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Policy Brief

Preference purification and the inner rational agent: a critique of the conventional wisdom of behavioural welfare economics

KEYWORDS: preference purification, inner rational agent, behavioural welfare economics, libertarian paternalism, context-dependent preferences.

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BACKGROUND

- When addressing problems in behavioural findings related to neoclassical rational choice theory, a common response is to treat deviations from conventional rational choice theory as mistakes, and to try to reconstruct the preferences that individuals would have acted on, had they reasoned correctly.
- The authors argue that this *preference purification* approach implicitly uses a dualistic model of the human being, in which an inner rational agent is trapped in an outer psychological shell. This model is psychologically and philosophically problematic.

METHODOLOGY

- The research draws insights by analysing and evaluating existing behavioural economics literature.

KEY FINDINGS

- In response to claims made in the seminal works of Sunstein & Thaler, which purport to offer a more realistic portrayal of human psychology compared to conventional economists who supposedly assume a human being “thinks and chooses unfailingly well”, the article argues that these claims are misleading.
- It is more accurate to think of conventional behavioural welfare economics as modelling human decision-making as a neoclassical rational inner agent, trapped inside and constrained by an outer psychological shell. The psychological mechanisms that induce deviations from supposedly rational choice are treated as properties of the outer shell that can prevent the inner agent from achieving its objectives.

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- If behavioural and normative economics are to be satisfactorily reconciled, the first essential is that economists learn to live with the facts of human psychology.
- One possible line of advance is to find a normative criterion that respects individuals' choices without referring to the preferences – consistent or inconsistent – that lie behind them.
- A perspective that conserves more of the framework of conventional welfare economics is as follows: Instead of claiming to reconstruct the latent neoclassical preferences of individuals whose psychology has led them into error, economists might think of themselves as doing their best to represent the complex reality of human judgement and decision-making in a highly simplified but perhaps still useful normative modelling framework. This would require a significant deviation from the ambition of much of the current literature of behavioural welfare economics.

POLICY ISSUES

- A benevolent social planner is no more than a theoretical or literary construct. To bridge the gap between neoclassical and behavioural theories, human psychology has to be encompassed within the analysis.

THE CCP

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Robert Sugden is a Professor of Economics at the UEA School of Economics and a member of the Centre for Competition Policy at the University of East Anglia. His research uses a combination of theoretical, experimental and philosophical methods to investigate issues in welfare economics, social choice, choice under uncertainty, the foundations of decision and game theory, the methodology of economics, and the evolution of social conventions. He is the author or editor of eight books, of which the most widely-read are Principles of Practical Cost-benefit Analysis (1978, with Alan Williams) and Economics of Rights, Co-operation and Welfare (1986 and 2004)

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