

Humane Economics – from Adam Smith to Vernon Smith*

Balázs Sárvári

Vernon L. Smith – Bart J. Wilson:

*Moral Sentiments and the Wealth of Nations for the Twenty-First Century
Cambridge University Press, 2019, p. 215.*

ISBN: 978-1316648810

Hungarian translation:

*A közgazdaságtan humanizálása: Az erkölcsi érzelmek és A nemzetek gazdagsága
a 21. században*

Pallas Athéné Könyvkiadó, Budapest, 2020, p. 235

ISBN: 9786155884917

The Hungarian edition received an impetuous title: ‘The humanisation of economics’. Moreover, this combination of words certainly seems to be an oxymoron for many, also catching our attention easily. Humanising economics. On the one hand, readers could expect the book to eventually shed light on a new path, following which the authors and the reader together will make economics humane. On the other hand, many may approach the book reluctantly, saying that economics is more precise and methodological than humane, and it should not even be made humane. In contrast to these attitudes, in the book the authors show that economics is already essentially and originally humane. One could also say that it is not this branch of science that they want to humanise, but the picture we have formed of it. They undertake all of this by tracing economics back to its roots in many respects, in an approach, which is deeply humane. One of the authors, Vernon L. Smith, received the Nobel Prize in Economic sciences in 2002 for his study of alternative market mechanisms. He is a professor of economics and finance at Chapman University, California. In addition, he is a founding member of the University’s Economic Science Institute and its Smith Institute for Political Economy and Philosophy as well as a Distinguished Fellow of the American Economic Association. The other author, Bart J. Wilson, is a professor of economics and law at Chapman University. He is

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

Balázs Sárvári is a Senior Methodological Expert at the Magyar Nemzeti Bank and an Assistant Professor at the Institute Department of Economics of Corvinus University of Budapest. Email: sarvarib@mnbb.hu

a founding member of the Economic Science Institute as well as a founding member and Director of the Smith Institute for Political Economy and Philosophy.

If the market is considered to be the location where people make economic decisions, the neoclassical approach performs well in the analysis of these impersonal relations. However, if these relations are embedded in personal interactions, the resulting picture is much different. This is the starting point (Chapter 1) of the fascinatingly complex book by Vernon L. Smith and Bart J. Wilson. With the title (*Humanomics*) they also want to stress ‘the very human problem of simultaneously living in these two worlds, the personal social and the impersonal economic’ (p. 2). In their argumentation they return to the thoughts of Adam Smith, where the personality of people, or more exactly their emotions, sentiments, passions and affections (Chapter 2 separates these aspects of human life with inspiring precision) as well as fellow feeling and a sense of propriety still played a greater role.

The importance of these concepts was highlighted by the fact that the neoclassical approach was typically unable to predict the outcomes of two-person interactive games. The models of ultimatum and trust games were created in the 1980s, and laboratory experiments using them were conducted in the following decade. The studies focused on cooperation between actors and found cooperation of a degree that was incompatible with the pursuit of self-interest of the neoclassical approach. The answer of Adam Smith is that human decisions are driven by self-love and not by the pursuit of self-interest. The book is the restoration and proof of this thought.

The interpretation of the meaning of words is an abstract level, and therefore it is justified to project Smith’s answer to the practical level of economics as well (Chapter 3). The book’s authors address criticism to contemporary economics and cognitive psychologists, who in their opinion, ‘maintain the positivist tradition, having merged it with Benthamite utilitarianism’ (p. 36). The result of this is that when discussing the preferences they almost only deal with the choice. Meanwhile, they lose sight of the decision-maker’s taste, behaviour and conduct – all of the reasons and contexts that may have played a determining role in the decision. It was exactly the importance of context that was explored by laboratory experiments carried out in the 1990s. In these experiments, the participating persons ‘regularly make choices that would result in lower cash payoffs for themselves when another available alternative would have made them materially better off’ (p. 38).

This paradox of preferences posed a challenge to researchers. One of the directions of looking for an answer was the separation of individual and social preferences. The other direction, Smith’s answer, ‘eschews outcomes and their utility, including social preferences, and begins with actions as signals of rule-following conduct’ (p. 41). If we approach the individual’s decision from the direction of compliance,

i.e. context, the elements determining the individual's social relations become more important. For example, these elements include his/her ability to tell right from wrong, or what the individual is incited to do by sympathy or resentment. The authors consider this approach to be an independent model, the axioms of which are contained in Smith's work *The Theory of Moral Sentiments*. Model value is an important element in the book, because the authors highlight the positivist slogan typical of economics as well: 'It takes a model to beat a model' (p. 60). Accordingly, they not only criticise the neoclassical framework, they also offer another model or axiom system in its stead.

This concluding thought of Chapter 4 must necessarily be followed by a presentation of the axioms themselves and the related principles (Chapter 5), occasionally complemented with formalised proofs. Of course, we are not in a position here to describe all of these in detail, but the concept is made perceptible if one reads the 2nd axiom and the 6th principle, one after the other. The 2nd axiom reads: 'Human beings judge the sentiments and passions of each other' (p. 71). The 6th principle reads: 'The circumstances or context of an action acquires importance because it enables human beings to read intentions and find meaning in each other's actions' (p. 78). For our interpretation it is important to underline that morality for Smith is not an exogenous element (stemming, e.g. from beliefs), but means the rules that are followed by people and that can be observed through decisions. These rules are remembered by people as they more and more often opt for actions for which they may expect to be praised, and less and less often for those for which they may be blamed. Reading the book, it becomes clear that by proceeding in this manner the authors can give real answers to the decisions observed in the laboratory experiments.

The authors continue their argumentation with conclusions regarding the prediction of context-specific actions (Chapter 6). This is a more readable approach to the formal structure of Smith's model. One of its steps is that they separate beneficence and justice, which also means direct preparation for the interpretation of the decisions observed in the experiment. Following that, the formalised language returns (Chapter 7). By introducing new concepts, they verify that the system stems from human sentiments and not from conscious human sense. A good example for this is their wording that 'positive reciprocity arises from a sense of gratitude, negative reciprocity from feelings of resentment' (p. 100).

Following that, the text is a description of game theory modelling and the concrete experimental observations. First, the authors deal with trust games (Chapter 8) and then with ultimatum games (Chapter 9). They present games during which the participants 'routinely and deliberately depart from playing payoff dominant strategies' (p. 111). Before looking for the reasons, they reject the idea of avoiding an analysis of the problem in detail by citing the concept of altruism or the preference

called social. Namely, in their opinion this is not about unselfishness (for example), but human sympathy and self-control is expressed in these decisions. The games described present human decisions and the explanatory power of Smith's model in an exciting form. Among other things, the authors demonstrate that participants are typified by their first decisions, as they determine their susceptibility to sympathy to a great degree.

Relying on the observations, the authors construct new trust games (Chapter 10). During that, in one of the most interesting subchapters, they provide a detailed comparison of the traditional model and the one resting on Smithian foundations. In addition, they also demonstrate that what is written in *The Theory of Moral Sentiments* predicts the observations of trust games and many other experimental observations as well – and prediction capability is an extremely strong feature of a model. In light of all this, the authors go even further and propose a revision of the formal structure of the traditional game theory (Chapter 11). Within the context of the mathematical formalisation of human behaviour, they present where the traditional game theory model failed and what amendments allow the elimination of these failures as well as how the Smithian model can be applied during these steps.

One of the main attributes of this model is that it takes the various narratives into account, and therefore this is the main subject of Chapter 12. Context became very important when the results of the experiments went against the utility maximisation approach. Context became the element through which researchers attempted to capture what may divert decisions in these simple situations from what works in the case of much more complex market decisions. On one side, there is traditional economics, where the main emphasis is on the payoffs and the steps in the game theory. On the other side, there is Smith's approach, where the story, human relations and narrative memories are also determinants. In order to illustrate that, the authors share a narrativised trust game as well with the reader. In the closing chapter (Chapter 13), they give an answer to the classic Smithian dilemma. They link his two main works to one another, and with that they take up the position that the volumes should be considered as continuation or complement, and not as two completely different approaches.

This book is recommended to everyone for whom humanomics (or humane economics) is not an oxymoron, or for those who are at least open to becoming acquainted with this side of science as well.