

can be built and can be made to predict well. However, we have been interested in building a model that embodies the actual decision-making process. Our reasons for this position have been amplified elsewhere in this book. We do not believe a radically different model can be built that captures the actual decision process and predicts as well. Because our objective is to understand the actual process, we have not attempted to minimize the number of assumptions, the number of variables, or the number of inputs to the model.

The department store model is a specific application of the general model described in this book. The evidence supports the specific model and thereby presents corroborative evidence for the general model. We would not argue that the evidence is conclusive. It is not. It is, however, consistent with the model. The model lends itself to further elaboration and testing – and the world is full of firms for further empirical study.

Notes

- 1 This chapter is based on an unpublished working paper by R. M. Cyert, J. G. March, and C. G. Moore. Mr Moore did the bulk of the field research and shared fully in the development of the model.
- 2 This statement may not portray the process accurately. During the period we observed it was not possible to determine the interactions between the sales estimates and the goals. They always tended to be consistent with each other but it was difficult to determine the extent to which an implicit goal of “equal or exceed last year’s sales” influenced the estimates.
- 3 We do not mean to imply that the department consciously uses such a rule. Although the rule was inferred from a study of actual behavior, the head of the department did not describe his estimation rule in these terms.

7

A Summary of Basic Concepts in the Behavioral Theory of the Firm

In its classic form, economic theory is simply a language designed to provide a systematic framework within which to analyze economic problems. Such a role was assigned to theory by Marshall and is clearly implicit in contemporary theory. In this view theory performs two major functions. On the one hand, it is an exhaustive set of general concepts. Any variable observed in the system can be assigned to an appropriate niche. The theory is a set of filing cabinets with each drawer bearing the title of an economic concept. Within each file drawer there is a set of folders for each economic variable relevant to the concept. Within each folder there is a further breakdown in terms of the factors affecting the variable. At the same time, the theory is a statement of critical relations among system variables. These relations may be assumptions about interdependence among variables, about the functional form of the interdependences, or about broad structural attributes of the system.

As an example in classic theory, consider the concept of market demand. The usual treatment of demand involves (1) a description of demand in terms of a “demand curve,” (2) the decomposition of the market demand curve into individual demand curves, and (3) the specification of individual demand in terms of individual preference orderings and the concept of utility. Within such a filing system we establish relations between external events and demand phenomena (e.g., a relation between demand for a particular commodity and money income) by introducing relational concepts (e.g., income elasticity).

One of the most important requirements for the usefulness of theory conceived in this general way is the requirement that all

important variables in the system be conveniently represented within the concepts of the theory. The theory of the firm seems to meet this requirement reasonably well for the kinds of problems with which it has usually been faced (e.g., the perfectly competitive market). However, the theory has not been adequate to cope with oligopolistic markets. The theory outlined in this volume specifies an alternative framework and an alternative set of key relations for dealing with the modern "representative firm" – the large, multiproduct firm operating under uncertainty in an imperfect market.

7.1 Goals, Expectations, and Choice

The basic framework for analysis we have proposed, like the classic one, has two major organizing devices: (1) it has a set of exhaustive variable categories; (2) it has a set of relational concepts. The exhaustive categories are implicit in the organization of this volume. We have argued that we can analyze the process of decision making in the modern firm in terms of the variables that affect organizational goals, the variables that affect organizational expectations, and the variables that affect organizational choice.

Organizational goals Quite simply, we have identified two sets of variables affecting the goals of an organization. The first set influences the *dimensions* of the goals (what things are viewed as important). Within this set of variables, we can cite the composition of the organizational coalition, the organizational division of labor in decision making, and the definition of problems facing the organization. Thus, we have argued that organizational goals change as new participants enter or old participants leave the coalition. We have argued that the operative goals for a particular decision are the goals of the subunit making that decision. Finally, we have argued that goals are evoked by problems. The second set of variables influences the *aspiration level* on any particular goal dimension. Here we have identified essentially three variables: the organization's past goal, the organization's past performance, and the past performance of other "comparable" organizations. The aspiration

level is viewed as some weighted function of these three variables.

Organizational expectations Expectations are seen as the result of drawing inferences from available information. Thus, we consider variables that affect either the process of drawing inferences or the process by which information is made available to the organization. With respect to inference drawing, we have not attempted to reflect all of the recent efforts in the psychology of individual choice. However, we have identified some simple pattern-recognition variables (e.g., linear extrapolation) and the effect of hopes on expectations. With respect to the process by which information is made available, we have cited particularly variables affecting search activity within the firm. Affecting the intensity and success of search are the extent to which goals are achieved and the amount of organizational slack in the firm. Affecting the direction of search are the nature of the problem stimulating search and the location in the organization at which search is focused.

Organizational choice Choice takes place in response to a problem, uses standard operating rules, and involves identifying an alternative that is acceptable from the point of view of evoked goals. Thus, the variables that affect choice are those that influence the definition of a problem within the organization, those that influence the standard decision rules, and those that affect the order of consideration of alternatives. The standard decision rules are affected primarily by the past experience of the organization and the past record of organizational slack. The order in which alternatives are considered depends on the part of the organization in which the decision is being made and past experience in considering alternatives.

In the earlier chapters 3 to 5, we have tried to elaborate on this simple structure in order to develop meaningful and useful theories of organizational goals, expectations, and choice. We think it is possible to subsume any variable within the theory of business decision making under one or more of these categories.

7.2 Four Major Relational Concepts

In the course of developing the three subtheories, we have developed a relatively small number of relational concepts. In many respects, they represent the heart of our theory of business decision making. The four major concepts used in the theory are (1) quasi resolution of conflict, (2) uncertainty avoidance, (3) problemistic search, and (4) organizational learning. In this section we review briefly the meaning of each of these concepts. In the subsequent chapter we will use the concepts to suggest implications for economic and organizational theory.

7.2.1 *Quasi resolution of conflict*

In keeping with virtually all theories of organizations, we assume that the coalition represented in an organization is a coalition of members having different goals. We require some procedure for resolving such conflict. The classic solution is to posit an exchange of money from some members of the coalition to other members as a way of inducing conformity to a single, consistent set of goals – the organizational objective.

We propose an alternate concept of organizational goals and an alternate set of assumptions about how conflict is resolved. Basically we have argued that most organizations most of the time exist and thrive with considerable latent conflict of goals. Except at the level of non-operational objectives, there is no internal consensus. The procedures for “resolving” such conflict do not reduce all goals to a common dimension or even make them obviously internally consistent.

Goals as independent constraints In our framework, organizational goals are a series of independent aspiration-level constraints imposed on the organization by the members of the organizational coalition. These constraints may include non-essential demands (i.e., demands that are already satisfied when other constraints are met), sporadic demands (i.e., demands that are made only occasionally), non-operational demands (i.e., demands for which there are no operational measures), as well as essential, continuous, operative goals. In general, although we recognize the importance of goals that are non-essential (because

they might become essential), of goals that are ordinarily sporadic (because they occasionally are enforced), and of goals that are non-operational (because they sometimes can be made operational), we will focus on those constraints that are essential, continuous, and operative.

Specifically, in the case of price and output models of the business firm, we assume a profit goal, a sales goal, a market share goal, an inventory goal, and a production goal. In any particular firm we expect some subset of these objectives to be essential, continuous, and operative. Moreover, we expect that subset to pose problems for the organization in the form of potential conflict. Thus, we require assumptions about procedures for resolving conflict. We assume that conflict is resolved by using local rationality, acceptable-level decision rules, and sequential attention to goals.

Local rationality We assume that an organization factors its decision problems into subproblems and assigns the subproblems to subunits in the organization. From the point of view of organizational conflict, the importance of such local rationality is in the tendency for the individual subunits to deal with a limited set of problems and a limited set of goals. At the limit, this reduces to solving one problem in terms of only one goal. The sales department is primarily responsible for sales goals and sales strategy; the production department is primarily responsible for production goals and production procedures; the pricing department is primarily responsible for profit goals and price decisions; and so on.

Through delegation and specialization in decisions and goals, the organization reduces a situation involving a complex set of interrelated problems and conflicting goals to a number of simple problems. Whether such a system will in fact “resolve” the conflict depends, of course, on whether the decisions generated by the system are consistent with each other and with the demands of the external environment. In our theory consistency is facilitated by two characteristics of the decision process: (1) acceptable-level decision rules; (2) sequential attention to goals.

Acceptable-level decision rules In the classic arguments for decentralization of decision making, we require strong assumptions

about the effectiveness of the "invisible hand" in enforcing proper decisions on a system of local rationality. Consistency requires that local optimization by a series of independent decision centers result in overall optimization. On the other hand, we are persuaded that organizations can and do operate with much weaker rules of consistency (i.e., we require that local decisions satisfying local demands made by a series of independent decision centers result in a joint solution that satisfies all demands). Such rules are weaker in two senses: (1) there will ordinarily be a large number of local decisions that are consistent with other local decisions under such a rule. The demand constraints do not uniquely define a solution; (2) any such system will tend to underexploit the environment and thus leave excess resources to absorb potential inconsistencies in the local decisions.

Sequential attention to goals Ordinarily when we talk of "consistency" of goals or decisions we refer to some way of assessing their internal logic at a point in time. As a result, in classic theories of organizations we are inclined to insist on some consistency within a cross-section of goals. Such an insistence seems to us inaccurate as a characterization of organizational behavior. Organizations resolve conflict among goals, in part, by attending to different goals at different times. Just as the political organization is likely to resolve conflicting pressures to "go left" and "go right" by first doing one and then the other, the business firm is likely to resolve conflicting pressures to "smooth production" and "satisfy customers" by first doing one and then the other. The resulting time buffer between goals permits the organization to solve one problem at a time, attending to one goal at a time.

7.2.2 *Uncertainty avoidance*

To all appearances, at least, uncertainty is a feature of organizational decision making with which organizations must live. In the case of the business firm, there are uncertainties with respect to the behavior of the market, the deliveries of suppliers, the attitudes of shareholders, the behavior of competitors, the future actions of governmental agencies, and so on. As a result, much of modern decision theory has been concerned with the problems of decision making under risk and uncertainty. The solutions

involved have been largely procedures for finding certainty equivalents (e.g., expected value) or introducing rules for living with the uncertainties (e.g., game theory).

Our studies indicate quite a different strategy on the part of organizations. Organizations avoid uncertainty: (1) They avoid the requirement that they correctly anticipate events in the distant future by using decision rules emphasizing short-run reaction to short-run feedback rather than anticipation of long-run uncertain events. They solve pressing problems rather than develop long-run strategies. (2) They avoid the requirement that they anticipate future reactions of other parts of their environment by arranging a negotiated environment. They impose plans, standard operating procedures, industry tradition, and uncertainty-absorbing contracts on that environment. In short, they achieve a reasonably manageable decision situation by avoiding planning where plans depend on predictions of uncertain future events and by emphasizing planning where the plans can be made self-confirming through some control device.

Feedback-react decision procedures We assume that organizations make decisions by solving a series of problems; each problem is solved as it arises; the organization then waits for another problem to appear. Where decisions within the firm do not naturally fall into such a sequence, they are modified so that they will.

Consider, for example, the production-level decision. In most models of output determination, we introduce expectations with respect to future sales and relate output to such predictions. Our studies indicate, to the contrary, that organizations use only gross expectations about future sales in the output decision. They may, and frequently do, forecast sales and develop some long-run production plans on paper, but the actual production decisions are more frequently dominated by day-to-day and week-to-week feedback data from inventory, recent sales, and sales staff.

This assumption of a "fire department" organization is one of the most conspicuous features of our models. Under a rather broad class of situations, such behavior is rational for an organization having the goal structure we have postulated. Under an even broader set of situations, it is likely to be the pattern of behavior that is learned by an organization dealing with an

uncertain world and quasi-resolved goals. It will be learned because by and large it will permit the organization to meet the demands of the members of the coalition.

Negotiated environment Classical models of oligopoly ordinarily assume that firms make some predictions about the behavior of their environment, especially those parts of the environment represented by competitors, suppliers, customers, and other parts of the organization. Certainly such considerations are important to any decisions made by the firm. Our studies, however, lead us to the proposition that firms will devise and negotiate an environment so as to eliminate the uncertainty. Rather than treat the environment as exogenous and to be predicted, they seek ways to make it controllable.

In the case of competitors, one of the conspicuous means of control is through the establishment of industry-wide conventional practices. If "good business practice" is standardized (through trade associations, journals, word of mouth, external consultants, etc.), we can be reasonably confident that all competitors will follow it. We do not mean to imply that firms necessarily enter into collusive agreements in the legal sense; our impression is that ordinarily they do not, but they need not do so to achieve the same objective of stability in competitive practices.

For example, prices are frequently set on the basis of conventional practice. With time, such variables as the rate of mark-up, price lines, and standard costing procedures become customary within an industry. Some effects of such practices were indicated in chapter 6. The net result of such activity with respect to prices (and comparable activity with regard to suppliers and customers) is that an uncertain environment is made quite highly predictable.

Such negotiation among firms is not obviously collusion for profit maximization. Rather, it is an attempt to avoid uncertainty while obtaining a return that satisfies the profit and other demands of the coalition. The lack of a profit-maximizing rationale is suggested by (1) the stability of the practices over time and (2) the occasional instances of success by firms willing to violate the conventional procedures (e.g., discount houses in retailing).

In a similar fashion, the internal planning process (e.g., the

budget) provides a negotiated internal environment. A plan within the firm is a series of contracts among the subunits in the firm. As in the case of industry conventions, internal conventions are hyperstable during the contract period and tend to be relatively stable from one period to the next (e.g., in resource allocation). As a result, they permit each unit to avoid uncertainty about other units in making decisions.

7.2.3 *Problemistic search*

In the framework proposed in this volume, the theory of choice and the theory of search are closely intertwined. Necessarily, if we argue that organizations use acceptable-level goals and select the first alternative they see that meets those goals, we must provide a theory of organizational search to supplement the concepts of decision making. In our models we assume that search, like decision making, is problem-directed. By *problemistic search* we mean search that is stimulated by a problem (usually a rather specific one) and is directed toward finding a solution to that problem. In a general way, problemistic search can be distinguished from both random curiosity and the search for understanding. It is distinguished from the former because it has a goal, from the latter because it is interested in understanding only insofar as such understanding contributes to control. Problemistic search is engineering rather than pure science.

With respect to organizational search, we assume three things:

- 1 *Search is motivated* Whether the motivation exists on the buyer or seller side of the alternative market, problemistic search is stimulated by a problem and depressed by a problem solution.
- 2 *Search is simple-minded* It proceeds on the basis of a simple model of causality until driven to a more complex one.
- 3 *Search is biased* The way in which the environment is viewed and the communications about the environment that are processed through the organization reflect variations in training, experience, and goals of the participants in the organization.

Motivated search Search within the firm is problem-oriented. A problem is recognized when the organization either fails to satisfy one or more of its goals or when such a failure can be anticipated in the immediate future. So long as the problem is not solved,

search will continue. The problem is solved either by discovering an alternative that satisfies the goals or by revising the goals to levels that make an available alternative acceptable. Solutions are also motivated to search for problems. Pet projects (e.g., cost savings in someone else's department, expansion in our own department) look for crises (e.g., failure to achieve the profit goal, innovation by a competitor). In the theory we assume that variations in search activity (and search productivity) reflect primarily the extent to which motivation for search exists. Thus, we assume that regular, planned search is relatively unimportant in inducing changes in existing solutions that are viewed as adequate.

Simple-minded search We assume that rules for search are simple-minded in the sense that they reflect simple concepts of causality. Subject to learning (see below), search is based initially on two simple rules: (1) search in the neighborhood of the problem symptom and (2) search in the neighborhood of the current alternative. These two rules reflect different dimensions of the basic causal notions that a cause will be found "near" its effect and that a new solution will be found "near" an old one.

The neighborhood-of-symptom rule can be related to the subunits of the organization and their association with particular goals and with each other. A problem symptom will normally be failure on some goal indicator. Initial reaction, we assume, will be in the department identified with the goal. Thus, if the problem is the failure to attain the sales goal, the search begins in the sales department and with the sales program. Failing there, it might reasonably proceed to the problem of price and product quality and then to production costs.

The neighborhood-of-existing-policy rule inhibits the movement of the organization to radically new alternatives (except under circumstances of considerable search pressure). Such an inhibition may be explained either in terms of some underlying organizational assumptions of continuity in performance functions or in terms of the problems of conceiving the adjustments required by radical shifts.

When search, using the simple causal rules, is not immediately successful, we assume two developments. First, the organization uses increasingly complex ("distant") search; second, the

organization introduces a third search rule: (3) search in organizationally vulnerable areas.

The motivation to search in vulnerable areas stems from two things. On the one hand, the existence of organizational slack will tend to lead search activity in the direction of slack parts of the organization. On the other hand, certain activities in the organization are more easily attacked than others, simply because of their power position in the system. One general phenomenon is the vulnerability of those activities in the organization for which the connection with major goals is difficult to calculate concretely (e.g., research in many firms). In either case, a solution consists in either absorbing slack or renegotiating the basic coalition agreement to the disadvantage of the weaker members of the coalition.

Bias in search We assume three different kinds of search bias: (1) bias reflecting special training or experience of various parts of the organization, (2) bias reflecting the interaction of hopes and expectations, and (3) communication biases reflecting unresolved conflict within the organization. Bias from prior experience or training is implicit in our assumptions of search learning (below), local specialization in problem solving (above), and subunit goal differentiation (above). Those parts of the organization responsible for the search activities will not necessarily see in the environment what those parts of the organization using the information would see if they executed the search themselves. The bias in adjusting expectations to hopes has the consequence of decreasing the amount of problem-solving time required to solve a problem and of stimulating the growth of organizational slack during good times and eliminating it during bad. We assume that communication bias can be substantially ignored in our models except under conditions where the internal biases in the firm are all (or substantially all) in the same direction or where biases in one direction are located in parts of the organization with an extremely favorable balance of power.

7.2.4 *Organizational learning*

Organizations learn: to assume that organizations go through the same processes of learning as do individual human beings seems

unnecessarily naive, but organizations exhibit (as do other social institutions) adaptive behavior over time. Just as adaptations at the individual level depend upon phenomena of the human physiology, organizational adaptation uses individual members of the organization as instruments. However, we believe it is possible to deal with adaptation at the aggregate level of the organization, in the same sense and for the same reasons that it is possible to deal with the concept of organizational decision making.

We focus on adaptation with respect to three different phases of the decision process: adaptation of goals, adaptation in attention rules, and adaptation in search rules. We assume that organizations change their goals, shift their attention, and revise their procedures for search as a function of their experience.

Adaptation of goals The goals with which we deal are in the form of aspiration levels, or – in the more general case – search equivalence classes. In simple terms, this means that on each dimension of organizational goals there are a number of critical values – critical, that is, from the point of view of shifts in search strategy. These values change over time in reaction to experience, either actual or vicarious.

We assume, therefore, that organizational goals in a particular time period are a function of (1) organizational goals of the previous time period, (2) organizational experience with respect to that goal in the previous period, and (3) experience of comparable organizations with respect to the goal dimension in the previous time period. Initially at least, we would assume a simple linear function,

$$G_t = a_1 G_{t-1} + a_2 E_{t-1} + a_3 C_{t-1}$$

where G is the organizational goal, E the experience of the organization, C a summary of the experience of comparable organizations, and where $a_1 + a_2 + a_3 = 1$. The parameters in this goal adaptation function are important attributes of the organization. a_3 reflects the organization's sensitivity to the performance of competitors or other comparable organizations. a_1 and a_2 reflect the speed at which the organization revises goals in the face of experience. In some cases, we will want to define two values for a_3 – one for when comparative experience exceeds

the organization's goal and a different one for when it is below the goal. Similarly, we may want to allow the effect of the organization's experience to depend on whether it exceeds or is below the goal.

Adaptation in attention rules Just as organizations learn what to strive for in their environment, they also learn to attend to some parts of that environment and not to others. One part of such adaptation is in learning search behavior, which we will consider in a moment. Here we wish to note two related, but different, adaptations:

1 In evaluating performance by explicit measurable criteria, organizations learn to attend to some criteria and ignore others. For example, suppose an organization subunit has responsibility for a specific organizational goal. Since this goal is ordinarily stated in relatively non-operational terms, the subunit must develop some observable indices of performance on the goal. Among the indices objectively available to the subunit, which will be used? Observation suggests this is a typical case of learning. Subunits in the short run do not change indices significantly. However, there are long-run shifts toward indices that produce generally satisfactory results (i.e., in this case, usually show the subunit to be performing well).

2 Organizations learn to pay attention to some parts of their comparative environment and to ignore other parts. We have assumed that one of the parameters in the goal adaptation function is a parameter reflecting the sensitivity of the organization to external comparisons. This parameter is not fixed. We would expect it to change over time as such comparisons do or do not produce results (in the form of goals) that are satisfactory to the important groups in the coalition. At the same time, we have represented by C in the goal adaptation function a summary description of comparable organizations. Concealed in such an abstract form is organizational learning with respect to what is properly comparable. With which attributes of which organizations should we compare ourselves? Although in a relatively short-run model we might reasonably consider this fixed, we would expect that in the long run we would require a model in which such attention factors changed.

Adaptation in search rules If we assume that search is problem-oriented, we must also assume that search rules change. Most simply, what we require in the models are considerations of the following type: when an organization discovers a solution to a problem by searching in a particular way, it will be more likely to search in that way in future problems of the same type; when an organization fails to find a solution by searching in a particular way, it will be less likely to search in that way in future problems of the same type. Thus, the order in which various alternative solutions to a problem are considered will change as the organization experiences success or failure with alternatives.

In a similar fashion, the code (or language) for communicating information about alternatives and their consequences adapts to experience. Any decision-making system develops codes for communicating information about the environment. Such a code partitions all possible states of the world into a relatively small number of classes of states. Learning consists in changes in the partitioning. In general, we assume the gradual development of an efficient code in terms of the decision rules currently in use. Thus, if a decision rule is designed to choose between two alternatives, the information code will tend to reduce all possible states of the world to two classes. If the decision rules change, we assume a change in the information code, but only after a time lag reflecting the rate of learning. The short-run consequences of incompatibilities between the coding rules and the decision rules form some of the more interesting long-run dynamic features of an organizational decision-making model.

7.3 The Basic Structure of the Organizational Decision-Making Process

We have described four basic concepts that seem to us fundamental to an understanding of the decision-making process in a modern, large-scale business organization. The quasi resolution of conflict, uncertainty avoidance, problemistic search, and organizational learning are central phenomena with which our models must deal. In our judgment, the natural theoretical language for describing a process involving these phenomena is the language of a computer program. It is clear that some parts of

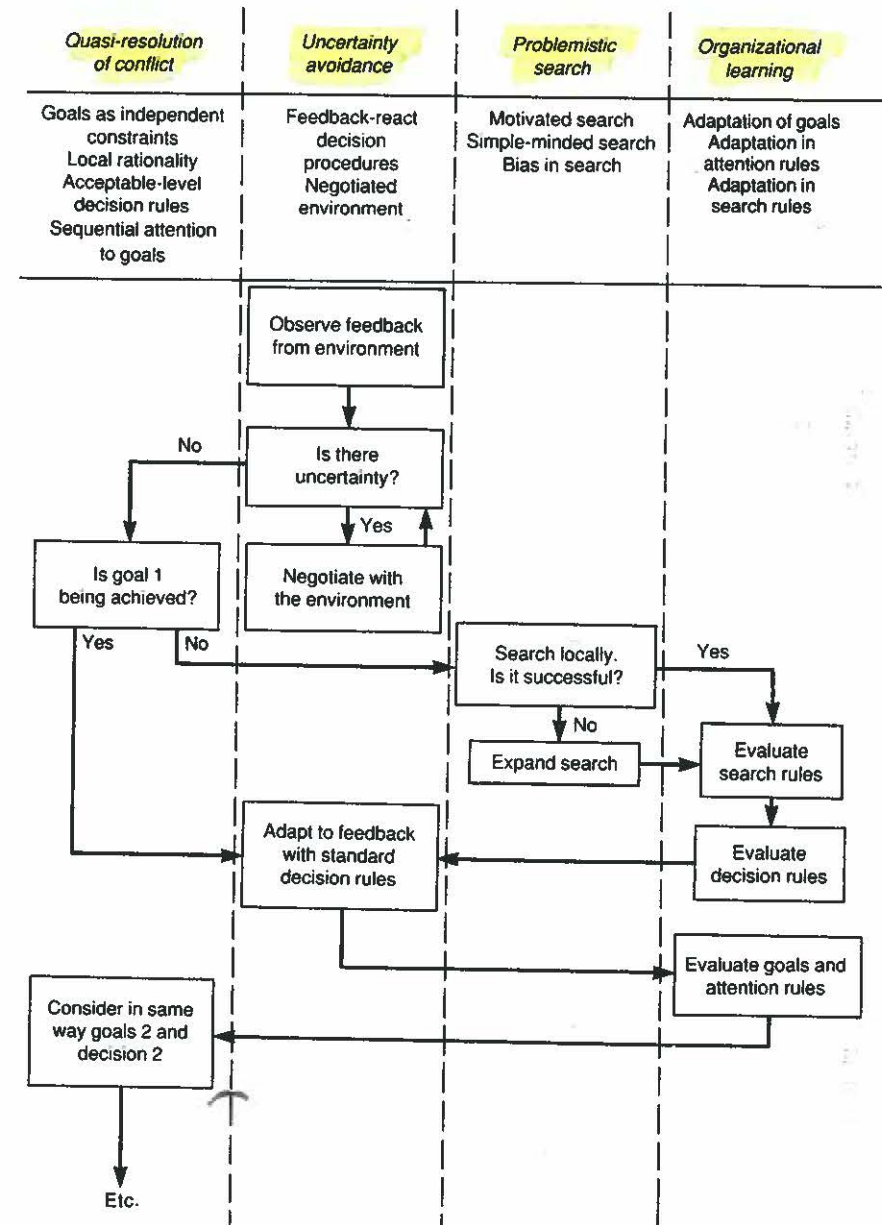


Figure 7.1 Organizational decision process in abstract form

the theory are susceptible to representation and solution in other forms, but the general structure of the process can be conveniently represented as a flow chart. Such a flow chart is outlined in its most general form in figure 7.1.

Figure 7.1 is intended to illustrate two things. On the one hand, it shows abstractly the step-by-step decision process. For convenience, we have started the process at the point of receiving feedback from past decisions. Since the decision process is continuous, this start is arbitrary. Starting from the feedback, the figure shows the sequence of steps taken by a particular subunit in the firm with respect to a specific decision and a specific goal. Other decisions by other subunits using other goals would occur in parallel with this one. Loose connections among the subunits and decisions are secured by the environmental feedback and (when indicated) by expanded search.

At the same time, the figure shows (by the vertical columns) the relation between the basic concepts of the theory and the decision process flow chart. At a general level, each of the concepts is represented in a decision process having this structure. Obviously, when a specific decision in a specific content (e.g., chapter 6) is considered, this abstract description of the process must be substantially elaborated with specific content.

Clearly, models based on these concepts will deviate significantly from models based on the approach of classical economics. Such differences are not surprising. We have emphasized the fact that the behavioral theory of the firm is designed to answer a set of questions different from those to which traditional theory of the firm is directed. We think that these concepts will prove useful in dealing with organizational decision making as it is reflected in business firms.

8

Some Implications

The theory of the firm serves four major purposes within the framework of economic theory:

- 1 It describes how individual business firms make decisions in a market system. It specifies a set of rules or motivational assumptions that describe a firm's decisions on output, price, and resource allocation. With respect to this purpose, the adequacy of the theory is determined by comparing the predictions of the theory with observations on individual firms.
- 2 The theory prescribes how individual business firms should make decisions in a market system. On the basis of assumptions about the goals of the firm, it specifies a set of decision rules for decisions on output, price, and resource allocation. The rules have some properties of optimality vis-à-vis the goals. With respect to this purpose, the adequacy of the theory is tested by using it as a basis for decisions and comparing the result with the result obtained from decisions derived from alternative rules.
- 3 The theory is a basis for describing the behavior of certain aggregates of firms – specifically for an industry, a particular sector of the economy, or the economy as a whole. Simple propositions, from the theory, about the behavior of individual firms are used to derive predictions of aggregate behavior. With respect to this purpose, the adequacy of the theory is assessed by comparing the predictions of aggregate behavior with the actual behavior of the specified aggregates.
- 4 The theory is a tool for deciding among some alternative economic policies. Since many policy recommendations are designed to influence the decisions made by business firms, the theory is used to deduce the probable consequences of alternative policies. With respect to this purpose, the adequacy of the theory is evaluated by comparing the results of public policy with the desired results.