Foreword

In the study of decision-making by people in the world, the laboratory, in surveys, or in all of the above, many scholars have derided our decisions as irrational, uninformed, biased or vulnerable to illusions, if not delusions, that steer us off track. You won't find that simplistic reduction in this book. You will find plenty of cases of error, sometimes random, sometimes systematic, and sometimes in the models that are alleged to specify rational behaviour. You will also find penetrating analyses of institutions and other social systems that have made us smart, or smart enough to muddle through in an uncertain world.

For me this shift in methodology from the search for anomalies that prove that the standard model is wrong – a search that was assured of finding what was sought – to a closer examination of the circumstances that make for success or failure is particularly welcome. Both experimental economics and the anomalies literature grew out of a welcome new wave of empirical investigation that can only be understood against the intellectual backdrop of a hundred-odd years of equilibrium theory development. That development had been jump-started by the marginal utility revolution of the 1870s, devolving into powerful new theory by the mid-twentieth century. Theoretical insights into topics ranging from individual decision-making and two-person games to the determinants of prices in markets invited new experimental investigations by psychologists and economists in the 1950s and 1960s. Both verifying and falsifying evidence surfaced as part of these investigations. When you are looking to verify the predictions of a theory and get glaring contrary evidence proving your beliefs are wrong, it changes the way you think about the phenomenon.

In retrospect, neoclassical economic theory provided insights so powerful and influential that it displaced rather than supplemented the classical economic perspective. Under the influence of neoclassical theory, my first supply and demand experiments were designed to show that complete information – a pillar of theory at the time – was necessary to observe efficient competitive outcomes. However, the experiments demonstrated the opposite. We were wrong. Inadvertently, I was rediscovering that process is what matters. 'The propensity to truck barter and exchange' is a process; empower people with a trading institution, and they will use it to discover rich forms of specialization that otherwise did not exist.

Neoclassical equilibrium in outcomes displaced rather than supplemented socio-economic interactive processes of change, prominent in the writings of David Hume and Adam Smith.

I see this book as a return to that perspective, but driven by new and exciting ways of modelling and thinking about the great issues that have created the modern world.

Vernon L. Smith, Professor of Economics and Law
George L. Argyros Endowed Chair in Finance and Economics
2002 Nobel Laureate in Economics
Chapman University, USA