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HAGGLING AS AN INFORMATION-TRANSMISSION SYSTEM

by Gary North

It is naught, it is naught, saith the buyer: but when he is gone his way, then he boasteth (Prov. 20:14).

Long before the days of King Solomon, face-to-face bargainers were crying the blues to each other. "You can't expect me to pay that much. Why, I've seen it for half that price in Damascus!" The obvious answer, of course, would have been this: "Then why didn't you buy it in Damascus?"

Why all the haggling? Because of ignorance. The seller of item A does not know how much buyer B is willing to pay. Similarly, buyer B does not know how much seller A is willing to accept. So the two of them negotiate. Each one wants the other to pay more; each one wants to pay less. They haggle. Selling prices get lower; buying offers get higher.

What the textbook example does not always make clear is that both people are buyers and sellers. Usually, the seller is identified as the person who is offering a product or service for sale. The buyer is the person who is offering money. But both of them are buyers. The "seller" is a buyer of money; the "buyer" is a seller of money.

There are some people who love to haggle. There are some cultures that are filled with such people. The Middle Eastern cultures are famous for bazaars and haggling. Western cultures are less haggling-oriented. People understand that there are discounts available for volume purchases, but for individual sales, they do not expect discounts. They do not ask for them.

For example, all stores sell items for cash. Most of them sell the same items at the same price for credit card purchases. All credit card firms charge the stores a fee of a few percentage points per sale: possibly 3%. So, the average store-owner is just as well off selling an item for cash at the net price he would otherwise receive for a credit card sale. Some states have laws requiring retail stores to make this discount available to buyers who pay cash. But very few buyers know this, few clerks know this, and the time and embarrassment value is high enough so that few buyers ever ask for the discount. Westerners usually prefer not to haggle.

The Time-Price Trade-Off

Are Westerners foolish? Are they too squeamish to become good business people? Not necessarily. They understand at least something about the value of their time. They know that bargaining takes time. The money saved from bargaining face to face may not be worth the potential savings. It is faster just to pay retail and leave.

Furthermore, the existence of a developed free market, with its system of full-scale advertising, has enabled buyers to know the price of many alternatives. **Where advertising is legal and unrestricted, price cutting becomes**

a way of life. Specialized mail-order catalogues offer discounts on many products that sell for more in a local retail outlet. Supermarkets and superstores like Wal-Mart have drastically restructured local retailing. They are to retailing what McDonald's is to the restaurant industry. These high-volume retail outlets are places where profit margins per sale are very thin. If a buyer finds something he wants in one of these outlets, he knows that he is unlikely to find it cheaper elsewhere. It pays him to buy without spending a lot of time comparing prices, if he knows the product he wants.

When we go to the check-out counter, we do not haggle with the sales clerk. The clerk is probably using a computerized scanner. There is no way for him to reprogram the computer to change prices on an individual sale basis at the check-out counter. The clerk's scanner reads the universal product code on the item, matches this digitized symbol with a store price, and records the sale. There is no room for haggling. Everything in these stores hinges on maintaining volume sales; getting you through that line fast is part of this sales strategy.

If you want a salesperson to tell you the details of some product, you have to go to a no-discount store. Prices are higher in these stores, but service is presumably better. You can get more "free" information there. There are some people who will take up a local retailer's time and then buy the item from a discount store, but most people sense that this is not quite fair. There is always some slack in the system, of course, for both buyer and seller. The retailer may be willing to take less for a big-ticket purchase, especially for cash. The buyer has to ask, however, and he may have to tell the seller that he knows he can buy for less locally. Similarly, a shopper might ask a few questions, but not take up very much of the salesman's time, or not take him away from another customer, and then buy from a discount catalogue.

The market system allows for such "haggling at the margin." Most people do not set out to cheat the other person, so the market system can tolerate a few cost-cutters. Like those "eat all you can" restaurants that take occasional losses from gluttons or visiting football teams, they still survive on meeting the average eater's capacities.

Shopping around is not a zero-price endeavor. It is a form of investment. We search out information and pay for our trouble. We may find that all our time is sometimes wasted; we might have done better just by buying the item we wanted at the first price offered. But we can't be sure. In short, buyers are confronted with **zones of ignorance**. This is why there is still haggling. But this haggling is not always face-to-face and personal; it is becoming increasingly impersonal. It is based on buyers' evaluation guides,

specialized catalogues, telephone calls, and time.

The more expensive the item, and the less common the price information on alternatives, the larger the expected benefit from haggling, whether face to face or computerized. The real estate market is the premier example; so is the used car market. Hamburgers are not worth arguing about.

Motivation and Responsibility

Basic to Greek philosophy was this assumption: to know the good is to do the good. This is the opposite of the biblical view of fallen man, which defines sin as actions in defiance of accurate ethical knowledge: "Therefore to him that knoweth to do good, and doeth it not, to him it is sin" (James 4:17).

A product may be the best available at a particular price, but it is not enough for people to know this; they must **act** in terms of this knowledge. Consider life insurance. The only economically rational life insurance policy for a wife to own on her husband's life is annual renewal term insurance, the kind with a clause that allows the insured person to take a medical exam every two years and get lower rates if he passes. When it comes to life insurance, the cheaper the premiums, the better, so long as the company is rated A or above by the A. M. Best Co.

How many wives understand this? Very few. Who has an incentive to tell them? Almost no one. The commission fees on term insurance policies are too low for agents to devote time to selling them, except to sign up people who may be persuaded later to switch to whole life insurance, which no one should ever do. Term insurance gets sold only to very well-informed buyers (such as corporations that buy "key man" insurance policies) or to price-resistant buyers who would not otherwise buy anything, and who will be pressured to buy something more costly later on.

Time is money, Ben Franklin said. A life insurance agent has an hour to spend on a call. Will he spend it to get a \$100 first-year commission with a few dollars a year thereafter or a \$1,000 commission with far higher renewal fees thereafter? The answer is obvious. The system rewards those who devote their skills to selling something that the buyer really should not buy. We should not be surprised to find that salesmen respond to these incentives. They sell what they are paid to sell.

Are life insurance companies to blame? Not entirely. It does no good simply to tell people about term insurance. They will not buy it because they resist buying any life insurance. Husbands do not want to buy life insurance, since the product is **death** insurance, and men do not want to think about dying. So, they must be **sold** life insurance. They will do the right thing—buy protection for their heirs—only under considerable external pressure. Thus, they implicitly tell insurance firms: "We will not act in our wives' interest voluntarily. Furthermore, they won't act in their own self-interest. They refuse to pressure us to buy policies that are best for them and the children. You must pressure us to buy. We are determined to act irresponsibly unless you come to our homes and pressure us."

The companies respond predictably to this appeal by responsibility-fleeing people. They sell them what is profitable for the companies in the name of what is good for the heirs. (The salesmen are trained not to mention the word "death" or "die"; it is as if the whole world were made up of Christian Scientists.)

I lost a lot of money setting up a company that told people which policies offer the best rates. Without a salesman in the living room to pressure the potential buyer—to tell him what he wants to hear, even if it isn't the information people really need—men will not buy inexpensive term life insurance.

Wives have the greatest self-interest in getting good policies, but they do not know what questions to ask. They think this is not their responsibility. Churches refuse to counsel wives on this, even though the church has tremendous self-interest in getting every husband insured—one obvious source of accurate information. After all, the church becomes responsible for poverty-stricken widows. Why do the churches ignore this responsibility? Because the deacons are men, and like most men, they are underinsured. Second, there are too many high-pressure life insurance salesmen in churches (and on the board of deacons) for the diaconate to "buck the trend."

Businesses also don't tell their employees. There is no economic incentive for them to do so. They should, but they don't. In short, unless buyers read magazines like *Consumer Reports*, they are unlikely to find out about a firm like the Old Line Life Insurance Co. of Milwaukee, Wisconsin. A wife is unlikely to buy a \$500,000 term policy on her husband's life, which is the minimum that a family needs today. A husband is also unlikely to buy a \$100,000 policy on his wife's life, which is what she is worth, as he will find out fast if she dies.

There has to be motivation to buy. If it is not internal motivation, then it must be external. The closer we get to questions of life and death, the more priestly this motivation must be. The life insurance salesman holds a near-priestly office, yet is governed strictly by profit and loss. He sells what is best for his income. Thus, the free market by itself is insufficient to provide the best information **and most effective motivation** possible in this instance. But the churches have done nothing to fill the gap.

Has the free market failed? No worse than the churches have. If the churches refuse to recognize the economic implications of their priestly function, why should anyone criticize life insurance salesmen for their self-motivated actions? The flight from responsibility is universal today. Therefore, the flight from good information is universal.

There are limits to market information and motivation. Neither is a free resource. There are also limits on church and State information and motivation. A Christian society would not neglect the legitimate informational and motivational obligations of any institution. No institution would have a legal monopoly on public information. (I am not speaking here about military secrets or counselling confidentiality.) There would be competing sources of information.

If Men Were Omniscient

If men were omniscient, there would be no room for mistakes. There would be room for evil, of course. They still might not do what is right. People know they should eat less sugar, smoke fewer cigarettes, exercise daily, and eat leafy green vegetables. They don't do these things, at least not everyone does all of them. So, the price of pork rinds, even in a world of omniscient people, might remain above the price of broccoli. But there would be no room for profit or loss. There would only be payments for land, labor, and time (interest).

There are different prices in different markets. If men were omniscient, the differences would be due to such factors as shipping fees. (In the real world, there would be an insurance fee, but not in a world of perfect knowledge.) There would be no differences based on the lack of knowledge. People in all markets would know what every product costs.

In the real world, such a state of affairs can never happen. Even in paradise, man did not have perfect knowledge. Perfect knowledge is an incommunicable attribute of God: "The secret things belong unto the LORD our God: but those things which are revealed belong unto us and

to our children forever, that we may do all the words of this law" (Deut. 29:29). There will always be room for error. This means that there will always be bargaining. There will always be profits and losses.

What would have been different had man not sinned would be the element of deception. Men would not say, "it is naught," if in fact it was really valuable to them. They would tell people "no" only if they really meant "no." People making bargains would not have to guess about being deceived by the other trading partner. This would not mean that every trading partner would have a moral or legal obligation to tell the other one exactly how much he is willing to pay. That knowledge is his private property. No one has a legal right to invade another person's mind, in this world or the next. It would mean that a person would not tell another person a maximum price that is in fact below the true maximum price that he really is willing to pay.

Biblically, a Christian should not deceive his potential trading partner. At the same time, he need not tell everything he knows. He need not give away free information that is valuable to his partner. This information has value. He may be able to buy something cheaper if he does not reveal the maximum he is willing to pay. Similarly, the seller need not tell the buyer that he can buy the same product less expensively across the street or next week at the inventory sale. He may choose to tell him, for the sake of future business as a result of greater confidence on the part of the buyer, but he is under no legal requirement to tell him.

But what if the other person is mentally retarded? What if the other person cannot learn all the alternatives because of some mental or physical defect? From the point of view of civil law, the cases are the same; not in God's law, however. "Cursed be he that maketh the blind to wander out of the way. And all the people shall say, Amen" (Deut. 27:18). Disobey this injunction, and God will curse you accordingly: "And thou shalt grope at noonday, as the blind gropeth in darkness, and thou shalt not prosper in thy ways: and thou shalt be only oppressed and spoiled evermore, and no man shall save thee" (Deut. 28:29).

The Pearl of Great Price

What governing principle does the Bible offer to the individual conscience? If the economically weaker party would be able to locate someone who would make a better offer if it were not for the particular circumstance — pressures on a widow or orphan, legal discrimination against a stranger, etc. — then the economically stronger party should offer a price comparable to what the person might reasonably expect to receive. A person who finds "a pearl of great price" on another person's property has a moral right to sell what he has and offer to buy that property in order to get ownership of the pearl (Matt. 13:44).

But what if the seller is blind, and would never have had an opportunity to find that pearl? The discoverer should remember that God is not blind. The buyer of the field might choose to give, say, half of the net profits in the transaction to the economically weaker party, in order to avoid inflicting economic oppression. (Again, there are no fixed rules available to us, but a 50-50 split is a good operating principle.)

Nevertheless, the Bible is silent with respect to any State prohibition against such a transaction, either retroactively or in advance. To write a legal code that would attempt to cover every similar transaction would become a nightmare of confusion and uncontrolled State power in a short period of time. The behavior of monopolistic bureaucrats is not noticeably superior to profit-seeking buyers of hidden pearls. At least such oppression by private entrepreneurs is not subsidized by the taxpayers.

There are those who deny the legitimacy of a "pearl of great price" type of transaction under any circumstances. They do not understand (or choose to deny) the inescapable fact of **man's lack of omniscience**. They assume, consciously or unconsciously, that accurate knowledge is (or ought to be) a zero-price resource — a resource that really ought to be available free of charge to all, either naturally or through the intervention of the State.

This kingdom parable is important for a proper understanding of entrepreneurship — **forecasting** the economic future and **efficient (low waste)** planning in terms of the forecast. Jesus said: "Again, the kingdom of heaven is like unto treasure hid in a field; the which when a man hath found, he hideth, and for joy thereof goeth and selleth all that he hath, and buyeth that field" (Matt. 13:44).

Consider what the buyer in this parable is doing. He stumbles across an important piece of information: there is a valuable treasure hidden in a field. He is not sure just who it was who hid it there, but now he knows where it is. He presumes that the person who hid it was not the present owner of the field. If the owner of the field hid the treasure, then before he sells it, he will go and search for it. When he does not find it, he can report it lost to the authorities. At that point, the discoverer is required by biblical law to return it to the owner (Ex. 23:4). The Bible does not teach "finders-keepers, losers-weepers." He hides the treasure, and then goes out and sells everything he owns in order to buy the field. Notice that he does not steal the treasure. He is not a thief. He is simply the possessor of information.

He may have done some preliminary investigating, just to see if the present owner of the field is willing to sell it. Still, the present owner may change his mind before the sale is completed. Perhaps the owner may sell it at what he knows is a higher-than-normal market price, since he knows that the treasure has been left there by a vicious criminal who stole it. Perhaps the stolen treasure will be confiscated by the police and turned over to the victim, or the victim's insurance company, as soon as it appears on the market. It is even possible that the treasure is a fake: the owner may have placed a phony treasure on his land just to lure in some ecstatic discoverer. The discoverer cannot be sure. But he takes a chance, meaning that he decides to bear some uncertainty in hope of economic profit. He sells what he owns and buys the field.

Now he owns the treasure. Assume that the police do not confiscate it, and some criminal does not return to collect it. The new owner did take advantage of a special situation: his knowledge of this treasure in his newly purchased field. He took a risk and sold everything. Now he has his reward. He has benefitted himself, and he has given the original owner of the field all that he asked for. If the treasure is worth selling, then someone who buys it will gain access to his heart's desire. Who loses?

Clearly, the original owner might have stumbled across that treasure. On the other hand, he might never have found it. Is it a moral obligation on the discoverer to run to the owner of the field and tell him? Jesus did not indicate that it was. The discoverer has a potentially valuable asset: information. He lacks ownership of the field. The owner of the field also has a potentially valuable asset: title to the treasure. But he lacks knowledge of its presence on his property. Each man possesses something of potential value, but neither man can make personal use of his potential asset: the owner of the field has no knowledge of the pearl, and the man who knows where the pearl is has no economic incentive to make this knowledge public unless he owns the field. Society gets no use of it until the potential asset is translated through market exchange into a known asset. The **opportunity for profit** is what

translates that potential asset into a marketable asset. The discoverer buys the field. In this way, potential assets become market assets.

The modern socialist is outraged at this parable. The entrepreneur (uncertainty-bearing forecaster) who discovered the treasure is seen by the socialist as immoral. First, the land he was on should have been owned by "the people" through the State. Second, he had no business being on the land, since he had no official papers entitling him to be on the State's property. Third, he should never have hidden the treasure again. It belonged to the State. Fourth, if the land was not yet the property of the State, then he should have notified the present owner of the field about the existence of this newly discovered treasure. Fifth, failing to do this much, he was immoral in making an offer to buy the field. He was really stealing from the owner of the field. Sixth, should he attempt to sell the treasure, the State ought to tax his profits at a minimum rate of 50 percent, and probably more. Seventh, if he refuses to sell, the State should impose a capital tax or property tax in order to force him to sell.

Socialists Resent Limitations

What the socialist-redistributionist objects to, in the final analysis, is **mankind's lack of omniscience**. The socialist believes, implicitly or explicitly, that the economy should operate as smoothly, as efficiently, and as profit-free as a hypothetical economy in which each participant has equally good knowledge—perfect knowledge—as all other participants. Knowledge, in a "decent" social order, should be a zero-price resource, equally available to all, and equally acted upon by all. Socialist arguments implicitly assume that it is only the **temporary** existence of such factors as private property, personal greed, and people's willingness to exploit the poor, that has created a world of scarcity, profits, and losses. Knowledge concerning the future should be regarded as a free good, they implicitly assume. Profits are therefore evil, not to mention unnecessary, in a sound economy. This has been the underlying line of reasoning for centuries of all those who equate economic profits with exploitation.

Men are not omniscient. This angers the socialists. They strike out in wrath against the free market institutional order that encourages men to seek out better information, day by day, so that they might profit individually

from its application in economic affairs. The socialists prefer to create legislative barriers that interfere with the operation of the market's "auction for information."

It should be clear why so little innovation takes place in socialist economies. The development—or rather, the lack of development—of commercial technology in the Soviet Union is a representative historical example. Innovation is not a service that people normally offer free of charge to others. It involves creativity, capital, and the willingness to take risks. In a socialist commonwealth, the entrepreneur who is willing to bear uncertainty cannot legally receive payment for the full economic value to society—as determined by market forces—of his innovation. For entrepreneurs to receive full value for services rendered, the socialist commonwealth would have to abandon the collective ownership of the means of production-distribution.

Those who discover treasures in "collectively owned" fields, meaning State-controlled and bureaucracy-administered fields, have these choices: 1) provide information, free of charge, of the treasure's whereabouts to bureaucratic officials of the State; 2) say nothing and save themselves a lot of trouble; 3) work out an illegal deal with some official; or 4) steal the treasure. In the Soviet Union, predictably, the final three possibilities are the ones people choose; the first choice is simply not taken seriously as a sensible alternative.

Conclusion

The haggling of the free market society is necessary to the spread of accurate information. Advertising, open entry for all comers, and comparison shopping all tend to reduce the extent of face-to-face haggling. Haggling as a means of information-gathering becomes less prominent over time as publicly available information spreads, thereby reducing commission rates. The better the information possessed by buyers and sellers, the smaller the zones of ignorance, and therefore the less opportunity for profit as a result of "sharp bargaining." The sharp bargainer cannot obtain large monopoly returns based on the other person's ignorance. The more competitive the economy, the greater the spread of accurate information. By allowing bargaining, the free society reduces the possibilities of profiting through other people's ignorance. When anyone can announce, "Let's make a deal," the deals will be better.