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## ARTICLE

# HOW “IS” BECAME “OUGHT”; OR, WHAT DO BANKERS REALLY WANT?

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Economics famously holds that people are rational maximizers of their self-interest. While nothing in economics requires self-interest to be maximized through zero-sum acquisition of money, the canonical formulations typically assume that it is. The zero-sum aspect is critical. People want (more) money, but money is a limited resource. If A is successful in his pursuit of more money, B–Z will probably be getting less money. A measures his well-being based on what he can get—as much as possible. If his pursuit of money increases the overall pot so that B–Z end up getting more, that’s fine with A, but A will not incur costs to bring this about. Hence the classic prediction as to how parties will behave in the “ultimatum game.”<sup>1</sup> The first party is given some amount of money. He chooses how much to give the second party, who can then accept or reject the first party’s offer. If the first party’s offer is refused, neither party gets anything. The classic prediction is that the first party will offer the second party as little as possible—one cent—and the second party will accept, since, after all, one cent is more than zero.

The classic prediction has turned out to be colossally wrong. The first party rarely offers a 99:1 split or anything even close to it, and the second party rarely accepts an offer that gives the first party the vast bulk of the amount to be shared.<sup>2</sup> This is sometimes used as evidence that people are not “rational.”<sup>3</sup>

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1. See generally Elizabeth Hoffman, Kevin A. McCabe & Vernon L. Smith, *On Expectations and the Monetary Stakes in Ultimatum Games*, 25 INT’L J. OF GAME THEORY 289 (1996).

2. “On average, proposers offer about 40% of the pie to the second player. Moreover, offers are rejected about 15-20% of the time. Perhaps not surprisingly, lower offers are more likely to be rejected.” Jonathan Levin, *Experimental Evidence*, STANFORD.EDU, 2 (May 2006), <http://www.stanford.edu/~jdlevin/Econ%20286/Experimental.pdf>.

3. See, e.g., *Application of Fairness in the Ultimatum Game*, PRINCETON.EDU, [http://scenic.princeton.edu/network20q/wiki/index.php?title=Application\\_of\\_fairness\\_in\\_the\\_Ultimatum\\_Game](http://scenic.princeton.edu/network20q/wiki/index.php?title=Application_of_fairness_in_the_Ultimatum_Game) (last modified Jan. 14, 2013).

Economists originally characterized their view as to people's rationality, the rational person model, as descriptively accurate, or at least able, for reasons of accuracy or for other reasons, to generate good predictions (presumably better predictions than available alternatives).<sup>4</sup> When its descriptive accuracy (or sufficient usefulness to make predictions) was increasingly questioned, the economists' claim became normative—"maybe people are not rational, but they *should* be."<sup>5</sup> This latter move, from "is" to "ought," is what this comment seeks to highlight—and condemn. The condemnation is intended strongly but narrowly. As I noted above, nothing in economics requires self-interest to be maximized through zero-sum acquisition of money. Economics has ample room to include dynamics that might explain the results of the ultimatum game and other supposed anomalies, such as evolutionary theory.<sup>6</sup> For instance, people might give more than one cent in the ultimatum game because evolution selects for those who abide by norms of fairness. Even putting aside reasons why seemingly irrational behavior might, given a broader perspective, serve traditionally conceived narrow self-interest, recall that the original theory took no position on what was in people's self-interest. As Nobel Prize-winning economist Gary Becker said in his 1992 prize lecture, "[t]he [economics] analysis assumes that individuals maximize *welfare as they conceive it*, whether they be self-ish, altruistic, loyal, spiteful, or masochistic."<sup>7</sup>

Having narrowed my condemnation, let me return to it. Economics has, perhaps to some extent unwittingly, given more credence and respectability than might otherwise have been given to both the descriptive and the normative claims about "rationality"—that people *are* engaged in a narrow zero-sum pursuit of material wealth, and that they *should* be—that "greed is good." To overstate a bit, not being greedy is irrational. The result is that this sort of "rational" behavior is encouraged; constraints, in the form of societal condemnations (for, say, business practices that place a strong onus on the buyer to beware) are muted.

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4. See generally MILTON FRIEDMAN, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3 (1966).

5. See generally Claire A. Hill, *The Rationality of Preference Construction (and the Irrationality of Rational Choice)*, 9 *MINN. J.L. SCI. & TECH.* 689, 689–711 (2008).

6. See, e.g., Gary S. Becker, *Altruism, Egoism, and Genetic Fitness: Economics and Sociology*, 14 *J. OF ECON. LITERATURE* 817 (1976). See also David G. Rand, Corina E. Tarnita, Hisashi Ohtsuki & Martin A. Nowak, *Evolution of Fairness in the One-Shot Anonymous Ultimatum Game*, 110 *PROC. OF THE NAT'L ACAD. OF SCI. OF THE U.S. OF AM.* 2581 (2013).

7. Gary S. Becker, *The Economic Way of Looking at Life*, in *NOBEL LECTURES IN ECONOMIC SCIENCES 1991–1995*, 38 (Torsten Persson ed., World Scientific Publishing Co., 1997). In a recent paper, economist Dani Rodrik seems to be suggesting that Becker has been too generous to economists: "What the economist typically treats as immutable self-interest is too often an artifact of ideas about who we are, how the world works, and what actions are available." Dani Rodrik, *When Ideas Trump Interests: Preferences, Worldviews, and Policy Innovations*, 28 *J. OF ECON. PERSP.* 189, 206 (2014).

What does any of this have to do with bankers? The ethos described here helps explain why bankers behaved as they did in the years leading up to the financial crisis. The ethos encouraged single-minded accumulation of money, well beyond amounts needed for present and future material needs,<sup>8</sup> and without (sufficient) regard to costs to third parties. Bankers were rewarded, financially and otherwise, for creating and selling subprime securities and for pressuring rating agencies to rate many such securities AAA, even when it was becoming increasingly clear that those securities were probably “toxic.” Had bankers not been rewarded for this behavior, the 2008 financial crisis probably would not have happened. This is not to say bankers caused the crisis. But rather their role was necessary and important. While not all bankers behaved in problematic ways, enough did that it is fair to see them as within the mainstream, not as outliers.

What form did the reward take? Most notoriously and saliently, money, in the form of salary and more importantly, big bonuses contingent on performance. Typically, the performance was good for the bank, at least in the short term (although in some cases, it clearly was not, with Lehman Brothers as exhibit A and Bear Stearns as exhibit B). But it certainly was not good for the broader society. Besides money, there were other rewards as well, including status and good professional prospects. And importantly, even though in the canonical formulations money is pursued for what it can buy—goods, services, leisure, and financial security in the future—the reality is far more complex. Declining marginal utility of money should have kicked in for the many bankers who already had much more money than they could use, and were already in a position to retire and never work again if they so chose: those bankers could already buy whatever they wanted, and did not need more money to do so.<sup>9</sup> Money also enabled bankers to rank themselves favorably relative to their peers and their previous selves.

Following economist Robert Frank, I would argue that many bankers were afflicted with “Luxury Fever.”<sup>10</sup> People are engaged in an arms race, each trying to get better “stuff” than their peers, and valuing the stuff not for its inherent qualities, but for its acknowledged or measurable superiority over their peers’ stuff (bigger houses, for instance).<sup>11</sup> Society too has had luxury fever. The fever doesn’t just inspire competitive acquisitiveness. It

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8. See e.g., Christopher K. Hsee, Jiao Zhang, Cindy F. Cai & Shirley Zhang, *Overearning*, 24 *PSYCHOL. SCI.* 852 (2013).

9. That being said, even extremely well-heeled bankers might want more money as a competition emerges among them that increases the price of some of the goods and services they might want, such as prime New York real estate. Robert Frank might say they only want the real estate because it’s fancier than their neighbors’ real estate, but here I might disagree. See FRANK, *infra* note 10.

10. See generally ROBERT H. FRANK, *LUXURY FEVER: WHY MONEY FAILS TO SATISFY IN AN ERA OF EXCESS* (1999).

11. *Id.*

also mutes the golden rule, a broader sense of community, and the associated other-regarding preferences, both in individuals and in the society overall.

The "greed is good" ethos was a shift away from community-oriented other-regarding societal norms, lessening if not eliminating the costs to bankers of inflicting costs on third parties in their pursuit of riches.

What follows from this? Recall the real-world results of the ultimatum game discussed above, as well as the Becker quote. What people want and view as being in their self-interest is not necessarily and always zero-sum acquisition of material wealth. We can't know what people want, but we can know that they are influenced by societal values. We know, too, that these values are changeable. Speaking with precision about values at different points in time is difficult, but a persuasive narrative suggests, and perhaps linguistic search tools can provide some evidence, that following the 2008 crisis, values have shifted away from those reflected in the banker ethos I have described. Not that highly lucrative careers (or huge quantities of money) are out of fashion, but there may be more emphasis on doing good or at least not doing bad. Some employers may be deciding that their employees would prefer a better lifestyle to more money. *Some evidence* and *may* are the operative words here. I can't do more than speculate—perhaps linguistic analysis would allow for more ambitious claims. But these more ambitious claims are not necessary for my purposes. My claim is narrow, but I think important—it is simply not accurate to claim as a descriptive matter that what people want is necessarily as big a slice as they can have of the material pie. Nor is it appropriate to claim that they should want the biggest possible slice as a normative matter—that not wanting this is somehow irrational. Claims that people simply *are* this way have been common, certainly in the popular understanding and to some extent, albeit mostly by implication, in academic literature. These claims have been pernicious, especially from a societal point of view. While other-regarding preferences may not be an unambiguous good—great innovation that ends up benefiting many people might be motivated solely by a person's desire for vast riches and glory—our society would surely have been far better off if, in the years leading up to the 2008 financial crisis, more bankers had had more such preferences.