

'How the market deals with incoherent preferences'

By

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Abstract

The standard normative response to incoherent preferences has been to retain the principle that normative analysis is concerned with well-being, but to look for non-preference-based measures of well-being. This approach licenses paternalistic constraints. In this paper, I propose a different approach, one that maintains a tradition in economics of treating ideally competitive markets in private goods as a normative benchmark. I investigate how competitive markets react to incoherent preferences. I show that the main objective features of competitive equilibrium – the single-price law, market-clearing and zero profit – can be generated by the actions of profit-seeking arbitrageurs, provided only that consumers are 'price-sensitive'. In a competitive equilibrium all opportunities for 'mutually beneficial transactions' are realised. The concept of a mutually beneficial transaction includes transactions between different 'dated selves' of the same person. I argue that each of us can coherently see this as desirable, even if we know that our preferences are incoherent.

Because the market privileges each consumer's 'acting self' over her 'planning self', consumers, while uncertain about their future circumstances and preferences, can be assured that the market will (very probably) allow them to satisfy their future preferences, whatever they may be, when the time comes. Entrepreneurs are rewarded for anticipating desires that consumers are not yet aware of, including the desires of future economic agents (e.g. the unborn, young children, future immigrants) who currently cannot record their preferences.

Markets, by privileging the acting self, make it difficult for individuals to impose constraints on their future actions; so there is room for debate about whether problems of self-control justify regulation of markets. But this issue has been disproportionately emphasised by 'soft paternalists'. It is separate from the question of whether preference incoherence in general justifies paternalism.