

Section X - Ch 22, 21, 20

- observe → consumers behave at odds with standard theory
 - revise theory - update with new data
 - aggregate behavior consistent with "neo-classical" theory
- 1890s Marshall 1940s Hicks

- behavioral economics - 1970s

↳ explain anomalies

- status quo bias - new info
or product - ignore

- costly to assess new info

- devote costly decision resources

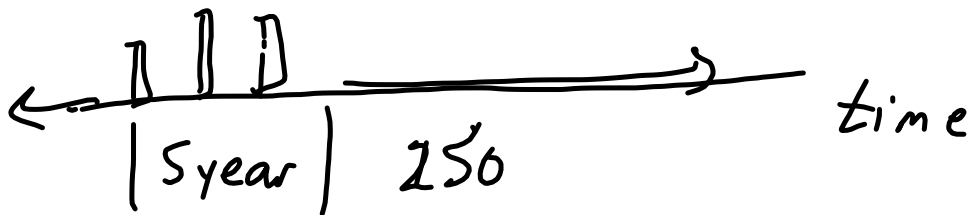
to decisions where error costs

high.

Herbert Simon - "bounded
rationality"

Cass Sunstein Nudge

- probability -
 - underestimate prob of bad event
 - investments poorly made
- floods 0.01 "100 year Flood"



- update prob based on event
prior \rightarrow est prob before info

$$Pr(R) = 0.50$$

see B $Pr(R) \downarrow$

Bayes Rule - evaluate B draw
conditional on R + B
distribution

$$P_r(B|R) = \frac{P_r(R|B) \cdot P_r(B) \times}{P_r(R)}$$

Priors $P_r(R)$ $P_r(B)$ - posterior
is $P_r(B|R)$

- people don't do well at this
bias toward favored outcome
- scenario → App state beats Michigan
at Football.
 - "we can beat the big guys +
should move to "FBs"
overweight good outcome
+ underweight bad outcomes]
- "investments" in poor options hoping
good draw.

- Fairness - opposite of selfish.

- observe → charity
- letting someone in line

Trust game - A & B persons

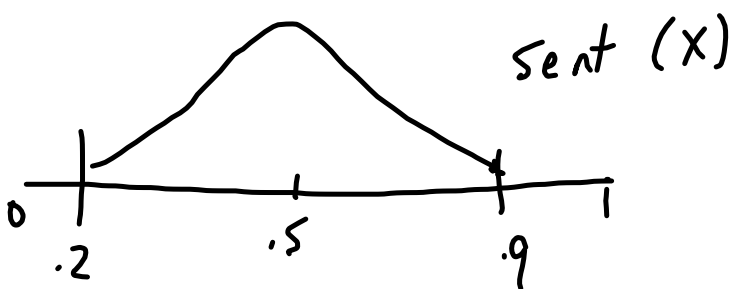
A - endowment \$ y

- keep all or pass some amount to B \$ $x \leq y$

- at B - multiplied (investment)

B - choose how much to give back to A

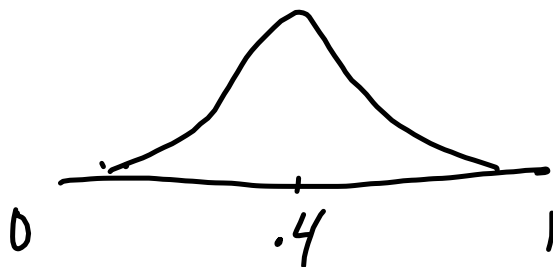
predict $\rightarrow X = 0$



returned - % < 0.5

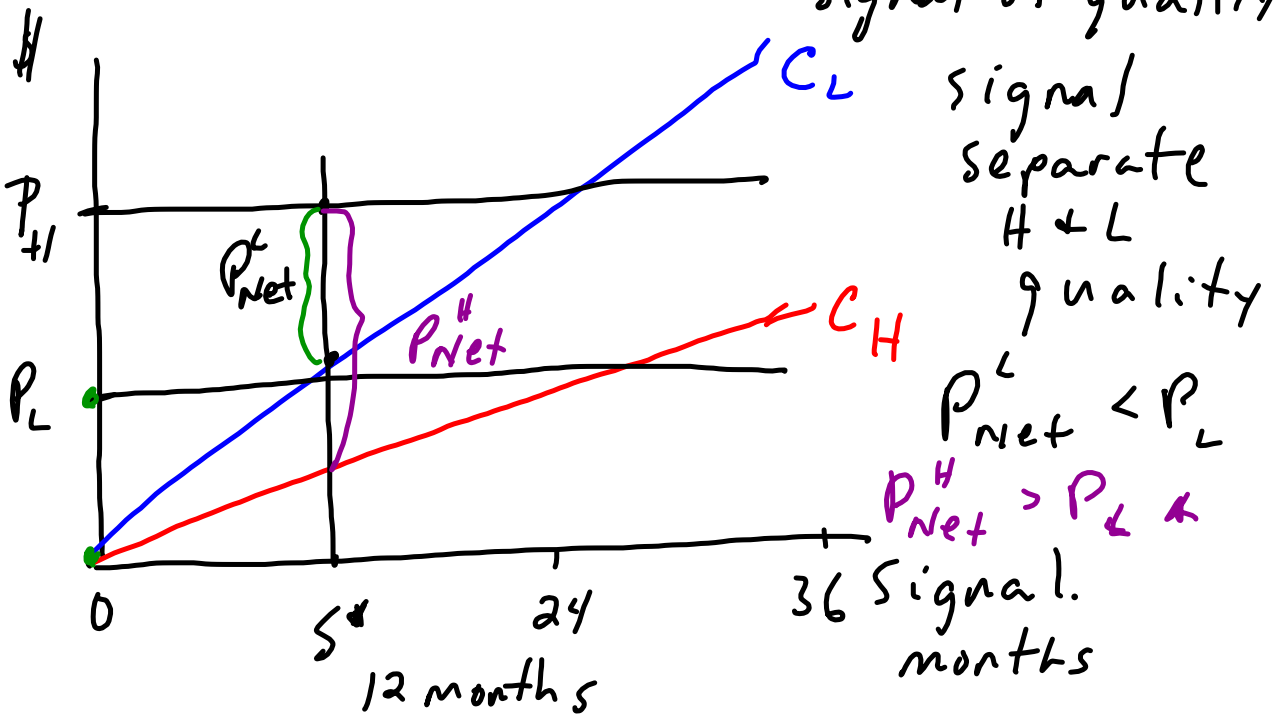
but greater than X

share return on investment



- augment theory
 - trust
 - fairness
 - decision errors

- solutions to asymmetric info (adverse selection) → warranty, signal of quality



If we require longer warranty

+ $P_{net}^H < P_c$ + so no warranty
 $P_{net}^H = (P_H - C_H)$ + all cars listed
 as low quality

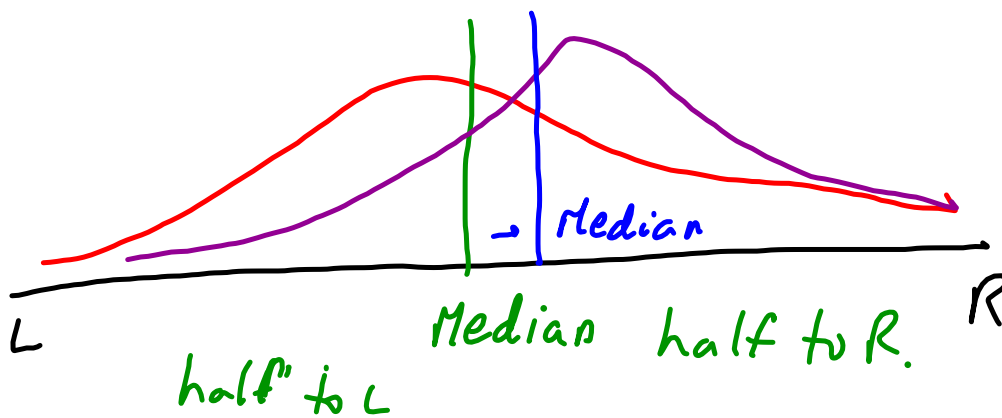
- Signals - length of warranty
- education - signal of ability
 ↳ level separate L & H
- reputation - costly to maintain.

Political Economy.

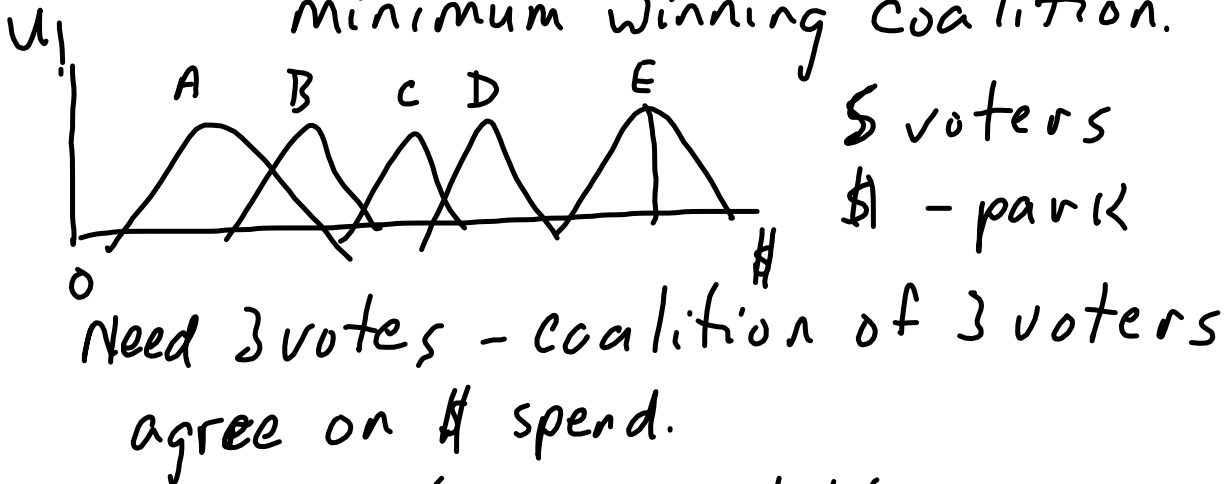
- ↳ economics of politics - (public choice)
- politicians + voters - economic agents maximize satisfaction.
- voters $\rightarrow U_v = U_v(G, I - t)$
 - mix of gov't goods
 - Income - taxes
 - education
 - public safety
 - infrastructure

for politicians $\rightarrow G \rightarrow$ gets votes
 $t \rightarrow$ cost votes

$U_p = U_p(V)$
 \rightarrow majority of votes to get elected.



Median preferences defines
minimum winning coalition.



Need 3 votes - coalition of 3 voters
agree on \$ spend.

A & E in coalition? - not likely

ABC - agree on B level.

D & E go to C join us - C level.

C - median voter → C determine \$