ECONOMIC MAN

The term "***economic man"*** (also referred to as "homo economicus") refers to an idealized person who acts rationally, with perfect knowledge and who seeks to maximize personal utility or satisfaction. The presence of an economic man is an assumption of many economic models.

Keypoints:

- The economic man is a concept developed by economists to understand the behaviour of humans engaged in economic activity.
- The abstraction known as the economic man was developed in the 19th century by philosophers like John Stuart Mill as part of the broader enlightenment project, the aim of which was to bring natural science to bear on all areas of knowledge.
- Later research in the late 20th and 21st centuries, referred to as behavioural economics, has challenged the legitimacy of the economic man abstraction.

Understanding Economic Man

- To explain a phenomenon scientists often build models, and to build these models, scientists have to make assumptions that simplify reality. In economics, one of those simplifying assumptions is a person who is fundamentally rational in economic situations.
- Unlike a real human, economic man always behaves rationally in a narrowly self-interested way that maximizes his or her satisfaction. This assumption enables economists to study how markets would work if they were populated by these theoretical persons. For example, economists assume that the law of supply and demand is describable with a mathematical equation. (That is, demand for a product is a linear function of price.)

The term **homo economicus**, or **economic man**, is the portrayal of humans as agents who are consistently rational, narrowly self-interested, and who pursue their subjectively-defined ends optimally. It is a word play on Homo sapiens, used in some economic theories and in pedagogy

In game theory, homo economicus is often modelled through the assumption of **perfect rationality**. It assumes that agents always act in a way that maximize utility as a consumer and profit as a producer, and are capable of arbitrarily complex deductions towards that end. They will always be capable of thinking through all possible outcomes and choosing that course of action which will result in the best possible result.

The rationality implied in homo economicus does not restrict what sorts of preferences are admissible. Only naïve applications of the homo economicus model assume that agents know what is best for their long-term physical and mental health. For example, an agent's utility function could be linked to the perceived utility of other agents (such as one's wife or children), making homo economicus compatible with other models such as homo reciprocans, which emphasizes human cooperation.

As a theory on human conduct, it contrasts to the concepts of behavioral economics, which examines cognitive biases and other irrationalities, and to bounded rationality, which assumes that practical elements such as cognitive and time limitations restrict the rationality of agents.

The History of Economic Man

The idea that human beings are rational creatures whose behaviours are explainable through mathematics has its roots in the European enlightenment of the 18th and 19th centuries. Many assumptions built into the idea of the "economic man" were first developed by early thinkers like René Descartes and Gottfried Wilhelm Leibnitz and then later, Jeremy Bentham and John Stuart Mill.

In the 19th century, thinkers wanted to harness the analytical power of mathematics in the areas of politics and government. Prior to the 19th century, these subjects had been the domain of qualitative philosophers. Thinkers like John Stuart Mill, and later, economists like Carl Menger insisted that political economy (the word "political" was dropped later and the subject simply became referred to as economics) was a discipline that had to proceed with mathematical rigor in all of its principles.

In his essay, "On the Definition of Political Economy; and on the Method of Investigation Proper To It" from 1830, Mill argues that the study of political economy is not a study of applied politics. Rather, it is a limited study of man in the abstract seeking material gain in the world. Mill doesn't deny that human beings may have emotions and motivations outside of the pursuit of material wellbeing. However, those properties of a human being should be left out of the study of economics so that it can be more deductive and logical. The idea of "stripping" a human being to a bare essence in order to get to a central truth is a key component in the initial creation of the economic man.

In this formulation, economic man does not have to act morally or responsibly; he doesn't even need to act rationally from the perspective of an outside observer. He only needs to act in a way that allows him to attain pre-determined, narrow goals at the lowest possible cost.

For example, if a fisher in the Pacific Ocean can catch the same amount of fish with a disposable plastic net that he could with a more expensive hand-woven natural fibre net, he will choose the plastic net–even if that means he will eventually and unintentionally poison the fish that he depends on for his livelihood.

Model

Homo economicus is a term used for an approximation or model of Homo sapiens that acts to obtain the highest possible well-being for him or herself given available information about opportunities and other constraints, both natural and institutional, on his ability to achieve his predetermined goals. This approach has been formalized in certain social sciences models, particularly in economics.

Homo economicus is seen as "rational" in the sense that well-being as defined by the utility function is optimized given perceived opportunities. That is, the individual seeks to attain very specific and predetermined goals to the greatest extent with the least possible cost. Note that this kind of "rationality" does not say that the individual's actual goals are "rational" in some larger ethical, social, or human sense, only that he tries to attain them at minimal cost. Only naïve applications of the homo economicus model assume that this hypothetical individual knows what is best for his long-term physical and mental health and can be relied upon to always make the right decision for himself. See rational choice theory and rational expectations for further discussion; the article on rationality widens the discussion.

As in social science, these assumptions are at best approximations. The term is often used derogatorily in academic literature, perhaps most commonly

by sociologists, many of whom tend to prefer structural explanations to ones based on rational action by individuals.
The use of the Latin form homo economicus is certainly long established; Persky traces it back to Pareto (1906) but notes that it may be older. The English term economic man can be found even earlier, in John Kells Ingram's A History of Political Economy (1888). The Oxford English Dictionary (O.E.D.) cites the use of homo oeconomicus by C. S. Devas in his 1883 work The Groundwork of Economics in reference to Mill's writings, as one of a number of phrases that imitate the scientific name for the human species

Criticisms of the Economic Man Concept

Consequently, the homo economicus assumptions have been criticized not only by economists on the basis of logical arguments, but also on empirical grounds by cross-cultural comparison. Economic anthropologists such as Marshall Sahlins, Karl Polanyi, Marcel Mauss and Maurice Godelier have demonstrated that in traditional societies, choices people make regarding production and exchange of goods follow patterns of reciprocity which differ sharply from what the homo economicus model postulates. Such systems have been termed gift economy rather than market economy. Criticisms of the homo economicus model put forward from the standpoint of ethics usually refer to this traditional ethic of kinship-based reciprocity that held together traditional societies.

Economists Thorstein Veblen, John Maynard Keynes, Herbert A. Simon, and many of the Austrian School criticise homo economicus as an actor with too great an understanding of macroeconomics and economic forecasting in his decision making. They stress uncertainty and bounded rationality in the making of economic decisions, rather than relying on the rational man who is fully informed of all circumstances impinging on his decisions. They argue that perfect knowledge never exists, which means that all economic activity implies risk. Austrian economists rather prefer to use as a model tool the homo agens.
Empirical studies by Amos Tversky questioned the assumption that investors are rational. In 1995, Tversky demonstrated the tendency of investors to make risk-averse choices in gains, and risk-seeking choices in losses. The investors appeared as very risk-averse for small losses but indifferent for a small chance

of a very large loss. This violates economic rationality as usually understood. Further research on this subject, showing other deviations from conventionally defined economic rationality, is being done in the growing field of experimental or behavioural economics. Some of the broader issues involved in this criticism are studied in decision theory, of which rational choice theory is only a subset.
Behavioural economists Richard Thaler and Daniel Kahneman have criticized the notion of economic agents possessing stable and well-defined preferences that they consistently act upon in a self-interested manner. Using insights from psychological experiments found explanations for anomalies in economic decision-making that seemed to violate rational choice theory. Writing a column in the Journal of Economic Perspectives under the title Anomalies, Thaler wrote features on the many ways observed economic behaviour in markets deviated from theory.
Economists are aware of the deficiencies of using the model of the economic man as a basis for economic theories. However, some are more willing to abandon the concept than others. One obvious problem is that human beings don't always act "rationally."

The concept assumes that the options faced by economic man offer obvious differences in satisfaction. But it is not always clear that one option is superior to another. Two options may enhance a person's utility, or satisfaction, in two different ways, and it may not be clear that one is better than the other.

A body of work in economics that has come to be called behavioural economics presents the largest sustained challenge to the analytical construct of economic man. The elements that make up behavioural economics are diverse, ranging from bounded rationality and prospect theory to inter-temporal choice and nudge theory. However, they all offer the same critique of economic man: the reduction of economic actors to first principles is not robust enough to provide a full explanation of economic activity or markets.