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Behavioral economics research and the foundations of economics☆

Vernon L. Smith*

University of Anchorage Alaska, USA

Abstract

Five propositions on which economists and psychologists including behavioral economists are in agreement are presented, leading to a discussion about two kinds of rationality. After some comments on methodology and on concepts of fairness, I will discuss the question of wealth maximization versus the economics of survival, and their different implications for behavior.

I want to begin with five propositions on which economists and psychologists including behavioral economists are in agreement.

This will lead me to talk about two kinds of rationality.

After some comments on methodology and on concepts of fairness, I will close on the question of wealth maximization versus the economics of survival, and their different implications for behavior.

Keywords: Behavioral economics; Economist; Rationality

1. Propositions

Curiously, the image of economists and psychologists as protagonists obscures their underlying agreement on foundations. Both rely upon the same underlying interpretation of economic rationality as follows:

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* Present address: Interdisciplinary Center for Economics Science, George Mason University, 4400 University Drive, MSN 1B2 Fairfax, VA 22030, USA. Tel.: +1 703 993 4850; fax: +1 703 993 4851.

E-mail address: vsmith2@gmu.edu.

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(1) *To the extent that markets are rational, as in controlled S & D experiments or irrational, as in experimental asset bubble markets, this derives directly from the rationality or irrationality of agents*.

Thus, even a "... monopolist ... has to have a full general equilibrium model of the economy" (Arrow, 1987, p. 207). The default explanation for market rationality is assumed to derive entirely from individual rationality. Markets cannot be rational if agents are not fully rational in the particular sense in which theorists have modeled it, and this proposition has been uncritically accepted by psychologists and behavioral economists.

(2) *Individual rationality is a self-aware, calculating process of maximization*.

Here is a particularly clear statement of decision as deliberate intentional action: "Incentives do not operate by magic: they work by focusing attention and by prolonged deliberation" (Tversky and Kahenman, 1987, p. 90). But this is an inference based on how the theorist conceptualizes and models decision problems, not the subject. The inference ignores the demonstrated capacity of motivated subjects to find equilibrium outcomes by repeat interaction in market experiments without cognitive awareness of this capacity, and their capability of achieving better outcomes in two-person anonymous trust interactions than if they applied traditional game-theoretic principles.

(3) *Predominantly both economists and psychologists are reluctant to allow that naïve and unsophisticated agents can achieve socially optimal ends without a comprehensive understanding of the whole, as well as their individual parts, implemented by deliberate action*.

People are not supposed to achieve desirable outcomes, and not be able to tell you about it. There is no 'agic'; no room for the Gode and Sundar zero intelligence traders who in simple environments reveal that at least some of the rationality in markets is encapsulated in the institution; no room for the results of hundreds of single and multiple commodity market supply and demand experiments in which subjects with private information on values and costs achieve unintended equilibrium predicted outcomes. The phenomenon, not being constructively explicable with the tools of standard theory, is in effect denied: if subjects achieve rational outcomes it is because in effect they think about decision problems as we economists do.

(4) *Consequently, psychologists test the rationality of individual decisions largely by asking for subject responses to choice problems to discover how they 'reason.'*

Rather than challenge this interpretation, economists, subject to the identical vision—how do agents consciously think about economic choice?—are critical of the question–response survey methods used in cognitive psychology: the stakes are zero or too low, and it is claimed without citing the experimental evidence on stakes, that the subjects are too unsophisticated, inexperienced or untrained to allow a serious researcher to find out how 'real agents really think.' Many psychologists appear to find irrationality everywhere, and many economists appear to see the findings as everywhere irrelevant. To both, how agents think indeed exhausts the core of investigation.