

# The irrationality defense of Paternalism

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## Abstract

*In this paper, we investigate the challenges associated with the competing approaches of utility theory and behavioural economics. It has become commonplace to argue that humans act irrationally. This fallacious argument provides the foundation for paternalism. The fallacy of course is the error in determining objective value and absolute measures of rationality. Everyone is subjective in their utility valuations and consumer behaviour varies over time and place even for individuals. There is no challenge to regulatory design. The problem is not the addition of regulations designed to objectively maximise selected outcomes but rather the introduction of subjective decisions imposed from above paternalistically.*

**Keywords:** Utility Theory, Paternalism, Rational Choice, Economics, Psychology

## Introduction

Many criticisms of economics stems from a rudimentary analysis of the basics. If example we take equilibrium theory (Arrow & Hahn, 1971; Black, 1995; Samuelson, 1941), we see heavy criticism due to the inherent lack of equilibriums in society (Schumpeter, 1994, 1954). The key to understand this is that before we can understand disequilibrium we need to understand the ideal state. Just as the water in the Atlantic moves to an average level in equilibrium (von Stackelberg, 2011), it is the disequilibrium of the waves, tides and currents that makes it interesting and provides us with a real system. It is these currents, tides and other fluctuations that create a global environment that can sustain us. We can model the system equilibrium in the ideal and state that economics fails when it does not meet this condition (Geanakoplos, 2008), however, the truth is no system is in equilibrium for more than an instant and it is these moments of dynamic change that are of greatest interest.

In this paper, we investigate the challenges associated with the competing approaches of utility theory and behavioural economics. It has become commonplace to argue that humans act irrationally (Sahlin & Brännmark, 2011). This fallacious argument provides the foundation for paternalism. The fallacy of course is the error in determining objective value and absolute measures of rationality. Everyone is subjective in their utility valuations and consumer behaviour varies over time and place even for individuals (Mises, 2010, p 96).

There is no challenge to regulatory design. The problem is not the addition of regulations designed to objectively maximise selected outcomes but rather the introduction of subjective decisions imposed from above paternalistically.

## Rational choice theory

Utility or rational choice theory is based on the hypothesis that individuals make prudent and logical decisions (Arrow, 1987, pp 25-39). These are decisions that bring the individual the greatest benefit or satisfaction given a selection of choices that are available at the time. This is a theory that has come under constant attack. It is easy to forget that all value is subjective. Economics is not based on the objective value of trade, rather it derives from the individualised selection of choices. What seems rational or irrational to one individual at one period maybe perfectly logical for another.

The attacks against this theory come from a subject of misunderstanding of time preferences and value. A lot of misunderstanding has come from the imposed condition of rationality based on objective standards. To make rational value judgements, it is necessary to be in the proverbial shoes of another, living at the time and place that the decision was made and knowing the subjective value judgements of the individual. Everyone has different time preferences, risk tolerances and objectives. To judge these as arbitrarily irrational precludes the differences that come at the margins.

It was a common fallacy to value the absolute. In this misapplied theory, arguments over the value of water versus diamonds were common. Since Ricardo, we have understood that value at the margin determines the trade value of a good at a point in time and place (Böhm-Bawerk, 1891). For the thirsty traveller in the Sahara Desert the marginal value of a flask of water can exceed the value of diamonds. Yet, that same individual in that same desert would be unlikely to accept an exchange as large as a swimming pool full of water (Rothbard, 2009). The value is on the margin.

This miscomprehension of subjective value has led economic pundits to create theories of bubbles and animal behaviour (Keynes, 1936). Without much in-depth analysis, we see the Tulip collapse<sup>1</sup> of Holland (Calvo, 1987) as a bubble and this becomes commonly applied in the hypothesis of a rational behaviour, yet an analysis that does not take the environment into account. The world of the 17<sup>th</sup> century

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<sup>1</sup> [https://medium.com/@adam\\_selene/tulips-and-other-myths-c7f69cf2b59d](https://medium.com/@adam_selene/tulips-and-other-myths-c7f69cf2b59d)

in Holland was one of upheaval and change. The gamble of life-and-death is not something we can expect to understand in modern Western society (Ariès, 1974). In an age of plague and starvation through crop failures in extended winters<sup>2</sup>, the question to ask would be whether it was more rational to gamble one's future and what we now call a bubble or to risk certain death for yourself and your family. Like now, wealth creates opportunities.

The question of rationality is not a matter of a decision and one direction at one time, it is bounded on the environment we create that choice within. Simon (1967), proposed the theory of bounded rationality<sup>3</sup>. In this, people are limited in the information that they would need to make a complete decision. Thaler (2005) took this further with the idea of mental accounting, arguing that irrationality stems from differences in purchase choices. In each instance, they have of course failed to understand that the subjective value of good at one time and in one place is different from the same good at another time and place. The psychic energy that an individual obtains in the occasional longshot of a win can well exceed the perceived monetary benefit of saving the money and having a sure thing. For each of us, the subjective choices we make come from a combination of our environment, the situation we find ourselves in and the marginal differences at a point in time. Rational behaviour is not objective (Gordon, 2000), it is subjective and this is the main error in behavioural studies.

### Rational expectations

Rational choice theory has been extended to incorporate information people hold that is derived from their past and expectations of this future experiences. It is possible to see this reflected in the example above. People living within the 17<sup>th</sup> century in Europe acted in a manner that was rational given their expectations. We commonly judge people based on our own expectations. For instance, when people compare the ability of Europe to improve following the Marshall plan<sup>4</sup> with the injection of aid into Third World countries such as Uganda, it is usual to neglect the impact of human capital.

In Europe following World War II the destruction of capital goods and property did little to destroy the overall level of human capital even when the overall loss of life is considered (Sowell, 1995). When this is compared to the injection of aid into Third World countries, the error can be directly attributable to the difference in human capital available. Whereas the situation in Europe was the immediate destruction of capital equipment that would have been replaced over time, that in Third World countries is the introduction of new capital without the prerequisite knowledge and institutions. In each instance, the injection of funds can be similar and yet the outcome can be radically different. In one, knowledge of engineering, science and mathematics is coupled with existing institutions and legal process. On the other, the injection of capital is provided in an environment without institutional legal controls that can adequately stop corruption and a difference in knowledge (Sowell, 1996, 1998).

The same scenario was seen throughout history. Just as the Scots in the 18th-century became divided through differences in their high land and low land environments into those who embraced and those who rejected the "New scientific learning" (Sowell, 1995), so today we see cultural differences, biases and different levels of human capital leading to radically different outcomes. It is not irrationality, but the subjective nature of our choices that leads us into different outcomes.

### Behavioural economics

Simms (2009) provided examples of what he deemed to be irrational behaviour. His research demonstrated that when people are anxious they make what he terms irrational decisions. This was extended to show that anxiety creating stressors act on the given brain to change the way that neurons

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<sup>2</sup> <https://www.eh-resources.org/timeline-middle-ages/>

<sup>3</sup> Simon's research starts with administrative systems. In 1947, he published "Administrative Behavior: A Study of Decision-Making Processes in Administrative Organization" with the objective of promoting top down paternalistic systems.

<sup>4</sup> <https://townhall.com/columnists/thomassowell/2002/03/29/foreign-aid-n784211>

react in what is termed rational decision-making. Another way to look at this is to consider that stress is an influencing factor. Laboratory experiments demonstrating differences in behaviour fail to take the efficacy of these stresses into account. It is simple to state that human should react based on an unemotional response however, it is the heuristics and mental shortcuts that allow us to react in a manner that is considered humanly rational (Rothbard, 1962).

The concept of “rational emotions” has been proposed by Ariely (Ariely & Berns, 2010). Rather than the deviations of subjective rationality posited by researchers such as Dan Ariely (Ariely & Berns, 2010) and Daniel Kahneman (Kahneman & Tversky, 1996). In many ways, the concept of universal rationalism seems to be a manner of imposing subjective values. Not all individuals seek to maximise the same outcomes. And in a world of radical differences in many choices there is no one individual optimisation that can be available. Jehle & Reny (2000) present “Arrow’s Impossibility Theorem” (Arrow, 1957) demonstrating how extended scenarios lead to problems such as Condorcet’s paradox<sup>5</sup>.

The laboratory experimentation into behavioural studies and games simplifies these choices in an unrealistic manner. The reported sub-game will rarely if ever reflect the super game and yet this is what is modelled. A common game, the prisoner’s dilemma can be demonstrated in university experiments in isolation. When applied in real scenarios the model breaks down. The super game fails to account for subsequent events. It is deemed that the individual in prison can no longer have any effect. The reality and criminal studies demonstrates different outcomes (Miles & Ludwig, 2007). The sub optimal theoretic outcome does not apply due to additional external factors. For instance, do the parties in the game have contacts within prison that can punish the defector. Do others exist who could punish defection including through punishment of one’s family.

The primary problem with the addition of alternate forms of utility is how to choose which one is included, how much and then who decides. We see from social choice theory (Arrow, 1957) the problem resulting from no two parties deriving the same utility that results from the same expenditure. The most important part of this consequence is that any additional inclusion is either of no utility and thus should not be incorporated or is of utility that can be expressed across a market in the form of profit or increased utility. The utility associated with the alternate use many not seem rational to external parties, but this does not mean it is not to that person, even if they have regrets latter when things do not go as well as they would prefer.

The result is that people will still seek to maximise the utility, but that we express different time and risk preferences. This rational behaviour leads each of us to the optimal strategy seeking returns that are just over the risk-free rate as other parties enter the market. When the utility is divided between alternative uses, the result that must naturally flow is that the choices made by some people will naturally seem irrational to others.

## **The cost of information**

We have seen that there are multiple aspects to the nature of economic decisions. Condorcet’s paradox (1989) allows us to understand that outside of the laboratory environment, conflicting choices lead to trade-offs and though these may seem suboptimal to one party, they can be rational when the time preferences and risk preferences of an individual are considered. Equally importantly, it is important to incorporate the cost of gaining information. Information is effectively infinite in nature. This leads to a scenario where the cost of gaining further information can exceed the value of the information being obtained. Optimal is not perfect.

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<sup>5</sup> [https://ocw.mit.edu/courses/economics/14-75-political-economy-and-economic-development-fall-2012/lecture-notes/MIT14\\_75F12\\_Lec12.pdf](https://ocw.mit.edu/courses/economics/14-75-political-economy-and-economic-development-fall-2012/lecture-notes/MIT14_75F12_Lec12.pdf)

When considering any economic cost, it is important to also consider the trade-offs. There are no distinctions between corporate investments or personal decisions in this matter. The incorporation of information into economic decision-making becomes part of any rational decision. Rationality is not perfection, rather, it involves optimisation. In making such a decision, the trade-offs between choices become critical. In many experiments related to behavioural economics, the measured decisions suffer from a subjectivity bias. The experimenters determine what they consider to be the rational choice. People can state that they wish to lose weight and yet still eat excessively and this does not mean they are acting irrationally if they value the short-term utility greater than the long-term results (Smith, 1776).

Similarly, when the cost of obtaining information is considered, different individuals will have different cost payoff structures. The result is that information gathering may be suboptimal when viewed by one individual subjectively and yet remain optimal for another when alternative strategies are valued to a higher level of overall utility. When one group subjectively determines the value of an outcome, this does not make the rejection of that outcome suboptimal for the other group. Rationality comes from maximising one's own utility against their own preferences (Gordon, 2000). In all instances, rationality fails to appear rational to any but the individual to whom the subjective choices made or applied.

It is always possible that an individual could gain more. In a different role or a different job many individuals could and more than they do in their preferred occupation. Most economists working within academic environments would be able to increment their income and earn higher levels of profitability in financial organisations or within market environments. The argument on rationality precludes emotional choices and decisions. The subjective value of a good is the value at the margin (Menger, 2009, Rothbard 1962). This is not only the margin of the trade but the margin derived from the time and circumstances surrounding the exchange. It needs to incorporate the cost of information on the time preferences of the individual. Stating that individuals are irrational due to discrepancies in their risk preferences for instance is simply applying the preferential judgements of one subjective choice and valuing these more than the individual making the choice. The psychic utility obtained in risk avoidance by some and risk seeking by others is not irrational, it demonstrates the subjectivity of economic choice and values.

## **Welcome to Core, SegWit and SegWit2x**

This is the eternal dichotomy we see from paternal statist and socialists everywhere. They believe they know best. The argument always comes down to decentralised control. They state how they need to protect us from companies that will centralise and dominate and control us. How do they manage this? That answer is simple, they, those who know more than the rest of us combined, in this instance the developers within Core, BlockStream and the DGC pull the wool over our eyes teaching us a lesson in decentralised centralisation. They remove the companies except for theirs.

Companies do not act as a whole. Rather, corporations in competition are a means of distributing the votes of many people. Each shareholder incorporation acts independently in buying or selling the shares of that organisation. Any individual can do this with a public company. Even private companies, competition between companies means that state-controlled organisations are the only ones that can gain a monopoly. The reality of the argument being posited is that corporate control is somehow centralised. The reality is that a small group of developers and companies are hijacking a project with the aim of centralising it, dominating it and incorporating the means to control this project through the creation of the one thing that can destroy it. It is scarcity that makes bitcoin strong.

It is use value as a payment source that makes bitcoin valuable. These are the things that are being destroyed. The network in bitcoin is not centralised. In capitalist societies companies come and companies go. Each and every block solved within the bitcoin Blockchain is a new challenge. Each is a new investment in each is a new opportunity for disruption. That is what cannot be centralised.

The lie is that they (Core and their cronies) fear corporations. They do not want professionalism. They do not want something that scales to help the masses. They want control and they want paternalism. Like all socialists and anarchists, they fear capitalism for it is a meritocracy. You do not rise to the top because you have the right connections but rather because you can offer something that the masses want. Capitalism is vulgar but that is because it serves the common man.

The fear is not of centralisation but rather the loss of their paternalistic control.

## Conclusion

All too often, we see the argument that behavioural economics demonstrates the irrationality of humans in economic decision-making. Individuals make choices based on their individual values and utility. However, all utility is obtained at the margin. The concept of rational choice theory has been hijacked through the inclusion of objective constraints that differ from the individual subjective values. The maximisation of one's psychic utility is an emotional decision that is rational only when the time preferences, risk preferences and life experience of the individual are considered. These preferences change not only in time but through continued experience. To complicate matters, they may differ throughout the day (Mises, 2010). The preferences expressed by an individual in the morning will not reflect those presented following events that have been emotionally uplifting or emotionally draining.

This does not as a behavioural economist may argue make these decisions irrational. Rational behaviour within the amenity is an emotional response with the consequence that any obtained utility is not going to be objectively measured in monetary value but rather an overall economic utility that can only be subjectively measured by the individual. What is rational for one person at one time may not be rational for the same individual at a slightly different place and time let alone anyone else. All choices exist on the margins and it is there that we may find areas of interest to explore.

This fear of capitalism is what is played by those who seek to maintain and ongoing paternalistic control. They use the fear of centralised power to subvert an open process moving away from a truly free system into one where we are told what to do. When we allow them to tell us that we are irrational, we allow them to decide our fate. Rational choice and rational expectations are not the irrational option they are made to be. The greatest win of those who hate capitalism is the behavioural school of economic thought. Like that of Keynes before them, it opens the means to allow other to tell us that we don't really know what we desire, what we want, or what we need. It is not companies we need to fear, what we need to fear most of those who tell us paternalistically that they can choose best.

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