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Founding a New Socioeconomics

Since the economy is nestled within society and rooted in its institutions, economists should join psychologists and sociologists to study human behavior. Given the demand for such broad training, can the academy lag far behind?

An often suggested cure for the considerable difficulties encountered by neoclassical economics is to draw on sister social sciences to provide more "realistic" assumptions about human motivation and institutions. This approach might be referred to as an attempt to resurrect the traditional fields of political economy or institutional economics. However, these terms have acquired over the years specialized meanings not intended by those who call for injection of new psychological and sociological assumptions into the study of economic behavior.

A new discipline may be developing which would merge economics and other social sciences as "socioeconomics" ("neither Samuelson nor Marx," as one wit put it). The subject is approached in very different ways in the works of numerous groups, including five new journals, both in the United States and overseas. Although members of these groups range from writers espousing Catholic values to humanist psychologists to hard-nosed psychologists and sociologists, the groups seem to share certain premises. These include the conceptions that people are not to be viewed as cold-blooded, self-interested, rationalist calculators; that the economy should be viewed as nestled within the society and culture; and that the notion of power is to be granted a central role in any theory.

I see four areas in which progress is being made in fashioning such an alternate paradigm and each has its own difficulties: (1) opening up the preferences; (2) modifying the assumption of rationality (again!); (3) the societal nestling of the market (a matter of institutions and political power); and (4) increasing the empirical, inductive elements of the study of economic behavior.

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Opening up the preferences

If one could register bets on the future developments of social sciences, I would bet that the study of the factors that shape preferences will prove to be the most productive staging ground for socioeconomics. Neoclassical economists typically assume that the preferences are stable. Hence, if behavior has changed between two points in time (recall, they tend to deal in "comparative statics," not in processes of change), it is typically assumed that the change "must be" due to changes in "constraints," not in preferences. Thus, observing that in 1985 Americans consumed less liquor than in 1980, a neoclassical economist will ask if the prices had increased, the drinking age been raised, bar hours been shortened, and so on. Other social scientists will suggest that the rise of a fitness-and-health movement and, more recently, of a neotemperance movement may explain why the "taste" for liquor has declined. (By the way, the latter is a rather parsimonious interpretation because the same factor may also explain, in part, whatever changes have occurred in constraints—for example, the imposition of higher taxes on "sinful" consumption.)

A neoclassical economist may say that such explanations are "too easy"; one may always assume that tastes have changed. However, reference here is to (a) empirical evidence that preferences actually have changed in the period specified and to (b) spelling out the factors that account for these changes and demonstrating that they have been at work. The first step can be undertaken when one analyzes several changes in the level of consumption of liquor and collects data about changes in prices (and other constraints) as well as evidence concerning changes in the social valuation of liquor. Regression analysis can then determine the variance in consumption of liquor as attributed to changes in preferences versus changes in constraints.

Concerning the factors that cause changes in preferences, numerous hypotheses are found in psychological, sociological, anthropological, and political science literature, for instance, in dealing with the dynamics of social movements. However, attempts to demonstrate that these factors are at work have run into three difficulties.

First, the social sciences involved are very overdetermined and contested. There are too many factors to be considered and there is no agreed-upon list. An overelaborated list might include attributes of leaders, psychic and social attributes of the members, the substance of the values at issue and their internal dynamics, the level of legitimation of established social institutions, the effect of cross-cutting groups, and many others. Significant progress can be expected only after social scientists will agree, as a first approximation, to focus on a shorter and more concentric list of factors.

Second, many of the factors involved are difficult to make operational (e.g., emotions); and third, the correlations of inner mental states of the subjects and their behavior have often been found to be quite low. Recently, though, these difficulties have been reduced and progress has been made in developing various measurements.

A sample of findings

Without going here into details, a masterful example of such a socioeconomic study well grounded in evidence is the analysis of the causes of crime by Wilson and Herrnstein (see For Further Reading). The study encompasses neoclassical economic findings, the findings that crime rates reflect "costs" (size, certainty of penalty) and "profits" (size of loot). Wilson and Herrnstein recognize that these factors account for a significant chunk of the variance. However, they also show that another considerable amount is accounted for by differences in preferences, due to such factors as moral socialization (differences in family structures and values) and personality (ability to control impulse). Similarly, in *The Psychology of Taxation*, Alan Lewis showed that both kinds of factors affect the extent of compliance with tax laws.

Possibly the greatest opposition to such an approach is a hidden normative "hang up." Neoclassical economists seem to adhere to the notion that the preferences are fixed, in part, because they fear that if preferences are changeable they also can be manipulated. This would fly in the face of the notion of consumer sovereignty and their most cherished assumption of individual autonomy. As Michael S. McPherson pointed out, they are committed to a fallacy by assuming that, if their theory is free from manipulation, the real world will also be free from it. Once the impossibility of tailoring the world to a theory is brought into the open, resistance to opening up the preferences—a main barrier in the way of more collaboration between economics and other social sciences—will be reduced.

Rationality: how much less is enough?

The major second front—and a front it is—between neoclassical economics and the sister social sciences concerns the assumption of rationality. Hardcore neoclassical economists still argue (a) that individuals are, or it is productive to assume that they are, rational utility-maximizers, and (b) that if people act nonrationally, their behavior is lawless and hence cannot be studied. Ergo, you either assume rationality or leave the realm of science. Sociologists, since the 1840s, have shown that nonrational behavior by *subjects* of scientific study (the behavior of individuals) can be understood and systematically explained by scientific *observers*. If a lemming runs off the cliff, all *his* followers may do so; we, though, will remain standing on the top, observing the effect of the lead lemming.

Attempts to reduce the distance between neoclassical economics and other social sciences on this crucial issue have followed mainly two approaches: (1) relaxing the definition of rationality; and (2) arguing that individual behavior may approximate rationality even if it does not quite qualify as rational. Neither approach seems sufficient.

The first approach is illustrated by the notion of "intended rationality," according to which the actor is rational when he/she uses all the information available, in a logical manner based on the actor's assumptions, as distinct from collecting *all* the information necessary and using it in line with *established* rules of reasoning, that is, logically. The trouble with "intended rationality" is that anything goes; it is a concept that does not differentiate and does not help our thinking, explanations, or predictions.

Thus, Shweder argued that a preliterate tribe that maintains a cargo cult (they believe that, if they worship a plane that crashed in their woods, more whiteman goods will be delivered) acts rationally, because according to the information available to the tribe members and *their* logic this makes sense (see For Further Reading). Such an approach may save the label "rational" but deprives it of content. If the concept does not allow us to distinguish between what a cargo-worshiper does and what a scientist does; between soothsayers and modern management; between rain-making and irrigation; between magicians and economists; what is it good for?

The moderating approach, launched by Herbert Simon's "satisficing" and much expanded by recent psychological work which uncovered various systematic biases in human inferences, points in the right direction for socioeconomics. The main question is whether this approach goes far enough, since it does not deal with the intrusion of emotions and values into inferences and decision-making; indeed Nisbett and Ross explicitly reject these factors and focus instead strictly on intracognitive limitations. However, as Katona and a whole stream of psychologists have demonstrated since then (see For Further Reading), people's economic behavior is determined largely by impulse and habits.

Neoclassical economists respond that these acts are rational because they reduce transaction costs. For instance, a person who keeps buying at the same supermarket rather than engaging in comparative shopping "must have established" that the savings to be gained that way are smaller than the costs involved. However, it seems individuals adhere to their habits, especially addictions, long after this point has been passed. And, to apply Winter's well-taken point: Most people are unable to know or calculate the cost and benefits of less versus additional searching.

What is needed is a theory of decision-making that assumes a rather low ability to know and infer logically and one that recognizes that the selection of means, not just goals, is deeply affected by emotions and values.

Economic nestling

The role of preference changes, emotions, and values concerns either the meta assumptions and core concepts of socioeconomics or micro (individual) behavior. Progress is also being made on the macro, collective, institutional level. This is well illustrated by the way markets are seen.

Neoclassical economists tend to assume that the market is basically self-regulating. This notion is deeply rooted, going as far back as Adam Smith's famous point that following division of labor, people engage in exchanges out of self-interest, not out of benevolence. It finds formal technical expression in works such as those of Leon Walras and Gerard Debreu who specified the conditions of perfect competition without references to any exogenous factors.

A typical list is:

•The largest firm in any given industry is to make no more than a small fraction of the industry's sales (or purchases).

•The firms are to act independently of one another.

•Actors have complete knowledge of offers to buy or sell.

•The commodity (sold and bought in the market) is divisible.

•The resources are movable among users.

A neoclassical economist may acknowledge that the values of a society and its government are necessary for the working of a market, but the neoclassical paradigm naturally does not study the specific conditions under which the ethical and political system *protects* the market.

A core assumption of socioeconomics is that all economies are nestled within a society which contains specific ethical and political institutions. Their specific attributes determine *both* whether the market forces are accorded sufficient range for the economy to be able to flourish (for instance, via legitimation of commerce and of entrepreneurship) and whether antimarket forces are contained. These forces not only emanate from the societal-political realm but are also generated by powerful economic actors using both intraeconomic means (e.g., predatory pricing to block the entry of new competitors) and political (e.g., lobbying for tariffs, quotas, tax exemptions) and unethical means, violating the trust which lies at the root of all transactions. The ability of the market to function "autonomously" is hence shown, in effect, to be largely controlled by the ability of the societal capsule to protect the market from such forces.

Two simple socioeconomic propositions illustrate this approach.

•First, the higher the ethical commitments of individuals who transact with each other, and the stronger the shared norms of proper conduct, all other things being equal, the lower the production costs and the higher the productivity (see Phelps in For Further Reading). The reason for this surmise basically is that, when ethical bonds are low, large amounts of resources must be dedicated to lawyers to draft and execute written contracts, to retaining inspectors and accountants, and so on. But when the level of ethics and trust is high, these costs—which add nothing to production—are significantly lower. In *Accounting for Slower Economic Growth in the United States in the 1970's*, Edward F. Denison reported that the high level of theft by employees is a significant factor affecting productivity in the United States, whereas the low rate of crime in Japan is a major factor in its favor.

•Second, the level of industrial concentration is not due merely to changes in intraeconomic strategies (e.g., greater use of advertising) but also reflects changes in the regulatory environment (e.g., the enforcement of antitrust laws) and in the political activities of powerul economic actors. Thus a change in power from the Republican to the Democratic party may enhance the ability of unions (auto and steel workers, for instance) to gain protections. Such a realignment may favor Coke over Pepsi; again, it may affect the distribution of routes among American airlines (see Etzioni, 1985 in For Further Reading). In short, the level of industrial concentration is determined in part by the extent to which the economic realm is isolated from the political one. This isolation is higher, the more private power cannot be converted into political power—for example, when the costs of campaigning for political office are paid by the public (as is the case in U.S. presidential elections) and not by private power wielders (as is the case, in part, for Congress).

Attempts to model such political factors in neoclassical economic terms (that is, as themselves subject to competition such as might exist among those corporations who organize political action committees [PACs]) have not proven quite successful. The need for more traditional political science analyses, especially of coalition formation among interest groups, seems called for. The success, for example, of the Economic Recovery Tax Act of 1981 is often attributed only to President Reagan's great communicative powers. When Congress balked, it is said, the president appealed to the country, and citizens flooded the Congress with mail. However, the bill was also supported by an unusually wide array of business lobbies which were often in conflict in the past—and since. Then, too, the bill was greatly redrafted and much expanded so that it, in effect, would pay off a large variety of special interests.

More induction

Neoclassical economics has become increasingly – and many, including Leontief, believe excessively – deductive (see For Further Reading). The other social sciences tend to be more inductive. A combined socioeconomic approach may hence serve to restore a balance to the study of economic behavior. Already psychologists, who conduct laboratory experiments and field experiments, and sociologists, using attitude surveys, have enhanced the inductive elements of the study of economic behavior. For instance, survey studies have shown the effect of attitudes on consumer choice and on economic achievement and the effects of personal characteristics of the owner/manager on firm performance.

A "market" for socioeconomics

In principle there should be no difficulty in adding another interstitial discipline to the academic scene: the way, say, biochemistry was added as a synthesis of those two disciplines. However, there are some reasons to believe the interest in socioeconomics ranges farther. First, in the private sector, there is considerable disappointment with the way MBAs are trained and a growing demand that future business executives be trained in a broader manner. True, the curriculum of business schools already includes some classes in psychology and a few in organizational sociology or in political science. However, many business schools are still dominated by neoclassical economics, by formalistic, highly quantitative approaches, and by the lack of an integrated conceptual scheme of the work of firms, markets, and economies. They may teach a course on management by the numbers and one on human relations, but they leave it to the student to integrate these often conflicting perspectives. Many classes focus on the firm as a profit-maximizing "black box," rather than as a small subpolity, part and parcel of an encompassing society. Socioeconomics ought to do well here once its conceptual scheme is evolved, so that it is able to provide the much needed, balanced and integrating framework.

In the public sector, which regularly deals with the "political economy," whether it is the question of economic development in the Third World or of reindustrialization of the West, of education vouchers or of changes in the institutions that provide health services, there is a need for policy analysts and evaluators to combine the examination of economic forces with the study of forces of other aspects of society: in short, for socioeconomics. To put it another way, the demand for socioeconomics is quite evident: could the supply be far behind?

Social Protection

Edited by **Martin Rein,** *M.I.T., and* **Lee Rainwater,** *Harvard University*

The essays in this volume discuss the interrelationship between government and the private sector in providing social welfare benefits. The main theme which emerges is that it is a mistake to attempt to draw a distinct line of demarcation between the functions of the public and private sectors, or between "state" and "market." An approach that takes account of the interconnection or "interplay" between the two is much more illuminating. The contributors—Ellen Immergut, Michael O'Higgins, Harald Russig, and the editors—offer a comparative look at this interrelationship in key areas such as sick pay, maternity benefits, health insurance, and retirement benefits in industrialized nations.

1986 256 pp. 383-1 Cloth $35.00

Stagnation and Renewal in Social Policy

Edited by **Gösta Esping-Andersen,** *Harvard University,* **Lee Rainwater,** *and* **Martin Rein**

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The Scandinavian Model

Welfare States and Welfare Research

Edited by **Robert Erikson,** *The Swedish Institute for Social Research,* **Erik Jørgen Hansen,** *The Institute for Social Research, Denmark,* **Stein Ringen,** *The Swedish Institute for Social Research, and* **Hannu Uusitalo,** *Helsinki School of Economics*

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