

The historical foundations of *new* political economy¹

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1. Introduction

Since the 1950s, economists have shown an increasing recognition that “institutions matter” (Frey 1990), and have worked to develop economic analyses of institutions and rules, analysing their origins and how they shape and influence individual behaviour. These contributions have subsequently led to the suggestion that the analyses of institutions in question – such as public choice, law and economics and, later, constitutional political economy – might form a *new* political economy reviving the spirit of the founding fathers of the discipline (Atkinson and Stiglitz, 1980; Inman, 1987; Hirshleifer, 1982; Johnson, 1991). While the various branches of the *new* political economy differ in many respects, they can nevertheless be captured in two broad categories. On the one hand, a contractualist (constructivist) approach considers that institutions are explicitly built from a state of nature characterised by the absence of any rule. On the other hand, a spontaneous order approach argues that institutions are not created or designed by human beings but emerge through a market process. Now, these two approaches claim to descend from the same ancestors, namely the founding fathers of political economy. In fact, and it is the argument that we develop in this chapter, neither can legitimately claim his heritage.

With regard to contractualist new political economy, the alleged classical political economy heritage is a consequence of the fact that it emerged and developed at a time of economic imperialism, when economists were trying to demonstrate that their models were relevant to explaining, in particular, political phenomena. To legitimise the new approach, therefore, some of its proponents were keen to show that the founding fathers of the discipline were themselves “the first imperialists”². More precisely, as Brennan puts it, “the enterprise of attempting to erect a single unified theory of social phenomena on rational-actor foundations should not surprise us. It is, after all, by no means a new enterprise. It was specifically, an important part of the Enlightenment project from which economics as a discipline emerged” (1992, p. 15). Now, such an assumption is linked to the assumption that individuals are self-interested and that their behaviour is guided by rational deliberation. Buchanan, a well-known contractualist, is worth quoting here. Launching constitutional economics, he states that the “foundational position [of constitutional economics] is summarised in *methodological individualism*” and “the concomitant ... postulate of rational choice” (1990, pp. 13-14). He then quotes Hume in support: “each man ought to be supposed a knave, and to have no other end, in his actions, than private interest” (Hume, 1741, p. 117-118, in Buchanan, 1987, p. 587). Even if, as Salmon writes, “economists have always known that to assume rationality is a research strategy for the purpose of modelling interesting mechanisms rather than a descriptive assertion about reality” (2001, p. 453; see also 2000), it remains that assuming rationality and self-interest nonetheless influences the way institutions are analysed. Indeed, it implies that rules and institutions are to be tailored to control the potential opportunism of these rational self-interested and

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² Here, we paraphrase Anderson who, analysing Adam Smith’s “economics of religion”, argues that “Smith was probably the first ‘economic imperialist’” (1988, p. 1067).

non-benevolent ('knaves') individuals. The social contract is then considered as the only institutional form that has the capacity to reach this objective.

Now, in contrast to what is put forward by modern contractualists, the founding fathers of political economy did not actually conceive of individual actors as rational beings. Rather, they developed a theory of human nature, whose major characteristic is not only the subjectivist dimension of human cognition but essentially the weakness, or the limitations of human rationality. The latter point has been stressed by the advocates of a theory of spontaneous order. Criticising the top-down contractualist approach to the study of institutions, the spontaneous order theorists have defended a bottom-up line of reasoning in which institutions are assumed to emerge from the repetition of interactions between individuals. Hayek, among others, is well known for having both rejected the rationalist constructivism of social contract theories and having claimed the heritage of Hume or Smith. The argument then goes on to show that spontaneously emerging institutions are likely to generalise and to govern large and open societies. However, if one accepts the theory of human nature of the founding fathers of political economy, one has also to accept the fact that spontaneous orders depend upon and therefore are limited by the existence of sympathy between individuals. In other words, it is not possible to envisage an unlimited generalisation of emerging rules without more formal rules.

Therefore, a genuine new political economy should really elaborate upon the non-rationalist conception of man proposed by Hume and Smith. The goal of this article is thus to explore this theory of human nature and its consequences in terms of rules and institutions. We shall distinguish between formal and informal rules, and show that they are complementary rather than competing and that they serve to highlight the crucial role of sentiments in the emergence of institutions.

Interestingly, our perspective overlaps with that of "inspired economics" (Frey and Stutzer, 2001), which builds upon the necessity of going "beyond *homo œconomicus*" (see Anderson, 2000) and moving "from *homo œconomicus* to *homo sapiens*" (Thaler, 2000). Various behavioural anomalies and irrational behaviours that have come to light – especially thanks to experiments performed by psychologists or even by economists³ – suggest that "humans do not act rationally in the sense of following the von-Neumann/von Morgenstern axioms" (Frey and Stutzer, 2001, p. 9). Of course, reference to the founding fathers of political economy has disappeared in this work – implicitly confirming that economists' attempts to analyse rules and institutions with the help of the assumption of rational individual behaviours was indeed a legacy of the origins of the discipline[???]. To be inspired, economics could no longer refer to economists who were used by imperialistic economics. As a consequence, inspiration could not but come from other social sciences. In this respect, while a large literature was devoted to understand the implications of abandoning the assumption of rational behaviour, many attempts were also made to incorporate the insights of other social sciences into the economic models of institutions (for instance, see Frey, 1997; Frey and Stutzer, 2001; Mueller, 2001). Thus, it was proposed to develop *behavioural* political economy, such as behavioural law and economics (see Jolls, Sunstein and Thaler, 1998) and behavioural public choice (Ostrom, 1998). Now, since the founding fathers of political economy do not defend the assumption of rationality, it appears that inspiration could come from within rather from outside the discipline after all. Economists could be inspired by the founding fathers of their discipline.

³ Among others, one can quote Kahneman, Slovic and Tversky (1982), Arkes and Hammond (1986), Dawes (1988), Schoemaker (1982), Hogart and Reder (1987), Thaler, (1992).

The paper is organised as follows. First, we analyse the theory of human nature proposed by Hume, Smith and other founding fathers of political economy. In particular, we show that human reason played a less powerful role here than is usually assumed in modern economics (section 1). As a consequence, the problems of co-ordination which result from the older conception of human beings cannot be solved by institutions. Therefore, successful co-ordination requires information on the behaviour of others and institutions cannot be considered as a means to convey information (section 2). In fact, focusing exclusively on institutions throws into relief the logical aspect of co-ordination and co-operation, at the expense of the psychological dimension of the problem. It is therefore necessary to understand how individual beliefs about others are formed, independently from institutions. Sympathy plays a crucial role here, delineating the domain in which institutions can emerge (section 3). Thus, the core argument of this paper is that, in contrast to standard analyses, sympathy is a necessary condition for successful co-ordination, and institutions complement sympathy.

2. Human nature: from sensualism to associationism

“Inspired economics” has insisted on the necessity, usefulness and innovation of looking towards psychology to understand and model human behaviour. This insistence is all the more interesting in view of the fact that the founding fathers of political economy had themselves already based their analysis upon psychology, namely associationist psychology, whose origins can be traced back to the publication in 1749 of David Hartley's *Observations on Man, his Frame, his Duty and his Expectations*⁴. Thus, as noted by Young, “the association of ideas was also a basic assumption of the epistemology and psychology of David Hume and had continental parallels in the work and influence of Condillac” (1985, p. 65). More precisely, Hume as well as Condillac do not investigate the physical origins of association, but address the question from a philosophical point of view. As philosophers, the founding fathers of political economy, included Condillac, belong to the philosophical movement of the Scottish Enlightenment. In fact, associationist psychology and the philosophy of the Scottish Enlightenment are closely intertwined because of the emphasis put on the role of the senses in the perception of the world and the building of human knowledge. The Scottish Enlightenment, as opposed to the Continental version of the *Siècle des Lumières*, rejected Cartesian dualism and the corresponding rationalist conception of human behaviour. As a consequence, the problem that has necessarily to be dealt with is that of explaining how a mind can know an external object. More precisely, challenging Cartesian dualism not only raises the question of the origins of human faculties, capacities and knowledge, it also implies locating the origin of human knowledge within the object rather than within the knowing mind. This is the reason why associationism cannot be understood without reference to the process through which knowledge results from sensory perception (2.1). Conversely, to insist on the role of senses – rather than on that of reason – in the relation between human beings and their environment, necessarily leads to an associationist conception of human cognition (2.2). Associationism, in psychology, and sensualism, in philosophy, are the two sides of the same theory of human nature.

⁴ Hayek is often rightly presented as one of the first and rare 20th century economists having attempted to understand how the mind of human beings functions, trying also to link the mechanics of the human mind with individual behaviour and the rules. His 1952 *Sensory Order* is then put forward as a work of a great importance, a book where Hayek develops a theory according to which the mind functions on an associative basis (see among others Tuerck, 1995; Rizzello and Turvani 2000). Interestingly, it appears that Hayek's argument reflects an old tradition.

2.1. Sensualism and the weakness of human reason

Let us begin with sensualism. Hume, Smith and other Scottish scholars, such as Ferguson or Stewart, are praised for having proposed a *sensualist* theory of human nature. Sensualism is a philosophy of the mind that considers man as a *tabula rasa* upon which impressions received through the senses from the external world progressively gather and draw the shape of an individual. To illustrate this assumption of a *tabula rasa*, the French philosopher Condillac imagined, not unlike how social contract theorists envisage the fiction of a state of nature, the fiction of a marble statue that, although having the same internal organisation as a man, has none of the five senses that characterise human beings. Condillac builds his demonstration around describing how the statue becomes a man when senses give him access to the world, that is, how senses allow the statue to perceive the world. The lesson that Condillac draws is simple: without sensory perception, man is nothing more than a marble statue. In his own “version” of the statue, Hume writes that “When my perceptions are remov’d for any time, as by sound sleep; so long am I insensible to myself, and may truly be said not exist” (1992 [1739], p. 252). Thus, the basic, and also the smallest, unit that constitutes human beings is a perception of the world. As Hume writes, “for any part, when I enter most intimately into what I call myself, I always stumble on some particular perception or another, of heat, cold, light or shade, love or hatred, pain or pleasures. I can never catch myself without a perception” (Hume, 1992 [1739], p. 252). More precisely, there are two forms of perceptions, impressions and ideas: “All the perception of the human mind resolve themselves into two distinct kinds, which I shall call IMPRESSIONS and IDEAS” (Hume, 1992 [1739], p. 1). This is an interesting classification of perceptions for it already reveals that ideas also have their origins in the external world as well as within the mind. Furthermore, the difference between impressions and ideas, as it is indeed put forward by Hume, is solely a matter of “force and liveliness”, the “force and liveliness with which they strike upon the mind, and make their way into our thought or consciousness” (ibid.). In this comparison between these two forms of perceptions, impressions dominate ideas:

Those perceptions which enter with most fort and violence, we may name impressions; and under this name I Comprehend all our sensations, passions and emotions, as they make their first appearance in the soul. By ideas I mean the faint images of these in thinking and reasoning (ibid.).

Therefore, not only do ideas have their origin in the world, but they are also solely images of impressions. As Hume repeatedly remarks, ideas are only *copied* or *derived* from impressions. The hierarchy that Hume establishes between ideas and impressions is clearly in favour of the latter: “our impressions are the causes of our ideas, not our ideas of our impressions” (1992 [1739], p. 5), and “all our simple ideas proceed either mediately or immediately from their correspondent impressions” (ibid, p. 7). Therefore, everything proceeds from the senses, and nothing exists in the mind that has not been first experienced, that is perceived through the senses.

At this first stage of reasoning, the human being is left as a sum or more precisely a “chaos” (Renault, 1989) of impressions received from the environment. To propose a complete analysis of human cognition, sensualism has to deal with the need to explain how the ongoing information that is transmitted to the mind is stored (memorized), processed (impressions transformed into ideas) and utilised. What does the mental activity of human beings, which organises impressions into structured and meaningful knowledge, consist of? From the perspective of a comparison

with a rational conception of man, the role and nature of human reason have to be investigated. The description of the rationalist view on human cognition will help us to see why sensualism cannot but imply that human rationality is bounded.

Rationalism, particularly as expressed by Descartes, assumes the existence of a specific human capacity, namely reason or, more precisely, rational reason. Reason, which distinguishes man from animals, goes far beyond the simple capacity to compute data: it not only organises the impressions that are received from the environment but also allows human beings to identify the false information conveyed by the senses as well as speculate about facts and events that have not been experienced. Rationalism thus develops a "central planning view of brain function" (Gifford, 1996). This perspective is in total contradiction to the Scottish Enlightenment philosophy. Indeed, interpreted within the sensualist framework, rational reason should be considered as an impression and, moreover, should be defined as a specific impression, standing above all other impressions, granted with stability and permanence to which other impressions would be referred. Now, as Hume points it out, "there is no impression constant and invariable" (1992 [1739], p. 251). Therefore, reason does not exist as a central and organising capacity. Furthermore, it is not solely the absence of a rational reason that is at stake. Hume's conception of man conveys the more general absence of a central organising function in the mind which, beside unifying impressions, would define goals and means, and would check upon their execution. Absence of rational reason also precludes men from introspection, and does not allow self-awareness. Hume thus writes that "It cannot, therefore, be from any of these impressions, or from any other, that the idea of the self is deriv'd; and consequently there is no such idea" (1992 [1739], p. 252).

Therefore, what sensualism denies is that individuals possess rational reason, viewed as a cause of knowledge and the origin of behaviour, a capacity very close to what mainstream economic theorists assume of the rational economic agents. Nevertheless, the existence of reason is acknowledged as "a heap or collection of different perceptions" (Hume, 1992 [1739], p. 207)⁵. Reason is not a capacity for organising knowledge. Rather than being a cause, reason is a consequence – the unintended consequence of the accumulation of impressions. Thus, even if reason exists, it cannot but be a far more limited capacity than what rationalism assumes. That is to say, human beings cannot but be labouring under bounded rationality.

2.2. Rules of association

Having rejected what may be regarded as a constructivist approach to human mental activity or human cognition, Hume develops a spontaneous order theory based on rules or principles of association. More precisely, having identified the basic units of knowledge transmitted to the mind by the senses, and having rejected reason as an organising capacity, Hume proposes that these units cannot but spontaneously organise into structured and meaningful knowledge.

In a nutshell, the process breaks down into three major parts. First, the structure of knowledge is influenced by the exercise of two important faculties, memory and imagination: memory stores and "repeat impressions in the first manner" (1992 [1739], p. 8) while imagination separates ideas and unites "them again in what form it pleases" (*ibid.*,

⁵ The entire sentence is as follows "we may observe, that what we call a *mind*, is nothing but a heap or collection of different perceptions, united together by certain relations, and suppos'd, tho' falsely, to be endow'd with a perfect simplicity and identity".

p. 10), thus creating new and perfect ideas. Imagination thus has a clear speculative and forward-looking role to play. Once this role has been played, impressions become structured in meaningful way by virtue of a “gentle force” (ibid.), a “kind of ATTRACTION, which in the mental world will be found to have as extraordinary effects as in the natural, and to show itself in as many as various forms” (ibid. p. 13). Impressions are joined, united and associated according to three “qualities”, “RESEMBLANCE, CONTIGUITY in time and place, and CAUSE and EFFECT”. (ibid., p. 11). Hume then sums up human cognition as follows: “These are therefore the principles of union or cohesion among our simple ideas, and in the imagination supply the place of that inseparable connection, by which there are united in our memory” (ibid., p. 12). These are the principles or rules of association among impressions which are at the basis of human cognition.

Human cognition is thus depicted as a process through which impressions are associated and connected into networks and groups of networks or, more exactly, classes: “sensory perception” is thus what Hayek has described as “an act of classification” (1952, p. 142). Indeed, the formation of classes reduces the costs of cognition in separating out the important and ongoing stream of impressions that are received. The idea that human beings are able to identify each received bit of information assumes cognitive abilities that far exceed the effective capacities of human beings. Perception is therefore not a passive act but an act of interpretation which consists in assigning the incoming data to the already existing classes: “External objects [...] become present to the mind [when] they acquire such a relation to a connected heap of perceptions, as to influence them very considerably in augmenting their number by present reflections and passions, and in storing the memory with ideas” (Hume, 1992, [1739], p. 207). Thus, the human mind always selectively utilises information, classifies and re- classifies perceived stimuli and frames them within existing patterns according to a “winner-take-all” strategy (Gifford, 1996). Either an impression can be recognised, that is can be identified as belonging to an existing class, or it is rejected. As a consequence, a phenomenon or an event is perceived because the impression related to this event or phenomenon is associated with an impression related to past events or phenomena. If the impression is rejected, therefore the event is not “perceptible” (Hayek, 1952, pp. 142-143). Data are thus received only if they are consistent with other beliefs. This conception of human cognition explains the phenomenon known as the curse of knowledge – once an individual knows something, he cannot imagine thinking otherwise. Put in different terms, it means that the perception of an event is path-dependent. Indeed, it depends on the already accumulated knowledge and, subsequently, is driven by our tacit expectations about this event. As Kuran, among many others, puts it, individuals “perceive selectively, noticing facts consistent with our beliefs more readily. This bias imparts resistance to our beliefs by shielding them from counter-evidence” (1995, p. 173). Now, the selective perception and storage of information following established preconceptions or perception-filters has largely been put forward by psychologists (Rosenberg, 1991; Rabin, 1998) and utilised to demonstrate the limitations of human reason. Human reason is a bounded capacity, limited for depending upon perceptions rather than on calculation.

The conception of man developed by the sensualist-associationist approach of the founding fathers of political economy, contrasts with the traditional model of man that is utilised by economic analysis. For the sensualist-associationist approach acknowledges that reason is not as powerful as is suggested by standard economic analysis. Besides, the process of knowledge acquisition depicted above not only conveys the image that the human mind functions as a screening device or a “filter of experience” (Lachmann, 1975, p. 9, quoted by O’Driscoll, 1977) but also that “each individual’s filter is different from every other filter” (ibid.). Indeed, each individual is a unique example of a human being because his cognitive history is unique. This insight implies a subjective appraisal of the environment and a subjective elaboration of the individual plans of actions that govern behaviour. The subjective

nature of human cognition therefore reveals that, within this framework, co-ordination among individual actions is an issue of the utmost importance. The nature of the problems raised by subjectivity and the role of institutions with regard to these difficulties are analysed in the next section.

3. Subjectivism, expectations and induction

There are at least two important sources of inconsistency that stem from the theory of human nature we have just described. First, as we have seen, perception, which is an act of classification, involves interpretation (selection) and imagination (speculation) as essential aspects of human cognition. Thus, because of the role of imagination in the elaboration of individuals' plans of action, inconsistencies may arise because each individual forms his own image of the future⁶. Besides possibly diverging expectations about the future, a second but not unrelated problem results from the fact that individuals' plans of actions depend on expectations about others' behaviours. Indeed, the differing and subjective nature of individual plans of action can be carried out successfully only if expectations converge and, in particular, if individuals are able to co-ordinate with others. Now, individuals' capacity and willingness to co-operate with others is related to the possibility of gathering information about others in order to identify reliable and trustworthy partners. The problem is made all the more complex in view of the fact individuals' expectations are not about others' behaviour but about their expectations. Therefore, in such a theory of human nature, co-ordination depends on the possibility of gathering information about others' intentions and actions that would stop an infinite regress of reciprocally conditioned expectations. A possible answer is to imagine that each of us engages in numerous and discrete mental experiments in order to assess the subjective preferences of every individual we meet. This is probably a psychological impossibility. Moreover, the associated transactions costs would be prohibitively high and prevent any interaction (Wärneryd, 1990). What is needed to elicit information about others is a framework in which it is possible to make stable and reliable expectations.

Undoubtedly, rules and institutions, either formal or informal, explicit or tacit, written or unwritten, do enable large numbers of individuals to co-ordinate their actions, locking their expectations into a self-consistent pattern. The point has been heavily emphasised that tacit norms or rules of law guide peoples' actions in order to give birth to stable and consistent expectations about each others' behaviour. However, although true, the statement that institutions serve to co-ordinate the actions of millions of individuals is only partial because it assumes the solution without explaining how the problem is solved⁷. The hypothesis that institutions exist leaves unanswered the question of the origins of institutions. In a rationalist, Cartesian or Hobbesian (namely, contractualist), setting, it is possible to envisage the explicit and constructivist design of institutions that generate ordered and co-ordinated behaviours.

⁶ Once again it is interesting to parallel Hume with Lachmann who writes that "the formation of expectations is an act of our mind by means of which we try to catch a glimpse of the unknown. Each one of us catches a different glimpse" (1976, p. 59)

⁷ As does Lachmann: "In a complex society such as our own, in which the success of our plans indirectly depends on the actions of millions of other people, how can our orientation scheme provide us with firm guidance? The answer has to be sought in the existence, nature and functions of institutions" (1970, p. 49). Bianchi notes the same problem about Hayek: "Hayek does more to pinpoint the problem of arriving at social order than he does to solve it" (1993, p. 209). These two economists illustrate a more general problem of Austrian economics about institutions (see Gloria, 1999).

However, the assumption that rationality is an act of classification, depending on the accumulation of experiences, rather than an act of creation, makes it difficult to accept the idea of a social contract, at least in its Hobbesian form. Sensualist rationality, does not allow individual to create institutions that never existed. The question about the mutual consistency of individuals plans of action thus echoes the individual problem of the origin of knowledge and of the internal consistency of perceptions: since individuals cannot create rules that they have not yet experienced and in the absence of a central planner, institutions have to be considered as the result of a decentralised process of repetition of interactions. That is to say, the theory of human nature developed by the founding fathers of political economy does not support a social contract approach of institution but legitimates a theory of spontaneous order. Institutions emerge as the result of the repetition of interactions; even Smith and Hume emphasized that individuals learn from their experiences of repeated interactions. Conditions are nonetheless required for institutions to emerge.

First, individuals have to initiate interactions. Why should they choose to do so? The many game-theoretical models that, since the pioneering work of Axelrod (see e.g. 1984), have been developed to analyse the emergence of rules mostly focus upon the logical aspect of the co-ordination problem: once individuals have agreed to participate in interaction, one can expect that they will end up in co-ordinating with one another. However, a necessary condition for repeated interactions is the *a priori* existence of reciprocity. For instance, when Parisi writes that "the principle of reciprocity serves as a crucial pillar for the process of law formation" (1998, p. 575), he means that reciprocity is a causal mechanism which explains the origins of institutions. In the same vein, when Hayek writes that "wherever the use of competition can be rationally justified, it is on the ground that we do not know in advance the facts that determine the actions of competitors" (1968, p. 179), the problem is just that we do not know *in advance the facts that determine the actions of competitors*. Put differently, individuals engage in repeated interactions because they anticipate the repetition of interactions, and thus because they already display some willingness to co-operate. Therefore, the hypothesis that institutions exist assumes the existence of reciprocity and that individuals already have stable expectations, but it does not provide an answer to the question of the consistency of expectations. The problem remains: one has to explain the consistency of expectations and the existence of trust towards others to understand why individuals initiate and then repeat interactions. Therefore, rules must exist to inform individuals about the behaviour of others but these rules cannot exist without their having such information, expectations or beliefs about others.

Second, suppose that actors nonetheless enter an interaction without having the required knowledge of each others' characteristics. The next question concerns the possibility of learning from repeated interactions. If one returns to the process of human cognition, we see that knowledge acquisition about others' characteristics – in order to know whether they are reliable partners or not – as well as knowledge about facts or events, is also a matter of inductive inference. As Hayek put it, "one person's actions are the other person's data" (ref, emphasis added), echoing Smith's affirmation that rules emerge from "our continual observation upon the conduct of others" (1739, p. 139; emphasis added). What is important in these two sentences is that the focus is on actions rather than on intentions. In a sensualist-associationist process of knowledge acquisition, we have no access to the motives and intentions of others. Thus, information about others' characteristics is acquired only by observing others' behaviours. However, to learn about others by observing their behaviour is tricky. As we have demonstrated elsewhere (Josselin and Marciano, 1999b), building upon the reasoning of Hempel (1956) and Goodman (1983), observing the behaviour of another person might inform us that this individual follows a rule but does not tell anything about the rule he follows. Now, the reasons that motivate an individual to act in a specific way are diverse and may be based on grounds quite different from what the observer expects. Obviously, this informal way of communicating allows

individuals to co-ordinate without knowing each others' intentions. However, because different persons may be motivated by different aspects of a problem, and because intentions to act remain hidden, there is no way to have reliable information about others' characteristics. In particular, observing behaviour does not always allow us to separate cheaters and potential defectors from reliable partners. Indeed, cheaters and defectors can imitate the signs that we use for identifying reliable trading partners (Frank, 2001).

Of course it is not totally true that observation fails to provide the observer with any information whatsoever. Indeed, an inductive learning process systematically relies on prior beliefs about the behaviour of those being observed – pure induction does not exist. In the same way that perception is always an act of interpretation, which consists in classifying impressions, the behaviour of others is always interpreted through the cognitive history of the spectator. Therefore, our perception of the behaviour of others is driven by our expectations about this behaviour. The behaviour of others is understandable (and then understood) only if it fits coherently with our other beliefs. Then, while observing behaviours does not inform us about the intentions of others, it can confirm our own expectations; this is a typical illustration of the “curse of knowledge” applied to expectations about others and to the way one learns from the observation of the conduct of others. Two consequences follow. First, successful co-ordination requires a correct interpretation of the behaviours of others – mutual understanding is necessary for us to co-ordinate with others; if these reciprocally conditioned expectations diverge co-ordination is unlikely. Second, to explain successful co-ordination, one must, in the first place, explain why and how stable and consistent expectations are possible.

Let us sum up our line of reasoning. Co-ordination is possible if mutual expectations about each others' behaviour are consistent, that is, if individuals have information about each others' characteristics. Thus, to enter into an interaction, an individual also needs information about others party to that interaction. Furthermore, these expectations cannot result from observation of the actions of other persons alone, since these observations do not teach us more than what we expect to learn. Therefore, it is necessary to understand how our beliefs about others are formed, if it is not from the repetition of interactions.

4. Sympathy and spontaneous co-ordination: necessary but not sufficient

The Scottish Enlightenment scholars were convinced that co-ordination and co-operation could not be analysed solely as logical problems. For instance, Hume was aware of the necessity to understand individual psychological motives to explain why people could be led to follow a particular convention. This is the reason why he emphasised sympathy as a means by which individuals are able to recognise people who are predisposed to co-operate. From this perspective, as Vanderschraff (1998) shows, Hume anticipated the modern account of co-ordination given by Lewis (1969) and Schelling (1960). The latter demonstrated that co-ordination requires the existence of a “common background”: behaviours co-ordinate because expectations about one another's behaviour are consistent. Their argument presupposes that the reliability of partners has to be known before the interaction takes place – more precisely, the interaction takes place because partners have been identified as being trustworthy. The willingness or propensity to co-operate must therefore precede co-operation. Thus, sympathy can be used as a psychological justification for the spontaneous propensity to co-operate identified by Schelling and can be used to explain how it

functions. Put differently, the formation of beliefs about others' behaviours depend on sympathy and thus grounds a spontaneous co-ordination (4.1). However, sympathy is also a relatively limited "quality". Thus, it limits the domain of spontaneous orders (4.2).

4.1. Sympathetic identification and communication with others

The crucial role played by sympathy stems from its role as a communication mechanism, which allows tacit communication among individuals. Thus, Hume considers that "no quality of human nature is more remarkable in itself and its consequences, than the propensity we have to sympathise with others, and to receive by communication their inclinations and sentiments, however different from, and even contrary to our own" (1992, p. 316). And he adds: "The minds of all men are similar in their feelings and operations, nor can any one be actuated by any affection, of which all others are not in some degree susceptible. As in strings equally wound up, the motion of one communicates itself to the rest; so all affections readily pass from one person to another, and beget correspondent movements in every human creature" (Hume, 1992, p. 575-576). Here, Hume insists on the fact that an individual who feels sympathy towards others, participates in the same experiences. Therefore, because of sympathy, knowledge is not restricted to one individual but is shared by all the individuals feeling sympathy towards one another. Sympathy extends individual knowledge beyond the limits of personal experience, by providing information about experiences that have not yet been experienced but that have been experienced by others and, further, by providing information about others' feelings and behaviours. Thus, one cannot dissociate the two aspects, individual and social, of cognition. Sympathy not only explains communication, it also explains the origins and existence of social beliefs about one another's behaviour. Sympathy explains why, "although subjective in nature, the individual's cognitive development [...] is moulded in social process" (Witt, 1998, p. 102).

The reason that sympathy facilitates communication is that it rests on identification with others (Fontaine, 1997). Thus, "sharing another's feelings cannot be regarded as mere contagion or infection, but rather as the outcome of an act of imagination, whereby the spectator tries to figure out what it is like to be the other person in his or her circumstances" (1997, p. 265). Human beings are able to communicate and to co-ordinate their actions because they are capable, not only of imagining themselves in the same circumstances with others, but also of imagining oneself as being another person: when I sympathise. "I consider what I should suffer if I was really you, and I not only change circumstances with you, but I change persons and characters" (176 [1759], p. 317). Further, sympathy differs from another, narrower form of identification with others, namely empathy. While empathetic identification consists solely in the simple imaginary change of positions with others, sympathy implies concern for others' welfare (Fontaine, 2001). Smith was clear about this (see Fontaine, 1997). Because of sympathetic identification, individual behaviour is not motivated by self-interest and the search for personal advantage. Therefore, sympathy not only explains the possibility of communication; it also exemplifies the normative value of behaviour. In societies shaped by sympathy, free-riding disappears and individuals no longer behave as knaves.

Sympathy thus becomes a principle of communication which allows, through identification with others and because of concern for their welfare, spontaneous co-ordination among individuals. Sympathy is a precondition for human interactions. It creates the common background or tacit commonalities that are necessary to repeat interactions, and which allows for the emergence of rules. As Frank puts it, "emotional commitment" is a necessary condition for co-operation (2001).

4.2. The scarcity of sympathy and the limits of spontaneous order

Sympathy can thus be regarded as the characteristic of human nature that explains individuals' willingness to co-operate. At the same time, even if sympathy is a universal characteristic, in the sense that all human beings, as well as animals, "possess" such a "quality", this does not imply that every one must feel sympathy towards anyone else in particular. Sympathy indeed depends on distance (where distance is expressed in psychological as well in physical terms) that separates individuals. As Hume puts it, "Nothing is more certain, than that men are, in a great measure govern'd by interest, and that even when they extend their concern beyond themselves, 'tis not to a great distance; nor [??? Check] is it usual for them, in common life, to look farther than their nearest friends and acquaintance" (1992 [1739], p. 534). More precisely, sympathy decreases when distance between individuals increases: "sympathy, we shall allow, is much fainter than our concern for ourselves, and sympathy with persons remote from us, much fainter that with persons near or contiguous" (Hume, 1992 [1739], p. 116). Sympathy can thus be considered as a "scarce" feeling, being restricted to those groups of individuals who, having been able to repeat interactions, share rules and common beliefs. Because of its scarcity, sympathy explains why spontaneous order societies are 'nearness societies' in the geographical space or in the space of preferences (Josselin and Marciano, 1999b). These societies consist as a sum of close-knit groups of "nearest friends and acquaintances", in which interactions are sympathetic and thus possible. Therefore, sympathy not only defines the condition for co-operation but also explains its limits. Indeed, since reliable expectations about others remain limited to group members, the individuals with whom sympathetic links exist, there is a problem with interactions with outsiders, namely the individuals who belong to other groups, that is those individuals who have a different degree of sympathy. The problem is twofold.

The first difficulty concerns the arrival of newcomers who are supposedly attracted by efficient groups, which are groups assumed to rest upon efficient rules. An individual will choose to join a group, and to imitate other individuals, because he assumes that they have better information. Thus, the choice depends upon a comparison between the benefits and costs of joining the group. In this respect, threshold or bandwagon models (Schelling, 1978; Granovetter, 1978) or models of informational cascade (Barnejee, 1992; Bikhchandani, Hirshleifer and Welch, 1992, 2000), that implicitly relate efficiency and the size of the group, link the cost of joining a group and the number of people who are already members of the group. Furthermore, when a newcomer enters a group, he cannot know the rule that guides the behaviours of the group members. He can only observe their behaviour and infer from his observations the rules they follow. Thus, an individual entering a new group, because he only imitates behaviours and does not sympathise with other members, will fail to gather information about reliable partners and will be unable to co-ordinate with them. Put differently, he may face induction problems because he is unable to know positively the meaning another person gives to the rules or to infer this meaning from the observation of his behaviour (Josselin and Marciano, 1995).

Second, problems may arise due to the differences – differences revealed by free-riding and opportunistic behaviours – that exist between individuals' degree of sympathy. These differences affect interactions between individuals from different groups, as seen in the preceding paragraph. These differences may also appear within a given group when the size of the group in which interactions take place increase. Indeed, the greater the number of individuals involved, the higher the probability of meeting individuals characterised by a different degree of sympathy,

that is by a willingness to co-operate. Here, the problem is not only that it is difficult to know the rules that these individuals follow. Rather, the difficulty consists in identifying these individuals as reliable. Therefore, when the size of the group increases, non co-operative behaviours are likely to emerge and to persist, whether or not the game is repeated (Witt, 1989). Moreover, it is possible to show that interactions between players characterised by different degrees of sympathy lead to exploitation (Buchanan, 1975; Stark, 1983). Costs are thus imposed on group members. Of course, one can argue, thanks to evolutionary models, that homogeneous groups composed by individuals with a high willingness to co-operate can resist the invasion of individuals less prone to co-operate. However, the problem does not disappear but rather is only moved one step further. Indeed, in this type of situations, conflicts among groups, and especially border conflicts, are likely to occur. These possible conflictual outcomes increase the costs of spontaneous, thereby reinforcing and strengthening the respective limits of the groups.

As a consequence, although sympathy is a necessary condition for co-ordination, it is not sufficient in large and open societies. On the contrary, rules that emerge from repeated interactions tend to remain limited to the group of individuals that took part in interaction with one another. Thus, emerging rules cannot be considered general rules (Josselin and Marciano, 1999a). Beyond the frontiers of the original group or as the number of individuals increase, egoism and self-interest tend to replace sympathy. Interactions are no longer peaceful and cooperative. Then, emerging rules have to be sustained by "human conventions" as Hume (1992 [1739], p. 483) himself insisted. Even if such conventions do not resemble to a Hobbesian social contract, their purpose is nonetheless of the same nature: to extend identification with others beyond the limits of sympathy.

Conclusion

The first works in the new political economy that has been developing in recent years, have assumed that rules are tailored to rational individuals – an assumption presented as a heritage of the founding fathers of the discipline. Now that the necessity of going beyond homo oeconomicus is admitted, this link to the origins of political economy has been abandoned. In this chapter, we have tried to show why reference to these early findings about human nature nonetheless remains important. Rather than the "first imperialist" economists, it is Hume and Smith who should be regarded as the true forefathers of "inspired" economists. Their contribution rests in the "complete" theory of human nature that they propose, linking associationism, bounded rationality and identification with others – and moral sentiments - as a condition for co-operation. Two final points are thus worth noting. First, a political economy approach towards institutions cannot neglect that spontaneous orders are possible and restricted to spheres characterised by sympathetic identification. Thus, a covenant remains necessary to order large societies. Second, institutions must be built upon sympathy and must not oppose these moral sentiments on pain of threatening the areas in which it already exists.

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