

How do we decide?

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Economists assume that we don't need to make decisions, because since we are possessed of perfect knowledge, knowing what to do is innate to us. But that's nonsense. So, how do we decide what to do?

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This is the transcript:

How do we make decisions in the real world? It's an important question because economic theory says, in essence, that we don't really need to make decisions at all, because according to the assumptions of both neoclassical and neoliberal economics, we have perfect knowledge. In other words, we know everything now, and in the future, and as a consequence, why would we need to make a decision, because the world is optimal?

Now, obviously, this is complete nonsense. There's no beating around the bush here. The whole of economic theory is based upon this stupid assumption, and most of the papers that are published in most of the serious economic journals in the world do in

some way relate back to this absurd claim.

So this isn't a minor issue. It's a fundamental problem within the vast range of economic theory that is produced every year by our universities, but which informs the decision-making of people like the UK Treasury and the Bank of England. They assume that we have this perfect knowledge and that there is no difference between risk and uncertainty, but in the real world there is.

The real world is uncertain. In other words, we do not know what is going to happen. We cannot appraise all the possibilities. We can't attribute probabilities to their outcomes. We simply live in a fog. There's nothing wrong with that. That doesn't imply that we are somehow inferior beings. It just means that reality isn't the same as the economic models that are used by economists to make predictions, which are wholly unrelated to reality.

So, how do we, in the real world, make decisions even though we haven't got all the information that we need to make perfect decisions?

There's a paradox here. We have to act without knowing what is best to do, but not acting is at the same time an utterly unacceptable option. We do actually need to get on with life.

So the consequence is that any decision that we make involves both risk - that is stuff that we can predict can go wrong - and things that we don't even know might go wrong, but which nonetheless could do so.

So we must accept that not knowing is part of our decision-making process, but what, in that case, can we do?

We clearly can't rely on data alone. Nor can we rely on economic models or forecasts, because those things are built on the basis of this apparent certainty, which economists claim exists. So instead, in the real world, we rely on three things when it comes to the making of decisions. They are values, heuristics and maxims.

Values are, in many ways, the most important of these three because they reflect our basic ethical assumptions about life. They reflect the fact that we will be law-abiding. We will comply with the regulation that is imposed on us by law. We will respect other people's property. We will actually act in what we consider to be an ethical fashion. We won't discriminate, and so on.

These are our values, the things that define us as who we are, and in most cases, that define us as law-abiding human beings. They provide the framework in which our decision-making will take place.

We won't, in the case of most people, stand in front of a supermarket shelf and think, I'll have that and take it, slip it into our pocket, and never have any intention of paying

for it. Some people do, but most of us don't, and that's because our values won't let us, and values therefore matter enormously. They help us decide what we're going to do.

But heuristics are in the same group. They are something that also help us decide. A heuristic is something that simply provides us with a rule of thumb that lets us deal with the complexity of any decision-making process. Now, sometimes heuristics can be reduced to very basic rules.

For example, drive on the left in the UK; drive on the right in the USA and most of Europe. That's a heuristic. There is no right or wrong about driving on the left or right, but there is a convention that says that this is what we do, and we know it, and therefore we comply with it, and therefore we overcome the problems that would otherwise arise if we didn't follow the necessary rule of thumb. This isn't a moral issue that we're talking about here. I know it is laid down in law, but the reality is that we use that rule of thumb to interpret our behaviour to such an extent that we don't even realise that it is, in fact, dictating what we do.

And this is true of a great deal in life. We've learned patterns of behaviour that let us decide in ways that shortcut the entire process of doing a great deal of the things that are necessary in life.

I leave a room; I turn the light off. It's, as far as I'm concerned, a heuristic. My sons have never learned it. They drive me around the bend. Every single time they leave a room, the light is left on. We have different rules of life that we've learned, and behaviour is different as a consequence, but all of us have to learn what is useful and what is not.

Heuristics provide us with simple guides for what might be complex decisions. For example, one of the most difficult things to learn when you become a driver is how to manage a roundabout. These are intensely complex decision-making events. So heuristics are really important.

But there's one other thing that we use as well, and that is maxims. And maxims are the way in which we interpret our values to actually come up with actions. A value is something that is, in a sense, not specific to an outcome. We believe this to be true, but a maxim translates that into a way of acting.

So, be compassionate.

Do no harm.

Love your neighbour as yourself.

All of those are maxims. They're guides for interpretation of behaviour in specific situations, and we use them in conditions of uncertainty to let us decide what we actually want to do. They embrace equality, and justice, and sustainability, and care,

and as a consequence, they help us navigate uncertainty.

Now, none of these three methods of thinking provides us with outcomes that will necessarily be perfect. Mistakes will happen, but doing nothing is worse. If there are situations where we must decide, and we don't, paralysis is normally the alternative. You could sit at the roundabout forever if you hadn't learned the heuristic about how to make your way around it. You would create a traffic jam. The world would get very annoyed with you.

That's true with regard to a lot of economic decision-making as well. You not only have to go to work, but you have to learn the routines that work requires of you to ensure that you can deliver what is expected of you during the course of the working day.

That's what training is for. It is there to shortcut the processes that would otherwise literally create paralysis within your working day.

And the point is action with care is always better than inaction through fear.

But we have to remember, the economy is not a machine. The diktats that come out of the economic thinking of universities and elsewhere would suggest that it is mechanical, but it isn't. It's a living process, managed by humans, informed by judgment and not certainty, and we have to be able to undertake our economic decision making, recognising that embracing uncertainty is a strength, and acting with humility is wisdom. Doing the right thing is never a waste of time. That is how we build a better future and we can know what the right thing is by combining our values, our heuristics, and our maxims. Together, they give us the capacity to make good decisions.