

# Why do we do it?

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## Introduction

The first principle of economics is that every agent is actuated only by self-interest (Edgeworth, 1881). It is perhaps reassuring to know that even in 1881, economists were being encouraged to dismiss that aspect of human nature known by many as 'compassion'. We are still told that the only reason we help others is to help ourselves. All feelings of sympathy and 'compassion' are inherently selfish, for we are inherently selfish.

However, as Collard (1975) points out, even Edgeworth was highly suspicious of what he saw as an inaccurate representation of human motivation. Why then does it remain a fundamental precept of microeconomic theory?

Revealed preference theorists tell us that if we choose something, then by definition, we prefer that selection to all other feasible selections. When queried as to the validity of such a philosophy, many adherents will defend the stance, beginning by assuming that it is in fact correct. Thus, for example, when one gives money to charity, it is done because it makes one feel better, net of the loss of money. Thus, one cannot set one's own interests aside, giving preference to those of the family, for alas there are no other

interests, only selfish ones. This is because, in the final analysis, one chooses that which maximises one's utility function. Like Polemarchus in Plato's "Republic", we are meant to stand back, aghast by the wisdom of this searing insight into our daily lives. In truth, however, it is merely a circular argument, one which avoids the issue, and does not do the science of economics justice.

## Homo Oeconomicus

We then have our economic animal; one which is '*rational*', it acts so as to maximise its own welfare, given structural and budget constraints. Unless choices are explained by some preference relation consistent with the narrow bounds of economic rationale, the agent will be deemed to be behaving irrationally.<sup>2</sup> We are left with no choice-independent way of assessing welfare. We do not need one, for we can rely on

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<sup>2</sup> Such views are looking increasingly stringent with the development of chaos theory, which suggests that there are grounds to believe that the behaviour of atoms, molecules and subatomic particles may be modelled as random.

the individual agent to maximise that welfare through its revealed preferences. Thus, all non-choice sources of information on welfare are ignored.

It is perhaps to be expected that behavioural characteristics will remain anonymous behind such stifling, formal, limitations. However, it does not stop there. Economics has developed two models of human behaviour. One is an unsympathetic isolationist, and the other is an agent which allows the welfare of others to affect its selections and welfare. These may be represented as:

Isolationist :  $U_i = U_i(X_i)$ ,

Integrationist :  $U_i = U_i(X_i, U_j)$ ,

where  $U_i$  is the utility of the  $i$ th person,  $X_i$  is the consumption bundle of the  $i$ th person, and  $U_j$  is the utility of the  $j$ th person.

I wish to concentrate on the integrationist, as the isolationist is perhaps more self-explanatory.

There are two ways in which exterior influences can affect  $i$ . One is through a change in  $j$ 's welfare leading to a perceptible change in  $i$ 's welfare. Thus

$U_i = U_i(X_i) + \phi(U_j)$ , where  $0 < \phi < 1$ ,  
 $i$  not equal to  $j$

This model does not explicitly state that changes in  $j$ 's welfare will alter  $i$ 's behaviour, although it seems clear that if  $i$  feels that through a change in its preferences it can radically alter  $j$ 's welfare, and hence its own welfare, it will do so. The second possibility is that changes in  $j$ 's welfare lead *ipso facto* to changes in  $i$ 's preferences, without necessarily altering  $i$ 's welfare. Thus

$U_i = U_i [X_i (U_j)]$ ,  $i$  not equal to  $j$ .

Thus consideration for  $j$  leads  $i$  to choose bundles which it otherwise would not have chosen. Examples of such behaviour are ethical decisions, or reactions to suffering of those in foreign countries. Though the distinction may seem overly technical, it is significant as the latter form of integrationism, what Sen (1982) refers to as "commitment", is not egoist. Sympathy in the first case constitutes concerns which must be directed towards the self for them to have any importance. This is an important difference for behaviour theory.

Rational behaviour, as a model of human behaviour, is often criticised for being too complicated. Certainly, it is admitted that individuals do not consciously equate the marginal costs and benefits of all their actions. It is also true that individuals do not carefully investigate all options available to them - an information problem. Maximisation of utility often comes a poor second to habits formed over years. However, it may plausibly be argued that individuals do tend to 'gravitate' towards an efficient allocation of resources in the medium-term, even though there are clear imperfections which lead to minor inefficiencies, especially in the short-term. However, the manner in which the workings of the human mind are presented, far from being overly complex, are misleadingly simplistic, rendering *Homo Oeconomicus* a "social

<sup>3</sup> See Sen, A. op. cit. Moron is his word not mine!

moron".<sup>3</sup> This creature has but one manner of selection which must accommodate such diverse impulses as self-interest and normative judgements on the welfare of society. This Homo Oeconomicus is sadly incapable of distinguishing between greed and altruism. The motivations behind eating and devotion to loved ones is but an opaque blurr. We must ask ourselves whether this is an acceptable view of human nature.

### The Problems of Igor

Our Homo Oeconomicus shall henceforth be referred to as Igor. Igor is desperately (in every sense) in love with Voluptua, the most beautiful girl on the street. Igor, though not the brightest of individuals, realises that the effects on Voluptua of his attempting to demonstrate his stifled emotions, would most probably be irreparable. Thus Igor restrains himself. He does this, not through a fear of embarrassment (poor Igor has made a fool of himself on far too frequent a basis for that), but rather through concern for Voluptua's emotional stability. Though one hesitates to infer too much from such a flippant example, I believe that it demonstrates that there are two aspects of consumer theory which are erroneous. The nature of Igor's concern for others - in this case Voluptua - exposes the true form of interdependent utility functions.

Concern for others does not act as a determinant of selfish utility; rather it acts as a constraint, making impossible options which would otherwise be optimal. Instead of a

utility function in which the welfare of others acts solely as an influence on selfish utility, there is a function which represents preferences as being personal, but tempered by concern for others. Using the example of a two good, two person economy with no production, in which all consumption derives from endowments and person B has an 'income' which is below subsistence level, then with goods  $x$  and  $y$ , the position can be represented thus:

$$Q_a = \alpha x + \beta y$$

$$Q_b = \gamma x + \delta y$$

where  $Y_0$  is total income for the economy.

$$Q_a + Q_b = Y_0$$

If A's income exceeds  $Q_a^*$ , there will be a transferral of resources from A to B [ $Q_a^* - Y_0 = Q_b'$ , such that  $Q_b'$  is below subsistence level for B]. This will be the case because A is unwilling to see his sole companion die of starvation, while he (A) eats to excess. Thus A's utility maximisation problem is  $\text{Max } U = U[Q_a(x,y)] + \lambda(Q_a - Q_b' - Y_0)$ .

It is quite possible, therefore, that preferences do not reflect welfare maximisation. To view exterior concerns as being merely elements of utility maximisation is the same as viewing conformity to budget constraints as being but a source of utility. We thus keep to these budget constraints because we like it, not because something tells us we should. The analogy is deeper, for ethics enters into both. Those individuals who do

not feel bound by intertemporal budget constraints (including credit extensions) will by definition take that which is not theirs. Many feel that this is morally unacceptable. Similarly, many feel that it is morally unacceptable to ignore the plight of others in our community. However, in the case of concern for others, the effect on preference cannot be quantified; it cannot be modelled satisfactorily for the purposes of hypothesis testing etc. The increasingly mathematicised nature of economics has perhaps led us to sweep away those qualities which do not lend themselves to quantitative analysis. This whole approach makes the concept of sacrifice somewhat incongruous. If someone starves for twenty four hours, allegedly for those dying in the Sudan, she or he must be lying. In fact, she or he is clearly doing it due to some macabre pleasure derived.

"Commitment" violates this quite unique economic pleasure principle. It drives a wedge between personal welfare and personal choice. Returning to the tired example, let us say that Igor knows that he could embarrass Voluptua into receiving his advances, and yet he remains inactive. Economists tell us that he does nothing because nothing is what he wants to do; we always do what we want. However, Igor would be happier doing something. Certainly, there will be some benefit derived from the knowledge that Voluptua has been spared the worst experience of her life. Yet this is merely an externality from inactivity. It is insufficient to compensate Igor for the loss he suffers from inaction. At the risk of labouring the obvious, what is

being said is that people are driven by a plurality of forces. To subsume all human emotions under the blanket of self-interest, while useful for pedagogical reasons, is an unreasonable over-simplification. One major drawback of this approach is that it can lead to incorrect inferences regarding societal welfare. This is due to the fact that people are not necessarily the best judges of what is best for others. While we can probably sleep safe in the knowledge that Igor's assessment of the situation is uncharacteristically accurate, in other situations divergent assessments can be a source of inefficiency, prohibiting the exploitation of Pareto improvements.

#### **We do not always choose what we want**

Apart from commitment, there are two other reasons why there may be a divergence between preference and utility.

i) Rigid adherence to habits prevent individuals from exploiting utility-increasing opportunities. There is an overlap between this problem and the question of the role of ethics and its impact on the basic premises of rational economic behaviour. Are we to say that strictly honest behaviour can be irrational? If economics is to fulfill its purpose of aiding the community in understanding the workings of the economy, then it must explicitly incorporate that system of ethics which influences the behaviour of economic agents. Instead of this, there is a tendency to feel that somehow people are misbehaving if they refuse to obey

the strict rules set down by economic rationale. Prescriptive modelling has no place in a science.

ii) Due to the psychological make up of certain individuals, they may be unable to act rationally in the face of extremes of pain or pleasure. The concept of free will in general, however, is undergoing radical transformation. The legal precedents regarding the inclusion of subliminal messages in song lyrics opens up an enormous dilemma. Is any one of us in control of what we are doing, when there is the possibility of implanting concepts within our minds without us knowing? Thankfully, such philosophical niceties are beyond the scope of this paper (and writer).

### Conclusion

It may be felt that the thrust of this paper is merely a discussion of semantics. I wish to refute this. To say that it is unimportant whether one includes concern for others as an indirect influence (via personal welfare) or as a direct impingement on personal welfare, is simply not true. To use personal welfare in the broad sense that economics currently uses it is to denude the term of all its meaning. It is similar to one referring to all books as novels, ignoring all other categories, and destroying the usability of the term novel. Now no one knows precisely what one means by 'novel'. In the final analysis, as words are the sole medium of discussion, to destroy them leaves us with little to discuss.

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