The Institutional Dimension to New Economic Policy[1]

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Abstract

In the mainstream economics, the postulate of rational expectations downgrades the relevance of macroeconomic policy and institutions. In a world of full information and rational expectations, aggregate demand is irrelevant in anything other than a strictly short-run context, and the only institutions that matter (apart from competitive markets) are those that bind the state to consistent (and therefore predictable) policy interventions. However once the existence of fundamental uncertainty is recognized, both the importance of aggregate demand and the role of institutions in the economy are radically revised. Institutions must be required and designed to reach a full employment level of economic activity. A well-designed institutional framework is a necessary condition to warrant the existence of that outcome and to help to implement macroeconomic policies that allow to reaching and maintaining this objective.

Keywords: economic policy, institutions, equilibrium, aggregate demand, uncertainty

1. Introduction

From the perspective of the mainstream economics, the postulate of rational expectations led to downgrade the relevance of institutions in the economic analysis, both to understand the individuals' decision-making processes and the design and implementation of economic policies and public interventions. In this approaches, markets are the only institution needed to reach a market-clearing equilibrium outcome. Only when the assumption of rational

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expectations is relaxed, and problems of asymmetric information are introduced, at least from a short-run perspective, it is justified the introduction in the analysis of institutions-policies to solve this problem and to reach the market-clearing equilibrium outcome. Therefore, in a world of full information and rational expectations, aggregate demand is irrelevant in anything other than a strictly short-run context, that is when problems of asymmetric information and price rigidity exist, and the only institutions that matter (apart from competitive markets) are those that bind the state to consistent (and therefore predictable) policy interventions.

However once the existence of fundamental uncertainty is recognized, both the importance of aggregate demand and the role of institutions in the economy must be radically revised. Institutions must be required and designed to reach a full employment level of economic activity. A well-designed institutional framework is a necessary condition to warrant the existence of that outcome and to help to implement macroeconomic policies that allow to reaching and maintaining this objective.

The paper organises as follows. The first section focuses on the analysis of information problems, and the role played by institutions as mechanisms that help to solve these problems. The section remarks the differences existing between mainstream and Post Keynesian economics about the relevant information problems suffered by agents, and consequently, about, the kind of institutions required to solve them. The second section analyses the role played in economics by the concept of equilibrium. Thus, we show that when the axioms of perfect information and perfect markets are abandoned, any economic outcome can be defined as an equilibrium outcome. In this situation, a full employment level of economic activity can be considered as the desired economic outcome in a society, and, consequently. The fourth section, deals with the role played by demand-side economic policies and by the design of institutions as instruments that help to reach that outcome by creating in individuals the expectations of a full employment outcome. Final section summarises and concludes.

2. Institutions and information problems

The analysis of the information problems that agents must solve in their decision-making processes is one of the most complex issues that the economic science faces. The particular way that each economic theory uses to incorporate the information problem in their models could be used as a guide to know and underline their differences.

The origin of the different treatment given to these problems must be found in the two existing different concepts of what is the economic science. For the neoclassical school, economics is the science that studies the distribution of scarce resources among alternatives uses. Consequently, the central problem is the study of the efficient allocation of resources through the mechanism of the market. In this view, there is not historical time, only logical time[3]. However for an alternative concept, the economics studies how individuals satisfy their needs through an economic process that changes along time. Here, it is historical time, and not logical time, what plays a key role in the economic analysis. Nonetheless, and despite the existence of these differences, all the theories agree on linking the analysis of the institutional framework with the existence of information problems. Institutions are shown as a source of information for individuals, and, consequently, as an instrument that help them to make decisions.

An institution can be defined as a set of formal and informal rules, including their enforcement arrangements. The general aim of institutions is to provide individuals with a set of rules that guide or determine their individual behaviour. Thus, institutions help to reduce uncertainty (North, 1990). The concept of uncertainty usually encompasses the set of information problems that individuals face in their decision-making. Thus, we face uncertainty when we do not know what will happen in the future. We also face a problem of uncertainty when we do not know whether the agent with whom we relate has more information than us, and consequently we do not know if our decision has been right or not. Nonetheless, given the relevance that in all the economic paradigms has the way in which the concept of uncertainty is interpreted, it is convenient to make a clear-cut definition of the information problems.

Some of the decisions made by individuals in the present are influenced by events that will take place in the future. This makes that individuals must foresee future events, something that is not always feasible. The economic process is not a continuous process but an evolutionary one. The articulation of the variables that characterize this process in a specific moment of time may be different than that existing in another point in time. As a result, it is not always possible to anticipate the future using the probabilities calculation. From this

[3] Logical time is a situation where the relevant variables in the economic analysis are stable, and, therefore, the relationships among them can be studied in terms of causal relations. Historical time is a (long-term) situation where the relationships among variables lose stability, and, consequently, in econometric terms, the correlation coefficients are weaker.

perspective, the concepts of ‘risk’ and ‘uncertainty’ are different. Risk situations would be those situations that can be anticipated using probabilities estimated from past frequencies. On the contrary genuine ‘uncertainty’ (Davidson, 1991, 2010) means that an event cannot be anticipated by the probabilities calculation due to the evolutionary (non-ergodic) nature of the economic process.

The interaction of individuals through the market generates other kinds of information problems. Agents face information costs when they try to buy or sell their property rights. These costs can arise as a result of different elements. The search of the necessary information when a transaction it to be made involves costs in terms of time. The costs can also be the result of the bounded capacity that agent have to analyse all the available information, what can lead these agents to pay for the analysis of the information to a specialized agent. There are also costs coming from the asymmetric distribution of the information among agents. In all cases, it is worth noting that when we work with these kinds of information problems, we are implicitly assuming than the information exists and that the relevant problem is how to get access to information and not the (non)existence of information. Although, in some situations this assumption can be valid, there are situations where the problem of genuine uncertainty is faced, because information simply does not exist.

Since the main role of institutions is to solve information problems, the analysis of the former must be related to the analysis of the economic process. The question that immediately arises is if institutions must be considered an endogenous or an exogenous variable in the economic models. In the neoclassical theory of equilibrium, institutions simply do not exist, with the only exceptions of those institutions compatible with the economic equilibrium. Institutions are something strange to the economic model: an exogenous variable whose working is determined by the hypothesis and axioms leading to an equilibrium outcome.

The new institutionalism, although it shares some key elements with the neoclassical theory, has involved a rediscovery of the institutions for the economic theory. Like the neoclassical theory of the equilibrium, its aim is the analysis of the process of resources allocation. Nonetheless, its macroeconomic analysis is deeper. Institutions are shown as a constituent element of the resources allocation process, and, consequently, they are an endogenous variable in the economic models. The rationality of the agents is not unlimited, and, consequently, institutions can help to correct their bounded capacities of information processing.

However, the new institutionalism retains the assumption of the existence and availability of information. The information problem above mentioned, although is still present, has not a similar analytical relevance to that existing in the real world. Although this absence does not invalidate the outcomes reached by this theory, its outcomes must be taking with caveats. An example will help to understand what we mean. The agency models are one of the main developments of this approach. However, these models assume than the agent has the information that the principal needs to make her decision. Therefore, the analytical problem focuses on the setting of necessary and sufficient conditions that make that the relationship between the principal and the agent is not dominated by the latter as a result of the asymmetric distribution of the information. However, if because of the existence of uncertainty the information is not available, the problem of asymmetric information will not exist. This situation poses the need of a different institutional problem. In this scene, the relevant issue is not how to correct the problem of asymmetric information but how to build institutions to solve the risks coming from the existence of uncertainty.

Are both analysis, that is, the problems of uncertainty and asymmetric information, compatible? Initially, one could be tempted to give a positive answer. The problems of the asymmetric distribution of information are different to those coming from the existence of uncertainty and in the real world we can find proofs of the existence of both information lacks. Moreover, not all the decisions that individuals make are necessarily influenced by events that can happen in the future. However, from a theoretical perspective, these two dimensions of the institutional analysis are based on radically different theories of the economic equilibrium, and it is not clear that both theories can incorporate both dimensions of the institutional analysis. The neoclassical theory cannot incorporate the institutional dimension related to the existence of uncertainty. Moreover, the existence of equilibrium in a dynamic frame of economic analysis, similar to that argued by Keynes, is not accepted. Therefore, the question posed at the beginning of this paragraph would simply be a rhetoric question, lacking of analytical relevance. Nonetheless, in our opinion the question is relevant, and it must lead to reflection about how to make compatible the different information problems that agents face.

In sum, the neoclassical treatment of the information problems warrants that, at least in the long-term, the economy will reach a stable and optimum equilibrium outcome. The design of institutions and the working of the public sector must be directed to warrant this outcome,

solving the potential problems of asymmetric information. However, what happens if this assumption is relaxed and we accept the existence of problems of genuine uncertainty? Can we keep arguing the existence of an equilibrium outcome with similar characteristics to those mentioned above?

3. What role for equilibrium in economic theory?

In a simplistic manner, it is tempting to divide the different economic theories and models in two categories. The first category would include the neoclassical inspiration models. The main characteristics of these models would be the existence of rational expectations, flexible prices, an optimizing behaviour of agents and, consequently, flexible prices and the existence of a market-clearing equilibrium outcome. The second category would encompass alternative, or heterodox, models, which, by rejecting the existence of rational expectations and flexible prices, argue the absence of an equilibrium outcome, what would lead the economy to a situation of permanent instability. However, this approach is not correct. The rejection of the existence of perfect information or rational expectations does not involve the rejection of the existence of an equilibrium outcome. Actually, the discussion about the existence of an equilibrium outcome is a recurrent debate, for instance, in the Post Keynesian school[4].

In our opinion, the latter debate arises because equilibrium is identified with the specific neoclassical concept of equilibrium. In the neoclassical theory, equilibrium is the result of a set of hypothesis and axioms about the behaviour of individuals, the characteristics of the markets and the nature of the information that agents handle. The normative criteria used, first, to define equilibrium is that of "market-clearing", and, second, to choose between different equilibrium states (when the problem of efficient allocation is studied) is the concept of "Paretian optimum". Agents always anticipate and predict the equilibrium outcome since this is predetermined before the economic process begins. This equilibrium is a stable result and, in the absence of an exogenous shock, the economy will permanently stay at the equilibrium outcome. Any transitory change in the determinants of the individual process of resource allocation generates a transitory outcome that, nonetheless, returns to the point of origin when the transitory shock disappears. This economic system is, therefore, homeostatic and time-reversible. On the contrary, a permanent shock will generate a new equilibrium that will be known by the agents once they have all the relevant information. Actually, under the

[4] See Caldari (2010), Ferreiro and Serrano (2007), Lang and Setterfield (2006-7, 2008) Lawson (2005) or Sardoni (2008), among others.

hypothesis of perfect information or rational expectations, the agents will always be able to anticipate the new equilibrium.

To reject the existence of rational expectations means to emphasize the evolutionary and non-egordic nature of the economic process and, therefore, the relevance of the uncertainty (Davidson, 1991, 2002, 2007). The existence of uncertainty places the notion of historical time at the core of the economic analysis (Robinson, 1962): events are not predetermined but contingent, that is, their probabilities are directly influenced by past events and, consequently, the current economic level of activity is path-dependent[5]. Therefore, any economic outcome is the result of a specific combination, historically determined, of economic and social forces.

In a world ruled by uncertainty the economic process would be unstable and the capacity of the agents to predict and incorporate the future in their current decision-making process would be nil (Setterfield, 2003). This world, where agents do not have information about future events, about the behaviour of other agents or about the consequences of their own decisions, poses, however, a number of methodological problems for the analysis of the decision-making processes of individuals and of the macroeconomic performance of that economy. Thus, in this economy we could not:

- include expectations on future events or results that influence current agents' decisions in a specific way;
- model the economy, in the sense of setting stable causal relations and predicting the consequences of any shock-change in the variables included in those relations;
- argue the existence of certain key determinants of economic activity (like aggregate demand as determinant of the economic activity or the relevance of profits expectations for the current investment decisions);
- make qualitative valuations of current outcomes; and
- set objectives and targets for the economic policy.

Actually, the historical evidence "demonstrates that capitalist economies move through time with a substantial degree of order and continuity that is disrupted only on occasion by bursts of disorderly and discontinuous change" (Crotty, 1994). In these periods the economy would evolve in a cyclical way around a "stable" trend or path (Crotty, 1992, 1994).

[5] "The future outcomes of today's decisions are largely influences by agents' current behaviour and beliefs" (Terzi, 2010, p. 564).

In our opinion, the concept of equilibrium involves the existence of an economic outcome that can be considered as stable, predictable and desirable. This notion also involves stable functional relations among economic variables and stable individual behaviours, which allows incorporating such relations and behaviours into economic models. Thus, the economic analysis is not limited to a simple ex-post explanation of past events but it is enlarged to the prediction of future behaviours and results depending on changes in the relevant variables or in the parameters of the model.

In this sense, both in the mainstream and in Post Keynesian approaches, the concept of equilibrium plays a similar role in the economic analysis (a benchmark to evaluate individual behaviours, economic performances and impacts of the economic policy). However, the content of the notion of equilibrium is not the same in the two approaches. There are some elements that distinguish both concepts: the capacity to predict economic results, and the normative content of these results.

For the neoclassical economy, given the rational-optimizing behaviour of individuals, any equilibrium is, by definition, always desirable. Thus, the equilibrium outcome is only determined by economic-technical criteria. In the neoclassical model, equilibrium is, therefore, a laboratory result, a game of relations which are built ignoring the most obvious aspect, the existence of historical events which determine the nature of relations among variables. But for non-neoclassical approaches, like Post Keynesian school, the concept of equilibrium has a normative content since it includes criteria which permit individuals to assess how desirable these outcomes are. These criteria are not immutable, being subject to changes in as much the interests of the different agents in presence and their interrelationships evolve along time and space.

This approach involves not only a different concept of equilibrium and a different role played by institutions in the real world but also a different criterion to evaluate economic results and the working of economic policy and institutions[6]. Opposite to the notion of neoclassical efficiency, whose benchmarking is the market-clearing equilibrium, we can talk of an objective of *social efficiency* based on the values shared in a society in each historical period. We understand by social efficiency a historical situation in which the desirable economic objectives and the procedures to reach these objectives are clearly determined and shared by

[6] Our notion of equilibrium is closely related to a notion of balance of forces, which represents the existing social order (Lawson, 2005).

the majority: that is, a certain distribution of competences between the State and the market; certain institutions working as sources of information in the generation of expectations; or even certain public and private actions to correct the undesired outcomes of the economic process[7].

This equilibrium is not based on the existence of perfect information but on the existence of a set of stable expectations in the short and in the long-run. Nonetheless, the stability of expectations can be reached at any level of economic activity. In this sense, Kregel (1976) explains how Keynes in the lecture notes to the *General Theory* presents a model of stationary equilibrium where both short-term and long-term expectations are fulfilled, but where these expectations do not guarantee that the economy reaches a point of equilibrium with full employment. Therefore, the stability of expectations is a necessary condition but not sufficient to attain full employment.

It must be noticed that the concept of full employment has a deep normative content. Its meaning is different for the different economic approaches. For the neoclassical economy, the full employment is identified with a situation of market-clearing, and, thus, the full employment is understood as a situation where the current real wage equals the labour market clearing wage. At this point, all the workers willing to work at the equilibrium wage find a job. This definition involves that the equilibrium in the labour market, and consequently, the full employment can be reached at any level of (un)employment. In the case of New Keynesian economy, the full employment is identified with the NAIRU or the NAWRU, that is with a level of (un)employment that guarantees a certain rate of growth of prices or wages. On the contrary, for Post Keynesian economics, full employment is identified with a situation where all the workers willing to work at the prevailing market wage can find a job. This involves a low rate of unemployment, usually that compatible with the existence of frictional unemployment (i.e. 3%). And even for Beveridge a full employment situation would be identified with a situation where the number of unemployed workers is equal or below to the number of vacant jobs.

Institutions are, therefore, a key instrument to solve, or to palliate, the information problems faced by the agents, both the problems related to the bounded rationality and the lack of information about the future and the problems of coordination with other agents. It is this

[7] Therefore, the prevailing definition of equilibrium at any time, like the modelling-theory of the economic process is institutionally specific and historically contingent (Crotty, 1990, 1992).

sense, that institutions are a key determinant of the economic activity in market economies. The stability of economic outcomes is related to the existence of stable institutions that help individuals to behave in a specific way. Consequently, if economic outcomes are to be changed in a specific permanent way, current institutions will have to be reformed or substituted by new institutions that contribute to create a new set of expectations and to modify the economic decisions made by individuals.

The different definitions of full employment involve that the kind of expectations required to desired full employment-equilibrium outcome are also different. In the New Classical Economics and the New Keynesian Economics, a full employment outcome, that is an unemployment rate equal to the NAIRU, is reached when the agents' expectations of inflation are right and coincident with the target of inflation set by monetary authorities. On the contrary, for the Post Keynesian economics, to reach a full employment outcome, the agents' expectations on the future economic activity must be equal to the full employment level of economic activity.

Consequently, in the mainstream economics only matter expectations on inflation. The long-run level of economic activity, the potential output, is predetermined by supply-side factors. As a result, from a long-term perspective, aggregate demand and macroeconomic policies do not have any influence on the equilibrium level of economic activity. As mentioned, the only needed institutions are those required to solve potential problems of asymmetric information. The role of such institutions is to warrant the existence of an equilibrium outcome.

On the contrary, in the Post Keynesian economics there is no predetermined long-run level of economic activity. The current level of economic activity will depend of the agents' expectations on the aggregate demand, and, thus, a full employment outcome will be reached if agents expect that there will be a full employment aggregate demand. In this approach, an active macroeconomic policy is needed to offset any deviations of the current level of aggregate demand from the full employment aggregate demand. But this is not a sufficient condition. Besides demand-side economic policies, there must be institutions that help to create expectations that in the future there will be a level of aggregate expenditure that allows to reach a maintain the objective of the full employment. We will develop this argument in the next section.

4. Institutions, aggregate demand and demand-side economic policies

As we have argued, the level of economic activity prevailing at any time is contingent of the current set of expectations that rule the individual decision-making processes. In turn, these expectations are provided by the current set of conventions and institutions.

As mentioned in previous sections, in the mainstream economics there is no need of institutions besides the market and those institutions that help to solve the problems of asymmetric information. In this frame, the resource allocation decisions will lead to an optimizing equilibrium outcome. However, in a world with uncertainty there is no a priori outcome or a technical solution to the problem of allocation of resources. The level of economic activity will depend, also, on the individual expenditure decisions and on the level of aggregate demand, where this level will depend on the information about the behaviour of other agents and about the future value of the determinants of the spending decisions.

In as much there does is not a predetermined outcome, any level of economic activity can be considered as an 'equilibrium' outcome. That is, the economic activity can be managed to reach a certain stable level of economic activity or a certain path of economic growth. The necessary and sufficient condition is that the short and long-term expectations be compatible with that level of economic activity. The common recipe in textbooks is that a Keynesian equilibrium outcome, which would be usually identified to a full employment level of activity, simply involves to set a full level employment level of aggregate demand through different measures of fiscal and monetary policy. Thus, a well-designed macroeconomic policy is a necessary and sufficient condition to reach and maintain the full employment.[8]

However, this kind of measures does not guarantee that the expectations be permanently stabilized at a point compatible with the full employment level of activity. Agents´ expectations cannot be determined in such a precise way. Only with the design of institutions oriented to the attainment of full employment that outcome can be effectively reached (Stockhammer, 2006-7): "To make sure that there is never a persistent lack of effective demand, the government must develop institutional arrangements that encourage some

[8] Thus, for instance, it is often argued, like the European Central Bank usually does, that keeping a low stable inflation rates help to foster economic growth and employment: "Over the last few decades there has been a remarkable convergence on the need to make price stability the main or primary objective of monetary policy. Price stability has taken central stage because it is both an achievable medium-term goal for central banks and a pre-condition for a well-functioning market economy. In preserving price stability, monetary policy facilitates economic growth and the efficient use of resources" (European Central Bank, 2001, p. 7)

decision makers to spend in excess of their current income so that aggregate spending on the products of industry will offset any excess savings propensity at full employment" (Davidson, 2007, p.23). The ground for the macroeconomic policy to continue unfolding remains untouched. Policies oriented to institutional design are not in direct contradiction to macroeconomic policies. On the contrary, by emphasizing the relation between expectations and institutions, a new field for reflection for Keynesian thought is opened, bringing about a reconciliation with classical institutionalism.

This is one lesson that we can learn of the "golden age" of capitalism. The implementation of a Keynesian economic policy, based on the management of aggregate demand via demand-side policies, was possible thanks to the existence of national (for instance, the Welfare States) and international (for instance, all the institutions around Bretton-Woods like the IMF or the World Bank) institutions that helped individuals to create and maintain the expectation that in the long-term the economy would be around or close a full employment level of activity. The design and implementation of these (national and international) institutions was the responsibility of public authorities. Full employment could be reached and maintained not only because public authorities adopted it as the main objective of their economic policies, but, mainly, because, first, they adopted the commitment to implement a macroeconomic policy that offset the current deviation from the objective, and, second, they made the institutional changes that allowed individuals to forge the necessary expectations.

Since mid-seventies, however, the new, or the reformed, institutions have helped to create a new environment where different long-term expectations have emerged. Price stability has been adopted in most countries has the main, if not the only, objective of economic policy. Under the axioms of the existence of efficient markets and rational expectations, it is taken fro granted that the economic policy can not influence the real level of economic activity, and, consequently, that the labour market is, or will be, in an equilibrium where the prevailing rate of unemployment will be determined by the NAIRU, that is, by the target of inflation and by the institutional environment of the labour market. Macroeconomic policies are only focused on the objective of a low and stable inflation rate. This outcome will be reached if agents belief that this will be outcome generated in the future, i.e., if agents' expectations of the inflation rate are equal to the inflation target set by monetary institutions.

In this framework, a right monetary (and fiscal policy) is a necessary condition to reach the desired objective. But, in addition, a proper institutional environment must be created. This

new institutional environment does not only involve a new institutional dimension of monetary policies, like the independence of the central banks, but a institutional change in all the dimensions of the economic activity that may have an impact on the inflation performance, that is in all the variables that influence in the agents' price setting decisions, like, for instance, in the labour market. Moreover, domestic and international markets must be liberalized in order to get a macroeconomic police as close as possible to the (market-clearing) equilibrium outcome. This involves a lower public intervention in the economic field, both in the economic domain (a lower size of public revenues and expenditure, for instance) and in the regulatory domain (for instance, deregulation and liberalization of financial markets)

The achievement of lows and stable inflation rates might be considered as an equilibrium situation. If this outcome is socially optimal or desirable is another question. If the answer is no, then a new economic policy strategy must be implemented, which involves a new vector of economic objectives and instruments. But, moreover, new institutions will have to emerge allowing the implementation of a different strategy of economic policy focused on a new economic objective (Ferreiro and Serrano, 2009a).

Post Keynesian economics sets full employment as the main objective of the economic policy. To reach this objective it is needed "a very different package from that of the New Consensus. We outline an alternative policy package where monetary policy aims at stabilizing the distribution of income by setting the real interest rate equal to the growth rate of labour productivity. Nominal stabilization is addressed by incomes policy and mediation of distributional conflicts through coordinated collective bargaining, while fiscal policy aims at real stabilization" (Hein and Stockhammer, 2009, pp. 273-274). Accepting the validity of this argument involves, however, that these measures can only be effectively implemented if they are accompanied with a proper institutional change. Following the authors' argument, the institutional design of central bank must be reformed, not only in terms of the set of objectives and instruments, but also in terms of its relationship with the (political) economic authorities. Labour market, namely, the wage setting process must also change, moving to a centralized-coordinated collective bargaining structure, with macroeconomic performance being the main determinant of wage dynamics. Finally, the size and functions of public sector (size and sources of revenues, and size and kinds of public expenditure) must be adapted to the new strategy of fiscal policy, thus involving a new role for public sector and a new relationship between public and private sector.

In a world of uncertainty, agents can not foresee their future flows of income and expenditure, and, consequently, the future level of aggregate demand. This not only makes difficult, if not impossible, the existence of a stable outcome of full employment: it also affects negatively the capacity of macroeconomic policy to offset the undesired behaviour of private agents/spending. The instability and volatility of both the current levels and the expectation of economic activity removes the existence of a stable relationship between the private spending and its determinants, mainly the current disposable income. If precautionary savings are a mechanism to protect individuals about uncertainty, a higher economic instability and uncertainty will lead to higher and volatile rates of precautionary savings, what, in turn, will increase the economic fluctuations and reduce the effectiveness of macroeconomic policy.

In this situation, "government should develop economic institutions which attempt to reduce uncertainties by limiting the possible consequences of private actions to those that are compatible with full employment and reasonable price stability" (Davidson, 2005, p. 473). The kind of institutions required are those that, at a macroeconomic level, help to create the expectations of a full employment aggregate demand. At a microeconomic level, the required institutions are those that increase the guarantee of a sufficient level of income to finance a socially acceptable level of consumption, and that stabilize the relationship between the current levels of consumption and disposable income (Ferreiro and Serrano, 2009b).

5. Conclusions

The acceptance of the principles of the neoclassical economics led to the implementation of a strategy of economic policy focused on the objective of price stability. This strategy gave a central role to the monetary policy. The underlying reason was that if agents had an inflation expectation equal to the inflation target, the economic activity was anchored to the (market-clearing) equilibrium level of economic activity. This objective also involved a reconfiguration of the institutional framework of the economy, with the aim that the agents' economic decision created an optimal, or sub-optimal, outcome.

However, the rejection of the axiom of rational expectations means that in a world of fundamental uncertainty there is no neoclassical equilibrium outcome. Any economic outcome is possible and feasible, which involves that "equilibrium" outcomes (that is satble outcomes) below the full employment can exist and persist. In full employment is adopted as

the main objective for a society, then active economic policies focused on the management of the main determinant of the economic activity, the aggregate demand, must be implemented. The existence of uncertainty does not mean that individuals' current decisions are not influenced by expectations, but that these expectations are not necessarily right. Consequently, to reach a full employment outcome, it is needed that individuals have expectations of future economic activity (aggregate demand) equal to the full employment aggregate demand. Here, the design of institutions is a key piece of the new strategy of economic policy. These new institutions must help to generate and generalize the full employment expectations. Moreover, these institutions will help the implementation of the macroeconomic policies, offsetting the transitory deviations of aggregate demand from the ful employment equilibrium.

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