CHAPTER 5

Dramatis Personae

WHO ARE THE ECONOMIC ACTORS?

> ‘There is no such thing as society. There are individual men and women, and there are families.’
> MARGARET THATCHER
>
> ‘The corporations don’t have to lobby the government any more. They are the government.’
> JIM HIGHTOWER

Individuals as Heroes and Heroines

The individualist vision of the economy

The dominant Neoclassical view is that economics is the ‘science of choice’, as we saw in Chapter 1. According to this position, choices are made by individuals, who are assumed to be selfish, only interested in maximizing their own welfare – or at most that of their family members. In doing so, all individuals are seen to make rational choices, namely, they choose the most cost-efficient way to achieve a given goal.

As a consumer, each individual has a self-generated **preference system** that specifies what she likes. Using the preference system and looking at market prices of different things, she chooses a combination of goods and services that maximize her utility. When aggregated through the market mechanism, the choices made by individual consumers tell the producers what the demands are for their products at different prices (the **demand curve**). The quantity that the producers are willing to supply at each price (the **supply curve**) is determined by their own rational choices, made with a view to maximizing their profits. In making these choices, producers consider costs of production, given by technologies specifying different possible combinations of inputs, and the prices of those inputs. The market **equilibrium** is attained where the demand curve and the supply curve meet.

This is a story of the economy with individuals as the heroes and the heroines. Sometimes the consumers may be called ‘households’ and the producers ‘firms’, but they are essentially extensions of individuals. They are seen as making choices as single, coherent units. Some Neoclassical economists, following the pioneering work by Gary Becker, talk of ‘intra-household bargaining’, but this is conceptualized as a process between rational individuals ultimately seeking to maximize their personal utilities, rather than that between real-life family members, with their love, loathing, empathy, cruelty and commitments.

The appeal of the individualist vision of the economy and its limits

Even though this individualist vision is not the only way to theorize our economy (see Chapter 4), it has become the dominant one since the 1980s. One reason is that it has powerful political and moral appeals.

It is, above all, a parable of individual *freedom*. Individuals can get what they want, so long as they are willing to pay the right price for it, whether those are ‘ethical’ products (like organic food or fair trade coffee) or toys that children will forget by the following Christmas (I recall the Cabbage Patch Kids fever of 1983 and the Furby craze of 1998). Individuals can produce whatever will make money for them, using any method of production that maximizes profit, whether footballs made by child workers or microchips made with hi-tech machinery. There is no higher authority – king, pope or the planning minister – to tell

individuals what they should want and produce. On this basis, many free-market economists have argued that there is an inseparable link between the freedom of individual consumers to choose and their broader political freedom. Friedrich von Hayek's seminal critique of socialism, *The Road to Serfdom*, and Milton Friedman's passionate advocacy of the free-market system, *Free to Choose*, are famous examples.

Moreover, the individualist view provides a paradoxical but very powerful *moral* justification of the market mechanism. We as individuals all make choices only for ourselves, the story goes, but the result is the maximization of social welfare. We don't need individuals to be 'good' to run an efficient economy that benefits all its participants. Or, rather, it is exactly because individuals are *not* 'good' and behave as ruthless maximizers of utility and of profit that our economy is efficient, benefiting everyone. Adam Smith's famous passage is the classic statement of this position: 'It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.'

Appealing though they may appear, these justifications have serious problems. As for the political one, there is no clear relationship between a country's economic freedom and its political freedom. A lot of dictatorships have had very free-market policies, while a lot of democracies, such as the Scandinavian countries, have low economic freedom due to high taxes and plenty of regulations. In fact, many believers in the individualist view would rather sacrifice political freedom to defend economic freedom (this was why Hayek praised the Pinochet dictatorship in Chile). In the case of the moral justification, I have already discussed many theories, including the market failure approach based on the individualist Neoclassical vision, showing that unrestrained pursuit of self-interests through markets often fails to produce socially desirable economic outcomes.

Given that these limitations were well known even before its ascendancy, the current dominance of the individualist vision has to be at least partly explained by the politics of ideas. The individualist view gets so much more support and approval over alternative visions (especially the class-based ones like the Marxist or the Keynesian ones) from those who have power and money and therefore more influence. It gets such support because it takes the underlying social structure, such as property ownership or worker rights, as given, not questioning the status quo.*

Organizations as the Real Heroes: The Reality of Economic Decision-making

Some economists, most notably Herbert Simon and John Kenneth Galbraith, have looked at the reality, rather than the ideal, of economic decision-making. They found the individualistic vision to have been obsolete at least since the late nineteenth century. Since then, most important economic actions in our economies have been undertaken not by individuals but by large organizations with complex internal decision-making structures – corporations, governments, trade unions and increasingly even international organizations.

Corporations, not individuals, are the most important economic decision-makers

The most important producers today are large corporations, employing hundreds of thousands, or even millions, of workers in dozens of countries. The 200 largest corporations between themselves produce around 10 per cent of the world's output. It is estimated that 30–50 per cent of international trade in manufactured goods is actually **intra-firm trade**, or transfer of inputs and outputs within the same **multinational corporation** (MNC) or **transnational corporation** (TNC), with operations in multiple

countries.[1] The Toyota engine factory in Chonburi, Thailand, ‘selling’ its outputs to Toyota assembly factories in Japan or Pakistan may be counted as Thailand’s export to the latter countries, but these are *not* genuine market transactions. The prices of the products thus traded are dictated by the headquarters in Japan, not by competitive forces of the market.

Corporate decisions are not made like individual decisions

Legally speaking, we may be able to trace the decisions made by these large corporations to particular individuals, such as the CEO (chief executive officer) or the chairman of the board of directors. But those individuals, however powerful they may be, do not make decisions for their companies in the way in which individuals make decisions for themselves. How are corporate decisions made?

At the root of corporate decisions lie shareholders. Typically we say that shareholders ‘own’ corporations. Even though it would do as a shorthand description, it is, strictly speaking, not true. Shareholders own shares (or stocks), which give them certain rights concerning the management of the company. They do not own the company in the sense that I own my computer or my chopsticks. This point would become clearer if I explained that there are actually two types of shares – ‘preferred’ and ‘ordinary’ (or ‘common’).

Preferred shares give their holders priority in the payment of **dividends**, namely, profits distributed to shareholders, rather than ‘retained’ by the corporation. But that priority is bought at the cost of the right to vote for key decisions concerning the company – such as who to appoint as the top managers, how much to pay them and whether to merge with, take over or be taken over by another company. The shares that come with the right to vote on those things are called **ordinary shares**. The ‘ordinary’ shareholders (who are anything but ordinary in terms of decision-making power) make collective decisions through votes. These votes are usually according to the one-share-one-vote rule, but in some countries some shares have more votes than others; in Sweden, some shares could have up to 1,000 votes each.

Who are the shareholders?

These days, few very large companies are majority-owned by a single shareholder, like the capitalists of old. The Porsche-Piech family, which owns just over 50 per cent of the Porsche-Volkswagen group, is a notable exception.

There are still a considerable number of giant companies that have a **dominant shareholder**, who owns sufficient shares that he/she/it can usually determine the company’s future. Such a shareholder is described as owning a **controlling stake**, usually defined as anything upwards of 20 per cent of the voting shares.

Mark Zuckerberg, who owns 28 per cent of Facebook, is a dominant shareholder. The Wallenberg family of Sweden is the dominant shareholder in Saab (40 per cent), Electrolux (30 per cent) and Ericsson (20 per cent).

Most large companies don’t have one controlling shareholder. Their (share) ownership is so dispersed that no single shareholder has effective control. For example, as of March 2012, Japan Trustee Services Bank, the biggest shareholder of Toyota Motor Corporation, owned only just over 10 per cent of Toyota’s shares. The next two biggest shareholders owned around 6 per cent each. Even acting in unison, these three together do not have one-quarter of the votes.

The separation of ownership and control

Dispersed ownership means that professional managers have effective control over most of the world's largest companies, despite not owning any significant stake in them – a situation known as the **separation of ownership and control**. This creates a **principal-agent problem**, in which the agents (professional managers) may pursue business practices that promote their own interests rather than those of their principals (shareholders). That is, professional managers may maximize sales rather than profit or may inflate the corporate bureaucracy, as their prestige is positively related to the size of the company they manage (usually measured by sales) and the size of their entourage. This was the kind of practice Gordon Gekko (you've met him in Chapter 3) was attacking in *Wall Street*, when he pointed out the company that he was trying to take over had no less than thirty-three vice presidents, doing God knows what.

Many pro-market economists, especially Michael Jensen and Eugene Fama, the 2013 Nobel Economics Prize winner, have suggested that this principal-agent problem can be reduced, if not eliminated, by aligning the interests of the managers more closely to those of the shareholders. They suggested two main approaches. One is making corporate takeover easier (so more Gordon Gekkos, please), so that managers who do not satisfy the shareholders can be easily replaced. The second is paying large parts of managerial salaries in the form of their own companies' stocks (**stock option**), so that they are made to look at things more from the shareholder's point of view. The idea was summarized in the term **shareholder value maximization**, coined in 1981 by Jack Welch, the then new CEO and chairman of General Electric, and has since ruled the corporate sector first in the Anglo-American world and increasingly in the rest of the world.

Workers and governments also influence corporate decisions

Though it is not common in the US and Britain, workers and the government also exercise significant influences on corporate decision-making.

In addition to trade union activities (which we'll explore below), workers in some European countries, such as Germany and Sweden, influence what their companies do through formal representation on company boards. In particular in Germany, large companies have a two-tier board structure. Under this system, known as the **co-determination system**, the 'managerial board' (like the board of directors in other countries) has to get the most important decisions, such as merger and plant closure, approved by the 'supervisor board', in which worker representatives have half the votes, even though the managerial side appoints the chairman, who has the casting vote.

Governments are also involved in managerial decisions in large corporations as shareholders. Government ownership of shares in private-sector companies is much more widespread than people think. Stora Enso, the world's largest paper and pulp manufacturer, is 25 per cent owned by the Finnish government. Commerzbank, the second-biggest bank in Germany, is also 25 per cent owned by the German government. The list can go on.

Workers and governments have different goals from those of shareholders and professional managers. Workers want to minimize job losses, increase job security and improve working conditions. The government has to consider the interests of groups that go beyond the legal boundary of the company in question – for example, supplier firms, local communities or even environmental campaign groups. As a result, companies with strong worker and government involvement in management behave differently from companies dominated by shareholders and professional managers.

Volkswagen and the complexity of modern corporate decision-making

Volkswagen, the German car-maker, showcases the complexity of modern corporate decision-making. It has a majority owner, the Porsche-Piech family. Legally speaking, that family can bulldoze through any decision it takes. But that is not how things are done in Volkswagen. Like other large German companies, it has the two-tier board system, where workers have strong representation. Also, the company is 20 per cent owned by the government – or more precisely the state (Land) government of Lower-Saxony (Niedersachsen). As a result, decisions in Volkswagen are reached through very complicated processes of bargaining, involving shareholders, professional managers, workers and the population in general (through government ownership).

Volkswagen is an extreme example, but it powerfully illustrates how corporate decisions are made in a very different way from individual ones. We simply cannot understand the modern economy without having at least some understanding of the complexity involved in corporate decisions.

The cooperative as an alternative form of enterprise ownership and management

Some large companies are **cooperatives** owned by their users (consumers or savers), employees or independent smaller business units.

A **consumer cooperative**, the supermarket chain Coop, is the second-largest retailer in Switzerland. Its UK counterpart, Co-op, is the country's fifth-biggest supermarket chain. Consumer cooperatives allow consumers to get better prices by pooling their purchasing powers and negotiating for discounts from suppliers. Of course, getting discounts from suppliers by pooling consumers is exactly what many retailers, from Walmart to Groupon, do. But the difference is that, other things being equal, cooperatives can pass on more discounts to consumers, as they do not have shareholders to pay.

The **credit union** is a cooperative of savers. Nearly 200 million people around the world are members of credit unions. Some of the world's biggest banks, such as the Netherlands' Rabobank and France's Credit Agricole, are actually credit unions. Both of them started as savings cooperatives of farmers.

There are two types of **producer cooperatives**: worker cooperatives, owned by their own employees, and producer cooperatives, owned by independent producers that agree to do certain things together by pooling their resources.

Mondragon Co-operative Corporation (MCC) of Spain has nearly 70,000 employee-partners working in over 100 cooperatives and annual sales revenue of around $19 billion (as of 2010).[2] It is the seventh-biggest company in Spain, both by sales and employment. It is also the largest cooperative in the world. Another famous worker cooperative is John Lewis Partnership of Britain, the owner of John Lewis department stores and Waitrose supermarkets (the UK's sixth-biggest supermarket chain). It is of similar size to that of Mondragon – over 80,000 partners and a turnover of around $14 billion (as of 2011).

The most common examples of cooperatives of independent producers selectively working together are dairy farmers' cooperatives, in which farmers own their cows but together process and sell the milk and milk products (butter, cheese, etc.). Arla (the Swedish-Danish dairy cooperative that produces Lurpak butter and Lactofree milk), Land O'Lake (the Minnesota-based American dairy farmer cooperative) and Amul (the cooperative of Indian dairy farmers) are the most famous examples.

One-person-one-vote: rules of cooperative decision-making

Being membership organizations, cooperatives make decisions based on the one-person-one-vote rule, rather than on the one-dollar(share)-one-vote rule of corporations. This results in decisions that are impossible to imagine in shareholder-owned corporations.

The Mondragon cooperative group is famous for having the wage rule in which the partner in charge of the top management position can be paid only three to nine times the minimum wage paid to a partner who does a front-line job, with the exact ratio being decided by votes among the partners of each cooperative. Compare this with the pay packages of top American managers, who get at least 300–400 times the *average* (not minimum) worker's wage.* Some cooperatives even rotate jobs, so that everyone has experiences in positions at different levels in the company.

Many workers do not make decisions as individuals any more

In modern economies, at least some workers do not make economic decisions as individuals any more. Many workers are organized into **trade unions**, or **labour unions**. Allowing workers to bargain as a group, rather than as individuals who may compete against each other, trade unions help workers extract higher wages and better working conditions from their employers.[3]

In some countries, trade unions are considered counter- productive, blocking the necessary changes in technologies and work organization. In others, they are seen as natural partners in any business. When Volvo, the Swedish vehicle manufacturer, bought the heavy construction equipment arm of Samsung in the aftermath of the 1997 Asian financial crisis, it is said to have asked the workers to set up a trade union (Samsung had – and still has – an infamous 'no-union' policy). The Swedish managers didn't know how to manage a company without a trade union to talk to!

Like cooperatives, trade unions are membership organizations, in which decisions are made according to the one-member-one-vote rule. These decisions by enterprise-level unions are usually aggregated by national-level unions, such as South Africa's COSATU (Congress of South African Trade Unions) and the UK's TUC (Trades Union Congress). In many countries, there is more than one national-level union, usually divided by political and/or religious allegiances. For example, South Korea has two national-level unions, while France has as many as five.

In some countries, enterprise unions are also organized into industry-level unions. The most famous of these are IG Metall (Industriegewerkschaft Metall), the German metal workers' union, and the UAW (United Auto Workers), the American auto-workers' union. In the case of IG Metall, its influence stretches over the metal-related industries (including the all-important automobile industry), because, as the most powerful union, what it does tends to set the trend for the other unions.

Some trade unions even play a part in national policy-making

In a number of European countries – Sweden, Finland, Norway, Iceland, Austria, Germany, Ireland and the Netherlands – trade unions are explicitly recognized as key partners in national-level decision-making. In those countries, they are involved in policy-making not just in 'obvious' areas like wages, working conditions and training, but also welfare policy, inflation control and industrial restructuring.

In some countries, such arrangements exist due to the fact that a very high proportion of workers are unionized. Around 70 per cent of workers in Iceland, Finland and Sweden belong to trade unions – the ratio is around 11 per cent in the US, to put it into perspective. However, the rate of unionization (known as 'union density') does not fully explain these arrangements. For example, more workers are unionized in Italy (around 35 per cent) or Britain (around 25 per cent) than in Germany and the Netherlands (both less than 20 per cent), but the Italian and the British unions have much weaker influence on national policy-making than do their German or Dutch equivalents. The political system (e.g., how strongly political parties are related to trade unions) and political culture (e.g., consensual or confrontational) matter too.

The government is the single most important economic actor

In all countries that are not in a virtual state of anarchy (the Democratic Republic of Congo and Somalia at the time of writing), the government is the single most important economic actor. We will discuss what it does in greater detail in Chapter 11, so let me just give you the big picture for now.

In most countries, the government is by far the single largest employer, employing anything up to 25 per cent of the national workforce in some cases.* Its expenditure is equivalent to anything between 10 and 55 per cent of national output, with the ratio generally higher in the richer countries than in the poorer ones. In many countries, the government owns and runs SOEs. These typically produce 10 per cent of national output, even though it could be over 15 per cent in countries like Singapore and Taiwan. The government also affects how other economic actors behave by creating, shutting down and regulating markets. Respective examples are the creation of the market for tradable permits for pollution, the abolition of slavery and various laws regarding working hours and conditions.

How the government makes its decisions: compromises, compromises (and lobbying)

The process of government decision-making is far more complicated than that in even the largest corporations with the most complex ownership structures. It is because it does far more things than a corporation does, while having to accommodate far more actors with much more diverse goals.

When making decisions, even one-party states cannot override minority interests in the way the majority can in corporate decisions. Except in the most extreme cases, such as Pol Pot's Cambodia, political factions exist, and the competition between them can be quite intense, as it is in today's China.

In democracies, the decision-making process is even more complex. In theory, the majority party can impose its will on the rest of society. This is sometimes done, but in many countries the parliamentary majority is made up of independent parties in coalition, so compromises have to be made all the time. Anyone who has watched the Danish dramas *The Killing* or *Borgen* would appreciate this point.

Even after the politicians have made broad decisions, detailed policies have to be drawn up and implemented by civil servants, or bureaucrats. These people have their own decision rules, which are hierarchical, like those found in corporations, rather than deliberative, as found in parliaments.

Politicians and bureaucrats are lobbied by all sorts of groups to adopt particular policies. There are single-cause campaign groups, focusing on particular issues, such as the environment. Trade unions also have direct influences on politicians in some countries. But corporations exert the greatest influences. In some countries, such as the US, with weak restrictions on corporate lobbying, corporate influences are enormous. Jim Hightower, the American political commentator, was certainly exaggerating, but not by much, when he said, 'The corporations don't have to lobby the government any more. They are the government.'

International organizations with money: the World Bank, the IMF and others

Some international organizations are important because – how shall I put it? – they have money. The World Bank and other 'regional' multilateral banks, predominantly owned by rich country governments, make loans to developing countries.* When they lend, they offer more favourable terms (lower interest rates, longer repayment periods) than do private-sector banks. The International Monetary Fund (IMF) makes large-scale loans on a short-term basis to countries in financial crises, which cannot borrow from the private market.

The World Bank, the IMF and other similar multilateral financial institutions demand the adoption of particular economic policies of their borrowing countries. Admittedly, all lenders attach conditions to their loans, but the World Bank and the IMF are particularly criticized for imposing conditions that the rich countries think are good, rather than those that would really help the borrowing countries. This happens because they are corporations with one-dollar-one-vote rule. The majority of their shares are owned by the rich countries, so they get to decide what to do. Most importantly, the US has de facto veto power in the Bank and the Fund, as the most important decisions in them require an 85 per cent majority, and the US happens to own 18 per cent of shares.

International organizations that set rules: the WTO and the BIS

Some international organizations have power because they set rules.[4] One example is the Bank for International Settlement (BIS), which sets international rules on financial regulations. But by far the most important of these rule-setting international organizations is the World Trade Organization (WTO).

The WTO sets rules on international economic interactions, including international trade, international investment and even the cross-border protection of intellectual property rights, such as patents and copyrights. It is, importantly, the only international organization that is based on the one-country-one-vote rule. Thus, in theory, the developing countries, which have the numerical advantage, should dictate how things are done there. In practice, unfortunately, votes are almost never taken. Rich countries use all kinds of informal influences (e.g., issuing thinly disguised threats to reduce foreign aid to non-compliant poor countries) to avoid voting.

Those that promote ideas: UN agencies and the ILO

Some international organizations influence our economic life because they lend legitimacy to certain ideas. Various United Nations (UN) organizations belong to this category.

The UNIDO (United Nations Industrial Development Organization), for example, promotes industrial development. The UNDP (United Nations Development Programme) promotes poverty reduction on a global scale, and the ILO (International Labour Organization)[5] worker rights.

These organizations promote their causes mainly by offering a forum for public discussion on issues in their respective areas and by providing some technical assistance to countries that wish to implement their ideas. Sometimes they may issue declarations and conventions, but subscription to them is voluntary, so they have very little power. For example, virtually none of the immigrant-receiving nations have signed up to the ILO convention protecting migrant workers' rights (but then you cannot expect turkeys to vote for Christmas, as they say).

Not being backed by money and rule-setting power, the causes that these organizations promote are far less strongly promoted than the agenda of the IMF, the World Bank and the WTO.

Even Individuals Are Not What They Are Supposed to Be

Individualist economic theories misrepresent the reality of economic decision-making by downplaying, or even ignoring, the role of organizations. Worse, they are not even very good at understanding individuals.

The divided individual: individuals have 'multiple selves'

The individualist economists emphasize that the individual is the smallest irreducible social unit. It is obviously so in the physical sense. But philosophers, psychologists and even some economists have long

debated whether the individual can be seen as an entity that cannot be divided up further.

Individuals don't need to suffer multi-polar disorder to possess conflicting preferences within themselves. This **multiple-self** problem is widespread. Even though the term may be unfamiliar, it is something that most of us have experienced.

We often see the same person behaving completely differently under different circumstances. A man may be a very selfish person when it comes to sharing domestic work with his wife but in a war may be willing to sacrifice his life for his comrades. This happens because people have multiple roles in their lives – a husband and a foot soldier in the above example. They are expected to, and do, act differently in different roles.

Sometimes it is due to weakness of will – we decide to do something in the future but fail to do it when the time comes. This bothered the old Greek philosophers sufficiently that they even invented a word for it – *akrasia*. For example, we decide to lead a healthier lifestyle but then see our willpower crumble in front of a tempting dessert. Anticipating this, we may devise tricks to prevent our 'other self' from asserting itself later, like Ulysses asking to be tied to his ship's mast in order not to be seduced by the Sirens. You declare at the beginning of dinner that you are on a diet and won't be having a dessert to be prevented from ordering one later, for fear of losing face (and you can always have a few compensatory chocolate cookies when you go back home).

The embedded individual: individuals are formed by their societies

The multiple-self problem shows that individuals are not atoms because they can be broken down further. They are not atoms also because they are not clearly separable from other individuals.

Economists working in the individualist tradition do not ask where individual preferences come from. They treat them as the ultimate data, generated from within 'sovereign' individuals. The idea is best summarized in the maxim 'De gustibus non est disputandum' ('Taste is not a matter of dispute').

Yet our preferences are strongly formed by our social environment – family, neighbourhood, schooling, social class and so on. Coming from different backgrounds, you don't just consume different things but you get to *want* different things. This process of **socialization** means that we cannot really treat individuals as atoms separable from each other. Individuals are – if we use a fancy term – 'embedded' in their societies. If individuals are products of society, Margaret Thatcher was seriously wrong when she famously (or infamously) said, 'There is no such thing as society. There are individual men and women, and there are families.' There *cannot* be such a thing as an individual without society.

In a scene from the 1980s cult BBC sci-fi comedy *Red Dwarf*, Dave Lister, the protagonist of the show, who is a Liverpudlian working-class slob, guiltily confesses that he's been to a wine bar once, as if he had committed some kind of crime (but then some of his friends would have called him a 'class traitor' for that). Some young people from poorer classes in Britain, even after decades of government policy encouraging university education for them, still believe that 'unis' are simply not for them. In most societies, women have been conditioned into believing that 'hard' professions such as science, engineering, law and economics are not for them.

It is an enduring theme in literature and cinema – *My Fair Lady* (the movie version of George Bernard Shaw's play *Pygmalion*), Willy Russell's *Educating Rita* (play and movie) and Marcel Pagnol's *La Gloire de mon père* (book and movie) – how education, and the resulting exposure to different lifestyles,

will tear you away from your own people. You will want different things from what they want – and what you once wanted yourself.

Of course, people have free will and can – and do – make choices that go against what they are supposed to want and choose, given their backgrounds, as Rita did by choosing to do a university degree in *Educating Rita*. But our environment strongly influences who we are, what we want and what we choose to do. Individuals are products of their societies.

The impressionable individual: individuals are deliberately manipulated by others

Our preferences are not just shaped by our environment but often deliberately manipulated by others who want us to think and act in the ways they want. All aspects of human life – political propaganda, education, religious teachings, the mass media – involve such manipulation to one degree or another.

The most well-known instance is advertising. Some economists, following the works of George Stigler, a leading free-market economist of the 1960s and the 1970s, have argued that advertising is basically about providing information about the existence, prices and attributes of various products, rather than manipulation of preferences. However, most economists agree with John Kenneth Galbraith's seminal 1958 book *The Affluent Society* that much of advertising is about making potential consumers want the product more eagerly than they would otherwise do – or even want things that they never knew they needed.

Advertisements may associate a product with a celebrity, a sport team (which company logos does your favourite football or baseball team have on its uniform?) or with a fancy lifestyle. They may use memory triggers, which work on our subconscious. They may be aired at times when viewers are most susceptible (that's why you get TV advertisements for snacks around 9–10 p.m.). And not to forget product placements in movies, savagely satirized in the film *The Truman Show*: I still remember Mococoa, made with 'all natural cocoa beans from the upper slopes of Mount Nicaragua'.

Individual preferences are also manipulated at a more fundamental level through the propagation of free-market ideologies by those want constraints on their profit-seeking minimized (so we're back to the politics of ideas again). Corporations and rich individuals generously finance think tanks that produce pro-market ideas, such as the Heritage Foundation in the US and the Institute of Economic Affairs in the UK. They donate campaign funds to pro-market political parties and politicians. Some big companies use their advertising spending to favour business-friendly media.

Once poor people are persuaded that their poverty is their own fault, that whoever has made a lot of money must deserve it and that they too could become rich if they tried hard enough, life becomes easier for the rich. The poor, often against their own interests, begin to demand fewer redistributive taxes, less welfare spending, less regulation on business and fewer worker rights.

Individual preferences – not just of consumers but also of tax-payers, workers and voters – can be, and often are, deliberately manipulated. Individuals are not the 'sovereign' entities that they are portrayed as in individualist economic theories.

The complicated individual: individuals are not just selfish

Individualist economic theories assume that individuals are selfish. When combined with the assumption of rationality, the conclusion is that we should let individuals do as they please; they know what is best for themselves and how to achieve their goals.

Economists, philosophers, psychologists and other social scientists have for centuries questioned the assumption of self-seeking individuals. The literature is huge, and many points are quite obscure, even if they are theoretically important. Let's stick to the main points.

Self-seeking itself is too simplistically defined, with the implicit assumption that individuals are incapable of recognizing long-term, systemic consequences of their actions. Some European capitalists in the nineteenth century argued for a ban on child labour, despite the fact that such regulation would reduce their profits. They understood that continued exploitation of children without education would lower the quality of the workforce, harming all capitalists, including themselves, in the long run. In other words, people can, and do, pursue **enlightened self-interest**.

Sometimes we are just generous. People care about other people and act against their self-interest to help others. Many people give to charities, volunteer for charitable activities and help strangers in trouble. A fireman enters a burning house to save an old lady trapped inside and a passer-by jumps into rough sea to save drowning children, even knowing that they themselves may be killed in the process. The evidence is endless. Only those who are blinded by a belief in the model of the self-seeking individual would try to ignore it.[6]

Human beings are complicated. Yes, most people are self-seeking much of the time, but they are also moved by patriotism, class solidarity, altruism, sense of fairness (or justice), honesty, commitment to an ideology, sense of duty, vicariousness, friendship, love, pursuit of beauty, idle curiosity and much else besides. The very fact that there are so many different words describing human motives is testimony to the fact that we are complicated creatures.

The bumbling individual: individuals are not very rational

Individualist economic theories assume individuals to be rational – that is, they know all possible states of the world in the future, make complicated calculations about the likelihood of each of these states and exactly know their preferences over them, thereby choosing the best possible course of action on each and every decision occasion. Once again, the implication is that we should let people be, because 'they know what they are doing'.

The individualist economic model assumes the kind of rationality that no one possesses – Herbert Simon called it 'Olympian rationality' or 'hyper-rationality'. The standard defence is that it does not matter whether a theory's underlying assumptions are realistic or not, so long as the model predicts events accurately. This kind of defence rings hollow these days, when an economic theory assuming hyper-rationality, known as the Efficient Market Hypothesis (EMH), played a key role in the making of the 2008 global financial crisis by making policy-makers believe that financial markets needed no regulation.

The problem is, simply put, that human beings are not very rational – or that they possess only bounded rationality.* The list of non-rational behaviour is endless. We are too easily swayed by instincts and emotion in our decisions – wishful thinking, panic, herd instinct and what not. Our decisions are heavily affected by the 'framing' of the question when they shouldn't, in the sense that we may make different decisions about essentially the same problem, depending on the way it is presented. And we tend to over-react to new information and under-react to existing information; this is frequently observed in the financial market. We normally operate with an intuitive, heuristic (short-cut) system of thinking, which results in poor logical thinking. Above all, we are over-confident about our own rationality.

Concluding Remarks: Only Imperfect Individuals Can Make Real Choices

A paradoxical result of conceptualizing individuals as highly imperfect beings – with limited rationality, complex and conflicting motives, gullibility, social conditioning and even internal contradictions – is that it actually makes individuals count more, rather than less.

It is exactly because we admit that individuals are products of society that we can appreciate more the free will of those who make choices that go against social conventions, prevailing ideologies or their class backgrounds. When we accept that human rationality is limited, we get to appreciate more the initiatives exercised by entrepreneurs when they embark on an 'irrational' venture that everyone else thinks is going to fail (which, when successful, is called an innovation). In other words, only when we admit the imperfect nature of human beings can we talk about 'real' choices – not the empty choices that people are destined to make in the world of perfect individuals, in which they always know which is the best course of action.

Emphasizing the importance of 'real' choices is not to suggest that we can make any choice we like. Self-help books may tell you that you can do or become anything if you choose to. But the options that people can choose from (or their **choice sets**) are usually severely limited. This could be because of the meagreness of the resources they command; as Karl Marx dramatically put it, the workers of early capitalism had only the choice between working eighty hours a week in harsh conditions and starving to death, because they had no independent means to support themselves. The limited choice set may also be, as I argued above, because we have been taught to limit the range of what we want and what we think may be possible through the socialization process and deliberate manipulation of our preferences.

Like all great novels and movies, the real economic world is populated by complex and flawed characters, both individuals and organizations. Theorizing about them (or about anything), of course, has to involve some degrees of generalization and simplification, but the dominant economic theories go too far in simplifying things.

Only when we take into account the multi-faceted and limited nature of individuals while recognizing the importance of large organizations with complex structure and internal decision mechanisms will we be able to build theories that allow us to understand the complexity of choices in real-world economies.

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