Book Reviews

Amitai Etzioni: The Moral Dimension. Toward a New Economics

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There is a struggle going on over the domain of the social sciences and over their theoretical identity. The Rational-Choice approach, no longer content with its unchallenged dominion in the heartland of standard economics, and encouraged by the easy colonization of the nearly undefended territories of political theory, seems now ready to invade the homelands of mainstream social science. The attack is launched with an arsenal of new weapons developed to conquer and hold the new terrains — among them public choice theory, collective action, and the economic theory of politics; transaction costs, information economics, principal-agent theory and the economic theory of organizations; property rights, game theory and the economic theory of institutions. As in any invasion, fifth columns of indigenous sympathizers are only too willing to set up collaborator regimes to stabilize and legitimate the new imperial order.

There are also, of course, recent instances of insurrection among the invading forces (e.g., Nelson and Winter 1982; Heiner 1983), and manifestos of resistance in the territories threatened by invasion (e.g. Granovetter 1985; Perrow 1986; March and Olsen 1989). But that is not enough, or so Amitai Etzioni has concluded, to avert the fate suffered earlier by the German Historical School and American Institutional Economics. Social scientists must join forces with dissident economists in a 'socio-economic' counter-offensive to secure a bridgehead deep in the heart of neoclassical territory — that will then permit negotiations from a position of strength over the 'codetermination' of the social and economic realm. That, at any rate, seems to be the message of the book to be reviewed here as well as of the 'Society for the Advancement of Socio-Economics' which Etzioni has launched at a large conference at the Harvard Business School in the Spring of 1989.

Let me begin this review by declaring my admiration for Etzioni's work, and my partisanship in his cause. As the erstwhile director of a multi-disciplinary institute for labour market research, I yield to no one in my exasperation over the neoclassicist disdain for all information that does not fit their models, and in my dismay over the iron grip in which the world views of economic policy-makers seem to be held by these information-impoverished models. Yet before we all agree on what is wrong with the neoclassical paradigm, it seems useful to look briefly at the sources of its apparent strength so that we know what we are up against when we accept, as Etzioni does, the challenge that 'you cannot beat a theory with nothing' (p. 2).

All theories are of course attempts to reduce the overwhelming complexity of the real world to simpler representations that can be grasped and manipulated by human minds with limited cognitive capabilities. Since all theories must simplify, none of them can approach the impossible ideal of complete explanations of true predictions of real-world social phenomena. The only question is where they introduce their most radical simplifications, and how useful these are for producing explanations and predictions that are at least of limited validity (Lindenberg 1983, 1989). What makes neoclassical (and other variants of standard) economic theory hard to beat is the efficiency with which it is able to generate predictions from very little data.

Economics is a variant of the rational-choice paradigm which, in its generic form, is not at all information efficient. Thus the specific competitive advantage of economic theory derives entirely from a set of 'auxiliary factual assumptions' (Simon 1986) which are used to replace a wide range of difficult to obtain empirical data with standardized postulates about the identity of relevant actors (individual firms and households), about their goals (self-interested maximization of profits or material goods), their perceptions (true representations of real-world data) and their computational capabilities (for practical purposes unlimited).

This form of simplification has two obvious advantages: the need for exogenous information is largely reduced to data about quantities of goods and services and their relative prices that are comparatively easy to obtain. Moreover, the combination of simple assumptions and quantitative data permits the mathematical modelling of aggregation effects. As a consequence, economic models are able to produce a wide range of specific and non-obvious predictions from a very small amount of empirical information. Of course, these predictions will often be inaccurate when the simplifying factual assumptions are not a good approximation of — average — reality. Nevertheless, as far as it goes, standard economics is indeed an extremely information-efficient theoretical system.

Etzioni is convinced that socio-economics must strive to approximate these advantages if it is to compete successfully against the neoclassical paradigm. At the same time, however, his book is a massive (and highly successful) attempt to show how limited the range of phenomena really is for which the neoclassical model can serve even as a reasonable approximation. That has been done before, but Etzioni's brief is lucid and cogent, well written and generally a pleasure to read. What economists might consider missing is a more sympathetic discussion of some recent extensions of the neoclassical paradigm, such as property-rights theory, information economics (which is beginning to come to grips with incomplete and asymmetric information) and, of course, transaction-cost economics. But a more complete discussion of these theoretical innovations clearly couldn't change Etioni's verdict.

The reason is that neoclassical economics is caught in what March and Olsen (1989: 63) have called a 'competency trap'. For even if neoclassicists were aware of all of Etzioni's objections, they could not relax their unrealistic assumptions very far before they would run into two disastrous problems: they would become dependent on a much wider range of hard-to-obtain and difficult-to-quantify empirical data and, worse still, in accepting the relevance of such data they would damage most of the machinery of mathematical modelling that is grinding out all those 'interesting' (i.e. non-obvious, though not necessarily true) explanations and predictions. That would leave them no better off than if they had become 'soft' social scientists in the first place. If that dismal fate is to be avoided, the realism that can at best be achieved by theoretical extensions of neoclassical economics is narrowly constrained by the amount of empirical variety, contingency and complexity that can be accommodated by the slow progress of mathematical modelling.

Thus Etzioni is surely right when he proposes 'socio-economics' not as a theoretical fusion between economics and the other social sciences, but as a 'cross-disciplinary integration' that 'attempts to link spheres that will remain distinct' (p. 15). In his view, these spheres are fundamentally divided by reference to 'at least two irreducible "utilities", and . . . two sources of valuation: pleasure and morality' (p. 4), and the constructive parts of Etzioni's book are dedicated to the demonstration of the theoretical necessity and empirical productivity of a duty-oriented 'deontological' perspective that cannot be derived from pleasure-oriented utility, however extensively defined or ingeniously redefined (Chaps. 2–5).

It is important to note, however, that in Etzioni's critique of theoretical monism, the two paradigmatic spheres are defined in such a way that not only neoclassical economics, but all varieties of rational-choice theorizing, are put beyond the demarcation line. That explains why authors who have treated moral issues within a rational-choice (but certainly not neoclassical) frame of reference — including Thomas Schelling, Albert Hirschman, and Amartya Sen — are only briefly discussed (or should one say, summarily dismissed?) as 'antecedents to the line evolved here' (pp. 36–41). It may also explain why game theory as the most useful rational-choice tool for the analysis of moral dilemmas is not discussed at all or misinterpreted — e.g. when Axelrod's (1984) simulations of the iterated Prisoner's Dilemma are taken as evidence of unselfish behaviour that rational choice theory cannot account for (p. 61).

In my view, this is not an entirely fortunate choice of friends and foes. By lumping all variants of rational-choice theory together, Etzioni permits himself to focus his critical attention on the most benighted strains of neoclassicism, which weakens the force of his critique. More important, this dividing line also deprives his constructive efforts of the help which they could get from recent attempts to integrate rule-based and value-oriented behaviour in explanatory models that are rational-choice in spirit and technology, but not neoclassical in their assumptions. As it is, the deontological paradigm must succeed or fail on its own strength.

If the test of success were the plausibility and richness of the insights conveyed, or their moral attractiveness, there could be no question. Of course, 'normative/affective' considerations are important, and often determinative, in human choices; of course, that is true not only of the choice of goals or 'preferences' but also of the choice of means; and of course, much behaviour is habitual or routinized, rather than the result of consciously deliberated rational choices. All that is true, and Etzioni says it better and more convincingly (and, what is no mean feat, at the same time more entertainingly) than most others before him. Nor is that all.

Even though the book is styled, and must be judged, as a major methodological effort, there are a few substantive chapters that one must simply admire for their rightness and brilliance. One of them sets out to examine the supportive conditions of instrumental rationality (Chap. 9). Starting from the premise that 'non-rational choice is natural; rational decision-making is artificial' (p. 151) and that the limited zones in which instrumental rationality has its place are themselves defined and legitimated by normative-affective factors (p. 93), the chapter develops a research perspective on 'anti-entropic rationality' that seems most promising. Equally rewarding in a substantive sense are the chapters on 'encapsulated competition' and the relationship between 'political power and intra-market structures' (Chaps. 12 and 13). The first emphasizes the pervasive role of asymmetrical power relations in market competition, and its dependence on a 'curvilinear relationship' with normative, social, and governmental mechanisms that are necessary for its creation and maintenance, but which may also restrain or even suppress it. The second focuses on the influence of economic interests on governmental processes, and the ways in which the manipulation of government by business may create instances of 'pseudo-concentration' in the market (p. 218). The chapter also includes a highly suggestive typology and discussion of the possible interaction effects between the structural characteristics of government ('interventionist power') and of the ('economic power') of markets. This is economic sociology and political economy at its best.

There are many more nuggets of brilliant insight in this book. Take the hypothesis that the experimental findings of the 'prospect school' about the asymmetric valuation of gains and losses might be explained by ego-defenses against a threatening loss of self-esteem (pp. 109–110), take the discussion of rationality, freedom and the psychological anchoring of actors in a supportive community (p. 138), or take the assertion that changes in relative prices, interest rates, or tax incentives are more likely to have no effect than to generate the responses predicted by neoclassical theory (p. 103). I could go on with similar examples. But in a sense, that would be beside the point. The book deserves to be judged by its own claims, and they are defined in terms of a theoretical approach that could achieve 'codetermination' with the neoclassical paradigm on the latter's own terms.

These claims are backed by a self-conscious effort to achieve a comparable degree of parsimony or information efficiency. Hence the insistence that there should be no more than two distinct types of 'utility' — pleasure and morality — and the awkward collapsing of 'normative' (ethical as well as merely rule-bound) commitments and 'affective' involvements into a single concept of 'normative–affective (N/A) factors' that can then be opposed to 'logical–empirical (L/E) considerations' (Chap. 6). But what is gained by the collapsing of highly heterogeneous action motives?

Of course, they can all be combined in a concerted critique of neoclassical assumptions, but as far as the construction of positive explanatory and predictive theory is concerned, the parsimony that is achieved in this fashion seems spurious. There are worlds of difference between behaviour that is value-rational in the Weberian sense, behaviour that is guided by conventional norms or sanctioned legal rules, and behaviour that is purely expressive of overwhelming emotions. In that sense, the postulate that 'the majority of choices that people make, including economic ones, are completely or largely based on normative–affective considerations, not merely with regard to selection of goals, but also of means' (p. 93) may be true enough — but these different decision premises do not seem to converge, and they certainly cannot be substituted by specific assumptions. At any rate, there is no attempt to specify the substantive choices that actors under the influence of normative–affective factors would tend to favour.

Hence the attachment of a common abstract label to the variety of motives and perceptions subsumed under it does not achieve predictive power in the way that neoclassical assumptions are able to predict. In order to form expectations, we still need to collect empirical data (and the problems of obtaining them are barely touched upon — pp. 111–112) about specific ethical orientations of actors, about specific systems of social norms and institutional rules, and about specific emotional states. The same is, of course, true of the infinite number of ways in which reality may be misperceived under the influence of non-rational beliefs and emotions, and of bounded rationality.

Thus it seems that Etzioni's goal of a new paradigm that 'must be more predictive, and explain more' than neoclassicism does (p. 19) is being approached at the price of enormously increasing information requirements. That may well be the best that we can do, but it is exactly what conventional social science at its best has always done. Etzioni has admirably restated the case against neoclassicism, and he has added important substantive insights in the process. If he is right that one 'cannot beat a theory with nothing', and if his goal was an alternative paradigm that could compete with the information efficiency of standard economics, that game is yet to be won.

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Harold Demsetz: Ownership, Control, and the Firm: The Organization of Economic Activity, vol. 1

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This is the first of two volumes containing selected papers of Harold Demsetz on *The Organization of Economic Activity*. The first volume deals mainly with the nature of the firm and the special topic of ownership. The second, yet to be published, volume will deal with issues of market structure, ethics, policy and politics.

The volume opens with an autobiographical sketch and a framework for the study of ownership. The selected papers are organized in three parts: (a) Private Rights: Externalities, Content, and Development; (b) The Firm and the Problem of control and (c) Normative Issues. Most papers have been previously published, but the collection also includes some yet unpublished papers. This review will focus mainly on the new materials.

Demsetz writes in the economic-legal tradition of which R. H. Coase may be regarded as the founding father. Demsetz's particular contribution is his focus on issues of ownership, and the concomitant issue of control. Ownership is conceptualized as a bundle of rights. For example, in the well-known Alchian and Demsetz (1972) paper on 'Production, Information Costs, and Economic Organization' (contained in this volume), firm ownership is defined as possession of the following rights: (1) to be a residual claimant, (2) to observe input behaviour, (3) to be the central party common to all contracts with input owners, (4) to alter the membership of the team and (5) to sell these rights.