

# A Menu Final Examination Questions

## Methodology, Rationality and Some Basic Concepts

1. Why do the 'old' behavioural economists reject the notion of optimization and instead propose models that assume decision-making is a 'satisficing' process? If decision makers are unsure whether a choice will enable them to meet their goals, how can they make a 'satisficing' choice?
2. In his autobiography *Models of my Life* Herbert Simon recalled a follow a visit to his old friend Jacob Marschak:

“We took a long walk together, slowly because he was already frail. We engage in our usual debate, he expressing his permanent faith in human optimizing rationality and I defending a bounded rationality point of view. We were revisiting old territory, yet he expressed no impatience at my intransigence and listened thoughtfully to my arguments.”

Write a dialogue showing how you think this debate between Simon and Marschak might have unfolded.

3. In his book *Misbehaving*, as he writes about the development of Prospect Theory, Richard Thaler claims that:

‘Simon had coined the term “bounded rationality”, but had not done much fleshing out of how boundedly rational people differ from fully rational ones. There were a few other precedents, but they too had never taken hold’.

Discuss the accuracy of Thaler’s claim regarding Simon’s contribution and critically assess Thaler’s coverage of the ‘precedents’ to which he alludes.

4. Why do behavioural and evolutionary economists see social interaction as playing a major role in shaping choices, rather than seeing decision-making in terms of the preferences of, and constraints faced by, individuals? Can your answer be extended to help make sense of the significance of ‘fads and fashions’ in approaches to managing firms and other organizations?
5. Discuss the view that ‘new’ behavioural economics is nothing more than an extension of neoclassical economics that provides a clear indication that the research program of neoclassical economics is, in Lakatos’s terms, ‘degenerating’.
6. What do you understand by the notion of an ‘infinite regress’? Explain where infinite regress problems arise in the process of making decisions and the means by which people prevent these problems from resulting in decision paralysis.
7. Why is Darwinian natural selection an inadequate analogy, by itself, to analyse and understand economic evolution?

8. Human decision makers have finite attentive capacities. They also have finite capacities to imagine how the future will unfold, yet their powers of imagination can also result in them giving attention to imagined events that never actually happen. What do these human shortcomings imply for theorizing about the choices that people make?
9. Discuss the evolutionary foundations of human tendencies towards altruism and docility. Examine the roles played by altruism and docility in the functioning of modern economic systems and consider whether there could be optimal levels of altruism and docility for achieving economic progress.

## **Complex Systems and Change**

10. Write an essay on the significance of the structure of connections in an economic system for understanding why some changes in prices lead to major changes in behaviour and others do not. You are encouraged to consider the connective structure of the economy in terms of beliefs that decision makers hold, groups of products, trading relationships and balance sheets.
11. In what ways do consumer 'lifestyles' and corporate 'strategies' have similar rationales and serve similar roles in the economic system?
12. Discuss the significance of system prerequisites and co-requisites for designers of policies aimed at (a) promoting changes towards more eco-friendly patterns of consumption, and (b) promoting industrial development in poor nations.
13. What do you understand by the concept of 'embeddedness' when it is used to characterize people in complex economic systems? Show how embeddedness can be used for analysing choices that people make regarding their lifestyles, their education and their labour mobility. Discuss the significance of embeddedness for policymakers who are trying to devise policies to reduce regional income inequality.
14. What strategies can consumers, entrepreneurs/managers and national planners adopt to increase the resilience of their economic systems in the event that they are subject to shocks?
15. How do economists who view the economy from a 'complex systems' perspective differ from mainstream economist in the extent of the coordinating role they see the price mechanism as playing and in how they see the responsiveness of behaviour to changes in relative prices?
16. With the aid of examples, characterize revolutionary and evolutionary changes from a complex systems standpoint in each of the following four contexts:
  - (a) An entrepreneur's way of thinking
  - (b) A household's lifestyle
  - (c) The operations of a firm and the markets to which it supplies its products,
  - (d) A transportation system.

## **Risk and Uncertainty**

17. Compare and contrast George Shackle's 'potential surprise' model of choice under uncertainty, and Daniel Kahneman and Amos Tversky's 'prospect theory'. Which do you regard as the greatest advance beyond the traditional subjective expected utility theory?
18. Compare and contrast Prospect Theory with the analyses of decision-making in the face of risk and/or uncertainty offered by J. M. Keynes, G. L. S. Shackle and H. A. Simon.

## **Heuristics and Biases**

19. Are the 'heuristics and biases' perspectives associated with the work of Kahneman and Tversky fundamentally at odds with the 'fast and frugal decision rules' view of decision-making advocated by Gigerenzer? Explain your reasoning.
20. Outline ten of the 'heuristics and biases' that are recognized by behavioural economists as commonly causing real-world behaviour to conflict with rational choice theory. Next, select five of those that you have outlined and show how knowledge of them could be useful to firms or policy makers in the public sector seeking to shape consumer behaviour.
21. Using examples, explain why 'new' behavioural economists see 'heuristics and biases' as a key cause of behaviour that does not seem rational in terms of standard economic thinking. Do any of these heuristics and biases play a positive role in evolutionary terms, or at least would have assisted the survival of the human race in its early stages when people lived as hunter-gatherers?
22. Which of the 'heuristics and biases' identified by behavioural economists do you regard as the most empirically significant causes of departures from the mainstream economist's view of rational behaviour?
23. What is meant by the phrase 'hyperbolic discounting' and why do behavioural economists see it as a cause of behaviour that is inconsistent with rational choice?
24. Explain what you understand by:
  - (a) hyperbolic discounting
  - (b) the endowment effect
  - (c) the sunk cost fallacy

Discuss the significance of each of these concepts for public policymakers and for the theory of choice.

25. Discuss the significance of the ‘endowment effect’ and the ‘sunk cost fallacy’ for public policymakers and for the theory of choice.
26. Explain what you understand by the term ‘hindsight bias’. Why is hindsight bias significant for understanding the investment behaviour of corporations? Examine how the adoption of ‘scenario planning’ techniques could be used to offset the effects of hindsight bias.
27. What do behavioural economists mean by the term ‘mental accounting’? With the aid of some examples, explain how mental accounting leads to behaviour at odds with what is predicted by rational choice models. What does the human tendency to engage in mental accounting imply for the design of economic policy?

### **Context, Choice and Resistance to Change**

28. In some contexts, buyers make their decisions largely on the basis of brands but in other cases they use decision rules that refer to product characteristics. In what kinds of context would you expect brands to play a key role in determining choices? When buyers do use characteristics-based decision rules, what factors will be likely to determine whether they use non-compensatory rules rather than ones that involve trade-offs?
29. Discuss the concepts of ‘bounded rationality’ and ‘fast and frugal decision making’ in relation to the three-way distinction between ‘search goods’, ‘experience goods’ and ‘credence goods’. Illustrate your answer with practical examples and where possible draw attention to significant business policy implications.
30. Explain, using ideas covered in this course, how you expect the context of choice to affect decision making processes in the following situations:
  - (a) Buying a new printer for a computer;
  - (b) Buying a bed
  - (c) Choosing a hairdresser
  - (d) Buying toothpaste
  - (e) Purchasing airline tickets and travel insurance for an overseas holiday
31. How can behavioural economics be used to make sense of
  - (a) differences in the ways that people change their behaviour in response to changes in relative prices,
  - (b) why some people procrastinate before eventually changing their behaviour, and
  - (c) situations in which, despite no relevant changes in relative prices or the set of available options, people abandon commitments they have made?

In addressing these issues, note any policy implications that you can derive from your analysis.

32. What new insights do modern behavioural economists offer about how prices affect consumer behaviour and hence about strategies for setting prices? To what extent are their arguments compatible with the analysis of price-setting offered by 'old behavioural'/evolutionary economists?
33. What role do emotions play in human decision-making? How can an understanding of emotions be used by firms and governments to manipulate behaviour?
33. How useful is personal construct psychology for helping economists make sense of differences between products in their price elasticities of demand?

## **Policy Design and Applications**

34. Write a memorandum setting out a case for including a behavioural analysis of decision making as part of the standard training of health economists.
35. Discuss the contention that the report of the Productivity Commission Inquiry into Australia's Consumer Policy Framework paid too much attention to 'new' behavioural economics and too little to the possible implications of 'old' behavioural economics when seeking insights about when and how markets need to be regulated to promote consumer well-being.
36. What predictions does behavioural economics have to offer regarding the kinds of choices that Queensland residents will make concerning the risk of suffering from skin cancer due to exposure to the sun? What challenges do they face when choosing between rival sunscreen products if they decide to purchase sunscreen as a means of reducing their skin cancer risks? How does behavioural economics lead you to expect them to resolve these challenges?
37. Imagine you have been asked to give a talk to a meeting of your local Real Estate Agents' Association about the significance of behavioural economics for the real estate sector. Write a draft of the talk that you would give at this meeting, including areas such as its implications for website design for estate agents, the advice that estate agents should give house-sellers about the presentation and pricing of their homes, and about how property buyers and renovators may be susceptible to poor financial decisions.
38. What lessons does behavioural economics offer for policymakers who are trying to design ways of protecting consumers from devious business practices?
39. Imagine that you have recently started working as a member of a behavioural insights team and have discovered that none of your colleagues is aware of personal construct theory (PCT). Write a draft of what you would say if you were to give a talk to the rest of your team about how PCT can be applied to economic issues and its relevance for designing economic policy.

40. Outline and critically appraise Richard Thaler and Cass Sunstein's 'Nudge' approach to economic policy.

### **Firms and Efficiency**

41. To what extent should we see the rise of the modern corporation as a problem for the Marshallian view of the evolution of firms? How helpful is Marshall's analysis for making sense of the success of franchised business systems in modern economies?
42. Discuss the view that the pressure of competition and selection processes of markets force firms to maximize profits.
43. Use ideas from this course to explain why firms evolve distinctive 'corporate cultures' and discuss the role of corporate cultures in shaping the abilities of firms to survive as their competitive environments change.
44. Examine the relationships between the following concepts:
- (a) X-inefficiency;
  - (b) organizational slack;
  - (c) information impactedness/information asymmetry;
  - (d) tacit knowledge.

As you do so, show how your analysis can be used to enhance Wilfred Salter's perspective on industry restructuring.

45. What are the key features of the behavioural theory of the firm? How compatible are they with (a) Nelson and Winter's 'evolutionary' analysis, and (b) modern behavioural economics that builds on the work of Kahneman and Tversky?
46. Compare and contrast the key ideas in Cyert and March's *Behavioral Theory of the Firm* and Penrose's *Theory of the Growth of the Firm*.
47. Discuss the view that economists can safely ignore the 'old behavioural'/evolutionary approaches to the firm on the basis that, in the long run, firms will discover optimal ways of operating by experimenting under the pressure of competition.

### **The Competitive Process**

48. Discuss the contention that 'Competition is a process in which innovation is the most important factor.'
49. How do behavioural/evolutionary analyses of pricing differ from those normally offered in economics textbooks?
50. What is evolutionary about Marshall's theory of the industry and competition?

51. What lessons do the theories of the mind offered by F.A. von Hayek in *The Sensory Order* and G.A. Kelly in *The Psychology of Personal Constructs* have for economists seeking to understand why some new products have trouble winning sales, whereas others are rapidly adopted by consumers?
52. Discuss the view that the ‘normal cost’ theory of pricing proposed by P.W.S. Andrews is misleading for sectors of the economy subject to major cyclical fluctuations or characterized by rapid technological changes that are funded from retained profits.
53. What challenges do firms face in choosing where to spend money on improving their products or production processes and what insights do behavioural and evolutionary economics offer for understanding how they do, or should, make such choices?
54. Consider the ways that the transport and communications sectors have changed in the past two centuries from the standpoint of Schumpeter’s analysis of economic evolution. As you do so, reflect on the following comments by journalist Jeremy Clarkson regarding the ending of Concorde’s supersonic air travel services: “If you can communicate instantly with anyone anywhere, the only reason to travel is for fun, for your holidays. And given the choice of doing that at Mach 2 or for two pounds, I know which I’d choose. Perhaps, then, this is not a step backwards. Maybe Concorde dies not because it’s too fast but because, in the electronic age, it’s actually too slow” (*The World According to Clarkson*, p. 307).
55. Discuss the workings of the competitive process in the following two contexts: (a) competition between real estate websites that enable real estate agents and/or individual homeowners to list properties for sale or rent, and (b) competition between hotel booking websites. What insights does behavioural economics offer about the designs of website that are most likely to succeed in these contexts? Do you think that in either context a single website is likely to end up dominating the market?
56. Discuss Hayek’s (1948) contention that ‘... if the state of affairs assumed by the theory of perfect competition ever existed, it would not only deprive of their scope all the activities which the verb “to compete” describes but would make them virtually impossible.’
57. Discuss the contention that it is always misleading to talk about ‘revolutionary’ innovations, since new products and production processes are always merely more cost-effective methods of doing things that could already be done using older technologies.
11. What are the main elements of Schumpeter’s theory of innovation, competition and industry dynamics? To what extent does this theory need to be revised for the 21<sup>st</sup> century?
58. How suitable is the micro-meso-macro framework of Dopfer, Foster and Potts for analysing the evolution of the retail sector over the past century and a half?

59. How do patterns of industrial organization change as industries mature? What happens to the pace of innovation in an industry as it matures?
60. Use material from this course to address both of the following two questions:
  - (a) Why are the prices of raw materials prone to be much more unstable through time than the prices of manufactured products?
  - (b) Why do manufactured products commonly fall in price in real terms through time, contrary to conventional economic analyses of long-run supply curves?
61. What are the main ideas underlying the Dopfer/Foster/Potts 'micro-meso-macro' framework for analysing structural change in economic systems? With reference to examples from business history, consider how this approach can help economists understand macroeconomic cycles.
62. Discuss the contention that the Dopfer-Foster-Potts 'micro-meso-macro' framework is overly focused on the spread of new technologies in the process of economic growth and pays insufficient attention to the coordinating role of new kinds of business institutions and the impacts these have on the growth process.

## **Macroeconomics and Finance**

63. Examine the growth of consumer indebtedness prior to the Global Financial Crisis from the standpoint of behavioural and evolutionary economics. In doing so, examine both the growth in the willingness of consumers to get into debt and the increasingly easy access to credit provided by financial institutions.
64. What insights does behavioural economics have to offer for financial market regulators seeking to increase competition in the financial services sector, reduce the lenders' exposures to defaults on loans, and help ensure that consumers have paid off their mortgages by the time they reach normal retirement age?
65. How can a behavioural/evolving systems perspective help economists who are trying to make sense of episodes of financial instability, including what causes financial difficulties to spread and what limits the scale of a financial crisis?
66. How useful are behavioural and evolutionary microeconomics for understanding the short-run behaviour of macroeconomic variables, as opposed to long-run phenomena such as economic development and growth?
67. Examine the origins of the Global Financial Crisis from the standpoint of behavioural and evolutionary economics.
68. What insights do behavioural and evolutionary approaches to economics have to offer towards understanding the origins of the Global Financial Crisis of 2007-2009 and for the design of policies aimed at preventing such crises from occurring again?



69. In his book *Misbehaving*, Richard Thaler notes that an increasing proportion of homeowners in the United States of America are reaching normal retirement age without having fully paid off their mortgages. How can behavioural economics help us make sense of this?
70. Discuss the functioning of foreign currency markets from the standpoint of behavioural and evolutionary economics.
71. If some players in financial markets have been trained in behavioural economics, does it follow that this will result in those who lack such a training losing their money and being forced to exit these markets, so that sooner or later financial markets will cease to be distorted by non-rational behavioural tendencies? Explain your reasoning.

## **Environmental Issues and Wellbeing**

72. Has behavioural economics got anything novel to say about environmental issues such as how to deal with water shortages, traffic congestion and global warming?
73. The 'happiness economics' literature emphasizes that, beyond a relatively low level of income per head (about US\$15,000 per annum), happiness is poorly correlated with affluence. How can behavioural economics help explain this phenomenon?
74. What lessons does behavioural economics offer for policy-makers who are trying to design ways of ensuring that economic growth results in rising happiness for as many of their country's residents as possible?
75. There have been massive socio-economic changes since Thorstein Veblen's *Theory of the Leisure Class* was published in 1899, most notably, the collapse in numbers of people working as servants on the estates of the rich, the rise of the middle class, and the growth in female participation in the labour force. Have these changes rendered Veblen's theoretical analysis obsolete? Explain your reasoning.