real-world economics review, issue no. 81
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Why consumers are not sovereign: the socio-economic causes of market failure

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> "We should be awake to the consequence, far and near, of the way we earn our living. So many modern industries are harmful to humans and nature" (Thich Nhat Hanh, *The Heart of the Buddha's Teaching,* 1999).

> "To gather one's profit out of the need of another is condemned by all laws, human and devine" (*Rerum Novarum*, Enitcyclical of Pope Leo XIII on Capital and Labor, May 1891).

> "I play to people's fantasies … That's why a little hyperbole never hurts. People want to believe that something is the biggest and the greatest and the most spectacular" (*Trump: The Art of the Deal*, 1987).

> "The relationship between empathy and profit is necessarily a fragile one… It should be possible to have constructive competition. The key factor is the motivation of those engaged in it. When the intention is to exploit or destroy others, then clearly the outcome will not be positive. But when competition is conducted with a spirit of generosity and good intention the outcome… will at least not be too harmful" (Dalai Lama, *Ethics for the New Millennium*, 1999).

Introduction

The purpose of this paper is to explain why competitive markets, for important noneconomic reasons, too often fail to serve the best interests of society. Before getting to these reasons, it is important to provide a brief review of the essential tenets of mainstream economics concerning the role that competitive markets play in maximizing the welfare of society.

Consumer sovereignty: mainstream and alternative views

According to mainstream economics, it is the self-interest motive (the invisible hand in the words of Adam Smith) that leads firms in competitive markets to pursue profits and avoid losses, and thereby, to maximize the net benefits to society in the long run (Frank, 1991, p. 350; Smith, 1776). This favorable economic outcome occurs, as Vilfredo Pareto recognized, when advantageous trades continue to be made until it is not possible to make another trade that will increase the well-being of any one person without reducing the well-being of any other person (Hyman, 2011, p. 58). When the latter point is reached, assuming that the values of the goods traded reflect the true values of these goods to the people involved, markets can be said to be efficient and fully functional for society. Economists, of course, recognize that there are a few important economic reasons why markets could still fail to achieve the optimum, maximizing the net benefits to society. They understand that society will fail to achieve full economic efficiency if 1) some markets suffer from a lack of competition, i.e., have monopoly power; 2) some traded goods have positive or negative external effects (externalities) on others who are not buyers or sellers; 3) some valuable goods (public goods) cannot be traded because their benefits can be obtained even if people do not pay for them; and 4) would-be traders of some goods cannot obtain information about these goods' benefits and costs. In these cases of market failure in which the market activity by itself does not lead to an efficient outcome, most economists acknowledge that there is a strong case for government action to intervene in order to correct the market failure.

When competitive markets are efficient and maximizing the net benefits of society, consumers will in theory be sovereign in the sense that consumers' wishes will determine what is produced and offered for sale. "Most economists believe that consumer sovereignty reigns," that in the real world people as buyers really do control business (Colander, 2010, p. 65). On the other hand, quite a few people and some economists such as David Colander have doubts about consumers' control of business. For example, some people believe that their consumption choices are strongly influenced by businesses who fool them and control their choices using advertising and other means (p. 65). If that is the case, businesses can be said to control consumers rather than vice versa. To understand the argument against the existence of consumer sovereignty, it is important to make explicit a number of important assumptions. For consumer sovereignty to exist 1) consumers must really know what they want and what is best for themselves, 2) consumers must communicate this to businesses via their market behavior, and 3) consumers must not allow themselves to be influenced contrary to what is really best for them by businesses' communications and market behavior. Later in the paper it will be argued that for consumer sovereignty, it is also important that a fourth assumption must apply. Businesses must not just be motivated by profitability considerations; they must be motivated as well to supply goods that are really in the best interests of their consumers.

Colander (2010, p. 534) recognizes that "individuals sometimes do not do and pursue what is in their best interest"; in this sense they often do not behave rationally. In the absence of rational behavior on the part of consumers, market economic activity will not be efficient, and consumers will not be sovereign. And it is unlikely that consumers will get what they truly want. Although Colander, in the above quote from his introductory text, does not provide a full explanation, he clearly has some sense of the noneconomic reasons for market failure. Colander refers to this as a "rationality failure of individuals" (p. 534). A later section of this paper will develop this and related ideas further.

Akerlof and Shiller (A&S) (2015) have given considerable thought to why too often the free market system fails. In their view, it fails when the functioning of the market spawns manipulation and deception (p. vii), notably when business people behave in a purely self-serving way. According to A&S, businesses' manipulation, deception, and trickery causes the failure of markets because consumers wind up paying too much for products they do not need. A&S have a dual view of the workings of free market economies. On the one hand, businesses' profit incentives enable us to be supplied with many great products. On the other hand, free market economies lead to selfish business practices "that are analogous to biological cancers" in the human body (p. x). This happens when buyers in markets have weaknesses in knowing what they want, and such weaknesses give businesses the incentive to take advantage of buyers by learning about them, priming them, and then setting the trap for them (p. x).

Consumer preferences and business orientations

To fully explain why competitive markets may fail and consumers might not be sovereign, it is necessary to explain carefully about several types of consumer preferences and several different business orientations.

First consider consumer preferences. It is useful to distinguish between actual preferences, metapreferences, and true preferences (Tomer, 2008). Actual preferences reflect our ordinary wants and desires. They are the preferences that a consumer applies when he/she makes a choice among alternatives (p. 1706). Metapreferences are a person's preferences about one's actual preferences. Metapreferences reflect a person's capacity to critically stand in judgment of his/her actual preferences and contemplate their worth. True preferences are the preferences that are a person's ultimate ideal; they represent the unique truth about what is really the right and best for that person. True preferences are the preferences that a person would have if she were perfectly informed about not only herself but the desirability of goods that she might consume (p. 1706). Choosing in line with true preferences will lead the person to the highest possible health and vitality. To illustrate, consider two classes of foods, healthy (H) and junky (J), the latter being less healthy and potentially damaging to one's health (p. 1707). Suppose that her actual preferences are for J goods, and accordingly she will choose J food. Suppose, however, that her true preferences are for H goods as H food really is better for her health. If true preferences represent what is really right and best for the person, not only in the short-term but in the long-term, then the ultimate of rationality, true rationality, means choosing in line with true preferences (p. 1707).

Second, it is necessary to understand the different orientations of businesses. We are concerned here with businesses' orientation to act responsibly and ethically. It is useful to think of the orientations of firms as falling into three categories: 1) socially responsible, 2) market oriented, and 3) negatively opportunistic (see Tomer and Sadler, 2006; Tomer, 2013, pp. 95-97). "Socially responsible companies seek out strategies and behaviors that are simultaneously good for society, all their stakeholders, and themselves, and they avoid actions imposing costs on others" (p. 96). "Firms that are negatively opportunistic have a low ethical orientation and tend to behave not just self-interestedly but opportunistically in the sense of seeking opportunities in which they can gain at the expense of others" (p. 96). Market oriented firms are in between the other two. They respond in self-interested ways to economic and social incentives. However, these companies "are oriented to following conventional social norms; [they] are generally unwilling to cause [significant] harm to others, but are also unwilling to go out of their way to be helpful to others" (p. 96).

Phishing for phools: the essence

Why don't free competitive markets serve us well? In their book, *Phishing for Phools: The Economics of Manipulation and Deception*, Akerlof and Shiller (A&S) (2015) develop a theory that explains why competitive markets are often dysfunctional in the sense of not serving the interests of market participants. In their explanations, they use two words (phish and phool) associated with the internet. Originally, the word phish meant using misleading internet communications in order to induce individual computer users to provide valuable personal information, information that presumably could be used to make a profit at that individual's expense. A&S use the word phish in a broader sense. According to A&S, people who phish are trying to get other people, the target people, to do things that are in the interests of the phishers or phishermen, but not in the interest of the target people (p. xi). A phool is a target person who is successfully taken advantage of, i.e., phished. "It is about angling, about dropping an artificial lure into the water and sitting and waiting as wary fish swim by, make an error, and get caught" (p. xi).

According to A&S, in the context of markets, there are two general kinds of phools: psychological and informational (Akerlof and Shiller, 2015, p. xi). And there are two types of psychological phools. In the first type, a person's "emotions override the dictates of his common sense, thereby making him vulnerable" (p. xi). In the other type, an individual's cognitive biases, which are like optical illusions, lead a person to misinterpret reality. When an individual acts on the basis of one or more of those misinterpretations, he becomes vulnerable (p. xi). Among these cognitive biases are availability, anchoring, representativeness, status quo, endowment effect, and loss aversion. Lastly, an individual becomes an information phool with its associated vulnerability when he "acts on information that is intentionally crafted [by businesses] to mislead him" (xi). It should be noted more generally that psychologists of all stripes ranging from Sigmund Freud to Daniel Kahneman (in contrast to mainstream economists) "understand that people frequently make decisions that are not in their best interest. Put bluntly, [people] do not do what is really good for them; they do not choose what they really want. Such bad decisions [and their corresponding vulnerabilities] make it possible for them to be phished for phools" (p. 1).

In the view of Akerlof and Shiller (2015, pp. xi-xii) businesses operating in competitive markets commonly phish, but it is not because they have an unethical motivation or orientation. As A&S understand it, the basic problem is that the competitive markets in which companies do much of their business put a lot of pressure on those companies (or incentivize them) to be less than scrupulous. In other words, it is the competitive market environment, not the ethical orientation of businesses, that A&S believe provides the crucial influence that leads business people to behave as phishermen with respect to their customers (p. xi). Further, according to A&S, these markets "rarely reward [either in terms of profits or social kudos]… those [business people] who restrain themselves from taking advantage of customers' psychological or informational weaknesses" (p. xii). A&S emphasize that whenever there is an opportunity for above equilibrium (or above normal) profits to be made by phishing, some would-be phishing businesses will act to take advantage of the opportunity and others will join in.

Although A&S do not mention anything about businesses' orientation, it is clear in their view that phishing businesses have a negatively opportunistic orientation. These businesses are actively seeking to discover biases and other weaknesses that make the buyer vulnerable and, thus, make it possible to take advantage of them. Their orientation is to make a profit by exploiting the consumer if that is possible. The flip side of this is that such businesses do not have a socially responsible orientation. That is, they do not have an orientation toward or convictions about doing good for their customers. These businesses are not trying to figure out what is really good for the consumer and then trying to supply that. Accordingly, they are not interested in their customers' true preferences. These businesses are only interested in their customers' actual preferences. And if their customers are found to have unhealthy or otherwise unwise actual preferences, they are not interested in helping these customers have different preferences. Further, these businesses are also not attempting to figure out how they can avoid causing negative consequences for their customers. For example, they are not trying to find out about and lower the risks associated with the use of their products.[1]

The story of Cinnabon is recognized by A&S to be a very good example of a company that has been successful in phishing for phools. Cinnabon is a company that makes a very tasty cinnamon roll that has an attractive, strong smell, has 880 calories, and is slathered in frosting (Akerlof and Shiller, 2015, pp. 2-3). It is very tempting to buy Cinnabons, but they are not a healthy food. The success of Cinnabon is an example of a company that has phished for a long time and found many phools to buy its product. Moreover, it is an example of how "the free market system exploits our weaknesses" (p. 3). There are many other such companies phishing in the same waters. One suspects that if Cinnabon had not introduced this kind of tempting cinnamon roll, some other company surely would have (p. 3). There is good reason to believe that the choices made by Cinnabon's customers are not choices that are in their best interests, certainly not from a health perspective. Of course, buying a Cinnabon roll is not the worst mistake you can make in your life. To get a better idea of the full human cost of phishing for phools, Akerlof and Shiller provide many other examples where the stakes are much higher. These examples include rip-offs in cars, houses, credit cards, politics, food, pharmaceuticals, innovative products, tobacco, alcohol, and finance. Additional examples will be provided later in the paper.

Dual motive theory: the core underlying human motivations

While Akerlof and Shiller's phishing for phools model captures the opportunistic, exploitative aspect of all too much business behavior, their analysis fails to capture the essential core underlying human motivations that are at play. They fail to appreciate that not all business behavior has a negatively opportunistic orientation. They do not appreciate that businesses can aspire to and achieve behavior that is socially responsible. The point here is not that socially responsible behavior is attained every day by all businesses. The point is that socially responsible behavior does happen and is happening increasingly. To appreciate that businesses can have motivational orientations other than negative opportunism, it is necessary to consider dual motive theory which has its roots in brain physiology.

The two core human motivations are self-interest and other interest (or empathy). The starting point for understanding these two motivations is Paul MacLean's (1990) research on brain physiology. He conceived of the human brain as having three interconnected modular levels. The first part of the brain, the earliest in evolutionary terms, is the innermost core of the brain, the reptilian complex, which governs fundamental physiological operations and is concerned with self-preservation (Tomer, 2012, p. 78). It is associated with self-interest motivation. The second brain module, the paleomammalian brain, is located on top of the reptilian brain. It

[1] Although the main thrust of Akerlof and Shiller's (2015) book is developing a theoretical perspective that explains the omnipresence of phishing in markets, the authors do mention that there are at least a few individual leaders who have resisted phishing activity (p. 136). A&S refer to these leaders as heroes. Some heroes have taken responsibility to reduce phishing by making good product information available to consumers. Others have been involved in measurement of quality standards and in enforcing these standards. Also, they have been involved with product standardization, grading, and certification, while working for governments and other organizations (pp. 137-139). A number of these heroes have been businessmen of conscience who have developed organizations concerned with product quality and ethical business practice such as the Better Business Bureau (pp. 140-141). Heroes working in governments have been concerned with developing laws, legal standards, contracts, and regulations that protect consumers from being victimized by information phishes.

provides for the distinctively mammalian features of humans such as maternal care, parental responsibility, family life, and social bonding. This part of the brain is associated with caring, other interest, and empathic motivation. The third brain is the neo-mammalian brain or neocortex which envelops the other two brains. This brain provides the human capacities for problem solving, learning, memory, language, thinking, and related functions. According to MacLean, the neocortex is involved in determining how the two strong core motivations, empathy deriving from the paleomammalian brain and self-interest deriving from the reptilian brain, are interrelated and expressed. This dual human motivation view deriving from MacLean's research is in sharp contrast to mainstream economics' view of humans as motivated solely by self-interest. The dual motivation view also contrasts sharply with A&S's view that business decision makers almost inevitably behave in a negatively opportunistic fashion, that business decision makers too often behave in an aggressively negative manner with respect to their customers and others. Further, in A&S's perspective, there is relatively little hint of business being motivated by empathy or regard for others' interests.

Based on the brain physiology research of MacLean, Gerald Cory (1999) developed a model explaining how the two core human motivations tend to be balanced. In Cory's view, it is the executive functioning of the brain's neocortex that attempts to bring about a balance between the self-interest and empathy motivations which frequently are in conflict with each other (Tomer, 2012, pp. 78-9). This theoretical development has been labeled the dual motive theory (DMT).

DMT has important implications for understanding socio-economic behavior (see Cory 2006). It, of course, implies that in making decisions people have two dominant motivations, ego or self-interest and empathy or other-interest. Further, it implies that the meaning of rationality in DMT is different from its meaning in the mainstream economic model (Tomer, 2012, p. 80). Rationality in the DMT model does not involve simply maximizing the self's utility. Rationality a la DMT involves attempting to do well for oneself as well as attempting to do well by others. In the DMTs broad conception of rationality, the essence of rational behavior is attempting to live a well-balanced life in which one's own interests are integrated with others. Clearly, this behavioral perspective does not accord with the A&S view.

Tomer (2012) has proposed a revised DMT model that incorporates recent insights from brain science. In the revised model, an individual's empathic capacity is determined not just by genetics but also by brain changes that happen as a consequence of the individual's life experience. The latter phenomenon is known as brain plasticity; it is the ability of the brain to change structurally and functionally as a result of input from the environment (p. 81). Although every human has basically the same brain physiology, a particular person's brain functioning is shaped as well by that individual's unique path through life. That is, an individual's capacities such as his/her empathic capacity is shaped by every sustained activity of the person, that is, all the person's physical activities, sensory activities, cultural activities, learning, thinking, imagining, etc. (Doidge, 2007, pp. 287-91). In the revised DMT model of the human brain's functioning, people still have two dominant motivations (ego and empathy), but the strength and character of an individual's empathic motivation depends very much on the individual's life experience and whether the individual has made efforts to develop his/her empathic capacity. This revised DMT model implies that businesses and their decision makers could be motivated to develop their empathic capacities, and thereby, improve their relationships with the customers and other stakeholders of their business. In other words, businesses might for instance seek more balanced relationships with customers, not just exploitive ones.

According to Lynne et al (2016), the relationship between humans' self-interest and empathy motivations is somewhat different from the relationship articulated in the original and revised DMT models. As Lynne et al understand it, while the two motivations (ego and empathy) could be directly in conflict, generally the self-interest motive is primal, and a person's empathic capacity plays a restraining or conditioning role with respect to self-interest. This is particularly so when human self-interest is excessive. Excessive self-interest may manifest as egoistic, selfish, hedonistic, or greedy behavior. When this excess is present, humans are arguably in need of greater self-control as well as greater understanding and appreciation of the people and organizations they interact with. That is, it would be desirable if people in businesses would do more to temper, restrain, or condition their self-interest motivation. Otherwise, economic activity will not be sustainable because the economy will be dominated by the actions of business decision makers who do not consider the harm they impose on the public as a whole nor consider the interests of others they interact with (Lynne et al., 2016). It is important to realize that in a "good capitalism," humans' empathy along with other human virtues play a very positive role, ideally leading businesses to more balanced behavior that involves an integration of self-interest with the interests of others (McCloskey, 2006). Interestingly, as Lynne et al. (2016, pp. 244-246) note, taken together Adam Smith's two books, *Wealth of Nations* (1776) and *The Theory of Moral Sentiments* (1759), articulate the essence of this view.

Integrating the phishing for phools and dual motive theory perspectives

Although the phishing for phools (PfP) and the dual motive theory (DMT) perspectives are quite different, both theoretical perspectives arguably contain considerable truth. The purpose of this section is to suggest how these two theoretical perspectives can be integrated. The key to the integration is the recognition that the two perspectives apply in quite different situations. As A&S suggest, the PfP model is likely to apply where 1) businesses are strongly competing for customers to improve their profitability, 2) consumers in the market have significant weaknesses and/or lack of knowledge that make them vulnerable (in other words, these consumers are not sophisticated), 3) societal and community norms regarding proper business behavior are weak, 4) government regulations and enforcement with respect to businesses' market activity and products are weak, and 5) there is a strong tradition of self-interested, opportunistic behavior among ambitious business people. On the other hand, the DMT model is more likely to apply where 1) market competition is less cutthroat in character, 2) consumers are more sophisticated in the sense that they are not so easily deceived because they are more knowledgeable, have less weaknesses, and overall are less vulnerable, 3) societal norms strongly oppose businesses taking advantage of customers, 4) strong regulations and enforcement with respect to products and market behavior discourage businesses from exploiting customers, 5) there is a strong tradition of businesses serving society and community, 6) there exists a strong tradition of ethical business behavior that has roots in religious, spiritual, and humanistic practices, 7) business education is oriented to supporting socially responsible business behavior, and 8) business leaders have strong nonpecuniary motivations such as for prestige, good reputation, conformity, and desire to improve society.

As explained above, the PfP model has better explanatory power in certain kinds of situations, and the DMT model seems to apply better in alternative situations. In effect, these two models are complements. The PfP perspective explains better in situations where the ethical or social responsibilities of business decision makers are not likely to be a key factor.

PfP provides too little recognition that business decisions are often made in an excessively self-interested manner and that businesses are generally too quick to take advantage of customer weaknesses. On the other hand, the DMT is likely to have greater explanatory power in situations where the ethical and social responsibilities of business decision makers are an important factor. The DMT perspective is most useful for explanations that are related to humans' inherent motivations and to what could be if humans lived up to their highest social and ethical potentials. The DMT model can be faulted for insufficiently recognizing customers' weaknesses, and for not recognizing customers' inability to understand or appreciate what is really good for themselves. The upshot is that understanding the interactions of buyers and sellers in markets, particularly when sellers are likely to be taking advantage (perhaps unfairly) of buyers, requires both of these perspectives.

Let's consider an important example that illustrates both phishing for phools and the dual motive theory perspectives. This is the example of predatory mortgage lending practices. These practices reached their peak during the years 2002 to 2007, the period just preceding the advent of the financial crisis and the beginning of the great recession (2008). During this period, mortgage lending grew at an excessively rapid rate. This is indicated by the fact that in 1994, the value of subprime mortgage originations equaled $35 billion. Whereas in 2005, this value reached $625 billion, an almost eighteen fold increase in eleven years (Blinder 2013, p. 70). It is very clear that this huge increase in subprime mortgage lending was not due to a correspondingly huge increase in the number of creditworthy subprime borrowers. This lending increase was due to a large drop in lenders' standards for making these loans. Banks and nonbank lenders during this time were making far too many mortgage loans to people who had little or no ability to repay them. Lenders were unscrupulously taking advantage of unsophisticated subprime borrowers who wanted to buy houses but did not have the financial capacity to repay the loans. Lenders also were taking advantage of significant changes in the mortgage market. The fall in lending standards was indicated by the fact that many of these mortgage loans were low-doc, no-doc, liar loans, and Ninja loans, i.e., mortgage loans with little documentation, no documentation, false documentation, or loans to people with no income, no jobs, and no assets (p. 70). Many of these loans to financially unsophisticated borrowers were "designed to default" (pp. 68-71).

Why were lenders willing to make such loans? During this time, many lenders came to the realization that by making such mortgage loans, they could profit by earning the loan commission, and then quickly sell the loan, usually to a securitizer, thereby letting the securitizer, or some investor further down the line, worry about the frequently negative consequences (p. 69). Ultimately, of course, the securitizers as well as the investors (presumed to be sophisticated), who bought a great variety of mortgage backed securities from the securitizers, lost considerable money. But the biggest losers were the subprime mortgage borrowers (the home owners) many of whom reached a point where they could not pay what they owed, and therefore, were forced to default on their loans. Many of these people not only lost their houses but were forced to declare bankruptcy. These mortgage market events are consistent with the PfP perspective insofar as the borrowers' were vulnerable because of their significant weaknesses and lack of information and because government regulations and enforcement at that time were particularly weak. There is no doubt that during this period subprime mortgage lenders were phishing for subprime mortgage phools. It is noteworthy that mortgage loan company decision makers, not to mention many other decision makers in the financial sector of the economy, have lacked a strong tradition of ethical business behavior, and positive social norms have been lacking. Besides PfP, the DMT perspective also helps to explain the failure of the mortgage market.

Lenders were too often behaving in an excessively self-interested, greedy manner. They were single-mindedly pursuing profit, and their self-interest motivation apparently was not being sufficiently tempered or constrained by their empathic, other regarding motivation. Blinder's view on this is very clear. "Making loans that are 'designed to default' to financially unsophisticated borrowers who likely do not know what they are getting themselves into violates every principle of sound banking—not to mention of human decency" (Blinder, 2013, p. 71).

Once the causes of the financial crisis were coming to be widely understood and people realized how far from "normalcy" that things had gotten, it became very clear that mortgage lending practices had to change, that there had to be a very significant move toward sound banking practices. Now much of this has occurred. At least the worst practices have presumably stopped. Despite this, one suspects that some degree of phishing for phools still occurs and that, although it may be largely constrained, some degree of excessive self-interest survives and could conceivably under certain conditions emerge again in a full-blown fashion. For a more complete, lasting solution to the problem, people, at least those who are business decision makers, would have to develop their dual motivations in a much more balanced and integrated way, achieving a more desirable mix of the two core motivations, a mix with much more empathy and a mix in which self-interest is restrained by other regarding interest.

Manipulation

Manipulation occurs when a person uses influence to get other people (the choosers) to behave in a way that is to the benefit of the person who is manipulating. It is often done in an unfair or fraudulent way, but not always. When business people are said to phish, generally that means they are manipulating. Manipulation is not the same as persuasion. "With (non-manipulative) persuasion, people are given facts and reasons, presented in a sufficiently fair and neutral way" (Sunstein, 2016, p. 4). Not so with manipulation. An effort to influence a person's choices is "manipulative to the extent that it does not sufficiently engage or appeal to their capacity for reflection and deliberation" (p. 6). Manipulation is likely to have occurred "when choosers justly complain that because of the actions of a manipulator, they have not… had a fair chance to make a decision on their own" (p. 6). Some types of manipulation seek to influence by getting people to forgo deliberation altogether. Other types of manipulation attempt to influence by triggering automatic forms of mental processing (p. 7). Manipulation undermines people's ability to decide by engaging in rational deliberation. People who have been manipulated often feel that they have been tricked or fooled because they have not had the opportunity to make a decision using their own deliberative capacities (p. 11). Thus, when they are manipulated, people's choices may not promote their own welfare (p. 31).

In Hanson and Kysar's 1999 article entitled "Taking Behaviorism Seriously: Some Evidence of Market Manipulation," they state that their most important finding is that "individuals' perceptions and preferences are highly manipulable" (p. 1422). They also state their belief that to survive in a competitive market, manufacturers and marketers must manipulate their customers' perceptions. Based on their research, Hanson and Kysar conclude that businesses' manipulation is a very important reason why markets fail in the sense that consumers pay too much and do not get what is truly best for them. Their case studies of a variety of consumer markets "reveal sustained and deliberate efforts by manufacturers and retailers to manipulate consumer product perceptions" (pp. 1427-1428). This is particularly so with respect to product risks. Based on their findings, they conclude not only that "manufacturers attempt to manipulate consumer risk perceptions… [but] that their manipulation succeeds" (p. 1428). Because of this manipulation, "many consumers are likely purchasing too many risky products" at too high a cost (p. 1428). Note also that as part of businesses' manipulative efforts, companies spend a huge amount of money studying consumers' behavior and psychology in order to understand consumers' behavior patterns and to determine the effectiveness of various kinds of marketing efforts (pp. 1429-1439). "The resulting studies and analyses provide the tools that manufacturers need 1) to shape consumer perceptions of their products, 2) to alter consumer behavior in the purchasing context, and 3) to influence consumer-safety risk assessments" (p. 1439).

In thinking about manipulation, it is useful to distinguish between soft manipulation and hard manipulation. Soft manipulation occurs when the seller's practices, while designed to influence consumer decision making, are not considered to be unfair, unethical, or illegal. In soft manipulation, the seller is not waiting for the consumer to make an error or to display a weakness so that the seller can unfairly gain an advantage. Nevertheless there is an element of manipulation, because the seller is taking an action that perhaps in a very subtle fashion is designed to induce the buyer to consider the seller's product(s) in a more favorable light than otherwise. Hard manipulation, on the other hand, involves a more definite, less subtle action by the seller to gain an advantage at the expense of the buyer. Hard manipulation would generally be considered unfair, unethical, or illegal. Hard manipulation is certainly phishing; soft manipulation is probably not. It is useful to think of a manipulation spectrum with soft manipulation on one end and hard manipulation on the other end. The idea of a manipulation spectrum indicates that there are many shades of manipulation involving different degrees of softness and hardness (Sunstein, 2016). Note that it is conceivable that even very soft manipulation could contribute to an element of market failure if the sellers' actions were somehow able to influence consumers to buy more (or less) of the seller's product than what is really best for them.

Consider the following business practices that Hanson and Kysar consider to be manipulation. In my view, the following practices should be considered types of soft manipulation. First is the used car salesman who never shows the potential customer just one car; he shows the customer many cars including irrelevant options (decoys). The idea is that the car that initially interested the buyer becomes more attractive as additional cars are shown (Hanson and Kysar, 1999, p. 1440). Also, typically the used car salesman prominently displays a price on the car; this sticker price then usually becomes an anchor in negotiating the selling price. Second is the seller who sets the price (say of gasoline) a little below some round number, for example, $1.99, $2.99, $4.95. Arguably, this causes consumers to "think they are getting a better deal than they really are" (pp. 1441-1442). Third, in a similar vein, are the typical pricing strategies of home sellers. Home sellers typically ask for an amount below some 'round' number (for instance $195,000). This takes advantage of the typical buyers' mental accounting related to their house buying budget (their budgets are usually expressed in round numbers such as $200,000) (p. 1442). Fourth is the design and atmosphere of the modern supermarket. These supermarkets are "marketing marvels [with] a shopping climate scientifically calibrated to induce as many unplanned purchases as can possibly be wrought from the 'sovereign' consumer" (p. 1444). Such supermarkets are designed to induce in the consumer a particular state of relaxation and positive mood most conducive to consumption (p. 1444). Fifth, is the supermarket's product placement. For example, "staples such as milk, bread, and eggs are placed at opposite extremes of the supermarket to force the shoppers to cover as much store real estate as possible" (p. 1447). Other store design features include aisles designed as mazes to encourage meandering and wide aisles to encourage browsing, especially among the highest margin products. Sixth is the supermarket's pricing strategy. One example is that staples are typically priced "very competitively, counting on consumers to use the low milk or egg price as a proxy for other items in the store" (p. 1449).

There is no shortage of examples of hard manipulation. Let's consider just a few, particularly ones in which sellers take advantage of buyer biases or weaknesses. First is an example related to products marketed to thrillseekers, consumers who typically underestimate a product's risk. Fast sports cars are a product in this category. Advertisements for these sports cars typically do not adequately account for the risks of driving them very fast. One example of this is the advertisements for the Chevrolet Corvette, a well-known fast sports car. It turns out that the Corvette has "the worst death rate of any automobile in the United States," a fact not reflected in their advertisements (Hanson and Kysar, 1999, p. 1462). Second are products marketed to people who have many fears and tend to overestimate the negative consequences associated with particular products or activities. Such overestimation can become a company's selling opportunity (p. 1462). The anxiety that many people feel over possibly losing their jobs should they be forced to be absent from their jobs due to a medical problem became the angle used by the manufacturer of a cold medicine. The advertisement sought to persuade readers/listeners/viewers that the cold medicine was needed so that the cold sufferer would be able to work despite his/her cold: "No work, no pay" (p. 1463).

One interesting and noteworthy example of manipulation relates to health clubs. These clubs supply opportunities to use fitness facilities and receive health related instruction to people who want to become more fit and healthy. Their new customers are typically people who have recently resolved to improve their physical fitness and health. To use the club's facilities, the new members must choose from three different payment plans: 1) pay by visit, 2) sign a contract to pay monthly by credit card with automatic monthly renewal unless cancelled, or 3) sign an annual contract (Akerlof and Shiller, 2015, pp. 3, 167, 169; see also DellaVigna and Malmendier, 2006). These new members typically suffer from "present bias." That is, they are inclined to put off until "tomorrow" some of their fitness and health efforts. They always aspire to do more tomorrow. Most club customers choose the monthly contract with automatic renewal. This is understandable in light of their plans to do more tomorrow. The clubs understand their customers' behavior pattern and motivation and take advantage of this by making it difficult for them to cancel the contract (Akerlof and Shiller, 2015, p. 3). As a consequence, these members almost always wind up doing less physical exercise than they had hoped to and paying more on an annual basis ($600 per year more) than they would have if they paid per visit (p. 3). This is clearly a manipulation (a hard one) as the clubs are taking advantage of many new and not so new members' bias and/or lack of self-control, and profiting at their expense.

Consider another interesting way that sellers can take advantage of buyers. This is the example of goods with "shrouded" attributes (Akerlof and Shiller, 2015, pp. 167-169; Gabaix and Laibson, 2006). Any good or service in this category will include a base good and an add-on good(s). In the case of printing, the printer is the base good and ink (ink cartridges) are the add-on. The printer company typically will advertise the printer including its price and compete aggressively to sell it. On the other hand, in the case of the add-on, ink cartridges, the company typically will hide or shroud its price and will not compete to sell these cartridges, which represent a very significant part of the customer's cost of printing as well as the company's profits (p. 506). As a consequence, many printing customers (the unsophisticated ones) will not know about and do not think about the ink cartridge add-ons when buying the base good. They only focus on the price of the base good. Because of these customers' myopia or unawareness concerning a very significant part of the cost, the sellers can manipulate or take advantage of the buyers of this product. Not surprisingly, firms typically decide to shroud attributes like add-on costs when a relatively high percentage of buyers are unsophisticated (p. 506). Another example of a good with shrouded attributes is the case in which a bank advertises the merits of one of its accounts, but the marketing materials hide or do not disclose add-on account costs such as ATM usage fees, bounced check fees, minimum balance fees, etc." (p. 506). One other example is the hotel room whose price is listed and known by customers but there are many other attributes whose prices are hidden. The latter attributes or add-ons might include parking, telecommunications, room service, etc. (p. 507) The upshot is that in a market where there are unsophisticated customers and shrouded attributes, there are sure to be 1) customers who are being taken advantage of and 2) a market that is to some degree failing.

The above examples of manipulation have only scratched the surface of the universe of possible manipulations. Note that there are plenty of ways to exploit people that have much more serious negative consequences than the ones mentioned above. But even a short listing is useful to get a better idea of the scope of the phishing/manipulation problem and its associated market failure. As Akerlof and Shiller (2015, pp. 103- 116) explain in an important chapter, the consequences of phishing are probably worst in the case of the four great addictions: tobacco, alcohol, drugs, and gambling. In these areas, the phools are not simply losing money or failing to receive benefits, they are often losing essential elements of their physical and mental health and well-being. Among the negative consequences of tobacco use are lung cancer and early death. For people who become alcohol dependent, the negative consequences include chronic, debilitating physical and mental illness, notably personality changes such as the loss of one's capacity for intimacy (pp. 109-115). Addiction to drugs and gambling carry with them negative consequences that can be similarly dire. With regard to tobacco and alcohol, the most basic fact "is that they are easily available… This easy availability of tobacco through the market, in and of itself, is the basic phish of the smokers, likewise, the easy availability of alcohol is the basic phish of those who end up drinking too much" (p. 116).

Changes in patterns of manipulation

Not surprisingly, the patterns of manipulation in the economy change over time. The "free-market system brings [into being] ever more sophisticated manipulations and deceptions" (Akerlof and Shiller, 2015, p. 136). Over time manufacturers learn more about the existing pattern of biases and shortcomings of consumers as well as learning about new patterns of biases and weaknesses of consumers. What sellers learn about buyers naturally leads them to develop new manipulations (Hanson and Kysar, 1999, p. 1467). According to Hanson and Kysar (p. 1555), it may very well be that "the most successful sellers will be those who, wittingly or not, are the most successful manipulators" or phishers.

Capuchin monkeys' dysfunctional market behavior

To get an idea of how dysfunctional markets might become when phishing is omnipresent, Akerlof and Shiller use the example of Capuchin monkeys. Research has shown that these monkeys can learn how to use money and acquire goods in markets (Akerlof and Shiller, 2015, p. 4). Capuchins can understand the prices of goods and anticipate these goods' payoffs. Imagine an experiment in which these monkeys were given incomes and encouraged to buy goods in markets without any regulatory safeguards. In these laboratory experiments with Capuchin monkeys, the experimenters can easily phish the monkeys with different food offerings, many of which the Capuchins find good tasting, but which are relatively unhealthy. Note that "Capuchins have limited ability to resist temptation" (p. 4). These monkeys will be able to get whatever they choose in the market. How would these monkeys behave? Obviously, they will buy whatever they find good tasting. The problem is that those choices are likely to be very different from what makes them happy. We know, for example, that Capuchins love Marshmallow Fluff-filled Fruit Roll-Ups (p. 4). It is unlikely that they would resist the Roll-Ups. Moreover, there is good reason to believe that the Capuchins would not only choose the Roll-Ups but make many similar choices. And as a result of their many poor choices, "they would become anxious, malnourished, exhausted, addicted, quarrelsome, and sickened" (p. 4). In other words, Capuchins' free market choices are likely to be phoolish ones; their choices are not likely to make them better off. No doubt, humans are smarter, have more self-control, and are generally more capable of making good choices than Capuchin monkeys. But as Akerlof and Shiller (2015, p. 4) explain, humans in many contexts too often make choices that are not much better than the Capuchins (for more on Capuchin monkeys' trading behavior, see Chen, Lakshminarayanan and Santos, 2006).

Behavioral market failure

As indicated earlier, mainstream economists use the term market failure for the purely economic reasons why markets fail to achieve optimum efficiency (for example, monopoly power, externalities, public goods, and lack of information). In addition to the standard market failure concept, behavioral economists refer to behavioral market failures in which the failure of the market occurs for noneconomic reasons, in particular due to the human propensity to err (Sunstein, 2014, p. 16). These behavioral failures typically stem from the all too common opportunistic orientation of businesses to take advantage of the weaknesses of their customers. "Businesses know… that consumers are easily manipulated by sellers into making bad choices—choices they would never make if they knew better" (pp. 8-9). And "free markets … reward sellers who attempt to exploit human errors" (p. 10). When businesses manipulate buyers, people's genuine, real, true needs (the needs that reflect their true preferences) are not satisfied. If that is the case, it implies a lack of consumer sovereignty because businesses are not serving the best or true interests of their customers. These behavioral market failures reflect both the weaknesses of consumers and the negatively opportunistic orientations of businesses. Such businesses are acting with an excess of self-interest and too little empathy.

Degree of socio-economic dysfunction

The socio-economic dysfunction associated with behavioral market failure has a resemblance to the phenomenon that Harvey Leibenstein's concept of X-inefficiency refers to. According to Leibenstein (1978, p. 17), "When an input is not used effectively, the difference between the actual output and the maximum output attributable to that input is a measure of the degree of X-inefficiency." In the analysis presented in this paper, when sellers act to gain at the expense of buyers using manipulation, deception, and trickery, the outcome is that customers' true needs are to some degree not being satisfied. In concept at least, one could construct a measure of the degree to which customers true needs are not being satisfied because of the relationship of sellers to their customers. This measure could be called the degree of customer exploitation or the degree of phishing for phools or, perhaps better, the degree of socio-economic dysfunction. The degree of socio-economic dysfunction has a similarity to the degree of X-inefficiency in the sense that it helps us understand how the economy is not working as well as it could. If one could devise such a measure, it would provide important new insight into how our economy is performing or not performing.

Conclusion

Consumer sovereignty is an ideal. In the view of mainstream economists, that ideal is to a great extent realized as businesses' efforts to self-interestedly pursue profits leads them to supply what consumers want. It is important to note that the mainstream economic analysis is purely economic in nature; noneconomic considerations are left out. Further, that analysis assumes that the products that people buy reflect their actual preferences. There, is, however, good reason to believe that what people really desire are satisfaction of their true preferences, the preferences a person would have if he/she were perfectly informed and mindful. The mainstream economic analysis does not consider the possibility that businesses' pursuit of their self-interest might not lead them to produce what satisfies people's true needs. The mainstream economic analysis also does not consider the possibility that firms might seek to gain at the expense of their customers. This paper attempts to develop a more accurate conception of both the consumer sovereignty ideal and how businesses and consumers actually behave in their market interactions. Part of the story is that businesses often behave in a negative opportunistic fashion. They learn about consumers' lack of information, weaknesses, biases, and emotionality, and then they learn how to take advantage of this knowledge at the expense of the customer. The model in Akerlof and Shiller's *Phishing for Phools* helps to understand this part of the story. The dual motive theory model (self-interest and other interest (empathy)) provides another important part of the story. It indicates how businesses need to be oriented and to behave if they are to produce goods and services that truly satisfy their customers. Integrating these two perspectives enables us to understand why consumers are often not sovereign.

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SUGGESTED CITATION:
John F. Tomer, "Why consumers are not sovereign: the socio-economic causes of market failure", *real-world economics review*, issue no. 81, 30 September 2017, pp. 76-90,
http://www.paecon.net/PAEReview/issue81/Tomer81.pdf

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