ECONLOG POST
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BEHAVIORAL ECONOMICS

The Psychology of People Against Profit

By: Bryan Caplan

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Categories: Behavioral Economics

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I just read a fascinating new working paper by Penn's **Amit Bhattacharjee**, **Jason Dana**, and **Jonathan Baron** (henceforth BDB). The title: "Is Profit Evil? Associations of Profit With Social Harm." The paper is not yet publicly available, but I have the authors' permission to share a sneak peak.

The paper starts by noting the apparent tension between laymen's and experts' beliefs about the social effects of profit. Laymen often seem to equate profit with social harm. But:

> The scholarly consensus is that profits arise as part of a win-win situation in which the pie becomes much larger as a result of efficiency and investment, leading to larger slices for both consumers and producers… Even scholars who have highlighted the shortcomings of the market… readily agree that our profit-driven economic system has produced tremendous technological innovation and provided the public with unprecedented value.

Could the public really overlook the social benefits of the profit motive in favor of crude populism? BDB put some experimental subjects to the test – or rather, a series of tests.

In Test 1a, subjects rated the profitability and social value of 40 firms from the Fortune 500.

> [S]ubjects firstindicated their familiarity with the firm on a 3-point scale (1=Never heard of it, 3=Familiar). Next, they rated the firm on perceived profit ("How much profit do you think this business made on the average (of businesses in general) in the last year?"; 1=Zero or less, 6=A lot more than average). Subjects then indicated… the perceived value of the firm to society ("What do you think about the value of this business to society, on the whole?"; 1=It would be better if it did not exist, 5=It is important and useful).

out the **fun scatter plot** – and see what's in the lower right-hand corner. More amazingly, they found that the correlation between *actual* profit and perceived social value worked about as well (r=-.57). People's average guesses about relative profitability are amazingly accurate, even though their average guesses about social value are way off-base.

In Test 1b, BDB replaced specific firms with industries, and once again checked the correlation between perceived profitability and perceived social value. r=-.67! Check out the **next fun scatter plot**. Credit cards, the basis of virtually all internet commerce, absurdly occupy the lower right-hand corner. Solar energy, in contrast, is rated the *most* "important and useful" (?!) of all the named industries. The only bright spot: BDB find that a pro-profit minority is out there:

> For Study 1a, 66% of participants had a negative correlation, indicating anti-market bias, 30% had a positive correlation. For Study 1b, the corresponding percentages were 91% and 9%. Thus, most, but not all, participants hold anti-profit beliefs, and more variation in these beliefs occurs for individual firms, with whom people may have had variable individual experiences.

BDB's final test tries to establish causality with randomized hypotheticals:

> The scenarios described: 1) an organization that requests volunteer donations of blood plasma and sells it to hospitals; 2) an organization that buys quality handmade jewelry and crafts from poor artisans in developing nations and sells them at high margins in retail outlets in developed nations; 3) an organization that buys the rights to promising new medical technologies from the inventors, then develops and sells the technologies to hospitals; 4) an organization that provides microloans to poor people in developing nations at high interest rates; and 5) an organization that sells Fair Trade coffee at higher prices so that small coffee farmers are paid more.
>
> The key manipulation varied only whether the organization was described as a "for-profit corporation" or a "non-profit organization."

BDB predictably find that merely changing a hypothetical organization from a non-profit to a for-profit noticeably reduces its perceived social value.

The paper's punchline is eloquently depressing:

> People apparently have little faith in the power of markets to create and reward value for society. Across actual firms (Study 1a), entire industries (Study 1b), and hypothetical organizations (Study 2), our participants associated greater levels of profit with social harm and less social value. Further, they saw greater profits as undeserved and at the expense of others. Though firms themselves were not seen as generally evil or devoid of value, profit *was* viewed as evil. Increasing firm profitability (or profit motive) greatly detracted from perceived social value… These results are quite in opposition to the view of markets espoused by economists and scholars that supply, demand, and competition will most reward profit-seekers that provide what society wants. Even in one of the most market-oriented societies in human history, people do not believe in the invisible hand.

In a just academic world, "Is Profit Evil?" would go very far indeed. Fingers crossed, and I'll post a link once the full article is available.

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Dec 14 2010 at 10:31pm

Did they use some more pertinent modern day questions? How do people rate profits from trades on synthetic CDOs vs profit gained from selling food? Legal firms making money on class action suits vs a video chip company?

IRC correctly, the invisible hand guy understood and wrote about moral behavior being an important part of economic behavior.

Steve

Doc Merlin

Dec 14 2010 at 10:33pm

I wonder if… this suggests that if a company is trying to improve its corporate social responsibility image, I should run the other way?

I'd like to see a granger causality tests on this and a relation to price, this could help me make more money.

JC

Dec 14 2010 at 10:42pm

Thanks for sharing this.

Robin Hanson

Dec 14 2010 at 10:57pm

I wonder if they consider debt just as evil as equity. Imagine asking the questions in terms of how much debt payments the firms must make, rather than the returns to their equity.

frosty840

Dec 15 2010 at 5:56am

> Credit cards, the basis of virtually all internet commerce, absurdly occupy the lower right-hand corner.

Going to have to argue with you on that score.

EFTPOS, or maybe just EFT, is the basis for virtually all internet commerce. Credit card companies run a hell of a lot of EFTPOS and EFT systems, but credit cards aren't the internet-commerce-enabling factor, the actual fund transfer process is.

IMO, IANAAccountant, and so forth, anyway.

Dale Moses

Dec 15 2010 at 6:21am

Lets play "Devil's Advocate"

Suppose the relationship exists and people do see negative relationships between profits and social value.

Maybe they're just adaptively learning the market environment as they operate within it?

On a more serious note that wont rile anyone up; the graphs as presented seem to indicate a significant amount of omitted variable bias. Specifically "what the company does". I am also concerned that there simply isn't enough variation within each category of "what a company does" to get a good result(but am unsure on the last part)

Dale Moses

Dec 15 2010 at 6:29am

It seems to be that a better method of questioning might be to fix the company AND the profit level.

I.E. instead of telling people "how much money do you think they make?" say "JP Morgan made X dollars last year, this was better than y% of the industry, how evil do you think they are?"

Vary x and y yourself and you have better data. Even if you use a well known firm you're unlikely to land people in your survey who know the profit level off the top of their head to the effect that they will not trust you when you lie to them.

Ask them about familiarity with the firm and with the industry it exists in to get rid of that bias.

liberty

Dec 15 2010 at 10:40am

"People's average guesses about relative profitability are amazingly accurate, even though their average guesses about social value are way off-base."

How do you know their estimates of social value are way off-base? Isn't social value determined *socially* i.e. by the very same population they've taken a sample from for the test?

Of course, economists assume that profit comes of offering social value – but this assumes a free market with complete property rights (and hence limited problems of externalities, no rent-seeking, etc); the real-world markets in which these industries compete are not free and all property rights are not well protected. In fact, many of the companies are somewhat protected or subsidized. Their profit may well exceed their social value.

Furthermore, if free markets cannot maximize social welfare because not all members of society can work and express themselves in the market, then profits won't be well correlated with "true" social welfare. Gucci may have too much profit, while manufacturers of equipment for the disabled may have too little. etc.

Ben

Dec 15 2010 at 10:56am

The finding isn't that laymen object to profit–if that was the case, then Barnes and Noble (average profit) wouldn't be rated so highly on social value. Rather, the finding is that, beyond a certain point, greater profitability is associated with lower social value. I don't think this is so far off from economists' opinions.

Higher profitability tends to come from greater monopoly power, which can result either from innovation or by creating artificial barriers to entry. The latter *is* pretty evil, while the prior tends to only last for so long.

bill shoe

Dec 15 2010 at 12:08pm

Agree with frosty840. Credit cards combine 2 fundamental things: payment systems and high-interest debt.

Imagine that instead of simply saying "credit cards" the category was broken up into two more specific groups: "Debit Cards" and "Payday Loan Providers". I agree with Bryan that Debit Cards would be socially good. As a libertarian I want loan providers to be legal and largely unregulated, but there is no way I would say they had good social value.

Dan Weber

Dec 15 2010 at 12:54pm

I second liberty's question. What is the "right answer" for social value?

That last sentence is kind of hard to deal with. In one single case it's true, because for a single transaction, after we establish that the transaction occurs, there is a zero-sum game of whether the buyer or seller extracts more of the surplus. But in the macro, I suspect this doesn't hold at all.

tomslee

Dec 15 2010 at 1:19pm

In your dismay, aren't you confusing profit with markets? Surely profitability of a company is a measure of how far its market deviates from fully competitive – how close to a monopoly the firm is.

tribsantos

Dec 15 2010 at 1:32pm

I wonder if people are not simply thinking of "social value" as "positive externalities". If so, this could be just a semantics issue.

Doug

Dec 15 2010 at 2:07pm

I think that while most believe it is not evil to take a profit, they do believe that the higher the profit, the lower the consumer surplus that is received when the product is sold, and thus the lower the benefit the firm is providing the public for its money.

I'm not sure they are wrong about that. You certainly have not done anything to explain why that is wrong. Indeed, stating that a firm is non-profit implies that it is providing goods or services at or below cost, which allocates all of the economic surplus to the consumer.

Pavan

Dec 15 2010 at 2:12pm

Firstly, economists cavalierly cite economic theory in reference to "profit" while neglecting to point out that "economic profit" is different from the layman's understanding of the term, which is more properly called "accounting profit."

Secondly, to less a personage than Adam Smith himself pointed out that in a healthy, perfectly competitive market the economic profit across an industry goes to 0. So even if we are talking economic profit, if the firms in an industry are posting a profit year after year then does that not imply that they're leaching value from somewhere else?

Perhaps they are extracting surplus value from their workers by leveraging the semi-monopsonistic nature of the labor market to bid wages below their 'natural' price? Perhaps they're using their monopolistic or semi-monopolistic market power to extract extra consumer surplus? Or perhaps people have unmet preferences for equity, justice, fairness, and other abstract concepts that are damaged by the negative externalities of rampant profiteering yet, being unquantifiable, are not adequately reflected in pricing mechanisms?

Doug

Dec 15 2010 at 2:21pm

Also, you seem to ignore the most significant fact: according to the scatter plot, ALL of the companies scored above a 0, which means "better if it did not exist," and the lowest scored about a 1.4, almost halfway to 3 "important and useful." So even the highest profit firms were thought to convey some level of benefit to society. The scatter plot is plotted in such a way to obscure this fact, since it starts at 1.4 rather than 0.

Phrased correctly, I think the answer is unquestionably yes, whether you ask academics or the unwashed masses.

Dan Weber

Dec 15 2010 at 4:50pm

I don't think you can compare profits across industries easily. In software, there are often huge markups on the media, but that has to be offset against development costs. Oil extraction is very different, but one thing it comes down to is the capital-intensive nature of the business. You don't put a billion dollars into an oil company to get out a 2% return. Until all other long-term investment opportunities dry up, that industry won't go to zero profits.

On the other hand, 2% seems to be pretty good for retail. Airlines are lucky to just not be bankrupt at any particular time.

(Didn't MR have a thread recently about the industries that give the most consumer surplus?)

liberty

Dec 15 2010 at 4:59pm

Often times people don't realize what profit is necessary to induce production of certain types (risky in terms of profit, risky in terms of liability, expensive to begin, difficult to begin, etc). This explains the high profit level in some areas – including, e.g., pharmaceuticals. When it costs many billions to research a drug, you *should* expect billions in profits.

Its sad to me that people see profit as such a bad thing – still, we should be careful as economists not to mistakenly associate profit as a perfectly correlated measure of social value, just as the layperson ought not to do the reverse. (see my comments above)

Foobarista

Dec 15 2010 at 5:06pm

This "profitophobia" has been exploited rather shamelessly by "nonprofits" who argue that they're somehow selfless servants of the common good because they don't happen to have "owners" and throw off cash to them. The fact that the enterprise profit they produce is instead payed out to their officers is, naturally, a cost of getting the best, most selfless people to run the enterprise.

Jacob Oost

Dec 15 2010 at 6:15pm

Sounds like a fun article (sorry, *paper*), but I have to point out that *revenue* is a direct measurement of how much value a company provides for society, and profits are a direct measurement of how efficient they are at providing that value.

That is to say, Company A and Company B could both produce the same product, equally valued by consumers and equally priced, and who sell equal amounts of product. Company A is more efficient and has a 35% profit margin, whereas Company B is less efficient and has a 5% profit margin. Both provide the same value to society.

Not correcting for this can kind of skew the results when deciding the correlation between respondents' answers and "actual" social benefit (which, as others have pointed out, economists can only give a good approximation of, not an exact value, but let's see a command economy do any better! :-P)

Greg

Dec 15 2010 at 7:46pm

I generally like free markets, but why are we assuming there is a positive correlation between profits and social benefit?

Dec 15 2010 at 8:19pm

Just to address the credit card company example:

As a previous commenter posted, it is really the EFT process that facilitates 9X%+ of web transactions. You can interpret the public scorn of credit card companies severally ways: One is to naively assume the public is stupid and misguided, another is to assume that the public disentangles EFT (or liquid, non-cash money in general) from credit card companies' current oligopoly of that business.

This article already has based its conclusions traveling down the first path. However, let's look at the second path:

#1 Is the second path feasible or reasonable? Is it a pipe dream that EFT could support internet commerce without credit cards? I think the answer is a qualified no.

The primary point in favor, is the simple existence of non-credit card backed EFTs. The qualification gets to the root of profit motivation: whether absent the high profit motivation of the credit card industry, some other force (be it regulation or other market forces) would have stepped in to provide the near ubiquity of access that enabled CC adaptation to thrive?

Obviously, adaptation by market forces would have been far slower (almost by definition, reducing profitability reduces the market forces driving adoption). Legislation encouraging non-CC EFT is a possibility, but very uncertain.

Regardless, if you sweep aside these historical concerns about the credit card industry and the rise of EFT, it's conceivable that some other payment method would be able to ease EFT. Also conceivable are halfway regulation would make the credit card industry less profitable (and presumably make people happier). See *s in part 2 for areas that cause the most popular angst, and are currently under proposed increased regulation.

#2 Why does the public perceive these credit card companies (more specifically their profits) as evil? Well, examine their method of extracting profits, and the social effects of these methods:

Main profit center #1:

Merchant fees. If you assume they are a uniform mark-up, then it's not clear why these could be considered evil. I.e. sales taxes are not considered evil, and credit card companies certainly provide value above and beyond what many sales taxes do. (Increasing liquidity, insuring against theft, providing EFT infrastructure, etc.)

Merchant fees are not uniform. In fact, they scale harshly against the size of the business. A mega-corporation such as Wal-mart or Mcdonalds pays very little per transaction, while a local one-shop business pays not just high percentage rates, but a large flat rate per transaction. #1 This is anti-small business bias, resulting in higher barriers to entry, lower ability for the market to adapt to local preferences via local businesses. #2 It is a heavy bias against small value goods, pricing many otherwise valuable goods out of the market. (If you want to see this in action, go visit Chinatown, or any other high immigrant area that predominantly only takes cash transactions. You will see a huge variety of small shops selling 2$ black diamond earrings and other very inexpensive goods. You won't see stores like this in places where CC has come to dominate, and per transaction charges range up to 2.50 + %.) *regulation pending to reduce flat charges for atm* *also, regulation to enable small vendors to price discriminate their cash preferences (not allowed in current CC-merchant contracts)*

However, aside from merchant fees, credit cards would not be profitable without profit center #2, very high interest, high fee credit card debt holders:

Several reasons why this could be considered evil should be obvious.

At it's most basic level, credit cards have chosen to be funded by a reverse insurance policy. Generally, when people can afford to do so, their preference is to insure against negative shocks to reduce their impact. Whatever adverse financial circumstance cause them to pay their credit card bill late, the resultant deluge of fees and interest charges, is not helping. *various limitations on late fees and interest are or have been considered*

Furthermore, credit cards have also chosen to fund themselves through reduced transparency. The legal writing is small, dense, and impenetrable to the majority of applicants. Even those wise to the initial offering have difficulty keeping up with terms that can change at any time, and terms that are too numerous to remember. This lack of transparency makes planning more difficult, and

Finally, fee and interest rate setups transfer funds from low credit/income groups to higher income groups. For most people, what is conceivably robbing from the poor to give to the rich is one definition of evil. Credit card companies subsidize high income credit cards, and their generous benefit plans, and recoup by the means above.

In conclusion, I think a deeper look at the impact of CC companies reveals a number of traits that could be considered economic and/or social evils. Personally, I wish government regulation would require 100% transparency in payment method cost differentials to the merchant (allowing price discrimination). Furthermore, I believe a large scale effort to provide electronic payment through the federal government would not only pay dividends through the elimination of various profit centers, but also bring a large portion of the money supply back under government control.

real estate accountant

Dec 15 2010 at 8:52pm

I'd be interested in the demographics of the population surveyed. Are they mostly college students, employees of government or non-profit groups or people who are employed by a profit making company? I've noticed that America's best and brightest students are relentlessly propagandized to value the non-profit and governmental over the profit seeking.

mad

Dec 15 2010 at 11:31pm

[Comment removed for supplying false email address. Email the webmaster@econlib.org to request restoring this comment. A valid email address is required to post comments on EconLog.–Econlib Ed.]

Paul

Dec 16 2010 at 10:51am

As usual it looks like the public is right and the economists are wrong. People instinctively know which firms are making the world a more fragile place.

happyjuggler0

Dec 16 2010 at 10:53am

The first thing that struck me was why the $%^& is Hershey rated as having high social value while McDonald's has low social value?

It finally dawned on me that this survey was likely done in Pennsylvania ("paper by Penn's Amit Bhattacharjee, Jason Dana, and Jonathan Baron").

This could explain why Hershey (candy is socially beneficial?) and Heinz (sugar syrup with tomato added) overlap since they are both famously located in the state. Indeed, while I am not sure where all the companies are headquartered, I strongly suspect that the bulk of the companies in the upper right of the chart (i.e. "the sweet spot") are HQ'd in or around Pennsylvania based on my hazy knowledge of where they are from.

If I am right about this, they seriously need to do this survey in other areas of the US too. For example, Dallas would likely skew more in one direction in my opinion, while Santa Monica would skew in the other direction.

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