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Book Reviews

Herbert A. Simon, *Reason in Human Affairs* (Stanford University Press, Stanford, CA, 1983) viii + 107 pp., \$10.00.

This book contains the contents of the author's Harry Camp Lectures presented at Stanford University in February of 1982. As one might expect, the book concerns itself with the problems of decision making, rationality and bounded rationality, but there are some new variations on these themes that make the book both enlightening and enjoyable.

Chapter 1 investigates the limits of reason by first discussing the fact that the process of logical deduction can only be as good as the inputs into that process, i.e., our values or assumptions and facts. Next, three different models of the reasoning process are discussed: the subjective expected utility theory, the behavioral theory and the intuitive theory. Since these topics have been extensively discussed in a long series of works by Simon (beginning with his classic *Administrative Behavior*), they are only outlined here.

Some prominence is given to a stimulating suggestion first put forward in Simon's (1967) paper *Motivational and Emotional Controls of Cognition*. The question at issue is the role that emotion plays in the intuitive theory of reason, and Simon's observation has an appealing simplicity. In the Olympian view of the subjective expected utility theory, all solvable problems can be solved simultaneously. With unlimited calculating abilities, any human can solve all of the world's problems at once. However, if our problem solving abilities are considered limited (which they clearly are), then a mechanism must be developed which chooses which among our most pressing problems we will concentrate on today. Such a mechanism is emotion. When a book or motion picture stirs the emotions of the population on a particular problem, society turns its attention to its solution. (Rachel Carson's, *Silent Spring* is the case in point.) In addition, the chances of an insight into a problem may be heightened when the emotional content of the problem is high since the problem may be more vivid to us in that case.

Chapter 2 investigates a fourth theory of rationality – the evolutionary theory. The chapter starts with a rebuttal to the view held by proponents of the optimization school or the subjective expected utility school which maintains that people basically function as if they maximize, since if they didn't, they would be weeded out by the Darwinian social forces of the market. What the remainder of the chapter does is attempt to elaborate on

this rebuttal by demonstrating that it stands on too crude a version of the Darwinian hypothesis. For example, one maxim of Darwinian theory is 'one niche, one species'. Hence, if the physical environment is fixed and unchanging, as time goes on, only those species best fit for the existing niches will survive. In the end, all is optimized out. But, niches are not fixed. The very process of adaptation creates new niches and the process of niche elaboration allows the process of evolution to continue indefinitely in a non-teleological manner. Under this view, even given sufficient time, people may not act as if they maximize, since survival is not predicated on such behavior. Simon uses the example of an altruist to illustrate this point, since one would expect altruists to disappear over time from a population and yet, due to certain social feedback mechanisms, they do not.

Of all the chapters, I find Chapter 3 to be the most interesting. The idea here is quite simple. If human beings are boundedly rational satisficing creatures, then it should not be surprising if the collective social institutions they create would be so as well. But in a world of uncertainty, institutions provide a source of stability, since they contain quite a bit of inertia and this stability, according to Simon, is functional. [This idea is similar to the view taken by Schotter (1981) where he defines institutions as regularities in behavior that provide solutions for social agents to the myriad of games they repeatedly play. In that view, in a boundedly rational world, these regularities are efficient rules of thumb that alleviate the need to resolve old problems everytime they arise.]

Despite this benefit, institutions still suffer from the limitations of the agents who created them. For instance, like individuals, institutions cannot concentrate on all of the problems they face. Rather, they tend to solve them serially. Hence, some pressing social problems are ignored while other faddish ones are concentrated on. Further, political and social institutions have problems dealing with the fact that societies are multi-valued creatures subject to Arrowian intransitivities. However, a satisficing attitude may help here. Rather than attempting optimal solutions, our institutions might attempt solutions that are nearly good enough. In short, the analogy drawn in this chapter between the boundedly rational individual and the societal individual (i.e., the social institution) is a useful one, especially if we can use insights which have allowed for better individual decision making to help us rationalize our collective institutional decision making.

Perhaps the economics profession could stand more books of this type – books which just allow the author to think out loud and explore ideas that interest him. Of course, social welfare would not be served if anyone were allowed the luxury of such ruminations. Rather, it might well be reserved for scholars of Professor Simon's stature, and, in his hands, the experience is quite rewarding. Finally, I am beginning to suspect that the big payoff to Professor Simon's ideas will come in the years ahead in the hands of

experimental economists. In short, all economic experiments are tests of rationality. Hence, what the collective evidence is starting to demonstrate is that certain types of decision making situations (or experiments) are such that when people are put in them, they basically act as if they were maximizing (i.e., the experiment 'works'), while others fail to substantiate that hypothesis. The role of experimental economics may well be to characterize the types of experiments (or theories) we can expect to 'work' and hence to outline those economic situations in which optimization (or game theoretical equilibria) will emerge. What we may expect to find is some threshold of complexity such that below that threshold optimizing theories work while above it, satisficing theories work. Experimental evidence, however, may give us better insights into which satisficing rules are used.

Reference

Schotter, Andrew, 1981, *The economic theory of social institutions* (Cambridge University Press, Cambridge).

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James D. Hess, *The Economics of Organization* (North-Holland, Amsterdam, 1983) viii + 288 pp., \$35.00.

To write a textbook in a new and rapidly expanding field is attractive and challenging. There are no previous models from which to take off or to be judged by, but there is the risk of rapid obsolescence. A first textbook also sets its own range and limits. That the economics of organization is a new subject appears from the references, which although including Bernoulli (1730) and Coase (1937), are all from the fifties, sixties and seventies.

To impress the reader with the flavour of organization theory, James Hess uses the ingenious device of presenting first a caricature of organizations as they appear in the textbooks of micro-economics. The traditional entrepreneur is cast in the role of a coordinator 'who contacts artisans who can cut and sew slippers to produce a finished slipper from leather he supplies. To minimize transportation the coordinator rents a building which the artisans can use. Finally, he arranges to sell the hand-sewn leather slippers to door-to-door salespersons for a specified number of dollars per slipper. The coordinator matches the number of hides with the number of slippers and buys hides to be delivered to his building. Production begins. The coordinator's role at this point is as an accountant to keep track of the payment due to the workers. Has the coordinator created an organization or