

LXXIX. Cultural Aspects of Economic Decision Making

- A. There are many dimensions of a society's culture that are relevant for micro economics, although they are not given very much attention by most economists. A society's history affects its holdings of natural resources, its capital stock, and the size and skill of its present labor force. All these clearly affect the relative costs of goods and services produced in that society. (The historical origins of such economic resources are not always of particular importance, but their levels clearly are.)
- B. Culture also affect individual demands for goods and services. For example, it is clear that demand for such fundamental goods as food, clothing, music, and shelter reflect local aesthetics as well as climate and relative prices.
 - i. (Stigler and Becker (1977 JPE) have argued that fundamental tastes do not change, but rather human capital is acquired that affects a person's relative productivity and comparative advantage at enjoying particular kinds of music, art, foods, and so forth.
 - ii. It remains the case that rankings of alternative bundles of goods and services are affected by culture in their analysis, but, according to B & S, fundamental preferences over what might be called "ideal goods" like "music," "food" etc. are not.
- C. Culture also affects the various ways in which individuals measure success or status, and thereby the extent of approbation or censure associated with different kinds of activities. A society that values work, gives hard workers a lot of intangible benefits (approval, encouragement) that would not be present in a society without a work ethic. (In a "leisure" culture hard working "over achievers" would be scorned rather than lauded.)
- D. Evidence of the significance of such cultural influences are apparent in all manner of human behavior. But it is especially evident (if neglected) in economics insofar as the demand for goods and services, the quality and/or productivity of inputs, details required in contracts, and the crime rate *are all affected by culture: that is to say by norms and values transmitted from one generation to the next.*
 - i. One current example is the "green" emphasis on recycling products. Here increasing numbers of individuals voluntarily engage in the unpleasant activity of sorting their own trash, without monetary compensation, out of "regard for *the environment.*"

LXXX. Honesty, Cooperation, and Contracts

- A. To the extent that behavior that is locally non-rational is rewarded, or inculcated as moral habits, it is clear that various prisoner's dilemma, coordination, and contract problems can be more readily overcome.
- B. Experimental results always find far more "cooperation" in prisoner's dilemma games than the rational self-interest model predicts. Narrow self-interested models of rationality predict *no cooperation* in (discrete) PD games. The observed pattern of behavior is that half or more of the parties involved in PD experiments cooperate.
 - i. At the margin relative prices still seem to matter: as the reward to cheating vs. cooperation increases, one gets more opportunistic (rational behavior).
 - ii. But, one still gets too much cooperation in those models.

- iii. And, the degree of cooperation varies with groups, suggesting culture plays role.
- C. Greater cooperation is not all for the good.
 - i. There are cases where more cooperative or more honest behavior in PD like settings will yield mutually beneficial outcomes for the players and society at large (by reducing externality problems, theft, and lowering contracting costs.
 - ii. However, there are others where increased cooperation makes life more difficult as cartels become in principle more stable, and criminals resist confessing to crimes the original PD game was designed to elicit.
- D. In settings where not all players behave as game theory predicts, strategies of conditional cooperation may be "rational" in the large if not in any single round of the game. That is to say, Players who use "ethical" strategies score may better on average than those who play more "pragmatically." (See for example Axelrod (1984) or Vanberg and Congleton (1992).)
- E. Robert Frank (1992) has argued that "Homoeconomicus" would want a conscience if he could choose to have one. In a world where some players are more cooperative than others, there is a signaling game. Cooperators would like to be able to discriminate among other cooperators and opportunists. Opportunists would likewise like to be able to recognize cooperators and avoid other opportunists. A more or less permanent "conscience" (blushing when one lies, say) allows other similar "nice" players to choose partners that will cooperate more often than opportunistic players. [Screening from signals: hawk-dove or a separating equilibrium?]

LXXXI. Status Seeking and Positional Goods

- A. There has been a fairly long standing argument in economics, and social science generally, whether perceived individual welfare (utility) is increased by securing greater *absolute* income or by securing greater *relative* income, Veblen (1899) or Easterlin (1973).
- B. Related to this idea, is an idea of "positional" goods that Hirsh (1976) posited as the ultimate limit on social growth. The supply of "position" within a hierarchy (as in a firm, organization, or subculture) and of goods that are themselves "ranked" can not be as readily increased as ordinary mass consumption goods. There can only be a few *best* cars or coats. [Obviously relative income can not be increased for every one.]
- C. Frank (1985) argued that position is important at the level of organization and between organizations. But notes that individuals can choose which organizations to belong to. [Big frog in little pond?] He argues that, to compensate for their relatively smaller status, the "lowest" ranked members of an organization are paid more than their marginal product and the "highest" are paid less because position (status/rank) is itself a form of compensation.
 - i. The lower positions need to be compensated with cash for taking a position of lower rank in order to attract people into such positions.
 - ii. The higher positions have returns in excess of the monetary compensation.

- D.** It turns out that often too many resources are devoted to games where relative advantage is competed over.
- In effect there is a type of "rent-seeking" loss involved in status seeking games.
 - For example, consider the case where individuals care about status and ordinary income. Both take time to produce, so $U_1 = u_1(y_1(W_1), s(S_1, S_2))$ where $T_1 = W_1 + S_1$.
 - Status increases as one's own time devoted to status seeking increases, but falls as effort devoted by other(s) increase. Here we assume there are just two individuals in the game of interest to simplify notation a bit, but the results can be easily generalized.
 - Each person will seek status at the level which sets $U_{S_1} - U_{Y_1} Y_{W_1} = 0$. Note that the status obtained is partly a matter of effort and partly a matter of the "rules of the status game" which determine how effort (and what kinds of effort) yield status (function s).
 - The f. o. c. implies a status seeking reaction function $S_1^* = s^*(T, S_2)$ for each player which can be used to characterize the Nash equilibrium of the game.
 - That the Nash equilibrium is not likely to be Pareto optimal can be seen by observing that an externality exists between the status seeking efforts of each status seeker and the status received by all others in the game. In principle, each player should have taken account of the spillover cost that his status seeking effort imposes on the other.
 - Using a Benthamite social welfare function, or assuming that decisions would be reached from behind a veil of ignorance are such that everyone is equally likely to be anyone party, implies that Mr. 1 should have status sought at the level where:

$$U_{S_1}^1 - U_{Y_1} Y_{W_1} + U_{S_1}^2 = 0$$
 - The new term is an additional cost of status seeking neglected by the status seeker. Since each person should have engaged in less status seeking, given the efforts of the other, the Pareto efficient level would have been lower effort overall and for each. (This of course is a standard result in the rent seeking literature.)
- E.** Of course the means by which one gains or loses status within an organization and in society itself is not simply a matter of income or productivity. These rules for assigning status are endogenous. To the extent that the rules of the game change through time in a manner which makes status seeking productive (by for example imposing positive externalities on non-players), much of the potential loss identified by Frank might be mitigated. (Hayek/Congleton (1989 JEBO))

LXXXII. The Work Ethic

- A.** One example of an efficiency enhancing ethical code and/or status game is the "work ethic." There are two kinds of "work ethics" that one can imagine. First there is an internal work ethic that is an internal ingrained normative system which makes individuals relatively more inclined to work hard and well. Second, there is a cultural work ethic in which status or approbation is achieved by hard workers in addition to their ordinary economic salaries.
- B.** A work culture implies that individuals will supply more labor at a given wage than they would have in the absence of a supporting non-pecuniary reward for working hard or well. In effect, *real wages* are partly income and partly status or approbation.

- Note that if labor markets were otherwise efficient, a work culture might (in its purely instrumental role) induce too much labor supply. A work culture might simply create an unproductive rat race.
 - However, if labor markets are inclined to be inefficient because of team production, economies of scale or scope, incomplete contracts etc., a work culture can increase labor supply in a manner that promotes efficiency, Congleton (1990, JEBO).
- C.** Buchanan (1994 UM Press) examines the implication of an internal work ethic, where some privately adopted normative rules regarding work change the marginal rate of substitution between work and leisure.
- He argues that in a setting where the extent of specialization is limited by the extent of the market, supplying additional labor to the market increases the scope for specialization which reduces production costs economy wide.
 - Here, a work ethic enhances economic efficiency by allowing greater possibilities for specialization.
 - Consequently, intensification of a work ethic can be a source of endogenous growth.
 - A similar, although somewhat less direct argument is made regarding the savings component of the Puritan Work Ethic.
 - Max Weber (1904) attributes the rapid growth of northern Europe after the Protestant reformation to the "new" Puritan work ethic.
- D.** The internal work ethic examined by Buchanan is clearly one of the unobserved characteristics of labor that efficient screening contracts are designed to elicit.

LXXXIII. Review Problems

- A.** Consider a two person team production game in which output is generated via a Cobb-Douglas production function over each team member's labor supply (effort or hours of work). Suppose each team member has a Cobb-Douglas utility function defined over labor income and leisure. Assume that all the exponents in the CD functions are .5.
- Determine the number of hours that each person on a 2 person team works.
 - Determine whether the result is Pareto efficient (for the team).
 - Show that a work culture, by appropriately subsidizing labor at the margin, can solve this problem.
- B.** Consider the bounds of economics. Can culture be a proper subject of economic analysis? What characteristics must a problem have to be amenable to economic analysis?