Behavioural Economics and Economic Policy

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Outline

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Bounded rationality

Behavioural economics:
empirical data about actual human decisions

$\Rightarrow$ Humans rather than econs
constraints on information processing, limited knowledge, heuristics and biases, ...

$\Rightarrow$ Decision making is sensitive to frames
Choices do not always maximise utility; supposedly irrelevant aspects of the environment determine which choices are made

Different phrasing

600 people affected by a deadly disease:

- option A saves 200 people's lives
- option B has a 33% chance of saving all 600 people and a 66% possibility of saving no one

72% of participants chose option A
28% of participants chose option B.

Tversky & Kahneman (1981)

Different phrasing

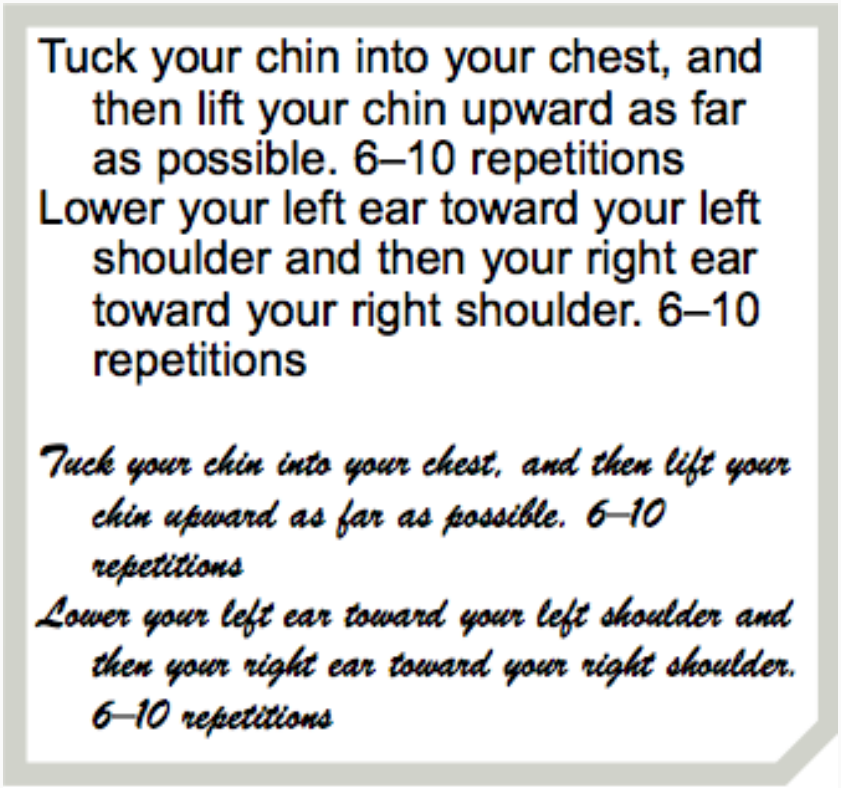
600 people affected by a deadly disease:

- option A ~~saves 200 people's lives~~ 400 will die
- option B has a 33% chance ~~of saving all 600 people~~ that no people will die and a 66% possibility ~~of saving no one~~ that all 600 will die

~~72%~~ 22% of participants chose option A
~~28%~~ 78% of participants chose option B.

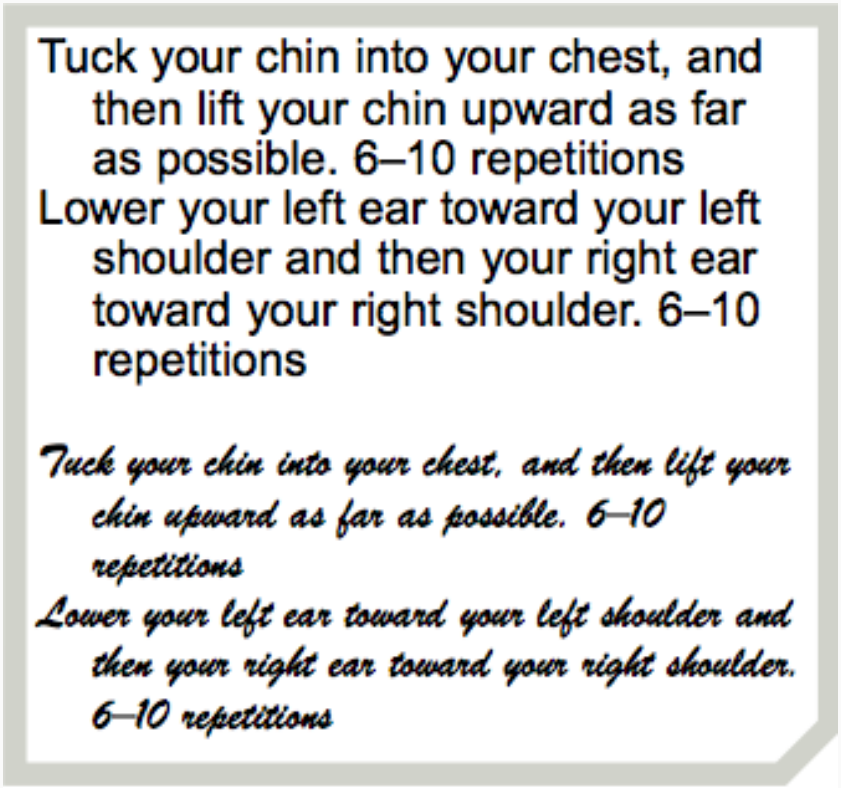
Tversky & Kahneman (1981)

Fluency



Subjects estimated that the task would take 8mns, respectively 15mns, depending on the font.

Fluency



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Constructing preferences

Asymmetric dominance:

Choosing one's vacation

- Rome
- Rome without coffee
- Paris

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Choice architects

Choice architecture = how the choices are presented

Choice architectures are means to influence which choices are made without (in Thaler and Sunstein's perspective) strongly changing the incentives.

Nudging decisions

Designing the environment in which people make choices
examples:

- Menus or store layouts
- Organ donation

Nudging pissoir

Nudging pissoir

Roles and duties of politicians as choice architect

Libertarian paternalism
or just informed policy making?

"gallon per miles" awareness policy
or increase in gas tax?

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Cross-cultural behavioural economics

Cross-cultural experimental economics

Experiments show that economic decisions vary across cultures even when the alternatives are (through experimental settings) made identical

Variation in altruistic behaviour

Depending on their culture, economic agents can be more or less altruist when playing experimental games

How to account for this cultural diversity?
The "Collective's view" : variations in group beneficial altruistic preferences

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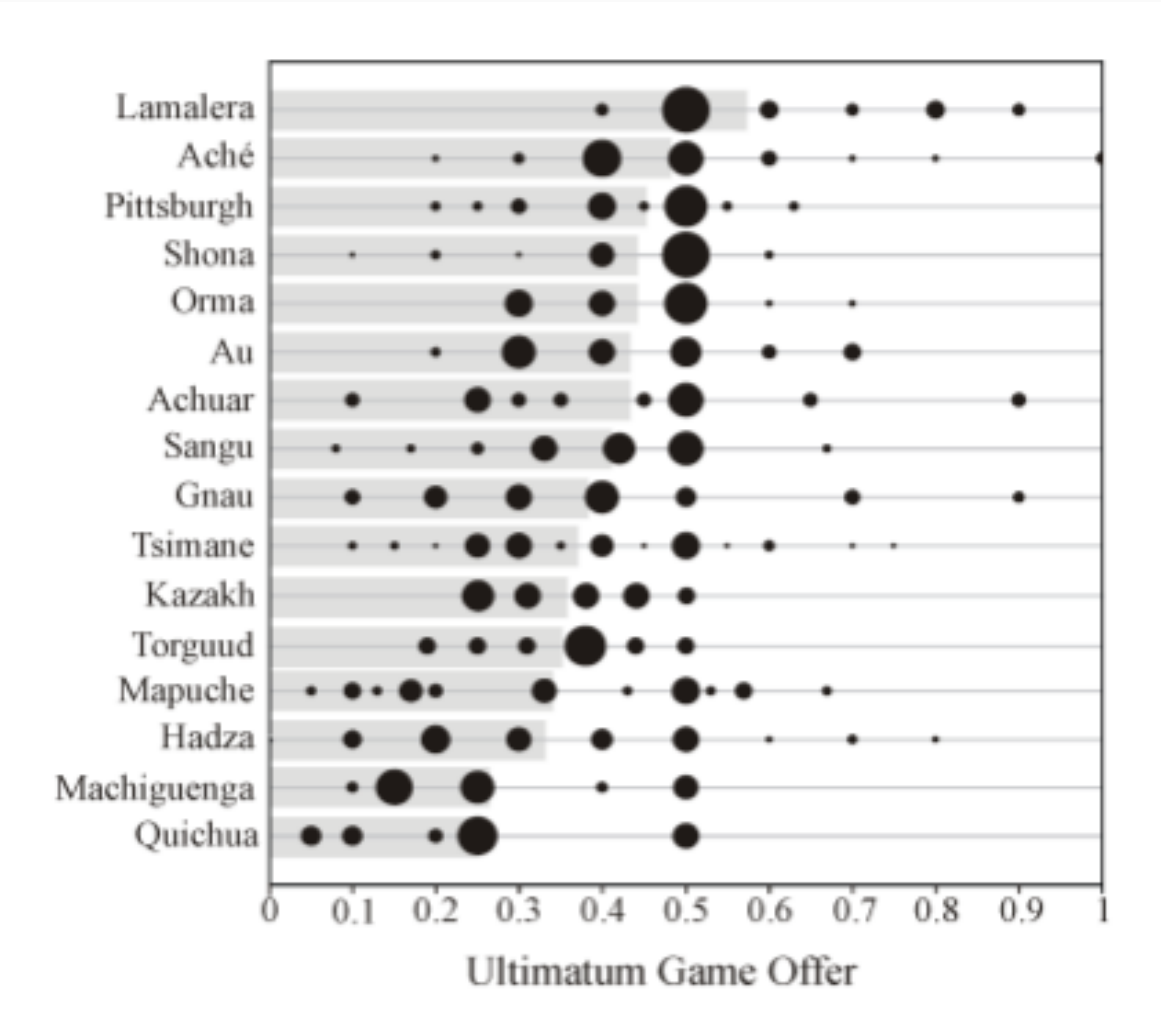
Experimental games

- Dictator game
- Ultimatum game
- Public goods game

Results


Lamalera
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1
Ultimatum Game Offer

Results

Relation between altruistic behaviour in experimental games and:

1. market integration

   people engage frequently in market exchange

2. payoffs to cooperation

   economic life depend on cooperation with non-immediate kin;

   it measures the presence of extrafamilial cooperative institutions

How to interpret the experimental data?

The Collective

The decisions made in one shot games reveal altruistic preferences.

$\Rightarrow$ relies on standard rational choice theory
$\Rightarrow$ Culturally variable pro-social preferences evolved through group selection

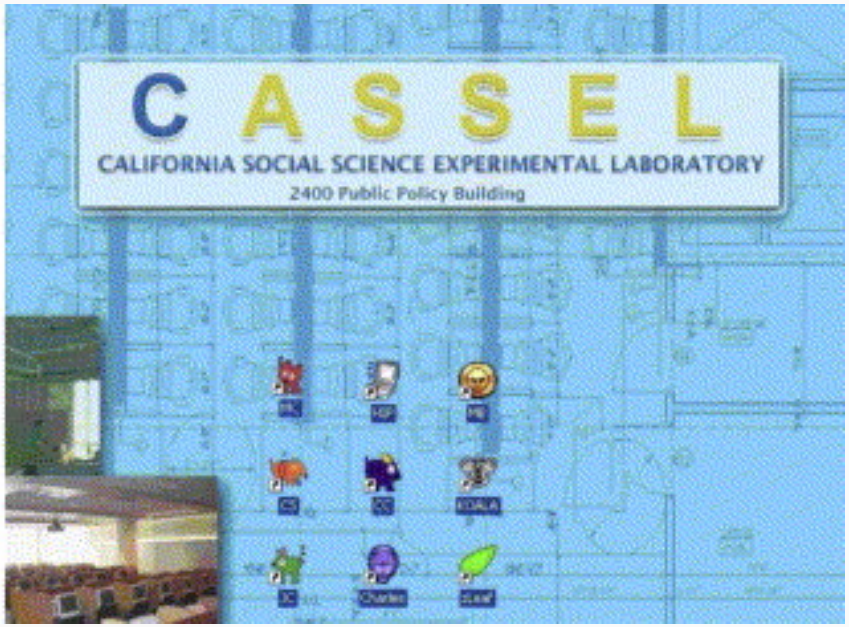
Alternative interpretation

The variation is better explained in terms of
locally adapted rules of thumbs

$\Rightarrow$ cultural variability of interpretations of the games
$\Rightarrow$ Learned rules of thumbs for managing reputation

Some cues affecting generosity

K. Haley and D. Fessler (2005)
Nobody's watching?: Subtle cues affect generosity
in an anonymous economic game



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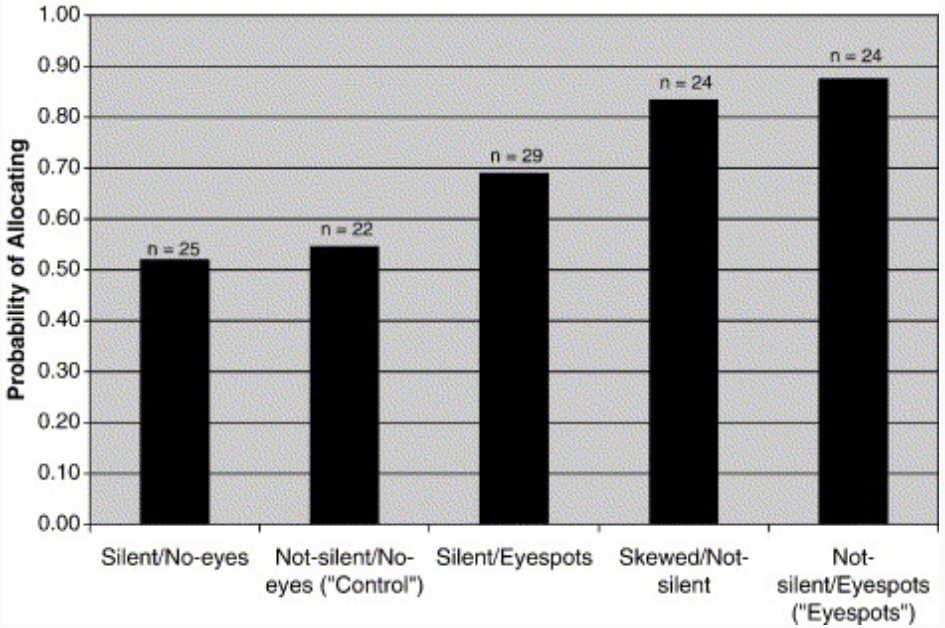

Some cues affecting generosity

Melissa Bateson, Daniel Nettle and Gilbert Roberts (2006)

Cues of being watched enhance cooperation in a real-world setting

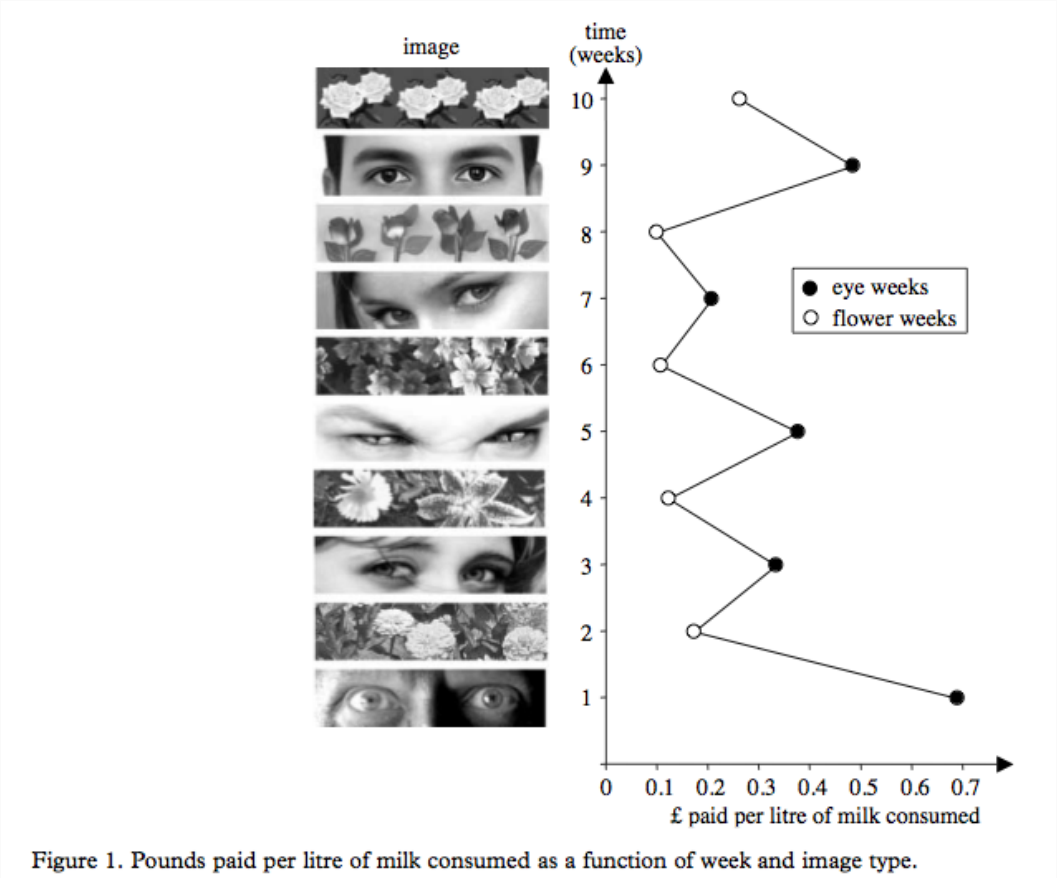

Figure 1. Pounds paid per litre of milk consumed as a function of week and image type.

Pro-social utility theory: experiments versus ethnographic data

Experimental results:
subjects punish others at a cost to themselves
Interpretation:
altruistic punishment (or its underlying pro-social preference)
is at the origin of the evolution of human cooperation

BUT

Ethnographic surveys (Baumard, 2010; Guala 2010):
Costly punishment is rarely observed out of the lab
Costly punishment disrupts rather than sustain cooperation

Observed source of cooperation:
Costless punishment: gossiping (indirect reproaches)
Ostracism or avoidance of the non-cooperators

Institutions as choice architectures fostering cooperative behaviour

- reducing and distributing the cost of punishment
- framing/producing indefinitely repeated games (stable membership, exclusion of outsiders)
- conflict resolution mechanisms

Strategies are adapted to the specifics of local institutions.

Fostering cooperation: changing values or institutions?

Changing values: promote pro-social values; enable altruistic punishment

Change the incentives via regulation and institutions