11 *Homo œconomicus*: should we let him go?

The journey through the basic models of political economy reveals that the bulk of these models is built on the assumptions that individuals have connected and transitive preferences over alternatives and that all the action in political economy is about making choices. Taken together, these assumptions imply that essential to political economy is maximizing behavior. As we saw in chapter 4, *homo œconomicus* has been under attack for quite some time, but survived in remarkably good shape. Much of the success of this model is due to the lack of credible alternatives. If one abandons the assumption of rationality in the thin sense, then the floodgates are open for nearly arbitrary explanatory accounts of human behavior. If the systematic violations of rationality axioms are taken as the point of departure – as e.g. in prospect theory – the simple elegance of the axiomatic choice theory is lost and we are left with a bewildering variety of theoretical systems which account for some particular types of violations of the standard theory.

Homo œconomicus as a concept fits nicely in the tradition of thinking that Smith (2005) – using Hayek's (1973) term – calls constructivist rationality. The basic tenet of this tradition is that social institutions are to be seen as results of conscious human reasoning. Whenever an institution appears, there is also an agent who has consciously designed it. This tradition has its roots in the rationalist philosophy. Smith contrasts this tradition with what he calls ecological rationality which allows for – and is particularly interested in – those institutions which have rational characteristics and, yet, have not been designed by anyone. The ecological rationality tradition investigates the preconditions and processes of evolution or emergence of social systems out of interaction of individuals and groups following their behavioral norms and strategies. These individuals and groups may not have any idea of the order or system emerging out of this interaction.

As characterized by Hayek and Smith the constructivist rationality seems implausibly narrow. Admittedly there are institutions that have been designed with certain desiderata in mind and which turn out to achieve those very desiderata. However, there are also institutional designs which bring about unintended changes in other institutions. For example, the abandonment of trade barriers in Europe over the past decades is changing the organization of the labor markets. Similarly, the establishment of the European Parliament and the growth of its importance in the Union legislation will undoubtedly be reflected in the national parliaments. So, the constructivist rationality represents an unduely narrow view of institutions: very few of them – probably none – have been designed to their last detail anticipating all effects on other institutions.

Accepting the ecological view of rationality presents new challenges to *homo œconomicus* as a descriptive model. These are illustrated with the PD tournament strategies discussed in section 5.4. The dominant strategy in a one-shot PD leads to very low aggregated payoff in sequential PD tournaments. A population of TFT players reaches a higher level of aggregated payoff than a population of players resorting to the dominant strategy in each game. Obviously, TFT as a general norm has a better survival capability than the dominant strategy.

The ecological rationality plays a central role in what is known as evolutionary economics. As the term suggests this approach traces the over-time variation of economic behavior, structures and – most importantly – institutions. It differs from neoclassical economics not only in terms of rationality concept, but also in the importance attached to equilibria (Young 1998: 3–6). Its focus is in processes whereby standards, customs, norms and behavior patterns emerge over time out of interactions between individuals going about their business not necessarily realizing that what they are involved in is an institution building process. Nevertheless, this approach does not do away with rationality as the primary predictor of individual activity. Instead of looking at one-shot or repeated games with invariant rules, it focuses on adjustments of individuals and rules to external shocks. So, the difference between neoclassical and evolutionary economics is not in the former's concentration on equilibria and short-term behavior, but in the latter's focus on out-of-equilibrium adjustments and learning processes that eventually may lead to an equilibrium. Thus, even in evolutionary economics *homo œconomicus* has a role to play.

Even the most ardent advocate of rationality in the axiomatic sense is likely to admit that predictions based on player rationality are sometimes counter-intuitive and burdened with a large body of contrary experimental evidence (see Colman 2003). The best-known examples are one-shot and sequential PD games, but also in Rosenthal's (1981) centipede game and in several other settings the game-theoretic solution methods, like backward induction, lead to implausible outcomes.[66] This has motivated the development of behavioral game theory (Camerer 1997, 2003). It has some similarities with the ecological rationality concept, but is not exclusively concerned with institutions. Instead, it looks for principles of reasoning that would make the observed deviations from the game theoretic predictions intelligible. The behavioral game theory is very much akin to prospect theory and other similar attempts to account for the observed deviations from the EU theory. Colman argues that the weakness of game theory is that its concept of rationality as expected utility maximization defined in individual decision settings does not readily apply to interactive decisions, i.e. those dealt with by game theory proper. Yet, he is ready to admit that 'game theory has vastly increased our understanding of interactive decision making, and no alternative

theory even comes close to challenging its power' (Colman 2003: 152). Indeed, the main value of game theory and its underlying concept of rationality is in its relative simplicity and simultaneously in its explanatory and predictive power. The latter is by no means universal, but provides a good benchmark for experimental and, more generally empirical work. So, *homo œconomicus* continues to be an important construct in the research on political economy. It is, after all, primarily a model, and as such a useful approximation or idealization of politico-economic agents of the real world. Experimental and other empirical observations have occasionally cast a shadow on its usefulness in certain areas, but due to its conceptual simplicity and intuitive plausibility it remains a useful research tool in many other domains. Eventually, it is likely to be replaced by at least as general and predictively more successful model, but at present no such model is in sight.