THE ECONOMIC RECORD, VOL. 82, NO. 258, SEPTEMBER, 2006, 365–376

Reviews

The Wisdom of Crowds, by James Surowiecki (Doubleday, New York), pp. 296.

I confess that after reading *Freakonomics* my expectations of popular economics were lowered slightly. Thus – a terrible sin – I had composed part of my review of *The Wisdom of Crowds* before actually reading the book. This review was based on the rather lengthy subtitle 'Why the Many Are Smarter Than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations'. I would make a sneering reference to the dotcom bubble as evidence of this collective wisdom. Then I would lament the short historical memory of Americans and point to Charles Mackay's classic *Extraordinary Popular Delusions and the Madness of Crowds*. How sad that this ignorant journalist had pinched the title but absorbed none of the content. I would round off by a brief summary of the theory of information cascades, which shows how it can be individually rational to follow the crowd instead of your own opinion.

I thought all this, and suffered terrible embarrassment, if only in the privacy of my own home. For James Surowiecki, of course, covered all these bases and more. The book is not a mindless hymn to the virtues of the marketplace but a nuanced analysis, supported by many historical and contemporary examples, of the conditions under which groups can make better decisions than even the most brilliant individuals, and those where they cannot. He argues that there are

> four conditions that characterize wise crowds: diversity of opinion (each person should have some private information, even if it's just an eccentric interpretation of the known facts), independence (people's opinions are not determined by the opinions of those around them), decentralization (people are able to specialize and draw on local knowledge), and aggregation (some mechanism exists for turning private judgements into a collective decision). (p. 10)

I did not find these definitions entirely clear at the time of reading. My understanding in light of subsequent chapters is this: for diversity, individuals must have different information available to them, or draw different conclusions from the same information. Decentralisation means that individuals must have power to take *action* on the basis of their diverse information and perspectives. The fourth condition also seems incomplete. Any decision method, after all, turns *someone's* private judgement into a decision. A good aggregation mechanism uses *all* of the available information, or at least as much as possible, and it must weigh conflicting information in a sensible way.

Because this is the most important paragraph in the entire book, it is a pity that it was not given a more explicit place in its organisation. Indeed, at other points the necessary conditions are whittled down to three, aggregation for some reason being left out. The first part of the book is divided into six chapters: three for the surviving conditions of wisdom, and three for the three types of problem Surowiecki considers: cognition, coordination and cooperation. These definitions, and the link with the chapters, are not made totally clear either. Chapters 2 to 5 are plainly named, Chapter 6 is fairly clearly about cooperation, which leaves Chapter 1 for cognition, although the word is not used in the title or anywhere in the text that I could find. Cognition problems are first defined as those with 'definitive solutions' or those for which 'some answers are better than others', as opposed to coordination problems which 'require members of a group … to figure out how to coordinate their behaviour with each other' and cooperation problems which 'involve the challenge of getting self-interested, distrustful people to work together, even when narrow self-interest would seem to dictate that no individual should' (pp. xvii–xviii). Presumably the key feature of cognition problems is that they have solutions independent of the actions and opinions of the group that is trying to solve them. The distinction between coordination and cooperation games (which must also have better or worse solutions for the subject to be important at all) seems to be the difference between situations where the socially optimal solution is a Nash equilibrium in a single-shot game, and situations where it is not. The examples given here and later make the distinctions clearer, but a little more work on the definitions

doi: 10.1111/j.1475-4932.2006.00346.x

themselves would have made the argument much easier to follow. The second part applies these concepts to various settings: traffic jams, science, small group decision-making, company organisation, markets, and democratic government. However, to describe the two-part division as being between theory and applications is too simple, as the first part abounds in practical illustrations of each concept.

So much for the form of the book. Fortunately, the content is excellent. The pages are crammed with humorous and illuminating tales, with the range of subjects as great of that in *Freakonomics*. My own favourite: In the wake of the *Challenger* disaster, the stock of the four major contractors involved with the shuttle program all lost value. By the end of the day, Thiokol (who built the solid fuel boosters) was down 12 per cent, the other three only 3 per cent. The next day, the *New York Times* reported two rumours unconnected with Thiokol and declared there were 'no clues'. Six months later the Presidential Commission revealed its findings: the O-ring seals on the boosters were responsible. There was no evidence of any insider trading. If this story does not take your fancy, there are dozens of others to choose from (many from more systematic if less memorable studies). Deviations from group rationality are given space along with confirmations: stock bubbles, intelligence failures, the *Columbia* disaster.

Some of the conclusions are commonplace to economists and possibly surprising to those who are not: seemingly 'wasteful' competition can be a valuable discovery procedure, central planning fails because those who have the information lack the power and incentive to act on it, congestion taxes in London and Singapore work, fund managers tend to underperform market indexes, prediction markets (which were so strongly rejected when proposed for terrorism) are the way of the future. And some may be shocking to economists and commonplace to everyone else: sometimes the collective good is served by individually irrational decisions – voting, paying taxes, and generally worrying about fairness even to your own personal disadvantage. One minor complaint: predictions are described as being 94 per cent accurate in a context (ordering of more than two items by size) where the interpretation of a percentage is unclear (p. 5). And the final lines 'The decisions that democracies make may not demonstrate the wisdom of the crowd. The decision to make them democratically does' (p. 271) may sound deep and portentous, but at the same time is a bit of a cop-out.

Like *Freakonomics*, *The Wisdom of Crowds* is based on a wealth of informative and amusing material that is partly spoiled by its presentation. Unlike *Freakonomics*, it is a book that is unashamedly devoted to one central theme. As such, the sheer abundance of information is sometimes a distraction. A little pruning, combined with clear and consistently applied terminology, would have paid dividends. The book also lacks an index and chapter headings on each page, which can be a considerable nuisance.

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Classics and Moderns in Economics: Essays on Nineteenth- and Twentieth-Century Economic Thought, by Peter Groenewegen (Routledge, London, 2003), 2 vols, pp. viii + 285; pp. viii + 310.[1]

Peter Groenewegen's work and interest in the history of Australian economics is well known, particularly the controversial book-length study of the history of Australian economic thought with Bruce MacFarlane. Peter also promoted the study of the history of economics both in New Zealand and Australia through establishing the Centre for the Study of the History of Economic Thought (within the Department of Economics, University of Sydney). Peter's work in this area has thrown new light on various distinctive features in the history of Australian economics, the significance of which may be judged by the recent proposal to produce a scholarly *Biographical Dictionary of Australian and New Zealand Economists*, a handsome venture intended to give the field of antipodean economics the exposure it warrants.

It is to Peter's credit, then, that he decided to include in this collection of his papers several Australian economics-centred papers published in relatively less well-known Australian periodicals. The excellent piece on Colin Clark, originally published in the *Australian Quarterly* as the third Colin Clark Memorial Lecture as well as the piece on 'Alfred Marshall and Australian economics', first published in the *History of Economic Thought*

[1] The first part of this review was published in the March 2006 issue of the *Economic Record*.