Don't throw away those theories just yet! [1]

Written by **Tim Worstall** [2] | Thursday 12 July 2012

The recent exciting events in the wider economy have brought cries that clearly, obviously, we must throw away some of the basic building blocks of neoclassical theory. You know the sort of thing: the Crash proves that the efficient markets hypothesis must be wrong so therefore we should ditch using markets. This one suffers from the problem that those critiquing it don't understand what the EMH actually says.

No, it is not that markets are necessarily efficient ways of organising the world. Nor that they are efficient at all times and in all places. Really, what it says is that markets are efficient processors of the information about what prices should be in a market. And no more than that either. That the markets dived the moment it became clear that a bank or two were in trouble rather proves, rather than disproves, their efficiency at doing that.

Another is that humans just aren't rational so therefore, given that rationality is a presupposition of market based systems working, we should again do away with markets. Presumably to be replaced with Comissars to tell us all what to do. This again fails in that the assumption of rationality is not that we are all rational beings. Carefully considering each and every option: rather, it is that we are not irrational. And we can show that cats and or dogs are rational in this sense [3]:

> Take two pieces of food from the fridge, for example, some left-over chicken and a cube of tofu. Simultaneously present the two pieces to the animal. Take care to position the two pieces so that they are equally accessible, and not to distract the animal with movement.

Read the rest over there to see the full argument. But for our assumption of rationality to hold we need only that humans do have preferences, that such preferences are transitive (if I prefer A to B and B to C then I prefer A to C) and that, in general, we'd prefer more to less. In this sense, the sense that we use it in building economic theories, yes, humans are indeed rational: it's nothing at all to do with the fact that we sometimes get things wrong nor that some of us are nutters at times.

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