

Special Issue Democracy and Financial Order—Legal Perspectives

Rational Choice and Its Limits

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Abstract

This Article asks the fundamental question of whether the concept of a market-oriented (economic) order can be reconciled with the idea of democracy from the perspective of rational choice approaches to the law. Europe has been facing great economic challenges for the past years—sovereign debt; fiscal and monetary policy; financial market regulation; trade and investment agreements. Some observers argue that prioritizing an economic rationale in the policy response to these challenges comes at the expense of democracy by undermining its most vital preconditions (such as equality and solidarity), while their antagonists state that in fact democratic decision-making is undermining financial stability and long-term welfare of societies.¹ This Article will establish that both positions contribute important insights and yet display too narrow a field of vision. Combining the arguments puts the cart before the horse: Democratic decision-making undermines, among other things, financial stability—and thus long-term welfare of societies—because it follows a logic that is primarily economic.

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¹ In some sense, this can be understood as a variant of the question whether a market economy is helpful (if not a precondition) for a democratic order; for a recent example of such an argument see Carl Christian von Weizsäcker, *Die normative Ko-Evolution von Marktwirtschaft und Demokratie*, 65 *ORDO* 13 (2014).

A. The Economic Paradigm²

When I say “economic logic” or “economic paradigm,” I am not using this vocabulary in the language of everyday life. Rather, I am using this terminology as a shortcut or code for Rational Choice Theory’s behavioral model of the *homo oeconomicus*. The core ideas of this model are that resources are scarce, people will behave as in order to maximize their individual utility—or, to use a criticized word, employing some sort of cost-benefit analysis—to foster their self-interest, and that incentives and restrictions are thus major levers for influencing behavior. If two or more people interact in such a way that one’s utility is dependent on both one’s own and another person’s action, then we talk about strategic interaction, and can analyze these situations with the tools of game theory. Markets can be understood to be a particular game theoretic setting, using competition to identify a price. Public Choice Theory, and more generally the study of political economy, extends the idea of actors behaving rationally—in the terms of Rational Choice Theory—to the political realm. This does not mean that Public Choice Theory assumes that politics is only about money; rather, it uses general insights on human behavior as a framework to study human behavior in a specific field, namely politics. Finally, Social Choice Theory reflects on aggregating individual preferences in such a way that the ultimate collective decision maximizes social welfare; its insights are important when construing the common weal or when analyzing democratic decision-making procedures.

In the first part of the following two Sections, this Article shows that a somewhat shrouded economic idea is at the heart of the prevailing doctrinal perspective on democracy, and that this allows for a remarkably powerful description and explanation of the political order. Many of the shortcomings of the political order, however, have severe implications on, among other things, financial stability, and thus on welfare.

At the heart of this Article lies an attempt to explain the limits of a rational choice driven perspective by drawing on behavioral insights: First, by looking at the risks of a descriptive behavioral theory, and second, by showing—in contrast—the expectations that rational choice theory can shape anyway. Finally, this Article will show the usefulness of this model to explain how competitive behavior influences morals and markets.

² See EMANUEL TOWFIGH & NIELS PETERSEN, ECONOMIC METHODS FOR LAWYERS 18–31 (2015).

B. An Economic Theory of Democracy³

I. *The Law of Democracy*⁴

The economic perspective on democracy is not new; it can be traced back to authors such as Schumpeter and Downs. Many observers will reject the claim that this view of democracy is dominant, however, and most lawyers will categorically deny that the prevailing legal doctrine is a manifestation of a rational choice approach to democracy. But if we have an unemotional look at the ideas underlying constitutional theory and democratic institutions, we can descriptively state that modern democratic thought is saturated with economic concepts: To construct a collective will, the political discourse aims at reflecting the interests of citizens, bundling them into platforms and programs. Competition is used as a mechanism to select among these the citizens best suited to fulfill the common weal. And decision-makers are chosen and controlled such that aggregation of the citizens' interests—necessary for the construction of both collective will and common weal—are secured, and the resulting policies are implemented. This constitutes the *leitmotif* of political orders on both shores of the Atlantic, namely in Germany and in the United States.⁵ If we boil the idea down to its essence, we can describe our political order as a system of interest aggregation through competition. There are several elements that can easily be connected to the economic model of democracy; rational choice—and, in the political context, public choice—studies precisely the ways to maximize one's utility and to further one's self-interest; competition—often dubbed “market”—is a central mechanism in economic thought, one of the few substantial concepts that the field is genuinely concerned with apart from method; and “aggregation”, which is the core interest of social choice theorists.

II. *Politics as Markets*⁶

Even though the connection of political practice and theory of democracy to economics seems pretty straightforward today, it took a while for it to be recognized in legal scholarship. In their seminal 1998 Stanford Law Review paper *Politics as Markets*, Samuel Issacharoff and Richard Pildes make this connection. Issacharoff once wittily remarked in a conversation that the idea went from being harshly criticized, to being commonplace in

³ See generally ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1957).

⁴ See generally SAMUEL ISSACHAROFF ET AL., THE LAW OF DEMOCRACY: LEGAL STRUCTURE OF THE POLITICAL PROCESS (4th ed. 2012).

⁵ EMANUEL V. TOWFIGH, DAS PARTEIEN-PARADOX: EIN BEITRAG ZUR BESTIMMUNG DES VERHÄLTNISS VON DEMOKRATIE UND PARTEIEN 55 ET SEQ. (2015).

⁶ See generally Samuel Issacharoff & Richard H. Pildes, *Politics as Markets: Partisan Lockups of the Democratic Process*, 50 STAN. L. REV. 643 (1998).

virtually no time, depriving its authors of any praise. The triumph of the description of democratic institutions in economic terms is probably due to its strikingly plausible explanation of the political everyday reality.

If the political discourse is the basis for furthering one's self-interest, then collective action is a major problem. Therefore, platforms are built; they reduce information costs and coordinate voters with like-minded interests. Political parties are the entrepreneurs on this market, offering ready-made bundles, mobilizing for elections, organizing majorities on the one side of the aisle and effectuating political control on the other side. Acting in competition through elections creates incentives for the professionalization of personnel, making politics a profession. Here too, political parties help candidates by serving as a commitment and signaling devices, so politicians can make credible offers, and they are a screening instrument in choosing political personnel to further their platform. Voters choose among the menus they are presented with by the platforms, and have been likened to consumers of policies.⁷

*III. Market Failures and Failures of Markets*⁸

But *Politics as Markets* was not so much a paper in praise of this system, but rather served as a contrast agent to render the shortcomings of the U.S. political system—which has since gone defunct—both visible and understandable. Indeed, the economic paradigm allows a better understanding of why democratic decision-making was apt to disappoint time and again. If everyone behaves rationally in terms of rational choice theory, then political entrepreneurs have incentives to disregard the interests of non-voters, for example the interests of future generations—a political myopia—of voters in other constituencies. This has especially become a problem in international contexts, specifically in the European Union. As there are no European parties, there are barely any incentives to see the big European picture, giving rise to scattered regionalism.

Ian Goldin and Tiffany Vogel argue that in the time preceding the financial crisis (2007–2009), the connection and intertwining between global forms of governance and their local counterparts were largely ignored. As a consequence, a “crisis limited to the local level transformed into a crisis of international magnitude, which is called ‘systemic.’”⁹

⁷ See Daniel R. Ortiz, *Duopoly Versus Autonomy: How the Two-Party System Harms the Major Parties*, 100 COLUM. L. REV. 753, 754 (2000) (“[W]e might well view voters in modern mass democracy more as political consumers than as political principals.”).

⁸ See generally Daryl J. Levinson, *Market Failures and Failures of Markets*, 85 VA. L. REV. 1745 (1999).

⁹ Ian Goldin & Tiffany Vogel, *Global Governance and Systemic Risk in the 21st Century: Lessons from the Financial Crisis*, 1 GLOBAL POL. 4, 11 (2010).

One of the basic messages Robert A. Axelrod gave in his seminal work about the agent-based models of the complexity of cooperation—which ties in to Goldin’s and Vogel’s observations smoothly—is that no level of political and regulatory control is “sufficient as an island of governance control.”¹⁰ Therefore, from his viewpoint, it is imperative that the global financial system is governed together at all levels, sizes, and sectors, and not independently from another in a vacuum.¹¹ In consequence, as projects taken by only a few countries are extremely likely to be inherently inefficient, as well as ineffective, many systemic risks—for example, the financial crisis, modern pandemics, bioterrorism risks, risks emerging from the internet, climate change—¹² will require international collaboration and coordination.¹³ In the light of an ever-increasing number of state and non-state actors, collective action problems will inevitably increase and contribute to systemic fragility, as they will bring with them a momentous multiplication of interests.¹⁴

Likewise, a focus on the cost-benefit calculus entices politicians to exploit the voters’ rational ignorance in favor of special interest group issues—such as by giving in to lobbying. In other words, politicians are motivated to design policies where few benefit hugely at the expense of many who are just below the threshold of having the resources to assemble the information necessary to unmask such policy. Germans may remember what has since been dubbed the *Mövenpick* law, a break on hotel room VAT, that was only uncovered by the press after its entry into force as a clandestine provision in the “Law to Accelerate Growth.” It is estimated that this led to a tax loss of 960 million Euros in the 2013 fiscal year alone.¹⁵ Such bargains, reinforced through logrolling, illustrate how an economic understanding of democracy and its procedures may endanger a society’s long-term (economic) welfare.

From another perspective, these phenomena have also been described as ‘intellectual hazard’, namely the tendency of behavioral biases to interfere with accurate thought and analysis within complex organizations.¹⁶ One commonly distinguishes different types of intellectual hazard, *inter alia* the so-called “incentive bias,” which leads to effects like the

¹⁰ *Id.*

¹¹ See generally ROBERT R. AXELROD, *THE COMPLEXITY OF COOPERATION: AGENT-BASED MODELS OF COMPETITION AND COLLABORATION* (1997).

¹² Goldin & Vogel, *supra* note 9, at 11.

¹³ See generally AXELROD, *supra* note 11.

¹⁴ Goldin & Vogel, *supra* note 9, at 12.

¹⁵ Beschluss [Resolution], Bundesrat Drucksachen [BR] 485/12 (Ger.).

¹⁶ Geoffrey P. Miller & Gerald Rosenfeld, *Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008*, 33 HARV. J. L. & PUB. POL’Y 807, 808 (2009).

infamous “cognitive dissonance.”¹⁷ Geoffrey P. Miller and Gerald Rosenfeld illustrate this phenomenon through the imagination of a person working in a complex institution who may stay under pressure or may be motivated to see things in a particular way. The actor’s problem is of such a nature that the information available to him suggests a type of interpretation which is contradictory to his own interests. This inconsistency creates cognitive dissonance—in consequence, he feels uncomfortable to see things in a way that might have the potential to threaten his interests. He will work to overcome his uncomfortable state by superseding concerns about possible contradictory or unfavorable competing effects.¹⁸

If we now think about the political scene and consider politicians to be in the position of such actors who are constantly confronted with the economic way of thinking as primary logic of today’s society, they might somehow unconsciously adopt this logic and apply it as a yardstick for their own operations. Consequently, this incentive bias may cause intellectual hazard, which has a tendency to threaten an accurate analysis. Incentive bias may also become manifest in self-serving behavior, which can be observed in real life in forms like the *Mövenpick* Law: In the case of self-serving behavior, the actor knows that there is causal connection between the facts but consciously decides to ignore them, distorting the analysis and suppressing information with the intention to promote the actor’s self-interests.¹⁹ Miller and Rosenfeld claim that this kind of intellectual hazard might be a major compounding factor in financial crises in general and especially in the crisis of 2008.²⁰

B. Guy Peters, Jon Pierre, and Tiina Randma-Liiv identify the “loss of memory and willingness” as that the “most glaring” factor for losing governance control during the period leading up to the crisis.²¹ This created a blind spot so that governments were not capable of seeing the real menace of economic failures coming from markets with insufficient supervision. They conclude that governance is destined to fail if the ideas being used to manage a society and an economy tend to dim, disguise, and falsify information rather than to supply accurate interpretation.²² These observations strongly support the theory of cognitive dissonance and incentive bias, as well as the viewpoint presented in this piece—that democratic decision-making may undermine financial stability precisely because its primary logic is economic.

¹⁷ See MICHAEL M. POMPIAN, BEHAVIORAL FINANCE AND WEALTH MANAGEMENT 83 (2012).

¹⁸ Miller & Rosenfeld, *supra* note 16, at 816.

¹⁹ *Id.* at 808.

²⁰ See generally *id.*

²¹ B. Guy Peters, Jon Pierre & Tiina Randma-Liiv, *Global Financial Crisis, Public Administration and Governance: Do New Problems Require New Solutions?*, 11 PUB. ORG. REV. 13, 14 (2011).

²² *Id.*

Therefore, in the aftermath of the financial crisis, Miller and Rosenfeld plead for technocratic governance reform:

Ideally, the leadership and staff would be individuals who are not directly affiliated with the institutions that breed intellectual hazard . . . [as this problem] will not be effectively addressed if the personnel in the agency charged with identifying systemic threats to financial stability are simply recycled regulators [who] . . . will not bring new ideas to the table. A preferable solution would be to establish . . . [a] truly independent board, composed largely of people from outside the government, selected according to some principle of merit rather than political connections, and adequately funded and protected against retaliation for expressing unpopular views²³

Another example can be seen in what political economists call the “opportunistic business cycle.” There is plausible evidence the administration in power tries to manipulate fundamental macro-economic data—for example, the unemployment or growth rates—through unsustainable short-term measures—especially through fiscal and monetary policies—to beef up their political legacy and to enhance the prospects of re-election.²⁴ As economic measures are typically extremely debatable, it is barely possible to make a certain case as to whether such a measure was an opportunistic flash in the pan or a sustainable policy innovation.

Moreover, rent-seeking political entrepreneurs have incentives to collude and to build cartels on political markets, just as corporations do on commercial markets. Through political parties, they circumvent some of the features regulating the political market. For example, these political entrepreneurs effectively shortcut the separation of powers by combining political patronage and coordination of personnel across the three branches of government. Finally, patronage leads to political representatives being dependent on their party, giving political parties the leverage to pursue their own class of interests, namely party interests.

²³ Miller & Rosenfeld, *supra* note 16, at 837–39.

²⁴ ANSGAR BELKE, POLITISCHE KONJUNKTURZYKLEN IN THEORIE UND EMPIRIE: EINE KRITISCHE ANALYSE DER ZEITREIHENDYNAMIK IN PARTISAN-ANSÄTZEN (1996); William D. Nordhaus, *The Political Business Cycle*, 42 REV. ECON. STUD. 169, 187–89 (1975).

The main point stressed by political scientist Mancur Olson in his seminal book “The Logic of Collective Action,”²⁵ is that smaller, agile, and versatile groups are likely to dominate bigger, more cumbersome groups in seeking to influence governance regulation and legislation. Olson predicts that those small and smart kinds of groups could outperform more immobile and inflexible citizen-based groups, which often grow hidden and are rather concealed. In consequence, groups representing shareholders’—or in fact citizens’—interests are likely to see themselves in a situation of great disadvantage in competing with financially powerful industry lobbies. Therefore, it is evident that in the pre-crisis period, mighty financial trade and financial associations were putting pressure on politics concerning regulation and supervision.

Clinging to the idea that democratic politics are best understood as market activities, the remedies suggested have remained in the realm of the economic toolbox. If competition on the political market leads to distortions, namely to market failure, it is then argued that we need better regulation of the political market. In analogy to the guardians of competition protecting commercial markets, many call for the courts—the Supreme Court in the U.S., the Federal Constitutional Court in Germany—to take on the role of the umpire of the political process.

Some, however, have raised doubts. Daryl Levinson has put them in a nutshell with his pun—“Market Failures and Failures of Markets”—,²⁶ asking whether we observe market failure—to be countered with market regulation—or whether the problem is more severe in the sense that actually the market as an instrument fails altogether in politics.

C. Is Public Choice Immoral?²⁷

James Buchanan and Geoffrey Brennan, two of the most illustrious proponents of public choice theory, have asked more pointedly whether, along the same lines, public choice may be immoral. While it seems far-fetched to consider a theory which merely claims to describe a reality as immoral, applying an economic rationale, one may come to the conclusion that the behavioral costs of an economic theory of democracy may outweigh its descriptive benefits.

The remainder of this Article briefly²⁸ follows up on three questions: (I) What are the risks connected to behavioral theory, even if it claims to be merely descriptive? (II) How do

²⁵ MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1971).

²⁶ Levinson, *supra* note 8, at 1745.

²⁷ See generally Geoffrey Brennan & James M. Buchanan, *Is Public Choice Immoral? The Case for the ‘Nobel’ Lie*, 74 VA. L. REV. 179 (1988).

²⁸ For a more extensive set of arguments, especially with view to the field of politics, see TOWFIGH, *supra* note 5, at 149–80 (2015).

expectations shaped by rational choice theory influence behavior? And (III) how does competitive behavior interfere with fiscal considerations in a democratic setup? The Article will argue that an institutional regime which, in following the commonplace “politics as markets idea,” constitutes democratic process as interest aggregation through competition, in fact lowers decision quality in terms of societal welfare, and therefore, in the context of this conference, undermines, as the conveners have put it, the financial stability of polities. The three arguments will be about the challenges of a descriptive behavioral theory, about rational expectations, and about competitive behavior.

I. Risks of a Descriptive Behavioral Theory

First, this Article explores the risks of economic theory. The reproach of economic theory exerting influence on human behavior is often rebuffed with the reflexive argument that economics, at least when discussing the law, is mostly descriptive and not normative. Rational choice theory aims at explaining behavior, maybe even at predicting it, but it is not meant to be prescriptive. Even if behavior that is in line with the theory is called rational—a word carrying a positive connotation in everyday language—it does not contain a valuation; its antonym is not irrational but non-rational. In this sense, a descriptive theory may provide an accurate description or an inaccurate one, may have predictive power or not, but it does not say anything about the way the world ought to be. But even descriptive theory is not as innocent as this response may wish to pretend. Geoffrey Brennan and James Buchanan raise the issue pointedly; they explain that colleagues experimenting with rats

must take into account how their own behavior might influence the behavior of the rats they study. But they need not worry at all about the influence of their research on the behavior of other rats. Other rats do not read or understand economists’ conversations about rats; the behavior of those other rats will remain totally unaffected by the reporting of the results of the experiments or by new analyses ‘explaining’ such results to economists.²⁹

But economists, other social scientists, and sometimes even lawyers and politicians, do read results of experiments. For them, when evaluating their choices, the question how the world is—and how people behave—may be at least as important as how the world should be; the question how the world is extensively studied by rational choice theorists. To the extent that their insights are appreciated by a wider audience, they become performative in the sense of shaping the understanding and the interpretation of concrete

²⁹ Brennan & Buchanan, *supra* note 27, at 182.

lifeworld situations and by creating expectations of how humans will behave in such situations. As most people in most situations do not align their behavior to invariant—say, moral—behavioral rules but rather condition their own actions on the behavior of others—conditional cooperators—³⁰ the expectation of how others will behave is of eminent importance. A descriptive behavioral theory such as public choice—fuelling expectations of other behaving as *homines oeconomici* and explaining what constitutes a rational reaction to such behavior—will thus develop into a self-fulfilling prophecy. For conditional cooperators, such theory may even become an *ex ante* justification for egoistic behavior; you maximize your own utility because if everyone else behaves that way and you do not, you will perish (“sucker aversion”). This may even hold for well-wishing altruistic actors because vanishing in competition renders achieving altruistic goals impossible altogether, while submitting to some degree of egoism may secure chances of reaching them. Thus, there may be behavioral contagion effects.

II. Rational Expectations

But even if nobody reads economic scholarship, a rational choice perspective of democracy may shape expectations. Two behavioral effects are particularly noteworthy, namely framing and crowding out.

1. Framing: “The Name of the Game”³¹

Varda Liberman and colleagues have conducted experiments in which two subjects repeatedly played a prisoner’s dilemma game. In every round, each player could choose to cooperate or to defect—without the options being labeled that way. If both cooperated, they each earned 40 cents; if both defected, they did not earn anything. If one cooperated while the other defected, the cooperator had to pay 20 cents to the experimenter, while the defector earned 80 cents. The payoff matrix looks like this:

³⁰ Simon Gächter, *Conditional Cooperation: Behavioral Regularities from the Lab and the Field and Their Policy Implications*, in *ECONOMICS AND PSYCHOLOGY: A PROMISING NEW CROSS-DISCIPLINARY FIELD* 19, 30–33 (Bruno S. Frey & Alois Stutzer eds., 2007); Urs Fischbacher et al., *Are People Conditionally Cooperative? Evidence from a Public Goods Experiment*, 71 *ECON. LETTERS* 397 (2001); Bruno S. Frey & Stephan Meier, *Social Comparisons and Pro-Social Behavior: Testing “Conditional Cooperation” in a Field Experiment*, 94 *AM. ECON. REV.* 1717, 1720 (2004); Claudia Keser & Frans van Winden, *Conditional Cooperation and Voluntary Contributions to Public Goods*, 102 *SCANDINAVIAN J. OF ECON.* 23, 23–24 (2000); cf. Ernst Fehr & Urs Fischbacher, *The Nature of Human Altruism*, 425 *NATURE* 785, 788 (2003).

³¹ See generally Varda Liberman et al., *The Name of the Game: Predictive Power of Reputations versus Situational Labels in Determining Prisoner’s Dilemma Game Moves*, 30 *PERSONALITY & SOC. PSYCHOL. BULL.* 1175 (2004).

PRISONER'S DILEMMA

		Moves Player 2	
		Cooperate	Defect
Moves Player 1	Cooperate	Player 1: +40 cents Player 2: +40 cents	Player 1: -20 cents Player 2: +80 cents
	Defect	Player 1: +80 cents Player 2: -20 cents	Player 1: 0 cents Player 2: 0 cents

Game theory explains that rational actors should defect, and thus predicts that they will end on the individually and collectively worst situation. The twist of Liberman's experiment was that the game was presented as "Wall Street Game" to one group of subjects, and as "Community Game" to the other group; there were no other differences. To sum up the results, in the Wall Street Game, approximately one third of subjects cooperated, while two thirds cooperated in the Community Game. Bilateral cooperation was observed in half the cases in the Community Game, while the rational equilibrium—the option where both players defect—was only observed in 19 percent of games. The opposite was true for the Wall Street Game. In this iteration of the game, half the players played the rational equilibrium, coming away empty-handed and bilateral cooperation was only observed in 13 percent of cases. While subjects were presented with the same substantial decision, the presentation of the task—and expectations regarding their fellow players' behavior—made all the difference.

In politics, the situation may even be exacerbated, as real-life situations are more equivocal and thus more difficult to interpret. According to an economically informed interpretation, a superior may not be friendly to her employees because she has come to appreciate them, but rather because she is cold and calculating and expects a greater personal benefit from being friendly. The employees' reactions to her friendliness may well depend on the interpretation of her motives.

2. Crowding-Out: "A Fine is a Price"³²

There are additional results of experiments that point in the same direction, showing that the economization of a decision context may lead to encourage egoistic behavior, and to "crowd out" altruistic behavior. In a controlled twenty week field-experiment, Uri Gneezy and Aldo Rustichini studied the behavior of parents when picking up their children from kindergarten in ten Israeli kindergartens. In the first four weeks, they merely observed how

³² See generally Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1 (2000).

many parents picked up their children ten or more minutes late. At the beginning of the fifth week, six of the ten kindergartens introduced a fine of 10 NIS (approximately 3 U.S. dollars) for each child that was picked up ten minutes or more late. At the beginning of the seventeenth week, the fine was abolished without further explanation. The effect of the introduction of the fine was dramatic. Within a short time-span, the number of children who were picked up late nearly doubled. Interestingly, this effect was not reversed—at least not promptly—when the fine was rescinded.

The authors offer two possible explanations; the second, more widely appreciated one, is the focus here. It is based on the idea of social norms that are somewhat orthogonal to rational choice ideas. According to this explanation, before the introduction of the fine, there is a tacit understanding that the contract provides for the kindergarten to take care of the children until pickup time. After that time, it is a sign of generosity of the personnel to continue oversee the children; to overstrain this generosity would contravene social norms. With the introduction of the fine, the understanding of the situation changes: The payment becomes a price for the delayed pickup, and the overtime supervision becomes a tradable commodity. In such a situation, aligning one's behavior to one's best interest is not condemnable. The social norms are thus summed up as being:

Parents feel justified in their behavior by a social norm that states, approximately: "When help is offered for no compensation in a moment of need, accept it with restraint. When a service is offered for a price, buy as much as you find convenient." . . . Perhaps a third social norm is needed: "Once a commodity, always a commodity."³³

Similar effects have been shown empirically for the siting of permanent repositories for nuclear waste³⁴ and for blood donations.³⁵ And there are studies that show that such effects may also work in the opposite direction, for example (and overly simplified for the

³³ Gneezy & Rustichini, *supra* note 32, at 14.

³⁴ Bruno S. Frey & Felix Oberholzer-Gee, *Fair Siting Procedures: An Empirical Analysis of Their Importance and Characteristics*, 15 J. POL'Y ANALYSIS & MGMT 353, 359 (1996).

³⁵ See RICHARD MORRIS TITMUS, *THE GIFT RELATIONSHIP FROM HUMAN BLOOD TO SOCIAL POLICY* (1997); Carl Mellström & Magnus Johannesson, *Crowding Out in Blood Donation: Was Titmuss right?*, 6 J. EUR. ECON. ASS'N 845, 852–57 (2008); see also Christoph Engel, *Verhaltenswissenschaftliche Analyse: eine Gebrauchsanweisung für Juristen*, in RECHT UND VERHALTEN 363, 385 (Christoph Engel et al. eds., 2007). See generally Elinor Ostrom, *Collective Action and the Evolution of Social Norms*, 14 J. ECON. PERSP. 137 (2000).

purpose of brevity), being reminded of the Ten Commandments may make you more honest.³⁶

All in all, these empirical findings show how important the decision context is beyond incentives and restrictions, and how sensitive people react to the specific setting a decision task or problem is embedded in.

III. Competitive Behavior

Competition is a specific form of following self-interest in a special situation. We should not be surprised to see the described behavioral effects extend to this domain. But as experimental and econometrical studies show, markets and competition create even more far-reaching behavioral effects.

1. Decisions-Making in Markets: "Morals and Markets"³⁷

In an experimental study which has received broad academic and public attention, Armin Falk and Nora Szech were able to show that individual decisions taken in a competitive environment, modeled to resemble markets, were less moral in the sense that the market environment increases the disposition to impose substantial negative consequences of one's own behavior on a noninvolved third party. To study behavior in such situations, the experimenters confronted subjects with a drastic and irreversible decision; the participants of the study had to decide whether they wanted to receive a certain sum of money or instead save a young and healthy mouse's life by forgoing the money which would then be spent on providing end-of-life care to the mouse.³⁸ In the individual-decision treatment, each subject had the choice to earn €10 or to save a mouse's life. In a bilateral treatment, a buyer and seller would negotiate how large a share of €20 each would get; if they executed the contract, each received their respective sum and the mouse lost its life. Buyer and seller had a veto position, however, and could reject conclusion of a contract altogether, thus saving the mouse's life. In rational choice terms, the two described situations—unilateral decision and bilateral decision by seller—were equivalent. Finally, there was a

³⁶ Nina Mazar et al., *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MKTG. RES. 633, 635 (2008).

³⁷ See Armin Falk & Nora Szech, *Morals and Markets*, 340 Sci. 707 (2013); see also Christoph Luetge & Hannes Rusch, *The Systematic Place of Morals in Markets*, 341 Sci. 714 (2013) (criticizing Falk and Szech's conclusions drawn from the mice experiment); Armin Falk & Nora Szech, *Response*, 341 Sci. 714 (2013) (responding to Luetge and Rusch's criticisms).

³⁸ The subjects did not know the mice were surplus mice from other laboratory experiments and therefore moribund, and that the experiment was not so much about active killing, but rather about extending the lifespan or saving the mice's lives. In the post-experimental de-briefing, the subjects were informed about this fact. See Falk & Szech, *supra* note 37, at 707.

multi-lateral decision situation in which nine sellers and seven buyers negotiated prices with each seller having one mouse at her or his disposal.³⁹

In the independent, unilateral situation, 45.9 percent of subjects would agree to let a mouse die for €10, but in the bilateral situation 72.2 percent of subjects and in the multilateral situation 75.9 percent of subjects were willing to give away a mouse's life for €10 or less. The experimenters tried to assess how much money they had to pay in the unilateral situation to reach the figures observed in the bilateral and multilateral situation; €47.50 helped reach 72 percent, but they stopped at €50 per mouse before having reach the three-quarters threshold.

The experiment itself does not teach us much about the mechanism that drives this robust, non-rational behavior, but the authors offer three plausible explanations. First, in a plurilateral situation, at least two parties need to agree, so there might be a diffusion of responsibility and a reduced feeling of guilt. Second, the interaction with others reveals information about prevalent social norms. This may shape and change the expectation regarding behavior of other actors; if you observe others breaking ethical standards, then such behavior may seem admissible and thus motivate you to behave the same way. Third, markets may focus your attention on material aspects—such as negotiation and competition—reducing the attention that is directed at the negative consequences of one's own action. Moreover, in the multilateral situation, the logic of substitutability may rule; "if I don't sell the mouse, someone else will," and one will (silently) mumble "and I will go out empty-handed; this way, at least I earn some money."

Of course, this study only gives us hints regarding distortions in market-like competitive environments. It does, however, support an often-voiced intuition. It does tell us something about the difference between decisions made in solitude and isolation, if you will, and decisions taken in market-like group environments. This does not preclude the market to still be a better mechanism than many other environments. Critics of the study have correctly argued that the overall cooperation levels in centrally planned economies are typically substantially lower than in market economies.⁴⁰ What we do see is that individual responsibility leads to a lower focus on one's own utility.

³⁹ A number of additional treatments were run to ensure robustness of the observations. See Falk & Szech, *supra* note 37, at 709–10.

⁴⁰ See generally Jeannette Brosig-Koch et al., *Still Different After All These Years: Solidarity Behavior in East and West Germany*, 95 J. PUB. ECON. 1373 (2011); Axel Ockenfels & Joachim Weimann, *Types and Patterns: an Experimental East-West-German Comparison of Cooperation and Solidarity*, 71 J. PUB. ECON. 275 (1999).

2. *Evolution in Markets: "Does Studying Economics Inhibit Cooperation?"*⁴¹

Finally, markets can have an impact on the evolution of values and tastes.⁴² Two effects play an important role here, namely selection and adaptation, and they are difficult to disentangle at times. A number of behavioral experiments⁴³ have shown that students of economics display less pro-social and more egoistic behavior when compared to students of other disciplines. Basically, these studies revealed that this effect was present when the students took up their studies, and also that it aggravated over time. This supports the conclusion that there is both a selection and an adaptation effect; typically, people who follow their self-interest more strictly tend to choose economics as a field, and studying economics also seems to amplify the focus on one's individual utility. Such effects show, once more, that a descriptive behavioral theory may have substantial effects on real behavior.

D. Conclusion

Now, what do we make of this? Do not misunderstand—there is nothing wrong with indulging in self-interested behavior—at least at times—and there is certainly nothing wrong with competition. But the question is which instruments and models lead to the best results. For the exchange of goods, we seem to have figured out, in theory and empirically, that there is not a much better arrangement than a regulated market. But maybe these insights do not extend to politics. In a globalized world with international challenges, and especially within the framework of the European Union, a nation-state oriented economic model of democracy will inevitably bring about political myopia and hard-headed regionalism.

So let us respond to the fundamental question of this Article. Democracy, the way we understand and operationalize it today, may indeed put financial stability and long-term societal welfare at risk—not because it follows too little an economic rationale but rather

⁴¹ See generally Robert H. Frank et al., *Does Studying Economics Inhibit Cooperation?*, 7 J. ECON. PERSP. 159 (1993).

⁴² See Samuel Bowles, *Endogenous Preferences: The Cultural Consequences of Markets and Other Economic Institutions*, 36 J. ECON. LITERATURE 75 (1998) ("Markets and other economic institutions do more than allocate goods and services: they also influence the evolution of values, tastes, and personalities."); Carl Christian von Weizsäcker, *Adaptive Preferences and Institutional Stability*, 170 J. INSTITUTIONAL & THEORETICAL ECON. 27, 28 et seq. (2014).

⁴³ See generally John R. Carter & Michael D. Irons, *Are Economists Different, and If So, Why?*, 5 J. ECON. PERSP. 171 (1991); Robert H. Frank et al., *Do Economists Make Bad Citizens?*, 10 J. ECON. PERSP. 187 (1996); Frank et al., *supra* note 41, at 159; Anthony M. Yezer et al., *Does Studying Economics Discourage Cooperation? Watch What We Do, Not What We Say or How We Play*, 10 J. ECON. PERSP. 177 (1996). For an overview, see Astri Drange Hole, *How do Economists Differ from Others in Distributive Situations?*, 38 NORDIC J. POL. ECON. 1 (2013).

because it has absorbed too much of it. If the observations expressed in this Article are correct, then regulating political competition—for example, by supreme or constitutional courts stepping in to assure a level playing field for political competition—cannot be the solution. Regulation may soothe some of the most pressing problems connected to this understanding of democracy, but only in the short term. Ultimately, only a fundamentally rethought approach to democratic theory will be able to resolve the deep-rooted flaws of our current political institutions regime. It will require disrupting the nexus of self-interest and collective decision-making. Independent institutions with a highly functional expertise—such as the European Central Bank—may be one of the cornerstones of such institutional architecture. Constitutional theory has a great task to face.