



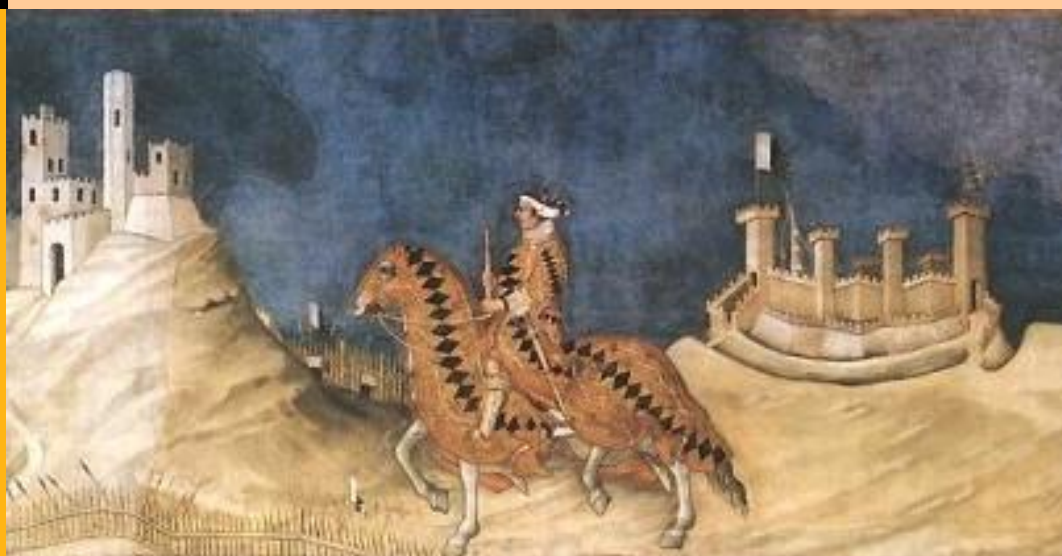
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Mandatory social label system as a super-nudge to reduce  
intention-behaviour gap and increase responsible consumption

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# **Mandatory social label system as a super-nudge to reduce intention-behaviour gap and increase responsible consumption**

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In this paper I discuss the proposal of a mandatory and internationally recognized system of social labelling as an attempt to at least partially reconcile free trade and democracy, modifying the Rodrik trilemma. A mandatory social labelling system can be seen as a super-nudge in the sense of Thaler and Sunstein. I argue that only a mandatory social labelling system can do the job. The current voluntary system is structurally unable to increase socially responsible consumption and to power up an endogenous race to the top in labour standards. I analyse the difference between a voluntary and a mandatory labelling system and discuss the advantages of the latter. It emerges that there are reasons to claim that a mandatory system could sharply reduce the intention-behaviour gap and increase socially responsible consumption, reducing the negative effect of the Rodrick trilemma. A mandatory social labelling system can therefore determine a race to the top in labour regulation, instead of the race to the bottom witnessed in recent decades, with some useful by-products in terms of within-country income distribution and fostering the democratic process in emerging economies.

**Keywords:** credence goods, labelling, social label, international trade, Rodrik's trilemma, moral wiggle room, ethical consumption

**JEL classification:** F1, F6, D12, J8

## 1 Introduction

Economic globalization had many positive effects on world population welfare, such as a sharp increase in efficiency and a robust decrease in poverty in less developed countries. However, it also produced negative effects like a huge world-wide increase in economic inequality, increasing impoverishment of the middle classes in developed countries, and more difficulties in addressing the global environmental problem. Most of the negative effects of globalization have been driven by its deregulating effects.

Economic globalization means free trade of goods and services as well as capital (as we know, the other production factor, labour, is not free to move). Free trade means that when they exchange goods, countries are also implicitly exchanging the rules used to produce them. Importing goods means importing the rules used to produce them. The rules may regard labour markets and labour, environmental, health and safety standards. Exporting capital means that countries engaged in outward foreign direct investment are implicitly importing the rules used in the country where they are investing. Dani Rodrik (Rodrik, 2012) proposed that in the absence global governance, deep economic integration is incompatible with democracy (i.e. the effective ability of a community to rule its economic life).

Free trade of capital and goods therefore has two important, closely related outcomes: the increasing difficulty of national economic policy to affect the welfare of citizens and voters, which in turn creates a widespread crisis of democracy and a race to the bottom in regulation, leading to direct and indirect deregulation of markets. If we lived in the perfect world often depicted by economists in their naive textbooks, this would not be a problem: markets would be perfect and complete, and the invisible-hand hypothesis would hold. Unfortunately, we live in a seriously imperfect world, in which market failures are frequent and require economic policy measures that can at least reduce the negative consequences of these failures on people's welfare.

The crisis of unregulated globalization has increased political instability and resuscitated dangerous ideas such as isolationism and nationalism that seemed relegated to the past.<sup>1</sup> Another important by-product of unregulated globalization was to fuel (mainly right-wing) populism (Rodrik, 2020)<sup>2</sup>.

Here we analyse a possible partial solution to Rodrik's trilemma. The starting idea is simple: since rules travel internationally with goods, i.e. they are implicitly traded with goods, we can use the labelling system to make this trade visible to consumers. Today consumers cannot know the rules under which the product they are about to buy was produced. They cannot choose the rules as voters (Rodrik trilemma), nor can they choose them indirectly as consumers. The main idea is to let them vote with their trolley, since they cannot vote as electors.

A system of mandatory social labels can return some degree of control of production rules to consumers. In this paper I discuss the proposal of a mandatory and internationally recognized

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<sup>1</sup> From a lexical point of view, it is interesting that the crisis of globalization brought a return to popularity of the word "protectionism". Only a few years ago, protectionism was a taboo-word: it had almost completely disappeared from political programmes and was only used by economists in a negative sense, as an example of a policy not to adopt or to suggest. We all know how it went.

<sup>2</sup> Trump's defeat in the 2021 US presidential election does not mean that the danger of right-wing populism is over. Trump was not the disease itself, but just one of its symptoms. And the disease is all but over.

system of social labelling in an attempt to at least partly reconcile free trade and democracy, modifying the Rodrik trilemma.

A system of mandatory social labels can be seen as a nudge (or a super-nudge) in the sense of Thaler and Sunstein. A nudge *“is any aspect of the choice architecture that alters people’s behaviour in a predictable way without forbidding any options or significantly changing their economic incentives”* (Thaler & Sunstein, 2008). A mandatory social labelling system only modifies the consumer's information set, making the social content of the good manifest and explicit by means of a label. Instead of changing the position of the fruit on the shelf, the mandatory social labelling system informs consumers how all the fruit on the shelf was produced.

I argue that only a mandatory social label system can make a difference. The current system of voluntary social labelling is structurally unable to increase socially responsible consumption and to power up an endogenous race to the top in labour standards. The possibility of changing trade content through consumer choice has been foiled by the fact that current flows of international social trade are very small. A major intention-behaviour gap has also been observed. This gap is the hiatus between consumers' praiseworthy intentions, often captured by surveys, and their actual behaviour, shown by their market choices (Dickson, 2014). This gap has greatly reduced trust in the possibility of changing the current pattern of international trade through responsible consumption, that is through consumer willingness to pay a social premium for fair trade goods.

A mandatory system is obviously different from the existing system of voluntary social labelling. The voluntary labelling system means that a company can label its product as socially responsible using the label of an external organization, such as Fairtrade International<sup>3</sup>. My main point here is to analyse the difference between a voluntary and a mandatory labelling system and to discuss the advantages of the latter. My analysis suggests that there are reasons to claim that a mandatory system would sharply reduce the intention-behaviour gap and increase socially responsible consumption.

The paper is organized as follows. In the first part, voluntary and mandatory labelling systems are presented and their differences analysed. In the second part, I discuss ethical consumption and the intention-behaviour gap, showing how a mandatory social labelling system can reduce this gap. The analysis suggests that the mandatory social label may trigger a race to the top in labour standards. A brief conclusion ends the paper.

## **2. Voluntary vs mandatory label**

From an economic point of view, we need product labelling when there is an information failure. If we lived in the perfect world mainstream economists use in their abstract models, consumers would know everything they need to know about the products they are about to buy. A label could not add any further information.

On the contrary, if goods have certain attributes (credence attributes) that cannot be known or discovered by consumers even after purchase and consumption, labelling is a way to solve information asymmetry (Brice & Mallar, 2020; Roe, Teisl, & Deans, 2014). Food labels are a classical example: a list of ingredients is mandatory; Typical Geographic Indication is voluntary. Consumers

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<sup>3</sup> See for example the Fairtrade International web site <https://www.fairtrade.net/>

do not know how the cake was prepared, at best they know the ingredients. Even by eating the cake, they cannot deduce this other information.

The welfare effect of introducing a label is not easy to evaluate for several reasons. From a general point of view, the introduction of a label segregates a market that was hitherto unified, influencing market structure and reducing competition (Bonroy & Constantatos, 2015). Thus we have eliminated one imperfection in exchange for another (a typical second best condition). Likewise, the welfare effect of the information failure is difficult to measure. Not all information is important or has the same degree of importance. The name of the person who cooks your hamburger at Hungry Joe's is much less relevant than the name of the chef in a Michelin 3-star restaurant. A general analysis is even more difficult since there are different types of label that can be adopted in different contexts.

Interestingly, in the recent past, the labelling system also considered public goods to have credence attributes. In this case, the credence attributes do not regard unobservable features of the good that affect the personal, egoistical interest of the consumer, but characteristics that the consumer considers important from a social point of view, e.g. environmental and social sustainability. Of course, this means assuming that the consumer has social preferences, since *Homo economicus* would not ascribe any importance to these aspects.

There are many examples of such labels, ranging from environmental to social, such as the Fair Trade label. In some cases, labels provide information on intrinsic but hidden characteristics of a good, in others on its process of production. In the case of public good credence attributes, evaluation of the effect of a label is even more difficult because we have to compute external effects and interaction of the market where the label is introduced with other markets.

Obviously, the effects and cost of a label are different if the label is voluntary or mandatory (Roe et al., 2014; Zilberman, Kaplan, & Gordon, 2018). Since introduction of a label is costly for the firm and consumers, a major differences regards the distribution of costs. Take the case in which a label provides information on the presence or absence of an ingredient in food. In the case of a voluntary label, the cost of the labelling system is only borne by consumers interested in the information, whereas in the case of a mandatory labelling system, the cost is borne by all consumers, even those not interested in the information. Mandatory labelling is therefore justified when ignoring the information can be directly dangerous for consumer safety, for example labels regarding allergens, or when a general interest is pursued by the labelling system.

Recently, some interesting new kinds of label have been adopted in many advanced countries. These are labels that provide information useful for consumers, selfish and otherwise: e.g. the European energy label on appliances manufactured or sold in Europe, and the nutritional facts labels which give information on the calories and fat in foods. They are interesting from two points of view. First, they are a mixed case in which information is useful for egoistic reasons (to save energy and to eat healthier), but since individual decisions also have major external effects, they also have a public-good component. Second, they are mandatory and not voluntary. The regulators therefore considered it necessary to provide this information to all consumers. In this case, the label is nothing but a nudge, which without banning goods, is designed by policy makers to influence consumer choices in the direction of consumer and social interests. Consumers are free to decide what they prefer, but before choosing, they must be able to access all the relevant information in a

standardized, clear and cheap way. Consumers can still buy an energetically inefficient refrigerator or very fatty and over-salted food, but they cannot pretend to do so for lack of information. They cannot lie to themselves, thinking: *If I had known that, I would not have bought the good*. Moreover, the mere fact that the label is on the package or the door of the dishwasher nudges the consumer to pay attention to nutrition information and energy consumption.

## 2.1 From energy label to social label

The current version of the European Energy Labelling Directive (ELD) was approved by the European Council in 2010. The Directive establishes the framework for an energy label for household appliances, requiring manufacturers and retailers to display a comparative label. The labelling system had the aim of providing information on energy efficiency with different formats for different appliances<sup>4</sup> and on the estimated total annual consumption of energy in kilowatt hours<sup>5</sup>. The energy label quite effectively communicates the energy efficiency of the appliance using categories in the form of letters from A to G (A+++ being the most efficient and G being the least efficient). The letter is associated with a colour which goes from intense green to bright red with decreasing energy efficiency. The estimated annual energy consumption is always mentioned on the label and indicated in simple numerical form in kilowatt hours.<sup>6</sup> The aim of the European Union is to encourage a reduction in energy consumption by favouring the purchase of more efficient domestic appliances through indicating running costs in terms of energy consumption.

The effectiveness of this choice appears evident as soon as you enter a store of electrical appliances, especially in the large household appliance department: today appliances belonging to categories below A have almost completely disappeared. In the case of products with high energy consumption, such as refrigerators, it is also very difficult to find products that have only A without at least one “plus”. The reason is evident; a company selling a product with a B energy label would immediately qualify its product as being of lower quality. The price difference to convince consumers to purchase such an appliance would presumably be economically unviable for the company. In the absence of a mandatory label, there would probably be a place for cheap products with low energy efficiency. Companies producing highly efficient products could still indicate the greater energy efficiency of their products, while companies producing low-quality appliances would give vaguer or no information. With ambiguous information, even a small price difference can of course play a major role.

The effectiveness of the European energy label is also testified by the recent decision of the European Commission to modify the labelling system, totally redefining the energy classes<sup>7</sup>. In fact, the mandatory labelling created an evident race to the top, that recently obliged regulators to add more and more pluses to the A to indicate more efficient devices. The new label shifted the energy standards upward. For example, the current top class is now B. The regulator has left class A empty, awaiting some innovative company that will invent a new, let’s say, refrigerator that meets the more ambitious standard.

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<sup>4</sup> See ENEA brochure [Http://www.enea.it/it/pubblicazioni/pdf-opuscoli/OpuscoloEtichettaEnergetica.pdf](http://www.enea.it/it/pubblicazioni/pdf-opuscoli/OpuscoloEtichettaEnergetica.pdf)

<sup>5</sup> For example, the rating of TV screens is calculated on the basis of energy consumed per square decimeter of screen.

<sup>6</sup> The scale varies with type of appliance.

<sup>7</sup> See Regulation (EU) 2017/1369 of the European Parliament and of the Council of 4 July 2017 setting a framework for energy labelling (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R1369>)

If we consider the scientific evidence, several recent empirical papers show that introduction of the energy labelling system did indeed increase the market share of appliances with energy ratings of A+ and above (Schleich et al., 2021, and Bjerregaard & Møller, 2019, among others). In conclusion, the system seems to work correctly.

So why not apply the same system to social labelling?

Social labelling and energy labelling are obviously quite different. The former does not aim to fix a failure in individual consumer behaviour. Aside from the case in which the consumer has a particularly high individual discount rate and assigns little value to future energy saving, the present discounted value of savings on future energy bills is generally higher than the price differential of more energy efficient equipment. The fact that consumers do not invest in energy-saving appliances with positive expected net current value has been defined as the *energy-efficiency gap*. This is clearly a case of market failure: a slower than socially optimal spread of energy-efficient products (Gillingham & Palmery, 2014) is one of the many market failures in the area of the environment that led to the problem of global warming.

On the other hand, it is not in the individual interest of consumers to buy ethical goods. The idea is nevertheless the same: to give consumers information that they could not otherwise obtain directly, and to enable comparison of different products on the basis of social parameters. By making this information mandatory, the consumer's attention is called to characteristics of goods that cannot be directly observed.

A mandatory social labelling system could be similar in form to the energy label. Class A would indicate that the good was produced observing labour standards, namely under conditions "*aimed at promoting opportunities for women and men to obtain decent productive work, in conditions of freedom, equity, security and dignity, and of respect for workers' freedoms and rights*" (International Labour Organization, 2014). Class F would indicate that the good was produced without any regard to labour standards, and intermediate classes would describe intermediate situations.<sup>8</sup>

Debate on the technical feasibility of the proposal must start from the observation that there is a clear difference between energy certification of household appliances and social certification of goods. While the former is based on physical parameters, the latter is based on criteria that are political and qualitative, and therefore much more difficult to condense into a simplified quantitative rating. While some doubts on the technical practicability of generalized mandatory social certification of goods are therefore legitimate, it must be recognized that we are not starting from scratch. First, the experience of voluntary social labelling, such as that of Fairtrade International, discussed above, is an interesting and rich starting point. Secondly, in recent years the International Labor Organization (ILO) has played a fundamental role in identifying *labour standards* that could easily be the foundations of a social certification system.

Though founded in 1919, the ILO is currently an organization of the United Nations. It is the only United Nations agency that brings together governments, employers and workers of 187 member States. It has the purpose of setting standards in labour relationships and developing policies and programs promoting decent work for all women and men in member countries. Although it is by

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<sup>8</sup> In what follows we speak mainly of social certification, but much will also apply to environmental certification; advanced social certification could include both aspects.

nature the most political of supranational bodies, or perhaps precisely for this reason, its role and profile appear to have receded in the last 20 years, especially compared to the IMF, the World Bank and the WTO. Liberalization and deregulation of the labour market have been fundamental ingredients of the economic programs of mainstream neoliberal economic ideology. An organization whose main objectives are to promote rights in the workplace and improve labour protection was considered superfluous and antiquated in the best case, a pernicious barrier to free trade in the worst. The myth of free international movement of goods could not permit differences in labour market regulation to be an obstacle to international trade.

In June 1997, the ILO proposed social labelling for goods from countries that guarantee the fundamental rights of workers. Although the labelling would have been purely voluntary, the proposal met with crossfire from many developing countries and representatives of large multinational companies, receiving only tepid consent from developed countries. The ILO General Secretary withdrew the proposal a few months later. Twenty years since then, many things have changed. Globalization has shown all its weaknesses and is no longer the undisputed dogma it was in 1997. As far as we are concerned, the ILO's attempt to launch social labelling can only confirm its technical feasibility, since the ILO is the top agency with experience in this field.

The ILO proposal was based on various Conventions that it had discussed and approved, regarding forced or otherwise unfree labour, freedom of association, right to collective bargaining, gender and other discrimination, and child labour. The ILO has refined these criteria in the course of time, developing clear priorities.<sup>9</sup> Starting from ILO work and from other private social labelling experiences (such as SA8000 certification), a labelling procedure showing a rating from A to E, depending on compliance with standards, does not seem technically impossible or even particularly difficult. Moreover, there would be an international organization with the necessary reputation and technical skills to manage the label and defend its credibility through a system of checks and tests. Of course, this does not mean that there cannot be technical difficulties and economic costs to deal with, but that such difficulties are not insurmountable.

## **2.2 Mandatory social label and protectionism**

Can the proposal have protectionist effects? On a priori grounds, it seems unlikely. As long as it is not used to ban certain imports (e.g. goods with a very bad social rating), or to introduce tariffs based on social rating, the measure is not inherently protectionist since it does not distinguish goods according to the country in which they were produced and does not violate any WTO rules. The requirement of a social label holds for domestic and foreign goods alike.

On the other hand, given existing differences in employment protection legislation between developed and less developed countries, the measure might change the comparative advantage of less developed countries, decreasing their trade flows to developed countries. Assuming that consumers are at least partly ethical and prefer goods with a higher social ranking, and that in less developed countries it is more difficult to meet the requirements for a high social ranking, in the short term, for logistic and political reasons, we might expect a reduction in south-north trade. This point was raised by (Bhagwati, 1995) in a well-known paper. He considered the idea of inserting a social clause in trade agreements to be nothing more than "the desire of labour unions [in rich

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<sup>9</sup> ILO international labour standards can be found in a publication of the institute (ILO 2014).



countries] to protect their jobs by protecting industries that face competition from the poor countries". Reading the paper again after than 25 years, most of his statements appear quite naïve (or over-optimistic), especially with respect to environmental standards (World Bank, 2007). Contrary to what he thought, a race to the bottom in social and environmental standards actually took place (Davies & Chaitanya Vadlamannati, 2013; Olney, 2013).

Theoretically speaking, we can add that in the presence of different labour standards, the comparative advantage of less developed countries in labour intensive goods is mainly the result of two components: differences in relative factor endowments (in the spirit of Heckscher–Ohlin) and differences in labour legislation that yield lower wages in the less regulated labour market. Mandatory social labelling does not in any way affect the first channel of comparative advantage. On the contrary, by partially eliminating the difference in relative wages due to political differences, it brings out the *true* economic comparative advantage.

On the other hand, it remains to be proved that a mandatory social labelling system will have the effect of reducing exports of less developed countries. Obviously, we do not have any empirical work on which to base an evaluation, since such a system does not yet exist. By looking at similar instruments, Carrère, Olarreaga & Raess (2021) recently showed that contrary to Bhagwati's idea, the introduction of a labour clause in preferential trade agreements increases exports of low and middle-income countries with weaker labour standards in north–south trade agreements. In a theoretical framework, Cueto (2017) shows that under some circumstances a global lower bound for minimum wages that re-establishes the competitive wage rate in very poor countries is a Pareto improvement: it enhances markets due to increased sales caused by the increase in real wages of the vast majority of workers.

From a political point of view, it can be noted that a mandatory social labelling system can not only have the effect of increasing the world average wage, but also the indirect effect of fostering the inception or strengthening of intermediate social institutions, such as trade unions in less developed countries. This in turn can enrich and enhance the quality of the institutional setting available in the less developed country. The low quality of the institutional framework is seen as one of the most important obstacles to economic and social growth in these countries.

### **3 Ethical consumption and the intention-behaviour gap**

Ethical consumption can be defined as a form of consumption that is consistent with a set of ethical principles and rules. In deciding what to buy, ethical consumers not only consider the intrinsic characteristics of goods and their price but also their ethical and social content. Ethical consumers purchase and use products and resources not only according to their personal interests but also according to ideas of what is right and good, versus wrong and bad, in a moral sense (Starr, 2009).

From an empirical point of view, ethical consumer behaviour is observed regularly in real life and certainly exists. It is equally obvious, however, that only a tiny minority of consumers choose socially certified goods, and that the proportion of such goods traded daily in the market is small.

In order to change trade flows via consumer choice we must assume that a large proportion of consumers do not behave in a purely selfish way. Faced with two goods that equally satisfy consumer needs, a selfish consumer will always prefer the cheaper good, without assigning any importance to its ethical or social characteristics.

The crucial question is whether the low level of social certified goods traded in the world economy depends on the scarcity of ethical consumers or on the difficulties experienced by ethical consumers in aligning their consumer choices with their ethical values? Can a system of social labelling change the environment and close the gap between intentions and behaviour? It is impossible to observe the number of ethical consumers directly. The number can be obtained indirectly through sample surveys, or it can be deduced from the actual size of ethical trade, which can be estimated quite precisely. The data from surveys on the willingness of consumers to purchase ethically responsible goods offers a very encouraging view of consumer willingness to pay an ethical premium, although in everyday life, few are actually willing to purchase ethical goods when faced with the monetary cost and the ethical premium. For example, a study showed that while 89% of British consumers declared that ethical questions came into play when they made a purchase and 30% explicitly stated that they were willing to pay an ethical premium, yet only 3% actually purchased ethical products (Carrington et al., 2014).

Scholars have called this evidence the intention-behaviour gap, the hiatus between praiseworthy intentions and actual behaviour (Dickson, 2014). Orthodox economists would give a fairly simple explanation of the paradox: as long as generosity is free and has a positive return (creating a worthy self-image), it is over demanded; when a positive price has to be paid (the ethical premium), demand collapses. Heterodox economists and psychological and sociological scholars suggest other possible explanations: most focus on the passage from will to action (influenced by external factors and internal cognitive processes) and on consumer decision-making which may inhibit translation of intentions into actions (Caruana, Carrington and Chatzidakis, 2016, Carrington, Zwick and Neville 2015).

Let us now examine three elements that can affect the passage from will to action and that can in turn be influenced by labelling: incomplete markets, moral wiggle-room and reciprocal behaviour. The main point is simple. Transforming the labelling system from voluntary to mandatory can reduce the intention-behaviour gap via its effect on these three elements.

### **3.1 Ethical consumption and market incompleteness**

How do consumers translate their willingness to make ethical consumer choices into real purchasing decisions? Through the market, obviously. Markets, however, are not complete but strongly segmented into the fair-trade market, where socially certified goods are traded, and ordinary markets, where all the other socially uncertified goods are traded. In an ideal complete market, a consumer could find both types of good: socially certified and not. Only in this ideal market are consumers truly free to translate intention to behave ethically into real behaviour.

Fair-trade certified t-shirts are different in design, brand, and colour from all the others, not socially certified, including the coolest and most fashionable ones. This was probably not taken into account by the consumer when she expressed her intention to buy ethically. When she answered that she was willing to pay an ethical premium for a good with satisfactory ethical content, she meant all other things being equal. In other words, between the identical goods with the same characteristics and the same attractiveness, she was willing to pay a higher price for ethical content. In the real market, the ethical motivation came into conflict with aspects other than price. She was willing to pay a premium for a fashionable bag that also has an ethical certification but not for a socially certified bag she does not like.

Let us take a different example. Assume that the consumer is truthful when he claims he would be willing to pay an extra euro (our ethical premium) to buy a novel printed on recycled paper. At the bookstore, however, he discovers that the books printed on recycled paper are only science fiction novels while he prefers romantic novels. His final choice, a romantic novel printed on virgin paper, will appear at odds with his claim, but the reason is *not* that the consumer was incoherent or that his real willingness to pay was actually zero, as orthodox economists would suggest. On the contrary the incompleteness of the market is to blame. In fact, the romantic novels the consumer likes are not available on recycled paper. At the bookstore, the consumer is torn between being consistent with his initial ethical considerations and what the market offers. His choice between a novel he does not like, though printed on recycled paper, and a novel by his favourite writer, but printed on virgin paper, is completely understandable and is due to incompleteness of the market, not to consumer incoherence.

In more formal terms, the ethical content of a good is only one element of the consumer's utility function (other elements may be colour, fabric, style, design, brand, etc. in the case of a pair of pants). Each will have a weight that varies from consumer to consumer. Markets are not complete, i.e. it is not possible to purchase the ethical version of all possible goods. In a strongly segmented market, ethically certified goods are different in many other ways from most similar uncertified goods.

The ethical premium therefore has two components, the explicit monetary one represented by the higher price of the certified good and the implicit non-monetary one represented by the cost of giving up all the attractive characteristics, possibly advertised by pervasive marketing campaigns, of the non-certified good. The consumer cannot perfectly adjust his choice due to market incompleteness, resulting in the intention-behaviour gap. The ethical premium is greater than it would be if the markets of certified and uncertified goods were integrated.

Furthermore, certification is currently only positive and not negative. Only a very small percentage of the products that the consumer can buy have a reliable social certification that assures the consumer that some ethical and environmental standards were complied with during the production process. The bulk of goods (all others) do not have any social certification, i.e. the consumer is not given any information about how the good was produced and what the environmental costs of its production were. Naturally this does not mean that during production, the standards that the consumer might consider ethically desirable were not complied with.

Another important aspect is the fact that globalization recently changed the social paradigm. Certain goods are produced all over the world; the global value chain makes it very difficult to know how and where the various components of a good were produced. The old distinction between imported and domestically produced goods is no longer clear. A good may appear to be produced domestically, and therefore to comply with a known set of social standards, but is actually a combination of pieces produced in other countries. It is very hard for a consumer to associate the article of a well-known fashion brand that he is admiring in a downtown boutique, with a sweatshop in Bangladesh where employees work in very poor sanitary conditions. However, this often is where at least part of the production has taken place.

If our hypothesis is correct, the potential of ethical consumption is much more promising than what the current data on ethical consumption actually seems to show. But to decrease the intention-

behaviour gap, it is necessary to radically modify the way information is transmitted to the consumer and the social certification system itself, integrating markets in a much greater way. The only way that we have to obtain this result is to introduce a mandatory labelling system. Its effect will be to reduce market incompleteness by removing segmentation between the few socially certified goods and all the others, and by making the possible trade-off between the other important characteristics of the good and its social content transparent and explicit to the consumer.

### **3.2 Moral wiggle-room and the intention-behaviour gap**

Some years ago in a seminal paper, Dana, Weber and Kuang (2007) reported some interesting evidence. Experimental subjects tend to remain willingly uninformed about the effect of their actions on third parties. This result immediately appeared tricky, because intentionally ignoring relevant information is inconsistent with the hypothesis of economic rationality. Moreover, the experiment showed that selfishness increases significantly in the absence of transparency. In a dictator game, the researchers found that individuals prefer to have something like moral wiggle-room in order to behave more selfishly. They purposely avoided information about the consequences of their actions on other people in order to be freer to take the more profitable decision.

The results of Dana et al. (2007) were confirmed by later studies (D’adda et al. 2018; Grossman 2014; Larson and Capra 2009; Matthey and Regner 2011, among the others): people use strategic information avoidance to behave less generously<sup>10</sup>.

Two main explanations for moral wiggle-room have been proposed. First, it can be seen as an attempt to reduce cognitive dissonance (Konow, 2000; Nyborg, 2011). People are torn between the desire to obtain the maximum material benefit and the wish to align their actions with their moral values. A simple way to reduce this tension and therefore to reduce the moral cost of behaving selfishly is to avoid and ignore information that could highlight the moral cost of an action.

An alternative way to rationalize strategic information avoidance is to see it as an instrument to defend personal self-image (Bénabou & Tirole, 2011; Grossman & van der Weele, 2017). As long as one decides under the veil of ignorance, one can still entertain the illusion of being pro-social and altruistic. Once the information is out, one can no longer lie to oneself and pretend to be good while behaving selfishly.

People who use strategic information avoidance are not pure selfish people; if they were, they would not care about the consequences of their actions on others and would behave in the same selfish way whether or not they uncovered the information. Only people with some social preferences would be motivated to strategically avoid information to prevent moral constraints from affecting their actions. Nor can they be pure altruists, as these would have no gain from avoiding information on the effects of their actions, since they would behave pro-socially in any case.

Following Matthey and Regner (2011) and Momsen and Ohndorf (2020), we can say that there are three types of person: selfish (or people with very weak social preferences), altruistic (people with strong social preferences) and intermediate (people with mild social preferences). Only the latter

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<sup>10</sup> Other studies found mixed result, see Felgendreher 2018; Lind, Nyborg and Pauls 2019; Momsen and Ohndorf 2020).

exploit the moral wiggle-room offered by the possibility of ignoring information. Since remaining uninformed is a necessary condition for pursuing their self-interest, when the consequences of their action are made evident, some or all of them will adopt pro-social behaviour.

This result is quite interesting when we discuss the effect of introduction of a mandatory labelling system. With a voluntary labelling system, when a consumer enters a shop he can choose from a minority of goods with a social label and many goods without any certification. In the first case the consumer has some credible information regarding the fact that the good was produced in compliance with some minimum social standards, depending of course on the nature of the label. In the second case, the consumer does not have any information about the social content of the good. He cannot infer any real positive information on the social content of the good. It may be produced in a sweatshop or in an innovative, safe, socially sustainable factory. Part of the production may have taken place (or some of the intermediate goods may have been produced) in a sweatshop and the rest in a modern and socially well-organized firm. So a consumer who buys an uncertified good in a sense prefers to remain uninformed about the social content of the good.

As already outlined, a system of voluntary social labelling would not affect the decision of the selfish consumer. She does not care about the social content of the good; for her, the difference between voluntary and mandatory social labelling system is completely irrelevant. Likewise, the pure altruistic consumer with strong other-regarding preferences is not affected by whether the labelling system is voluntary or mandatory, since she does not avoid any information. She aligns her trolley choices with her moral values and is willing to pay an extra cost, both in terms of ethical premium and shopping convenience (seeking out the right shops and the right goods).

Momsen and Ohndorf (2020) showed that wilful information avoidance can indeed occur in specific markets for goods with environmental or social co-benefits. It mainly regards people with mild and not so strong social preferences. They are torn between doing the right thing and saving money. Buying an uncertified good that offers no information, positive or negative, on social content enables them to reconcile their choice with their internal moral values. The lack of information suits them because they can hide behind it.

It goes without saying that if all such information were easily accessible for every good via a system of mandatory social labelling, they would be forced to resolve their internal conflict. According to how altruistic they are, they will decide in favour of the good with the high social label and a higher ethical premium or the cheaper good with a poor social ranking. At least some of them will increase the demand for socially responsible goods.

So changing from a voluntary social labelling system to a mandatory one will predictably increase ethical consumption by making it impossible for consumers to remain comfortably in their moral wiggle-room. At least some of them will translate their good intentions into pro-social behaviour.

### **3.3 The mandatory social label, companies and reciprocal consumers**

The mandatory social label can also be a nudge for firms. It could influence the conduct of large enterprises, especially those for whom brand reputation is a major asset. Selling goods with a low or moderate social rating could undermine the reputation and credibility of a brand, jeopardizing an important source of competitive advantage. Often these companies have high-profit margins (due to the added value of the brand) and their prices may be much higher than those of similar

products with unknown brands. Under a mandatory labelling system, it would be inconsistent from a marketing point of view to sell cool trendy sneakers in an elegant shop downtown at three times the price of similar no-logo sneakers in a discount store, if both products share the same low social rating. With the current system, consumers do not receive any information about the social content of either product. They might even infer from the high quality of the brand and its high price that the branded good was produced in conformity with labour standards. By analogy, it is reasonable to extend the quality of the final product to the quality of the industrial process. Under a mandatory labelling system, this information fallacy can no longer be exploited by companies. Profit-maximizing firms will have to consider the response of reciprocal consumers (Fehr & Gächter, 2000).

A reciprocal consumer can accept the low ethical "quality" of the cheap sneakers, but is not willing to pay a high price for goods with a low ethical rating. A consumer with weak social preferences but with a reciprocal attitude is willing to buy a good with a poor social rating when he believes that the benefit of minimizing production cost at the expense of ethics is transferred to him via a low price. However, a high price and a poor social label suggest that the benefit of the poor social standards only accrues to the firm. In this case, the consumer is much less likely to accept the deal and may be inclined to punish the firm for its opportunistic behaviour. This is what happens in the Ultimatum Game, the experimental game studied by behavioural economists (*Handb. Exp. Econ. Vol. Two*, 2016). There are two players. One player, the proposer, is given a sum of money. The proposer is asked to split it with another player, the responder. Once the proposer makes his decision, the responder may accept or reject it. If he accepts, the money is split as proposed by the former. If the responder rejects the proposal, both players receive nothing. Both players know in advance the consequences of the responder accepting or rejecting the offer. Experimental evidence suggests that some players are willing to give up the monetary prize in order to punish the other player if the latter is behaving unfairly. The first player, the proposer, knows this and forecasting such behaviour, anticipates it by increasing the amount of money left to the responder.

Large companies with well-known brands can behave like the proposer in the ultimatum game. They can reduce the price of the good, transferring the advantage of a poor social quality production system to the consumer, or they can increase the social rating of the goods they market, improving the social content of the production process. In any case the mandatory social label can be an indirect nudge to firms favouring pro-social behaviour without directly forcing their behaviour or explicitly modifying their incentives.

In addition, the marketing strategy and communication policy of a company selling fashion sport outfits, for example, may be based mainly on the evocative power of the brand. In advertising, a sports brand is often associated with the idea of fair competition between athletes, a healthy lifestyle, open-air activity and care for the natural environment. The advertising message may suggest that purchasing the shoes implies belonging to a community of loving, happy, loyal and sporting people. In some cases, the brand is also involved in campaigns against racism that promote fair play and sport as a vehicle for world peace. All these messages are incompatible with shoes produced in a dangerous Bangladesh factory where workers are exploited and human rights and union membership are denied. A poor social label can clash with a trendy, often pro-social brand, dramatically increasing the reputational cost of a policy of extreme and cynical cost minimization.

Let us take the example of Apple, one of the most famous brands in the world. The Cupertino company is known to have very high-profit margins and the cost of labour to be only a tiny percentage of the final cost of the product (Clelland, 2014). With such high-profit margins and with such low labour costs in relative terms, would it be politically and culturally sustainable for Apple to sell its products with a poor social rating? The working conditions of Chinese workers in some of Apple's gigantic suppliers (Foxconn and Pegatron) are not so good, to put it mildly, as shown in detailed inquiries by various independent NGOs. The minor improvements recently recorded were indeed the result of media pressure and concern for brand reputation. This is proof of the effect of increasing public awareness of the social and human costs of certain production systems. Mandatory social labelling does not directly prevent Apple from outsourcing production to socially poor firms, but forces the company to make this policy and its social impact transparent to consumers, potentially increasing the reputational cost of increasing profits at the expense of labour standards.

More generally, the introduction of mandatory social labelling does not directly change the choices of firms but modifies their milieu. It means that any trade-off between cost minimization and social content of production will be credibly visible, verifiable and known ex-ante to consumers. The trade-off becomes shared and verifiable, making the cost (in terms of brand reputation) of deceitful cost minimization, based on social dumping, explicit and foreseeable.

It goes without saying that mandatory social certification of goods can also operate in the other direction, i.e. in a positive sense, increasing returns from a positive image and ethical reputation for companies that decide to invest in a fairer production chain, taking the rights of workers and environmental sustainability into account. In the absence of social certification, a company embarking on more equitable and fair production has no way of communicating this information to consumers, except by unilateral declarations or ineffective indirect mechanisms such as Corporate Social Responsibility. On the contrary, such a company must face unfair competition from firms that exploit opacity and lack of information about how their goods are produced.

Finally, it should be noted that mandatory social labelling forces firms to expressly choose the social standard of their products, and this choice may have repercussions on consumers downstream, as well as on shareholders upstream. A firm that chooses to produce and/or commercialize solely goods with high social standards can attract investors and shareholders who wish to bring their own investment decisions under ethical principles. How a company is ranked regarding the social certification of its products could become a much simpler and more effective way of assessing the ethical and social responsibility of firms than obscure and complex social accounts, which are quite often the result of social washing and marketing operations. Likewise, companies that choose low social and environmental standards for their products would be avoided by investors who want to invest in a socially responsible manner. The social label would therefore also have the effect of stimulating ethical finance and investment as well as ethical consumption.

#### **4 Concluding remarks**

Free trade in capital and goods dramatically deregulates the economy. Along with goods, countries end up importing the rules used to produce them. Capital tends to go where net profits are higher and production costs lower, seeking out countries where taxation is low and labour and environmental regulations are lax. As Rodrik as pointed out, without global governance, the level of

economic integration is incompatible with a community's ability to determine how it rules its economic life.

This present paper proposed a third way besides accepting the deregulation of profound economic globalization and reducing the degree of economic globalization by reintroducing some form of protectionism. A mandatory system of social labelling can act as a nudge that could lessen the deregulative effect of globalization without introducing any form of authoritative intervention or creating trade barriers that reduce economic efficiency. If people cannot effectively determine the social rules that govern the community in which they live by voting in elections, they can affect them indirectly as consumers by "voting" with their trolley.

A mandatory social labelling system would render transparent the opaque exchange of rules that takes place when countries trade goods. It could increase socially responsible consumption by reducing the intention-behaviour gap. It would lower market segmentation (between few voluntary socially certified goods and the mass of uncertified goods) and moral wiggle-room effects. It could also have an important effect on the behaviour of firms: the transparency and communicative power of a social label make it difficult for a company whose main competitive advantage lies in the reputation of its brands to offer goods with a poor social label. Unscrupulous strategies of cost minimization are currently concealed by various sophisticated social-washing methods.

A mandatory social labelling system can therefore determine a race to the top in labour regulation, instead of the race to the bottom that we have witnessed in recent decades, and can also have some useful by-products that range from income distribution to the democratic process in emerging economies.



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