

Behavioral Economics and Market Institutions

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January 2018

- Main ideas regarding market institutions from earlier work:
 - 1 Formal institutions mainly serve to strengthen – not replace – informal institutions
 - 2 Social norms play a critical role in the functioning of markets and hierarchies: if people believe an incentive (e.g., punishment for breach, contractual condition) is unfair/illegitimate, they undermine it and it is less effective
 - 3 Norms and fairness are also/mostly about process, not just allocations
 - 4 Emotions play a part in the way humans interpret and apply social norms

- Market institutions and development:
 - ① Three main mechanisms for organizing economic activity:
self-provision; market exchange; hierarchies
 - ② Each mechanism implies its own set of social norms
 - ③ Economic development requires:
 - changes in social norms – e.g., learning hard budget constraints, employee discipline
 - changes in the domain of application of these norms
 - ④ Hence development can be impeded by wrong norms, or application of norms from one domain to another

Future directions for research

- ① Can we document the fact that people have different norms for different domains?
- ② Do people from different cultures or social groupings have different norms and different domain boundaries?
- ③ What can we do to change social norms or domain boundaries?

Question 1: Norms and Domains

- Here is an example from Belot and Fafchamps (2018)
- Subject choose between two payoff allocations between four participants
- Different frames to represent different domains:
 - Frame 1: non-market domain: subject chooses between two pies
 - Frame 2: mate selection: subject chooses between two team partners
 - Frame 3: market domain: subject chooses between two types of team partners
- We find that, among UK student subjects:
 - subjects are more altruistic in frame 1 than 2 or 3.
 - subjects are more rival in frame 3 than in 1 or 2.
- Would that generalize to other populations?

Question 2: Norms and Culture – (1)

- Here is an example from Davies and Fafchamps (2018)
- Mobile lab subjects are assigned worker or employer role
- Employer makes wage offer to worker in exchange for high effort
- Worker chooses effort ex post
- Game is repeated
- We find:
 - in UK employers punish low effort by lowering subsequent wage offer
 - in Ghana employers never punish workers for low effort

Question 2: Norms and Culture – (2)

- Here is an example from Davies and Fafchamps (in preparation)
- M-Turk subjects are assigned worker or employer role; one-shot game
- Incentive schemes: fixed wage (high, low); bonus (commitment, renege); malus (commitment, renege)
- Employer chooses incentive scheme and makes contract offer to worker
- Worker accepts contract and chooses effort ex post
- We find:
 - US 'workers' respond much more to incentivization than in India; exert lower effort in high fixed wage
 - US 'employers' more reluctant to offer high fixed wage, especially to US workers
 - US workers' effort responds much more to renegeing option in malus contract, even though US employers less likely to renege

Question 3: Changing Norms in a Domain

What kind of policy interventions are effective at changing norms/norm boundaries to make markets and organizations more effective? Here are three examples.

Example 1: Education campaign

The treatment is inspired of interventions aiming at changing people's beliefs and behavior: e.g., financial education, entrepreneurship training

- explain the logic of the market to small entrepreneurs and see whether reduces breach of contract/non-payment
- explain the logic behind hierarchical organization to workers and employers and see whether it reduces shirking/absenteeism
- Conjecture: no effect – because social norms not based on reason but on emotions

Example 2: Group identity

The treatment is inspired of interventions aiming at creating a sense of business community/contact theory of conflict: e.g., through joint sports activities, business groups, or through religious, gender-based, or ethnic-based events

- instill a sense of community among small entrepreneurs and see whether reduces breach of contract/non-payment (1) with high punishment for breach (2) with low punishment for breach
- instill a sense of community/family among workers and employers and see whether reduces shirking/absenteeism (1) with high incentives (2) with low incentives
- Conjecture: positive effect with low incentives – resistance to high incentives because punishment seen as disloyal to group members; may increase breach against non-members

Example 3: Individualism, competition, and incentives:

The treatment is inspired by interventions aiming at encouraging competition in an open field: e.g., business competition, talent show, contest

- encourage individualism and competition among small entrepreneurs and see whether reduces breach of contract/non-payment (1) with high punishment for breach (2) with low punishment for breach
- encourage individualism and competition among workers and employers and see whether reduces shirking/absenteeism (1) with high incentives (2) with low incentives
- Conjecture: negative effect with low incentives – positive effect with high incentives

Conclusion

- There are many opportunities for interesting work in behavioral economics on social norms, market institutions, and development
- For a research agenda to be fully successful, some paradigm changes are needed:
 - There is too little consideration for the emotional aspect of moral norms:
 - E.g.: guilt; shame; pride; moral outrage; self-righteousness
 - There is insufficient consideration regarding preferences over process:
 - E.g.: incentive and punishment systems; intentional vs spontaneous behavior
 - There is a need to distinguish social preferences over outcomes and over process:
 - More equal distribution yes but not through theft/criminal activity

Thank you

Belot, Michele and Marcel Fafchamps (2018). "Are People Equally Other-Regarding When Picking a Partner vs Choosing an Allocation?" *Southern Journal of Economics*, 84(4): 1088-108

Davies, Elwyn and Marcel Fafchamps (2018). "When No Bad Deed Goes Punished: Relational Contracting in Ghana versus the UK" , NBER working paper