individual property developed in the human mind, or in the prevailing habits of thought. Despite his broad contribution to the understanding of the genesis of important economic categories, like labor and property, Veblen is recognized in economic textbooks by providing an explanation to some kind of goods that violates the law of demand. When consumption is based on emulatory purposes, prices and demanded quantities may have a positive relation, going against the law of demand. Curiously, the young Douglass North of the fifties, who was not yet an institutionalist, was more attentive to Veblen’s ideas and made no mention of Coase's proposal. In his first published article, North (1950, p.71) recognized the contribution to the dichotomy between business and industrial pursuits that Veblen identified in the two habits of thought, respectively, business enterprise and mechanical processes. In virtue of his radical critique and non-adherence to the theory of choice paradigm, Veblen's contributions ended up being marginal in today’s mainstream Economics.

### **3 Coase’s Institutional Contribution to the Theory of the Firm**

Ronald Coase, alongside Douglass North, is considered the father of New Institutional Economics. This institutionalist branch is an attempt to bring more realism within the scope of the theory of choice. The article “The Nature of the Firm”, published in 1937, is considered the seminal work in new institutionalism. In this paper, Coase highlights the contractual dimension within which the firm exists, adding the transaction costs to the traditional production costs that a firm faces to operate in the economy. In this sense, Coase,

followed by Oliver Williamson, contributed to the field of transaction cost economics, and North dealt with issues concerned with the role of institutions in economic growth. However, none of the new institutionalists aimed a radical rupture with existing economic theory of their time, like Veblen did.

The body of thought that is now known as the New Institutional Economics began simply as an attempt to extend the range of applicability of neoclassical theory. During the postwar period, there was increasing dissatisfaction with, and criticism of, the traditional models of production and exchange. Nevertheless, neoinstitutionalism did not come into being as a result of any planned or coordinated effort to develop a new doctrine. In particular, marginalism was not rejected. What was desired primarily was change in certain key assumptions. Thus, modern institutionalism, while similar in many respects to standard neoclassical analysis, is distinct and is characterized by a significantly different perspective on microeconomic phenomena. (Furubotn & Richter, 2005, p.2-3)

The traditional theory of the firm defines the firm as a mathematical production function that transforms inputs and raw material into products (goods and services). The institutional framework surrounding the firm is not considered. Coase (1937) claimed that a more realistic theory of the firm was necessary, but this theory needed to be also tractable. To be realistic with tractability, Coase's theory of the firm considered the existing transaction costs within the choice at the margin framework. A firm, according to Coase (1937) is a resource allocation mechanism just like the market. In Coase (1960), the author also mentions the State as an alternative resource allocation mechanism alongside the firm and the market.

The question suggested by Coase (1937) was: why do firms exist? Why do individuals not allocate all transactions directly in the market? The author affirms that in virtue of positive transaction costs, some transactions are more efficiently engendered within firms. This is so because the use of the price system has itself a price, named by Coase as transaction costs. The origin of transaction costs are market imperfections, like problems of incomplete and/or asymmetric information, limited rationality, opportunism and free rider problem, and the incomplete nature of contracts. All those imperfections lead to uncertainty in transactions established between economic agents. But how did Coase reach these conclusions?

Coase (1991) considered the concept of transaction costs his major contribution to Economics. This concept answers a question related to the coordination and allocation of economic resources. According to the author, the answer to this coordination problem was found in 1932.

I found the answer by the summer of 1932. It was to realise that there were costs of using the pricing mechanism. What the prices are has to be discovered. There are negotiations to be undertaken, contracts have to be drawn up, inspections

have to be made, arrangements have to be made to settle disputes, and so on. These costs have come to be known as transaction costs. (Coase, 1991)

These ideas concerning costs beyond production costs were synthesized and published in the above-mentioned article of 1937. Before developing his ideas, Coase dug into the specialized literature, inquiring how other economists tried to explain the origin of firms. Coase (1937) mentions Usher and Maurice Dobb's understanding of the origin of the firm as resulting from the growing complexity of the division of labor. With the division of labor, an integrating force is necessary to bond the economy to prevent chaos, where firms would have this role of integrating force. However, Coase argues that an integrating force already exists in the form of the price mechanism. Thus, the author redefines the question, claiming that the significant question must be whether an integrating force should be replaced by another, why markets should be replaced by the entrepreneur as an allocative mechanism? As we know, Coase answered this question through the idea of transaction costs and substitution at the margin.

Another contribution analyzed by Coase (1937) was Frank Knight's explanation of the origin of the firm based on risk and uncertainty. Coase considers Knight's proposal as the most interesting, but still insufficient to explain the origin of the firm. As noted, uncertainty is a market failure that explains the origin of transaction costs but does not provide a complete explanation concerning the question whether markets should be replaced by any other coordinating mechanism. Therefore, Coase wonders why economists did not identify the existence of transaction costs, or the fact that the use of price mechanism has a price. According to the author, the problem is that economists developed very abstract models without any contact with the facts observed in real economies. This behavior of economists, Coase (1991) called "blackboard economics". In this sense, Coase identifies, like Veblen and Keynes, aspects in the economic theory that needed to be fixed.

Unlike Veblen, Coase did not claim a radical rupture with the existing economic theory, placing his contribution within the theory of choice paradigm. Observing the functioning of firms in economic reality, Coase (1937, p.5) identifies a system of relations that emerges when resource allocation depends on the entrepreneur as a coordination agent in production. He does not deny the effectiveness of the price mechanism but recognizes that the entrepreneur is an alternative allocation mechanism in some situations. What determines the best allocative mechanism? To this, Coase answers with the suggestion of a choice at the margin mechanism, considering the transaction costs implied in the allocation of resources into markets or within firms.

The next issue handled by Coase concerns the size of the firm, determined by its allocative efficiency, or its capacity of carrying out a transaction with lower transaction costs compared to the market. In this sense, a "firm becomes larger as additional transactions (...) are organised by the entrepreneur and becomes smaller as he abandons the organization of such transactions." (Coase, 1937, p.393) In a nutshell, the size of a firm is determined through a calculus based on the idea of substitution at the margin, where the firm will grow in size until the allocation of an additional contract, or transaction, equals the costs faced with the use of price mechanism.

To sum up, Coase intended to bring more realism to the theory of the firm through the concept of transaction costs. He does not deliver a radical critique of Economics, aiming to contribute to the theory of the firm within the theory of choice paradigm. Coase not only contributed with a more realistic conception of the firm, but also engendered the birth of a new branch in Economics, the New Institutional Economics. In the realm of transaction cost theory, Coase understood institutions as coordinating mechanisms, like firms, markets and the State. They are all organizations able to allocate resources, being chosen according to its efficiency in delivering lower transaction costs.

#### **4 Keynes, the Birth of Macroeconomics and the Role of “Conventions”**

In Boff & Cavalcante (2021), we have compared Keynes and Veblen regarding the ontological and epistemological status of their different theories. We argued, first, that their ontological commitments may be said to be largely compatible: on the one hand, Keynes’s use of the “principle of organic unity” (regarding the embeddedness of the economy in a larger social and natural world) would not be strange to Veblen. On the other hand, the presence, beyond rational calculation, of instincts, intuition and “animal spirits” (regarding human socioeconomic action) could plausibly be incorporated into a Veblenian theory of the economy.

Secondly, we argued that, despite their ontological proximity, Keynes’s epistemological arguments are more interdisciplinary than transdisciplinary (compared to Veblen’s theory). In other words, whereas Veblen intends to forge a new social science purged of “animistic”, “teleological” and “taxonomic” characteristics, Keynes, despite deploying new concepts (like the “marginal efficiency of capital”, “liquidity preference” and “conventions”), makes a compromise between Pigou’s “classical” theory of (un)employment

and his own new theory. This compromise appears in the form of the generality of his proposal as compared to the limitations of the classical theory. As Keynes himself put it<sup>3</sup>,

Thus I agree with Gesell that the result of filling in the gaps in the classical theory *is not to dispose of the 'Manchester System', but to indicate the nature of the environment which the free play of economic forces requires if it is to realise the full potentialities of production.* The central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government. (...) But *there will still remain a wide field for the exercise of private initiative and responsibility. Within this field the traditional advantages of individualism will still hold good.* (1936, ch. 24, our emphasis).

In the quote above, we can see that Keynes upholds both individualism and the market mechanism, admitting that the “Manchester System” is a special case of his own theory. If Keynes takes individualism and the market mechanism as a benchmark in the General Theory (henceforth, GT), it is important to see how he criticizes the view of individualism, and the market mechanism espoused by the “classical school”.

It is possible to argue that the effects of strong uncertainty in markets and individuals is the feature of modern monetary economies which separates Keynes’s approach (in his own view) from that of the classics. We will provide two examples of criticisms levelled by Keynes against the analysis of the classical school: the functioning of the labor market and the capital market.

Concerning the labor market, Keynes points out that, the first postulate of the classical school (“I. The wage is equal to the marginal product of labour”) can be accepted as an adequate representation of what happens in the real world. In other words, it is possible for entrepreneurs demanding labor in the market to hire workers according to their marginal product, so that, in the short run, real wages decrease as the number of employed workers increase. However, the same cannot be said of the second postulate (“II. The utility of the wage when a given volume of labour is employed is equal to the marginal disutility of that amount of employment”). Keynes stresses the fact that one cannot find a determinate supply curve of aggregate labor given the concrete circumstances in which real economies operate. What are these concrete circumstances? First, there is the fact that workers do not, on average, simply walk away from their jobs as their real wage decreases due to an increase in inflation. Second, the bargaining power of workers is related to money-wages, not real wages. That is, “there may be no method available to labour as a whole whereby it can bring the

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<sup>3</sup> And right at the beginning of chapter 1, Keynes explains: “I shall argue that *the postulates of the classical theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium.* Moreover, the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience” (our emphasis).

wage-goods equivalent of the general level of money wages into conformity with the marginal disutility of the current volume of employment” (ch. 2, section II).

As for the capital market, in part IV of the GT Keynes mounts a powerful critique of the supposed self-adjusting mechanism which would make the total of loanable funds and aggregate investment equal by means of the interest rate. Chapter 11 (dealing with the marginal efficiency of capital) and chapter 13 (titled “the general theory of the rate of interest”) are linked by “the state of long-run expectation”. The importance of long-run expectations is in the fact that, due to the strong uncertainty which pervades modern monetary economies, they are subject to sudden and harsh changes. As a consequence, their fluctuations can tilt the quantity of loanable funds toward money as an asset (whose production creates very few jobs and is always in demand, regardless of changes in its exchange-value) or the risky illiquid assets (whose production creates many jobs but whose demand can change sharply with increases in their exchange-value). In other words, because the environment is susceptible to strong uncertainty, there is no guarantee that loanable funds will be invested in a way which provides jobs for everyone demanding them (even if the real wage decreases). In such an unpredictable situation, rational calculation is not sufficient to explain how investment decisions are made. According to Keynes:

The actual results of an investment over a long term of years very seldom agree with the initial expectation. *Nor can we rationalise our behaviour by arguing that to a man in a state of ignorance errors in either direction are equally probable*, so that there remains a mean actuarial expectation based on equi-probabilities. For it can easily be shown that the assumption of arithmetically equal probabilities based on a state of ignorance leads to absurdities. (1936, Chapter 12, section IV, our emphasis).<sup>4</sup>

As a result, an economic science which cannot understand human behavior beyond rational calculation is doomed to fail. Psychological and/or conventional factors must be added to the picture, so we can properly understand what is going on in the real world. The economy is part of a larger whole (an “organic unity”)<sup>5</sup>, and the boundaries of economics regarding other social sciences must be porous, so as to take into account psychological and institutional concerns.

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<sup>4</sup> And not only in the long run: “*Most, probably, of our decisions to do something positive*, the full consequences of which will be drawn out over many days to come, *can only be taken as a result of animal spirits*—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.” (1936, Ch. 12, section VII, our emphasis).

<sup>5</sup> “(...) 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*”. (chapter 12, section IV, our emphasis). The expression “all sorts of considerations” may be interpreted as a sign of the embeddedness of the economy in a larger whole.

A conventional valuation which is established as the outcome of the mass psychology of a large number of ignorant individuals is liable to change violently as the result of a sudden fluctuation of opinion due to factors which do not really make much difference to the prospective yield; since there will be no strong roots of conviction to hold it steady. In abnormal times in particular, when the hypothesis of an indefinite continuance of the existing state of affairs is less plausible than usual (...) the market will be subject to waves of optimistic and pessimistic sentiment, which are unreasoning and yet in a sense legitimate *where no solid basis exists for a reasonable calculation*. (1936, Chapter 12, section V, our emphasis).

If modern market economies are, in fact, so changeable, how can they appear so stable? Here the role of conventions comes to the fore. In “assuming that the existing state of affairs will continue indefinitely, except in so far as we have specific reasons to expect a change”, (1936, ch. 12, section IV), Keynes’s appeals to “conventions” (as a form of institution) would also probably not be strange to Veblen. “Conventions” and “opinions” of the public are also linked (Dequech 2021), so that we may find a similarity between conventions and Veblen’s “habits of thought”. As a result, we can argue that the stability of conventions can explain the relation between the functioning of markets (principally of financial markets) and the need for more active or passive monetary and fiscal policies. In times of great instability, animal spirits, intuition and instincts will trump rational action and not all savings will be put to use productively, increasing levels of involuntary unemployment. That will not happen when conventions are stable in a monetary market economy: in this circumstance, markets tend to operate roughly as the classical model describes, the need of active fiscal and monetary policies being less prominent.

Although in a different guise from Coase, Keynes’s proposal is also to make economics a more realistic science. However, he does that by adding the hypothesis of strong uncertainty as a central feature of modern monetary economies. This hypothesis makes Keynes go beyond the study of rational action, incorporating instincts, intuition and animal spirits to human economic behavior. This more encompassing notion of economic behavior corresponds to a difference between investment in liquid (safer) and illiquid assets (riskier). Maintenance of wealth in safer, liquid assets, does not guarantee the full employment of resources in the economy, demanding a mix of active monetary and fiscal policies. The design and proportion of the mix will depend on the stability of conventions, which will in turn influence the degree of liquidity preference of agents and the marginal efficiency of capital.

Keynes contributions can be seen from two different perspectives - one practical and the other theoretical. From the practical side, Keynes sees much wisdom in the old mercantilists’ recommendations regarding “practical statecraft” in the active determination

of the rate of interest as a way to boost economic activity. As a faculty, Keynes admonishes, economists “prove to have been guilty of presumptuous error in treating as a puerile obsession [the self-adjusting mechanism of the interest rate] what for centuries has been a prime object of practical statecraft” (1936, ch. 23). He also cites Mandeville approvingly when the Dutchman states that

The great art to make a nation happy, and what we call flourishing, consists in giving everybody an opportunity of being employed; which to compass, let a Government's first care be to promote as great a variety of Manufactures, Arts and Handicrafts as human wit can invent; and the second to encourage Agriculture and Fishery in all their branches, that the whole Earth may be forced to exert itself as well as Man. It is from this Policy and not from the trifling regulations of Lavishness and Frugality that the greatness and felicity of Nations must be expected (...), (1936, ch. 23).

Summing up, Keynes's contributions from a practical perspective can be seen as the promotion of active monetary and fiscal policies whenever the economy falls short of fully employing everyone in need of a job.

These practical recommendations, however, stem from his theoretical analysis of the functioning of real existing market economies. As we have already stressed, Keynes's contributions to economic theory are in stretching its limits beyond the assumption of rational action and the importance of distinguishing between liquid assets (in special money) and illiquid assets. As we have already pointed out, concepts like “liquidity preference”, “marginal efficiency of capital” (in comparison with the interest rate) and “conventions” are used to enlarge the possibilities of investigating the operation of real markets. These theoretical concepts, in turn, come from more fundamental ontological commitments: the idea that the economy is but a part of a complex, “organic unity” and that modern capitalist economies (with their financial markets) are intrinsically unstable due to strong uncertainty.

## 5 Conclusion

We have briefly described in previous sections three different ways in which Veblen, Coase and Keynes tried to forge a new economic theory - an economic theory which would be more realistic and embedded in a web of social relations and psychological factors. Therefore, we can say that the three authors tried to forge a new social science as opposed to the nascent mainstream of neoclassical economics at the beginning of the 20th century.

Of the three authors, Veblen had the most radical criticism of the economic theory of his time. The timing of his critique is important to understand the independence he experienced in the construction of his proposal. At the end of the 19th century, we did not

have an established economic science, but a bunch of competing theories. Veblen saw problems in all those theories, identifying one or more of the three defects - animism, taxonomy and hedonism - in each of them. In this sense, he placed his contribution as another competing theory at the end of the 19th century. At the institutionalist level, Veblen contributed with an evolutionary view of how instincts and habits of thought molded societies through time. At the individual level, he provided a conception of human action that went beyond the lighting calculator hedonic man. Instincts were the drive for action and habits of thought the ways humans developed through time to satisfy those instincts. In this sense, rationality may be seen as a habit of thought specific to monetary economies, as Mitchell (1910), following Veblen, pointed out. Although Veblen provided a vast contribution to Economics, nowadays he is mentioned only in which concerns "Veblen's goods" in economic textbooks. As is expected from scientific textbooks, the selected ideas were those that fit what is currently considered as economic science.

The contribution of Keynes and Coase in the 1930s had a different tone compared to Veblen's. Coase, like other new institutionalists, saw problems in the economic theory of his time, but he did not intend to propose a new paradigm to Economics. As shown in section 2, Coase intended to bring more realism to the theory of the firm with the marginalist toolbox. As Furubotn & Richter (2005) pointed out, new institutionalism is a contribution to the neoclassical approach, criticizing the unreality of some assumptions, but attempting to build more realistic concepts at the borders of what is accepted as economic science. In that regard, Coase had a place in microeconomics, in a more critical approach, or in a cutting-edge theory of the firm. His contributions were better received in Economics than Veblen's precisely because Coase did not intend to replace economic theory entirely. Keynes contributions had a more ambiguous effect in Economics: the most conventional part of his ideas was absorbed by the mainstream of the profession (as the new Keynesian school did); however, the more radical part of his ideas were absorbed in the heterodoxy (as the post-keynesians did).

Keynes was also critical of the classical theory (associated with Pigou in the "General Theory") but did not entirely abandon the assumptions of the orthodox economics of his time – rather, he incorporated new concepts to deal with phenomena like the instability of markets (in special financial markets) and what he termed involuntary unemployment. However, his ontological commitments were closer to Veblen's, as he saw human behavior being determined by multiple psychological factors and real existing economies embedded

in specific socio-historical settings. A change in these settings could lead to different levels of instability in markets which, accordingly, would alter and influence market structure and organization. Describing this process step-by-step, we can say that socio-historical conditions influence the balance between rational action and other psychological motivations (like instincts and animal spirits) in economic agents. Depending on this balance, conventions (or institutions) will be more or less stable. The confidence of the public in these conventions will, in turn, determine the extent to which investments will be directed to the production of illiquid assets or to hoarding. Different roles for the state will be therefore needed depending on the level of uncertainty and instability present in real markets.

A possible link could be made between Coase and Keynes regarding the structure of markets. As we pointed out in section 2, Coase recognizes the importance of uncertainty in explaining the origin of transaction costs, for these costs will determine the size of the firms in the market, making it more or less competitive. In criticizing the theoretical arguments of the classical school, Keynes usually assumes that markets are competitive. However, it is clear in the whole GT that he is aware of the study of market imperfections, and he mentions that, in the case of the labor market, there is “imperfect mobility of labour”. So, it is possible to investigate in the future how the relation between strong uncertainty and conventions (backed by public opinion) impacts the transaction costs (and hence the size of firms and the structure of the market). In Keynes’s view, conventions are important in the sense that they give a minimum of stability to the calculation of future prices (which depend on long term expectations regarding the future gains agents hope to have by investing in different assets). This means that the price of assets with different degrees of liquidity, according to Keynes, will reflect a rational calculation only inasmuch as conventions are minimally stable – or else they will be a result of animal spirits, intuitions or instincts. Instead of being simply determined by market competition, prices are formed depending on the stability of conventions present in a market.

So, when Coase says that the use of the price mechanism has a cost, he does not notice the fact that the latter, following the keynesian argument above, depends on conventions and public opinion. These conventions do not imply that prices are reducible to bits of information similar to dispersed particles, as Hayek would defend in his 1937 and 1945 articles (Mirowski and Nik-Khah, 2017). The fact that markets have different structures means that the dispersion of information in society obeys a pattern related to the structure of actual, not abstract, markets – markets which can be more or less concentrated. According

to a possible Keynesian argument, the price (or cost) of using the market mechanism is not given: it depends on the structure, conventions and public opinion prevailing in actual markets.

To sum up, we may find common grounds on which our three authors could begin a dialogue, since they were investigating economic problems related to institutions, although in very different perspectives. Being strictly committed to individualism or not, all of them had a specific conception of human action: the drive of human action was instincts in Veblen, rationality in Coase and had multiple motivations in Keynes. Veblen tried to build a whole new economic theory, whereas Coase and Keynes had a more specific objective in their critiques. Veblen's contribution in forging a new economic theory became marginal in nowadays Economics, while Coase and Keynes found a more visible and accepting place in the profession. The time and the geographical place of their contribution may explain part of the reception of their attempts to create a new economic science, but the content and character of their critique also has a role to play. This article intended to highlight some aspects of the contribution of three important authors that helped shape the contours of modern Economics, although some have left a more visible mark in this science (at least in its mainstream version).

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