

Introduction to the special issue on Behavioral and Experimental Economics for Policy Making

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Introduction of the Special issue on Behavioral and Experimental Economics for Policy Making

Marie Claire Villeval

Behavioral and experimental economics constitutes a dynamic field of research that has produced new and perhaps more realistic theoretical models of human behavior, and allowed researchers to test empirically these models in laboratory and/or field settings. This field is based on models of preferences, beliefs, and decision rules that contrast with standard economic theories assuming selfish individual preferences, perfect and immediate information processing, and rational decision-making. By hybridizing knowledge from other social and cognitive sciences with economics, behavioral and experimental economics models and tests how cognitive biases and non-standard preferences affect the way people process information, update their beliefs, and make decisions.

Beyond its contribution to academic knowledge, behavioral and experimental economics can help policy makers make far-reaching and more efficient decisions. Taking into account the individuals' biases, social preferences and contextualized rationality can contribute to design more effective policies and anticipate the actual impact of interventions. Indeed, from the very beginning, the founders of this field, in particular Vernon Smith and Charles Plott, have emphasized the power of experiments for testing alternative economic mechanisms. The increasingly diversified experimental methods provide powerful tools to test the impact of economic, political and social institutions in a controlled environment.

There are many applications of behavioral and experimental economics to public policy and organizational design. This special issue of *Economic and Political Studies* devoted to Behavioral and Experimental Economics for Policy Making illustrates some of these applications in various domains, such as prevention and insurance, incentive schemes, and social choice and reaction to fake news. The six contributions that constitute this issue provide a nice illustration of the large diversity of methods and experimental designs in this field.

The first two papers use experimental economics to analyze individual decision-making in the presence of risk and uncertainty. Understanding how individuals perceive risk and include it in their strategies of insurance and prevention is crucial to design more effective policies.

In "Revisiting the Demand for Insurance: An All-or-Nothing Behavior", Anne Corcos, François Pannequin and Claude Montmarquette examine a puzzle of the insurance behavior. Surprisingly, individuals tend to leave the insurance market after a price increase but at the same time, they exhibit a strong attraction for full insurance contracts even when the insurance premium is unfair. The paper shows evidence of such an All-Or-Nothing heuristics driving insurance decisions in the laboratory. Importantly, this heuristics is observed even after controlling for individuals' risk attitude and knowledge of the risk exposure, and for the contract prices. This finding has important policy implications: the major stake for public authorities is to convince people to enter the market, but once they enter they tend to fully insure. However, the fact that low-risk individuals buy contracts designed for high-risk individuals highlights a risk that opportunistic companies exploit this heuristics.

In “Willingness to Pay to Reduce Future Risk: A Fundamental Issue to Invest in Prevention Behaviour”, Jim Engle-Warnick, Julie Héroux, and Claude Montmarquette investigate prevention decisions when people face future risks. Many people are reluctant to engage in prevention because its cost is immediate while its benefits are delayed and uncertain. The paper studies the determinants of the individuals’ willingness to pay to reduce a future risk, by manipulating the time horizon of the risk. It illustrates nicely how it is possible in a lab experiment to separate cleanly two sources of uncertainty - the uncertainty of the outcome and the uncertainty conveyed by the future -, and to measure the impact of one source when controlling for the other source. Interestingly, present bias is found in all conditions, even when uncertainty about the future risk is controlled. One important implication is that a better understanding of present bias is needed for improving individuals’ prevention behavior.

The second set of papers introduce social interactions and illustrate how experiments can help understand the role of monetary incentives on behavior in labor markets and in asset markets.

In “The multi-dimensional effects of reciprocity on worker effort: Evidence from a hybrid field-laboratory experiment”, Min-Taec Kim and Robert Slonim analyze employees’ reciprocity in response to a wage increase in employer-employee relationships. The previous literature has tested the gift exchange hypothesis by focusing on the impact of wages on employees’ quantity of effort. Contrasted evidence has been found in the lab and in the field. The novelty of this paper is considering not only the impact of a wage increase on the quantity of output but also on the quality of work. It is found that paying a higher wage does not increase output, but reduces the error rate significantly. The implications are clear: paying a higher wage is profitable for the company only if errors are sufficiently costly. From a methodological point of view, this paper is also a brilliant demonstration of how it is possible to combine the control permitted by the lab environment with the main features of a field setting.

In “Bubbles and Incentives: An Experiment on Asset Markets”, Stéphane Robin, Kateřina Strážnická and Marie Claire Villeval investigate the impact of incentives on the behavior of traders in experimental asset markets. Traders’ compensation schemes and competitiveness are sometimes accused of being at the origin of financial crises. The paper explores whether the introduction of competitive incentives for traders contributes to explain the mispricing of assets and an excessive trading activity in markets where the fundamental value of the assets is commonly known. The main finding of the study is that compared to a situation without competitive incentives, the presence of bonus contracts does not increase the likelihood of financial bubbles but it affects their severity. In particular, short-term bonus contracts increase price deviations from the fundamental value of the asset, but only in markets with a higher share of male traders who are probably more sensitive to competition.

The third set of papers shows how laboratory experiments help understand individual reactions to political phenomena that are difficult to observe with natural data, namely conspiracy or clientelism.

In “Exposure to Conspiracy Theories in the Lab”, Loukas Balafoutas, Alexander Libman, Vasileios Selamis, Björn Vollan address a question of crucial interest with the development of social networks where fake news spread out easily. It is important to identify whether and how the exposure to conspiracy theories affects the behavior of people and their level of trust in others. In the experiment, half of the subjects are first exposed to conspiracy narratives and then, play a game designed to measure their strategic sophistication. A very interesting result is found: players who have been exposed to the narratives become more sophisticated and think

harder about the possible reactions of the partner they are interacting with, independently of whether they believe or not in the narrative. The effect seems to be driven by the focus of conspiracy theories on *intents* behind actions. From a methodological perspective, this paper shows how priming can be used to identify the *causal* impact of a phenomenon.

Finally, in "Clientelism and Identity", James Habyarimana, Daniel Houser, Stuti Khemani, Viktor Brech, Ginny Seung Choi and Moumita Roy study the political behavior of voters and leaders who have the power to extract rents and keep their position through clientelist allocations. This is a major topic, especially in poor countries, because electoral clientelism biases the aggregation of preferences and undermines the quality of democratic institutions. In a voting game, one leader has to choose an allocation of money between four other players who, then, have to vote for keeping or changing the leader. The allocation options vary the size of the rent captured by the leader. Reassuringly, the paper shows that clientelist allocations are relatively rare. Adding group identity does not change the prevalence of clientelism, but leaders tend to capture lower rents when they belong to the majority group. The possibility to manipulate group identity constitutes another important advantage of experiments.

These studies apply to different domains and research questions but they share a common denominator: they reveal how powerful experiments can be to measure individual motivations and preferences, and to identify causal relationships between variables instead of correlations. They also allow researchers to measure variables that may be sometimes very difficult to observe in real settings because they occur rarely or they are hidden. For these reasons, behavioral and experimental economics constitutes a complementary and powerful instrument to analyze policy making and the potential or actual consequences of policy interventions on economic behavior.

Content

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