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Abstract

This note examines some issues involved in an attempt to go beyond the assumption, long-made by most economists, that people's preferences are simply to be treated as "given" and that the principle of consumer sovereignty entails a refusal to consider some (or some people's) revealed preferences as more authoritative than others. The most important break with that assumption has been the development of behavioral economics, which shows that people may not always know what they really want, and that economists have to develop a more critical approach, distinguishing people's true preferences from those that are merely apparent. While this approach, a version of which is proposed by Michael Woodford, might very well be needed to explain various otherwise mysterious ways in which actual societies defy economists' predictions based on the assumption of purely rational behavior, it also involves a danger of replacing an empirical investigation of human choice with a normative account of what people should chose--or might chose under some sort of "ideal conditions" that reduce the diversity of human preferences to merely erroneous deviations from what reason and human nature demand. To solve this conundrum, economics might need to incorporate a more robust theory of human choice, perhaps along the lines proposed by Robert Shiller and Edmund Phelps. Such a theory would bring economics closer to other social sciences, such as history, psychology, and maybe even ethics and aesthetics.

It may be somewhat surprising to see a group of economists celebrating the anniversary of Martin Luther's 95 Theses by considering the significance of his ideas for economic thought. Luther did not have much, and clearly nothing of importance, to say on any subject that we would today consider directly related to economic analysis. But perhaps not surprisingly, Luther's focus on the central place of the individual and his de-emphasis of the role of the community in mediating the relation between human beings and God—understood as the ultimate measure of any worth in this world—is something that naturally resonates with economists, who believe that individual preferences, rather than communal choices, constitute the basis of the economic system.

To be sure, unlike economists' stress on consumer sovereignty, which sees the individual as free to pursue his own goals rather than conforming to the value choices and opinions of others, Luther's emphasis on faith as the sole basis of salvation focuses more on the hardship than on emancipation as the main consequence of individual responsibility. Indeed, Luther's rejection of the idea that participation in an earthly community can help save one from damnation leaves the individual alone and essentially powerless in his striving for the highest human good of salvation. Still, an examination of the difficulties inherent in an often simplistic idea of individual preferences underlying much of modern economic theory may reveal that pursuing some implications of Luther's individualism can open the way to a more fruitful development of economic theory in the future.

Let's start with the increasingly controversial idea at the core of yesterday's (and still largely today's) economic theory: that individual preferences, taken as the ultimate basis of human actions and the driving force of economic developments, are to be treated as simply "given" and "revealed" by the subjects. As Michael Woodford[1] and other behavioral economists point out, things are more complicated because people's preferences are often inconsistent and unreliable; under many circumstances, people might "reveal" preferences that we have reason to believe are, in some sense, not really theirs. Moreover, as Robert Shiller's recent work[2] suggests, we may need to go beyond the behaviorist account and provide a *social* theory of preference formation, which explains how various "narratives" about reality spread among economic agents and influence their behavior. Indeed, Edmund Phelps[3] goes still further by arguing that neo-classical economics cannot account for the transformative moments in economic history, such as explosive growth and decline of productivity, without reference to broader *cultural* forces that affect dynamism and innovation.

All these critiques suggest that neglecting the intricacies of how people come to

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[1] See Michael Woodford's contribution to this issue: "Individualistic Welfare Analysis in the Age of Behavioral Science," *Capitalism and Society* 13, no. 1 (September 2018).

[2] Robert J. Shiller, "Narrative Economics," *American Economic Review* 107, no. 4 (April 2017): 967–1004.

[3] Edmund Phelps, *Mass Flourishing* (Princeton: Princeton University Press, 2013).

form and reveal their preferences weakens the foundations of economic theory and impairs economists' ability to explain some widely observed distortions of expected outcomes. On the other hand, the possibility that people's preferences, as revealed in a fairly simple and uncontroversial fashion, may not in fact be "really" theirs also opens a host of complex issues that may not be easily handled with the standard tools economists have used in the past. Insights and methods from other fields of scientific analysis, such as behavioral psychology or neurological science, may be of some help. But a robust theory of how human beings come to have these or other preferences and make choices determining their behavior is likely to bring us back to many old philosophical, political, and ethical dilemmas that economics was supposed to finesse in favor of a more "scientific" account.

To say that individual preferences are not simply "given" and that people may be "wrong" about what they really want can mean two very different things. It may point to a *cognitive* difficulty: the researcher (and the subject himself) may have trouble finding out what the subject really wants because the subject's habitual behavior makes him incapable of properly assessing the consequences of his actions, or because there is some "noise" in the circumstances under which the question is posed. But in the other case, the researcher may be making a *normative* claim: there is no doubt about what the subject *in fact* wants, but the subject's preferences are still not considered *really* his because they are in another sense wrong—they are not "objectively" in the subject's best interest and the subject *should not* hold them.

In fact, we are dealing here with two different understandings of what it means for an individual to have a preference, or of the way in which a preference belongs to an individual. At one extreme, self-revelation—the subject's actual identification of a preference as his or her own—is an indispensable anchor of what is in the true interest of the subject. Without such an identification, an external observer may perhaps believe that something I don't recognize as such is nevertheless in my best interest (as defined in terms of some objective criteria). But this is still not enough to identify the relevant "objectively better" preferences as in any sense *mine* or—and this is crucial—to substitute the observer's desire to make me better off for the choice that I, wisely or not, have made myself.[4]

On this understanding, the subjective state of having a preference is definitional with respect to one's "true" interest, and indeed to one's very personal identity. In other

[4] It has been suggested by Cass Sunstein and Richard Thaler that individuals may be "nudged" toward a choice that policymakers are confident reflects better the agents' true interests than the alternatives the agents themselves may think they prefer. While there may be a cost to an agent who insists on his own choices and does not follow the policymakers' suggestions, the very fact that a "nudge" does not really force anyone to do anything—so that the agent's own choice is the ultimate criterion of his interest—is the reason Sunstein and Thaler believe that nudging is not illegitimate. See: Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions About Health, Wealth, And Happiness* (New Haven: Yale University Press, 2008).

words, all kinds of my likes and dislikes are at the core of who I am, even if others don't share them or if acting on them may be self-defeating. In this context, for an external observer to say that the subject is mistaken about what she really wants at most amounts to a prediction that, when confronted with more facts or helped to understand the source of her error, the subject herself will simply recognize that she was wrong in what she thought she wanted. On the other hand, if the subject resists such corrective attempts, the observer may come to believe that the subject is not wise, but the observer cannot deny that the subject's own choice is a *defining element* of what is in her interest. By analogy, I may believe that your preference for Warhol over Matisse is very foolish, but unless and until I *persuade* you that Matisse is a better artist, I cannot say that you are making a mistake about what you "really" like. Given how constitutive aesthetic preferences are with respect to our personal identity, what I am saying in the end is that I would prefer you to be a different person than you in fact are.

At the other extreme is an objectivist view of human identity that, outside of a narrow area of ethics, finds few open adherents today, but which used to be held by many people, including most communists and quite a few religious believers. According to this view, what is "good" for human beings is essentially a matter of objective knowledge, so a better-informed person (perhaps a wise leader) might know better than I do what my *true needs* are, and thus also what I really want. From the objectivist perspective, the opposite of a "true" preference is not a preference that is merely apparent, but one that is *normatively* "wrong." When I am wrong in this sense, the problem is not just with my self-knowledge; it goes to the very core of who I am. Indeed, if I do not change my mind about what I want, my actual preference will carry no authority because it does not correspond to what will make me live in accordance with my true nature and pursue my real needs and desires. To be sure, proper education (or indoctrination) may bring me to see the light, but the light is the light whether or not I see it, and—to paraphrase Jean-Jacques Rousseau[5]—the individual might in the end be *forced* to be "authentically" himself.

To be sure, there is an area of human choices in which many people still believe that the objectivist account is right: the domain of ethics or basic moral judgments. The choice to kill someone or betray a friend is not thought to be a matter of individual preference, but rather a violation of an objective imperative that every agent must obey. It is possible, of course, to say that a person violating these kinds of ethical rules has a "preference" to harm someone, and deserves punishment precisely because such preferences are a result of his choices and reflect his personal identity. But unlike in the case of most preferences considered by an economist committed to the concept of consumer sovereignty—which implies that each individual's preference counts in the same way as a preference of any other

[5] Jean-Jacques Rousseau, *The Social Contract*, book 1, chap. 7.

economic agent—a preference violating a moral principle does not carry any authority and is seen as conferring no legitimacy on its satisfaction.[6]

Moral rules may therefore be seen as fixed, general constraints, derived from the principles of reason or from a general theory of human nature, and not subject to individual differences. But a broad objectivist view that sees all (or even just most) human preferences as similarly constrained is clearly incompatible with recognizing a wide diversity of legitimate individual life plans, and thus with the commitment to individualism underlying the market economy (and probably the very idea of human freedom).

Perhaps in response to this objection, some thinkers have tried to marry the objectivist approach with the acknowledgement of individual choice by deploying the so-called "contractarian" approach. According to this approach, the best interest of an individual may still be seen as consisting in what the individual ultimately chooses for himself; the choice in question, however, is not *any* choice, but one that would be made under some sort of ideal conditions.

Now "ideal conditions" is an ambiguous and potentially theory-laden term. It may simply and uncontroversially mean that people's preferences have more authority when formed in the absence of undue pressure and with access to proper information. I am pretty sure this is what Woodford has in mind when he talks about "ideal conditions." True, Woodford does say that economists and policymakers can arrive at a guess of what an individual would choose under such conditions without being able to observe the actual choice of the preferences they are imputing to the subject. Nonetheless, the question remains always fundamentally empirical and, like all empirical hypotheses, subject to experimental falsification. At no point does Woodford ask what the subject *should* choose, but rather what she *will* choose under certain conditions designed to help her make a better decision *according to her own lights*. The observer's claim about a subject's true preference in such a case does not involve any *norm* by which the agent is bound, but is just a *prediction* of what the subject will in fact choose when some objectively determined obstacles to self-knowledge are eliminated.

The same is not necessarily true when someone like John Rawls asks what choices would be made in an "original position" under a "veil of ignorance," [7] or when Jürgen Habermas speaks of "ideal speech conditions." [8] Both of these philosophers are committed

[6] It is noteworthy, however, that some economic thinkers, especially law-and-economics theorists, do tend to reduce moral reasoning to standard cost-benefit analysis, and are thus ready to weigh the satisfaction of a criminal's preference against the harm to the victims. An often-cited example is Judge Posner's analysis of the criminalization of rape with the help of a comparison of the utility of a rapist with the disutilities of the rest of society. See Richard A. Posner, "An Economic Theory of the Criminal Law," *Columbia Law Review* 85, no. 6 (October 1985): 1193-1231.

[7] John Rawls, *A Theory of Justice* (Cambridge: Belknap Press of Harvard University Press, 1971).

[8] Jürgen Habermas, *The Theory of Communicative Action* (Boston: Beacon Press, 1984).

to a legitimization of social and economic arrangements by uncoerced choices of individuals, and both of their theories contain nuances that are difficult to summarize. Still, the insistence by both on the possibility of consensus with respect to a rather comprehensive model of human life suggests that the question of what would be chosen under ideal conditions may very well cease to be an empirical one and turn on an *a priori* reasoning, such as the one characteristic of mathematical or ethical propositions. The very idea of a "veil of ignorance" strips individuals of all qualities that distinguish them from one another and assumes that all rational beings are in most important respects the same. But then we are not dealing with any "contract," and nothing depends on what choices will in fact be made. In the end, it is a single self that decides everything on the basis of the rules of reason alone and, much as in the case of Immanuel Kant's categorical imperative, the metaphor of the "veil of ignorance" (or other "ideal conditions") in fact stands for the *a priori* character of the results. If you don't agree with the outcome, you are not making any real choice—you are simply not being rational, much as when you commit a logical or an arithmetical mistake.

This is exactly what makes the ideal-conditions device problematic: when so understood, it becomes incompatible with a robust theory of human freedom and individual choice. Apart from some basic moral decisions, human choices contain a genuine element of *contingency* and are not in fact subject to such overpowering constraints that they can be simply deduced from the concept of pure rationality. Indeed, it is this element of contingency that poses a true challenge for both an economic theory of preference formation and a more general theory of action underlying the economic account of human behavior. Whether human preferences are seen as an object of a strictly empirical or of an essentially normative inquiry, preferences are often assumed to be static: already there and subject to proper discovery. In fact, however, regardless of how good the economists' methods of error correction are in assessing human preferences, the job does not really end there because the very object of the study may be in a state of flux. As Shiller points out, human preferences are not really "given" at all, either in the sense of the subjects having a set of stable inclinations, or in the sense of there being a set of unequivocally right choices that, under certain conditions, rational individuals can be confidently expected to make. Indeed, even perfectly rational individuals—as long as they are human—may not at most points in time have a well-ordered set of preferences, because preferences are a central part of who we are, and who we are is always a *work in progress*.

So sometimes our preferences are unstable just because we are not perfectly rational and are making mistakes about what we want. But sometimes our preferences simply change because we discover something new or consider hitherto absent alternatives. This type of discovery is not the same as scientific discovery, in which we learn something that was there, true at all times and waiting to be discovered. The sense of discovery at issue here is of a kind involved in artistic creation: when Matisse painted his *Dance*, he was not uncovering something that had been there before (perhaps only in the form of a Platonic idea); he genuinely created something new that had not been there at all.

This process of creative self-discovery, which also shapes the evolution of our preferences, is most often a social rather than a solitary pursuit: it is an extended, indeed continuous, social conversation about what is good, desirable, valuable, beautiful, etc. And the medium of this conversation is what Shiller calls "narrative," i.e., a more or less integrated "story" that is supposed to make sense of some otherwise obscure aspects of social reality. Some of these narratives are better than others, and the weaker ones may lead us into error that distorts, more than enlightens, the reality around us. But while Shiller sometimes focuses on those kinds of misleading narratives in order to explain otherwise inexplicable stretches of economic history, at the root of our openness to these narratives is not just a proneness to error. The main significance of our susceptibility to the various narratives lies in their being part of that continuous conversation about what goals we should be pursuing, how we should live, what we should like or dislike, etc. Our whole culture is very much composed of such debates, and a basic feature of them, in a liberal society above all, is that they concern not just who we *are*, but who we *want to be*, what gives our life meaning, and where we are going. And all this is also reflected in what we pursue and the choices we make as economic agents and consumers.

Which brings us back to Luther. The community, for Luther, is not an intermediary between our finitude and divine perfection. It cannot mediate between us and God and does not help us obtain salvation because salvation is an inherently individual matter. But then Luther is also very skeptical about our individual ability to save ourselves. Salvation could be "deserved" only by one's living a morally perfect life, following the absolutely unbending, objective commands of Divine Will—something that we, given our weakness, cannot possibly accomplish. So if Logos (for God is also infinitely rational) and Divine morality is all there is, we are completely dependent on God's mercy, and our earthly lives are essentially empty. But aside from the properly theological aspect of Lutheranism (that we can only be saved by faith and Divine Grace), there are also the extremely interesting and modern practical consequences of Luther's postulate of the inefficacy of both communal and individual searches for righteousness and rationality. For the fact that our "works" cannot save us does not change the fact that we need to—indeed must—live and act, and in this secular sphere of our lives, the community is very important. Our actions may be inherently flawed and imperfect, but we cannot just do nothing either. Somewhere between nothingness and eternity is our very own life that we have to live, and we can only do it by our own lights. The big principles that are "given" to us (the Ten Commandments) provide only the most basic framework of the game we are playing—they don't determine how to play it and we don't play it alone. How to fill our earthly existence depends on what we make of ourselves, both as a community and as autonomous individuals.

The challenge to economists like Shiller, who do not want to assume that preferences are just "given" and that their formation is *pre-economic*, is thus to integrate into economics a more general social theory accounting for how we change and what we learn as we go. In this sense, an economic theory of preference formation, as well as the role various narratives play in it, is not just a theory of economic agents' errors and their correction—it is a theory capable of coming to terms with the meaning of the continuous creative cultural process that contains genuine change and innovation. Edmund Phelps is perhaps the foremost economist to have stressed the importance of innovation not just for economic growth, but perhaps above all for human flourishing and our own life-satisfaction. So to study human creativity inherent in economic change, we may need to expand our ideas of what economic theory looks like. Should we think of economics as containing aesthetic, historical, and moral dimensions? Perhaps a true economic theory of human behavior also contains a whole liberal theory of "good life," with its constant choice, innovation, and self-creation?