Munich Lectures in Economics

Foundations of Economic Preferences

Ernst Fehr

Department of Economics

University of Zurich

Munich Lectures in Economics
Foundations of Economic Preferences

- **Society and Preferences – How Social Practice shapes Human Motives**
- **Economic and Cultural Influences on Risk Aversion and Honesty**
- **Neural Foundations of Preferences**

Society and Preferences

How Social Practice shapes Human Motives

Ernst Fehr

Department of Economics

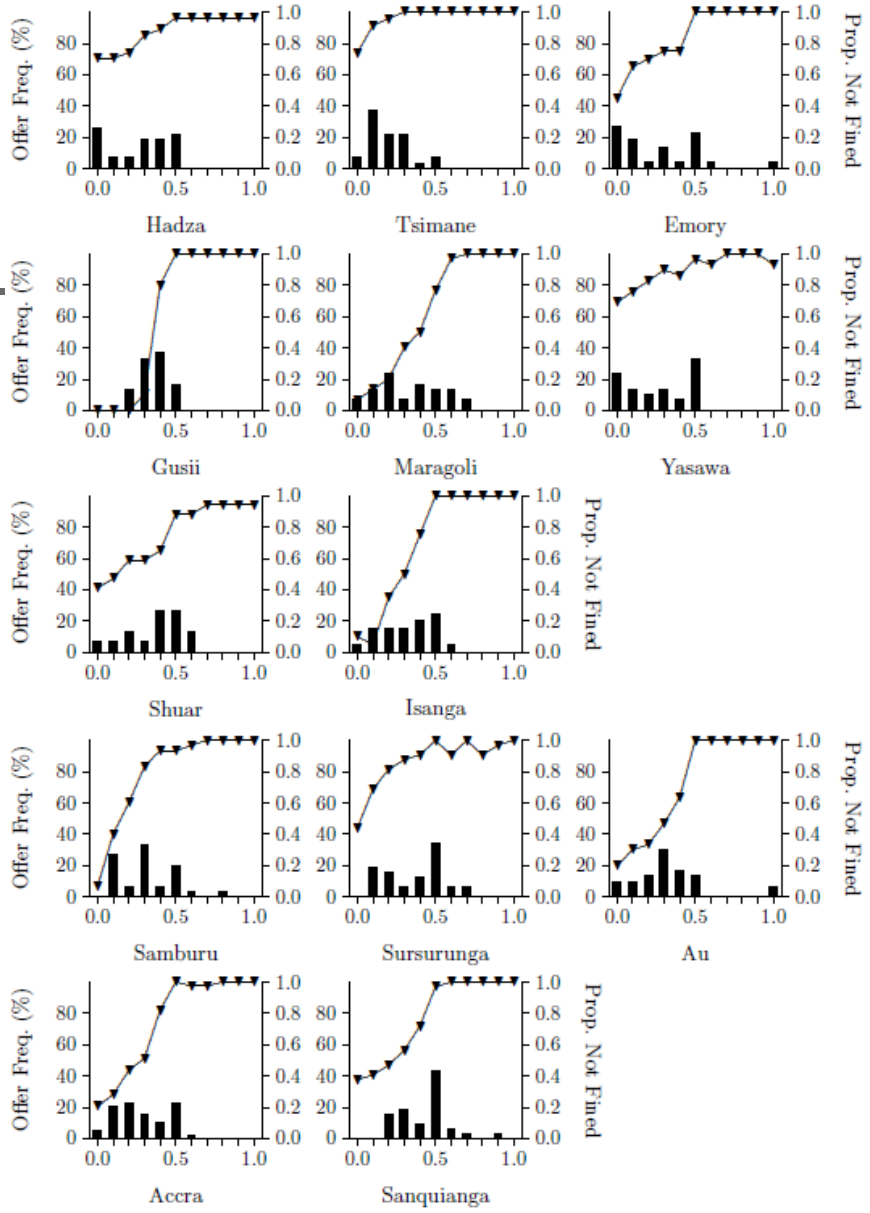
University of Zurich

Cross-cultural evidence on punishment behavior in simple societies (Barr et al. „Homo Equalis“)

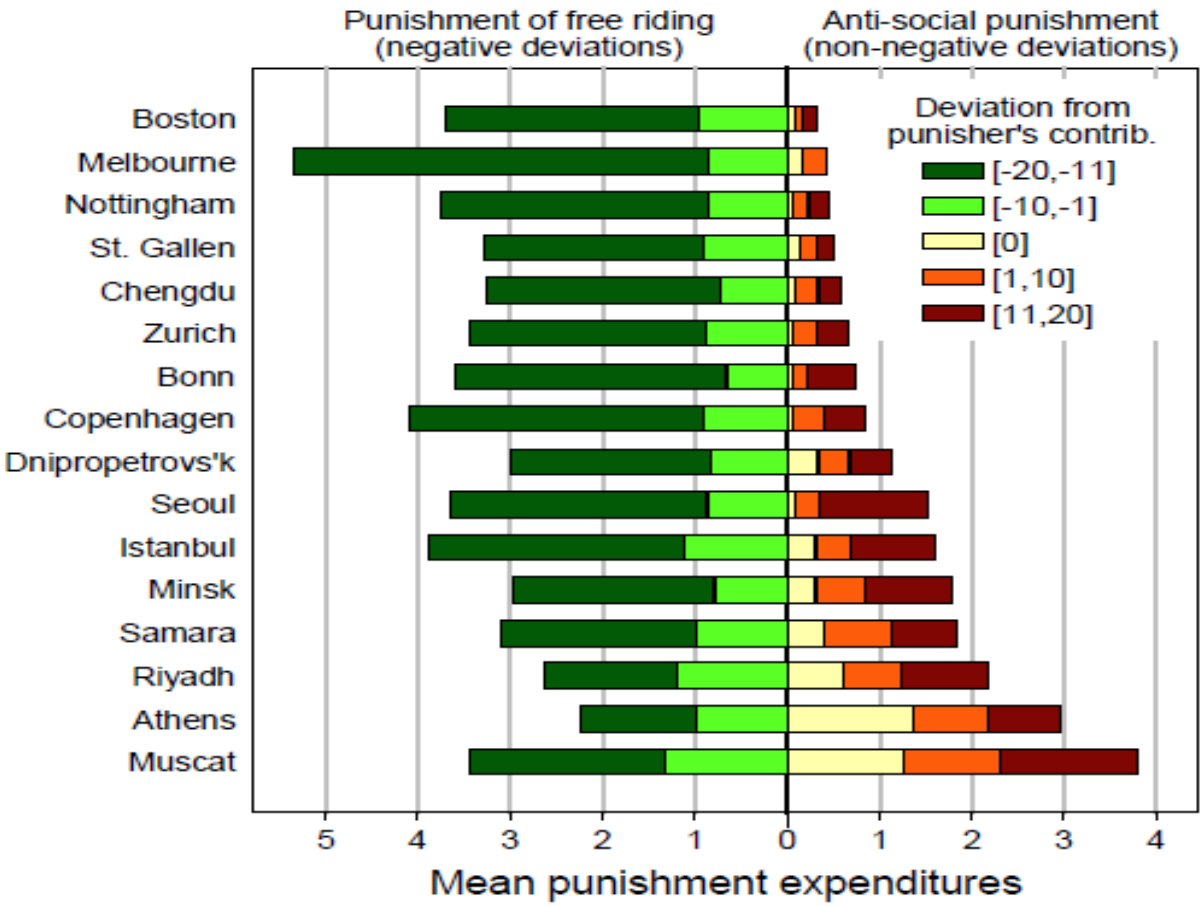
Across all cultures subjects face identical constraints Cultural differences cannot be explained in terms of differences in constraints

Barr et al.
Homo Equalis
Third Party
Punishment Game

FIGURE 3. Offers (■) and Fining (▼) in the Third-Party Punishment Game



Antisocial punishment across cultures
Defectors punishing cooperators
(Hermann, Gächter, Thöni; Science 2008)



What explains cultural differences in antisocial punishment

- Societies with a stronger rule of law have less antisocial punishment
- Societies with stronger norms of civic cooperation have less antisocial punishment
- Does a culture of cooperation or the rule of law **cause** low antisocial punishment?

- Do societies with little antisocial punishment develop a culture of cooperation with a strong rule of law?

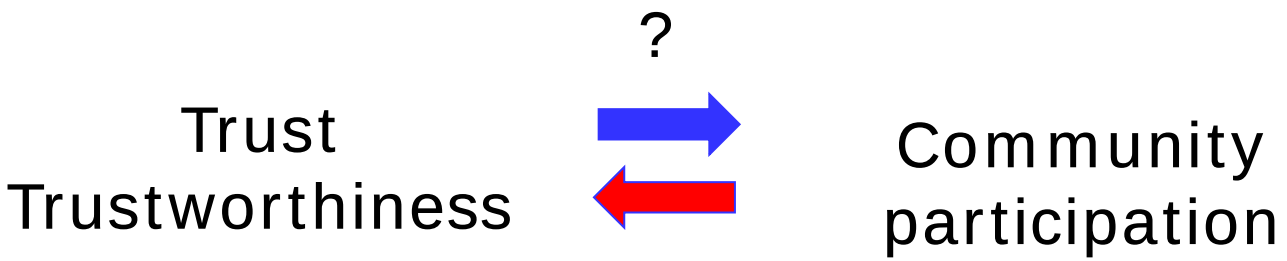
The Weave of Social Life

How Community Participation shapes the Individual

Algesheimer, Dholakia, Goette, Kosfeld & Fehr

The Weave of Social Life

How Community Participation Shapes the Individual



- How does an experimentally induced change in community participation affect
  - Altruistic (non-selfish) trustworthiness
  - Strategic (selfish, reputation-driven) trustworthiness
  - Trust in strangers
  - Incentives for reputation formation

Set-up I

- Large-scale field study on online auction site www.ebay.de (German division of eBay).
- Random selection of approx. 70.000 buyers and sellers from the “collectibles” category (“Sammeln & Seltenes”).
- Subjects did not belong to any community on eBay so far, and had completed at least one transaction within the collectibles category within three months prior to the study.
- Subjects were randomly assigned to treatment or control group (each ≈35.000).

Set-up II

- Subjects in the treatment group were informed about the possibility (1 email, 2 reminders) to participate in the eBay's customer communities
- Subjects in the control group received no emails with such information
- Four months later, all subjects were invited to participate in an experiment conducted by the University of Zurich (no relation to community at all)
- 15.114 subjects participated in the experiment (7.246 treatment, 7.868 control)

Trust & Reputation Game

- Three-player one-shot trust game
  - 1 trustee (B)
  - 2 investors (A and C).
- Investors A and C each receive 250 €
- Stage 1 (measuring trust):
  - Investor A can transfer 250 € or 0 € to the trustee
  - Transfer is tripled (i.e. B receives 750 € or zero)
- Stage 2 (measuring strategic trustworthiness):
  - If investor A transfers 250 €, trustee can return either 500 € or 0 € to him

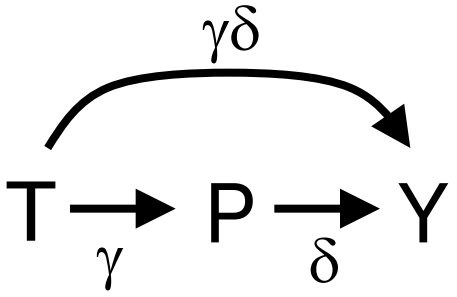
Trust & Reputation Game

- Stage 3 (measuring conditional trust):
  - Investor C is informed whether or not trustee has transferred 500 € back to investor A.
  - Investor A can then transfer 250 € or 0 € to trustee
  - Transfer is again tripled.
- Stage 4 (measuring altruistic trustworthiness):
  - If investor C transfers 250 €, trustee can return any amount between 0 € and 750 € to him.

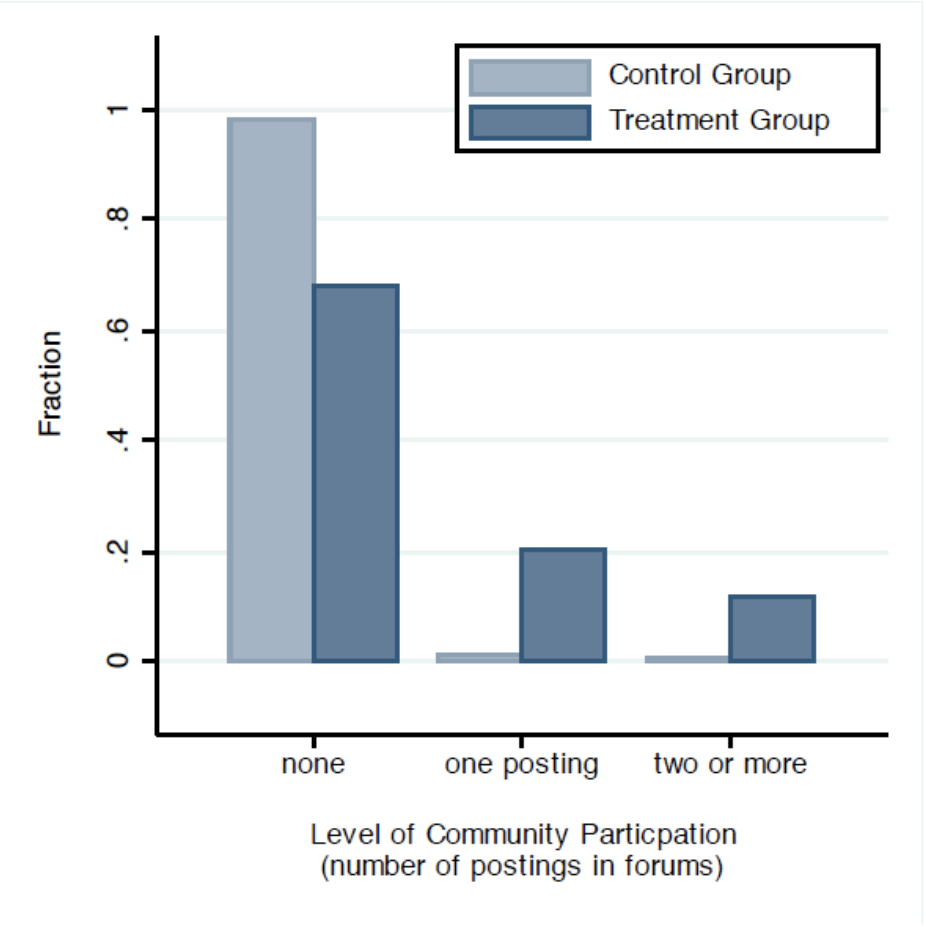
- 12 participants randomly selected and paid.

Estimation strategy

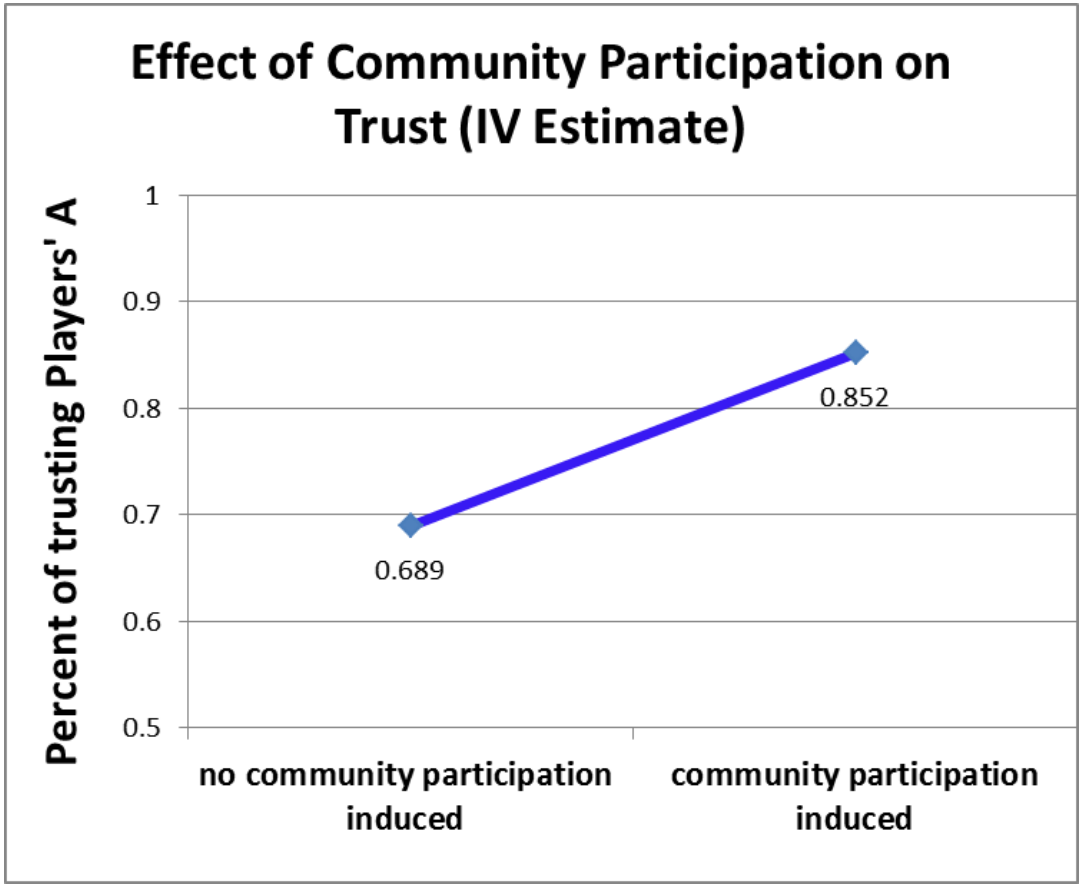
1. Check that subjects in treatment and control group share the same characteristics (i.e., that randomi-zation has worked).
2. Check that treatment increases participation in eBay communities.
3. Compare subjects' behavior in the experiment across treatment and control group.
4. Use treatment as an instrument to estimate the impact of community participation on behavior.



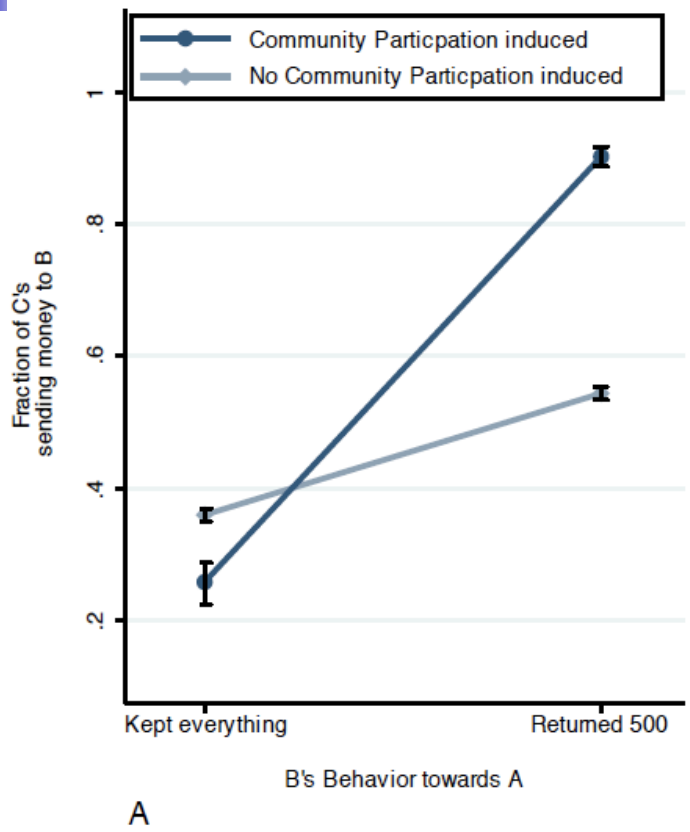
Does the treatment increase participation in eBay communities?



Does community participation cause an increase in trust of investor A?



Does community participation increase trust of investor C?



A

Community participation strongly increases reliance on reputation signal

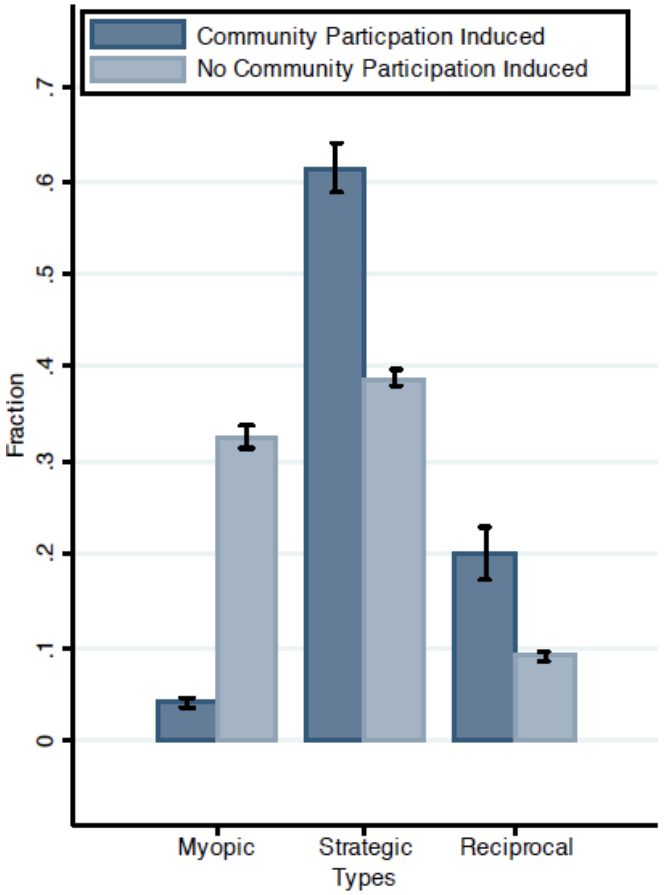
Why does community participation increase the reliance on the reputation signal?

- If B defects in the first round:
  - Community participation renders investor C‘s belief about the amount B will return more pessimistic
- If B is trustworthy in the first round:
  - Community participation renders investor C‘s belief about the amount B will return more optimistic

Does community participation increase the trustworthiness of player B?

Classifying player B

	Return to A	Return to C
myopic	0	0
strategic	500 €	0
reciprocal	500 €	≥ 250 €



Why does community participation increase strategic behavior by Bs?

- If B defects in the first round:
  - Community participation renders trustee B‘s belief about C‘s trust in him more pessimistic
- If B is trustworthy in the first round:
  - Community participation leaves B‘s belief about C‘s trust in him unchanged
- Community participation increases the actual and the believed incentives for B to pay back in the first round

Why does community participation increase reciprocal fairness?

- Hypothesis: Willingness to behave fairly towards others depends on subjects‘ believes about others „generalized kindness“?
- Does community participation increase subjects‘ views about the kindness of other eBay users?
- Subjects in the treatment group consider eBay users
  - More trustworthy
  - More honest

Summary

- Social and economic institutions shape preferences
- All the tools needed for understanding this influence are – in principle – available
  - Measurement of preferences and beliefs
  - Causal econometrics
  - Experimental tools

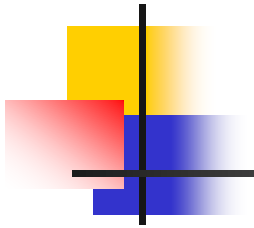
- Community participation
  - Increases reciprocal fairness
  - Increases strategic sophistication
  - Increases trust in unknown strangers
  - Increases trust after a trustworthy signal and decreases trust after an untrustworthy signal
    - Strongly increases incentives for reputation formation

Does community participation change preferences?

- If preferences are considered as independent of beliefs – which is the standard view – community participation changes subjects‘ preferences

- If one allows for belief-dependent preferences – such as in Levine (1998) – the change in reciprocally fair behavior is consistent with stable preferences

- Shows the flexibility of economists‘ tools and opens the door for a theoretically guided study of „preference changes“.
- May offer a reconciliation between economists‘ and sociologists views‘



Thank you for your attention!