Rationality in Economics: Constructivist and Ecological Forms

Vernon L. Smith
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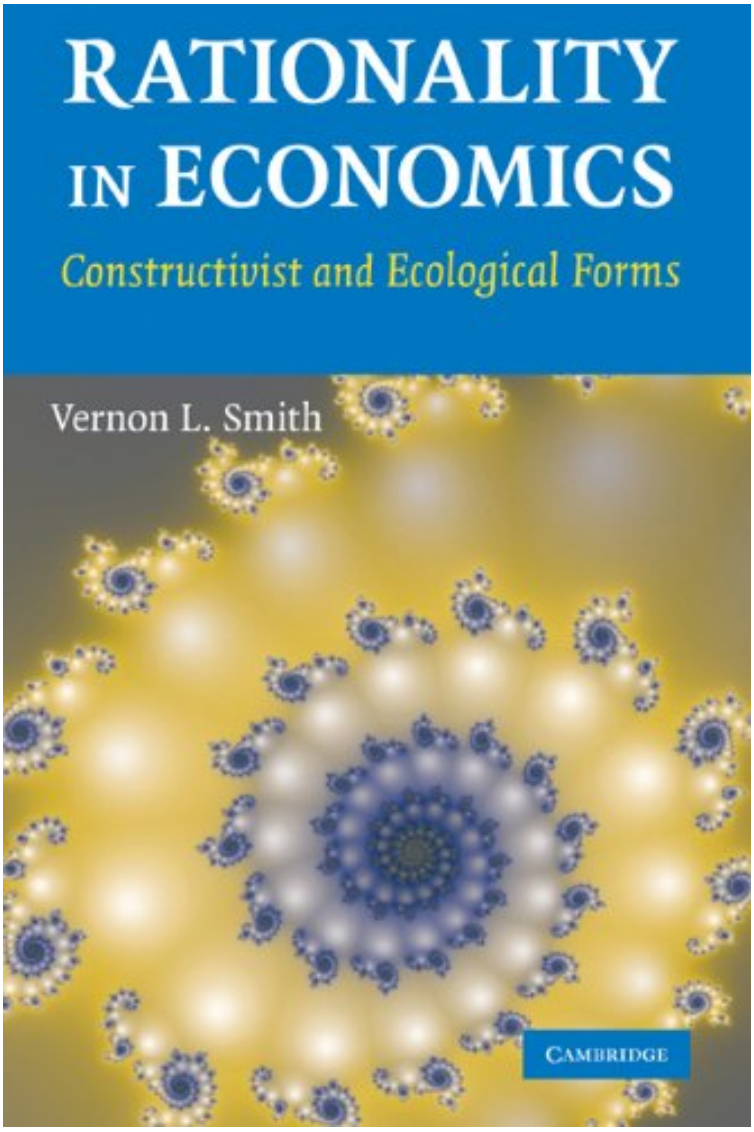

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Vernon L. Smith : Rationality in Economics: Constructivist and Ecological Forms before purchasing it in order to gage whether or not it would be worth my time, and all praised Rationality in Economics: Constructivist and Ecological Forms:

26 of 26 people found the following review helpful. Unique insights plus an enjoyable readBy Bartley J. MaddenI read a lot of books about economics. Until reading Rationality in Economics, I had not read an economics book that gave me precisely what I want: (1) genuine insights on a wide range of important issues, (2) a feel for the key contributions in the academic literature with a minimum of technical detail, and (3) a writing style that explains so much in

straightforward language that reading the book becomes a uniquely enjoyable learning experience. So, if you want to share that experience, read Rationality in Economics by the Nobel prize winning economist Vernon Smith. A major theme is the interplay between constructivist rationality (logical thinking) and ecological rationality (selection over time of what works best that results in our cultural and biological heritage). Gaining an appreciation for these two types of rationality illuminates the work of Adam Smith and Friedrich Hayek and also provides a healthy skepticism of "fix the economy" proposals from Washington. Wealth creation through specialization, innovation, and trade that meet existing needs and create new needs is facilitated by markets. Important to understand how markets work, right? Vernon's Nobel prize was awarded for his pioneering contribution to experimental economics that uses laboratory experiments to test hypotheses about how markets function --- the behavior of participants and the institutional rules of the game. This book is a beautiful summary of experimental economics. Along the way, we learn about smart ways to deregulate markets guided by laboratory experiments (what California politicians failed to do when they deregulated a portion of that state's electricity market). We learn how to think about market efficiency and the apparent conflicting view of behavioral anomalies. We learn about how decision making relates to the way in which our brains have evolved (neuroeconomics). Perhaps you have felt uneasy about the widely-touted superiority of Bayesian decision making and related handling of probabilites. The Psychology and Markets chapter contains an elegant explanation of why you should be critical (hint: surprises are important). The Rationality in Science chapter addresses the age-old dilemma of how we know what we think we know. Vernon's answer is an absolute treasure that everyone should read and ponder. These brief highlights give some indication of why Rationality in Economics is the most useful economics book that I have read.65 of 67 people found the following review helpful. Vernon Tells AllBy Herbert GintisMy colleague Samuel Bowles used to say that there are two types of economist: the Priest and the Engineer. The Priests live in their own little world and spin theories without any reference to the facts. The Engineers live in the real world, collect data, analyze time series, make predictions, give policy advice, and generally ignore all but the most basic economic theory. Certainly, the Engineers never give a thought to what the Priests are doing (they're usually separating hyperplanes, playing with Fredholm operators, or lost in Banach space). Not surprisingly, the microeconomics textbook used in all the best graduate departments around the world has more than a thousand pages stocked with axioms and theorems, but there is not one economic fact in the whole book.You may ask what this has to do with Vernon Smith's new book, Rationality in Economics. Well, more than a half-century ago, Smith set out to actually test economic theory! He put together a working laboratory, got amazing results having people play games that represent economic exchange, and thus started a movement that has begun to radically change the relationship between fact and theory in economics. Not only has experimental economics (that's what is done in his laboratory) expanded a thousandfold over the years, but leading journals now present models that attempt to account for the observed behavior of human subjects in the laboratory. Vernon Smith received the Nobel prize in economics 2002 for his efforts, but he really deserves half a dozen such awards for his energy, insight, and just play chutzpah.Vernon Smith changed my life in 1992, when I read an article he wrote in Scientific American surveying his work. To that point I had thought that experimental economics was just a bunch of right-wing know-nothings trying to show Adam Smith's invisible hand really worked, both with humans and pigeons. I was wrong. I can honestly say that everything I assert with confidence about economics comes from either the result of experiments or observing the comparative performance of different real-life economic institutions.Vernon Smith, in his discussion of the scientific method (Chapter 13) asserts that the idea that we can derive good theory just by carefully looking at the facts is not correct, despite the fact that virtually every great scientist believes he or she does just that. This is a curious position for a man who has spent his life assembling the facts. It is clear that the correct theory does not leap out at us as an ordered kaleidoscope of facts, but the normal everyday application of genius to the facts does quite regularly give rise to better theory. This is why experimental economics is so important.Intellectually, Vernon Smith is heir to the Scottish Enlightenment, plus Friedrich von Hayek. Hayek plays a front and center role in this book in three or four different ways. The most important really has nothing to do with experimental economics, although Vernon Smith does an excellent job of applying Hayekian insights to experimental methodology. Some historical background is in order. Hayek was a conservative Austrian school aristocrat whose major occupation in life was opposing and discrediting socialism, in an era where many intelligent people believed the triumph of socialism was virtually inevitable. In the mid-1930's, Hayek, Ludwig von Mises, and others entered into a debate with the market socialists Oskar Lange and Abba Lerner as to the feasibility of state socialism. Neoclassical economic theory was accepted by all, and the socialists won a decisive victory. This is not surprising, since neoclassical economic theory accepted the Walrasian general equilibrium model, in which a centralized actor, the auctioneer, orchestrated the whole economy, the only role of markets being to carry out s set of plans architected from the central planner (the auctioneer himself). What different did it make if there is private property and an auctioneer or state ownership of the means of production and a state planning board? According to neoclassical economics, none whatever.Indeed, as a result of this debate, the great Austrian-American economist Josef Schumpeter wrote a whole book explaining why socialism was inevitable, despite how much he despised it (Capitalism, Socialism, and Democracy, 1942). This defeat led Hayek in quite a different direction. He deeply rethought his commitment to neoclassical economics. In the late 1930's Hayek developed the

argument that the economy is an organic entity that cannot be properly modeled analytically, and information is so decentralized and distributed among economic actors that no sort of centralized planning was possible. He was prevented from publishing his ideas until the conclusion of WWII, his article appearing as "The Use of Knowledge in Society", American Economic Review 35,4 (1945):519-530. Read it and weep, socialists.It would be hard to overstress the importance of Hayek's ideas, and their essential correctness. Now, Hayek himself used his theory as an instrument for denying an important place for the state in regulating the business cycle, providing social insurance, and dealing with market failures in a productive economy. In this, like Milton Friedman after him, he was very incorrect. There is no advanced market economy without an equally advanced, interventionist state. But, his critique of the idea that planning could replace market competition is absolutely correct, and is the idea underlying the subtitle of Vernon Smith's book: "Constructivist and Ecological Forms." Smith offers a dialectical view in which social planners, scientists, and entrepreneurs develop analytical theories (constructs), but only their subjection to the ecology of market competition and the competition of ideas dedicated to the experimental method gives rise to social institutions, products, and ideas that are dynamically robust.The description and analysis of experimental economics in this book is first rate, as one might expect. The discussion of the spectrum auctions is an especially wonderful exposition of fundamental theory without all the equations. Smith's overall model of human behavior is insightful, and draws creatively on the fact that we are the product of gene-culture coevolution, so our ecological rationality make look weak to the constructivist models of the experimenters, but it is the most advanced form of information processing on this planet by far.Like most experimental economists, Vernon Smith is unmoved by the contributions of sociological theory. He certainly betrays no interest in the theory of social roles and social actors, or the concept of the internalization of norms. These are, however, among the most important tools in the behavioral scientist's arsenal for understanding exactly how and why humans are not simply selfish sociopaths. A good reading of Emile Durkheim, Talcott Parsons, and a few other major sociological figures would add materially to the insights of the Scottish school.Morality is a biologically evolved aspect of human genetic constitution, itself a product of the gene-culture coevolutionary process that underlies Vernon Smith's understanding of human nature. People sacrifice material benefits to achieve moral ends, including such character virtues as honesty, trustworthiness, and fairness. I used to doubt the centrality of this biological aspect of our nature, but experimental economics and neuroeconomics have disabused me of any notion that we could ever understand human behavior in terms self-interest, enlightened or otherwise.Vernon Smith embraces Hayek's model of human psychology in The Sensory Order (1952), which is indeed a brilliant work adumbrating modern connectionism. What is often overlooked is that Hayek's aim was to develop a completely decentralized model of human psychology for the same reasons he preferred a completely decentralized model of the ecological economy. In this, Hayek was really closer to the old associationists of the classical liberal period. although utilizing a relatively sophisticated understand of brain architecture. Like the model of well-known psychologist Donald Hebb, he treated learning as a process of increased communication ease between axons of cells that, based on external stimuli, tended to fire together (Hebb's law is often expressed in simplified form as "Neurons that fire together wire together."The problem with this view of human psychology is that it is so brain-based that it cannot deal with the emergent properties of human dyadic or multi-adic communication and strategic interaction. There is no difference, for instance, in the brain of a monkey and a human from the Hayekian/Hebbian point of view, except quantitative.In fact, as I show in my book The Bounds of Reason (Princeton, 2009), it is impossible to understand human strategic interaction without overarching social norms of the type first studied by Emile Durkheim, and now a standard part of the sociological literature. Moreover, modern neuroscience show that there are indeed specialized structures to deal with human interaction and personal morality. This does not contradict Hayek, of course, it is an important addition to the argument in The Sensory Order.0 of 0 people found the following review helpful. Five StarsBy Customervery nice book~

The principal findings of experimental economics are that impersonal exchange in markets converges in repeated interaction to the equilibrium states implied by economic theory, under information conditions far weaker than specified in the theory. In personal, social, and economic exchange, as studied in two-person games, cooperation exceeds the prediction of traditional game theory. This book relates these two findings to field studies and applications and integrates them with the main themes of the Scottish Enlightenment and with the thoughts of F. A. Hayek: through emergent socio-economic institutions and cultural norms, people achieve ends that are unintended and poorly understood. In cultural changes, the role of constructivism, or reason, is to provide variation, and the role of ecological processes is to select the norms and institutions that serve the fitness needs of societies.

'The journey that brought Vernon Smith to his Nobel Prize is not over. It obviously brought us constructive tools, in the form of controlled experimental methods that allow economists to see the lay of the behavioral land more clearly than before. But this magisterial review of the whole journey, including precursors, reminds us that the scope of economics has always been much wider than the straw man that behaviorists like to attack. Properly understood, experimental methods force all economists to think of constructivist and ecological rationality as complementary ways

of understanding behavior, rather than as fundamentally inconsistent views of behavior. The journey, then, has really just begun.' Glenn W. Harrison, College of Business Administration, University of Central Florida'Vernon Smith has spent a lifetime of research, combining theory and experimental evidence, exploring the idea and implications of rationality in economics. This book recounts that lifetime, synthesizes it and adds to it - producing a volume that soars above the usual material of economics. The end-product is a volume that takes an eagle's eye view of rationality in economics, and puts it in a new and glorious perspective. Reading it is essential for theorists and practitioners.' John D. Hey, University of York, UK and LUISS, Italy'Rationality in Economics is a delight, garnished with fascinating historical detail, philosophical scientific insights, and an eye on current public policy issues. Vernon Smith, as always, shows a skeptical, irreverent attitude toward 'rationality models' based on assumptions that are not stress-tested with cash-motivated subjects in the lab. His own policy recommendations, like the 'Combinatorial Clock Auction', are original and innovative.' Charles Holt, University of Virginia'Locating human sociality as a centerpiece of economics, Smith's clear vision of the meaning of rationality pierces the fog surrounding the place of economics in human society. Ideas of David Hume, Adam Smith, Friedrich Hayek and Herbert Simon are masterfully synthesized with fifty years of experimental data from the economics laboratory to bring us a book that might as well be called 'The Origin of Human Institutions'.' Shyam Sunder, School of Management, Yale University'I am pleased to report that Vernon Smith's new volume of opinions amounts to the most important book on economic methodology of the past decade.' Journal of Economics and Philosophy'... a rich book that is full of stimulating ideas ...' History of Economic IdeasAbout the AuthorVernon L. Smith was awarded the Nobel Prize in Economic Science in 2002 for having established laboratory experiments as a tool in empirical economic analysis, especially in the study of alternative market mechanisms. He holds joint appointments with the Argyros School of Business and Economics and the School of Law at Chapman University, California, where he also is part of the team that will create and run the Economic Science Institute there. Cambridge University Press published his Papers in Experimental Economics in 1991 and a second collection, Bargaining and Market Behavior, in 2000.