

Keynes compared speculative bubbles in the stock market to a newspaper game in which people guess what faces others will guess are most beautiful.

In this game, people immediately assume the average will be around 50, and so guess 33. But they realise this, and so guess 22. They realise that others will do this however and so guess 14. By iteration, **the game theorists solution is 0 (Nagel, 1995).**

Responses get lower as the game is repeated but it is never 0. There is a limit to people's **metacognition.**

Many transactions are less direct. People assume that one's brother or colleague will carry out the transaction.

Buchan et al. 2000 In foursome conditions where A gives to B and B gives to C etc. There is less direct trust, and so less is returned. In society conditions, in which

Experimental Labour Markets (Fehr et al. 1990–2000) Firms post wage offers and workers accept them or not. Self interest predicts that workers will choose minimal effort (**shirk**) and the firms, anticipating this, will offer minimum wage. However in experiments where firms offer high wages, workers reciprocate by working hard.

Iterated Experimental Labour Markets (Fehr et al. 1997–1999) When firms and workers can specify wage levels, workers compete by offering to work for less. Firms however persistently hire workers asking for highest pay.

Tradition vs. Trust Organisational Design The first assumes workers are lazy and require incentives. They fire shirkers and hire the cheapest. The latter assume workers will feel a moral obligation and work harder. They eschew threats and rely on goodwill. Which model works better?

Baron et al. 2001 conducted a field study of silicon valley firms. 20% were more trust orientated, monitored by peers rather than supervisors. These organisations grew most rapidly. This poses a problem for traditional economic theorists, as it causes them to reevaluate their understanding of utility.

The Beauty Contest Game

More Complex Scenarios

Trust

A firm belief in the reliability, truth, ability or strength of someone or something.

Trust Game

Classical Economists argue that to maximise profits, B should hand nothing back and anticipating this, A should hand nothing over in the first place.

This is a perfect way to measure trustworthiness. As the amount A gives is a measure of theirs and the amount B hands back is a measure of theirs.

Sociologists argue that the trust game does not capture the rich set of features that influence trust (relationships, communication etc.). This is an example of **blind trust.**

The Centipede Game

Self-interest predicts B will take money at £800, and so A will anticipate that and take £400 and so on. A should take the original £100. But people trust.

Culture

Koford, 1998 found that Bulgarian students are the most trusting (investing 70%) and trustworthy (returning 150%). Kenyans are least trusting and repay half what they receive.