INTRODUCTION: ABOUT THESE ESSAYS

THE LAST TWO CENTURIES HAVE REVEALED AN UPWARD, BUT unsteady, trend of capitalism in many portions of the world. And, during the same interval of time, there has beeen an upward trend in the reputation of the discipline of economics. In one sense, these are strongly related, since puzzlement about the economic system that we now call capitalism motivated much of the mainline work done by economists during this interval. However, in another sense, the two happenings are, or have become, unrelated, since much economic theory describes human behavior and production opportunies in ways that are not specific to a type of economic system. Thus, the first law of demand – the negative relationship between the quantity of a good acquired by a person and the cost (or, in capitalism, the price) of acquiring the good – is testably operative in every type of economic system. Similarly, the relationship between the unit cost of producing a good, measured in terms of amount of resources committed to its production, and the total number of units of the good produced is a question of technology, not of economic system.

The main difference between economic systems is in regard to the constraints that are applied to human behavior. The fact is that students of economics learn much about universally applicable propositions and little about the institutions that define applicable constraints. The primary reason for this is that those who created much of economic theory simply *presumed* they were writing about an economy based on private ownership of resources; they further presumed that those who would learn what they had written would possess an understanding of a private ownership system. Each of the essays in this volume has its own purpose, but the nature and role of the institutions of capitalism are discussed in many of them.

I intend these essays for a broad audience, but I especially hope to reach students and teachers of economics and the law. I make little use of technical jargon or formal models, so these essays are accessible even to people who are not specialized to these disciplines or even any other discipline. All the essays, save one, fit the themes implied by this book's title. The last essay, which discusses interdisciplinary work, is an exception to this claim. Its presence in this volume is due mainly to the presence of three other essays, *Rescuing Economic Man from Selfish Gene Theory*, *The Late Arrival of Capitalism*, and *Economic Man's Escape from Malthus's Population Trap*, all of which in greater or lesser degree involve disciplines other than economics.

I have touched on some of the topics covered here in other papers I have written, but these earlier appearances have been light and incidental in comparison to the treatments given them in this volume, and many topics discussed here have not had an earlier appearance. One exception to this is the essay *Firms and Households as Substitutes*. It is essentially a revision of a few pages contained in my *The Economics of the Business Firm* (1995). It is included here for two reasons – to make more clear some of what I had written earlier and to round out and complete the line of reasoning I use in the essay *Reinterpreting the Externality Problem*; these two essays, taken together, give a full explanation of my dissatisfaction with the way "transaction cost economics" has been used in the study of economic organization.

The essays progress from discussions of individual behavior to discussions of economic institutions, but they are meant to stand alone. The writng of each essay has its own starting point. A few examples explain what I mean. The first essay, "Where Economic Man Dwells," responds to frequently expressed concerns of students about the emphasis given in economics to self interested behavior. The essay on "Reinterpreting the Externality Problem" reflects the doubts I have accumulated as I attempted to explain R. H. Coase's (1960) notable discussion of the problem of social cost to students. The essay "Rescuing Economic Man from Selfish Gene Theory" springs from a reading of Dawkins interesting work on *The Selfish Gene* (1976) and from my realization that the *gene* as *the* seeker of self-interest leaves little room for the *person*. The essay on *The Late Arrival of Capitalism* emerges partly from a reading of *Guns, Germs, and Steel* (1997) by Jared Diamond. Diamond's book brought a bevy of facts to my attention, some of which are used in this essay to resolve a phenomenon about which I had been puzzling. Why did mankind fail to develop the institutions of capitalism during the first ninety-nine percent of known human existence? In answering this question, I was brought to an explanation for the rise of capitalism. Diamond's explanation of the success of Western civilization seems inadequate because it is mostly descriptive of innovational change and lacking in a theory by which to tie these changes into an explanation of Western progress.

The approach of these essays is in the spirit of positive economics, but I am sure that my normative preferences rise to the surface here and there. I hope this has not occured often. As with the other claims I have made, there is an exception. The essay "Protecting You from Yourself" is expressly normative; and justifiably so because it deals with ideas of writers such as Thorstein Veblen, John K. Galbraith, and Robert H. Frank that are quite normative.

Early in my writing of these essays, I thought about giving this volume the title *Open for Discussion.* This describes my hope in writing these essays but it does not describe this volume's contents, so I chose instead to call it *From Economic Man to Economic System.* However, please join the discussion.

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Harold Demsetz
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ON SELF-INTEREST

The doctrine of self-interest properly understood does not inspire great sacrifices, but every day it prompts some small ones; by itself it cannot make a man virtuous, but its discipline shapes a lot of orderly, temperate, moderate, careful, and self controlled citizens. If it does not lead to virtue, it establishes habits which unconsciously turn it that way.

Providence did not make mankind entirely free or completely enslaved. Providence has, in truth, drawn a predestined circle around each man beyond which he cannot pass; but within those vast limits man is strong and free, and so are peoples.

(Alexis de Tocqueville)

1 WHERE ECONOMIC MAN DWELLS[1]

LET ME INTRODUCE YOU TO ECONOMIC MAN. BUT, WAIT, YOU know him already. He is Scrooge before being reformed by ghosts of past and future times. He is the landlord in Puccini's *La Boheme*, who has the audacity to ask his poor, unemployed, and fun-seeking artist tenants for the rent due him. He is the banker who pressures a destitute widow to make the due mortgage payment. He is Veblen's predatory businessman of the 1890s, skilled at calculating and at pressuring rivals into submission. He thinks only of himself and, mainly, only of his wealth. He is ridiculed by critics who see him as a caricature of a real person, and who, therefore, drum him out of the human species by reclassifying him as *Homo economicus*. Yet, he is present within each of us and, more important for these essays, he is alive and well in economics. In this essay, I consider why this is so. First, however, I note the following three points:

(1) The task of understanding market processes is different from that of understanding a human being and even from that of understanding issues that are not ordinarily resolved through market processes. Except with respect to human intelligence, economics does not describe a person in a way that might serve the needs

[1] This essay develops an idea that I set forth in my Presidential Address before the Western Economic Society in 1996 (published 1997).

of biologists, sociologists, and philosophers. It did not, until fairly recently, give much thought to the workings of institutions other than markets. I make this clear even though I suspect that the economic analysis of the marketplace has much to offer in these regards.

Other social sciences are focused on problems that differ in various degrees from problems of the marketplace, and, appropriately enough, they view a person somewhat differently from the way economists do. Each of these different perceptions about human behavior are to be thought of as tools that serve specific purposes, not as complete, accurate descriptions of people. Failure to recognize this has been a major source of confusion.

(2) Although self-interest means serving one's own wants, it does not specify these wants. For reasons given below, this essay, for the most part, will assume that these wants do not include the well-being of others; the assumption is not an imperative of the economic model of human behavior but it allows this essay to deal with the caricature of economic man created by the model's critics.

There is bias in this caricature. Consider again the persons depicted in Puccini's opera. The landlord is cast as a dolt and narrow-minded seeker of rent; no matter that he has invested considerable sums in providing living spaces to those in need of them. His artist-tenants, on the other hand, are viewed as kind, fun-loving pleasure seekers. They acquire such pleasures by delaying payments of the rent due the landlord, which is narrow-mindedly seeking to use the funds of someone else, and by succeeding in bilking an elderly, past lover of coquettish Musseta. Now, I ask you, which of these two classes of characters is the more narrow-mindedly self-seeking? They both seek their self-interests. The difference between them is in the methods employed. The landlord supplies living space and offers contractual arrangements to use this space, expecting thereby to receive funds from tenants. The elderly lover buys lunch for others out of past remembrances of romance and present hopes of renewing this romance. The artists, on the other hand, pursue self-interests in duplicitous ways, delaying performance on the rental agreement that provides them with living space and deceiving an elderly seeker of romantic engagement. Critics of economic man generally visualize the landlord-type as the only person who fits the caricature they have fashioned.

(3) Human behavior does reflect concern for others. We know this from life within the family, interactions within the workplace and military platoon, and so on. Conscious cooperation with and personal feelings toward others are important in these areas of human activity.[2] Yet, it is precisely the narrower interpretation of human behavior, as motivated by concern for one's own wants, that makes the economic model of behavior so useful in the study of activity in the marketplace. And it is the marketplace that is the arena of behavior most relevant to what, historically, has been the central problem of economics. This essay explains why this is so.

I

Economic man remains alive in economics because he is very helpful to the resolution of what arguably is the most important puzzle economists faced during the first 150 years during which their discipline matured into a social science. This puzzle has been aptly described in contemporary times by F. A. Hayek (1988) as that of "spontaneous order": "spontaneous" because no person or group of persons, and no institution, determines how resources will be allocated in the liberal economy; a "puzzle" because, despite the absence of managed, conscious control there seems to emerge a "sensible" allocation of resources.

[2] Indeed, my colleague Armen Alchian and I cooperated in writing an article (1972) that stressed the importance of team production to the organization of the firm.

This puzzle not only shaped the discipline of economics, it also distinguished economics from the other social sciences. It plays no important role in other social sciences, not in anthropology, political science, or sociology, and, if these be social sciences, not in psychology and neuroscience. Not even in biology.

The model of human behavior used in economics is a tool applied to gain an understanding of how the decentralization puzzle is resolved, and, like any tool, it is specialized to its primary task. It emphasizes some aspects of human behavior while repressing others. Concern about one's own wants is emphasized; concern for the wants of others is slighted. Critics of economic man often express a preference for a model of human behavior that is more broadly conceived, one that incorporates all, or most, aspects of human behavior; it would meld concern for one's own wants with concern for the wants of others. No consensus has yet emerged about the formal nature of such a model, but there is no necessary advantage to a comprehensive model of human behavior. A tool fashioned to hammer nails is not made more useful by attaching a screwdriver to it. Multiple models of human behavior, each specialized to be useful in the examination of different important problems, may be more successful in solving different types of problems, although, human curiosity being what it is, there will remain the problem of a unified theory of human behavior. Like the quest for a unified theory of physical-chemical properties, a unified theory of human behavior may be a long time in coming. Meanwhile, solutions to particular types of human behavioral problems may be most expeditiously obtained through the use of specialized models of human behavior.

Extensive decentralization, characterized by independently acting private owners of resources, describes the core of the spontaneous order problem. The marketplace, in turn, is the dominant arena in which independently acting persons interact with each other in deciding how the resources they own are to be used. The virtue of the economic model of man is that it is well suited to the task of exploring behavior in this arena, *whether this is located in a solidly capitalistic economy or in a solidly socialistic economy*.

II

Conditions in the marketplace differ from those within the family, neighborhood, and political bureaucracy. They even differ from those that exist within the business firm, since people within the firm, because of their long-term association with, and dependency on, each other, cease to act in full neglect of each other. Perhaps this is why mainstream economists writing during the neoclassical period of their discipline gave little attention to what goes on inside the business firm.

Personalized interactions, borne of durable associations, also characterize dealings between family members, neighbors, and fellow bureaucrats. Emotionalizing and strategizing are much more likely in these institutional settings than in the marketplace. The setting that is consistent with the spontaneous order problem is that in which people make their decisions independently, meaning that their decisions are not affected by knowledge of or concern for how they might affect others. That setting is not the home. It is not the neighborhood. It is not the firm. It is, for reasons to be given, the marketplace.

Exchange in the marketplace is treated as exchange between persons who are essentially unknown to each other. Indeed, in the highly organized marketplace, people, buyers and sellers, do not face each other. They face prices. In the economic conception of the highly organized marketplace, there is no personalized interaction between buyer and seller; each simply acts independently in responding to an impersonally determined market price, making his or her decisions on the basis of this price and his or her own wants. Interactions between people within home and workplace are laden with personalized knowledge of those involved. Because of this, they imply conscious interaction between knowing people,