# Almost Everyone Misunderstands Rational Choice Theory

Pete Leeson's wonderful new book, *WTF?!* (review coming soon) is cathartic reading. Especially after reading some papers and comments by behavioral economists and their ilk recently. Everyone loves to throw around examples of humans being "irrational" to prove that the economic method, or rational choice theory, is of limited application and doesn't apply to real humans who aren't calculating machines.

This is an elementary error in understanding what "rational" means to a (good) economist. In common parlance, the word has a lot of meanings. It's loosely used to refer to reasonable, sound, understandable, or coldly scientific behavior. In the context of rational choice theory, however, it has a much simpler meaning. Rational action is any purposeful action taken to achieve an end desired by the actor. Here, every deliberate action is rational. Based on the preferences, information, incentives, and constraints an individual actor faces, they will act in a way preferable to perceived alternatives at the time of acting.

This understanding of rational choice is the foundation upon which Mises built his entire magnum opus, *Human Action*, and from it spring everything from demand curves to the structure of production.

When defined in this way, most people will dismiss the idea of rational action as useless. It's just a tautology. Sure, whatever a person chooses must, by definition, be the thing they preferred to other perceived alternatives at the time of choosing, otherwise they wouldn't have chosen it. So what? Isn't that like saying 'A is A'?

Yes, kind of. And the law of identity is one of the most important tautologies in the world. You can call it simple or obvious, but you'd better not ignore it or forget it is always and everywhere true. It's the same with rational choice theory.

Many of the same people who call it a useless tautology go on to make claims that contradict this 'obvious' truth. Things like, "People are just crazy/irrational/greedy" and therefore outside the reach of economic analysis. Or, "Humans have biases, therefore 'homo economicus' is unrealistic, therefore economics can't explain human behavior." Of course economics never seeks or claims to explain motives, or why people have the preferences, information, incentives, or constraints they do. It only seeks to demonstrate that, given these, their behavior is rational.

The power of this approach is staggering. When "That's just crazy" isn't an option, humility and curiosity replace fear and ignorance. If, given the preferences, information, incentives, and constraints, all purposeful human action is rational, we can't get off the hook with hand-waving or invective adjectives. We are forced to ask, “What are the preferences, information, incentives, and constraints facing this actor?” That is where the real understanding comes!

If you want to see different actions, by yourself or others, you needn’t hopelessly appeal to “just because it’s the right/better thing to do”. Instead, if you understand information, incentives, and constraints, you can try to alter them so that the rational choice for a given person’s preferences is closer to the choice you’d prefer. It’s easy to see this in government policy, but it also applies to daily individual life.