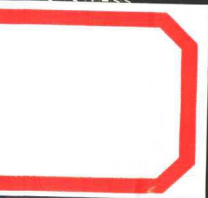


UBEL

FREE
Market
MADNESS

HARVARD
UNIVERSITY



Free Market Madness

WHY HUMAN NATURE
IS AT ODDS WITH ECONOMICS—
AND WHY IT MATTERS

Peter A. Ubel

Harvard Business Press
Boston, Massachusetts

To Paula

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Printed in the United States of America

13 12 11 10 09 5 4 3 2 1

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Library of Congress Cataloging-in-Publication Data

Ubel, Peter A.

Free market madness : why human nature is at odds with economics and why it matters /

Peter A. Ubel.

p. cm.

ISBN 1-4221-2609-9

1. Free enterprise. 2. Economics. 3. Human behavior. I. Title.

HB95.U24 2009

330.12'2—dc22

2008029735

The paper used in this publication meets the requirements of the American National Standard for Permanence of Paper for Publications and Documents in Libraries and Archives Z39.48-1992.

PREFACE

Is there any place where freedom is more apparent than a supermarket? Walking the aisles of your local grocery store, you can freely choose from among dozens of shampoos, scores of cereals, and hundreds of frozen delicacies.

But are you as free as you think? In some supermarket today, an anthropologist is wandering the aisles watching how you shop, observing whether your eyes roam the shelves from top to bottom or bottom to top, and measuring how long you linger in front of display cases if you have toddlers in tow. Meanwhile, over at the kitchen store, the proprietors have just placed an expensive new rice cooker onto the shelves, a deluxe model with a control panel that would put a 1990s VCR to shame. At nearly double the price of their next-best model, almost no consumers are willing to buy this new product. But that doesn't matter to the kitchen store, because the next-best model (which used to be its high-end, slow-selling brand) now races off the shelf, appearing to be a veritable bargain in comparison with this newer product.

The simple fact is, you know less about your own shopping behavior than the people running the stores that you shop at. Is it any wonder, then, that people have purchased themselves into debt, with the American citizenry demonstrating a negative savings

rate in recent years? And is it really surprising that our hospitals are teeming with people whose diseases are a result of smoking, drinking, and overeating?

Western-style democracies pride themselves on freedom: freedom to assemble, freedom to elect legislators, and freedom to interact in the marketplace. Indeed, capitalism and democracy seem to go hand in hand. How else do you explain that Thomas Jefferson proclaimed the importance of life, liberty, and the pursuit of happiness in the same year, 1776, that Adam Smith wrote his great economic masterpiece, *The Wealth of Nations*, a book that established much of the intellectual basis for defending capitalism against its critics?

I am lucky to live in a free democratic and capitalist country. Liberty is a precious commodity, good in its own right—a gift so special that many of us would die for it. Freedom is also valuable as a means to other ends. Freedom allows people to pursue their goals, goals that vary from one person to another. It allows us to choose what career to pursue, what person to marry, how many kids to have, and (to return to the grocery store) what bottle of shampoo to buy.

But freedom to choose is accompanied by the freedom to make bad choices. And in the current marketplace, filled with companies that make a practice of studying human behavior, freedom too often leads to harm and misery. Procter & Gamble owns multimillion-dollar functional MRI (fMRI) machines, which enable the company to visualize which part of your brain “lights up” when you view its products. Psychology and sociology PhDs leave academia to work for industry or Madison Avenue, where they can employ their knowledge of human behavior in the service of selling consumer goods. We might think that we are impervious to television ads or supermarket sales schemes. But marketers and sales experts know more about our behavior than we do, and they know how to influence us without our awareness.

I wrote this book to highlight some of the dangers of liberty, but even more importantly to show how restricting some kinds of liberty can improve people’s health and well-being. I intend to

highlight the harms that can befall people when capitalism meets human nature—when their freedom to behave in the marketplace confronts their propensity to make flawed decisions.

Who am I, to write this book? For starters, I'm a physician caring for patients whose illnesses are frequently caused by decisions they've made and behaviors they've, um, behaved. The majority of my patients are eating too much and exercising too little; they are suffering the harmful consequences of trans fat and tobacco; in short, they are consuming themselves to death.

But I am more than just a physician. I've been trained in psychology and behavioral economics, and I've spent the better part of fifteen years researching the forces that influence the way people make decisions. I've studied the errors people make when facing difficult choices. And having helped uncover the forces that lead to such errors, I've become acutely aware of the dangers of unfettered markets. I think the time is ripe for some fettering. I can hear Larry King introducing me: "Coming up next, an egomaniacal physician who has wasted the better part of his adult years studying decision making spouts off on why free markets give people too many opportunities to make irrational decisions." A risky message for me to convey, in these days of Rush Limbaugh and Fox News.

Besides, there's nothing new about criticizing capitalism. Ever since Adam Smith defended capitalism, with his appeal to the wonders of the invisible hand, people have been trying to restrain the free market, handcuffing the economic system, so to speak, to rein in its excesses. Moreover, many of the criticisms people have heaped on capitalism have been misinformed and prejudicial. For example, many people have opposed free trade without grasping what economists, beginning with Smith, have learned about the ability of free trade to benefit people on *both* sides of the trading border. Similarly, critics like Marx were convinced that capitalism would never benefit the broad masses, because so much power was concentrated in the hands of people with capital, people with large bank accounts or vast property holdings. Marx didn't anticipate,

among other things, that the power of capitalists would be reduced by labor unions. Many people still oppose free trade, and the world still has its share of Marxists. But these are no longer the most numerous or credible of capitalism's critics.

Instead, the most credible critics of capitalism today have settled into a two-front war against free markets. On one front, they try to beat back capitalism by pointing out its moral failings. In an entirely free market system, it is pointed out, people who can't afford health care won't receive it, meaning they will be essentially a ruptured appendix away from the grave. In such a system, people who can't find jobs will be left homeless, begging for spare change. Morally outraged at the heartlessness of unfettered markets, these critics contend that capitalism should be smoothed over on its rough edges, to take care of people who would suffer under its relentless competition.

On the second front, people fight back capitalism because free markets fail to protect people from spillover effects of market activity. Economists call these *externalities*. When a factory is allowed to dump toxins into a river, people living downstream are harmed. When a teenager revs up his mufflerless sports car at 2:00 a.m., he disturbs the sleep of the neighbors. An economic system that doesn't regulate water quality or noise pollution will seriously diminish the quality of life of its citizens. Once again, this critique of capitalism is put forward to address important problems that markets alone would never solve.

Let me state up front: I don't plan to debate either morality or externalities in this book. Instead, I plan to mount a third front against unfettered markets. Think of this attack as one designed neither to defeat free markets nor to force capitalism to surrender, but rather to prevent markets from gaining more territory than they deserve. To beat markets back when they've crossed the wrong boundaries.

Think of this third front as an example of "third-way" politics. I'm neither promarket nor antimarket. Free market capitalism has

helped many people thrive and has created social conditions that have alleviated much suffering. But markets always need to be restrained, sometimes for reasons of justice, other times for reasons of the greater good. And they also need to be restrained for a third reason—that when people operate, their unconscious behaviors too often cause them to act against their own best interests.

In this third front against capitalism, I want to show what happens when the invisible hand meets the unconscious brain. You see, defenders of free markets and other libertarian positions have long been able to pull out some very strong ammunition when battling those forces that restrict people's freedoms. For when critics of free markets complain about wealth inequality, libertarians can always point out the injustice of limiting people's freedoms. And to strengthen their position even further, these libertarians will also point out that different people value different ends in life: some people care a lot about money, while others want to spend more time with their families. Why should a policy address wealth inequality, when wealth inequality arises at least in part from these different preferences? If some people want to spend their cash on luxury cars, and others on college educations for their children, why should we stop them from doing this? Given the different values that people hold, libertarians can always argue that society should simply step out of the way and let people make their own choices.

Backing up this defense of libertarianism have been a series of brilliant nineteenth- and twentieth-century economists, who took the initial insights of Adam Smith and developed them into the most influential of the social sciences. Indeed, while there have always been left-wing and right-wing economists—with Karl Marx and Milton Friedman both belonging to the discipline—most academic economists by the middle of the twentieth century had embraced the libertarian view of individuals as the best promoters of their interests. The economic theories that came to dominate the discipline embraced a mythical being, *Homo economicus*, who made rational decisions that reflected his own preferences.

Because of the power of this myth, free markets have encroached on an increasingly large part of people's lives. Kids who struggle with basic math skills can rattle off a thousand consumer brands. New stadiums no longer don the names of famous politicians or athletes, and instead drape themselves in corporate logos. Pharmaceutical companies now convince us to "talk to our doctor" about diseases that they hope to convince us we have. It is this encroachment that I plan to fight.

I will show how economists came to hold a belief in human rationality, and how that faith has come under question by developments in neuroscience and behavioral economics. More importantly, I will raise questions about what the limits of human rationality imply for the proper limits of free markets. In doing so, I plan to show, in broad outline, what markets can look like when they are designed to take account of human nature.

ACKNOWLEDGMENTS

First and foremost, I owe this book to Charles Darwin. OK, not to Darwin exactly, but instead to evolution—to the amazing forces that caused human brains to evolve in such a way not only to give me (and most other members of my species) the ability to read and write, but also to give me the irrational desire to wake up at five every morning and delude myself into believing that I could write a book that thousands (nay, tens of thousands) of people would read. With the average American reading less than one book per year, it takes a certain kind of irrationality to spend hundreds of hours writing books. But people like you, holding this book (or e-book) in your hand right now, are clearly not average, and it is for people like you that I've written this book.

In writing this book, I'm lucky to have worked with many brilliant people who have given me helpful feedback on earlier versions. At the Center for Behavioral and Decision Sciences in Medicine, where I work, I had the privilege of bouncing ideas off of many wonderful people. I am grateful to Dylan Smith, Angie Fagerlin, Brian Zikmund-Fisher, and Scott Kim for commenting on specific chapters. Michele Heisler, another Michigan colleague, once again has proved to be an incredibly enthusiastic but critical reader. I also received invaluable advice from colleagues around the

country, and am especially grateful to George Loewenstein, Dan Ariely, and several anonymous reviewers for their feedback. This book is better because of their efforts.

When I discuss my own research in this book, I am always referring to collaborative studies. Almost none of the research I do is done just on my own. That's one of the joys of science. I'm sure that George Loewenstein, Heather Pond Lacey, Angie Fagerlin, Brian Zikmund-Fisher, Dylan Smith, Ellen Hummel, and Scott Halpern will all recognize our collaborative efforts peeking out through the pages of this book.

Thanks to Sarah Conner, Sandra Serna Smith, Melissa Shauver, Sarah Scheitler, and Lauren Bailey for helping me with multiple drafts of this book. Special kudos to Sarah Scheitler for taking every one of my requests three steps further than I anticipated, and enriching my understanding of this topic in the process.

My agent, Rob McQuilkin, has once again been an amazing help, full of encouragement, enthusiasm, and great advice. Jacque Murphy has shown me the benefits of getting a top-notch editor involved early in the drafting of the manuscript. I am really lucky to have been able to work with her. Special thanks to John Lofy for making it through an early version of this book. And my final thanks, and the dedication of this book, go to "my first wife"—Paula. Thanks for setting aside your love of fiction long enough to read and reread so many chapters of this book.

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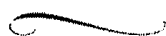
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PART I



Maximizing Our
Best Interests by
Expanding Our
Waistlines?



The Invisible Hand Meets the Unconscious Brain

JOHN HOWARD has always been a man of rituals. Back in high school, he owed much of his success as a star wrestler and sprinter to his mastery of each sport's rituals. During the winter wrestling season, he would starve himself to slim his 6-feet 2-inch frame down to 170 pounds, a feat he accomplished the night before weigh-ins by spitting intermittently into a cup to take off the last few ounces of water weight. In springtime, when training for the 100-yard hurdling competition, he would tirelessly practice his leaping form each day after school. He mastered these rituals well enough to earn a college wrestling scholarship and to win the city hurdling championship his senior year.

Fifty years later, John finds himself immersed in a whole new set of rituals that begin every day at the crack of dawn. Waking up, he rubs the sleep out of his eyes, pulls open his bedside drawer, then takes out a vial of insulin, a syringe, and a glucometer. Pricking his finger, he squeezes a drop of blood onto a test strip so his glucometer can calculate his blood sugar, and, glancing at the reading, he quickly determines how much insulin to draw up into the syringe—10 units if his sugar is in the normal range, 15 units if last

night's banana cream pie is still circulating through his system. Then he puts down the vial and, matter-of-factly, plunges the needle into his belly.

Thanks to his diabetes medicines, John is already ten years older than his father was when he died, succumbing to complications of diabetes at age fifty-eight. In fact, members of John's generation on average are living almost twenty years longer than their grandparents, proof, it might seem, of the miracles of modern medicine.¹

The longevity of John's generation, however, is hardly attributable to medical science alone. If anything explains their health and well-being, it is the modern evolution of free markets.

That's right. The marketplace has saved John's life.

Take a moment to imagine the needle poised above his abdomen. Now back up from this view, as if you were looking at John through the Google Earth Web site. Zoom out, above John's bedroom, and you'll see the top of his condominium. Back out farther, and you will see the city of Scottsdale, where he lives; soon you'll see the whole state of Arizona. Now travel across the Atlantic Ocean to the Terumo needle factory, in Leuven, Belgium (about 10 miles outside of Brussels), where, if you zoom back in during working hours, you can watch workers making the kind of needles that people like John use every day to give themselves their insulin.²

It will look like an ordinary modern factory. The factory floor will be an elegant synchrony of humans and machines. One group of workers, standing next to large vats of molten steel, will be pouring the liquid out and drawing it into the casts, which will be fitting the steel into the proper shape to become a needle. As the steel moves along the production line, it will be further formed into a continuous hollow wire by another series of machines. Yet another set of machines will be cutting the wires to form the needles. Along all these production lines, some workers will be monitoring the machines, while others will be bringing materials back and forth to different parts of the manufacturing site. In one