



Rational Risk Policy: Arne Ryde Memorial Lectures Series.

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Journal of Economic Literature, Vol. 38, No. 1 (Mar., 2000), 127-128.

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Journal of Economic Literature is currently published by American Economic Association.

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distribution we might embrace a concept which finds no place in the author's argument, namely compassion for the underdog and a sense of social solidarity with the less fortunate. When old people like me express the view that in health care priority should be given to the young over the old *on equity grounds*, is this to be dismissed as envy or greed masquerading as justice and humanitarianism? Might it not be motivated by a feeling that it would be unjust to deny them what I have already had? Is it only us muddle-headed Europeans who think in this way? I hope not, for the sake of justice and humanity in the USA.

So this is a curious book, recommendable for its review of empirical evidence concerning the extent of, and recent trends in, inequalities in income, education, and health care in the USA. But the philosophical commentary at the end is of value only as a sort of examination task for students of philosophy, who could use the material to test their powers of analysis. But only at the graduate level.

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Rational Risk Policy: Arne Ryde Memorial Lectures Series. By W. Kip Viscusi. Oxford and New York: Oxford University Press, Clarendon Press, 1998. Pp. xiv, 138. \$24.95. ISBN 0-19-829363-1. JEL 99-0831

In his first presidential candidate debate with Senator Robert Dole, President Clinton cited hazardous waste cleanup among his administration's important environmental efforts. W. Kip Viscusi's most recent book deals with the rationality of these and other efforts addressed at reducing risk and compensating risk victims. Unfortunately for President Clinton, the book's main conclusion about government efforts in general and hazardous waste cleanup in particular is negative: government regulations often mirror the irrationalities present in individual decisions leading to costly and relatively ineffective policies.

It is well known from the literature on decision under risk that individual risk perceptions are often in error and tend to be systematically biased. In particular, people give too

much weight to small risks, underestimate the more substantial risks, and are excessively sensitive to changes in accustomed risk levels. These biases lead to exorbitant reactions to newly discovered risks while accustomed risks are treated with comparative inattention. Distorted risk perceptions explain, for example, why people overreact to the presence of negligible concentrations of benzene in Perrier bottled water, while at the same time being indifferent to the far more substantial risks that are posed by their diet and lack of exercise.

The obvious government response to the market failure caused by inaccurate risk perceptions is to provide risk information. Regulators have generally opposed information programs in favor of regulatory action on the grounds that information programs are ineffective in altering individual behavior. Viscusi disagrees and argues that information programs can be effective if they provide information that is new to the individual and do so in a convincing manner, recognizing that individuals have cognitive limitations. The most convincing case showing that information programs can work is cigarette warnings. Ever since the Surgeon General's first warning about the health hazards of smoking, there has been a consistent decrease both in per capita cigarette consumption and in the kind of cigarettes people smoke.

A fundamental aspect of assessing of risk policies is establishing a value of human life. This has long been considered controversial and government policy used to incorporate only the "cost of death," i.e., medical expenses and lost earnings. Viscusi shows that the cost of death approach undervalues human life by a factor of 10. The true value of life should reflect the tradeoffs we are willing to make between small risks and money. That having been said, many questions remain. For example, should we place a greater value on saving the lives of the young rather than the old and should we allow differences in wealth to affect the valuation of life?

In several contexts, government policy is focused on reducing risks regardless of the costs. Viscusi warns against the fiction that expenditures spent on reducing risk are always beneficial. First, there may be competing risks arising either from the policy or

from behavioral responses to the policy. A well-known example is compulsory seatbelt use, which led to an increase in driving speed. Second, the expenditures spent on risk reduction reduce the resources available for other uses.

The presence of health and safety risks is ubiquitous and risk regulation must necessarily be selective. Unfortunately, rather than correcting distortions in individual risk perceptions, government mirrors these distortions in its selection of risk policies. Government policy tends to overreact to newly discovered risks, is too conservative in its risk assessment, ignores the size of the exposed population, and is strongly influenced by the media coverage of the risk. Such policies may be defensible from a political standpoint of maximizing popular support, but they are not from an economic point of view. Instead, government risk policy should be based on benefit-cost criteria, should aim to provide for honest risk assessments, and should take into account the effect of risk policy on other types of risk reducing activities.

Since the 1980s, the role of tort liability in risk policy has increased dramatically. This has made the task of government regulation more complicated. Ideally, government regulation and tort liability should jointly address market failures in a manner that is not duplicative. As Viscusi shows, in practice tort liability and government regulation often generate similar incentives for risk reduction, leading to inefficient risk levels.

As mentioned, the main conclusion of the book is negative for government risk policy. The book contains both empirical illustration and theoretical analysis, without ever becoming so technical that the reader has trouble following the main line of argument. Violations of individual rationality have been well-documented in decision under risk. Violations of governmental rationality have been largely unexplored. Viscusi's book makes an important contribution to the study of these violations and is recommended to anyone interested in risk policy.

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E Macroeconomics and Monetary Economics

Institutions and Economic Theory: The Contribution of the New Institutional Economics. By Eirik G. Furubotn and Rudolf Richter. Ann Arbor: University of Michigan Press, 1997. Pp. xv, 542. \$65.00. \$27.95, pbk. ISBN 0-472-10817-4. JEL 99-0078

As one would expect of two leading figures in this field, this book is an excellent survey of a huge body of literature generated by the new research program known as the New Institutional Economic (NIE).

The first two chapters introduce the main concepts and issues that brought about and are central to this new research program. The first chapter is a more general introduction while the second introduces the concept of transaction costs that is so central to the entire book. The next two chapters discuss absolute and relative property rights respectively. Chapter Five covers contract theory in general and the principal-agent issue more specifically. Chapters Six through Nine discuss the implications of New Institutional Economics to the theory of the market, the firm, and the state. Chapter Ten concludes the book with some reflections on the future of NIE as a research program.

For those who have not followed the development of the NIE research program in the last two decades, this is a remarkable and very useful survey. I strongly recommend it to any active economist in or outside academia and especially to graduate students who will find here an important and very clear guide to many concepts and issues that are becoming commonplace in the contemporary study of economics.

But it is precisely with an eye to these future readers that a word of caution is due. Furubotn and Richter emphasize two important features of the NIE that in their review seem to be the most fundamental departure of NIE from neoclassical economics: the prevalence of transaction costs and bounded rationality. While the authors mention time and again the centrality of the study of political institutions in the NIE program, they fall short of covering this topic adequately.

In the last two decades the study of political