

Book Review

Harold Demsetz. *From Economic Man to Economic System: Essays on Human Behaviour and Institutions of Capitalism.* New York, USA. 2011. 198 pages. U.S. \$ 39.99.

Harold Demsetz, Emeritus Professor of Business Economics at the University of California, Los Angeles, has done an excellent job of putting together research in the area of human behaviour and the influence of institutions thereon. Demsetz is one of the leading figures of the New Institutional Economics School. In this book, his focus is on the institution of capitalism, which is by far the most influential system prevalent now. It presents and reviews historical developments in the area and cites influential works, which makes the book a very interesting read. The book is not technical and is meant for a broad readership.

The book is divided into two broad themes, namely self-interest and capitalism and its institutions. First four chapters deal with the theme of self-interest and the remaining seven discuss the issue of capitalism and its institutions. The first chapter pitches the argument of situational understanding for human behaviour in a crispy manner. The author asserts in the Book that markets are unable to allocate resources automatically until self-interest, as proposed by the conventionalists, is brought into the interplay of market forces. Markets do not care for the type of commodities to be exchanged; rather the focus is on the wants only. After all, markets are not replacements of churches. Once the argument of morality is presented in the first chapter, the second chapter discusses how outcomes can be turned into morally acceptable ones. This chapter starts with Thorstein Veblen's theory of mismatch between acquisition and true needs, which was later extended by John Kenneth Galbraith's work on affluent societies. They claim that humans instinctively want more wealth and rank. Hence, the society without regulation or restriction would produce commodities in excess for the affluent class. But unlike Frank's (*Luxury Fever*, 1999) attack on wealthy segments of the society, Demsetz provides good examples where restriction might also be wrong.

In the third chapter, he spells out the context of selfish-gene theory [proposed by Richard Dawkins (1976)] and the ways to avoid getting into its trap. He first elaborates the natural selection process and points out that the consciousness and freedom of action are favoured by the gene survival needs and efficiency requirements. In chapter four, from the very beginning, the basic ideology of Adam Smith, namely the pursuit of selfish interest leading to an efficient outcome for society, is challenged with examples like prisoner's dilemma. Malthusian trap, namely the phenomenon of population growth ultimately leading to increased poverty in the long run, is also challenged based on the fact that it did not happen.

Starting from the fifth chapter, Demsetz elaborates the capitalism and its influence on society. Capitalism is a relatively new economic system, which started to operate in the nineteenth century. Earlier, human activity was managed by small hierarchical groups and preconditions for capitalism gradually made their way into the economic systems. Under the hunter-gatherer or agrarian systems, where land becomes infertile after some time, food was produced and gathered only as per requirements. As excess productions began to emerge, legal systems had to be innovated for exchange with others' excess production and private ownerships. Therefore, in stepwise transformation, capitalistic institutions started to grow in sixteenth and seventeenth century and finally matured in the nineteenth century. Now private ownership (decentralised mechanism of specialisation) and open markets were considered to help nations provide for the collective goals. The basis of capitalism was accumulation of capital in the hands of few (Karl Mark's prediction) or many with access to market.

The sixth chapter builds on the discussion of the previous chapter on the private ownership and exchange. Markets and prices are central to the idea of capitalism but precondition (what we teach in classes as assumptions) of private ownership of resources by all, is often not highlighted. Private ownership is established when society accepts it and exchanges are voluntary. Ownership and legal systems to protect these develop overtime and are still developing. Giving the example of Coase's theory (based on doctor-confectioner court case), the author argues that once ownership is decentralised the most efficient allocation takes place and it does not matter who owns the rights, although certain assumptions need to be invoked. Chapter seven furthers the issue of externalities, transaction costs and the allocation of resources. Who is assigned the rights does matter because it redistributes the wealth and the prices do not reflect the true value for the users due to transaction costs. Therefore, markets are not to blame, in Coase's example it is the court.

The next chapter dwells on the role of firms and households in the context of resource allocation. In explaining the firm's decisions for business, which are based on expected profit and loss, Demsetz refers to the classic works, such as *Risk, Uncertainty and Profit* (1921) by F. H. Knight and *The Modern Corporation and Private Property* (1932) by Adolf A. Berle and Gardiner Means. Knight, in his book, explained that it was the uncertainty and not the risk (where some probability can be assigned), which made the firms profitable. Berle and Means, on the other hand, talked about the internal organisation of the firms. Firms make their decisions on the basis of prices, technology and profit seeking behaviours.

In the ninth chapter, the author compares the political system with those of the firms and market, with the simple logic that firms provide private goods and governments provide public goods. The firms are relatively quick to adapt to changes whereas political parties, due to their internal inconsistencies, are reluctant to adapt and maintain a consistent position. The penultimate chapter of the book describes the case of public corporations, which are ironically referred to by Demsetz as Socialist entities within the capitalistic structure. He further elaborates how it has been proven empirically that the decisions are not made by all but are rather concentrated in a few hands only, which gets the management into agency problems.

In the final chapter of the book, Demsetz introduces the interdisciplinary debate on human species, now commonly referred to as the Homo Economicus. He argues that all the influential writers of the time had taken lessons from the previous influential works of others and the contemporary interdisciplinary pieces of works. He further states that lack of commonality is the barrier for a successful interaction, though each discipline has its own concerns/puzzles based on which specific tools are developed. Unlike a natural selection process of animals, competition is seldom present in markets; hence, this situation requires strong antitrust laws, such as the Sherman Antitrust Act of USA. Further, there are no norms for the animal kingdom and therefore, there is no reference of chaos, orderly distribution of goods, etc. but the man has to consider the normative aspects for society as well.

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