

*Homo economicus*

The Rational Fool

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HOMO SAPIENS

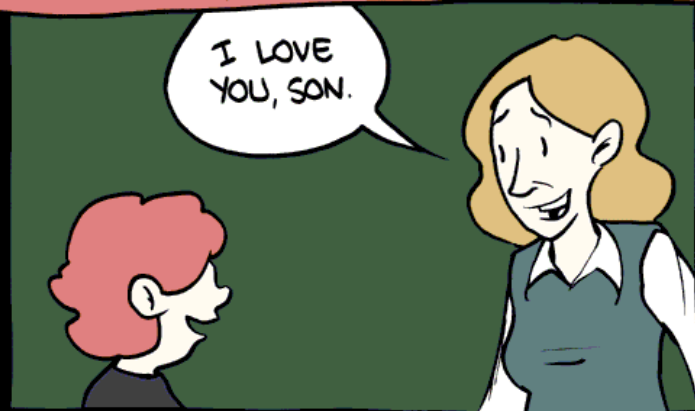
YEAH, THERE'S  
FREE ELECTRICITY.  
JUST FIND AN  
OUTLET.

OH, COOL,  
THANKS!



HOMO SAPIENS

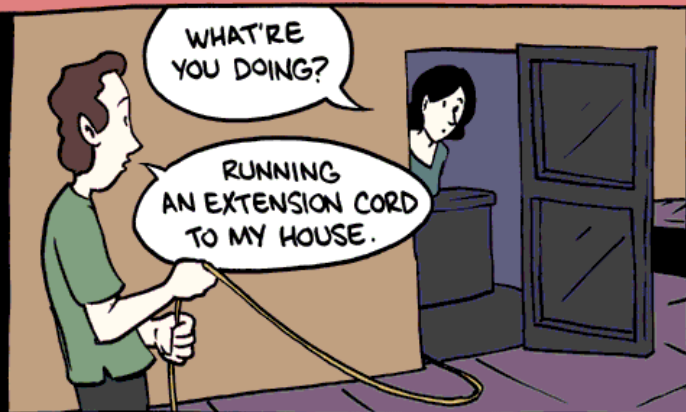
I LOVE  
YOU, SON.



HOMO ECONOMICUS

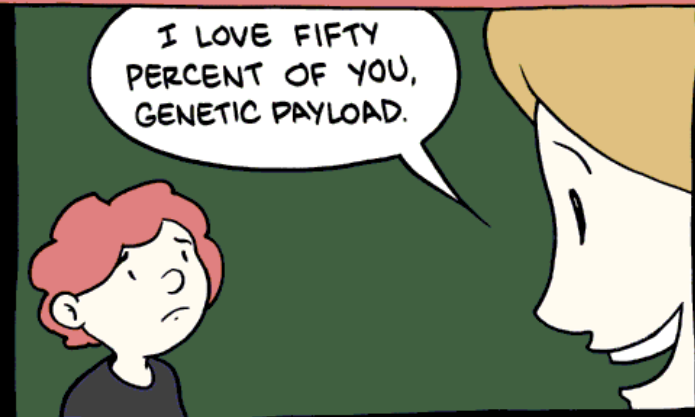
WHAT'RE  
YOU DOING?

RUNNING  
AN EXTENSION CORD  
TO MY HOUSE.



HOMO ECONOMICUS

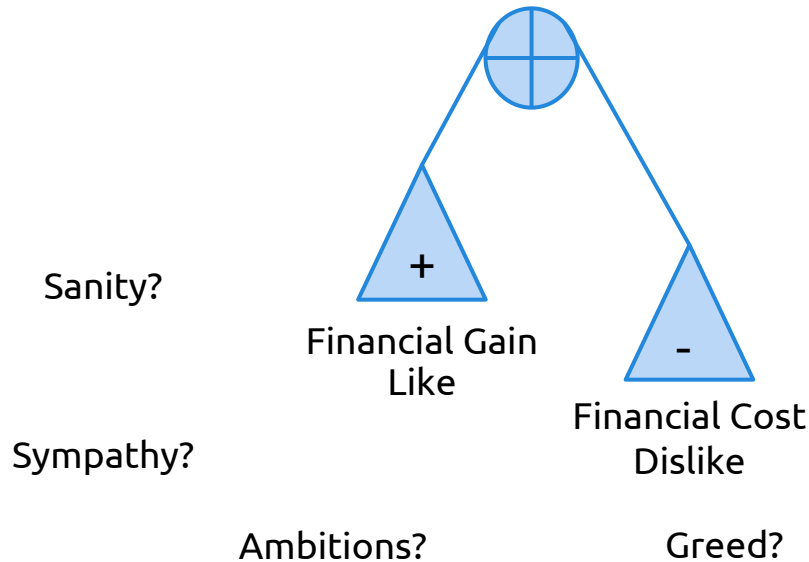
I LOVE FIFTY  
PERCENT OF YOU,  
GENETIC PAYLOAD.



# Motivation

## Rationality

Rationality in choice making: a cost-benefit analysis to maximise individual advantage.



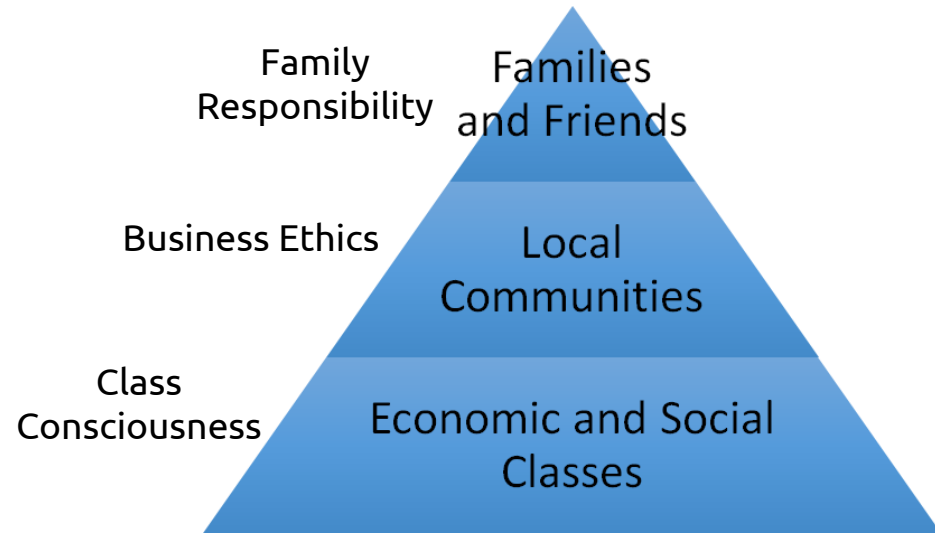
$$U(\mathbf{X}), \text{ where } \mathbf{X} = \{x_1, x_2, \dots, x_n\}$$
$$F(\mathbf{X}) = -\Delta_{\mathbf{X}}U(\mathbf{X})$$

Justice?

Love?

# Motivation

## Theory of Revealed Preferences

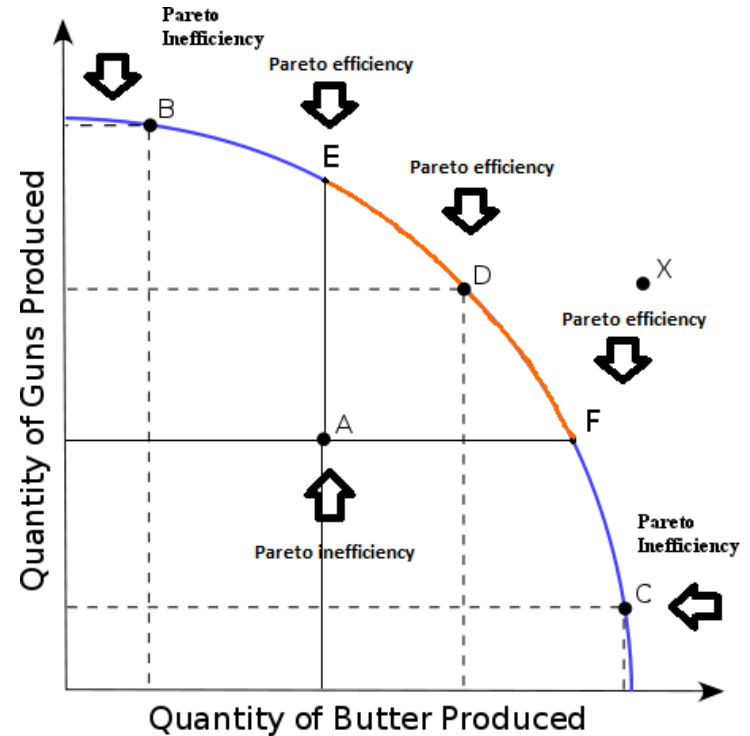


“It is possible to define a person's interests in such a way that no matter what he does he can be seen to be furthering his own interests in every isolated act of choice.”

Key is **consistency** of preference ( $A < B < C$ ), irrespective of egoistic or altruistic nature of an individual.

# Motivation Efficiency

- **Pareto Efficiency:** a condition wherein no single person can be made better off without making another person worse off.
- **Sen's Liberal Paradox:** No requirement of equitable wealth distribution → Social Welfare?
- Tragedy of the Commons!



# Motivation

## *Why Look Under The Hood?* - Daniel Hausman

“Even if all one cares about is predictive success in some limited domain, one should still be concerned about the realism of the assumptions of an hypothesis and the truth of its irrelevant or unimportant predictions.”

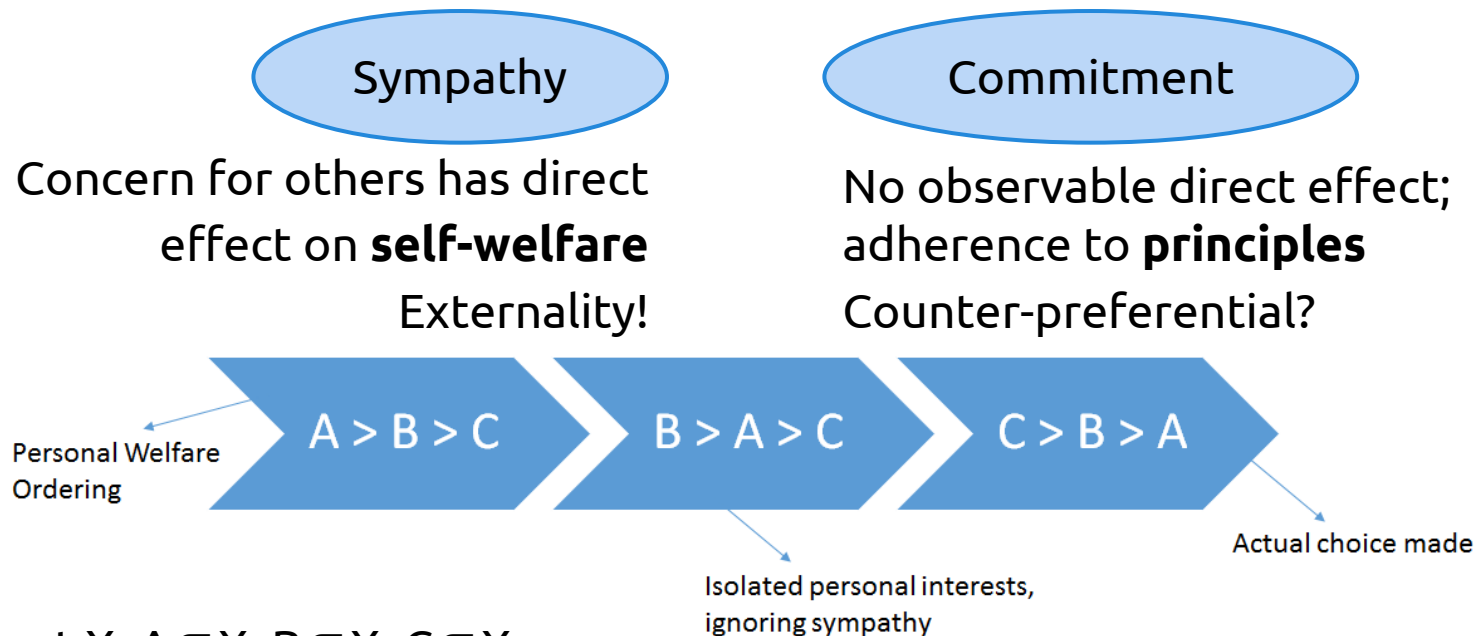
- Availability of wealth of **information**.
- Incomplete knowledge necessitates breakdown of **generalisations**.
- Difficulties of **testing**.



"You are completely free to carry out whatever research you want, so long as you come to these conclusions."

# Meta-preferences

*Rational Fools: A Critique of the Behavioral Foundations of Economic Theory* – Amartya Sen



Action set  $X$ :  $A \in X, B \in X, C \in X$

Ranking set  $Y$ :  $A > B > C \in Y, B > C > A \in Y, C > A > B \in Y, A > C > B \in Y, B > A > C \in Y, C > B > A \in Y$

# Non-Wanton change in preferences

*Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse* – Albert Hirschman

Wanton

**Unreflective** in their grip of whims and passions

Change in *tastes*

Non-Wanton

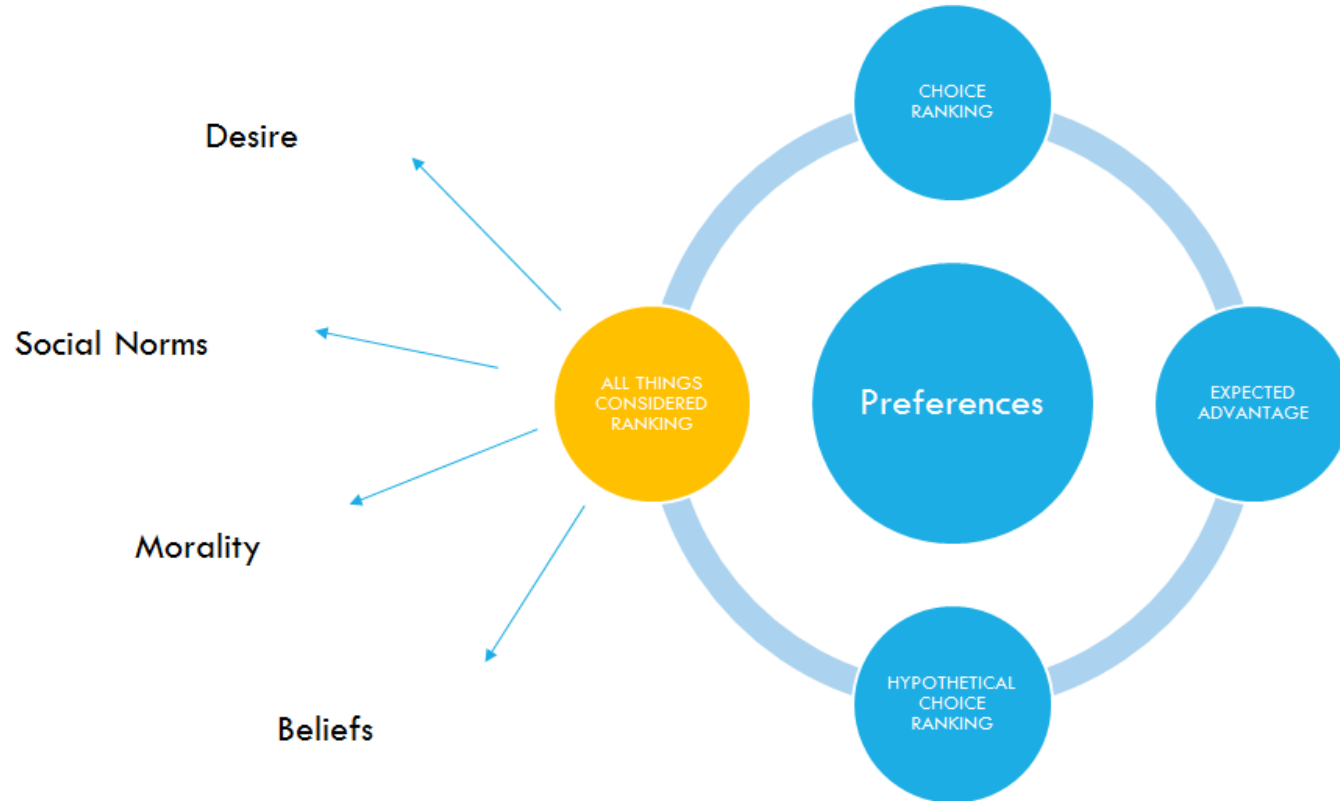
**Reflective**; preceded by a formation of meta-preferences at odds with practiced preference

Change in *values*; not a matter of less or more



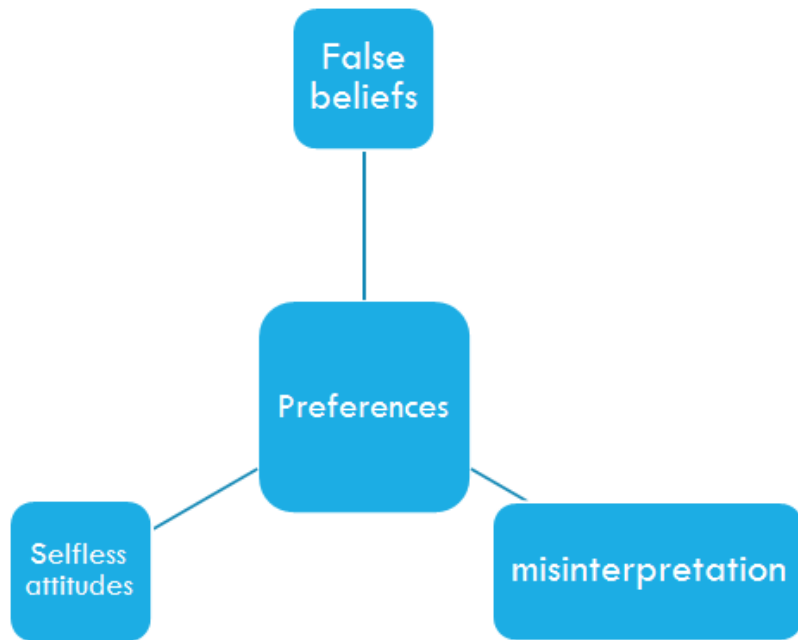
# The Notion of Preferences

*Sympathy, Commitment and Preference* - Daniel Hausman



# Welfare and Preference Satisfaction

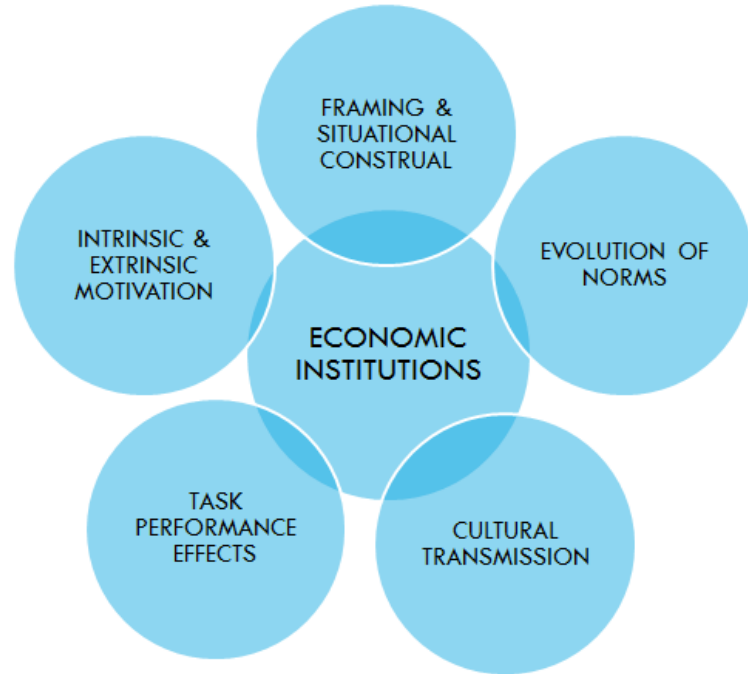
*Beware of Economists Bearing Advice* – Daniel Hausman and Michael McPherson



- Takes the case of in-cash versus in-kind benefits to counter argue.
- But does that give the policy makers the right to adopt paternalism?

# Endogeneity of Preferences

*Endogenous Preferences: The Cultural Consequences of Markets and other Economic Institutions* – Samuel Bowles

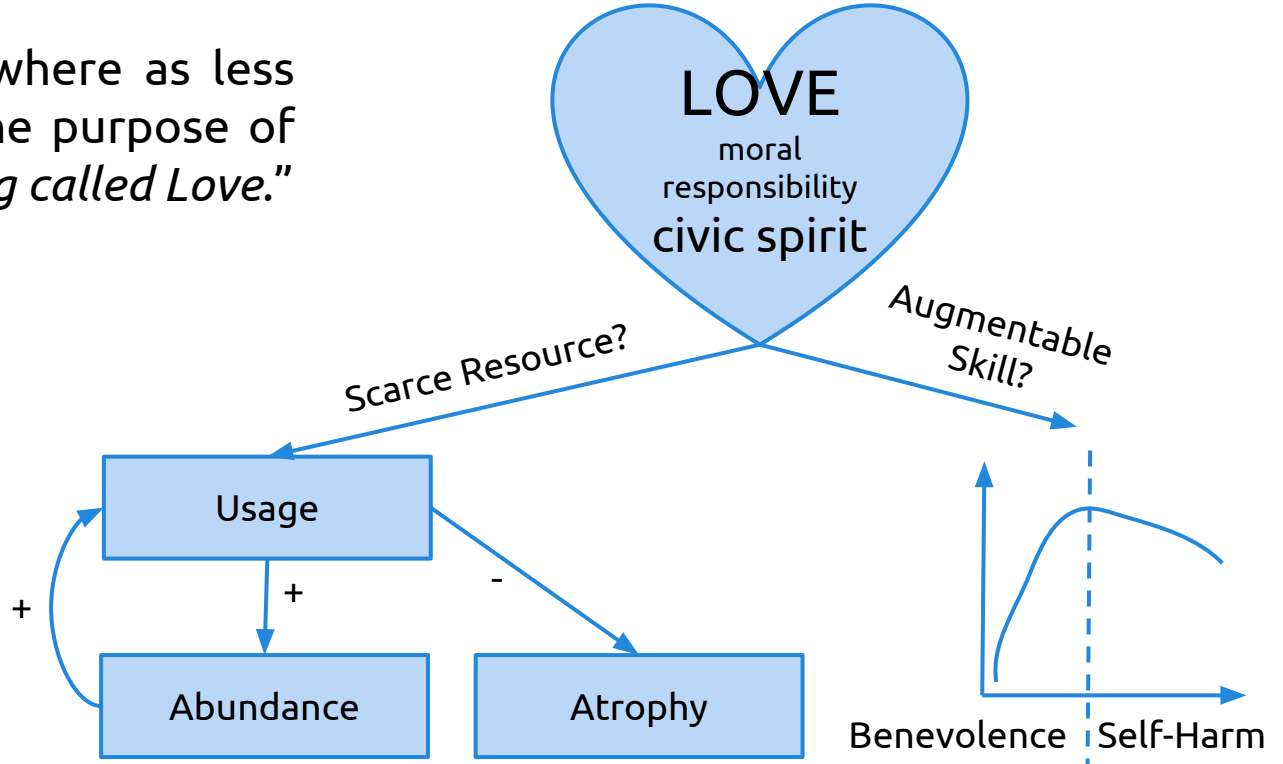
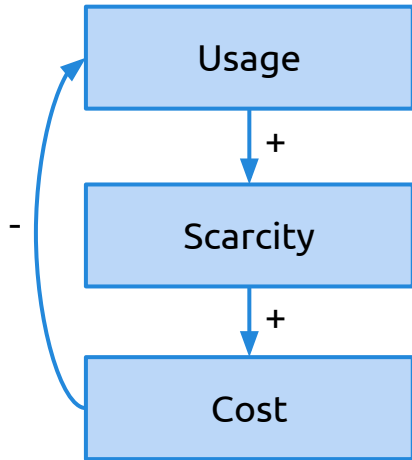


→ How do we account for external influence on our preferences?

# What do Economists economise?

*Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse* – Albert Hirschman

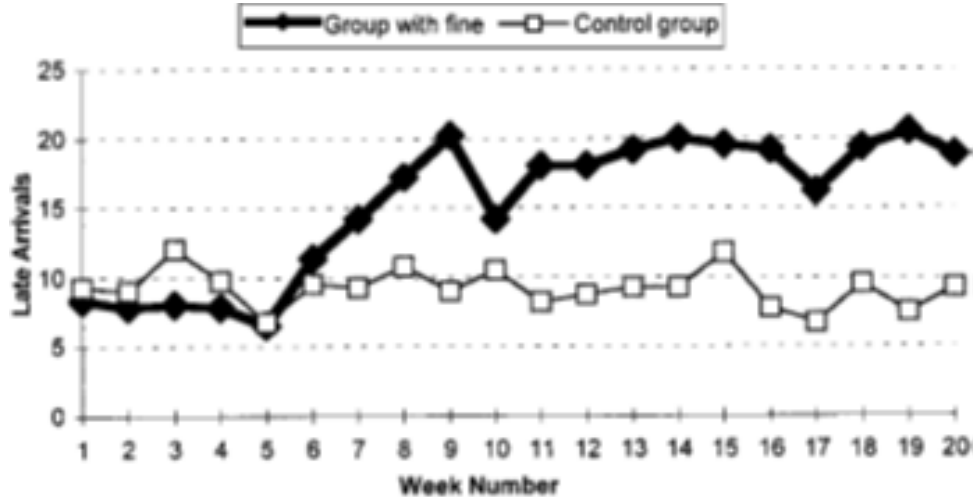
“Create an institution where as less burden is placed, for the purpose of functioning, on *this thing called Love.*”



# *Ceteris Paribus*; Information Introduction

## *A Fine is a Price* - Uri Gneezy and Aldo Rustichini

**Deterrence Hypothesis:** everything else remaining unchanged, introduction of a *penalty* will reduce the occurrence of behaviour subject to a fine.



### **Social Norms:**

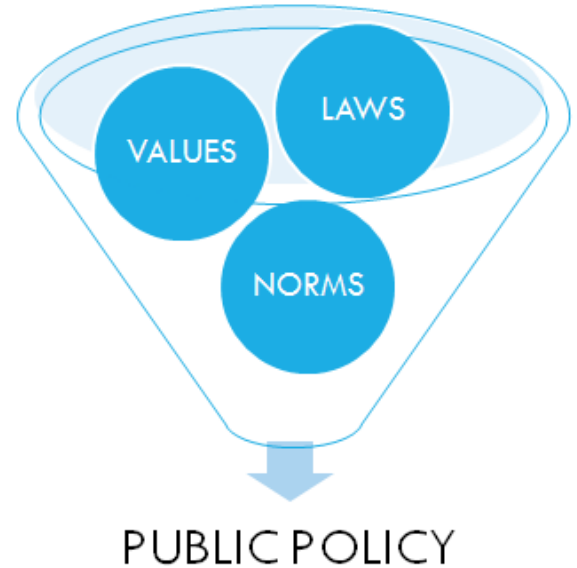
1. Fine is viewed as a price for “extra service”.
2. Fine is a Price.
3. Once a commodity, always a commodity.

# Incorporating Social Norms

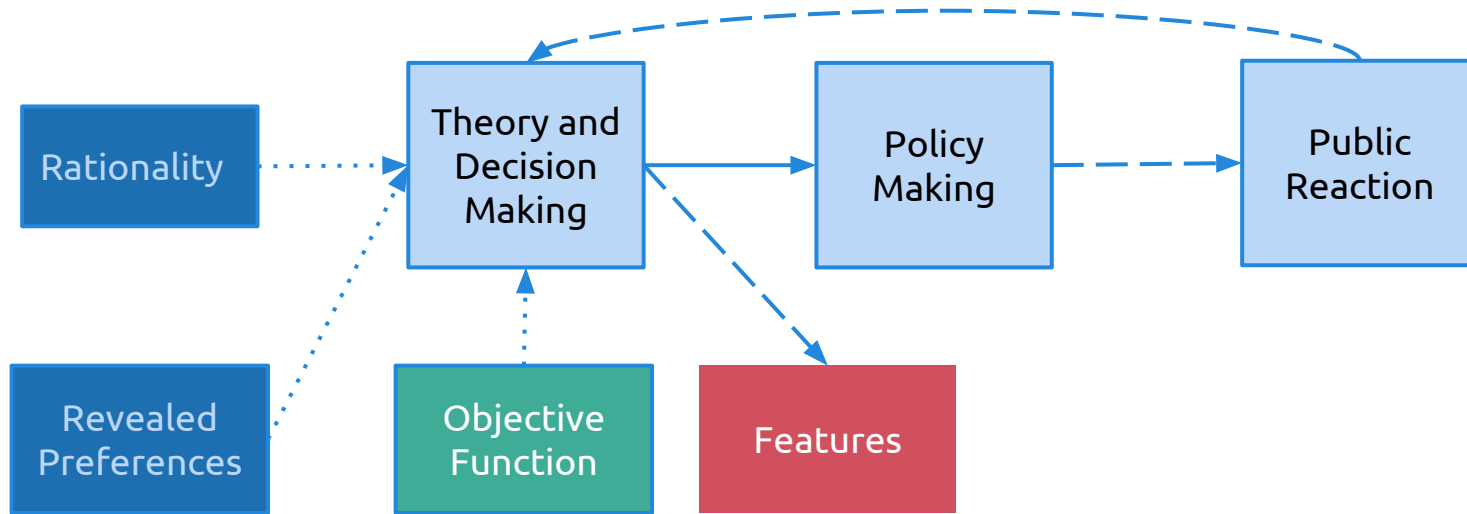
*Laws and Norms* - Roland Bénabou and Jean Tirole

## Three key shapers of Public Policy:

1. Values → Captures old economic idea of preferences
2. Laws → Captures material and other incentives
3. Norms → Social sanctions and rewards



# Theory-Policy-Public Model

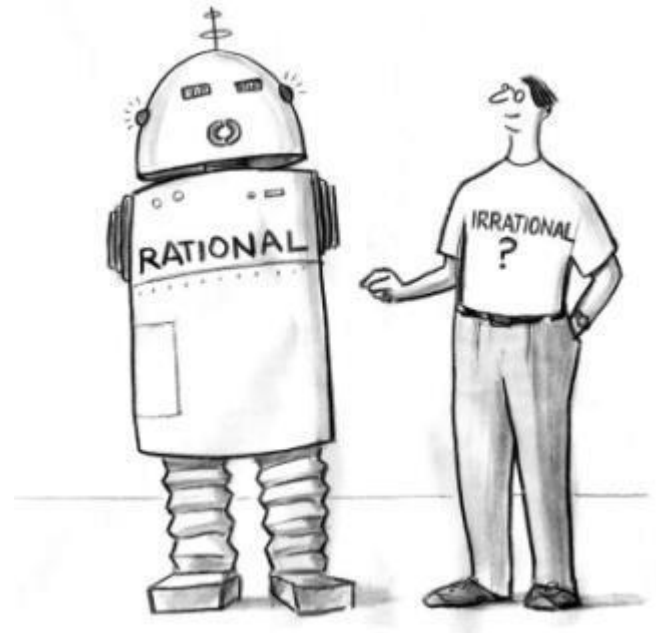


# References

1. Rational Fools: A Critique of the Behavioral Foundations of Economic Theory – Amartya Sen
2. Sympathy, Commitment and Preference – Daniel M. Hausman
3. Against Parsimony: Three Ways of Complicating Some Categories of Economic Discourse – Albert O. Hirschman
4. Beware of Economists Bearing Advice – Daniel M. Hausman and Michael S. McPherson
5. Why Surfers Should be Fed: The Liberal Case for an Unconditional Basic Income – Philippe Van Parijs
6. A Fine is a Price – Uri Gneezy and Aldo Rustichini
7. Endogenous Preferences: The Cultural Consequences of Markets and other Economic Institutions – Samuel Bowles
8. Laws and Norms – Roland Benabou and Jean Tirole
9. The Philosophy of Economics, An Anthology, Third Edition – edited by Daniel M. Hausman
  - a. Introduction, pp. 1-38
  - b. Why Look Under the Hood? – Daniel M. Hausman, pp. 183-187
  - c. Economics in the Laboratory – Vernon Smith, pp. 334-355
  - d. Welfare Propositions of Economics and Interpersonal Comparisons of Utility – Nicholas Kaldor, pp. 222-225



# Thank You! Questions?



“Rationality is bounded when it falls short of omniscience. And the failures of omniscience are largely failures of knowing all the alternatives.”

**Herbert Spencer**