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George Katona: A founding father of old behavioral economics

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ABSTRACT

Assuming the division of behavioral economics into old and new, the paper begins to argue that old behavioral economics began with the works of two giants – George Katuna and Herbert Simon during the 1950s and early 1960s. The contributors of Herbert Simon are well established, thanks to the popularity of bounded rationality and satisficing, and his being award Noble Prize in economics. However, economists are much less familiar with the contributions of George Katona that can be viewed as the father of behavioral economics. Furthermore, the author argues that Katona was also misunderstood by various economists when he was attempting to create a psychologically based economics that rejected the mechanistic psychology of neoclassical economics and introducing the survey method to economic research that he had been using in his experimental psychology research previously. He also had influenced various economists during their debates in the 1950s without given the credit for. Many historians of behavioral economics limit Katona's contributions to the start of behavioral economics only to his contributions to macroeconomics. However, the paper demonstrates that Katona's behavioral economics included his contributions to macroeconomics (bringing realism to Keynesian consumption function and consumption behavior), micro-economics (business behavior, the rationality assumption, etc.), public finance and economic policy, and his introduction of the survey method. To demonstrate these contributions, the author argues that Katona attempted to bring realism to economic analysis – through psychological concepts – beginning with his early days of research in Germany which coincided with German hyper inflation- and continued whether working at New school for Social Research, Chicago University's Cowles Commission, the U.S. Department of Agriculture, or the University of Michigan's Survey Research Center. The author also argues that Katona's contributions went through stages, depending upon what economic problem persisted at the time, what advertises he was facing, and what institution/organization he was associated with.

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1. Introduction

Although elements of what we now call behavioral economics can be found in the writings of Alfred Marshall, Wesley Mitchell, J.M. Clark and other less orthodox pre-WWII economists of this brand of economics is essentially a post-WWII construct. As suggested by Erik Angner and George Loewenstein, behavioral economics, which has little to do with behaviorism in psychology, consists of "the attempt to increase the explanatory and predictive power of economic theory by providing it with more psychologically plausible foundations" (Angner and Loewenstein, 2012, p. 1). To them, "behavioral economics should be seen as a branch of cognitive science", and "as an application of cognitive science to the realm of economic decision-making" (Angner and Loewenstein, 2012, p. 2). As argued by Herbert Simon, behavioral economics emerged because: "we need to augment and award the existing body of classical and neoclassic economic theory to achieve a more realistic picture of economic process" (preface to the Handbook of Behavioral Economics by Gilad and Kaish, 1986, p. xvi). To Simon, "economists as social scientists must be prepared to name the key attributes of human actors" (1985, p. 3030). This, to him, is only possible by utilizing behavioral economics (1986, p. xvi). Gilad, Kaish, and Loeb, in a 1984 paper, summarized the views of the 1984 SABE (Society for the Advancement of Behavioral Economics) participants about the nature of behavioral economics through four important attributes that distinguishes this new type of economics from the conventional one, the most important among those being their objection to the simplistic model of rational economic agents exhibiting optimizing behavior (1984, p. 1).

Various historians of economics believe that behavioral economics began, in the 1950s and early 1960s, in two different American universities – Carnegie Institute of Technology (now Carnegie-Mellon University) and the University of Michigan (Hosseini, 2003). However, Earl (1988, p. 3), Sent (2004) and Angner and Loewenstein (2012) add to those two American institutions also two English universities: Oxford

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University and the University of Sterling. This brand of economics was initially nameless, or sometimes being called psychological economics or economic psychology. However, it eventually became known as behavioral economics. As far as the term behavioral economics is concerned, Angner and Loewenstein (2012, p. 1) maintain that Kenneth Boulding and Harold Johnson used the term behavioral economics for the first time in their 1958 papers; Gilad et al. (1984, p. 1) believe the term was forged by George Katona. And, according to Esther-Mirjam Sent the term appeared in the works of several writers in the early 1960s (2004, p. 4).

While historians of behavioral economics initially did not speak of different types of behavioral economics, Sent (2004) and Angner and Loewenstein (2012) make a distinction between old and new behavioral economics. While these writers find old behavioral economics in the works of writers such as Herbert Simon and George Katona, however, they view the contributions of the likes of Amos Tversky, Daniel Kahneman, Baruch Fishoff, Paul Slavic and others as new behavioral economics. In my view, to be more exact, perhaps we should even acknowledge an older group in Europe who talked about economic psychology, of course distinct from what appeared after WWII. We are reminded by two Swedish economists – Karl-Erik Warneryd and Folke Olander – that the concept of economic psychology was discussed by Bohm-Bawerk and some other (unnamed) members of the Austrian school during the last quarter of the 19th century, and French social psychologist Gabriel Tarde published an article on the subject at the same time, and published a two-value study *La Psychologie Economique* in 1902 (1972, p. 120). Accusing Adam Smith of failing to use psychological insights in propounding his economic theory, as these two writers maintain, Tarde defined economic psychology as the study of the psychological foundations of economic theory (Warneryd and Olander, 1972). In 1954, another French writer – Louis Reynaud – also published another book about what Tarde had called economic psychology, by exactly the same title (Warneryd and Olander, 1972). Of course, their notion of economic psychology was not the same as what eventually became known as behavioral economics.

By founding fathers, in this paper, I mean the writers who started what Sent, Angner, and Loewenstein call old behavioral economists, namely those post-WWII writers who had in common a general dissatisfaction with conventional economics and a desire to develop a more realistic alternative that would utilize insights from (cognitive) psychology. As suggested by Yang and Lester (1995, cited by Hosseini, 2003, p. 394), while conventional economists were deducing principles of economic behavior from features of human nature assumed to be valid at all times and in all cultures, Katona and Simon tried to explain the actual behavior of economic agents. These founding fathers wanted to replace the mechanistic psychology of conventional economics with a real one, thus, creating a type of economics that, as Katona indicated, “tries to find out what actually takes place when people – as consumers, businessmen, or policy makers – make decisions” (Katona, 1975, p. 7). In other words, the founding fathers of behavioral economics were those post-WWII writers who wanted to increase the explanatory power of economics by providing it with a more realistic psychological foundation, thus, to bring more realism to this branch of cognitive/social science.

Among the founding fathers two writers – in my view giants – stand out: Herbert Simon and George Katona. The contributions of Herbert Simon – thanks perhaps to his well-known notions of bounded rationality and satisfaicing – have been acknowledged by the economic profession, not to mention that he was awarded the Nobel Prize in economics for those contributions, however, much of the contributions of Geoge Katona have been overlooked. As also indicated by Jose Edwards (2010, p. 208), Katona was also misunderstood by economists. He has also been ignored by historians of economic thought, although (as suggested by one of the referees) he was mentioned by Joseph Schumpeter (1954, p. 267). Undoubtedly, Katona, whose contributions to the start of behavioral economics are the focus of this paper, made substantial contributions to (old) behavioral economics. After all, as suggested by Likert (1972, p. 8), Katona had a major role in the start of behavioral economics; in the opinion of Bukhard Strumpel (1972, p. 3) Katona was the father of behavioral economics; and, according to Robert Pratt, Jr. “Virtually all research in the field of behavioral economics is an outgrowth of pioneering work done by George Katona and his colleagues at the University of Michigan’s Survey-Research Center” (1972, p. 193).

Interesting enough, in that 1972 essay, Robert Pratt, Jr, demonstrated that Katona also influenced the field of marketing. For example, on page 198 of the essay, he cites Katona’s (1964) book *The Mass Consumption Society* in which Katona lists (on p. 289–290) six “expenditures and conditions which cause consumers to reflect and make. . .. genuine decisions before making a purchase”. Among these are large expenditures (of houses, cars) which are subjectively thought to be major or fairly rare; unsatisfactory past experience, especially disappointment of expectations; some purchases of new products or the *first* purchase of a product; certain personality characteristics often associated with education; etc. According to Robert Pratt, Jr., Katona’s landmark study (with Mueller) published in 1954 too should be viewed as a contribution to the field of marketing. To Pratt, Katona defined this area of study by asking questions relevant to it (Pratt, p. 200).

What I intend to do in this paper is to argue that Katona made substantial contributions to the start of behavioral economics, and that, contrary to the assumption by some writers such as Sent (2004) who viewed Katona’s contributions to behavioral economics as limited to macroeconomics, Katona’s behavioral economics involved various aspects of economics. For example, many of the publications of George Katona are indicative of his interest in the theory of the firm. Examples are his 1945 book *Price Control and Business*, his 1946 AER paper “Psychological Analysis of Business Decisions and Expectations”, his 1955 paper “Business Expectations in the Framework of Psychological Economics: Towards a Theory of Expectations” (published in the 1958 book *Expectations, Uncertainty and Business Behavior*, edited by Mary Jean Bowman), and his 1957 book (with the Collaborations of Albert Lauterback and Stanly Steinkam) entitled *Business Looks at Banks: A Study of Business Behavior*. It is no wonder that he wrote: “Economics as a behavioral science studies the behavior of consumers, businessmen, and government policy makers in spending, saving, investing, price setting, and other activities” (1975, p. 3). However, as demonstrated below, his contributions to macroeconomics, in particular as it applies to consumer behavior (and the Keynesian consumption function), was the most significant. This explains James Tobin’s view that: “The careers of consumption function and George Katona have been intertwined since 1945. The consumption – saving decision has been a major subject of theoretical and empirical inquiry to which no one has contributed more than Katona” (1972, p. 37).

Katona, being influenced by Gestalt psychology and its expectations and problem-solving attributes, was very interested in public policy issues, whether writing about consumer or business behavior. In fact, introducing a psychological dimension to economics was his attempt to bring realism to economic analysis, making it more relevant to public policy. This policy-orientation of Katona explains why he wrote his 1942 book *War Without Inflation* and his 1945 book *Price Control and Business*. Utilizing his psychological theory of understanding (which he developed in his 1940 book about psychology) in his explanation of price controls in 1945, Katona demonstrated this policy orientation when he wrote: “If such an understanding is achieved, and if the price regulations are equitable and do not interfere arbitrarily with production, distribution, or consumption, price control need not arouse hostility but, on the contrary, can enlist the cooperation of all concerned. Such

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