Section 5: Identity, Motivation and Incentives

The basic idea behind the section is that self-interest is generally conceived as the main motivation for different types of behaviour such as saving, investing, working and so on but that, increasingly, behavioural economics is examining how other motivations such as altruism and the desire to conform might influence economic behaviour and outcomes. The first point we make in the section is that self-interest is an "add-on" to rationality. A way of thinking about this topic is to ask some questions like:

- Do I care about other people outside my family so much that I would genuinely give up things to help them?
- Do I change my core preferences as those around me change theirs?
- Would I be independent in situations where I was asked to do something wrong by someone in a position of authority?

II The influence of peers and groups

The first aspect of motivation that goes beyond self-interest is the idea of herding and peer effects. There is a high correlation between an individual's behaviour in any economic domain and the behaviour of their peer group. The very famous "Dartmouth paper" showed that the pre-college characteristics of flatmates that students were randomly assigned to live with had big effects on their behaviour. If you are randomly assigned to someone who drank before coming to college, you are more likely to drink during college - similarly, you are more likely to study if you are assigned to someone who did well at school. These results raise questions about the idea of fully stable economic preferences.

Moving on from this, we examine the idea that "group processes" may influence behaviour. The most striking example of this is Milgram's 'Behavioural Study of Obedience'. During the most famous of these experiments, Stanley Milgrim had 40 male participants between the ages of 20 and 50 play the role of 'teacher' to the 'learner' in the adjacent room. In the room with the teacher was a stern looking experimenter wearing an official looking coat (Fig 1). The task of the teacher was to administer increasingly powerful electric shocks to the learner whenever he made a mistake on the ostensible memory task he was working on - in reality the learner was a confederate working with the experimenter. There were no real electric shocks being administered, although the learner was trained to react to them as if they were real.

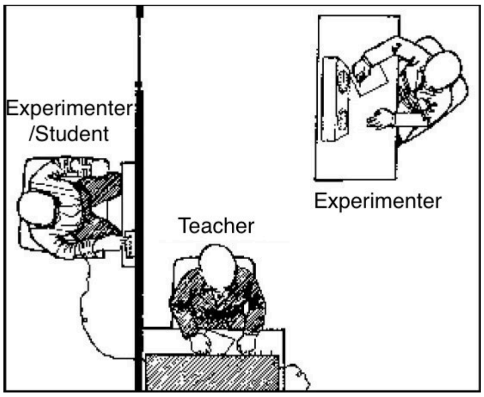


Fig 1. Experiment setup

Before running the experiment, Milgram polled 40 psychiatrists who agreed that "*only 0.1% of the subjects would administer the highest shock on the board*" - essentially it was thought that only a psychopath would continue all the way to the end where the voltage level was marked XXX and clearly hazardous. In reality , almost 2/3rds of participants went all the way to the end, even when some of them were clearly uncomfortable with the process. The Zimbardo prison experiment is another classic example of how randomly assigned social categories can have strong effects on people's actions.

II. Motivation to behave in group situations

We focus on complex social and economic situations, as are represented in the Prisoner's Dilemma and Ultimatum **(Fig 3)** bargaining games which are two of the most famous experiments in economics. The key paper for this topic is the paper by Ernst Fehr on Trust. He argues that trust, in some sense, involves processing risk but that it involves more than just risk preferences. Specifically, trust contains elements of an emotional engagement with others and that "betrayal aversion" can lead people to feel a lot worse if they lose in a game involving trust than simply if they lose a gamble. This is a key insight for behavioural economics; namely that one solution to cooperative games is that people trust each other and reach the pareto-optimal solution.

You can offer a one-time split of €20 with another person.
If they accept, you split it as per your offer.
If they reject, you both get 0.
How much do you offer?

Fig 3. The Ultimatum Game

Fehr argues that countries with better social institutions arguably grow better and have better all-round outcomes, basically because in such countries it is easier to do business and interact in economic and social contexts because there is a basic degree of confidence in other people. The idea is that many economic problems are solved not by contracts but by social norms and implicit cooperation that is regulated not by laws or by fines but rather by complex social emotions such as trust.

III. Other emotions and economic behaviour

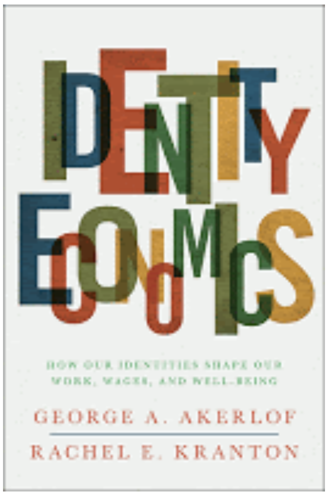
One consequence of relaxing the assumption of pure self-interest as a driver of economic behaviour and looking at a broader range of emotions is that we open up a number of facets of human economic behaviour and attitudes that may have seemed outside of the realm of economics beforehand. As discussed above, trust and the emotions surrounding it are involved in some of the most important non-financial motivations of behaviour - but there are many other different types of motivations and emotions that arguably play a role in regulating complex economic situations involving groups. A few of them are discussed below:

(i) Discrimination and Hate: One consequence of being in different groups is that we may form a preference for our group over other groups, women and ethnic minorities are less likely to get called back to job interviews compared to whites even when the characteristics of each group have been randomly assigned on the CVs. Furthermore, we know that many people dislike people not of their own ethnicity and that many people favour restrictions in trade and migration. The real question is whether such preferences are actually just irrational hangovers from the fact that we are basically animals with faulty cognitive equipment or whether they are rational preferences (albeit selfish preferences). For example, someone may oppose globalisation because of an irrational fear of foreigners but someone may also oppose it because my industry has lots of nice protections from competition that would be eroded if restrictions were lifted.

(ii) Reference Effects: Another consequence of being in groups is that we evaluate ourselves relative to others which can have positive and negative effects.

(iii) Intrinsic Motivation: As discussed by Fehr and Falk and others, many people engage in tasks because they are intrinsically interested. Furthermore, people may have a desire to keep control over their own behaviour.

IV. Identity and economics



The key paper for this is Economics and Identity by Akerlof and Kranton. This paper takes the view that looking at identity is vital to understand a wide range of economic phenomenon such as welfare dependency, ghettos, integration into the labour market, globalisation and economic growth. Identity emerges from the social categories we identify with or are members of by default. They outline a very simple model, where membership of social categories enters directly into utility functions and use this to explain a range of economic phenomena such as gender discrimination

Readings

Akerlof & Kranton (2010), Identity Economics: How Our Identities Shape Our Work, Wages, and Well-Being.

Akerlof (1998), Men without Children, The Economic Journal.

Fehr (2008), On the economics and biology of trust, IZA Discussion Paper.

Fehr & Falk (2001), Psychological Foundations of Incentives, Schumpeter Lecture at the European Economic Association Meeting.

Falk, Fehr & Fischbacher (2005), Driving Forces Behind Informal Sanctions, Econometrica.

5. Falk & Kosfeld (2006), The Hidden Costs of Control, American Economic Review.

Andreoni (1995), Cooperation in Public-Goods Experiments: Kindness or Confusion?, American Economic Review.

Milgram (1963), Behavioral Study of Obedience, Journal of Abnormal and Social Psychology.

Sacerdote (2001), Peer effects with random assignment: results for Dartmouth roommates, Quarterly Journal of Economics.

Supplementary Material

Steven Levitt's TED Talk discussing the motivation of drug dealers.

Benjamin Polak's excellent Yale lecture on Ultimatum games and bargaining

George Akerlof discusses his book Identity Economics.