FROM THE HUMAN CAPITAL DEFINED AS "HOMO OECONOMICUS RATIONALIS" TO THAT OF THE RATIONALLY BOUNDED AND OPORTUNISTIC "HOMO CONTRACTUALIS". AN INSTITUTIONALIST APPROACH

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Abstract. The rationality (its presence or its absence) of the business, be it producer or consumer, has been a constant preoccupation of all those who dedicated their energy and talent on the sinuous road of the history of economic thinking. Without rational behaviour it was inconceivable to determine a development path. From this point of view the position of the great schools of thought is based, essentially, on two main approaches. The classics and the neoclassics had in mind the perfectly rational and well-informed individual. In reply, the institutional economy, in its old or new form (NIE), opposes to homo oeconomicus rationalis a narrow-minded and insufficiently informed homo contractualis. The consequences of this re-evaluation of the basics of the business’s potencies on the physiognomy of the theoretical approach and also on the results of practical actions are significant. Those linked to the bounded rationality hypothesis, an important operating concept in the analytical structures of NIE, may trigger debates on the theoretical basis of standard economics.

Key words: bounded rationality, fulfilling, procedural rationality, opportunism, incomplete contracts, AS IF, institution.

1. INTRODUCTION

The toughest reply NIE gave to neoclassic economics is related to the questioning of the principle of rationality. Not the principle of rational choice but that of perfect rationality based on which there have been build the well-known models of the producer and the consumer, the main characters of the neoclassic age. Even with the “bounded” rationality only, which contradicts the Cartesian spirit of neoclassicism, NIE renders obsolete its function maximizing calculus and becoming a “special” social science, methodologically speaking. (Ménard, 2003:7)

The origins of the criticism of the (producer's or consumer's) Perfect Rationality Principle lie in the work of Th. Veblen and H. Simon.

More than a century ago, Veblen ridiculed the excessive hedonism of the neoclassic economic individual with these memorable words: “The hedonist conception on man is that of a computer operating, at the speed of light, with information on comfort and discomfort, oscillating like a homogeneous particle of the desire for happiness under the impulse of stimuli, carried around but still remaining intact … Self-imposed in the space of elements, it turns symmetrically around its own spiritual axis until it is caught in the parallelogram of forces where it follows the line of the resultant. When the impact force is depleted, it stops to
rest, a particle of desire, self-sufficient as it used to be”. (Veblen, 1919:73-74) “The homogeneous particle” which Veblen had in mind perfectly resembles the “cubic centimetre” of homogeneous capital from J. Robinson’s *Heresies*, engaged in the same critical process of neoclassic “dogmatist invulnerability”. It is possible that Veblen thought of Edgeworth’s “diagram in a box” when he spoke about the “parallelogram of forces”, which includes, in a “rational” manner, pleasures and discomforts. In any case, Veblen’s words echoed. This is how H. Simon, claimed by the neoinstitutionalists as their spiritual mentor, adopts the individuals’ “bounded rationality” hypothesis, accounting for the limited cognitive capacities and insufficient information. He is convinced that man is by far comparable to a programmable computer.

If this thesis, taken from H. Simon, including the sustaining arguments, turned NIE into a “special” social science, it is as true that **bounded rationality** had the effect of a Pandora Box. It has reignited debates on other principles, subsequent or adjacent to rationality, opened new and generous directions in research, and created a background for the disputes between the “crowned heads” of NIE. Here are some sequences of what embracing bounded rationality meant.

### 2. FROM MAXIMIZATION TO SATISFACTION

“The introduction of bounded rationality hypothesis forces the economic researcher to ask himself about agents’ motivation and the way they perceive and understand the environment in which they act. Indeed, agents do not always act towards maximizing their personal interest (they can, for example, to behave in an altruistic manner), and the manner they can decode their environment depends, partly, on the <<mental construction>> they have in their head” (Chabaud, Parthenay&Perez, 2004:4). This quotation, representative for the comments on North’s work, tells us, at least three things:

**First:** the agent’s perception of the environment cannot be a perfect one because of their limited cognitive capacity and imperfect information.

**Second:** this operation interferes with “the agents' motivations” which may be hedonistic or altruistic.

**Third:** “mental build-ups” have a major role in shaping the agent’s relation with the environment.

All of them sustain the hypothesis that the individual is not a perfectly informed robot and that he cannot set objectives that are beyond his power, he cannot hanker for optimizations or maximizations. If rationality is limited, the businesses can only ascertain a strategy that **meets their prospects**. This rule can be applied both for the producers and for the consumers. Louis De Alessi considers that, once the idea of “meeting the prospects” is accepted, it eliminates the familiar dichotomy between the firms' tendency to maximize their profits, on one side, and the one of families and consumers to maximize their utility, on the other (De Alessi, 1983:66). This dichotomy, we may add, is determined by the reminiscence of the Objective Theory of Value which penetrated the neoclassical structures with the help of its mentor – A. Marshall. Dichotomic or not, integrated or not in the rules of the zero-sum game imposed by the acceptance of “objectivity” of the value produced only by means of human work, individuals in the NIE environment share a common feature: “they try to maximize their objectives, which implies a detailed knowledge of the possible alternatives, high capacity to process related information as well as vast time periods available, to make choices; in reality, they settle with a <<satisfying>> (rather than <<maximizing>>) level in the pursuit of their goals and stop searching for additional alternatives when they have been reached” (Chavance, 2007:65).
3. IMPERFECT “MENTAL CONSTRUCTION”-IMPERFECT INSTITUTIONS. “PROCEDURAL RATIONALITY”

Veblen’s observation that a “mental construction” may also be “imbecile” has triggered over the years a vivid debate on the origin of inefficiency, a debate that is far from over.

Indeed, if we accept the idea that “the way in which individuals decode the environment” depends on their mental construction, which is the source for the creation of rules, then we can understand why North made such an effort to explain the persistence of inefficient institutions. Because there are, and the reality confirms it, inefficient institutions. They are the result of this chain of cause and effect: institutions = the reflex of mental construction; these mental constructions may be of higher quality or they may be “imbecile”; low-quality mental constructions = imperfect and inefficient institutions.

Faced with this scheme, one may cynically conclude that every nation has the institutions they deserve. We cannot stop here though, because neither neoinstitutionalists nor their supporters can.

Neoinstitutionalists offer three extra explanations and two solutions.

The first explanation comes from biology. From this area and especially from Darwin’s theory, the theorists of economic evolution, via NIE, will find explanatory sources for what they consider to be “evolution” and “learning through imitation”. This is also the source for explaining the fact that not all individuals contribute to the same extent to the evolution of society.

The second explanation sends us to ideology (ideologies). We are particularly interested in the imperfect institutions in a country with a totalitarian ideology. In this case the institutions are “perfect” only for those in power; they assimilate these institutions and make them work for their personal interests. For all others these institutions are “imperfect”. Still, these institutions manage to survive in time. Why? Two motives are being considered:

a) It is possible that the “critical mentality” should take more time to be built;

b) If the above mentioned period of time is too long, a kind of “perverted” behaviour may appear, even towards these institutions. It is possible that certain individuals, through the means of “efficient” indoctrination, start to consider “irrational” any deviation or breach, by other individuals, of rules that are “imbecile” from the beginning, but to which they got used and on which they conceive their image of the “rational”. In this case, the chance for these institutions to survive is extremely large.

The last explanation comes from North. He notices that the difficulty of rationally anticipating the future faced by the businesses is also influenced by the fact that mental constructions they use represent just a condensed history. The present is little or not at all embedded in them. “Individuals analyse the environment and solve their problems by treating the information using already existing mental schemes” (North, 1981:20). Hence, North concludes that the rationality of agents is limited also because they judge the present and anticipate the future through clichés which are linked to an already consumed experience! Is there another way? The fact that we use history to understand the present and make predictions about the future is extremely common. Not so for North, it seems.

The solution is found in a hayekian manner, with reference to what is known as “procedural rationality”.

It starts from the premise, advocated by Hayek as well as by Misses, that the individual’s integration in the environment does not necessarily imply the understanding of the rules. They comply with and apply them not because they understand them, but for the fact that the results of their application lead to an accomplishment of their objectives. Once this is noticed, a great part of their behaviour becomes a simple routine. The rational character of this rule is attained, hence, through an indirect route: through human behaviour in accordance to rules determined by the satisfactory result. This is “procedural rationality”.
In the case of the second solution, neoinstitutionalists take into account a highly normative-charged solution. The fact is that institutions are, essentially, human creations, hence nothing stops from supporting the agents that have a low cognitive capacity with a set of institutions that make it possible to reduce uncertainty and risk.

4. LIMITED RATIONALITY – OPPORTUNISM - INCOMPLETE CONTRACTS

It has already been underlined the fact that NIE refuses complete information and perfect rationality philosophies, but not the model of rational choice. In the NIE environment individual behaviour remains rational, with and within the stated limits. But the NIE environment is the real world, unlike the neoclassic one, “built” out of standardized images in order to provide the ideal picture, the Nirvana. In the NIE world everything changes. Everything is a succession of circumstances. In a world without patterns and fixed landmarks, any ex-ante –type of judgement lacks real importance. The bounded rationality of the businesses also contributes to this fact. They still have to reach their objectives, follow their personal interests. How is it possible to satisfy one’s own interests when everything is a “construction yard”? The solution proposed by NIE lies in opportunism: the business is “allowed” to “change” his behaviour; in its pursuit of personal interest depending on the succession of circumstances.

Moral implications of opportunism appear to have had no influence on O. Williamson, preoccupied with setting up the trajectory of the business in a corporative governance framework. He tries, in order to “protect” himself, to relate to the philosophy of the school mentioned before writing that “this concept includes the classical and neoclassical view on personal interest (the simple <<search>>) and, eventually <<cheating>>.” (Williamson, 1979:234, our underline.-I.P.) Just as many other neoinstitutionalists, Williamson accounted for his own evolution inside some concepts. Hence, on this subject, in an interval of six years, he no longer shares the classical and neoclassical point of view and writes that “Through opportunism I understand self-interest seeking with cheating” (Williamson, 1985:47). The “subtle forms of cheating” are no longer referred to as in terms of “possibility”. While Williamson looks the other way when it comes to “lies, theft and cheating” understood as a sacrifice which has to be made in order to avoid any breach of the business’s freedom of movement, the other neoinstitutionalists seem not to feel comfortable with the dead end to which bounded rationality, via opportunism, takes this analysis. They have reasons to do so. Not for a moment have they thought that their “contractual individual” will be different from classic and neoclassic “economic individual” by being able to lie and cheat just to reach his objectives. It is difficult to find arguments to defend the image of a cheater within an economy designed to be one of “civilized” rules and institutions. The price paid to cross from the perfectly rational individual to the “real” one, imperfect and with limited rationality, seems to be too high.

Relativization of the ex-ante judgements due to bounded rationality, imperfect information and environment mobility … must, also, find itself a solution. For NIE it bears the name of “incomplete contract”. This is, obviously, an answer to the complete neoclassical contract, one filled with provisions on price, quantity, quality, terms of execution, etc. These are clearly established. The institutionalist environment of imperfections has little to do with strictness. Between the date of signing and the date of execution, “the succession of circumstances”, may change for a number of n-times the initial terms of the deal. Also, cognitive limitations prevent a one hundred percent anticipation of what is going to take place in this period. This is why neoinstitutionalists act cautiously. They have the doors open to an “incomplete contract”. Certain pledges no longer function; the parts agree to adapt the stipulations of their contract according to circumstances. And adapting means just as many renegotiations as there are changes that appear from the initial situation. When we talk about
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adapting to circumstances we find ourselves on the similar field that provides “institutionalized” support for opportunism.

5. APPROXIMATING REAL BEHAVIOUR USING THE AS IF HYPOTHESIS

Just as Williamson finds in opportunism a refuge to reach a compromise between the business’s necessary freedom and his bounded rationality and power of anticipation, so does A. Alchian in using the AS IF methodological principle as an exit to saving, at least in appearance, the principle of necessary rationality. How does he do that? He transfers the problem to the market. For him, the dispute between rationality and irrationality has no meaning as long as the “battle” on the ground of rationality does not take place in the same space and at the same time when the working hypothesis is established. No, this confrontation takes place on the market. For Alchian, the market is the “selection environment”. All agents pass through its lattice. Only those corresponding to its functioning criteria are able to survive. Briefly, the market is populated by those who understand that they have no other alternative than responding to the “ungrateful” requests of minimal rationality: the cost must be lower than the income in order to leave place for profit. With regards to the actual size of the profit Alchian does not leave the line of thought of his school: not maximum profit, but accomplishment of goals. To justify the “modesty” of the business’s claims, he adds another element: the constraint imposed by risk and uncertainty. In his famous article from 1950, he builds a selection environment not only in constant movement, but also one above which there are floating the clouds of uncertainty (Alchian, 1950). And, how can one pretend, in such a framework, filled with uncertainty and unrest, maximum profit? Meeting the targets set will suffice. How does the environment – the market, solve this problem? By operating a selection and retaining only those who, even if they did not learn anything in school about the Hedonistic Principle and its marginal derivatives, act AS IF they knew everything or almost everything about this subject. In other words, the market operates by selecting “behaviour models”. Those who pass through the “customs” are those who are in line with the rules of the environment. The amount of these rules stands for a condensed experience, consumed in the spirit of rationality. The businesses, also inspired by a rationalist spirit (but without being preoccupied by it) take this experience and imitate it. Rather than rewriting the history of , it is more comfortable (“rational”) to duplicate it and eventually, transmit it.

In conclusion, the rationality problem limited or not, does not derive, for Alchian, from inter-individual confrontations. Rationality is addressed to the selection environment – the market. It plays a vital and active role. By exposing themselves to its competitive environment, the businesses “find out” if their actions are more or less rational. And only those who behave according to the “AS IF” criterion and prove that that they know everything about the unwritten laws of rationality are integrated in the environment. With this spin, by sending the problem of rationality from the relations between individuals to the selection environment, Alchian thought he had saved the authentic principle.

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