



ELSEVIER

The Journal of Socio-Economics xxx (2005) xxx–xxx

**The Journal of
Socio-
Economics**

www.elsevier.com/locate/econbase

Book review

3 **Schmid, Allan. *Conflict and Cooperation: Institutional and Behavioral Economics*,**
4 **Blackwell, Malden, MA (342 pp., Price: US\$ 39.95), ISBN 1-4051-1356-1.**

5 Although it is common in economics to compare institutions on the basis of single-
6 dimensional measures of concepts such as efficiency, fairness or freedom, Allan Schmid's
7 *Conflict and Cooperation: Institutional and Behavioral Economics* rejects that approach
8 with a sharply contrasting vision of what institutional economics is all about. In Schmid's
9 view, institutional change inevitably creates winners and losers. People correctly anticipate
10 that compensation of losers by re-distribution according to the Kaldor–Hicks principle rarely
11 occurs in the real world. Sometimes, the incommensurability of distinct categories of bene-
12 fits precludes the very possibility of compensation. Thus, policy options are virtually never
13 Pareto comparable, because it is almost never the case that all agents (even weakly) prefer
14 the same institution. Conflict is normal and, according to Schmid, its detail and dynamics
15 must therefore occupy center stage in any social science aspiring to real-world relevancy.

16 The goal of Schmid's book is to provide a conceptual framework for understanding the
17 connections between institutions and their corresponding distributions of costs and benefits.
18 Schmid writes (p. xvii), "I understand the angst that drives scholars and citizens to demand
19 aggregate welfare measures by which to scientifically judge the desirability of alternative
20 institutions. But I am not moved to supply their psychic balm . . . [E]fficiency is not a single
21 thing . . . [T]he choice is what to be efficient about."

22 The body of *Conflict and Cooperation* begins with two theoretical chapters that intro-
23 duce Schmid's situation–structure–performance (SSP) model. For Schmid, performance is a
24 description or measure of how net benefits are distributed (i.e., who gets what) and serves as
25 the dependent variable throughout much of his analysis. Schmid's multi-layered framework
26 allows for considerable breadth, including formal and informal institutions, equilibrium and
27 dis-equilibrium, psychological and anthropological variables, and both mainstream and het-
28 erodox techniques of analysis. Although remarkably open, Schmid is no relativist, and his
29 framework is not open to everything. His proposed framework eschews particular a priori
30 axioms such as more is better and the self-regarding norms of *homo economicus* because, for
31 Schmid, these are among the fundamental questions that economic research must attempt
32 to answer. More of what? More for whom? Opportunistic or cooperative to what extent?

33 Social interdependencies, power, hierarchy, non-marginal change, learning, evolution,
34 and multiple and non-existent equilibria are recurring themes. A chapter devoted to behav-
35 ioral economics connects these group-level processes to individual-level traits of human

1 1053-5357/\$ – see front matter © 2005 Published by Elsevier Inc.

2 doi:10.1016/j.socec.2005.07.020

36 cognition and the behavioral regularities they produce. Schmid catalogues relevant dis-
37 coveries in behavioral economics, including unstable reservation prices, mental accounts,
38 lexicographic choice rules, satisficing, multiple selves, emotions, reciprocity and trust,
39 underscoring the fragility of choice with respect to variation in context and the decision-
40 making environment. Schmid argues that discoveries in behavioral economics imply new
41 ways in which institutions matter, implying an expanded role for institutions in determining
42 how real-world economies evolve.

43 Schmid brings together previously disparate bodies of work in institutional and
44 behavioral economics demonstrating their strong complementarity, both in the substance
45 of their findings and in their commitment to assumptive realism and empirical validity.
46 Bounded rationality proves to be a fruitful bridging concept that ties a variety of informal
47 institutions to simple heuristics and behavioral rules of thumb. True to Simon's notion,
48 Schmid argues that heuristics and rules of thumb should not be regarded as second-best,
49 that they are instead strategic tools for dealing with uncertainty, complexity, and the social
50 interdependencies implied by both.

51 *Conflict and Cooperation* repeatedly emphasizes the economic significance of human
52 imagination and the difficulty of using probabilistic reasoning to analyze unknown future
53 events. In cases where the universe of future events cannot be specified (because it has yet
54 to be imagined and therefore does not exist), probabilities cannot be assigned and decision
55 rules other than those based on expected utility must be employed. With echoes of Hegel,
56 Schmid writes that the future itself is made out of imagined futures and that imagination,
57 creativity, and the institutions which facilitate and constrain them, are thus determinative
58 economic variables. Schmid offers lucid descriptions of how expectations and mutually
59 reinforcing beliefs are the fundament of a socially constructed reality that economic analysis
60 must take seriously in order to appreciate the full range of policies and feasible institutional
61 arrangements. The range of real-world possibilities, Schmid argues, is much larger than is
62 commonly appreciated because ideology and, in particular, strict adherence to constraining
63 notions of ubiquitous opportunism (*homo economicus*) constrict the range of options that
64 economists allow themselves to imagine. At the same time, Schmid is open to self-interested
65 maximization when circumscribed within appropriate bounds: on maximization, he writes,
66 "We do it when we think the situation calls for it."

67 Among the strongest links Schmid makes between institutional and behavioral eco-
68 nomics is the malleability of preferences. From high stakes constitutional questions to the
69 mundane detail of local business norms, the scope for institutions to matter is broadened
70 insofar as preference change is normal. Aware of the high stakes implications of malleable
71 preferences in Veblen and Galbraith, Schmid enlivens his case with engaging examples
72 illustrating the surprising influence institutional variation has over consumer choice. For
73 example, Schmid cites work suggesting that the institution of frequency of payments (in this
74 case, 12 monthly payments versus one annual payment) had significant effects on choices
75 that exercise club members made about how much to exercise. Those paying monthly used
76 club facilities at a relatively constant level of intensity, whereas those who made a single
77 annual payment tended to use the club's services intensely at the beginning and significantly
78 less toward the end of the payment year.

79 Schmid's chapter on the sources of human interdependence explains the concepts of
80 incompatible use, externalities, sustainability, exclusion costs, common pool resources,

81 rival/non-rival goods, decreasing and zero marginal cost, economies of scale, asset speci-
82 ficity, rent seeking and socio-emotional goods, with a constant focus on the goal of policy
83 relevancy (p. 137): “If you do not know where the interdependencies are coming from,
84 you can’t design institutions to direct them.” With this assertion, Schmid cautions that he
85 is not advocating planning versus *laissez faire*, or any other ideological agenda. His asser-
86 tion is simply that every institution implies a particular distribution of benefits and that
87 it is an important role of economic analysis to tabulate the distributions corresponding to
88 different institutions. Schmid wants those who undertake economic analysis to realize that
89 taking moral positions and making normative claims are unavoidable and, therefore, should
90 be done in the open, as explicitly as possible. Real-world policy instruments and tools
91 are never distribution neutral. Thus, efficiency cannot be considered separately from the
92 distribution of resources.

93 After introducing the theoretical material, *Conflict and Cooperation* includes a chapter
94 on methods, which covers experiments, case studies, econometrics and simulation. The
95 remainder of the book is devoted to applications. Applications are grouped into chapters
96 on markets, macroeconomics, technology, labor, political institutions and institutional
97 change. Schmid’s coverage is vast, with applications on Russian and Chinese privatization
98 initiatives in the 1990s, the role of property rights in the economic development of Spain
99 and England in the 16th and 17th centuries, the shoemaking industry in early America,
100 the development of time zones and railroads, functional explanations of the sacred cow
101 in India, development of rules governing open fields and containment of grazing lands in
102 England, and the concept of limited liability.

103 Ultimately, Schmid’s ecumenicalism regarding the question of whose work should be
104 included under the institutional and behavioral labels succeeds in yielding insight. Names
105 without obvious connections to either label, such as Stiglitz, Spence, Arrow, Myrdal, Solow,
106 Sen, Krugman, Greif, Milgrom and Roberts, feature prominently alongside behavioral
107 economists (e.g., Simon, Elster, Frank, Rabin, Scitovsky, Thaler) and established figures
108 from both mainstream and heterodox camps of institutional economics (e.g., Coase, North,
109 Williamson, Buchanan and Vernon Smith, alongside Ayers, Commons, Galbraith, Polanyi
110 and Veblen). Inclusion of psychologists such as Robin Dawes and Gerd Gigerenzer, social
111 economists such as Mark Granoveter and Ron Stanfield, and anthropologists such as
112 Boas and Boyd lend convincing weight to Schmid’s case for a large complex of channels
113 through which institutions exert causal force in shaping irreducible conflict inherent in
114 economic life. Students of institutional economics, behavioral economics and others with
115 an interest in systematic analysis of social interdependency will find much of interest in
116 *Conflict and Cooperation*.

117 Nathan Berg*

118 *School of Social Sciences, University of Texas at Dallas*
119 *Box 830688, GR 31, Richardson, TX 75083, USA*
120 *Center for Adaptive Behavior and Cognition, Max Planck*
121 *Institute for Human Development, Berlin, Germany*

122 * Tel.: +1 972 883 2088; fax: +1 972 883 2735

123 *E-mail address: nberg@utdallas.edu*