Global Crisis: Is Economics Rational?

Do Economists Understand the Causes and Consequences of the Crisis?

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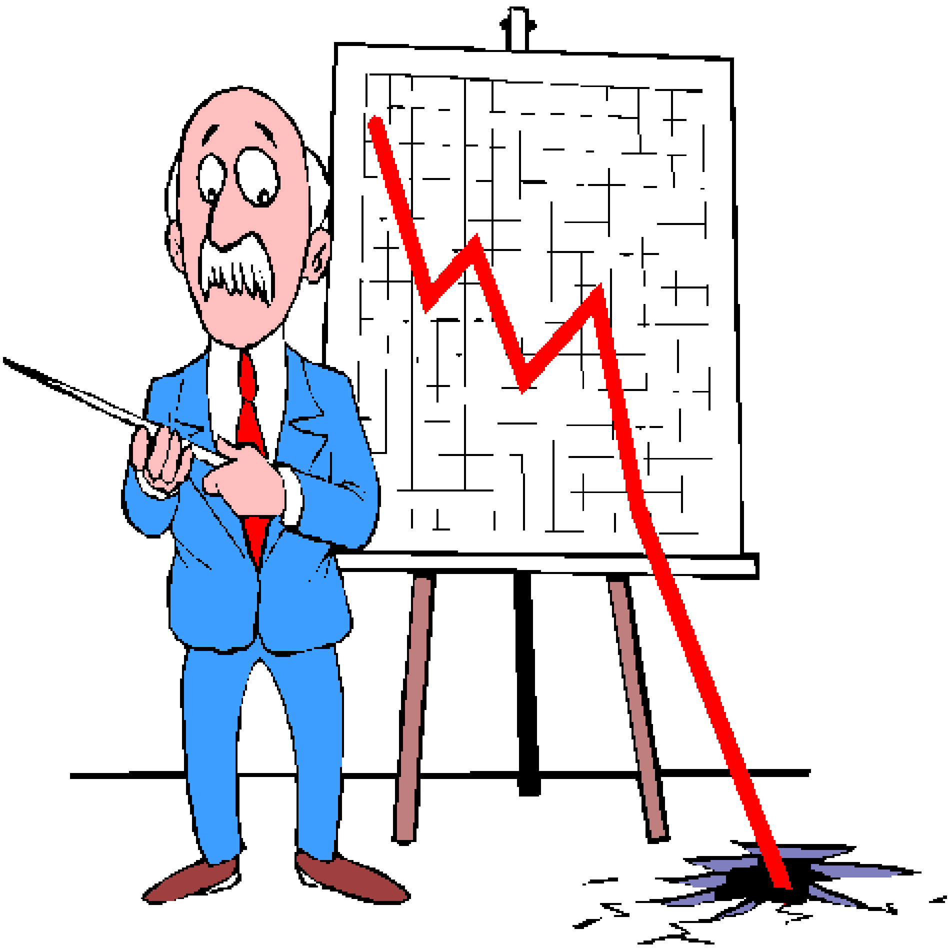
Classical/neoclassical economics has consistently protected the wealth of the privileged; it has preserved the status quo. This is capitalism's intent, and the evidence for it is overwhelming. It has impeded the improvement of the human condition for two hundred years, and unless it is scrapped, it will continue to do so. No mere change in government can stop it.



Aristotle defined human beings as rational animals, and even today, few people would openly describe themselves as irrational; yet many are. Even so, people don't generally go around calling their decisions, choices, and expectations rational or calling what they do rational activity. Except, that is, economists! They modify sundry and diverse nouns with "rational." In a short search of a few documents, the nouns actors, calculations, choices, decisions, expectations, firms, foundations, investors, outcomes, prices, responses, self-interest, societies, systems, and workers are all modified by "rational," and some seem oxymoronic when so modified. For instance, how is it possible to have an irrational self-interest? And if that isn't possible, what sense does modifying "self-interest" with "rational" make? Why economists feel the need to continually cite the rationality of classical economics is curious. Astronomers, physicists, chemists, biologists, mathematicians, engineers, and others have never felt a similar need. Physicists never speak of rational forces, rational particles, or rational mass. Chemists don't speak of rational reactions. Mathematicians never speak of rational calculations. One begins to wonder whether economists can be likened to the proverbial errant child who almost automatically utters, "I didn't do it!" when everyone knows that s/he did. One wonders whether they continually call themselves and economics rational because that's the only exculpatory response they can think of when what they proclaim turns out, as it so often does, to be wrong.

But if rationality is a human attribute, it is at best a latent one. Activating it requires care and nurture. And some studies have suggested that the ability to activate it declines as people age. Anyone who has tried to teach even basic logic to college students knows that most never acquire enough facility to become even moderately proficient. Many professors who are tasked with teaching it lack the ability to construct even moderately advanced chains of valid reasoning, and for decades, the most used textbook for such courses presented a set of logical rules so deficient that even if a student mastered them all, s/he would have been unable to apply them efficiently. Furthermore the findings of psychologists who have devised experiments to measure rationality claim to have shown that few people consistently behave in rational ways. But this finding is not interesting. Who, other than economists, hasn't known it? Even Aristotle must have known it more than two millennia ago; after all, he was familiar with the irrational claims Plato clearly exposed in his Socratic Dialogues. So the acute question is why economists don't know it, why they persist in accepting classical economic theory?

Those psychological experiments, however, when examined carefully are difficult to interpret. Although the psychologists claim to be measuring rationality, what, if anything, is really being measured is not easily seen. For instance, Prof. Daniel Kahneman is reported to have devised this experiment:

"let's take two groups of people and ask the first if the tallest tree in the world is taller than 300 meters. Then let's ask them how tall the tallest tree in the world is. Then we repeat the exercise with the second group, asking them whether the tallest tree in the world is taller than 200 meters, and then how tall it is. At the end of the experiment, we find that the first group's average answer to the second question is, around 300 meters, and the second's is around 200 meters. Why? [Because] People tend to latch on to a certain 'anchor"—usually one they come across by chance—instead of trying to use a more rational way to gather and process data and make economic decisions." [http://www.haaretz.com/hasen/spages/1077151.html]

But it is difficult to see how this experiment proves anything about rationality. The experiment requires the participants to merely guess, and guessing is not a rational activity. No rational participant would have even answered the initial question. S/he would have responded by asking something like, How would I know?, and the experiment would have collapsed.

But other experiments are more revealing. For instance,

"One of the more compelling studies described . . . involved trick-or-treaters. A few Halloweens ago, Ariely laid in a supply of Hershey's Kisses and two kinds of

Snickers—regular two-ounce bars and one-ounce miniatures. When the first children came to his door, he handed each of them three Kisses, then offered to make a deal. If they wanted to, the kids could trade one Kiss for a mini-Snickers or two Kisses for a full-sized bar. Almost all of them . . . opted for the two-Kiss trade. At some point, Ariely shifted the terms: kids could now trade one of their three Kisses for the larger bar or get a mini-Snickers without giving up anything. In terms of sheer chocolatiness, the trade for the larger bar was still by far the better deal. But, faced with the prospect of getting a mini-Snickers for nothing, the trick-or-treaters could no longer reckon properly. Most of them refused the trade, even though it cost them candy. Ariely speculates that behind the kids' miscalculation was anxiety. As he puts it, "There's no visible possibility of loss when we choose a FREE! item (it's free)." Tellingly, when Ariely performed a similar experiment on adults, they made the same mistake. "If I were to distill one main lesson from the research described…, it is that we are all pawns in a game whose forces we largely fail to comprehend."

[http://www.newyorker.com/arts/critics/books/2008/02/25/080225crbo_books_kolbert]

What are the problems with this experiment? There is absolutely no evidence that any child or adult involved did any "reckoning," and if no reckoning took place, no "miscalculation" could possibly have occurred. After all, people do make choices on impulse. So how does this experiment prove anything about rationality?

Just ask how a calculation, choice, decision, expectation, outcome, responses, or anything else can be determined to be rational. The only answer is by examining the reasoning process that led to it. But the experiment was built in a way that made any examination of any reasoning involved impossible. The description above says that when the experiment was performed on adults, "they made the same mistake," that is, they selected the free bite-sized Snickers bar. The "mistake" was that they didn't select the larger bar and maximize the amount of chocolate they were receiving. But what if they didn't want to maximize the amount of chocolate? Suppose, for instance, that an adult desired more chocolate than was in the three Hershey Kisses but was also trying to lose weight and didn't want to over indulge. Or suppose that an adult wanted more chocolate, didn't want to eat it immediately, but instead, wanted to put it in a pocket but had no available pocket large enough in which to comfortably place the larger bar. Or again, suppose that an adult wanted more chocolate but wanted to eat it in one bite so that his hands were free for other tasks. In all three of these cases, selecting the mini-Snickers was the rational choice. The mistake made in this experiment was made by the designer, not the participants. He assumed that the only rational choice was the one that maximized the amount of chocolate obtained. But rationality cannot be determined by arbitrary definition. Rationality is an attribute of deliberative processes and nothing that does not involve a deliberative process can be called rational. Human beings do engage in thoughtless activities. When doing so, they are not engaged in rational behavior. But they also sometimes think about what they are doing. When their thinking conforms to well-known norms of logic and is based on true premises, it is rational, when it doesn't, it is not. The thinking, not the result, is the deciding factor.

This experiment, however, is revealing, because economists do exactly what the experiment's designer has done. Defining the maximization of the amount of chocolate is perfectly analogous to maximizing one's income, and economists define that result as the only possibly rational one. Thus everything economists describe as rational is mere tautology. Unfortunately tautological theories, being hollow, are not rational, so neither are classical economics and the economists who advocate it.

In fact, rationality is a poorly understood concept. Consider this quotation from the Haaretz article cited above:

"Psychology today differentiates between two methods of thinking: There is the intuitive method, and there is the rational one. The intuitive method is characterized by rapid learning, and it concludes very quickly that what has happened the last three times will happen forever, again and again."

But what is here described as the intuitive method is nothing but an example of a well-known fallacious mode of reasoning known as hasty generalization, so what is described as "two methods of thinking" amounts to nothing more than good and bad, which is hardly a remarkable observation.

In fact, none of the fifteen nouns mentioned in the first paragraph that economists modify with "rational" are rational in themselves. They can only be called rational after the deliberative processes that lead to them have been examined, but no economic theory could ever do that. And to merely assume they are rational when they lead to a predefined result is as irrational as making choices on impulse. So why do economists believe in their theory?

Once put into practice, rational people judge theories, policies, and practices by how well they satisfy the intentions which led to their implementations. Unless the intentions are known, no sound judgment can be made. For instance, some years ago the Congress enacted harsh, mandatory sentencing of criminals. What was the Congress' intent? If the intent was to reduce crime, the policy has failed. If the intent was to merely punish criminals, it might be said to have succeeded. But what is some Congressmen intended the former and some the latter?

When we look at classical/neoclassical economics, how can it's intent be determined? In the absence of any stated purpose, one can examine the things it does and those it doesn't. In the two plus centuries it has been practiced, orthodox classical capitalism has not brought a growing or even a stable level of prosperity to the peoples who inhabit the countries in which it has been practiced. Spurts of apparent prosperity have been continuously destroyed by economic crashes that have over and over again ruined the lives of millions.

But what if its intent has never been the promotion of the people's prosperity? What, if any, result has it attained consistently? Well, it has consistently protected the wealth of the privileged; it has preserved the *status quo.* The wealthy privileged increase their wealth in good times and in bad. The system works for the privileged just as the market works for stock brokers who make money when prices are rising and when they are falling. If this is capitalism's intent, and the evidence for it is overwhelming, understanding the Obama administration's, and the developed world's, response to the current economic downturn is easy. As the meager apparent wealth that the common people acquired during the better years now disappears, as they lose their jobs and homes, the wealthy institutions and the people who manage them and created the downturn are rewarded and prevented from failing by obligating the common people to someday repaying a growing colossal national debt incurred for the sake of those privileged. None of this makes sense unless capitalism's intention is to preserve the *status quo* at the people's expense.

Of course, we're told that a stable financial system is essential to economic prosperity. We're told that credit must be easily acquired again, so that businesses can meet payroll and consumers can resume buying. But these claims are also irrational. Businesses properly should be capitalized by investment and products should be purchased with earnings. So why do governments claim businesses and consumption need to be financed by debt? The answer is really very simple. The wealthy increase their wealth by lending and they do it without even having to use their own money by means of the Ponzi scheme known as fractional reserve banking. And when debtors cannot meet their obligations, their assets are acquired by the wealthy at fire sale prices who then become even wealthier. This is what capitalism does; it does it consistently and spectacularly. It really can have no other purpose. Credit is good only for creditors; debtors always lose.

What is there about this that economists cannot understand? Are they absolutely irrational or complicit? Each must answer for him/herself. But the economic system they advocate is nothing but an irrational tower of Babel that is based on principles derived from simplistic, imaginary situations and assumptions about rationality that are contradicted by hundreds of years of evidence, and is devoted to the worship of Mammon which benefits only the rich. Capitalism has been very successful; it has impeded the improvement of the human condition for two hundred years, and unless it is scrapped, it will continue to do so. No mere change in government can stop it.

John Kozy is a retired professor of philosophy and logic who blogs on social, political, and economic issues. After serving in the U.S. Army during the Korean War, he spent 20 years as a university professor and another 20 years working as a writer. He has published a textbook in formal logic commercially, in academic journals and a small number of commercial magazines, and has written a number of guest editorials for newspapers. His on-line pieces can be found on http://www.jkozy.com/ and he can be emailed from that site's homepage.