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## Social Preferences: Fundamental Characteristics and Economic Consequences

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# **Social Preferences: Fundamental Characteristics and Economic Consequences**

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# Social Preferences: Fundamental Characteristics and Economic Consequences

## Abstract

We review the vast literature on social preferences by assessing what is known about their fundamental properties, their distribution in the broader population, and their consequences for important economic and political behaviors. We provide, in particular, an overview of the empirically identified characteristics of distributional preferences and how they are affected by merit, luck, and risk considerations as well as by concerns for equality of opportunity. In addition, we identify what is known about belief-dependent social preferences such as reciprocity and guilt aversion. The evidence indicates that the big majority of individuals have some sort of social preference while purely self-interested subjects are a minority. Our review also shows how the findings from laboratory experiments involving social preferences provide a deeper understanding of important field phenomena such as the consequences of wage inequality on work morale, employees' resistance to wage cuts, individuals' self-selection into occupations and sectors that are more or less prone to morally problematic behaviors, as well as issues of distributive politics. However, although a lot has been learned in recent decades about social preferences, there are still many important, unresolved, yet exciting, questions waiting to be tackled.

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## 5. Summary and Outlook

# 1. Introduction

The topic of social preferences has received a great deal of attention in economics and in the broader social-science literature in the past three decades. A large, and still growing, literature has documented the existence of social preferences, their social and economic implications, and the various conditions under which they influence the equilibria and outcomes of human interactions.<sup>1</sup> The key characteristic of social preferences is that individuals are willing to sacrifice money or other material resources to help or hurt other people, to establish fairness and justice, or to increase groups' joint payoff. In other words, people with social preferences do not maximize their own material payoff but are other-regarding – which has potentially far-reaching consequences for both theory and practical applications.

In this paper, we will summarize what has been learned in this line of research and we will identify what needs to be known and done to make further progress. First, we will describe the evidence for the existence of social preferences gathered in canonical (“paradigmatic”) experiments and suggested by behavioral patterns observed in the field in Section 2. We will then review the various theoretical models and the empirical relevance of the different motives that have been proposed as a foundation for social preferences in Section 3. In this context, we will discuss preferences over the distribution of material payoffs and the impact of merit, luck, and risk on these preferences. We will then review the evidence on belief-dependent preferences such as reciprocity and guilt aversion. Moreover, this section also discusses the role of self-image and social image in other-regarding behaviors.

Because a large part of the empirical research on social preferences has used laboratory experiments, it is important to point out that there is a broad consensus regarding the relevance of *qualitative* findings from economic experiments (Levitt and List 2007b; Falk and Heckman 2009; Camerer 2015; Kessler and Vesterlund 2015). While researchers may disagree with regard to the generalizability of the *quantitative* findings from experiments – such as the magnitude of discount rates – there is widespread agreement regarding the

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<sup>1</sup> The influence of this literature can be illustrated, for example, by the citation rates of the most prominent models of social preferences (Rabin (1993); Fehr and Schmidt (1999); Bolton & Ockenfels (2000); Charness and Rabin (2002); Dufwenberg and Kirchsteiger (2004); Falk and Fischbacher (2006)). These six papers alone have received a total of 40,000 Google Scholar citations and more than 6,500 citations in the Social Science Citation (SCCI) Index (situation July 2022), but the overall impact of the literature on social preferences goes well beyond these papers.

relevance of qualitative findings.<sup>2</sup> Applied to the domain of social preferences, this means that while the strength of different social preferences may vary across different (lab or field) environments, or between lab and field environments, the *very existence and the directional effects* of social preferences such as inequality aversion, a concern for the total surplus (“efficiency”), reciprocity, or guilt aversion can be reliably documented with laboratory experiments.<sup>3</sup> In Section 4, we will discuss important economic consequences of social preferences for labor markets and the macroeconomy, for the functioning of incentives and contracts, for the foundation of incomplete (employment) contracts, and for the demand for politically enforced redistribution. The subsections on labor markets and political redistribution indicate, in particular, a strong congruence between lab and field findings. Finally, we discuss what we have learned so far and point out important unresolved, yet exciting, questions in Section 5.

There are a few other older review papers on social preferences such as those of Fehr and Schmidt (2006) and Cooper and Kagel (2016), who provided selective surveys of aspects of social preferences. Our paper differs by being more encompassing, by exploiting the enormous accumulation of recent evidence about the distribution of social preferences in broad population samples, by discussing the role of merit, luck, risk and image concerns in other-regarding behaviors, as well as the deeper knowledge that has accrued with regard to the identification of reciprocity and guilt aversion. Finally, our review paper also benefits from the recent accumulation of exciting insights from field evidence that indicates the relevance of social preferences for nominal wage rigidity, the morale effects of wage inequality. or the demand for redistribution.

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<sup>2</sup> Individuals’ experimentally measured discount rates have, for example, been shown to be good predictors of their administratively measured relative wealth levels (controlling for a host of relevant individual characteristics) although the *magnitude* of the lab measured discount rate is often too high to be considered a meaningful *quantitative* estimate (e.g., Epper et al. (2020)). Note, however, that it is surely not impossible that quantitative experimental findings generalize to the field, but this needs careful empirical scrutiny for the involved behavioral domains. The quantitative estimates of peer effects (Herbst and Mas 2015) provide one example of generalizable quantitative findings. Benz and Meier (2008) also show a strong quantitative similarity of charitable donation of students in a laboratory experiment and their donations in the field.

<sup>3</sup> The first version of this paper included two additional sections. The first presented evidence on the predictive validity of laboratory social preferences measures for field behaviors, while the second presented evidence on the relationship between identity or parochial issues and social preferences. Due to space limitations, these sections have been outsourced to two separate papers (Charness 2023; Fehr 2023).



## **2. Social Preferences and Self-Interest in Paradigmatic Economic Games**

The role of social preferences can, in principle, manifest itself in the myriads of human interactions that take place every day in families, neighborhoods, markets, organizations, or the political sphere. They can inhibit or enhance the effectiveness of economic incentives or the functioning of markets and organizations; they can shape collective action, affect contractual arrangements and institutions, influence how people vote, and undermine or enhance political regimes. In fact, social preferences appear to at least partly drive many real-world phenomena. They range from helping friends and neighbors to support for co-workers, from charitable donations to participation in collective actions against oppressive dictatorships, from affluent individuals' political support for redistributing income towards the poor to workers' collective stance against wage cuts.

However, although social preferences of some sort are plausible drivers of behavior in all these real-world examples, many other factors – such as the expectation of future material benefits or reputational concerns – can influence individuals' behavior in these situations. Therefore, a skeptic who observes a seemingly other-regarding behavior in the field may not be convinced that it is due to social preferences because one can always argue that there may have been hidden, unobservable financial or reputational rewards. This is why a considerable part of the research on social preferences is based on laboratory experiments where one can rule out these hidden rewards with certainty by ensuring that the experiments are one-shot and that the parties interact anonymously with each other.<sup>4</sup>

There are several paradigmatic experiments that – when played one-shot and under anonymity between the players involved – document the widespread existence of social preferences. We call these experiments “paradigmatic” because they all capture an essential feature of an important economic or social situation. The games are described in more detail in Box 1 on “Paradigmatic Economic Games” (see below). They capture (i) situations that involve the unilateral determination of a payoff distribution between parties (dictator game), (ii) bilateral bargaining situations (ultimatum game), (iii) economic exchanges under

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<sup>4</sup> The implementation of anonymous one-shot experiments is thus a frequently employed conservative strategy that makes sense, but it is also important to keep in mind that important aspects of social relations, and their influence on social preferences, may be lost in these experiments (Frohlich, Oppenheimer and Kurki 2004). It is, however, possible to introduce many real-life features (e.g., lack of anonymity, reputation formation, the role of merit and entitlements, etc.) into the lab and to study them in a controlled manner.

incomplete contracts (gift exchange game, trust game), (iv) public goods contributions in the absence of supporting institutions and material incentives for their provision (public goods game) and (v) the private sanctioning by third parties of greedy, unfair, or norm-violating behaviors (third party punishment game). All of these games have been replicated dozens, and sometimes hundreds of times and show robust, replicable behavioral patterns (see Camerer (2003) for a review). The critical player in these games (i.e., the person for whom one can measure social preferences) always has a simple and transparent money maximizing choice, while systematic (i.e., non-random) deviations from that choice indicate some form of social preference.

For example, many responders in the ultimatum game from societies across the globe indicate a social preference by rejecting uneven offers and earning nothing as a consequence (Guth, Schmittberger and Schwarze 1982; Henrich et al. 2001). The proposer often anticipates this responder behavior, inducing him or her to make relatively fair offers so that the responder appropriates on average roughly 40% of the pie even though the self-interest model predicts that he or she should get 0%. In the dictator game, many subjects in the role of dictators make positive unilateral transfers – on average typically around 20% of the available money – to the recipient (Forsythe et al. 1994; Camerer 2003). Subjects in the role of workers in the gift exchange game (Fehr, Kirchsteiger and Riedl 1993) respond to higher wages with higher costly effort levels, although the minimal effort would always be the money-maximizing choice. In the trust game (Berg, Dickhaut and McCabe 1995), the trustees respond to trustors' positive transfers with positive back-transfers, although the money maximizing choice would be to transfer back nothing. In social dilemma games (Dawes, McTavish and Shaklee 1977; Dawes 1980) and public good games with (complete) defection as a dominant strategy (Andreoni 1988), many subjects nevertheless cooperate and make positive contributions to the public good. And third parties in third party punishment games (Fehr and Fischbacher 2004) who observe that other individuals have been treated unfairly or are the “victims” of a social norm violation punish the perpetrators at a cost to themselves.

The robust documentation of other-regarding behaviors in experiments has led many observers to assume that in addition to self-interest, people also care for other people's payoffs (Thibaut and Kelley 1959; Messick and Mcclintock 1968). However, one fundamental question that has bothered the field for a long time is how one can reconcile the existence of social preferences with evidence from other paradigmatic games that appear to indicate that people are largely selfish. How can we explain this *without arbitrarily assuming*

*that individuals' preferences are different across games?* For example, in a market game with responder competition (see Box 1 on Paradigmatic Economic Games), there is not just one responder as in the bilateral ultimatum game but several, so that the responders compete with each other for the share of the surplus the proposer offers. In this game, the parties behave in a much more self-interested manner – compared to the bilateral ultimatum game – because the proposers make much more unequal offers, and the rejection of these uneven offers decreases dramatically, allowing the proposer to appropriate the lion's share of the surplus (Fischbacher, Fong and Fehr 2009).

In a market game with proposer competition, one adds several competing proposers to a bilateral ultimatum game. Here again, the players behave much more in line with the self-interest prediction because the competition among the proposers drives up their offers such that the responder appropriates almost the whole surplus, i.e., responders accept a distribution of payoffs (Roth et al. 1991; Fischbacher, Fong and Fehr 2009) that appears very unfair. These facts are also consistent with the observations from competitive double auctions and competitive posted offer markets that indicate that the observed prices and quantities traded in these markets tend to quickly converge to the competitive equilibrium derived from selfish preferences (Smith 1982). Similarly, cooperation rates are often extremely low in the final period of finitely repeated public goods games, seemingly indicating that social preferences may play no role when sufficient learning has been possible.

How is the claim that many people have social preferences compatible with these facts? Does a little bit of learning or competition wipe out social preferences, i.e., are they simply inexistent under competitive pressure, or even worse, is behavior in these paradigmatic games that document social preferences just a strange behavioral aberration<sup>5</sup> or can models of social preferences also explain the conditions under which other-regarding individuals behave as if they were completely self-interested? We will address this problem when we discuss the different models of distributional preferences in Section 3.1.

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<sup>5</sup> In the early days of social preference research, it was not infrequent to meet economists who labelled subjects exhibiting behaviors indicating social preferences as “crazy” individuals or “crazy” types.

### Box 1: Paradigmatic Economic Games

In a ***dictator game*** one player – the dictator – is given a sum of money that she can unilaterally allocate between herself and a passive recipient who cannot make a decision. Self-interest predicts zero transfers to the recipient. In an ***ultimatum game***, a proposer can make a single proposal of how to distribute a given sum of money between herself and a responder. The responder can accept or reject the proposed allocation. If she rejects, both players receive nothing. If she accepts, the proposed allocation is implemented. Self-interest predicts that the proposer makes the lowest possible money offer, which the responder will then accept. In a ***third party punishment game***, two players, the dictator A and the recipient B, participate in a dictator game. A third player, the potential punisher C, observes how much A gives to B; then C can spend a proportion of his endowment on punishing A. A third party with a punishment option can, in principle, be added to any constituent base game such as, for example, the prisoners' dilemma game. Selfish third parties will never punish.

In a ***trust game***, two players, A and B, each have an identical initial endowment. First, A decides whether to keep his endowment or to send some or all of it to B. Then B observes A's action and decides whether to keep the amount she receives or share some of it with A. The experimenter triples A's transfer, so that both players are better off collectively if A transfers money and B sends back a sufficient amount. Self-interest predicts that B sends back zero money and, therefore, A also sends no money. In a ***gift exchange game***, a subject in the role of an employer can offer a fixed wage to a subject in the role of a worker. After observing the wage, the worker chooses a costly effort level that raises the overall surplus that can be distributed among the parties. Self-interest predicts the lowest possible wage offer and the lowest possible effort level. In a generic ***linear public goods game***, players have a token endowment they can invest in any proportion in a private project in their own favor or a public project to be shared equally among the group, where the experimenter increases any donation to the public project. Therefore, investment into the public project maximizes the group's aggregate earnings, but each individual has a dominant money-maximizing strategy to invest the whole endowment into the private rather than the public project.

In the ***market game with responder competition***, the proposer decides how to split a given sum of money between herself and one of the competing responders. All  $n > 1$  responders have to decide simultaneously whether to accept or reject the proposal. If all reject, all parties receive zero payoff; if some responders accept, one of them is randomly chosen to receive the proposed amount, and all other responders receive zero. In the ***market game with proposer competition***, all proposers simultaneously make a proposal of how to split a given sum of money with a single responder who can accept one of the proposals or reject all of them. The accepted proposal is implemented, while all other proposers earn zero. If all proposals are rejected, all players earn zero payoff.

The predictions for the experimental games mentioned above are based on the assumption that the games are played one-shot and interactions are anonymous.

A second question is how widespread are social preferences, i.e., what is the approximate share of selfish people, and which proportion deviates significantly from selfishness. The strategic games discussed above are not well suited for answering these questions because one needs several observations of the same individual at sufficiently different costs of the deviation from selfishness in order to measure an individual's (social) preference. For example, if the cost of giving a dollar to another individual is two dollars, significantly fewer individuals are likely to make this transfer compared to when the cost is 10 cents. In other words, whether an individual has selfish or social preferences is not a matter of a choice in one particular situation, but rather a matter of a structural preference parameter that indicates the limit of an individuals' willingness to give in terms of the costs of giving.<sup>6</sup> For this reason, we will discuss in Section 3.1 the results of papers that have undertaken more "structural" measurements of social preferences based on many individual choices.

Third, many of the paradigmatic experiments mentioned above were first conducted with student populations from Western societies that anthropologists (Henrich, Heine and Norenzayan 2010) have characterized as WEIRD populations because they seem to represent an outlier compared to the universe of historically observed and existing human populations.<sup>7</sup> The frequent use of student subjects from WEIRD societies raises the question whether the findings can be generalized to the broader population in WEIRD societies and to other societies, a question we tackle in Sections 3.1. and 3.2.

A fourth important question concerns the properties of social preferences. Responders in an ultimatum game, for example, may reject low, uneven offers for various reasons. They could simply be spiteful (i.e., value the other's payoff always negatively), or they could prefer equity instead of an unfair distribution of income, or they may want to punish the proposer for making an unfair proposal. Likewise, the precise motivation that underlies the reciprocal *behaviors* of second movers in the trust or gift exchange game is unclear. Second-movers may reward the fair intentions of first movers in these games, or they may aim for a more equal distribution of income, or they may avoid feeling guilty if they fail to reciprocate. Thus, while the above-mentioned paradigmatic games capture key aspects of important human social interactions they are, in general, not ideal for the robust identification of the

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<sup>6</sup> Strictly speaking, the only individuals who are entirely selfish are those who are not even willing to pay a penny for giving another person a dollar.

<sup>7</sup> WEIRD stands for Western, Educated, Industrialized, Rich, and Democratic societies.

relative importance of different properties of social preferences. To clarify the motives underlying social preferences more precisely, we must design experiments that can cleanly separate the motives for the different behaviors, a question that we also address in Sections 3.1. – 3.4.

Fifth, social preferences are different from risk and time preferences because the latter are completely independent from other people's payoff and actions, while the very notion of a social preference is based on the idea that others' payoffs and/or actions matter. This raises the question who the other people – whose payoff matters – are and which psychological, social, and economic forces determine who matters. Social preferences may importantly depend on the kind of social relationships individuals have with others and may, thus, be characterized by social boundaries and parochial instincts. Due to space limitations, we deal with this question in Appendix 9.

### **3. Fundamental Properties of Social Preferences**

#### **3.1. Social Preferences over Payoff Distributions**

##### **3.1.1. Models of Distributional Preferences**

A number of social preference models (see Box 2) are based on the assumption that people care about the distribution of payoffs between themselves and a set of relevant reference agents (Fehr and Schmidt 1999; Bolton and Ockenfels 2000; Andreoni and Miller 2002; Charness and Rabin 2002; Fisman, Kariv and Markovits 2007). These models are a natural starting point for the modelling of social preferences because the behavioral patterns observed in the paradigmatic games discussed above strongly suggest that some sort of interdependent preferences are at play. Another main motivation for the construction of some of these models (Fehr and Schmidt 1999; Bolton and Ockenfels 2000) was the existence of important facts from (i) market games with proposer and responder competition and final periods of public good games that appeared to contradict the existence – or at least the widespread relevance – of social preferences, and (ii) the observation that the same people are willing to engage in seemingly contradictory behaviors by increasing the other's payoff at a cost to themselves in some situations, while decreasing the other's payoff in other situations. For example, positive transfers in the dictator game indicate that the dictators value the recipients' payoff positively, while rejections in the ultimatum game reduce the

proposer's payoff and thus indicate a negative evaluation of the proposer's payoff. Likewise, a rise in the effort level in response to a higher wage leads to an increase in the employer's payoff in the gift exchange game, while the third party's sanctions in the third-party punishment game reduces the dictator's payoff in that game.

Thus, the question is whether social preference models can account for these seemingly contradictory facts. Obviously, a simple model of altruism that assumes that other-regarding individuals value others' payoffs positively cannot account for these facts nor can a model of spiteful/envious preferences, where individuals value others' payoff negatively, do so. Since simple models of altruism and spite cannot explain these facts, the concept of a social value orientation (SVO), that was developed by social psychologists (Liebrand 1984; Liebrand and McClintock 1988; Van Lange et al. 1997) is not capable of doing so because the SVO concept views an other-regarding individual as *either* altruistic/cooperative *or* as envious.

Surprisingly, however, relatively simple models of other-regarding preferences over payoff-distributions – such as those by Fehr and Schmidt (1999) and Bolton-Ockenfels (2000) – go a long way towards reconciling these facts. While this does not mean that these models are necessarily empirically correct – because this requires further empirical testing (see below) – it means that widespread seemingly selfish *behaviors* in certain strategic games can be perfectly consistent with the existence of widespread *social preferences*.

In the two-player case, a simple, linearized, version of player  $i$ 's distributional social preferences  $U_i(\pi_i, \pi_j)$  can be written as

$$U_i = (1 - \alpha)\pi_i + \alpha\pi_j \quad \text{if } \pi_i < \pi_j \quad (1a)$$

$$U_i = (1 - \beta)\pi_i + \beta\pi_j \quad \text{if } \pi_i \geq \pi_j, \quad (1b)$$

where both  $\alpha$  and  $\beta$  are from the interval  $(-1, +1)$ ,  $\pi_i$  and  $\pi_j$  represent the material payoffs of players  $i$  and  $j$ , respectively,  $\alpha$  is the weight on player  $j$ 's payoff when  $i$  is behind ( $\pi_i < \pi_j$ ), while  $\beta$  is the weight when  $i$  is ahead ( $\pi_i > \pi_j$ ). For simplicity, we drop the subscript  $i$  for the weights that player  $i$  assigns to the other player's payoff. Depending on the parameters  $\alpha$  and  $\beta$ , this model captures a number of distributional social preference motives discussed in the literature. If  $\alpha = \beta = 0$ , players are selfish and their indifference curves in the  $(\pi_i, \pi_j)$ -space are vertical (see Figure 1a). If both  $\alpha$  and  $\beta$  are negative, a player has *competitive or spiteful* social preferences because he or she always values the other player's payoff negatively. The indifference curves of *spiteful* players in  $(\pi_i, \pi_j)$ -space are illustrated in Figure 1b. Equations (1a) and (1b) can also capture the *inequality averse preferences* described in Fehr and

Schmidt (1999), where subjects dislike both being ahead and being behind. This preference implies that subjects value the other player's payoff positively if ahead but negatively when behind, which can be captured in terms of the parameters in equations (1a) and (1b) by  $\alpha < 0$  and  $\beta > 0$ .<sup>8</sup> The indifference curves of inequality averse players are illustrated in Figure 1c below. The key property of these indifference curves is that individuals are willing to sacrifice resources to reduce the other player's payoff in order to diminish disadvantageous inequality. In the two-player case, the social preferences Bolton-Ockenfels (2000) assume are quite similar to those of Fehr and Schmidt, i.e., the players basically dislike being behind as well as ahead.<sup>9</sup> Therefore, if a player is behind, she values the other player's preferences negatively, while she values them positively when ahead.

It is easy to see how social preferences like those in Fehr and Schmidt (1999) and Bolton-Ockenfels (2000) can explain that people sometimes increase and sometimes decrease other agents' payoffs. In the Fehr-Schmidt model, the criterion for when individuals switch from being benevolent to malevolent is whether they are ahead or behind the other player's payoff. As Fehr and Schmidt (1999) point out, this criterion may not always be the empirically relevant one – because equity is not always identical to equality – but it may nevertheless be a useful criterion in many experimental games and real-life situations. In the Bolton-Ockenfels model, the criterion for switching from benevolent to malevolent is whether the player receives an equal share of the overall surplus.

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<sup>8</sup> To see this more explicitly, recall that in the two-player case inequality aversion is defined by Fehr and Schmidt as  $U_i = \pi_i - \bar{\alpha}_i(\pi_j - \pi_i)$  if  $\pi_j > \pi_i$  and  $U_i = \pi_i - \bar{\beta}_i(\pi_i - \pi_j)$  if  $\pi_i > \pi_j$  with both  $\bar{\alpha}_i > 0$  and  $0 < \bar{\beta}_i < 1$ , implying that players dislike inequality. These utilities can be rewritten as  $U_i = (1 + \bar{\alpha}_i)\pi_i - \bar{\alpha}_i\pi_j$  if  $\pi_j > \pi_i$  and  $U_i = (1 - \bar{\beta}_i)\pi_i + \bar{\beta}_i\pi_j$  if  $\pi_i > \pi_j$ . Define  $\alpha = -\bar{\alpha}_i$  and  $\beta \equiv \bar{\beta}_i$  to arrive at equations (1a) and (1b).

<sup>9</sup> In the two-player case, a version of the Bolton and Ockenfels preferences can be written as  $U_i = \pi_i + f(\sigma)$  where  $\sigma = \pi_i/(\pi_i + \pi_j)$  measures A's relative payoff.  $f(\sigma)$  reflects the other-regarding part of an individual's utility function; it is increasing in  $\sigma$  for  $\sigma < 1/2$  (i.e.,  $\pi_i < \pi_j$ ) and decreasing for  $\sigma > 1/2$  (i.e.,  $\pi_i > \pi_j$ ). Note, that the preferences illustrated in Figure 1c represent a piece-wise linear approximation of Bolton-Ockenfels preferences.



## Box 2: Models of Distributional Preferences

Let  $\pi_i$  and  $\pi_j$  represent the material payoffs of players  $i$  and  $j$ , respectively. In the **Fehr-Schmidt (1999)** model, individuals are assumed to derive disutility from inequitable outcomes. For simplicity, inequity is formalized as inequality in the experimental games under consideration. This led to the following utility function:

$$U_i = \pi_i - \frac{\bar{\alpha}_i}{n-1} \sum_{j \neq i} \max(\pi_j - \pi_i, 0) - \frac{\bar{\beta}_i}{n-1} \sum_{j \neq i} \max(\pi_i - \pi_j, 0), \quad (2)$$

where  $\bar{\alpha}_i > 0$  measures the disutility from the average disadvantageous inequality while  $\bar{\beta}_i > 0$  measures the disutility from the average advantageous inequality. The Fehr-Schmidt model implies that players care positively for others' payoff if they are better off than the other player (advantageous inequality) and negatively if they are worse off than the other player (disadvantageous inequality).

The model by **Bolton-Ockenfels (2000)** stipulates a utility function

$$U_i = f_i(\pi_i, \sigma_i), \quad (3)$$

i. e., a player's utility is a function  $f_i$  that depends positively on the player's own material payoff and on the relative share  $\sigma_i$  that the player receives in the game. If the total payoff in the game,  $\Pi = \sum_{j=1}^n \pi_j$ , is positive, the relative share is given by  $\sigma_i = \pi_i / \Pi$  and if the total payoff is zero,  $\sigma_i$  is assumed to be equal to  $1/n$ . The model assumes that individuals derive additional utility from a higher  $\sigma_i$  if  $\sigma_i < 1/n$  while if  $\sigma_i > 1/n$ , a higher  $\sigma_i$  is utility-decreasing. In the Bolton-Ockenfels model, players do not care about the payoffs of specific other players as long as their "own" relative share  $\sigma_i$  is unaffected. In the two-player case, individuals care positively for the others payoff if they are better off and negatively if they are worse off than the other player.

The distributional preferences in **Charness and Rabin (2002)** are assumed to be given by

$$\begin{aligned} U_i &= (1 - \lambda_i)\pi_i + \lambda_i W(\pi_1, \pi_2, \dots, \pi_n) \\ &= (1 - \lambda_i)\pi_i + \lambda_i [\delta_i \min(\pi_1, \pi_2, \dots, \pi_n) + (1 - \delta_i) \Pi] \end{aligned} \quad (4)$$

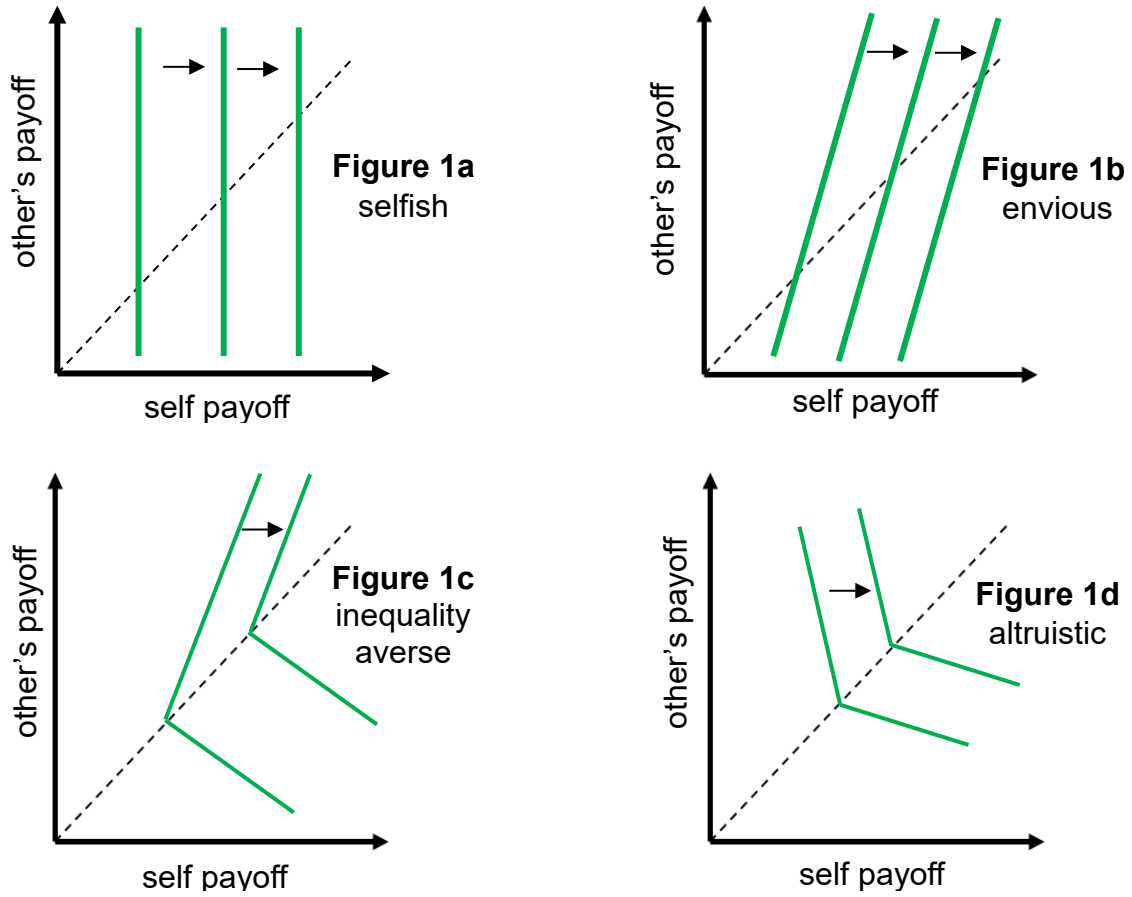
Here, subjects value a *social welfare function*  $W(\pi_1, \pi_2, \dots, \pi_n)$  positively with weight  $\lambda_i \in [0, 1]$ , while a subject's own payoff  $\pi_i$  has weight  $(1 - \lambda_i)$ .  $\lambda_i > 0$  indicates "other-regardingness", i.e., that player  $i$  cares in some way for other's payoff. The social welfare function has two arguments: the payoff of the least well-off player enters with weight  $\delta_i \in (0, 1)$ , and the sum of the payoffs  $\Pi$  enters  $W$  with weight  $(1 - \delta_i)$ . Thus, if player  $i$  cares for others' welfare ( $\lambda_i > 0$ ) and player  $i$  cares for the total payoff ( $0 < \delta_i < 1$ ), player  $i$  values the payoff of *each* other player positively *regardless of whether player  $i$  has a higher or a lower payoff than the other player*. The Charness-Rabin model therefore predicts altruistic behavior if player  $i$  cares for the total payoff, and this tendency is particularly pronounced towards the player with the smallest payoff.

**Altruistic CES preferences**, as in Andreoni and Miller (2002) and Fisman, Kariv and Markovits (2007), take the form

$$U_i(\pi_i, \pi_j) = \left[ (1 - \alpha')\pi_i^\rho + \alpha'\pi_j^\rho \right]^{1/\rho} \quad (5)$$

where  $\alpha' \in [0, 1]$  represents the weight on the other player's payoff, while  $\rho$ , which obeys  $-\infty < \rho \leq 1$ , captures the trade-off between equity and efficiency. Altruistic CES preferences and Charness-Rabin type distributional preferences share the property that the payoff of other individuals is never valued negatively.

**Figure 1: Indifference curves for different types of distributional preferences**



**Note:** The figure shows the indifference curves of different types of distributional preferences captured by equations (1a) and (1b) above. **a.** selfish preferences ( $\alpha = \beta = 0$ ). **b.** spiteful preferences ( $-1 < \alpha < 0$ ,  $-1 < \beta < 0$ ). **c.** inequality averse preferences ( $-1 < \alpha < 0$ ,  $0 < \beta < 1$ ). **d.** altruistic preferences ( $0 < \alpha < 1$ ,  $0 < \beta < 1$ ). The slope of the indifference curve in the domain of disadvantageous payoffs is given by  $((\alpha - 1)/\alpha)$  while the slope in the domain of advantageous payoffs is given by  $((\beta - 1)/\beta)$ .

How can these theories explain why other-regarding individuals behave very selfishly in competitive market games? A simple example may suffice to illustrate this. Consider a population of players consisting only of people with a relatively strong aversion against unequal payoffs in the sense of Fehr-Schmidt (e.g., they reject every offer in a *bilateral* ultimatum game that is below 40% of the available pie). Now put these people into the responder position of a market game with *two competing responders* who face a very unfair offer of, say, 3% of the pie. The rules of the game are such that if one responder accepts and the other rejects, the accepting responder gets the 3% and the proposer gets 97%. If both accept, the responder who receives the 3% will be randomly drawn and if both reject, all

three players receive nothing. If our fair-minded responders believe that the other responder will accept, they both believe that they will be unable to prevent a very unequal distribution of income. Given their beliefs, they essentially face two very unattractive options in which the proposer always gets 97% of the pie and one of the responders gets 3%. Therefore, even strongly inequality averse responders will accept the 3% offer (Proposition 3 in Fehr-Schmidt 1999). Fischbacher, Fong and Fehr (2009) provide empirical evidence that these belief mechanisms are a key driver of responder behavior in games with responder competition.

The example above illustrates that the mere belief that other players *behave* selfishly might sometimes induce fair-minded players to behave selfishly. More generally, perhaps the most important message from papers such as those of Fehr and Schmidt and Bolton and Ockenfels is that the heterogeneity of social preferences is key because – depending on the game played - the existence of selfish players can induce fair-minded players to behave as if they were selfish and the existence of fair-minded players can induce selfish players to behave as if they were fair-minded.<sup>10</sup>

The simple linear social preference model described in equations (1) can also capture the distributional preferences assumed in Charness and Rabin (2002) that are described in more detail in Box 2.<sup>11</sup> In the two-player case, the weights given to the other player's payoff in the disadvantageous and the advantageous domain, respectively, is given by<sup>12</sup>

$$\alpha = \frac{\lambda(1-\delta)}{1 + \lambda(1-\delta)} \quad (6a)$$

$$\beta = \frac{\lambda}{1 + \lambda(1-\delta)} \quad (6b)$$

Thus, if  $i$  cares about welfare ( $\lambda > 0$ ) *and* about the total payoff ( $0 < \delta < 1$ ) she values the other's payoff positively even in the disadvantageous payoff domain, and the valuation is even higher in the advantageous domain. Note, however, that the only reason why a

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<sup>10</sup> Selfish proposers in the ultimatum game have an incentive to make relatively fair offers if fair-minded responders reject low offers. Selfish “employers” in the gift-exchange game have a reason to make fair wage offers if fair-minded workers respond to fair offers with higher effort. The selfish players in public goods with punishment games have an incentive to cooperate if cooperative individuals punish defectors. In all of these cases, the existence of players with social preferences can induce fundamental changes in the selfish players' incentives.

<sup>11</sup> In this section, we discuss only the *distributional* preferences discussed in Charness and Rabin (2002). They also extend their distributional preferences model with negative reciprocity to account for behaviors where players incur cost to reduce the payoffs of “misbehaving” players. We deal with preferences for reciprocity in Section 3.3.

<sup>12</sup> In case that  $i$  earns more than  $j$ , utility is given by  $U_i = (1 - \lambda)\pi_i + \lambda[\delta\pi_j + (1 - \delta)(\pi_i + \pi_j)]$  while in case that  $j$  earns more than  $i$ , it is given by  $U_i = (1 - \lambda)\pi_i + \lambda[\delta\pi_i + (1 - \delta)(\pi_i + \pi_j)]$ . Reformulating the first function in terms of the weight  $\alpha$  on the other player's payoff and the second function in terms of the weight  $\beta$  on the other's payoff yields the expressions in the text.

Charness-Rabin player cares for the other player's payoff in the disadvantageous domain is a concern for the total payoff. Figure 1d illustrates the indifference curves this model implies.

From a behavioral viewpoint, the Charness-Rabin preferences are qualitatively quite similar *in the two-person case* to non-linear other-regarding preferences as captured by a CES utility function (see Box 2). Andreoni and Miller (2002) and Fisman, Kariv and Markovits (2007) have assumed CES preferences. However, while the CES utility function is capable of capturing very similar behaviors, the Charness-Rabin model provides a psychological foundation for altruistic behaviors in terms of a motive to increase the total surplus and to help the worst-off player. Knowing that these motives may underlie other-regarding behaviors can provide a deeper understanding of these behaviors.

As in Charness and Rabin (2002), subjects with these CES preferences always value others' payoffs positively and preferences are linear and given by  $U_i(\pi_i, \pi_j) = (1 - \alpha)\pi_i + \alpha\pi_j$  in the special case of  $\rho = 1$ . It is well known that preferences are Cobb-Douglas for the case of  $\rho = 0$ , while social preferences take the Rawlsian form  $U_i(\pi_i, \pi_j) = \min(\pi_i, \pi_j)$  for  $\rho \rightarrow -\infty$ . In the latter case, indifference curves in the  $(\pi_i, \pi_j)$ -space become horizontal for  $\pi_i > \pi_j$  and vertical for  $\pi_i < \pi_j$  with a kink at the 45° line, implying that subjects' social preferences are strictly egalitarian. These egalitarian preferences arise in Charness and Rabin for the two player case if subjects completely disregard their own payoffs (i.e.,  $\lambda = 1$ ) and the sum of payoffs (i.e.,  $\delta = 1$ ), but care only for the payoff of the least well-off player.

As in Charness and Rabin, CES preferences can thus capture a high willingness to pay to increase the other's payoff when ahead and a very low willingness to pay when behind. However, similar to Charness and Rabin's distributional preferences, CES preferences cannot capture subjects' willingness to reduce other's payoff at a cost to themselves because the other player's payoff is never valued negatively.

### 3.1.2. Empirical Frequency of Different Distributional Preferences

In the following, we will discuss the empirical properties of distributional preferences that emerged from more systematic attempts to identify the relevant parameters. Fehr-Schmidt (1999) and Bolton-Ockenfels (2000) were inspired by the evidence from the paradigmatic experiments. Their papers provided a unifying account for important, and seemingly contradictory, empirical regularities but they did not involve a systematic attempt to identify

the model parameters empirically. To achieve identification of the parameters of distributional preferences like those in equations (1), one needs information about subjects' behavior on many budget lines with different slopes in the  $(\pi_i, \pi_j)$ -space. In other words, one needs a large set of generalized dictator games in which one subject can unilaterally determine the distribution of payoffs between herself and another subject at various costs of redistributing payoffs.<sup>13</sup> By systematically varying the slope of negatively sloped and positively sloped budget lines, it is possible to identify individuals' indifference curves in the domain of advantageous and disadvantageous inequality and to determine which of the fundamentally difference distributional preference types illustrated in Figure 1 describes the behavior of (sub)groups or individuals best.<sup>14</sup>

### ***Concern for equality or concern for the total payoff?***

An important step towards answering this question was undertaken by Charness and Rabin (2002) who recruited roughly 220 students for their dictator games. Their structural estimate reveals that subjects *on average* put a positive weight of about  $\beta \approx 0.4$  on the other player's payoff when ahead, but the  $\alpha$  parameter, which captures distributional preferences when behind, fails to be significantly different from zero although it is positive with  $\alpha = 0.23$  ( $t = 1.1$ ). Overall, the authors interpret this as fairly strong evidence for social welfare motives as formalized in their model and against inequality aversion motives, since a non-negative value for  $\alpha$  means that subjects are not willing to reduce the other player's payoff when behind, and a positive value for  $\alpha$  even means that subjects positively care for the total payoff.

For example, when player A faced the choice between (200 for self, 800 for B) versus (0, 0), none of their student subjects was willing to pay 200 to implement the (0, 0)

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<sup>13</sup> To identify more complex social preferences like reciprocity (Rabin 1993), guilt aversion (Battigalli and Dufwenberg 2007), or Kantian Morality models (Alger and Weibull 2016), one needs to move beyond generalized dictator games and introduce some strategic component into the game.

<sup>14</sup> There is a considerable literature on social value orientation (SVO) in psychology that uses the so-called ring measure of SVO (Liebrand 1984; Liebrand and McClintock 1988) and/or the triple-dominance measure of SVO (Van Lange et al. 1997; Van Lange 1999) or the slider task (Murphy, Ackermann and Handgraaf 2011; Murphy and Ackermann 2014). These measures are based on generalized dictator games, but they do not lend themselves easily to the estimation of utility functions. For example, they do not allow us to differentiate between the four qualitatively different types of indifference curves displayed in Figure 1. Instead, they use measures such as the ratio between the total payoff given to the other player and the total payoff assigned to "self" (across all dictator games) to assign individuals to predefined SVO types such as "cooperative" (= desire to maximize joint gains), "altruistic" (= desire to maximize the other player's payoff), and "competitive" (= desire to maximize the payoff difference). In particular, the SVO measures cannot identify inequality aversion as defined in Fehr and Schmidt (1999) or Bolton-Ockenfels (2000). For this reason, we do not use them in the following review of distributional preferences.

allocation, consistent with the claim that inequality aversion is absent (i.e.,  $\alpha$  is non-negative). In addition, roughly half of their subjects preferred the allocation (400, 400) over (375, 750), i.e., they were not willing to sacrifice 25 to generate a gain of 350 for the other subject. Thus, these subjects showed limited altruistic tendencies when their choices would generate inequality, which illustrates why  $\alpha$  is *not* significantly different from zero. To see why  $\beta$  is clearly positive, consider the choice between (700, 200) and (600, 600); 73% of the subjects preferred the (600, 600) allocation in this case.

Charness and Rabin (2002) primarily used a between-subjects approach, and therefore did not have enough observations per subject to estimate individual utility functions. They estimate a representative individual's utility function, which necessarily neglects heterogeneity. For example, while 50% of the subjects refused to pay 25 to implement (375, 750) instead of (400, 400), there was also the 50% who did so. In addition, they find that 33% of their subjects preferred the allocation (500, 700) over (600, 300), meaning that these subjects sacrifice 100 to give the other party 400 although this generates inequality to their disadvantage.<sup>15</sup> These examples show that estimating an “average” subject's preferences hides important heterogeneity: although the average value of  $\alpha$  is not significantly different from zero, a substantial share of the students in Charness and Rabin displays behavior consistent with a concern for the total payoff.

Engelmann and Strobel (2004) report strong evidence for a motive to maximize the group's payoff (“efficiency motive”). In their experiments, undergraduate economics and business administration students had to choose between different three-person allocations that enabled the authors to disentangle the motive (i) to maximize the groups' joint payoff, (ii) to reduce overall inequality as predicted by the Fehr-Schmidt or the Bolton-Ockenfels model, or (iii) to maximize the payoff of the worst-off individual in the three-person group (max-min motive). They find that motive (i) and (iii) play a substantial role, while motive (ii) appears to play no significant role in three-person dictator games *in which the decision-maker is indifferent (or close to indifferent) between the available options*.

The generality of this conclusion has, however been challenged by showing that non-economists put a substantially higher weight on equality – compared to the maximization of the group's overall payoff – than economists do (Fehr, Naef and Schmidt 2006). While a majority of economists and business administration students preferred total payoff

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<sup>15</sup> Note the comparison to the (700, 200) and (600, 600) case; many people will sacrifice for equality, but few will do so when this means coming out behind.

maximization over equality, various groups of non-economists, ranging from students of various other disciplines to low-level employees of banks and financial institutions, showed the opposite pattern. In addition, the strength of the total payoff motive may be weakened if the decision-maker's self-interest is at stake because she is not indifferent between the available options. Bolton-Ockenfels (2006) show results indicating that a considerably larger share of subjects is willing to deviate from their self-interest when the deviation generates a more equal outcome compared to when it generates a higher group payoff.<sup>16</sup> The debate suggests the importance of moving beyond (i) traditional student subject pools and (ii) considering a larger class of games to arrive at firmer conclusions.

Many other studies have, in the meantime, estimated the structural parameters  $\alpha$  and  $\beta$  of model (1) above based on observations from strategic and non-strategic games. A recent meta-analysis by Nunnari and Pozzi (2022) uses data from 42 laboratory studies with a total of 289 estimates of the different populations' average  $\alpha$  and  $\beta$  values. The authors use state-of-the-art methods to estimate the overall distribution of parameters across populations and find weighted mean values for  $\alpha = -0.469$  and  $\beta = 0.331$ , both of which are significant at the  $p < 0.001$  level.<sup>17</sup> This indicates that the observed behaviors are consistent with inequality aversion *on average*. A similar qualitative conclusion is reached if one restricts attention to the non-strategic games, which arguably offer the cleanest preference interpretation of the estimated parameters: the mean values of  $\alpha$  and  $\beta$  are then given by  $\alpha = -0.239$  and  $\beta = 0.369$  (both significant at  $p < 0.001$ ), again indicating that subjects display inequality aversion *on average*. In addition, these results show a considerable change in parameters between strategic and non-strategic games, indicating that disadvantageous inequality aversion appears much more important in strategic games, while aversion towards advantageous inequality appears less important in strategic games.

The results discussed above suggest that there is substantial heterogeneity between individuals and different subject pools. Measuring this heterogeneity is therefore important. One possibility for characterizing a group's heterogeneous social preferences is to estimate a utility function for each individual. This approach has been applied to student subject pools in

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<sup>16</sup> In the three-player games of Engelmann and Strobel (2004), the subjects decide behind a veil of ignorance with regard to their role in the game. Iriberri and Rey-Biel (2011) show that this role uncertainty favors social welfare maximizing preferences (i.e., efficiency plus max-min motive) and underestimates selfish and inequity averse preferences. In their study, the share of social welfare maximizers drops from 74% with role uncertainty to 21% without role uncertainty.

<sup>17</sup> In their state-of-the-art in meta-analytic studies, Nunnari and Pozzi (2021) weigh the estimates of individual studies according to their standard errors such that more precise estimates receive a higher weight.

seminal papers by Andreoni and Miller (2002) and Fisman, Kariv and Markovits (2007), who estimated individuals' CES utility functions (see Box 2). Their results indeed show enormous heterogeneity in subjects' distributional preferences. In addition, the Fisman-Jakiela-Kariv-Markovits group shows in a series of papers striking differences between students and the general population's distributional preferences: the general population is much more other-regarding (i. e., has a much higher  $\alpha'$  in equation (5)) and puts a much higher weight on equality (i.e., displays  $\rho < 0$  in equation (5)) compared to students. This also holds, if one controls for age.<sup>18</sup> Because of space limitations and because the CES approach neglects important classes of distributional preferences –inequality aversion and envy – we describe the results of these studies in more detail in Appendix 1.

### ***How prevalent are inequality aversion and spite?***

Kerschbamer (2015) developed a systematic approach – the Equality Equivalence Test (EET) – that enables the identification of all four distributional preference types displayed in Figure 1. For this purpose, subjects are presented with choice lists in the domain of disadvantageous inequality (DA-lists) and the domain of advantageous inequality (A-lists). In any given list, the subjects face a series of binary choices where the equal payoff distribution E is always paired with an alternative allocation (See Figure A2 in Appendix 2). A list essentially confronts subjects with a series of positively and negatively sloped budget lines in the “self-payoff / other payoff” space with two discrete options on each budget line.

Table 1 below shows the results of a relatively large number of EETs in student samples (Kerschbamer (2015); Balafoutas, Kerschbamer & Sutter (2012); Paetzel, Sausgruber & Traub (2014) ; Balafoutas et al. (2014); Krawczyk and Lee (2021)) and in nationally representative population samples (Chapman et al. 2018; Kerschbamer and Muller 2020; Hedegaard et al. 2021).

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<sup>18</sup> The large differences between student samples and the broader population are consistent with research reported in Snowberg and Yariv (2021) and Cappelen et al. (2015).



**Table 1 Empirical Frequency of Different Distributional Preference Types in the Equality Equivalence Test**

Study		Subject Pool	Preference types			
			Altruistic ( $\alpha \geq 0$ ; $\beta \geq 0$ )	Inequality Averse ( $\alpha < 0$ ; $\beta > 0$ )	Envy/ Spite ( $\alpha \leq 0$ ; $\beta \leq 0$ )	Selfish ( $\alpha \approx 0$ ; $\beta \approx 0$ )
Kerschbamer (2015)	Student Samples	N = 92 Univ. Innsbruck Austria	33.7%	11.9 %	3.2%	48.9%
Krawczyk & Lee (2021)		N = 101 Univ. Warsaw Poland	48.5%	11.9%	9.8%	28.7%
Balafoutas et al. (2012)		N = 132 Univ. Innsbruck Austria	28%	8.3%	5.3%	58.3%
Balafoutas et al. (2014)		N = 195 Univ. Innsbruck	49.7%	6.7%	7.2%	33.8%
Paetzel et al. (2014)		N = 280 Univ. Bremen Germany	29.3%	9.3%	1.8%	58.3%
Hedegard et al. (2021)	Nationally representative samples	N = 885 Denmark	47.1%	23.2%	8.6%	20.0%
Kerschbamer & Müller (2020)		N = 2794 Germany	13.4 %	64.8%	14.0%	5.0%
Chapman et al. (2018)		N = 1000 USA	27.5%	41.9%	8.3%	16.6%
2 <sup>nd</sup> Wave of German Internet Panel <sup>19</sup>		N = 2583 Germany	11.5%	67.8%	11.0%	7.9%

Note: The equality equivalence test (EET) measures individuals' distributional preferences by identifying the slope of their indifference curves in  $(\pi_i, \pi_j)$  space both in the domain of disadvantageous inequality (providing a measure of the sign of  $\alpha$ ) and the domain of advantageous inequality (providing a measure of the sign of  $\beta$ ). To be classified as altruistic, either  $\alpha$  or  $\beta$  or both have to be *strictly* positive. To be classified as envious/spiteful, either  $\alpha$  or  $\beta$  or both have to be *strictly* negative. Individuals are classified as inequality averse if  $\alpha < 0$  and  $\beta > 0$  holds.

<sup>19</sup> The results in the Kerschbamer and Müller (2020) paper are based on a first application of the EET to the German Internet Panel (GIP) in 2016. In the meantime, the EET was performed with this sample a second time in 2018. We therefore also include the results of this second wave of data collection to illustrate the stability of the preference classification over time in Table 1.

Several striking facts emerge from these studies. First, the share of selfish individuals is much larger in the student samples, where it varies between 29% and 58%, while it varies only between 5% and 20% in the nationally representative samples. Second, the much larger share of other-regarding subjects in the nationally representative samples is primarily due to a much larger share of inequality averse individuals in these samples. While the share of inequality averse individuals in student samples varies between 7% and 12%, this share is between 23% and 68% in the nationally representative samples. Third, the share of envious subjects is also slightly higher in the nationally representative samples, where it varies between 8% and 14%, while in the student samples it varies between 2% and 10%.

Finally, the share of individuals with altruistic preferences is considerably larger in student samples compared to nationally representative samples. The average share of altruistic subjects over all student samples amounts to 37%, while the average share of altruists is only 19% in the nationally representative samples. Thus, the general population seem much more other-regarding and this higher share of other-regarding individuals reflects a much larger share of inequality averse subjects and a somewhat larger share of envious subjects. Interestingly, however, altruism is more prevalent in student samples.

The existence of large differences between the student samples and the general population samples are corroborated by two earlier studies by Bellemare, Kröger and van Soest (2008; 2011). Using a representative sample of the Dutch population that played ultimatum and dictator games, they estimated a non-linear version of the Fehr-Schmidt model and find that the young and educated individuals in their sample display a substantially lower aversion against disadvantageous inequality than the rest of the sample.

### ***How many endogenous preference clusters?***

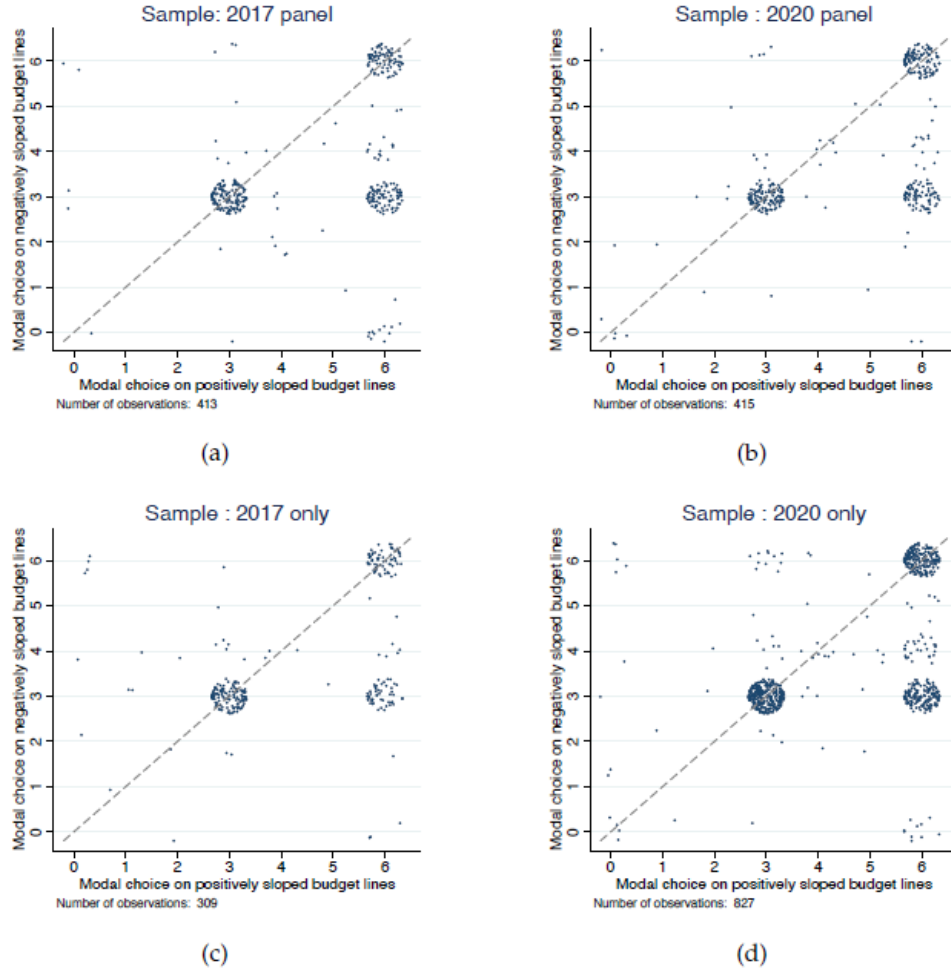
The EET assigns subjects to pre-defined preference categories based on the prevailing theories of distributional preferences. However, these predefined categories might not appropriately capture the empirical distribution of social preferences. Perhaps the empirical preference clusters defy these predefined categories by, e. g., clustering around several distinct altruistic types or several distinct inequality averse types. If that were the case, lumping all altruistic or all inequality averse types together may overlook important aspects of the broader distribution of preferences.

Recently, Fehr®Epper®Senn (2022) applied a non-parametric Bayesian clustering mechanism (“Dirichlet Process Means, DPM) to the data of four broadly representative Swiss samples from which they had collected measures of distributional preferences. In each trial of the preference elicitation task, the subjects in these samples faced seven discrete payoff allocations located on a linear budget line that is either positively or negatively sloped (see Figure A3 in Appendix 3).

An important aspect of the DPM approach is that it enables identification of preference clusters without committing to a pre-specified number of preference types. The algorithm allows for all possible type partitions of the data spanning from a representative agent (i.e., a single data-generating process) up to as many types as there are individuals in the population (i.e.  $n$  data-generating processes), i.e., it determines the number of preferences types endogenously. In addition, it assigns each individual to one of the types, and the behavioral (preference) properties of the types emerge endogenously.

Which preference types emerge from the Bayesian clustering algorithm? The DPM approach reveals the existence of three different preference clusters. Figure 2 below provides a graphical illustration of the observed clusters in all four Swiss data sets. Each dot captures (i) one individual’s modal choice on the positively sloped budget line (horizontal axes) and (ii) that individual’s modal choice on the negatively sloped budget line (vertical axes). The figure clearly shows that the individuals form three clusters in each of the four data sets. In the **inequality averse cluster**, the modal choice on the positively sloped budget lines and on the negatively sloped budget lines is the equal payoff allocation. In the **altruistic cluster**, individuals’ modal choice is the equal payoff allocation on the negatively sloped budget lines *and* the self-payoff maximizing choice on the positively sloped budget lines. And in the **predominantly selfish cluster**, the modal choice on negatively *and* positively sloped budget lines is the self-payoff maximizing choice. Quantitatively, the distribution of individuals to the three preference types is as follows (see Appendix Table A3): (i) Between 30 and 40 percent of the subjects are assigned to an altruistic cluster. (ii) Between 45 and 53 percent are assigned to an inequality averse cluster and (iii) between 10 and 24 percent are assigned to predominantly selfish cluster.

**Figure 2: Preference types in four broad samples of the Swiss population**



**Note:** The figures depict subjects' modal choices  $z$  among negatively sloped budget lines and among positively sloped budget lines. The figures look almost identical if we depict subjects' median choices. Each dot represents one individual. Dots are jittered to make identical choices of individuals visible. For each budget line,  $z = 6$  indicates an own-payoff maximizing choice,  $z = 0$  indicates an own-payoff minimizing choice, and  $z = 3$  indicates a payoff-equalizing choice. Note that  $z = 6$  simultaneously maximizes own payoff and the other individual's payoff on positively sloped budget lines, while  $z = 6$  maximizes the own payoff and simultaneously minimizes the other's payoff on negatively sloped budget lines. Panel (a) is constructed using panel subjects and their 2017 choices. Panel (b) is constructed using panel subjects and their 2020 choices. Panel (c) is constructed using the choices of individuals who only participated in the 2017 study. Panel (d) is constructed using the choices of individuals who only participated in the 2020 study. The data are taken from Fehr®Epper®Senn (2022).

To what extent is the existence of the three qualitatively distinct clusters displayed in Figure 2 a peculiarity of the Swiss data? To answer this question, we analyzed the data from a large Danish sample of  $N = 3691$  adult individuals, taken from Epper et al. (2020). The Danish data show a strikingly similar pattern to the four samples of the Swiss data presented in Figure 2, making it immediately apparent that most individuals cluster into three distinct behavioral types – altruistic, inequality averse, and predominantly selfish (see Figure A4 in Appendix 3). Table A3 reports the results of the Bayesian clustering algorithm for the Danish data set which formally confirms the clustering into the above-mentioned three types. And again, the inequality averse type is the most frequent one with 37.3% of the subjects, while 32.5% are predominantly selfish and 30.2% are altruistic.

Taken together, the data from broad population samples indicate the existence of three important distributional preference types: a large cluster of inequality averse subjects, another large cluster of altruistic subjects, and a third cluster of predominantly selfish subjects. Often, the predominantly selfish cluster comprises the lowest share of individuals. The frequency of envious/spiteful subjects is generally too small and their location in preference space is too scattered (see Figure 2), meaning that they do not constitute a distinct cluster but are subsumed either under the selfish and the inequality averse cluster.

The data from the broad population samples differ strongly from the behavioral patterns observed in student samples. In the latter, the share of inequality averse subjects is much smaller and sometimes almost nonexistent, while the share of selfish subjects is much larger. In the distributional preference domain, data from student subject pools thus clearly deviate from the preferences of the broader population in important ways.

Finally, why does the selfish type typically only constitute a (nonnegligible) minority in broad population samples? In our view, this is because if one offers subjects many different choice situations with sufficiently small costs of engaging in generous or inequality reducing behaviors, one can identify *purely* selfish types and individuals who are very close to purely selfish types (who are never willing to pay anything or only extremely low amounts to help or hurt others) with great precision. Apparently, many individuals in the broader population are at least willing to pay some measurable positive amount for increasing and/or decreasing others' payoffs.

## 3.2. The Role of Merit, Luck, and Risk in Distributional Preferences

In the standard dictator game and other pure distribution games, the experimenter provides the income that can be divided among the parties exogenously. Moreover, the role of the powerful player, who can make a unilateral allocation decision, is not based on some sort of merit but assigned randomly, and the subjects typically interact anonymously with each other and have no information about the other players' income, wealth, and social background. It seems natural that no player in such an environment has a priori a greater normative claim on the available resources compared to the other players, i.e., equality is a natural reference point for judging the fairness and equitability of outcomes. It is, however, also clear that social background, the saliency and status of particular individuals, the social proximity among individuals, as well as their effort and contribution to the available resources, including the risks and conditions under which they had to produce these resources, can play a role in what is considered an equitable distributional claim. The potential importance of these factors is widely acknowledged and will often drive a wedge between equality and equity (fairness) and offers ample opportunities for examining these factors in a controlled way.<sup>20</sup>

In this context, the notions of merit, luck, and effort play a key role. In many modern societies, meritocracy appears to be a widely held normative ideal. According to a prominent theory of equality of opportunity (Roemer and Trannoy 2015), individuals should be held responsible for factors under their own control, while they should not be held responsible for factors beyond their control. Based on this approach, there is no normative reason to redistribute resources that are entirely generated by an individual's effort, while earnings that accrue at least partly from non-controllable external factors ("luck") should be subject to redistribution.

### 3.2.1. Equity and Entitlements

Psychologists and sociologists (Homans 1961; Adams 1963; Adams 1965) have developed positive theories of justice that incorporate a widely applicable merit principle.

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<sup>20</sup> The very fact that equity and equality may diverge induced Fehr and Schmidt to first call the preferences they examine as "*inequity aversion*", i.e., "a general dislike for outcomes that are perceived as inequitable". However, under the special circumstances in the laboratory experiments they examined, where subjects entered the laboratory as equals, knew nothing about each other's background, and were randomly allocated to different roles, equality appeared to be a more reasonable reference point.

According to this view, individuals perceive inequity if their outcome/input ratios diverge from the ratio of their relevant comparison agent. The outcomes and inputs that enter the equity calculus have typically been interpreted very broadly, i.e., any kind of reward that the individuals experience can represent an outcome and any kind of perceived contribution to the outcome can represent an input.

Equity theory thus allows for many subjective influences that may make its predictions rather malleable and imprecise. However, if restricted to more easily measurable outcomes (e.g., received material payoffs) and inputs (e.g., time spent on a task or material payoff contributed to the group payoff), it makes sharper predictions. Mikula (1973) conducted, for example, an experiment with recruits from the Austrian Army to examine whether subjects follow the equity principle or the equality principle. Two matched parties produced a joint monetary payoff, and then one of the individuals could unilaterally allocate this payoff to the two parties. He found that the lower performing parties assigned themselves more than the proportional monetary payoff equity theory predicted but less than the equal monetary payoff. Likewise, the higher performing parties requested *on average* more than the equal split but less than the reward predicted by equity theory.<sup>21</sup> More generally, the data confirm the qualitative equity theory prediction that higher performing parties request (if they have the power to decide) and are conceded (if the partner has the power to decide) a higher share of the joint payoff. Likewise, lower performing parties allocate themselves and are allocated a lower share of the joint payoff (Leventhal and Michaels 1969; Leventhal and Anderson 1970; Leventhal and Lane 1970; Lane and Messe 1971; Leventhal and Michaels 1971). Thus, according to this literature, subjects behave as if they feel entitled to a larger (smaller) share if they contribute more (less) to the joint payoff than their experimental counterpart.

One drawback in these experiments was that participants were typically deceived in various ways. Often, there was no actual working partner who contributed to a joint surplus or the performance ratios to which the parties were randomly allocated did not reflect the subjects' actual performances, or individuals had to make hypothetical choices without real economic consequences. These practices may have generated doubts about the credibility of the implemented procedures or might have affected subjects' behavior in other ways. For this reason, it makes sense to ask whether the notion of "earned entitlements" or "earned property

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<sup>21</sup> For example, when the performance ratio between the lower performing and the higher performing party was between 62.5% and 37.5%, the higher performing parties requested on average 54.5% of the joint payoff, while the lower performing parties requested 42.7%.

rights” implied by equity theory is indeed robust to the methods used in experimental economics which rule out deception while implementing designs with transparent economic consequences for the involved parties.

The experimental economics literature (e.g., Hoffman et al. (1994), Ruffle (1998), Fahr and Irlenbusch (2000) Konow (2000); Cherry, Frykblom and Shogren (2002); Frohlich, Oppenheimer and Kurk (2004); Cappelen et al. (2007); Krawczyk (2010); Lefgren et al. (2016)) also strongly suggests that “earned entitlement” effects exist. For example, Hoffman et al. (1994) and Cherry et al. (2002) show that the dictators take a higher share of the pie when they earned the role of the dictator in a quiz or when they generated the pie that can be distributed themselves.<sup>22</sup> While Hoffman et al. (1994) and Cherry et al. (2002) show that the dictators behave more selfishly if they have acquired an earned entitlement, Konow (2000) shows that the dictators also respect the recipients’ earned entitlement, i.e., the recipients’ earned entitlements also constrain the dictators’ selfish behavior. Subjects in Konow’s experiment *jointly* produce the pie to be distributed in the subsequent dictator game in a (letter production) task that enables the exact measurement of the matched subjects’ relative contribution (i.e., the number of letters). He hypothesizes that fairness considerations will induce the dictators to tilt the allocation given to the recipients towards their relative contribution in the production task – a finding that his data nicely corroborates.

In a different design, Ruffle (1998) also shows that the recipients’ earned entitlements constrain the dictators. He implemented a general knowledge quiz that was used to establish a contest *among the recipients* that determines the pie size available in a subsequent dictator game with a paired dictator (who did not participate in the contest). If dictators are paired with a winning recipient (i.e., one with a high number of correctly answered questions), the pie size is set at \$10, while the pie size is \$4 for a losing recipient. In a control treatment, the outcome of the competition among recipients is determined randomly, i.e., by luck. Ruffle finds that the dictators in the “quiz condition” allocate significantly higher incomes to the winning recipients than in the “luck condition”, thus honoring the recipient’s contribution to

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<sup>22</sup> Hoffman et al. (1994) also claim that if one not only introduces anonymity between the subjects but also anonymity between the subjects and the experimenter, the dictators behave more selfishly and take a higher share. However, subsequent research (Frohlich, Oppenheimer and Kurk 2004) suggests that the way Hoffman et al. implemented experimenter-subject anonymity also generated doubts among the subjects about whether the recipient was a real person, which may well induce selfish behavior. Other research on double anonymity (e.g., Bolton, Katok and Zwick 1998; Barmettler, Fehr and Zehnder 2011) indicates that lack of subject-experimenter anonymity has only minor, insignificant effects in dictator, ultimatum, and trust games.



the available pie in the quiz condition. Fahr and Irlenbusch (2000) also provide strong evidence indicating that trustees in a trust game strongly respect earned property rights.

### 3.2.2. Modelling Entitlement Effects

How should we model the motivational forces underlying the earned entitlement effect? To set the stage for this discussion, it is useful to rely on a concrete example that is taken from the seminal paper of Cappelen et al. (2007). In their experiment, subjects participate first in two production tasks where they can finance an investment  $q_i$  that generates an output  $x_i = a_i q_i$  from an identical endowment  $E$ . Each participant was randomly assigned to a high ( $a_i = 4$ ) or a low ( $a_i = 2$ ) rate of return on investment.

After the two production tasks, each subject was matched twice randomly with a different partner and played a bilateral dictator game with each of the two partners. The pie size in each dictator game was given by the paired players' jointly produced total output  $X = a_1 q_1 + a_2 q_2$ . Note that some pairs in this experiment face a total output produced with identical returns on investment ( $a_1 = a_2$ ) and identical investments ( $q_1 = q_2$ ), while others can distribute an output that is produced with different rates of return ( $a_1 \neq a_2$ ) and/or different investment levels ( $q_1 \neq q_2$ ).

Which allocation would a sufficiently inequality averse dictator choose in this game? This type of dictator would implement the allocation that equalizes the two players' incomes. If we denote  $s_1$  ( $s_2$ ) as player 1's (player 2's) share of the total payoff  $X$ , income equalization implies  $E - q_1 + s_1 X = E - q_2 + s_2 X$ . From this follows that player 1's share is given by

$$s_1 = s_2 + \frac{q_1 - q_2}{X}. \quad (7)$$

Thus, inequality aversion is not identical to strict egalitarianism that would distribute the earnings equally regardless of how they were generated, but it incorporates a meritocratic aspect because it implies that differences in subjects' investment levels are honored. An individual receives a higher share if he or she contributed to higher output levels via higher investments. This follows simply from the fact that the principle of equality is applied to *all* material payoffs, and effort or investment costs are certainly part of this.

Another interesting aspect of inequality aversion is that it does not honor those contributions to earnings that have nothing to do with the costs incurred to produce the earnings. In the Cappelen et al. experiment, this means that inequality aversion does not

honor the luck of those participants who were randomly assigned a higher rate of return  $a_i$ . In other words, if two subjects invested the same amounts but faced different rates of return and thus produced vastly different contributions to the overall earnings, inequality aversion assigns both individuals the same share of the total earnings.

Which allocation would a dictator who is motivated by the forces stipulated by equity theory implement in the Cappelen et al. experiment? He or she would equalize the output/input ratios between the players. While a plausible interpretation of the “output” seems to be the earnings received, there is more ambiguity when considering the inputs. This depends crucially on whether one considers the investment levels  $q_i$  or the contributions to the total earnings,  $x_i = a_i q_i$ , as an “input”. However, if we view equity theory as embodying a merit principle, the appropriate input measure appears to be investment levels, implying that equity is established once  $s_1 X / q_1 = s_2 X / q_2$  or  $s_1 / q_1 = s_2 / q_2$  holds.

If we denote the players’ ratios of investments by  $\theta = q_1 / q_2$  and take into account that  $s_1 + s_2 = 1$ , the players’ equitable payoff shares are given by

$$s_1^E = \frac{\theta}{1 + \theta} = \frac{q_1}{q_1 + q_2} \quad \text{and} \quad s_2^E = \frac{1}{1 + \theta} = \frac{q_2}{q_1 + q_2}. \quad (8)$$

Thus, the equitable payoff shares are given by the players’ relative investment shares. This coincides with the notion of fairness advocated by Konow (2000) and with the notion of liberal egalitarianism in Cappelen et al. (2007). Note that the notion of equity described in (8) also implies that liberal egalitarians do not honor luck – in the form of randomly assigned investment returns – while honoring merit – in the form of players’ relative investment shares.

What kind of utility function rationalizes the behavior of players who are motivated according to equity theory? A plausible function could look similar to the Fehr and Schmidt utility function where the reference point is no longer the other players’ payoff, but the dictator’s own equitable payoff as defined by  $s_i^E$ , and income is denoted by  $y_i$ :

$$U_i = y_i - \alpha \max[s_i^E X - y_i, 0] - \beta \max[y_i - s_i^E X, 0] \quad (9)$$

A dictator with this utility function would never give herself less than  $s_i^E X$  and would allocate herself exactly  $s_i^E X$  if  $\beta > 1$ . In contrast, Cappelen et al. (2007) assumed that deviations from the equitable payoff impose symmetric (quadratic) costs on subjects, which led them to postulate the utility function

$$U_i = y_i - \gamma \frac{(y_i - s_i^E X)^2}{2X}, \quad (10)$$

The two utility functions above imply that there is a nonpecuniary disutility from receiving an inequitably large share in case of  $y_i > s_i^E X$ . Thus, because the players' income shares add up to one, subjects in this situation are willing to reduce their own income and behave generously towards the other player. Likewise, the associated nonpecuniary disutility from receiving a too low share generates a willingness to pay to behave in an envious manner towards the other player in case of  $y_i < s_i^E X$ .

Because social preferences are typically characterized by substantial heterogeneity, it is unlikely that all individuals will behave in an inequality averse manner (i.e., obey (4)) or according to utility functions (9) or (10). Therefore, to account for potential heterogeneity, Cappelen et al. (2007) introduced two additional “fairness ideals” that deviate from the meritocratic ideal of liberal egalitarians. They call them the libertarian ideal ( $s_i^L$ ) and the strictly egalitarian ideal ( $s_i^{SE}$ ). According to a strictly egalitarian ideal, the earnings should be distributed between the players regardless of their rates of return and their investment levels, i.e.,  $s_i^{SE} = 1/2$ . In contrast, each player in the libertarian ideal is entitled to the earnings he or she produced regardless of any luck or effort considerations, i.e.,  $s_i^L = a_i q_i / X$ .

To what extent are the different fairness ideals capable of capturing earned entitlement effects? Liberal egalitarians who behave according to utility functions (9) or (10) will exhibit earned entitlement effects if they contributed more effort or investments to the production process. Inequality averse individuals, who behave according to (7), will display a similar earned entitlement effect. In contrast, libertarians with a fairness ideal of  $s_i^L = a_i q_i / X$  will show an earned entitlement effect even if they provide higher output merely because of luck (i.e., a higher  $a_i$ ).

The introduction of heterogeneous fairness ideals by Cappelen et al (2007) represents an interesting innovation; it implies that if people do not share in one particular situation, then this may not mean that they do not care about fairness (i.e., put no weight on fairness in (9) or (10)) but that they consider sharing unfair. Many interpretations of experiments overlook this distinction and too often interpret people not sharing as selfishness. The distinction between the weight put on fairness and the concrete fairness ideals also opens an avenue towards studying the impact of institutions on distributional preferences.

It has been argued, for example, that studying economics makes people more selfish (possibly true, but the evidence is not entirely clear); but this approach misses the second (perhaps even more important) dimension, that studying economics may change people's view of fairness. More generally, fairness ideals are likely to be shaped by educational and political institutions as well as by the general moral infrastructure of societies.

Finally, what are the empirical results of the Cappelen et al. (2007) study? Based on the assumption that there are three types of fairness ideals –  $s_i^E$ ,  $s_i^{SE}$  and  $s_i^L$  – and that the subjects behave according to utility function (9), the authors estimate a mixture model that provides the relative share of individuals who are assigned to the different fairness ideals and also an estimate of the distribution of the strength of fairness preferences as captured by  $\gamma$ . They find that the share of strict egalitarians is 43.5%, the share of liberal egalitarians is 38.1% and the share of libertarians is 18.4%.<sup>23</sup>

The Cappelen et al. study deserves credit for introducing and estimating the share of subjects assigned to *heterogenous* fairness ideals that are based on different normative recognitions of “luck” and “effort”. At the same time, it is clear that the assumed existence of three exogenously given fairness ideals is a strong assumption, and that it would be desirable to develop experimental designs and econometric methods that make it possible to infer individual subjects' normative reference points from the data, instead of exogenously assuming them.

Likewise, while assuming that different reference points can capture the distinction between luck and effort, it is also possible that individuals' fairness ideals directly affect their interpretation of an individual's deservingness. For example, an individual with a meritocratic fairness ideal who faces a “lazy” individual may put a different weight (i.e., a different  $\alpha$ ,  $\beta$  or  $\gamma$  parameter) on being fair towards this individual compared to a situation where she faces a hard-working individual. Thus, we believe it is an important task for future research to find ways to identify individuals' normative reference points and to examine how

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<sup>23</sup> The high share of strict egalitarians is surprising in view of the fact that the subjects in this study are students from a Norwegian *business school*. On the other hand, Norway is known for a relatively strong egalitarian culture which may perhaps explain these results. In another study with a broader sample of Norwegian and German students (Cappelen et al. 2013), the allocation of individuals to the different fairness ideals is quite different, however, as only 22.5% of individuals are strict egalitarians, while 42.5% are liberal egalitarians, and 35% are libertarians.

the strength of fairness preferences is affected by environments differentially characterized by luck and effort.<sup>24</sup>

### 3.2.3. Who are the Meritocrats?

The experimental literature on fairness ideals largely relies on an experimental design involving an impartial third party whose own material payoff is not directly involved in the decision to redistribute resources between the two other parties. This makes it difficult to relate the findings of the literature on fairness ideals to the literature on altruism, inequality aversion and envy discussed in section 3.1. In particular, we do not know whether and to what extent altruistic or inequality averse subjects are meritocratic. Or are subjects who display primarily selfish behaviors in the distribution tasks that involve no obvious entitlements – such as the tasks used by Fisman, Kariv and Markovits (2007) Fehr®Epper®Senn (2022) – behaving according to meritocratic principles when entitlement effects exist?

To answer these questions, Epper, Fehr and Senn (2023) designed an experiment in which the subjects participated in two types of allocation tasks. In the first part of the experiment, the subjects allocated payoffs between themselves and another (anonymous) party in multiple trials where they faced different negatively or positively sloped budget lines in self-other payoff space across different trials. This part of the experiment enables the authors to estimate subjects' distributional preferences in the absence of any entitlement effects. By applying the Bayesian clustering algorithm (described in Section 3.1.2) to the subjects' choices, they identify an inequality averse, an altruistic, and a predominantly selfish cluster of individuals.

After the payoff allocation task, the subjects participated in several unrelated “filler” tasks and a performance task that involved real effort and produced a measurable performance output. Then they participated in another distribution task where they faced exactly one budget line with a negative slope – but this time the task involved two different entitlement manipulations involving luck or merit. In the two merit conditions, the subject

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<sup>24</sup> Cabeza (2021) conducted a study that varied the deservingness of players along the “effort” and “luck” dimensions. She reports that changes in deservingness are associated with changes in the strength of fairness preferences in both the domain of advantageous and disadvantageous inequality. If subjects become “more deserving”, the decision-makers' willingness to behave altruistically in the domain of advantageous inequality increases while the willingness to behave enviously decreases.

was (i) matched with a partner who performed better in the performance task and (ii) with a partner who performed worse. Thus, the subject had to make two payoff allocation decisions, one when she was performing better and one when she was performing worse than the partner. When the subject had performed better, the initial allocation – which was highlighted on the decision screen (see Appendix Figure A 5) – implied a payoff advantage for the subject. In contrast, when the subject had performed worse, the initial allocation implied a payoff disadvantage for the subject. However, the decision-maker in this task was still free to choose any feasible allocation on the budget line. The question is just whether the subjects honor the fact that they face a partner who had performed better or worse in a preceding performance task in their allocation decisions.

In the two luck conditions, everything was identical to the two merit conditions except that the initial allocation on the budget line was based on a random draw. The subjects in both the merit and luck conditions knew how the initial allocation had been determined.

Which allocations do the inequality averse, altruistic, and selfish subjects choose on the budget line in the two luck conditions? It turns out that the selfish subjects predominantly chose an allocation that is exactly or close to the own-payoff maximizing allocation – and this behavior prevailed regardless of whether the subject was a lucky winner or an unlucky loser. In sharp contrast, the inequality averse and the altruistic subjects overwhelmingly chose the equal-payoff allocation in the two luck conditions, regardless of whether they had been a winner or a loser.

Which allocations did the three distributional preference types choose in the two merit conditions? Interestingly, the selfish types again predominantly chose exactly or close to the own-payoff maximizing allocation, implying that they have little meritocratic concern. In contrast, the altruistic and inequality averse subjects again behave very differently. Roughly 30 percent of the altruists still preferred the equal-payoff allocation in the two merit conditions, but the large majority of the altruists showed substantial meritocratic concern. In particular, when they had performed better in the performance task, they chose an allocation that gave them more than the equal payoff and when they had performed worse, they chose one that gave them less than the equal payoff.

The behavior of the inequality averse subjects had strong resemblance with those of the altruistic subjects, except that a slightly higher share of the inequality averse subjects (roughly 40 percent) preferred the equal payoff allocation. But a majority of the inequality

averse individuals felt entitled to take more than the equal payoff in case of a higher performance and gave the partner more than the equal payoff in case of a lower performance.

These results indicate that the meritocrats largely consist of subjects who have other-regarding distributional preferences, while the selfish individuals care little for meritocracy.

### **3.2.4. Cultural Differences and the Relative Importance of Fairness and Efficiency Concerns**

Almost all experiments documenting entitlement effects have been conducted with Western student populations. These subjects are part of an educational and employment environment that permanently evaluates their performance and requires high effort levels to pass frequent examinations, provide satisfactory work results, or move up the career ladder. Meritocratic and libertarian ideas may well flourish in this environment, raising the question about the prevalence of difference fairness ideals in the broader population and in other cultures.

Jakiela (2015) studies entitlement effects in a younger population from rural villages in Kenya and compares them with those observed in a US student population. She implemented a luck treatment, where the roll of a die determines the size of the overall budget, and an effort treatments, where either the dictator or the recipient produced the budget in a real effort task. Jakiela's experiment is motivated by observations that these entitlement effects may not exist in poor rural communities with strong traditions of solidarity and mutual assistance (Platteau 2000).

In Jakiela' design, potential entitlement effects are strengthened with an additional feature – the so-called “Giving” and “Taking” treatment. In the Giving treatments, the budget is provisionally allocated to the dictators who also rolled the die in the luck condition and performed the real effort task in the effort condition. In the Taking treatment, the budget is provisionally allocated to the recipients who also rolled the die and performed the real effort task. Jakiela finds that the Kenyan dictators behave very similarly in the luck and the effort treatments. This contrasts sharply with the behavior of US students who showed strong behavioral differences between the Luck and Effort treatments: dictators allocated significantly higher income shares to those parties who had generated the budget through real effort rather than the role of a die.

Almas, Cappelen and Tungodden (2020), henceforth ACT, were the first to study the relevance of the distinction between “luck” and “effort/merit” in two *broad* population

samples – a Norwegian and a US sample consisting of 1000 decision makers in each of the two countries. Moreover, more recently, Almas et al. (2021; 2022) conducted a large study with 65’800 participants that comprise representative country samples taken from 60 different countries around the globe. In each country, at least 1000 individuals participated as impartial spectators in an experiment like that in ACT (2020). This study enables the examination of the potential universality of the role of merit vs. luck vs. efficiency costs on preferences for redistribution in a highly controlled experimental set-up that is kept constant across all countries.

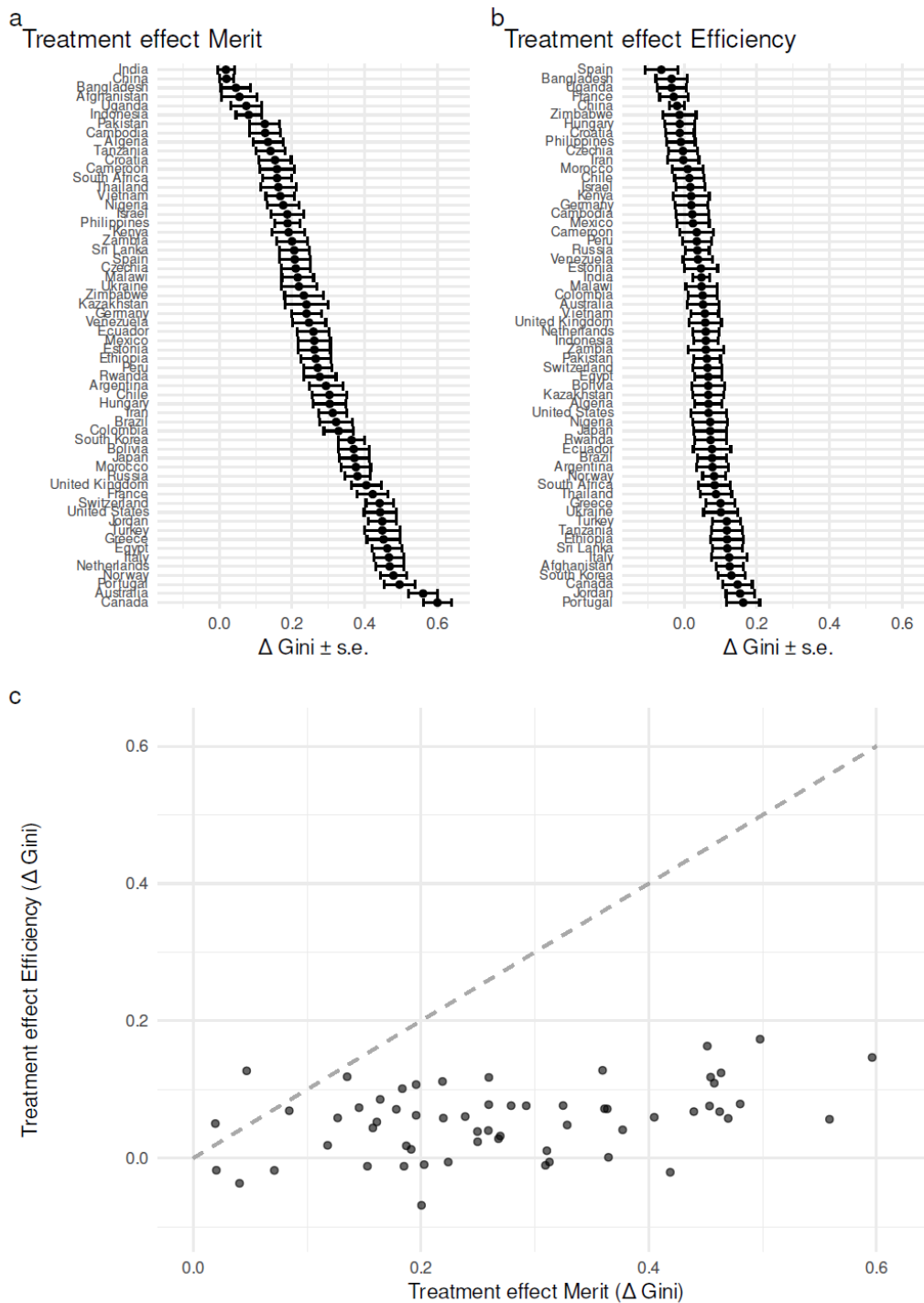
In these experiments, the decision makers were put in the role of an “impartial spectator” who had the option to redistribute income between two subjects (“workers”). Initially, before redistribution, one of the workers had an income equivalent to US \$6 while the other had US \$0. In the luck treatment, a lottery draw (from an earlier experiment on Mechanical Turk in which the workers participated) generated the inequality between the subjects. In contrast, the productivity differences between the two workers in a real effort task determined the initial inequality in the merit treatment. The impartial spectator could redistribute the \$6 in \$1 units without any cost in both the luck and the merit treatments.

In addition to the luck and merit treatments, the authors also conducted a so-called efficiency treatment. This treatment is identical to the luck treatment except that redistribution is associated with large cost: for every \$1 given to the poorer workers, the income of the worker who was initially richer is reduced by \$2. With such a large redistribution cost, one would expect a substantial increase in inequality acceptance.

Several findings of these studies stand out (see Figure 3 below). First, there are huge cultural differences in the extent to which the merit treatment causes an increase in inequality acceptance relative to the luck treatment (Figure 3a). The merit treatment causes basically no increase in inequality in countries like India and China, presumably because the implemented inequality is already very high in the luck treatment. However, in the overall sample, the Gini coefficient in the merit treatment is 26 percentage points higher than in the luck treatment, and the implemented Gini coefficient increases by 50-60 percentage points in the merit vs. the luck treatment in countries like Canada, Australia, or Portugal.



**Figure 3: The relative importance of merit and luck for distributional preferences**



**Note:** The figure shows how the introduction of performance-dependent inequality in the merit treatment and costly redistribution in the efficiency treatment increases the implemented inequality (delta Gini) relative to the luck treatment for each country. The treatment effects are estimated with a country specific regression controlling for pre-specified background characteristics. The figure shows much larger treatment effects for the merit compared to the efficiency treatment.

Second, the effect of the efficiency treatment – when compared to the luck treatment – is much lower than the effect of the merit treatment in almost all countries (Figure 3b and 3c).

On average, the Gini coefficient in the efficiency treatment is only 5 percentage points higher than in the luck treatment, and the treatment effect is zero or even negative in many countries. The efficiency treatment increases inequality acceptance at most by (slightly less than) 20 percentage points. Almas et al. (2021, 2022) thus document the near universality of the important role of merit for redistributive preferences, including the near universality of the greater role of fairness considerations relative to efficiency considerations for redistribution.

Third, the study finds vast differences in fairness ideals across countries. While almost 75% of the subjects display a libertarian ideal in countries like India and China, this share is in the range of 10-15% in countries like Canada, Australia, or Norway. Conversely, the share of meritocratic ideals is vanishingly small in India and China, while it is close to 50% in Canada, Australia, and Norway. Interestingly, the cultural/country differences in fairness ideals primarily show up in the different shares of libertarians versus meritocrats, while the share of strict egalitarians is roughly between 20 and 30% in most countries.

### **3.2.5. Shallow Meritocracy?**

The distinction between earnings generated through individuals' choices, as well as earnings that accrue to individuals because of lucky circumstances, is at the heart of the meritocratic fairness ideal. A key issue in this concept of fairness is, however, that choices are endogenous. In other words, individuals' choices are themselves affected by circumstances. For example, an individual who faces discrimination will generally have weaker incentives to exert high effort because the reward for effort is lower. There are myriads of external circumstances – such as gender norms, socio-economic background, ethnicity, or race – that are associated with unequal opportunities that generate differences in individuals' choices and earnings. Moreover, when people make merit judgements based on earnings or effort information, they often do not know the external circumstances under which earnings and effort choices took place. In this context, the question then arises to what extent individuals' merit judgements take these unequal opportunities into account.

In a recent paper entitled “Shallow Meritocracy”, Andre (2022) examines this question in a series of experiments involving a broadly representative sample of 4000 US respondents. Andre introduces an interesting twist into an effort treatment where two workers could generate earnings in a piece-rate environment, and an impartial spectator then had the opportunity to redistribute the earnings between the workers. The piece rate was either \$0.50

or \$0.10, each with a 50% chance, per correctly solved task, and the spectators knew that a lottery determined the piece rate. In the control treatment, the workers did not know the realized piece rates during the production phase, i.e., they faced an identical incentive environment which the spectators knew about. In the treatment condition, the workers knew the realized piece rates before they started working in the production phase. Therefore, the workers faced different incentives to perform, and again the spectators knew this. When spectators made their redistributive decision for a pair of workers they knew (i) each worker's effort share (i.e., relative share of the pair's solved tasks), (ii) each worker's relative contribution to the total earnings of the pair, and (iii) the piece-rate condition under which each worker had to perform the task.

The question then is whether spectators' redistributive choices consider that workers in the treatment condition face very different incentives depending on the assigned piece rate. The answer is that they do not. Spectators condition their redistributive choices in the control and the treatment conditions in the same way on the disadvantaged workers' effort share or the disadvantaged workers' earnings contribution. Spectators redistribute income to the disadvantaged workers, but they do not redistribute more to them in the treatment condition.

It is possible that spectators lack perspective-taking abilities, i.e., when they make their decisions, it does not come to mind that disadvantaged workers had a good reason to solve fewer tasks. To test this, the author explicitly informs the spectators that "the piece-rates strongly influence the number of tasks a worker completes" and spectators are also informed how large, *on average*, this incentive effect is. Yet again, the spectators' redistribution to disadvantaged workers is identical in the control and the treatment conditions.

The previous result means that explicit knowledge of the *average* incentive effect of low piece rates does not induce spectators to assign more merit to disadvantaged workers. But perhaps spectators would assign more merit if they knew with certainty that the *specific* disadvantaged worker whom they face would provide high effort levels under high piece rates. To test this hypothesis, Andre (2020) collected further data from a large number of workers under both high and low piece rates. This enabled him to inform the spectator in a subsequent experiment about the counterfactual effort share of the disadvantaged worker, i.e., although in the concrete redistributive situation of this experiment the disadvantaged workers had a low effort share, the spectator had credible information that this worker would work hard if had he faced a high piece rate. Interestingly, when this specific counterfactual

information was provided, the spectators redistributed significantly more money to disadvantaged workers compared to a situation where they lacked counterfactual information.

Taken together, the study by Andre (2022) suggests that individuals are held responsible for lower effort, dedication, and perseverance even though the disadvantageous environment is the source of their lower performance. The reason for this is that many spectators (37%) are “actual choice meritocrats”, i.e., they condition their merit judgements on the actual behavior of the disadvantaged individuals, while only 26% of the spectators (the “comparable choice meritocrats”) condition their choices on the *specific* counterfactual behavior of the disadvantaged. However, because specific counterfactual information is often unavailable in practice, the two types of meritocrats may often behave very similarly.

This disregard of unequal opportunities in the assessment of merit has also been documented in several other papers. Dong, Huang and Lien (2022) and Preuss et al (2022) conduct experiments with related designs, and document similar findings to Andre (2022). A final related experiment is found in Bhattacharya and Mollerstrom (2022), where the experimental conditions do not only differ in how (dis)advantageous it is for different agents to exert effort. Instead, the opportunity to work is randomly assigned to the workers in the experiment. Bhattacharya and Mollerstrom show that even if luck fully determines the opportunity to work, spectators reward work status – not only with higher earnings but also higher implied utility. Taken together, this growing literature shows that the disregard of unequal opportunities in merit judgements is robust and arises in different settings and cultures.

### **3.3. Belief-Dependent Social Preferences**

In distributional models of social preferences, the players care only about material payoffs: not only their own, but also those of others. The choice between actions is unaffected by the path leading to these choices or the perceived intentions behind the action of others. In this sense, these models are *consequentialist*. But the path and the perceived intentions may very well matter. A small example makes this point: Two brothers are dividing a pie. One cuts it into two pieces and offers the choice of pieces to his brother. The second brother takes the larger piece, and the first brother complains that he would have taken the smaller piece. The second brother says: “You got what you wanted. What is the problem?” Certainly, the path and the perceived (un)kindness of the players’ actions are likely to matter in this

case.<sup>25</sup>

In view of the potential importance of beliefs, this section discusses prominent classes of belief-dependent theories of social preferences – reciprocity theories, guilt aversion theory, and theories that include emotions in social preference research.

### 3.3.1. Reciprocity

#### *Models of Reciprocity*<sup>26</sup>

Rabin (1993) is the path-breaking paper in economics on intentions-based reciprocity, based on the tools of psychological game theory (Geanakoplos, Pierce and Stachetti 1989). The key idea in this research is that people have beliefs about others' beliefs and that these higher-order beliefs can affect their utility. Reciprocity models (e.g., Rabin 1993, Dufwenberg and Kirchsteiger 2004) assume that the desire to raise or lower others' payoffs depends on the perceived fairness or unfairness of their behavior: kind intentions are met with kind responses, while unkind intentions are met with unkind responses. In Rabin's model, player  $i$ 's utility includes both his material payoff  $\pi_i$  and a non-pecuniary fairness payoff that is the product of player  $i$ 's belief about player  $j$ 's kindness  $\tilde{f}_j$  and player  $i$ 's kindness  $f_i$  as follows:

$$U_i \equiv \pi_i + \alpha \cdot \tilde{f}_j \cdot f_i. \quad (12)$$

The fairness payoff is given by  $\tilde{f}_j \cdot f_i$  and  $\alpha \geq 0$  measures the weight given to the fairness payoff. Rabin defines the kindness terms in such a way that if  $j$  is believed to be kind to  $i$ , then  $\tilde{f}_j > 0$ , while if  $j$  is believed to be unkind to  $i$ , then  $\tilde{f}_j < 0$ . Likewise, if  $i$  is kind to  $j$ ,  $f_i > 0$  and if  $i$  is unkind to  $j$ , then  $f_i < 0$ . From this follows that player  $i$  can increase his utility by responding to kindness (i.e.,  $\tilde{f}_j > 0$ ) with kindness ( $f_i > 0$ ), and to unkindness ( $\tilde{f}_j < 0$ ) with unkindness ( $f_i < 0$ ). For given beliefs of  $i$  about  $j$ 's strategy, player  $i$  is kind to  $j$  if she gives player  $j$  his fair payoff. The fair material payoff is again defined for given beliefs of player  $i$  about  $j$ 's strategy, and is given by the average of the lowest and the highest material payoff on the pareto frontier that  $i$  can give to  $j$ . Thus, the fair payoff as well as

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<sup>25</sup> The second brother may, for example, infer unkind intentions from the fact that the first brother split the cake unequally.

<sup>26</sup> We focus our attention on intentions-based models of reciprocity because they have led to a considerable empirical literature. Other models of reciprocity exist, however, such as that by Levine (1998), that also have interesting implications.

player  $i$ 's kindness are entirely independent of player  $i$ 's own material payoff, i.e., fairness does not involve any interpersonal payoff comparisons or notion of fairly distributing the potentially available surplus.

To illustrate the logic underlying his model, let us consider the prisoners' dilemma game in the figure below. Suppose player 1 believes that player 2 believes that player 1 will cooperate. Suppose further that player 1 also believes that player 2 will cooperate. This means that player 1 believes that player 2 is kind to him because player 2 is believed to be giving him a payoff of 4 instead of zero. Therefore, if player 1 puts enough weight on fairness payoffs he will have an incentive to respond to 2's perceived kindness with cooperation. Since the game is symmetric, the same logic applies to player 2's choices, i.e., the strategy (cooperate, cooperate) is a fairness equilibrium for large enough values of  $\alpha$ .

		Player 2	
		<i>Cooperate</i>	<i>Defect</i>
1	Player	<i>Cooperate</i>	4, 4
	<i>Defect</i>	6, 0	1, 1

The Rabin (1993) model considers only simultaneously played two-player games. Retaining the kindness feature, Dufwenberg and Kirchsteiger (2004) formally extend and develop the notion of reciprocity by making it applicable to sequential and three-person games. This extension permits application to the more standard experimental games that are played in sequence. Dufwenberg and Kirchsteiger also slightly change the definition of kindness such that the 2<sup>nd</sup> mover's *conditional* cooperation in the sequential Prisoner's Dilemma can be part of a fairness equilibrium. Falk and Fischbacher (2006) combine the notion of inequity aversion with reciprocity considerations in a hybrid model where a person is less bothered by another's refusal to come out on the short end of a split than by a refusal to share equally. Like Rabin (1993) and Dufwenberg and Kirchsteiger (2004), they also use a kindness function.

A key feature is the assumption that harmful behavior by the other player (meaning that you come out behind) is resented less when the other player had no "reasonable" alternative

choices. For example, in Falk, Fehr, and Fischbacher (2003), when the 1<sup>st</sup> mover in a binary ultimatum game can propose (800 for self, 200 for other) or (500, 500), the rejection rate of the (800, 200) offer is 44%, while if the alternative offer to (800, 200) is (200, 800), the rejection rate of (800, 200) offer is only 27%. In the latter case, it is somewhat unreasonable to expect the first mover to propose (200, 800). When the equal-payoff alternative (500,500) is replaced by (800,200), the first mover clearly has no choice whatsoever and the rejection rate drops to 18%. Thus, depending on the alternative to the (800, 200) offer, the responder can make different inferences about the proposer's intention. When (500, 500) is the alternative, a proposer's unfairness intention when offering (800, 200) becomes very visible while if (800, 200) is the alternative to itself, the proposer has no meaningful choice and thus no unkind intention can be inferred.

Charness and Rabin (2002) also combine distributional preferences with reciprocity. As mentioned earlier, the key innovation of this model is that people care about the total payoffs for the reference group. The full model is given as follows:

$$U_i(s, d) \equiv (1 - \lambda) \cdot \pi_i + \lambda \cdot [\delta \cdot \min[\pi_i, \min_{m \neq i} \{\pi_m + bd_m\}] + (1 - \delta) \cdot (\pi_i + \sum_{m \neq i} \max[1 - kd_m, 0] \pi_m) - f \sum_{m \neq i} d_m \cdot \pi_m] \quad (13)$$

Unpacking this array of symbols,  $i$ 's utility is a weighted average of his own financial payoff (with weight  $1 - \lambda$ ) and a social-welfare function (with weight  $\lambda$ ). This social-welfare function is itself a weighted average of concern for the minimum payoff (with weight  $\delta$ ) of anyone in the reference group and concern for the total social payoff (with weight  $1 - \delta$ ). Of note is the “demerit function”  $d_m$ , which measures what is termed “misbehavior”, and which can be interpreted roughly as a measure of how much Player  $k$  deserves. The higher the value of  $d_k$ , the less player  $i$  thinks Player  $k$  deserves. Misbehavior is defined by the group's standards. Negative reciprocity takes two forms: 1) concern withdrawal and 2) willingness to sacrifice own payoffs. Concern withdrawal means that one's concern for the payoff of another player is reduced by adding  $bd_m$  to that player's payoff and subtracting  $kd_m$  from that player's contribution to the total social payoff ( $b$  and  $k$  are non-negative numbers). One might also be willing to sacrifice money to hurt another player (reflected in the  $f$  term near the end), being so upset by the other player's misbehavior that they are willing to destroy surplus. This logic can explain rejections in the ultimatum game.

The last model we discuss in this section is that of Cox, Friedman, and Gjerstad

(2007), who present a non-equilibrium approach that combines a form of distributional preferences with reciprocity considerations and is more tractable. In this approach, both status (relative position) and reciprocity affect one's emotional state, which in turn affects the choices that are made by a utility-maximizing agent. They introduce a parametric model of social preferences in which one's emotional state determines the marginal rate of substitution between own and others' payoffs, and thus one's subsequent choices. In turn, one's emotional state responds to relative status and to the kindness or unkindness of others' choices. They find that structural estimations of this model with six existing data sets demonstrate that social preferences depend on status, reciprocity, and perceived property rights.

One objection to reciprocity models and, in particular, to that proposed by Charness and Rabin (2002), is that they are considerably more complex compared to purely distributional preference models. One might thus wonder whether this complexity is needed. However, it seems fair to say that there are many papers that provide data that distributional models cannot explain without considering reciprocity. Below we discuss several studies that corroborate this view.<sup>27</sup>

Before we discuss the empirical evidence for reciprocity one point is important. Kind or unkind intentions are assumed to play a key role in intentions-based models of reciprocity. One would, therefore, expect empirical researchers to have invested a lot of effort in the identification of subjects' kindness perceptions. However, with a few exceptions (Offerman 2002; Dhaene and Bouckaert 2010), the empirical literature has often ignored this point, unfortunately. Instead of identifying the subjects' (un)kindness perceptions, the experimenters (and the reviewers) have typically been the judges of what behavior is kind or unkind. Yet, what really matters is what the participants in the experiment consider to be kind or unkind. Thus, if an experimenter assumes, for example, that a particular behavior is kind but the subjects themselves do not perceive it this way, and

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<sup>27</sup> Another objection to reciprocity models is that they can be associated with the existence of rather unintuitive equilibria even in very simple games. Consider, e. g., a binary ultimatum game where the first mover can either propose (500, 500) or (800, 200). Here, the strategy pair (800, 200) for the proposer and "accept (500, 500) but reject (800, 200)" for the responder can be a fairness equilibrium (involving mutual hostility) in Rabin's model. However, why should a proposer who knows that the responder rejects (800, 200) with certainty ever make that proposal? Likewise, why should a proposer interpret the rejection of the unfair (800, 200) offer as a hostile act rather than as an understandable response to an unfair offer?



hence do not reciprocate, one may erroneously conclude that positive reciprocity is absent when in fact the theory predicts the absence of reciprocal responses.

### ***Field Evidence on Reciprocity***

There is evidence from field settings that suggest negative reciprocity is often present. Workers have been known to engage in sabotage or increased theft rates after a pay cut or other actions perceived to be unfair (see for example Greenberg (1990), Shminkin, Cropanzano, and Rupp (2002)), particularly when procedural justice in the organization is low (Skarlicki and Folger 1997). And the studies by Krueger and Mas (2004) and Mas (2006; 2008) present results suggesting retribution with real firms and workers. The case for positive reciprocity in the field is weaker; cases involving tipping when on the road or higher response rates to mailed surveys that include small gifts may instead reflect guilt aversion, discussed below.<sup>28</sup>

Field evidence from uncontrolled natural environments rarely allows researchers to unambiguously pin down motives because reputational and repeated game issues may play a role. Field experiments are, however, capable of controlling these factors. Gneezy and List (2006) conducted such a field experiment that examined the effect of paying more than the participants were led to expect. In experiments in two different locations, they advertised to the public a job with a wage of \$10 (or \$12) per hour; however they then told the people who showed up that they would instead pay them \$20 per hour in one treatment. The job was six hours of work, split into morning and afternoon sessions. The research question is whether this surprise overpayment leads to greater effort.

In fact, there was significantly higher productivity in the morning but no effect after lunch. Breaking production into four 90-minute segments, the average production in the control treatment was 40.7, 40.5, 41.2, and 39.6; this compares to 51.7, 44.9, 41.7, and 40.3 in the gift treatment. So, there is a large (27%) increase in productivity during the first 90 minutes, which declines precipitously to only 11% during the second 90 minutes, and then

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<sup>28</sup> However, we do have one clean example of positive reciprocity from the field: One of the co-authors was approaching the toll plaza for the Richmond-San Rafael bridge around 1993. A driver had somehow gotten out of the line of waiting cars and she was trying to get back in. She kept trying, but other drivers weren't letting her in. The co-author's turn came along, and he waved her into the space in front of him; she waved back profusely. When he arrived at the toll booth, he had his dollar out for the toll-taker, but he was informed that the car in front of him had paid for him. Unless the other driver did this habitually for strangers (or she thought it was expected and so not paying would have led her to feel guilty,) this is positive reciprocity in the field.

completely disappears. This corresponds with an attitude of “What have you done for me lately?”. Does positive reciprocity stem from a form of warm glow that dissipates with time? The authors argue that this shows that reciprocity is a weak and ephemeral phenomenon and that paying higher wages may not lead to higher net profits. While we do not dispute the behavioral findings, we note that the authors did not measure the workers’ kindness perceptions. Thus, it remains unclear whether the higher productivity in the morning reflects intention-based reciprocity. Likewise, it remains unclear whether the absence of higher productivity in the afternoon occurred even though workers saw the \$20 wage as kind, i.e., whether reciprocity is indeed a very short-lived response.

In this context, a key question is how the recruited subjects interpreted the surprise wage increase. Is it, e.g., possible that subjects inferred from the higher wage that the employer is much wealthier than they thought, or that the employer made an announcement mistake when the subjects were initially invited for \$12? If true, then the initial effort response to the higher wage may not be a result of an increase in fairness perceptions but it may have resulted from short-run effects on subjects’ mood.<sup>29</sup> Bellemare and Shearer (2009) conducted a field experiment on the influence of wage gifts on worker productivity that circumvents this problem by providing a natural explanation for the wage increase. In addition, they increased the statistical power for identifying a wage effect with a within-subject design. Bellemare and Shearer found that the wage gift significantly increased workers’ productivity.

At the time Gneezy and List conducted their studies (2004), \$10 or \$12 was a very fair wage for this type of work (prevailing rates were roughly \$8.50), i.e., workers were already substantially “overpaid” at the baseline wage. Perhaps, this made it difficult to further increase the kindness perception in the group that received \$20 per hour. This interpretation would be consistent with the “fair wage – effort” hypothesis put forward by Akerlof and Yellen (1990). This hypothesis stipulates that workers respond to wage levels with their effort only if they are underpaid relative to a fair reference wage. Amounts paid above this fair wage are not predicted to have positive effects on effort. Thus, the surprise may be not that positive higher productivity vanishes over time, but that it was found in the first place.

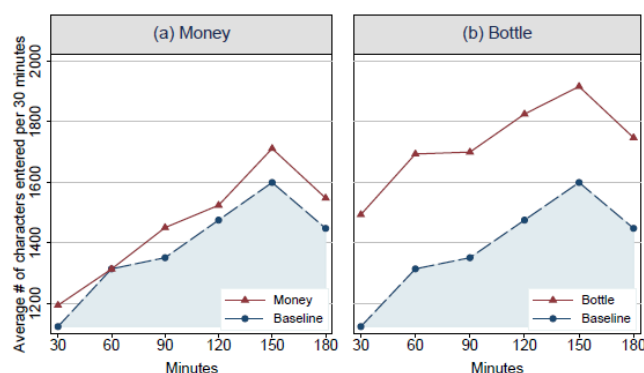
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<sup>29</sup> The importance of fairness perceptions in response to a wage increase has been documented in Cohn, Fehr and Goette (2015), who elicited independent measures of fairness perceptions and reciprocity preferences. They show that workers respond to a wage increase with higher effort if two conditions are met: (i) workers perceive the wage increase as an increase in fairness and (ii) workers have reciprocal preferences.

Kube, Maréchal, and Puppe (2012) consider how the form of payment or reward affects behavior. Their experiment consisted of a 3-hour job with an advertised pay of €12. In the baseline treatment, this was done as advertised. In two other treatments, there was a surprise bonus announced; in one case this was €7, and in the other it was a thermos bottle worth €7. There were also treatments where it was clear that there was more effort put into the gift (e.g., the additional money was folded into a complex origami). The figure below, taken from their paper, shows the results.

Throughout the whole experiment, people are much more productive in the bottle treatment (and in other treatments where a non-monetary gift was made) than in the baseline, a 25 percentage-point increase on average. The monetary bonus had a modest increase of 5% over the baseline. While there is no significant positive reciprocity in response to a higher wage, there is a great deal of positive reciprocity when the worker is given a gift. Although this paper did not measure subjects' kindness perceptions, a plausible interpretation of this difference is that giving a gift is much more likely to be perceived as kind. It is also quite interesting that, in a treatment where people were given a choice between the bottle and the cash, more than 80% chose the cash gift! It seems that, at least to some extent, it is (the perception of) the thought that counts. In any event, the article suggests that the “currency of reciprocity” may indeed not be surprise money *that is given without further explanation*.

**Figure 4: The effect of monetary and non-monetary gifts on productivity**



Notes: This figure depicts the average number of characters entered per 30 minutes' time interval for treatment Money (a), Bottle (b) as well as work performance in the benchmark treatment Baseline.

Kube, Maréchal, and Puppe (2013) implemented a wage cut treatment to study the role of negative reciprocity. Since internal review boards might not be happy with a researcher promising a wage and then reneging, they chose their words carefully when they

advertised a job. The announcement stated: “The hourly wage is projected to be €15” (the exact German wording was “Ihr Stundenlohn beträgt voraussichtlich €15”), leaving some room for later wage changes. There were three treatments: No change in pay (€15), pay reduction (€10), and pay increase (€20). In the pay increase condition, productivity is on average very similar to the no change in pay condition, while there is an immediate and sustained decline in productivity by 21% in the pay cut condition, indicating the considerable strength of negative reciprocity.

Why do subjects respond much more strongly to wage cuts compared to wage increases? In addition to the ambiguities in interpreting the intentions underlying a wage increase, loss aversion could also play a role. In the field experiments discussed above, the experimenter invites subjects to the experiment by generating an explicit expectation about the wage which constitutes a natural reference point. Thus, wage cuts will be interpreted as losses, while wage increases will be coded as gains. If losses loom psychologically larger than gains, then wage cuts are more likely to generate perceptions of unkindness while the kindness inferences associated with wage increases are more muted.

### ***Laboratory Evidence on Reciprocity***

Most laboratory studies also did not explicitly measure subjects’ kindness perceptions, but the lab enables treatment variations that render it more likely for (un)kindness perceptions to be induced. Most of the papers discussed below used a control treatment in which a random device determines the first-mover’s choice in a sequentially played game. Thus, the first movers in the control treatment cannot indicate any intentions, which maximizes the chances of treatment differences in intentions.

Charness (1996; 2004) is the first paper to simultaneously test for positive *and* negative reciprocity while controlling for distributional preferences. He considers gift-exchange in a bilateral setting, varying whether a self-interested firm or a random device generated the wage. In both cases, the firm benefits from the worker’s chosen effort. There is a strong positive relationship between wage and effort in both treatments. However, the effort level with low wages is lower when a self-interested firm chose the wage than when it was generated exogenously, suggesting the presence of negative reciprocity. On the other hand, there was little difference across treatments in the effort level with high wages. Here, intentionally receiving a low wage is very likely to be seen as unkind because the worker knows that higher wages are possible, and frequently even experiences that higher wages are

paid (as the worker sequentially faces offers from 10 different employers). In contrast, it appears less obvious that higher wages are kind because they may be offered for strategic reasons to elicit a higher effort level. This may help to explain why we observe that positive reciprocation is less prevalent than negative reciprocation.

Offerman (2002) also uses the random versus intentional first-mover choice approach of Blount (1995) and of Charness (1996) to study positive and negative reciprocity. He considers players' responses to an unambiguous helpful or hurtful choice. The helpful choice generates a positive payoff for the responder, while the hurtful choice causes a negative payoff. The responders could sacrifice one unit to either increase or decrease the first mover's payoff by four units. 75% of the responders reciprocate intentional helpful choices, while 50% of the responders reciprocate random and unintentional helpful choices. The difference of 25 percentage points is not significant but this most likely reflects the limited number of observations (12). In contrast, the effect of negative intentionality is quite strong: Responders reciprocate 83.3% of the intentional versus 16.7% of the unintentional hurtful choices. This difference is significant at  $p < 0.01$ .

To what extent are these large differences in reciprocation patterns a result of subjects' kindness perceptions? Offerman collected proxy measures of responders' (un)kindness experiences by measuring their positive and negative emotions. He finds that intentional hurtful choices generate much stronger negative emotions than unintentional hurtful choices do. In contrast, intentional helpful choices generate about the same positive emotions as unintentional helpful choices do. Moreover, negative (positive) emotions after a hurtful (helpful) first-mover choice are significantly correlated with punishing (rewarding) responses. Taken together, these results suggest that the differences in reciprocation patterns are driven by differences in the extent to which intentional hurtful and helpful choices trigger (un)kindness perceptions. The results are thus nicely in line with reciprocity theory but also suggest that inducing kindness experiences through intentional choices can be more difficult than inducing unkindness experiences. This differential ease with which one can induce kindness versus unkindness may well have been a factor in the results reported in Charness (1996, 2004).

Several other papers (Brandts and Sola 2001; Brandts and Charness 2003; Falk, Fehr and Fischbacher 2003; Charness and Levine 2007; Falk, Fehr and Fischbacher 2008; Dhaene and Bouckaert 2010) support the conclusion that intentions matter for reciprocal responses.

The evidence in these papers, as well as those discussed previously in this section, typically suggests that in addition to distributional fairness concerns, intentions are likely to play a key role for deviations from self-interested behavior.

While several of these papers do not measure kindness perceptions explicitly, they nevertheless implement plausible manipulations of intentions via random versus intentional first-mover choice designs or via other means. Brandts and Charness (2003) design an experiment, for example, where a particular outcome can be reached in two different ways that indicate very different intentions. There are three stages in their game. First, player A sends a message about her intended play to Player B. Second, the players then simultaneously make choices in the game depicted below. Third, the players are informed about their choices at the second stage; if B chooses B2, she is then given an opportunity to punish or reward player A at a cost to herself.

In this game, A prefers the outcome (A2, B2) while B prefers (A1, B2). The outcome (A2, B2) can be reached in two ways. A can send a message that he will play A1 but then he chooses A2. Alternatively, the outcome (A2, B2) can also be reached after a truthful message by A. The authors found that the responder was twice as likely to punish player A after a choice of A2 if A had previously lied about his play than if he had told the truth.

		Player B	
		<i>B1</i>	<i>B2</i>
Player A	<i>A1</i>	2, 2	6, 9
	<i>A2</i>	2, 2	12, 3

Not all laboratory evidence appears to support the relevance of intentions-based reciprocity. Bolton, Brandts, and Ockenfels (1998) find strong evidence for distributional preferences, no evidence for positive reciprocity, and only weak evidence for negative reciprocity. We believe, however, that their findings do not show the absence of reciprocity but are rather the result of an experimental design that very likely failed to elicit kindness and unkindness perceptions. Participants made choices in 2x6 matrix games via the strategy method. The payoff matrices used for their different treatments are shown in Appendix 5. In our view, the presentation of payoffs in this way makes it very difficult to induce any kindness or unkindness judgements for at least two reasons. First, the 2x6 game matrix is so

complex that even a researcher can use a guiding hand to understand the (un)kindness interpretations built into the matrix. Second, the game is a simultaneous move game and although the authors use the strategy method, the kindness judgements only emerge through a complex reasoning chain. This is rather demanding and presupposes a “theory of mind” capacity that many people are unlikely to have naturally.

### ***The Relative Importance of Distributional and Reciprocity Concerns***

There is evidence from student samples that reciprocity concerns can outweigh distributional concerns if the experimental design makes it easy to infer intentions. For example, in Falk, Fehr and Fischbacher (2008) distributional concerns play almost no role when a random device transparently determines the first mover’s behavior, while strong positive and negative reciprocity prevails when first-movers themselves make the choices. There are, however, also situations where distributional concerns can minimize reciprocal behavior. Xiao and Bicchieri (2010) consider the interplay between reciprocity and equality concerns with a variant of the Berg, Dickhaut, and McCabe (1995) investment (“trust”) game, comparing in particular the trustees’ willingness to reciprocate when reciprocation makes them worse off than the investor. Their results show that “the proportion of non-reciprocating decisions is twice as large when reciprocity promotes inequality” and that the first movers expect this.

A thorough analysis of the relative importance of reciprocity and inequality aversion is provided by Bellemare, Kröger and van Soest (2011). They simultaneously estimated the structural parameters measuring inequality aversion ( $\alpha$ ,  $\beta$ ) and intentions-based reciprocity ( $\iota$  for negative reciprocity,  $\kappa$  for positive reciprocity) on the basis of a representative sample of the Dutch population that participated in ultimatum games with randomly determined versus intentional offers. They find that disadvantageous inequality aversion is much higher than aversion to advantageous inequality ( $|\alpha| = 0.796 > \beta = 0.183$ ) in the general population, and that “inequity aversion tends to be more important than perceived intentions in the population as a whole”. However, the aversion to disadvantageous inequality is much lower for the highly educated and young subjects below the age of 35 than in the general population. Moreover, negative reciprocity quantitatively dominates aversion to disadvantageous inequality ( $|\alpha| = 0.248 < \iota = 0.474$ ) among the young and educated.

## *Summary*

What have we learned about reciprocity in this section? First, there are widespread and numerous examples of negative reciprocity in the lab (and in the field, although instrumental concern for the future may color the choices made). On the other hand, positive reciprocity is found in some but not all cases. Why this is the case?

A first important reason could be loss aversion, i.e., the notion that losses loom larger than gains. Recall that reciprocity theory defines (un)kindness always relative to a reference point. Kindness is naturally related to receiving more than the reference point while unkindness means receiving less. The finding of Offerman (2002) that negative emotions after an unkind choice are much stronger than positive emotions are after a kind choice is consistent with this view. A second reason is that certain actions – like surprisingly paying higher wages without providing a plausible explanation for the wage increase – can be interpreted in different ways and may thus not be viewed as kind. This interpretation is in line with the findings in Kube, Marechal and Puppe (2012), which indicate that clearly interpretable gifts (payoff-equivalent to a wage increase) trigger strong reciprocal effort responses, while mere wage increases show insignificant effects. When employers want to induce reciprocal effort responses, they must carefully design their gifts, and not just offer more money. We typically do not give money to our spouses at Christmas but think carefully about the gifts for them.

A third potential reason for the difficulties in inducing positive reciprocity is that a certain minimal level of kindness is taken for granted in many modern societies: people usually hold the door for each other. Typically, if one expects kind or favorable treatment and receives it, there is no strong emotional jolt; on the other hand, if one expects kindness and receives unkind or hurtful treatment, the emotional response is much stronger. This means that the threshold for inducing further kindness perceptions is higher than the threshold for inducing unkindness perceptions. Consistent with this conjecture, Khalmetski, Ockenfels, and Werner (2015) find that surprising gifts are quite effective in leading to behavior that resembles positive reciprocity.

A fourth potential reason is related to the fact that reciprocity is a cognitively demanding concept because it requires reading other people's intentions. This is much harder than just noticing that one received less than another individual. In this context, it is interesting that there appear to be large cultural differences with regard to the extent to which



intent is taken into account in moral reasoning. This has been shown by anthropologists who assessed how people judge the badness and punish-worthiness of bad outcomes that either occur accidentally or intentionally (Barrett et al. 2016; Curtin et al. 2020). While intentions played an important role for Western populations, they played a more minor role for many other cultures. These findings suggest that it may be interesting to study the role of intentions versus outcomes in social preferences across different cultures. In addition, except for the Bellemare, Kröger, van Soest (2011) study, very little appears to be known about the distribution of reciprocity in broad population samples.

### 3.3.2. The Role of Guilt Aversion in Social Preferences

Guilt aversion is based on the idea that people prefer to avoid feeling guilty. The basic idea is that decision makers experience guilt if they believe they disappointed others who depended on them. The avoidance of guilt may thus induce prosocial behaviors. However, unlike reciprocity and inequality aversion, guilt aversion cannot explain behaviors that reduce other people's payoff. Guilt aversion leads to a concept of utility in which a player's preferences over strategies depend on her beliefs about the beliefs of others, even if there is no strategic uncertainty.<sup>30</sup>

#### *Conceptual and Intuitive Foundations of Guilt Aversion*

Guilt aversion has its roots in social psychology: Baumeister, Stillwell, and Heatherton (1994; 1995) advance the notion that people suffer from guilt if they inflict harm on others. One way to inflict harm is to let others down.

To illustrate the intuition behind guilt, Dufwenberg (2002) introduces the marital investment game, presented in the game tree in Figure 5 below<sup>31</sup>: A wife can provide

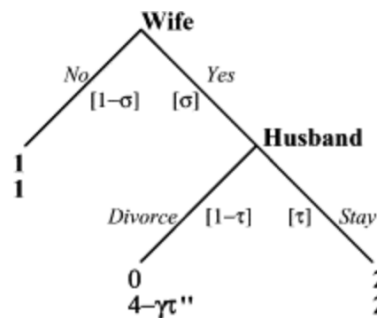
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<sup>30</sup> The role of other emotional factors such as anger, frustration or anxiety is shortly discussed in Appendix 7.

<sup>31</sup> Huang and Wu (1994) present the first applied theoretical work in economics to incorporate guilt. Two different forms of guilt aversion have been described. What we describe above is *simple guilt aversion*, where one experiences guilt for disappointing another person's expectations. A second form of guilt aversion is *guilt-from-blame* whereby one experiences guilt only to the extent that one expects to be blamed for a bad outcome (Battigalli and Dufwenberg 2007; Battigalli and Dufwenberg 2009). A key difference between simple guilt and guilt-from-blame is the effect of observation. With simple guilt, B feels guilt regardless of observability; only guilt sensitivity and second-order beliefs matter. With guilt from blame, B only feels guilt if A observes her effort. In the field, it may well be that observability of actions is a key driver for guilt-influenced behavior. Here, we limit our attention to simple guilt.

support for the husband to pursue a profitable education. If she refuses to do so, each person receives one monetary payoff unit. If she agrees to support the husband, then she forgoes the chance to invest in herself. In this case, her personal earnings are zero, but her husband's earnings are quadrupled. The husband can then choose to stay in the marriage and share the earnings or choose to divorce and keep the rewards. Since the husband promised not to do this, the wife will be quite upset, and the husband might therefore feel guilty.

**Figure 5: The Marital investment game with simple guilt**



In this game, guilt aversion naturally enters the scene as follows: “When a husband suddenly divorces his wife ... the stronger the wife’s belief that her husband would stay, the more *disappointed* she is. ... The husband may be averse to letting a trusting wife down, and the stronger he believes that she believes that he will stay the more *guilty* he feels by forcing divorce.”

Dufwenberg models guilt-averse preferences here by presuming some individual sensitivity to guilt ( $\gamma > 0$ ) for the husband, and then multiplying this sensitivity by the husband’s second-order beliefs  $\tau''$  concerning what the wife expects. Thus, the stronger the sensitivity to guilt and the higher the second-order beliefs, the greater the chance that the husband stays in the marriage.

### *Early Experimental evidence*

The first experiment to examine psychological game theory is Dufwenberg and Gneezy (2000).<sup>32</sup> They study the lost-wallet game where player 1 (the finder) finds a wallet containing a money amount  $x$ . The finder can take the money or ensure that the wallet is given back to the owner. Once the owner has received the wallet, he can reward the finder with an amount  $y$  from a given endowment of 20. For example, if the owner gives the finder  $y = 5$ , then the parties payoffs are (5 for the finder, 15 for the owner). The authors used  $x$  as a treatment variable set at 4, 7, 10, 13, and 16 in the different treatments. The key issue here is whether the owner's choice of the reward  $y$  is positively correlated with her expectation of the finder's expectation of  $y$  conditional on 1 choosing *Leave*.

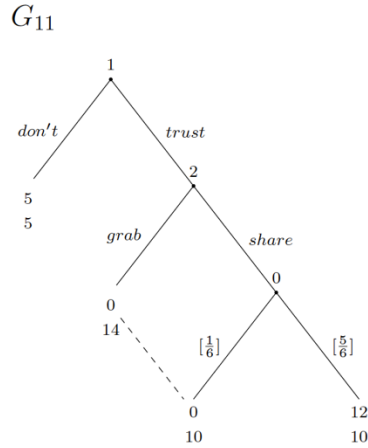
The game was played only once in a session. First, the finder was given an envelope with  $x \in [4, 7, 10, 13, 16]$ ; then the finder chose whether to leave it or to return it; in the latter case, the owner chose  $y$ . Beliefs were then elicited. Incentivized beliefs about  $y$  (for the known  $x$ ) were elicited from the finders. The owners were asked to make an incentivized guess of the average guess of the finders who chose to leave the money in the envelope. The results show a significant positive correlation between the reward  $y$  and the owner's expectation of the finder's expectation of  $y$ . This positive correlation is the very first evidence of what the authors call *letdown aversion*, a term changed to *guilt aversion* in later work (as suggested by the younger co-author of this article). Thus, the psychological mechanism hypothesized in guilt aversion theory appears to be operative here.

Guilt aversion can potentially also play an important role in economic interactions under incomplete contracting. Charness and Dufwenberg (2006) show this by studying the game below where player 1 can enter a trade that involves the sequential exchange of goods. If 1 forgoes the trading opportunity, each party receives a payoff of 5. In case player 1 trusts by sending his goods to 2, player 2 can send her goods to player 1, and if the batch arrives the payoffs are (12, 10). However, the sent goods may not arrive with probability  $1/6$  in which case player 1 receives nothing. Note that in this game player 1 cannot distinguish whether bad luck or bad behavior by player 2 generated a payoff of zero.

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<sup>32</sup> Due to space limitations, we are not able to provide an exhaustive discussion of the evidence on the role of guilt. For a more exhaustive presentation, see Cartwright (2019).

**Figure 6: Sequential Exchange with Moral Hazard**



In this game a self-interested player 1 who expects to face a self-interested player 2 will never trust. If player 2 is, however, guilt averse then it may be rational for player 1 to trust. From the viewpoint of guilt aversion theory, the key question is whether player 2's belief about player 1's expectation about 2 choosing *share* is positively correlated with player 2's actual probability of choosing *share*. Higher beliefs by player 2 about 1's expectation will increase the probability that a guilt averse player 2 will actually choose *share*.

Charness and Dufwenberg (2006) conjectured that giving player 2 the option to communicate with player 1 may be a particularly powerful way of strengthening player 2's second order belief because player 2 has a strong incentive to convince player 1 that 2 will share. Intuitively, if player 2 tries to persuade player 1 that he will choose to share, then player 2 can hardly avoid the inference that in case of trust player 1 had a high belief that 2 will share. Thus, guilt aversion provides a mechanism that can explain why communication between parties often enhances cooperative behavior.

The authors consider the effect of free-form communication in a one-way message treatment where player 2 could send a hand-printed message of any nature to 1 before the game commenced. Particular attention was paid to promises (statements of intent) since these might be particularly effective in affecting beliefs.

The experimental results clearly show the effectiveness of communication. In addition, they reveal behavioral patterns consistent with guilt aversion as an underlying mechanism. Examining subjects' verbatim messages is interesting and instructive (e.g., "I swear upon my mother's grave that I will share."), and shows that promises were particularly effective: Player 1 chose *trust* 79% of the time and 2's chose *share* 79% of the

time when a promise was made; this compares to 37% and 33%, respectively, when no promise was made. Of particular interest for guilt aversion, there is a strong relationship between 2's belief about 1's belief that 2 will choose *share* and 2's actual choice of whether to *share*. These beliefs were significantly higher for 2's who chose *share* compared to 2's who chose *grab* (66.7% versus 42.7%).

A comparison between the above discussed paper and Charness and Dufwenberg (2010) reveals that the effectiveness of communication is very much context dependent. In the latter paper, a second mover can only circle a message saying "I promise to choose Roll" or send a blank sheet. This bare promise is almost completely ineffective relative to the treatment with no communication. Richer messages tend to move beliefs more and it may well be that self-generated messages are particularly effective (in the same way that personal gifts were more effective than money in Kube, Marechal and Puppe (2012)). One open topic of interest is whether self-generated messages are more effective than if these messages were known to have been chosen from a menu of messages.

Andreoni and Rao (2011) investigate the effect of one-way and two-way communication on giving in a dictator game. They used an anonymously played one-shot \$10 dictator game with free-form communication, varying who in the pair could send messages. Although they did not measure beliefs, their results are suggestive for guilt aversion as a factor underlying communication-driven generosity.

In their main experiment, there is a Baseline treatment without communication, a treatment (A for "ask") in which the recipient sent a written message containing a numerical transfer request. In treatment E (for "explain"), only the dictator could send a written message (along with the pass request). There are also two combination treatments: In "Ask then Explain" (AE), the receiver first sent a numerical request and the dictator's pass choice was accompanied by an explanation. In "Explain then Ask" (EA) the dictator first indicated a (non-binding) split, and then the recipient responded with a numerical request. The dictator then chose an allocation.

Andreoni and Rao document dramatic differences in the mean transfer according to whether it is possible to make a numerical request. In AE, for example, dictators give 30%, which is four times more than in treatment E. The two treatments with bilateral communication have the highest mean transfer and, perhaps surprisingly, there is little difference in the mean transfer across these. Transfers in treatment A are also significantly

higher than in the baseline and treatment E, and statistically indistinguishable from AE and EA. It seems that treatment E could be considered an “Excuse” treatment, since the mean transfer is much lower than even the Baseline.

There are several possible explanations for the power of an ask. The authors themselves consider self-image maintenance and guilt aversion but social norm compliance is also a possibility. Perhaps, self-image maintenance plays a role in treatment E, where saying “sorry” to a recipient who is given little may help subjects to convince themselves that their selfishness is not too bad. Guilt aversion appears, however, a much more plausible source of the power of the ask. It appears quite likely that when a recipient asks for an amount, the dictator believes that the recipient is expecting a similar amount to be transferred; failing to do so could lead to guilt.<sup>33</sup> It is also possible, however, that the equality/fairness norm becomes more salient when recipients can ask, as they typically invoke fairness concerns in their asks. Because the role of dictator and recipient have been randomly assigned, there is little normative legitimacy for the dictator to deviate from equality, and the recipients’ asks may make this salient.

Vanberg (2008) argued that player 2 may keep her promise not because of guilt aversion (i.e., the aversion felt because she disappoints player 1’s payoff expectation) but because she experiences an obligation to keep her promise. He developed a clever experimental design that distinguishes between the guilt aversion and the obligation hypothesis: Each pair of player plays the same subgame with probability  $\frac{1}{2}$  that player 2 faces in Figure 6 where she has to choose between *grab* and *share*. If player 1 becomes the decision-maker (“dictator”), player 2 is assigned the role of the recipient and vice versa. Both players are given the opportunity to send two messages before the players know which role they are assigned. Thus, when the roles are not yet assigned, the players have an incentive to informally provide mutual insurance against exploitation by the other player, and mutually promising to play *share* might achieve this. In fact, the vast majority of players indeed promised to play *share* during pre-play communication.

To identify whether guilt aversion or feeling obliged to keep a promise is the motive

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<sup>33</sup> Andreoni and Rao (2011) argue that guilt aversion has trouble explaining the similar behavior in EA and AE, suggesting that perhaps a strategically biased perception of the other party’s beliefs is present and that maintaining distortions is more difficult with communication. Yet, it is not so clear that the dictators’ second order beliefs should differ between EA and AE, so we do feel that guilt aversion is a very plausible driver behind the “power of asking”, at least in part.

underlying the play of share, Vanberg randomly rematched half of the recipients with dictators in one treatment (“switch condition”). Critically, while dictators are informed about whether such a switch occurred, the recipients are not. In the case of a switch, the dictator can see the conversation that had occurred with the switched-out prior dictator, i.e., they learn whether the recipient has previously received a promise from a different dictator.

The key to this design is that recipients cannot know whether there was a switch, so their first-order beliefs can depend only on whether a promise was received, not on whether they are finally matched with the person who has made that promise. Since dictator subjects know this, their second-order beliefs should be equally affected by promises made by others (as in the switch condition) as by promises that they themselves made (as in the no switch condition). The data support this hypothesis. Thus, the guilt aversion explanation for promise keeping predicts that dictators should be more likely to *share* whenever the partner has received a promise, in both the switch and no-switch condition. In contrast, the obligation hypothesis predicts that promises made in the no-switch condition have higher commitment power (i.e., lead to more play of *share*) because the dictator in the switch condition did not make a promise to the partner she faces.

The main result in Vanberg (2008) suggests that feeling obliged to keep promises drives the behavior rather than second-order beliefs. Promises led to significantly higher *share* rates in the switch compared to the no-switch condition (73% versus 52%), although they are associated with the same second-order beliefs in the two conditions. Moreover, the second-order beliefs in the switch condition are higher when the recipient received a promise from her previous partner compared to when he received no promise. Note that the recipient’s previous partner generated this variation in second-order beliefs and the partner should thus, according to guilt aversion, provide higher share rates after the promise than after no promise. Yet, in fact the share rates are almost identical (54% versus 52%).

### ***Overcoming Problems in Identifying Guilt Aversion***

A key issue in identifying guilt aversion by measuring players’ second order beliefs is that these beliefs are endogenous. In the sequential exchange game in Figure 6, player 2’s belief about 1’s expectation could easily be a result of 2’s choice instead of driving it. For example, if 2 believes that player 1 correctly anticipates her choice, then 2’s second order belief perfectly coincides with 2’s action. In addition, because players’ second order beliefs

are typically elicited after the players have made their choices, the beliefs may simply reflect an ex-post rationalization of the choices made.

Several approaches have been put forward to solve this identification problem, such as the disclosure approach, the menu approach, and approaches that experimentally manipulate second-order beliefs. Applied to a dictator game, e.g., the disclosure approach elicits the recipient's expectations about the dictator's transfer and informs the dictator about this expectation. Thus, there is no need to elicit the dictator's second order belief because the experimenter knows that belief directly. The disclosure approach has been implemented in several papers and led to mixed evidence for guilt aversion. Some papers found no evidence for a positive correlation between second order beliefs and the players' prosocial choices (Ellingsen et al. 2010; Bellemare, Sebald and Suetens 2017), while others found a significant correlation (Reuben, Sapienza and Zingales 2009; Bellemare, Sebald and Strobel 2011). Bellemare, Sebald and Strobel (2011) also document that directly eliciting subjects' second-order beliefs leads to a strong overestimation of guilt aversion. In their disclosure treatment, the estimated willingness to pay (WTP) for avoiding guilt is only roughly 50% of the WTP in their baseline treatment that uses uncorrected second order beliefs to measure guilt aversion.

The disclosure approach is not without drawbacks, however. While it circumvents the endogeneity problem associated with the direct elicitation of second order beliefs, it introduces the possibility of other confounds. For example, providing information about a partner's expectation may also signal something about the prevailing social norm, implying that guilt aversion may be confounded with social norm compliance. In addition, if players are informed about the other players' expectations, they may wonder why the experimenter does this, whether the other players know this, and if so, whether other players have biased their expectations strategically. Ellingsen et al. intended to mitigate these concerns by telling the dictators that the recipients are not told of their expectations. But the second movers then might have wondered what was not being revealed to them. Doubt about the environment might have reduced the sense of guilt for those who felt uninformed.

Several papers have therefore tried to solve the endogeneity problem by implementing the so-called menu-approach. Here, the dictators or second movers stipulate a choice conditional on different, exogenously given, beliefs of their partners (Khalmetski, Ockenfels and Werner 2015; Bellemare, Sebald and Suetens 2017; Bellemare, Sebald and



Suetens 2018; Attanasi, Rimbaud and Villeval 2019). This approach generally leads to results that support the existence of guilt aversion, but the supporting evidence needs to be taken with a grain of salt because asking subjects to state their choices for different levels of the other party's first-order beliefs clearly suggests to them that they could or should make their choices dependent on these beliefs. Guilt aversion theory claims, however, that subjects naturally do so to avoid feeling guilty.

Is there a way to overcome the difficulties in reliably identifying guilt aversion through the exogenous variation of second-order beliefs? The papers by Ederer and Stremnitzer (2017) and Khalmetski (2016) indeed solve this problem. Ederer and Stremnitzer use a variation of the sequential exchange game displayed in Figure 6. Like in Charness and Dufwenberg (2006), player 2 can send free form messages to player 1 before player 1 decides whether to trust.<sup>34</sup>

Ederer and Stremnitzer successfully implement an exogenous variation in beliefs by introducing a chance move that generates either a reliable or an unreliable trading technology in case that player 1 plays *trust*. If the trading technology is reliable, there is a 5/6 probability that player 2 has the option to trade (i.e., the option to play *share*), while in case of an unreliable technology the option to choose *share* only materializes with probability (1/6).<sup>35</sup> Importantly, once the type of trading technology is determined, both players are informed about it, which will obviously affect the players' expectations. In particular, player 1 will expect a higher payoff in case of a reliable technology than in an unreliable trading technology because player 2 has the option of choosing *share* with a high probability in the former case. Moreover, player 2 will know this and will thus have higher 2<sup>nd</sup> order expectations which, according to guilt aversion theory, should trigger a higher rate of share choices in the presence of a reliable technology.

Ederer and Stremnitzer (2017) verify that the reliable trading technology indeed induces higher second order beliefs regarding the probability of playing *share*. Moreover,

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<sup>34</sup> Khalmetski (2016) used a sender-receiver game where the sender has an incentive to lie to the receiver which hurts the latter. Based on a clever design, he exogenously shifts first and second order beliefs without changing the sender's *material* incentive to lie. His results indicate that senders are more likely to tell the truth when the senders have higher second order beliefs about receivers' payoff expectations. The effect prevails, however, only when incentives for lying are small, but not when they are large.

<sup>35</sup> Ederer and Stremnitzer also allow for different degrees of sharing, but we abstract from this to keep the exposition simple.

this exogenous increase in second order beliefs holds regardless of whether player 2 made a promise, sent no message, or merely engaged in empty talk. Guilt aversion thus predicts that this exogenous increase in beliefs will be associated with a higher percentage of *share* choices under a reliable technology regardless of the message player 2 sends. Interestingly, however, the percentage of sharing choices is only higher under the reliable technology *in case of a promise*. When player 2 made no promise or simply engaged in empty talk, the exogenous shift in second order expectations was not accompanied with an increase in choosing *share*.

These results may help us understand the conditions under which guilt aversion theory applies. It seems that moving second order expectations is not always enough to move behavior in the direction of guilt aversion, but that additional psychological conditions – such as a promise – need to be present to induce guilt averse behavior. The special status of promises is also supported by evidence in Bracht and Regner (2013) who find a significant effect of promises even after controlling for second-order beliefs.

### ***Summary***

The theory of guilt aversion provides a simple and intuitively powerful account of prosocial behavior. There is considerable behavioral evidence that is consistent with guilt aversion and behavioral measures of individuals' guilt aversion have been shown to be correlated with psychological measures of guilt proneness (Bellemare, Sebald and Suetens 2019). However, the rigorous identification of behavioral guilt aversion is non-trivial and involves difficult identification problems. Guilt aversion also does not appear to manifest itself in all environments. The setting must give a sense of fairness, otherwise guilt sensitivity might diminish. Messages must be credible and persuasive to move beliefs, which in turn dictate choices. In addition, once beliefs change, the content of message matters for this change to become behaviorally relevant. We also feel that there is something to the commitment-based story of why promises are so effective. We do not view this idea as being in opposition to guilt aversion but rather as complementary. While we do not have a full characterization of when such emotions come into play, we expect that further research will help to clarify these connections.

### **3.4. The Role of Self-Image and Social Image Concerns for Prosocial Behavior**

One's image can be important for a great variety of reasons. Just like looking in a mirror and adjusting physical appearance, people will take actions to appear more favorably. This applies to both self-image and social image, which to some extent seem inextricably intertwined: improving one's self-image or self-esteem may well have positive spillovers socially, and one's social image can lead to a better self-image. This topic was first considered in the field of psychology, where impression management, self-concept, and self-presentation are terms that reflect the care taken to appear more favorably to self and others. The Tesser (1988) self-evaluation maintenance model proposes that people are motivated to maintain both positive self-views as well as their perception about how other individuals view them. Overall, there is considerable evidence indicating that social comparisons affect self-esteem (Gastorf and Suls 1978; Molleman, Pruyn and Van Knippenberg 1986).

In this section, we discuss how concerns about one's image – whether self or social – affects people's prosocial behaviors. While many of the prosocial behaviors we discussed in the previous sections appear to be driven by genuinely prosocial motivations such as altruism, equity-seeking, or positive reciprocity, it makes intuitive sense that the desire to appear prosocial to oneself or to others might also drive some prosocial behaviors.

We begin this section with a short presentation of related theory, after which we will discuss the evidence for self-image and social image driven prosociality. In this context, we will also pay particular attention to the effect size of image-driven prosociality relative to other, more genuine, forms of prosociality.

#### ***Theoretical concepts***

Self-perception theory (Bem 1973) stipulates that people observe their own behavior to infer what they are thinking and how they are feeling. People without initial attitudes or emotional responses develop them by observing their own behavior to assess what their attitudes and motives must have been to induce that behavior. While one might presume that one's personality and attitudes drive one's actions, self-perception theory suggests that this is not always the case. Instead, "we are what we do". One way of formalizing self-signaling is to assume that it is an attempt to influence the beliefs of a future self, who cannot remember the original motivation for the behavior. Bodner and Prelec (2003) were the first who developed

a dual-self signaling model, an approach that was later also applied in Benabou and Tirole (2006; 2011), Grossman (2015), and Grossman van der Weele (2017).<sup>36</sup>

Consider, for example, a simplified version of Benabou and Tirole’s (2006) model. Here, an agent has an intrinsic valuations  $v_a$  for contributing  $a$  to a charity that generates a costs  $C(a)$ , so the direct benefit of choosing  $a$  is  $v_a a - C(a)$ . Because the agent cares about her social image, there are also reputational costs and benefits  $R$  that depend on what others infer on average about the agent’s intrinsic prosociality,  $E(v_a|a)$ , given the agent’s observable prosociality  $a$ :

$$R(a) \equiv x[\gamma_a E(v_a|a)], \text{ with } \gamma_a \geq 0.$$

The sign of  $\gamma_a$  indicates that people would like to appear prosocial and  $x > 0$  is the visibility of their actions. Note that  $R(a)$  could represent an instrumental or an affective value of one’s social image. Letting  $\mu_a \equiv x\gamma_a$ , an agent with reputational concerns chooses  $a$  to satisfy:

$$\max_{a \in A} [v_a a - C(a) + \mu_a E(v_a|a)]$$

In a nutshell, this model assumes that individuals care for the intrinsic value of prosociality  $v_a a$ , the material cost involved in behaving prosocially  $C(a)$ , and their social image  $\mu_a E(v_a|a)$ . They choose  $a$  to optimally balance these components. The model can also be applied to self-image concerns by assuming that there is some chance that one might later fail to remember or (remember in a self-serving manner) the reasons for making a choice. If observable actions are easier to remember than imagined motives, signaling our type to our later self with our current actions could make sense. Perhaps the exact feelings or signals at that time are obscured with some probability proportional to  $x$  and the agent later cares about “who she is”.

Bénabou and Tirole (2006) use a slightly more complicated model to derive the image-spoiling and crowding effects of rewards as well as several other interesting social phenomena (social stigma, social norms, etc.). Grossman and van der Weele (2017) apply a self-signaling model in the spirit of Benabou and Tirole directly to explain prosocial

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<sup>36</sup> Dufwenberg and Battigalli (2022) make a strong case that image concerns imply that the decision maker’s belief about other’s beliefs enters the utility function. In other words, proper modelling of image concerns requires the tools of psychological game theory. In the case of self-image concerns, beliefs about other self’s beliefs, and in case of social image concerns, beliefs about other people’s beliefs enter the utility function. To ease exposition, we use a simplified version of the Benabou-Tirole (2006) model.

behaviors – such as information avoidance in altruistic choice (Dana, Weber and Kuang 2007) – that models distributional preferences cannot explain.

### *Avoidance behavior and self-image concerns*

Self-image concerns may play a role if people cross the street to avoid passing by a poor beggar. There are other plausible explanations for this behavior, however. Perhaps I give money to charities that I know and trust, so I have no self-image problem regarding my prosociality. Nevertheless, if I pass a beggar in need and give nothing, I frustrate my empathic concern and feel bad. But I don't feel bad because I have a bad self-image, I feel bad because I empathize with the beggar. In the same way, I feel bad when I see a starving child on TV or when I learn about a famine. It may have nothing to do with my self-image. Similarly, social pressure to give to a charity that randomly shows up on one's door or on the street can be aversive *per se* and thus avoiding such situations may have nothing to do with image concerns.<sup>37</sup>

Laboratory experiments provide a more precise tool to identify these concerns. Dana, Kuang, and Weber (henceforth DKW) (2007) conducted a paradigmatic and influential study providing support for self-image concerns in altruistic choice. They implemented a binary dictator game in a baseline treatment, a hidden information treatment, and a plausible deniability treatment. In the *baseline treatment*, the allocator can choose between option A, yielding allocation (6,1), and option B with allocation (5,5). In the *hidden information treatment*, the chooser has again two options (A and B) with corresponding payoffs of 6 or 5 for herself but unknown payoffs for the other party. There are two possible states of the world. In one state the players' preferences over A and B are aligned because choosing A yields payoffs of (6,5) while choosing B leads to (5,1). In the state with a conflict of interest, the payoffs are the same as in the baseline treatment. In the hidden information treatment, the chooser does not know which state of the world prevails, but she has the option to reveal the true state at no cost by clicking a box on the computer screen. In the *plausible deniability treatment*, the options were identical to the baseline treatment and the choosers were given

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<sup>37</sup> This argument applies, in our view, to the study of DellaVigna, List and Malmendier (2012) who convincingly show that some people dislike the social pressure associated in door-to-door funding campaigns. In their experiment, flyers posted on their front doors told some households that an individual will come to solicit donations for a charity at a particular time. In the control treatment, no flyers were distributed. They find that flyers significantly reduced the share of households opening the door and they also reduced overall donations.

10s to decide (as in the other treatments), but the computer could cut off the choosers at random time points within this 10 s interval and implement (with 50% probability) either (6,1) or (5,5). Moreover, only the choosers were informed about a cut off, while the receivers never knew whether the chooser or the computer made the decision. Thus, the chooser can hide her responsibility for the for an unfair outcome behind a random mechanism in this treatment, which may facilitate an “other-deceptive motive”. However, if they determine the selfish outcome on time (i.e., without being cut off), they are still responsible for that outcome. Delaying decision-making, in contrast, allows them to increase the likelihood of an actual responsibility delegation which may facilitate a “self-deceptive motive”.

74% of the dictators chose the fair (5,5) option in the baseline treatment, while only 37.5% of the dictators who were randomly assigned to the conflict state chose the fair option in the hidden information treatment. Thus, despite the fact that dictators in the conflict state of the hidden information treatment faced identical cost and benefits from a fair choice compared to the baseline treatment, they were much less likely to behave fairly. The key reason for this is that only 50% of the dictators who were assigned to the conflict state actively chose to seek information about the true state. All of those who remained uninformed chose the selfish option, while the informed dictators chose the fair option in 75% of the cases.

In the plausible deniability treatment, dictators who were *not* cut off chose the fair option in 45% of the cases, significantly less than in the baseline. This is consistent with the view that dictators exploit receivers’ incomplete information about who determined the outcome, but it is also consistent with guilt aversion. Since receivers knew that the software could cut off the dictator’s decision, they may have had lower expectations, dictators who anticipated this simply have felt less guilty when making the selfish choice. 24% of the dictators delayed their decisions long enough for the software to make the choice. The cut offs occurred after much more time than what subjects typically needed for deciding in the baseline treatment, consistent with the view that subjects were willingly cut off.

To what extent can self-image concerns really explain willful ignorance (and willful delay), i.e., to what extent can we go beyond mere intuitions about the potential role of self-image? A key paper in this regard is Grossman and van der Weele (2017), who developed a multiple-self model where a decision-maker (DM)-self manages her image vis-à-vis an observer-self. One can illustrate the basic intuition of their paper with the help of the notation

used when describing the simplified Benabou and Tirole (2006) model above where the decision-maker's utility is given by

$$v_a a - C(a) + \mu_a E(v_a | a, \sigma).$$

The DM self knows her preferences and derives altruistic utility  $v_a a$  from behaving prosocially ( $a = 1$ ), and also puts a positive weight  $\mu_a$  on her self-image  $E(v_a | a, \sigma)$ . The observer self lacks introspective knowledge of the DM's altruism parameter  $v_a$  but can infer it from the DM's actions and knowledge  $\sigma$  about the state of the world. The state of the world  $\sigma$  is either unknown, the conflict state, or the aligned state. The observer's inference about the DM's altruism is given by  $E(v_a | a, \sigma)$  which is the basis for the DM's self-image.

The key insight derived from this model is based on the existence of a “willful ignorance equilibrium” in which the selfish individuals ( $v_a = 0$ ) neither behave prosocially ( $a = 0$ ) in the baseline treatment nor in the hidden information treatment. Altruistic individuals, however, can be sorted into two groups: those with a strong preference for altruism ( $v_a \geq v^* > 0$ ) and those with a weak preference for altruism ( $v_a < v^*$ ). The strong altruists (i) choose the prosocial option in the baseline treatment and (ii) acquire information and choose the prosocial option in the conflict state of the hidden information treatment.

The third category of players, the weak altruists, are necessary to explain willful ignorance in the DKW paper. In the baseline treatment, the DM and the observer know that the conflict state prevails. Choosing option A with payoffs (6,1) thus provides a clear signal to the observer that the DM's altruism is low, which hurts the DM's self-image. In the hidden information treatment, however, neither the DM nor the observer know the state of the world. Therefore, maintaining the uncertainty and choosing A has a much lower signaling value regarding the DM's altruism because choosing A was not an unfair choice with 50% probability. But the *critical assumption* here is that the *observer does not infer something negative* about the DM's altruism from the mere fact that *the DM decides to remain ignorant*. In this regard, self-image models are also self-deception models because individuals can fool themselves into believing that they are more prosocial than they in fact are.<sup>38</sup>

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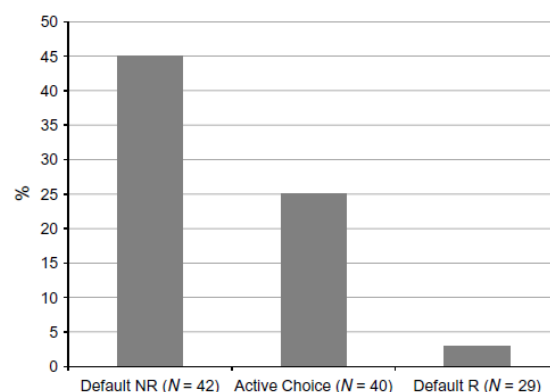
<sup>38</sup> Carlson et al. (2020) report evidence that a non-negligible share of individuals recalls being more generous in the past than they actually were – an effect that occurred mainly in those individuals who violated their own fairness standards. Motivated misremembering of selfish behaviors may be one source of self-deception and maintaining a positive self-image.

Thus, the essence of the model is that the hidden information treatment enables the DM to reduce the negative signaling value of behaving unfairly by obfuscating the observer's inferences about her altruism in case of an unknown state of the world. For weak altruists, the total value of an altruistic act – which consists of intrinsic altruistic utility plus the signaling value – thus declines below the cost of the altruistic act.

To what extent is self-image driven willful ignorance a robust phenomenon and how large are its quantitative effects on altruistic behavior? A recent meta-analysis by Vu et al. (2023) takes a large number of studies comprising roughly 6500 individuals and 56 treatment effects into account. The meta-analysis shows that across all studies, 57% of the individuals make an altruistic choice in the full information treatment and that this share is 15.6% lower in the conflict state of the hidden information treatment. Thus, the share of strong altruists appears to be roughly 2.5 times larger than the share of weak altruists.

Grossman (2014) examined the robustness of willful ignorance to small, seemingly innocuous changes in the experimental design. He changes the default for learning the true state in the hidden information treatment. In their “Default Non-Revealed (NR)” treatment, which is similar to DWK, subjects need to click a box to receive information; they remain uninformed otherwise. In “Active Choice” treatment, participants must click on a box to either learn the state or to not learn the state. In the “Default Revealed (R)” treatment, the default is reversed so that participants learn the state unless they click on a box to say they don't want the information. Figure 7, taken from Grossman (2014) , shows the results.

**Figure 7: The Percentage of Dictators Choosing Ignorance**



The basic result in DWK is confirmed. About 45% of the participants in “Default NR” maintained their ignorance and then almost invariably chose allocation (6, 1). Yet matters change dramatically when one must make an active choice of one of the two boxes, with the



non-reveal rate dropping significantly to 25%. The most compelling evidence, though, comes from reversing the default. When one is required to affirmatively state that one does not wish to learn the true state, only 3% of the participants opt not to learn it. This is a remarkable departure from the baseline rate, and it illustrates the sensitivity of preference for ignorance to the details of the environment. When remaining ignorant, the damage to one's self-image seems considerably more severe when one can only remain ignorant by deliberately electing to do so, indicating limits to self-deception.

Carpenter and Robbett (2022) conducted another robustness test. They implemented the plausible deniability treatment of DKW (2007) but instead of only *one* binary dictator game, subjects participated in 45 different binary dictator games. The reason for the large number of games was that the authors were interested in estimating subjects' distributional preferences parameters. The 45 games included a large number of different situations that involved many different costs of altruistic choices on negatively sloped "budget lines" (with two options). In some cases, the cost of the altruistic act was as low as in DWK's conflict treatment, i.e., the altruistic choice increased the total payoff, while in other cases the costs were high enough so that the total payoff decreased. In addition, subjects also faced many positively sloped "budget lines". Note that this set-up is likely to decrease demand effects associated with standard single shot dictator games because the large variation across games provides many justifications for selfish behaviors (e.g., high costs of altruism on negatively sloped budget lines or joint payoff maximization on positively sloped budget lines). Carpenter and Robbett show that plausible deniability does not lead to a significant change in the estimated distributional preference parameters, i.e., moral wiggle room does not affect subjects' preference for altruism in the domain of advantageous and disadvantageous inequality. This finding is important because it indicates that moral wiggle room may play little role in the typical experiments (Fisman, Kariv and Markovits 2007; Fisman et al. 2015; Fehr, Epper and Senn 2022) used to estimate distributional preference parameters.

Willful ignorance is one important example of avoidance behavior, but the literature has also considered other forms. Dana, Cain, and Dawes (2006), for example, give subjects a choice between playing a \$10 dictator game or taking \$9 with an exit option. The recipient received nothing with this exit option, but in this case the receiver never knew that there had been an option to make an award in a dictator game. About a third of the dictators chose to exit, hiding behind the receivers' ignorance. The authors also conducted a control treatment – the private dictator game – where the receivers never knew about the existence of the dictator

game or the source of any money paid out. Interestingly, very few dictators chose to exit the private dictator game. Thus, when exiting cannot affect the receivers' expectations, the exit option is rarely chosen, suggesting that dictators want to avoid violating the receivers' expectations. The results are therefore consistent with guilt aversion, but self-image concerns could also have played a role because the very fact that another anonymous individual knows that the dictator behaved selfishly may be associated with higher self-image cost. Knowing that the recipient knows that I behaved selfishly is perhaps like looking into the mirror.<sup>39</sup>

The literature on information avoidance in moral wiggle room experiments has undoubtedly increased our knowledge about the intricacies and driving forces underlying prosocial behavior. There are clearly relevant conditions under which self-image appears to play a role. However, the literature frequently also uses a rhetoric suggesting that preferences for fairness and altruism are merely “illusory” (Larson and Capra 2009) or that “the underlying motivation driving much fair behavior might be self-interest, coupled with a desire to maintain the illusion of not being selfish” (Dana, Weber and Kuang 2007). Likewise, the question is asked “if good deeds stem from altruistic tastes, why do the same people often seize upon the thinnest of veils to revert to selfishness?” (Benabou and Tirole 2011).

One may ask whether this rhetoric is justified in view of the overall evidence. The meta-analysis of Vu et al (2023) shows that the share of subjects who behave consistently altruistic in the baseline and the hidden information condition is 2.5 times larger than the share of subjects who engage in information avoidance and behave selfishly when the state is unknown. In addition, we must keep in mind that moral wiggle room experiments in the spirit of DKW do *not* prove the absence of truly altruistic components among those who avoid information. Based on the insights of the Grossman and van der Weele model, the weak altruists may well put positive value on prosocial acts; the evidence only allows us to say that their altruistic utility is not sufficiently high to behave consistently across both treatment conditions. Also, while it is true that seemingly innocuous design features (like the need to click a box to get informed about the state of the world) induces a minority of individuals to

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<sup>39</sup> Lazear, Malmendier, and Weber (2012) also consider avoidance behavior in a set-up that triggers a psychological mechanism similar to that in Dana, Cain and Dawes (2006). They compare giving behavior in a standard \$10 dictator game with a treatment where the dictators can exit the dictator game silently without any cost. In case of exit, the recipient never learns that he was potentially part of a dictator game. Thus, by exiting the dictator can manipulate the recipient's expectations, which reduces self-image cost and/or guilt.

revert to selfish behavior, equally innocuous design features (like the need to click a box to remain *uninformed*) basically remove this effect (Grossman 2014). And finally, if dictators make not just one but a large number of choices, moral wiggle room (plausible deniability) may have little effect on the estimated distributional preference parameters (Carpenter and Robbett 2022).

### ***Social Image Concerns***

The formal framework in Benabou-Tirole (2006) can be applied to self-image concerns and to social image concerns. In the latter case, the multiple-self interpretation can be discarded and the term  $\mu_a E(v_a | a, \sigma)$  represents the decision makers' intrinsic valuation of being viewed as a prosocial actor by relevant third parties. Note, however, that willful ignorance in experiments like DKW (2007) can hardly be interpreted in terms of social signaling because the experiments are one shot and subjects remain anonymous. In addition, the receivers do not know whether the dictator acquired information. Therefore, the social image interpretation has little explanatory power in this setting.

There are, however, powerful demonstrations of the relevance of social image concerns on prosocial behaviors, and many authors have provided models of such concerns (Hollander 1990; Benabou and Tirole 2006; Ellingsen and Johannesson 2007; Ellingsen and Johannesson 2008). Social image concerns are, in a sense, just another term for the preference for social approval. Rege and Telle (2004), e.g., conducted a simultaneously played one shot public goods experiment where complete free-riding is the dominant strategy. They implemented a private condition and a public condition where all group members saw how much an individual had contributed. In both conditions, each individual first privately committed to a contribution level by deciding how much of her monetary endowment to put into an envelope dedicated to the public good. Thereafter, each subject had to stand up and put her “public envelope” into a box in front of a room. In the private condition, the public envelopes remained sealed, but each subject had to open her public envelope, count the money in the envelope, and write the amount contributed on a blackboard in the public condition. Obviously, the public condition generates strong social image/approval incentives such that the average contribution rate increased from 34% in the private condition to 68 percent in the public condition.

Ariely, Bracha, and Meier (2009) also exploit the distinction between a private setting (where choices remained private), and a public setting (where choices were made public to the other participants in the study) to examine social image effects on prosocial behavior. In their lab study, participants performed a real-effort task (pressing two keys sequentially) that led to donations on their behalf to the American Red Cross. In the public setting, the subjects worked much harder to generate donations to the Red Cross. In addition, the authors tested an interesting prediction that follows from several social signaling models: that monetary incentives crowd out prosocial behaviors driven by social image concerns because public observers will attribute at least a part of subjects' effort to the monetary incentive rather than to their prosociality. Ariely, Bracha and Meier confirm this prediction neatly.

Andreoni and Bernheim (2009) consider social signaling in a \$20 dictator game with a stochastic element to the decision. Specifically, there is some probability  $p$  that Nature transfers a fixed value  $x_0$  to the recipient, i.e., Nature overrides the dictator's decision. To heighten social image concerns, participants were informed that all participants and outcomes would be publicly identified at the end of the session. Note that only the outcomes for the two players but not the dictators' choices are made public. This means that selfish dictators can hide their choices in those dictator games in which Nature chooses a low transfer with positive probability, and thus avoid damaging their social image by making the same transfer that Nature would have made.

Andreoni and Bernheim elicit dictators' choices for four values of  $p$  (0, 0.25, 0.50, and 0.75) and two values (0 and 1) for Nature's fixed transfer. Their findings provide strong support for the idea that people care about their social image. Between 57% (in case of  $x_0 = 0$ ) and 69% (in case of  $x_0 = 1$ ) of the dictators chose the equal split when  $p = 0$ . However, the frequency of equal splits dramatically declines with increasing  $p$ , and more and more dictators hide behind Nature's fixed value and choose exactly  $x_0$ . For example, for  $p = 0.5$ , and  $x_0 = 0$ , 72% of the dictators choose exactly 0 and only 28% the equal split. Likewise, for  $p = 0.5$ , and  $x_0 = 1$ , roughly 45% of the dictators choose  $x_0 = 1$  and the frequency of equal split is slightly below 40%. Thus, taken together, the evidence suggests that social image concerns (being viewed as fair) constitutes a strong motive. However, we need to consider that whenever an individual's social image is at stake, the individual's self-image is also likely to be involved. This is so because what could be a stronger hit to one's self-image than losing one's social image? Therefore, the strong effects observed in the experiments discussed above may be the result of a combined effect of social and self-image concerns.

## *Summary*

The evidence suggests that both self and social image concerns play a role in behaviors that have a clear prosocial meaning. In contrast to other-regarding preferences like altruism, inequity aversion, reciprocity or guilt aversion, self and social image concerns share a more self-regarding flavor. This does not mean, however, that truly other-regarding preferences and image concerns are mutually exclusive. In fact, it appears quite plausible that individuals simultaneously hold various other-regarding and image-based motives. In terms of quantitative importance, a recent meta-analysis finds that other-regarding motives appear to be considerably more important compared than self-image concerns (Vu et al. 2023). Moreover, both self and social image concerns do not seem to lend themselves to easily explain the rejection of low offers in ultimatum games or the payoff-reducing behaviors observed in allocation tasks with positively sloped budget lines because these behaviors lack a clear prosocial meaning.

Image concerns imply that situational and institutional factors, that are completely irrelevant and innocuous in a world without image concerns, can become highly relevant. Self-image concerns can be mobilized for prosocial behaviors by removing uncertainties about the prosocial effects of these behaviors, by reducing opportunities that enable plausible deniability, or by making decisions to remain uninformed public knowledge. All these precautions reduce the likelihood that players can deceive themselves into believing they are more altruistic than they in fact are. Likewise, making decisions transparent and publicly known to relevant others activates social image concerns.

The delegation of decision-making rights to agents, combined with ignorance about the agents' decisions, is an institutional set-up that appears particularly prone for mitigating responsibility for problematic behaviors. There is, in fact, a considerable experimental literature that documents the responsibility-alleviating and self-interest enhancing capacities of delegating decision-making rights (Charness 2000; Fershtman and Gneezy 2001; Charness and Jackson 2009; Hamman, Loewenstein and Weber 2010; Bartling and Fischbacher 2012), and image concerns might also drive the behaviors observed in these experiments.

Authoritarian rulers, emperors, and mafia bosses have long known about such responsibility-alleviating effects as they often let others do the dirty work. Experimental evidence also suggests that those who delegate and hope that their agents implement selfish

allocations on their behalf indeed receive less punishment compared to those who directly enact the selfish act. Although the literature on delegation and responsibility is exciting, space constraints induce us to defer it to Appendix 9.

#### **4. Economic and Political Consequences of Social Preferences**

Like time and risk preferences, social preferences have broad implications for a wide variety of domains. In Section 4 we review evidence how social preferences (i) affect employees' responses to wage inequality and wage cuts, (ii) the extent to which this affects firms' employment decisions, (iii) how they affect the allocation of workers with varying prosociality levels to different industries, (iv) how incentives and contract are influenced by them, and (v) how they affect the political demand for redistribution. These topics do not exhaust the consequences of social preferences, but space constraints force us to limit consideration on the above-mentioned issues. For this reason, we mention here only briefly two other important topics for which they are relevant: Cooperation and normative public economics ("welfare economics").

There is a large theoretical and empirical literature on the role of social preferences for cooperation and collusion, including several review papers (e.g., van Lange et al. (2014); Fehr and Schurtenberger (2018); Balliet, Mulder and van Lange (2011)). Theory suggests that altruistic preferences tend to facilitate cooperation while the role of behindness aversion or negative reciprocity is more nuanced and depends on the possibility, and specific features, of peer punishment opportunities. If such opportunities are provided in public goods experiments, behindness aversion and negative reciprocity are motivational forces that facilitate the punishment of free-riders which helps to maintain cooperation levels (Fehr and Schmidt 1999, Fehr and Gächter (2000), Falk and Fischbacher 2006). However, if such opportunities are absent, these forces may have detrimental effects on cooperation and induce players to cease cooperating.

The relevance of peer pressure and peer punishment has also been established in recent field studies of large-scale cooperation. Breza, Kaur and Krishnaswamy (2019) studied whether large groups of decentralized workers cooperate to prevent downward pressure on wages. They implemented a field experiment in 183 local labor markets in rural India and show that only 1.8% of agricultural workers are willing to accept jobs below the prevailing wage when this choice is observable by other workers. In addition, they document that this

unwillingness to accept low wages is due to workers willingness to sanction those who accept wage cuts, and if acceptance of low wages is not observable (and thus cannot be sanctioned by their peers) the willingness to undercut the going wage increases substantially. Moreover, consistent with the aggregate implications of downward rigidity, Breza et al. also show that measures of social cohesion in local markets correlate with downward wage rigidity and its employment effects across India.

Another powerful real-world example of large-scale cooperation supported by peer punishment is provided by the hugely successful recruitment of soldiers for the British Army at the beginning of World War I when the army relied entirely on the voluntary recruitment of soldiers. Between August 1914 (when Britain declared war on Germany) and September 1914 roughly 479 000 volunteers were recruited and until December 1915 roughly 2.5 million men joined the British Army voluntarily. Those who did not join faced the contempt of their community members who attached big red patches to the free-riders' front doors at night, so that everybody could see that the person living there was a dodger (Simkins (1988)). Recently, Becker (2022) documented how young women publicly shamed young men who refused to join the army. In many towns and cities, the women handed out white feathers to men in civilian clothes, marking them out as cowards. The young women often took substantial risk when doing so because the affected men retaliated. Becker collects evidence from local newspaper articles and exploits the gradual spread of the movement to show that during the 10 days after the first mention of White Feather Girls in the news, volunteering surged by a third.

Cooperation is not always a good for the overall society. The cooperation between companies for the purpose of maintaining high prices, or the cooperation within criminal organizations is an example. Another example is vote-buying, a frequent practice in many countries with weak democratic institutions. In a fascinating study, Finan and Schechter (2012) document how social preferences for reciprocity facilitate vote-buying in municipal elections in Paraguay. Vote-buying constitutes a serious puzzle in a secret voting environment with selfish voters because they cannot commit to vote for the candidate who tries to buy their vote. A selfish voter would just take the bribe and merely claim that he or she voted for the bribing politician. However, if voters have an intrinsic preference for reciprocity this commitment problem can be overcome.

In Paraguay, politicians hire respected community leaders in each village to interact with voters and offer them money and other forms of aid for the promise of their vote. Finan

and Schechter (2012) show that these community leaders have a very good knowledge of individual voters' preferences for reciprocity and preferentially target reciprocal voters for vote-buying. A one standard deviation increase in reciprocity increases the likelihood of being targeted for vote-buying by 44% - a finding that is robust to a large set of controls including other social preferences and voters' network relationships in the village.

Another domain where social preferences matter is the role of individual heterogeneity in public goods provision. The theory of inequality aversion predicts that groups that are more heterogeneous – in terms of their wealth (endowments) or in terms of the benefits they derive from public goods – are less likely to achieve and maintain successful cooperation, a prediction that is supported by a large experimental literature (Chan et al. 1996; Chan et al. 1999; Anderson, Mellor and Milyo 2008) and consistent with field observations (Mayer 2001; Fajnzylber, Lederman and Loayza 2002).

The influence of prosocial preferences on groups' abilities to maintain high levels of cooperation has been documented in Gächter and Thöni (2005). They measured individuals' willingness to cooperate in a one-shot social dilemma game and subsequently formed three types of homogeneous groups: (i) groups comprising individuals with a high prosocial preference, (ii) intermediate groups and (iii) groups comprising selfish individuals. Gächter and Thöni show that aggregate group cooperation in public good games with a dominant free-riding strategy is close to maximal in groups of type (i), intermediate levels of cooperation are achieved in groups of type (ii) and the lowest cooperation levels prevail in groups with predominantly selfish individuals.

These lab findings are nicely echoed in field evidence. Rustagi and Kosfeld (2015) measured prosocial and antisocial tendencies of village leaders in Ethiopia in a third-party punishment game. These leaders were responsible for monitoring and sanctioning of free-riders communities that are strongly relying on the successful management of forest commons. Rustagi and Kosfeld show that villages with prosocial leaders have significantly better forest outcomes. These results continue to hold after careful consideration of reverse causality issues and omitted variable bias. Similar results of the effects of prosocial preferences on cooperation have been reported in Rustagi, Engel and Kosfeld (2010) and Carpenter and Seki (2011).

Social preferences are also important for welfare economics. If individuals display altruistic or inequality averse distributional preferences, it may not make much sense to



compute optimal policies on the basis of social welfare functions that assume that every individual only cares for his or her own consumption. Isn't economics, after all, built on a deep commitment to respect individuals' preferences? Likewise, if people care also for equality of opportunity, it appears of paramount importance to incorporate that notion into modern welfare economics rather than computing optimal policies on the basis of a standard utilitarian welfare function that assumes that individuals only care for their own consumption.

With regard to the incorporation of distributional preferences into welfare economics there has been some progress recently. In a recent AEA Distinguished Lecture, Emmanuel Saez (2021) emphasized the importance of concerns about inequality, poverty and relative position for positive and normative public economics. Likewise, Aronsson and Johansson-Stenman (2020a) have studied optimal income taxation in the presence of externalities and inequality averse individuals, and the same authors have derived optimal second-best taxation conditions when individuals have social preferences (Aronsson and Johansson-Stenman 2020b). And more recently, Eden and Piacquadio (2023) discussed the normative content of other-regarding preferences. However, despite these recent studies, it is probably fair to say that the bulk of normative economics neglects other-regarding preferences.

## **4.1 Implications of Social Preferences for Labor Relations and Macroeconomics**

### **4.1.1 Fairness Concerns, Wage Inequality, and Job Satisfaction**

If people care for equity and reciprocity, it is likely that wage inequalities that violate their equity standards will have detrimental effects on performance and satisfaction. This viewpoint is expressed by many practitioners in Human Resource Management. Bewley (1999) who interviewed several hundred personnel managers about pay-related issues concludes, for example: "The main function of internal structure is to ensure internal pay equity, which is critical for good morale" (p. 82). However, are the views managers express in surveys and interviews also backed by *behavioral* data from laboratory experiments and field studies? As we will see below, the behavioral data generally provide a strong endorsement for the role of fairness and equity concerns in the assessment of wage inequalities and indicate the conditions under which pay inequalities have detrimental effects on performance.

The notion of inequity aversion implies that employees who work under identical conditions and provide identical effort should be paid identically. If, instead, they are offered

unequal wages, the prediction is that workers who dislike disadvantageous inequality and receive a lower wage will reduce their effort. Gächter and Thöni (2010) conducted a laboratory experiment in a repeated one-shot gift exchange setting (i.e., an environment with noncontractible effort) in which one experimental employer faces two workers and makes flat wage offers,  $w_i$  and  $w_j$ , to each of the two workers. The workers are then informed about  $w_i$  and  $w_j$  after which they choose their effort levels  $e_i$  and  $e_j$  which are associated with effort costs of  $c(e_i)$  and  $c(e_j)$ . Gächter and Thöni find indeed that disadvantageous wage discrimination for worker  $i$  (i.e., increasing  $w_j$  for a given level of  $w_i$ ) reduces her effort level, while advantageous wage discrimination (i.e., decreasing  $w_j$  for a given level of  $w_i$ ) leaves  $e_i$  unaffected.

In subsequent studies (Gächter, Nosenzo and Sefton 2012; Gächter, Nosenzo and Sefton 2013), the authors also showed that social preferences affect workers' effort behavior even in the absence of wage inequality. Their design is similar to that of Gächter and Thöni (2010), but after the workers observed the employer's wage offer, they chose their effort levels sequentially. Thus, the effort level of employee 1, who chose first, could affect the effort level of employee 2, who chose second. It turns out that if both workers received generous wage offers, the effort level of employee 2 is strongly positively correlated with the effort level of employee 1 – a finding that inequality averse preferences predict.

The lab-based papers discussed above implemented a situation where all parties knew wages, effort levels, and the workers' output at different effort levels. In this set-up, the involved parties have clean data that enables them to compare their outcomes. However, what happens if, e.g., there are large productivity differences between the workers, but they do not know the exact differences and are only informed that their productivity differs? In this case, social comparison processes are necessarily based on less precise information which – depending on workers' beliefs about the co-worker's productivity – may strengthen or weaken the impact of differential wage payments on effort choices. For example, if workers believe that productivity differences are minor, then wage inequality may have negative effects on effort, while they may consider wage differences to be more justified if workers believe that there are large productivity differences. Charness and Kuhn (2007), who were the first to implement three-player (one-shot) gift exchange games, implemented a design like the one described above. They report that co-workers' wages do not affect workers' effort choices. A possible interpretation of this finding is that the subjects in their experiments do not have social preferences. This is, however, unlikely to be the case because workers

responded strongly with their effort choices to generous *own* wages. An alternative interpretation is that workers believed that there are large productivity differences that justified differential wage payments.

To what extent are the findings above about the negative effort spillovers of higher co-workers' wages generalizable to the field? Cohn et al. (2014) implemented a wage cut in a field experiment that offered a one-time job opportunity to workers who performed the job in teams of two. The firm placed a job advertisement stipulating an hourly wage of about €10 on an online search platform. The task for both workers was identical and consisted of selling promotional cards that permitted entrance to specific nightclubs. The experiment had two phases that were spread over two subsequent weekends with 6 hours of work per weekend.

In phase one (the first weekend) both workers received the same the same hourly wage of €12 while in phase two (the second weekend) either (i) none of the workers or (ii) only of the two workers or (iii) both of the workers received a wage cut of €3 relative to the first weekend. Note that even the workers who received a wage cut on the second weekend earned a higher total income for the overall job ( $6 \times 12 + 6 \times 9 = 126$ ) than that which they initially could have expected with the hourly wage of about €10 initially announced ( $12 \times 10 = 120$ ).

The authors find that a unilateral wage cut leads to a 34% reduction in the performance of the worker whose wage is cut relative to the no-wage cut group while the performance of the worker whose wage is not cut remains unchanged.<sup>40</sup> Thus, similar to the lab experiments discussed above, disadvantageous wage inequality is associated with a large negative effect on effort, while advantageous wage inequality leaves effort unchanged. One might therefore expect that a multilateral wage cut would lead to a smaller effort reduction compared to a unilateral wage cut, which is indeed what Cohn et al observed. A multilateral wage cut to both workers reduced their performance “only” by 15% relative to the no-wage cut group, and this difference between the unilateral and the multilateral cut is highly significant. These findings are in line with the predictions of a model of inequality aversion.

Breza, Kaur and Shamdasani, henceforth BKR, (2018) implemented a month-long field experiment with Indian manufacturing workers who worked for a daily wage. Their study provides a rich collection of facts regarding the relevance of wage inequality for workers'

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<sup>40</sup> To interpret this finding, it is useful to understand that while the two workers in a “team” worked during the same shift and in the same environment (e.g. at a well frequented subway station) there was no interdependence in their task and their interactions during a shift were minimal. In particular, they had little information about their co-workers' effort during the shift.

daily labor supply (i.e., showing up for work), their effort during work, and the impact of wage disparities on the subsequent ability to cooperate in other tasks.

BKR assembled production units consisting of three workers who sit together in a separate physical space during work and lunch breaks. The workers in a production unit thus form a natural reference group. They randomized workers into (i) a pay disparity condition where the daily wage reflected workers' baseline productivity that was assessed during an initial training period, and into (ii) a pay compression condition in which all three members of a unit are paid the same wage. By randomizing workers with different baseline productivities to production units, they introduced variation in the extent to which pay differences overstate productivity differences in the disparity condition. And by randomizing production units to different tasks that differ with regard to the observability of co-workers' output, the authors can examine the impact of output observability on effort during work. In addition, the authors also measured workers' attendance on the job (they are only paid when they appear on the job) and their knowledge about co-workers' wages within and across production units. BKR show that workers within a unit are well aware of their co-workers' wages, while little wage information travels across production units.

BKR find that for workers with a similar baseline productivity and a given absolute pay level, a worker's output declines by 0.33 standard deviations (22 percent) on average when the worker is paid less than his two co-workers. Moreover, holding the level of absolute pay constant, there is no evidence that receiving a higher wage than one's peers increases output. In fact, pay inequality in the presence of similar baseline productivities across workers appears to cause a general dissatisfaction with the job situation in the sense that both overpaid and underpaid workers reduce their attendance at the job compared to the compressed pay condition. This means that the workers in the pay disparity group give up valuable earnings – on average by 9.3% - by substantially reducing attendance.

Note that these facts about the effect of over and underpayment on effort/output nicely coincide with the lab findings of Gächter and Thöni (2010) and the field findings of Cohn et al (2014). BKR also show that in tasks where individuals' productivity differences are easily observable, paying different wages has no negative impact on workers' output. This suggests that wage inequality has no negative effect when productivity differences justify pay differences – a finding that is consistent with our interpretation of the lab evidence in Charness and Kuhn (2007).

BKR also report a remarkable finding about the detrimental impact of unjustified pay disparities on the subsequent ability of workers to cooperate even when it is in their self-interest to cooperate. On the last day of their job, the workers participated in two cooperative games in each of which they could earn money on the basis of group piece rates for performance. The outcome of these games did not affect the firm's payoff. In the first game, the members of a unit had to build towers of raw materials; the higher the tower, the more each worker in the unit earned. In pay disparity units with little or no baseline productivity differences, the workers built towers that were 17% shorter on average compared to the compressed pay units. In contrast, when pay differences were justified – based on baseline productivity or task observability – pay disparity units performed equally well as compressed pay units do.

Finally, their endline survey reveals that workers from pay disparity units show a significantly lower social cohesion – in terms of their willingness to borrow or lend, seek or give advice or visit one another's homes – compared to workers in the compressed pay group.

More recently, Cullen and Perez-Truglia (2022) conducted a field experiment on the effects of salary comparisons with a sample of 2060 employees from a large corporation in Southeast Asia. They document substantial misperceptions of managers' and co-workers' wages and identify the causal impact of changes in salary perceptions with the help of an information provision experiment. They find that a higher perceived peer salary has a large negative effect on employee's own effort. A 10% increase in employee's perception of peer salaries significantly reduces the number of hours they work by 9.4%, the number emails they send by 4.3% and the sales performance by 7.3%. The authors also collected survey evidence that is consistent with the view that social preferences are the mechanism underlying these peer comparison effects, as they also find that higher perceived peer salaries have negative effects on pay and job satisfaction.

These negative effects of peer salaries on job satisfaction are consistent with the findings of Card et al. (2012), who conducted a field experiment with “University of California employees” by providing them with easy access to information about peer salaries. Employees who had salaries below the peer median subsequently displayed a reduced job satisfaction and an increased intention to switch jobs, while those with salaries above the median showed no changes in job satisfaction and no intention to switch. These findings are consistent with the view that employees have a considerable aversion against disadvantageous inequality.

D'Ambrosio, Clark and Bazzaretta (2018) provide further evidence for the role of fair reference wages on quitting behavior using data from the German Socio-Economic Panel (SOEP). The SOEP contains panel data on which income people consider as fair for their current job. They show that individuals' fair income gap (the difference between what they earn and what they consider fair for their current job) is not only significantly associated with individuals' life and job satisfaction, but it also influences workers' emotional states such as the frequency of feeling happy or feeling sad and a strong influence on the frequency of experiencing anger. Finally, consistent with these findings on subjective assessments of well-being, the fair income gap also predicts the probability of quitting within the next year.

The evidence provided by Dube, Giuliano and Leonhard (2019) further provides strong support for the view that fairness concerns involving comparisons with (higher) peer wages have a substantial impact on workers' quitting behavior. The authors estimated the own-wage and the peer-wage elasticities of employees' job quitting behavior at a large US retailer with hundreds of stores nationwide. They exploited a regression discontinuity that resulted from the firm's response to the federal minimum wage increases in 1996 and 1997 to identify the causal effect of own and peer wages on quitting behavior. The results show that job separations are extremely sensitive to rising peer wages with peer wage elasticities of 20, 9 and 3 for three, six and nine months after the raise. This result contrasts sharply with the rather low own-wage elasticities they found. Their estimates suggest that, holding the gap between own and peer wage constant, a uniform raise in wages has no impact on quitting behavior. Thus, the overall effect of wages on separations is mostly driven by peer comparisons.

Finally, Dube et al. show that the peer wage effects are asymmetric because they are driven by comparisons with higher paid peers, which again suggests that aversion against disadvantageous wage inequality is an important driver of labor market behavior. The overall findings from surveys, lab experiments, and field evidence suggest that aversion against disadvantageous wage inequality that cannot be justified by effort or productivity differences generates strong behavioral effects in terms of a reduced willingness to perform, an increased willingness to quit, a lower job satisfaction, a reduced social cohesion and lower willingness to cooperate.

#### 4.1.2 Fairness Concerns and Resistance to Wage Cuts

There is a considerable literature indicating the importance of fairness concerns for the presence of downward wage rigidity. Surveys conducted by Kaufmann (1984), Blinder and Choi (1990), Agell and Lundborg (1995; 2003) and Bewley (1995; 1998; 2002) all point in the direction that workers strongly resist (nominal) wage cuts for fairness reasons even in recessions, and that personnel managers are keenly aware of this resistance. While these surveys do not pin down the concrete social preferences underlying workers' fairness concerns, a plausible interpretation of the evidence suggests that preferences such as negative reciprocity or inequality aversion (with suitable reference points) may provide the motivational raw material for these concerns.

Because fairness concerns induce workers to resist wage cuts and personnel managers anticipate this resistance, the survey evidence suggests that firms will be very reluctant to cut wages, which in turn mitigates labor market adjustments to exogenous shocks. There is indeed substantial laboratory and field evidence of downward wage rigidity and often the data point towards the existence of fairness concerns as the underlying mechanism.

Regarding the field evidence related to whole labor markets, Dickens et al. (2007) document wage rigidity in many countries. Fehr and Goette (2005) show downward nominal wage rigidity for Switzerland, while Grigsby, Hurst & Yildirmaz (2021) document it for the US. In addition, Fehr and Goette (2005) show that downward wage rigidity is negatively related to employment and Kaur (2019) also finds that it is associated with employment distortions. Kaur studies downwards rigidity in the context village labor markets in India and documents strong rigidity. In addition, she reports that Indian village workers consider nominal wage cuts to be very unfair, suggesting that fairness related resistance to wage cuts is driving rigidity. Interestingly, workers do not consider *real* wage cuts that arise from avoiding nominal pay rises in response to inflation to be unfair – a finding that is consistent with data reported in Kahneman, Knetsch and Thaler (1986).

Firm-level evidence is provided by Greenberg (1990) who reports that workers responded to a temporary wage cut that was triggered by a negative demand shock, with an increase in employee theft during the period for which pay was cut. Krueger and Mas (2004) document that workers at Bridgestone/Firestone's Decatur, Illinois, plant responded to the firm's attempt to cut wages and hire replacement workers with the provision of lower quality tires. Their monthly data show that defective tires were produced primarily during those

months in which the firm demanded wage reductions and incumbents worked side by side with replacement workers.

Coviello, Deserranno and Persico (2022) report evidence on workers' responses to a wage cut in a sales call center in the US. This company paid its sales representatives on the basis of two performance indicators: commissions based on net sales (gross sales minus refunds due to dissatisfied customers) and conversion rates (percentage of calls resulting in positive gross sales). When the company raised the *required* conversion rates, which was associated with a 13% earnings reduction at a given performance, many sales representatives responded by keeping gross sales constant but increasing customer refunds by intentionally selling suboptimal items to the customers. Note that this behavior not only hurt the company but also the workers themselves, indicating that workers were willing to take costly actions to punish the firm for cutting their wages.

Labor relations are often long-term. Therefore, if workers respond to wage cuts with reduced effort, sabotage, or higher theft rates, one may interpret this as a rational punishment for employers in a repeated game, i.e., the workers' responses may not necessarily result from their social preferences. For this reason, it is useful to study responses to wage cuts in more short-term employment situations in lab and field experiments where there is no prospect for future employment.

The laboratory evidence on downward wage rigidity comes from experimental labor markets (e.g., Fehr, Kirchsteiger and Riedl (1993); Fehr and Falk (1999); Charness (2004); Charness and Brandts (2004); Brown, Falk and Fehr (2004)) that are designed in such a way that in the absence of social preferences, employers have an incentive to pay competitive wage levels that are rather low. However, if effort is non-contractible and workers respond to the low competitive wage levels with lower effort (due to social preferences such as reciprocity or inequality aversion), even selfish employers have a pecuniary incentive to pay high, non-competitive wages. The evidence from these experiments indeed indicates that employers are reluctant to cut wages to competitive levels because they will then receive low effort levels from their workers. The experiments also show that even in the presence of a large excess supply of workers, the experimental employers shy away from cutting wages to low, competitive levels because of anticipated detrimental effects on workers' performance.

Do the negative effort responses triggered by wage cuts in the lab generalize to field experimental settings that credibly rule out repeated game effects? There are studies



indicating that the answer is “yes” (Kube, Marechal and Puppe 2013; Cohn et al. 2014). We discussed already the negative productivity effects of wage cuts in Cohn et. al. in the previous section. Likewise, the evidence in Kube, Marechal and Puppe (2013) indicates large negative productivity effect of 20% from a wage cut relative to a no-wage-cut treatment.

Another interesting study documenting the employment effects of downwards wage rigidity is Breza, Kaur and Shamdasani, BKR, (2021). These authors implemented hiring shocks in local Indian labor markets by giving jobs to an average of 24 percent of the labor force of casual male workers in *external* jobsites for two to four weeks – a shock that substantially reduced how many workers remained in the local economy.

Their approach exploits the strong seasonality in labor demand in these local labor markets. The hiring shock led to immediate and strong rises in wages and a fall in employment in the local markets during the peak season, when demand for casual labor is generally high. However, in the lean season, when the demand for casual labor is generally low, the hiring shock had basically no impact on employment and wages in the local market. This is a remarkable finding since there were apparently enough unemployed workers who filled the gap generated by removing 24 percent of the available labor force, indicating severe rationing of labor supply – a finding that could not have happened in a competitive labor market with flexible wages. If the local labor market during the lean season had been cleared before the hiring shock, then the shock also should have led to large wage increases and a fall in employment. However, apparently there were enough unemployed workers before the hiring shock who were willing to work at the going wage but could not find employment at that wage. This made it possible for employers to find enough workers without needing to raise wages despite the considerable reduction in the local labor force. Breza, Kaur and Shamdasani also provide evidence indicating that moral hazard or nutrition efficiency wage models cannot explain their data, while a model that relies on workers’ resistance to wage cuts can.

Quach (2020) provides evidence for downward wage rigidity by exploiting the following natural experiment from the US. In May 2016, the federal Department of Labor announced that starting December 1, 2016, salaried workers earning less than \$913 per week would be entitled to overtime compensation if they work more than 40 hours in a week. In response to this announcement, many employers promised raises to their employees in anticipation of the new rule. However, one week before the rule became effective, a federal

court ordered an injunction on the new policy, implying that the employers would not face any legal obstacles if they wanted to refrain from the promised pay rises.

Quach (2020) shows that employers nevertheless increased wages. For the median worker, for example, wages rose by 5.8%, suggesting the employers shied away from cutting nominal wages to pre-announcement levels. The pay rises took the form of bunching many employees at \$913 per week and reclassifying some workers from salaried pay to hourly pay. Quach also shows that workers who received pay rises through bunching experienced the same wage growth compared to workers slightly above the bunching threshold, suggesting that firms did not lower the future wage growth of workers whose wages exhibited rigidity. Moreover, the paper shows that even a year after the proposed overtime policy was nullified, the employers continued to bunch the salaries of new hires at the \$913 threshold, indicating that wage nominal wage rigidity also affected the new hires.

The evidence from Quach (2020) suggests that even the mere promise of a pay rise based on a *temporary* legal requirement makes it hard for employers to subsequently lower wages. This finding is also consistent with the laboratory evidence documented in Fehr, Falk and Zehnder (2006) where the temporary implementation of a legal minimum wage led to lasting effects on wages that prevailed even long after the legal minimum wage was removed.

#### **4.1.3 Screening and Selection based on Social Preferences**

If social preferences are a relatively stable attribute of individuals, employers may want to attract workers with particular social preferences and avoid workers with others. Workers with altruistic preferences, e.g., may be valuable for employers because they generate positive spillover effects on other workers in interdependent production processes. Conversely, employers may shy away from workers with envious or spiteful social preferences because they may have detrimental effects on cooperation among employees and between the envious employee and the employer. Likewise, employers might avoid workers who are negatively reciprocal because they may have a strong tendency to engage in counterproductive activities when they are aggrieved.<sup>41</sup>

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<sup>41</sup> Selection and sorting only make sense if individuals' social preferences or their assignment to a particular social preference type exhibits a reasonable degree of stability over time. In Appendix 9, we discuss evidence suggesting that this is the case.

With regard to self-selection of employees, there is a relatively large literature suggesting that people with more prosocial inclinations tend to self-select themselves to a higher degree into the public sector in countries with a high degree of trust into the public sector (e.g., Dur & Zoutenbier (2014)). Most of these studies are based on self-reported data about motivation or self-reported prosocial actions. However, evidence based on revealed preference data also exists. Buurman et al. (2012) show that early career public sector workers are more likely to donate to a charity compared to observationally equivalent private sector workers. Gregg et al. (2011) study British Household Panel Data and show that workers who are more prosocial – in terms of providing unpaid overtime work – are more likely to sort into the non-profit sector. They also find that this effect is strongest for industries with “caring characteristics” such as health, education, and social care.

Prosocial individuals may not only prefer working in companies and sectors with caring or helping characteristics, but they may also shy away from sectors or companies involved in immoral business practices such as the intentional sale of toxic financial assets, the marketing of tobacco products to underage smokers, or the aggressive marketing of opioids by the pharmaceutical industry. Schneider, Brun and Weber (2020) used administrative, laboratory, and survey data to study the hypothesis that the least prosocial (i.e., most immoral) people are most likely to work in jobs perceived to involve (or actually involving) immoral activities. Moreover, if working for a company/industry that is perceived to be involved in immoral activities is emotionally aversive, standard economic theory would predict compensating wage differentials. In other words, labor market competition would induce companies/industries perceived to be more immoral to pay, *ceteris paribus*, higher wages.

To examine the compensating wage differentials hypothesis, they collected survey data from the Swiss population on the perceived morality/immorality of different industries in Switzerland. Then they regressed the gross hourly wages across the industries on the industries’ perceived immorality, controlling for observable industry and workers’ characteristics. The results indicate a strong positive correlation between the perceived immorality and the gross hourly wages, with industries such as tobacco and weapons manufacturing paying the highest wages and construction and sports facilities being among the lowest paying industries.

Because the correlational evidence from administrative data is, of course, not yet fully convincing, they also collected a measure of prosociality (immorality) where subjects had the chance to earn more money by giving wrong advice that reduced both (i) another individual’s

earnings and (ii) charitable donations to UNICEF. In addition, the subjects also participated in a separate competitive experimental labor market with two different treatment conditions – a neutral work condition and an immoral work condition. In the immoral work treatment, the subjects were competing for jobs that required them to give wrong advice to another individual that reduced that individual's earnings *and* the charitable donations to UNICEF. In the neutral treatment, the job involved giving advice that increased another individual's earnings and donations to UNICEF.

The striking result of this experiment is that the reservation wages, and thus the competitive equilibrium wages, for the immoral job are much higher than for the neutral job. Moreover, subjects with less prosocial preferences have a much higher frequency of employment in the market involving the immoral task. Thus, the lab experiments provide causal evidence for compensating wage differentials for immoral jobs and for selective sorting of more immoral individuals into these jobs. Finally, the authors also show with the help of survey evidence that subjects who are less prosocial are more willing to work for industries perceived to be more immoral.

Dohmen et al. (2009) provide further evidence on the sorting/selection hypothesis of social preferences. Their results suggest that workers' attitudes towards positive and negative reciprocity can have quite far-reaching effects on their workplace behavior and their earnings. They exploit an interesting survey measure of reciprocal preferences developed by Perugini et al. (2003). This personality questionnaire was developed and psychologically validated with the intention to identify positive and negative reciprocity as independent preference characteristics, i.e., the questionnaire is deliberately designed to minimize the correlation between positive and negative reciprocity. This survey measure of intrinsic reciprocity was included in the German Socio-Economic Panel (SOEP) in 2005, and Dohmen et al. (2009) used it to estimate the association between workers' willingness to voluntarily provide effort (in the form of overtime work) and their positive and negative reciprocity.

Controlling for a large number of individual characteristics, Dohmen et al. show that positive reciprocity measured in 2005 is significantly associated with workers' actual overtime work in the years 2005 as well as in the years 2006 and 2007. Moreover, the coefficient on positive reciprocity is almost twice as large for workers who perceived their current wage as fair, while if workers perceive their current wage as unfair, the association between overtime work and positive reciprocity is zero. These results are consistent with the

view – derived from theories of inequity aversion and reciprocity – that wages perceived as fair induce reciprocal workers to increase their work effort.

Dohmen et al. also find that negatively reciprocal workers are less willing to perform overtime work. In addition, they show that positively reciprocal workers are less likely to be absent from the workplace, while negatively reciprocal workers are more absent. Likewise, positively reciprocal workers “consume” fewer days for paid sick leave while negatively reciprocal workers are more days on paid sick leave.

Based on these results, one would expect that positively reciprocal workers are more valuable employees, i.e., that the labor market will reward them with higher wages, while negatively reciprocal workers are less valuable. Dohmen et al. estimate Mincer-type wage equations and find indeed, that positively reciprocal workers earn higher monthly and annual labor incomes. They do not find a negative impact of negative reciprocity on wages but instead they show that negatively reciprocal workers have a higher probability of being unemployed while positive reciprocity reduces the probability of being unemployed.

Barr and Serneels (2009) conducted trust games with several hundred employees from 20 manufacturing companies in Ghana; 164 of them were in the role of the second-mover, which provides a (noisy) measure of the workers’ willingness to display reciprocal behavior. Note that the first-mover in this game reaps a positive rate of return if she gets back more than what she transferred. Barr and Serneels categorize a worker as highly reciprocal if his back-transfer yields a rate of return for the first-mover of more than 50%.<sup>42</sup> The authors show that the output per worker across companies is strongly positively correlated with the share of high reciprocators among employees. This correlation persists when controlling for capital inputs and sector fixed effects. Moreover, a Mincer-type earnings regression that includes a dummy for highly reciprocal workers indicates that these workers earn a wage premium.

Although the papers by Dohmen et al (2009) and Barr and Serneels (2009) do not establish a causal relationship between workers’ willingness to reciprocate and their workplace behaviors and earnings, they nevertheless constitute suggestive correlations that deserve further scrutiny. Their findings are consistent with what one would theoretically expect based on knowledge about the behavioral properties of the involved social preferences and they are also consistent with the literature on the impact of early childhood characteristics

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<sup>42</sup> The parameters of the trust game are such that at a 100% return for the first mover, the payoffs between the two parties are equal, while the second-mover reaps all the surplus generated from the first-mover’s transfer at a zero rate of return.

on later life outcomes. Verdunst et al. (2019) show, e.g., that teachers' ratings of kindergarten boys' prosociality are positively associated with the boys' earnings in adulthood after controlling for a large set of covariates.

The findings in Dohmen et al. and Barr and Serneels are also in line with laboratory evidence of Bartling, Fehr and Schmidt (2012) on the role of employer's screening in experimental labor markets. In these experiments, employers in some treatments can condition their job offers – in terms of wages, rent-sharing, and employees' opportunities for effort discretion – on information about employees' past performance levels in other firms. The experimental employers make ample use of this information and offer completely different compensation packages to the workers depending on their past performance. Workers with high past effort levels – generally based on workers' willingness to reciprocate to generous job offers – receive generous current job packages with high wages, a high share of the overall surplus, and broad opportunities for effort discretion. In contrast, workers with low past performance received mediocre job packages with low wages, no rent-sharing, and tightly controlled effort opportunities. By exogenously varying (i) the employers' screening opportunities and (ii) the degree of labor market competition, the authors are also able to show the causal impact of these factors on the extent to which employers reward workers' reciprocal behavior (i.e., their past performance). These findings suggest that, under the realistic assumption that employers can acquire information about their employees' effort attitudes, positively reciprocally motivated workers are rewarded with better job packages.

## **4.2 The Role of Social Preferences for Contracts, Institutions and Incentives**

### **4.2.1 The Effects on Contract Enforcement and Financial Incentives**

In the past 20 years several authors illustrated the advantages and disadvantages of different incentive schemes in the light of fairness concerns. For example, it has been shown theoretically (e.g. Sliwka (2007)) and experimentally (e.g. Fehr and Gächter (2002); Fehr and List (2004); Falk and Kosfeld (2006)) that explicit incentive contracts may undermine voluntary cooperation that is based on social preferences. As a consequence, explicit incentive contracts may be less efficient than implicit alternatives based on trust, informal bonuses or informal sanctions.

Fehr and Gächter (1997; 1998), for example, tested the impact of trust and reciprocity on contract enforcement in a standard two-stage gift-exchange game where principals commit to

pay a wage and state a desired effort level, and workers respond to the offer with an effort choice. In an additional treatment they added a third stage in which the experimental firms can pay to reward or punish the worker for her effort choice. There was a positive wage-effort relation in both treatments but in the three-stage treatment the average effort level was much higher than in the two-stage treatment. Thus, workers apparently anticipated that firms reward high effort choices and punish low ones. Note that in the absence of social preferences we would neither observe a positive wage-effort relation nor would we see that firms reward and punish at the third stage because the worker-firm interactions were one-shot.

Fehr, Klein and Schmidt (2007) provided evidence suggesting that social preferences may affect the contracts principals offer to their agents. They consider the following three types of contracts: a trust contract in a two-stage gift exchange environment like the one described above, an incentive contract that introduced an explicit incentive into the trust contract and a bonus contract that introduced the option of informally rewarding agents in a third stage. The incentive contract is based on a verification technology that enables the principal to fine the agent in case of verified shirking. The verification technology is imperfect and the fine is limited, implying that the highest effort level that can be implemented is positive but falls short of the efficient effort level. The informal bonus contract contains no explicit incentives but gives the principal the opportunity to reward agents ex-post, i. e., after effort is observed. The bonus contract does not rely on effort verification and enforcement by third parties. Instead, the principal promises a nonbinding, voluntary bonus payment if the agent's effort is satisfactory. This bonus contract is an implicit contract because third parties do not enforce the principal's promise.

If all actors were completely selfish, the incentive contract is the only viable contract, and the trust and bonus contracts would be equally bad. However, in fact the incentive contract dominates the trust contract, but the bonus contract turns out to be much more efficient than the incentive contract. How is it possible that social preferences are not strong enough to render the trust contract more efficient than the incentive contract but strong enough to make the bonus contract the most efficient one? Fehr, Klein and Schmidt (2007) show that inequality aversion preferences can explain this puzzle.

#### **4.2.2 Social Preferences as a Behavioral Foundation for Employment Contracts**

The existence of simple employment contracts that pay a fixed wage and give employers the right to tell the employee what to do (i.e., to exert authority) is a long-standing puzzle in

economics. Why should the trading parties ever agree to such a seemingly inefficient contractual arrangement? Why do they agree on a fixed wage that may prevent trade (i.e., employment) in certain states of the world? Why do they not continuously renegotiate the contract terms to achieve ex-post (i.e., when conditions changed) efficient outcomes, as suggested by Alchian and Demsetz (1972)? And if continuous and efficient ex-post renegotiation is always possible, isn't the characterization of the employment contract as an authority relation thoroughly misguided? A negotiation, after all, means that task assignments are subject to *both* parties' agreement.

Hart and Moore (2008) tackle these and related questions by dropping the assumption that "*ex post* trade is perfectly contractible" and that "renegotiation always leads to *ex post* efficiency" (p. 3).<sup>43</sup> In the absence of perfect ex post contractibility we are in the world of incomplete contracts with gift exchanges and informal relationships where social preferences are typically playing a key role. Moreover, social preferences and their interactions with contractual arrangements are deeply affecting ex post inefficiencies (Fehr, Gächter and Kirchsteiger 1997; Fehr, Klein and Schmidt 2007), and thus also which contracts are most efficient. This raises the question whether social preferences could also render employment contracts with rigid wages more efficient compared to contracts that allow for the flexible adjustment of wages to the prevailing state of the world?

Fehr, Hart and Zehnder (2011) indeed show experimentally that rigid contracts can be superior to flexible contracts. In the experiment, there is ex ante uncertainty whether a good state of the world (e.g., high output prices) or a bad state of the world prevails. In addition, the parties' values and costs in the different states of the world are not verifiable so that state-contingent contracts cannot be written. The advantage of a flexible contract, that fixes only a wage *range* but not the wage *level*, is that it allows adjusting the wage  $w$  such that trade between an employer and an employee is also possible when output prices are low. In contrast, a contract with wages that are rigidly fixed ex ante (i.e., before the state of the world is known) may prevent trade in this situation. The flexible contract may, however, also have a disadvantage because it provides scope for diverging expectations regarding the wage that will be paid ex post. In other words, while the rigid contract pins down wage expectations ex ante and thus avoids ex post disappointments, under flexible wages workers may feel entitled to higher ex post wages in a good state of the world which provides scope for ex post disappointments. In

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<sup>43</sup> Hart and Moore (2008, p. 3) ask the following fundamental question: If the relevant parties can always sit down together ex post (i.e., after the state of the world is revealed) and bargain to an efficient outcome, why should "authority, hierarchy, delegation, or indeed anything apart from asset ownership matter"?



the presence of (i) non-contractible effort levels and (ii) fairness concerns (social preferences) workers may thus shirk more under flexible contracts than under rigid contracts. Moreover, the lower effort levels under flexible contracts may even render that contract less profitable than the rigid one.

The experimental results confirm the above conjectures. The drawback of the rigid contract is that it prevents trade in the bad state of the world, but this is often over-compensated by the fact that rigid contracts elicit considerably higher effort levels in the good state of the world. To prevent disappointments, and low effort levels, in the good state of the world employers pay much higher ex post wages under flexible contracts but still observe a non-negligible amount of shirking. In contrast, under rigid contracts the wage is competitively fixed at very low levels by market competition<sup>44</sup>, and despite these low wages low effort levels rarely occur. Overall, this renders fixed wage contracts more profitable than flexible contracts. Note that under selfish actors this result could not occur because the flexible contract would always dominate the rigid one.

Fehr, Hart and Zehnder (2015) show that the trade-off between trading frequency and effort provision that prevails under flexible contracts is also present when the parties can engage in informal agreements or ex-post renegotiation. Brandts, Ellman and Charness (2016) provide a robust replication of the results of Fehr, Hart and Zehnder (2011). In addition, they conduct a treatment that allows for free-form communication (and thus continuous bargaining) between the trading parties at any point in time. In this treatment, the flexible contract becomes more efficient and is chosen more often than the rigid one. This treatment may be interpreted as implementing an approximation of efficient ex-post contracting. In other words, the absence of such efficient ex-post contracting opportunities, which is a key assumption in the Hart and Moore (2008) approach, is indeed important for the superiority of the rigid contract.<sup>45</sup>

### **4.2.3 Social Preferences, Contractual Incompleteness, and Property Rights**

Many investments are relationship-specific, meaning that they are valuable only within a particular relationship. In the presence of incomplete contracts, such investments bear the risk of being exploited ex-post – the so-called hold-up problem. Rational parties anticipate being

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<sup>44</sup> Under flexible contracts, competition only determines the lower bound on wages.

<sup>45</sup> In practice, companies have rather rigid rules about who is allowed to approach whom in the hierarchy, and for what purpose. Thus, while easily implementable in the lab with a small number of involved parties, continuous free-form communication between the relevant parties is typically not possible in companies.

held up ex post, and thus underinvest in relation-specific assets. The property rights literature shows that the appropriate allocation of asset ownership can mitigate the underinvestment incentive. Incomplete contracting and the associated hold-up problem have thus provided an important economic rationale for the allocation of asset ownership to those parties that are most vulnerable to exploitation (Grossman and Hart 1986; Hart and Moore 1990).

The key assumption behind the property rights approach is that contracts are incomplete, which is justified by assuming that payoff-relevant information is observable to the involved parties but not verifiable by a third-party enforcer. There are many other applications of the “observable but not verifiable assumption” in economics and the assumption has therefore become one of the most important cornerstones of modern institutional economics.<sup>46</sup> However, all these applications of the incomplete contracting approach are subject to a fundamental criticism that has been raised by Maskin and Tirole (1999). They show that if parties commonly observe payoff-relevant information, one can construct an extensive form mechanism that leads to truthful revelation of the relevant information in the *unique* subgame perfect equilibrium of the game implied by the mechanism.

Thus, in principle, one could design contracts that embody this extensive form mechanism, and if the mechanism works as predicted by theory, all commonly observable information could be turned into truthfully reported verifiable information. This means that the *second-best* institutional arrangements derived under incomplete contracting would become superfluous because a superior contractual arrangement exists. The question, however, is whether the above-mentioned extensive form mechanism, which is based on the work of Moore and Repullo (1988), indeed works as predicted.

Fehr, Powell and Wilkening (2021) examine this question experimentally, and show that negative reciprocity thoroughly undermines the functioning of Maskin-Tirole-type mechanisms. Most parties are unwilling to enter a contract that incorporates the mechanism, and if they enter, these contracts typically perform worse than contracts without the mechanism. Intuitively, a key reason for the failure of the mechanisms is that they are based on large fines for the trading parties if they “misbehave”, but the threat and execution of large fines is also likely to induce extreme hostility (i.e., negative reciprocity) between the parties.

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<sup>46</sup> The assumption has, for example, been used to understand property rights and firm boundaries, the optimal scope of governments, problems of privatization, the control of insiders by outsiders through voting rights, financial contracts, and patterns of international trade and technology adoption.

Adding the mechanism to a usual hold-up problem is like handing out guns at a fist fight. The guns are unlikely to make the fight more peaceful.

Thus, social preferences in the form of negative reciprocity undermine the criticism of the theoretical foundations of incomplete contracting models. Ironically, to the extent to which social preferences are a force that contributes to contractual incompleteness, they help sustain their own behavioral importance. Why? Because incomplete contracts provide the terrain – gift exchanges, informal sanctions and rewards, informal agreements – under which social preferences can play an important role.

Overall, social preferences may contribute to the prevalence of incomplete contracting in two ways. First, they may render institutions like the above discussed mechanisms, that render contracts more complete, dysfunctional. Second, they may mitigate the contracting problems that arise under incomplete contracts. One example of this is the relatively high efficiency of incomplete bonus contracts in Fehr, Klein and Schmidt (2007), which we discussed above. Another example is provided by the large experimental literature on behavior under the hold-up problem (see Yang (2021) for a review). This literature shows that the underinvestment problem is typically considerably less severe than predicted by the self-interest model (see, e. g., Gantner, Güth and Königstein (2001); Ellingsen and Johannesson (2004a; 2004b); Dufwenberg, Smith and van Essen (2013)). A key reason for this is that fairness concerns induce the parties to take their ex-ante investments in the ex-post bargaining process partially into account. This means that the investing parties experience less exploitation than predicted under self-interest which weakens underinvestment. Negative reciprocity and disadvantageous inequality aversion appear to be important forces in this context because they provide a preference-based commitment to credibly reject very unfair offers. Parties who can hold-up their counterparts thus often face the threat of complete disagreement (like in the simple ultimatum game), and therefore they shy away from fully exploiting their ex-post bargaining power.

#### **4.3 The Role of Social Preferences in Politics**

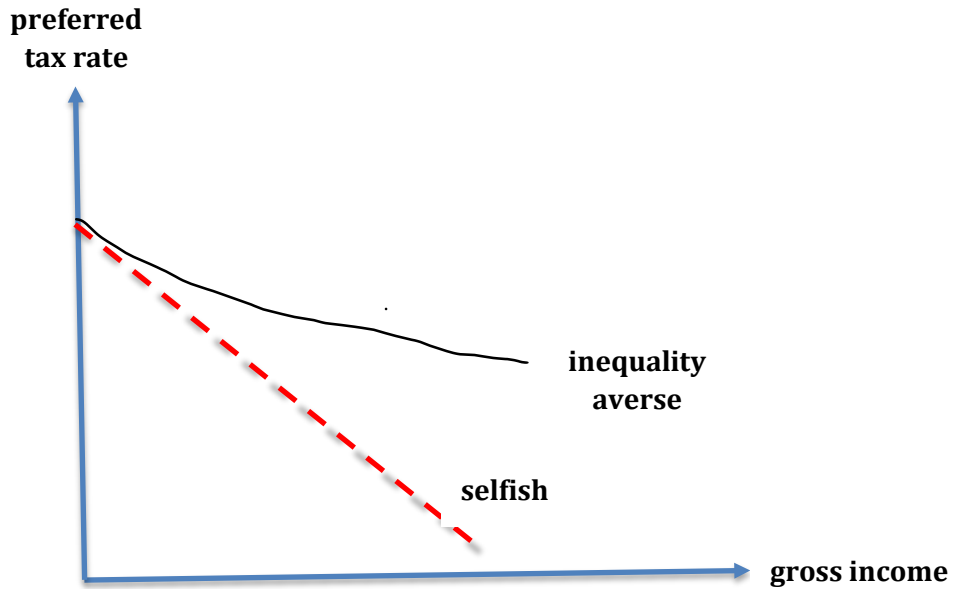
Individuals with non-selfish distributional preferences care not only about their own payoffs but also about payoff distributions. Their preferences should thus also affect their desire to *re-distribute* payoffs, which should affect their willingness to vote for redistributive policy proposals. Suppose, for example, an economic environment like that in the famous model of

Meltzer and Richard (1981), but assume that people are inequality averse. In this environment, individuals face the decision to vote on a proportional tax rate  $\tau$  to be levied on all individuals in the population and redistributed equally as a lump sum. An individual with gross income  $y_i$  who receives a lump sum transfer  $T$  will thus have a consumption level of  $c_i = (1 - \tau)y_i + T$ . Assuming that there are quadratic costs of taxation of  $(\frac{1}{2})\tau^2$  per tax dollar, the government budget is balanced if  $T = \left(\tau - (\frac{1}{2})\tau^2\right)\bar{y}$ , where  $\bar{y}$  represents the average gross income in the population. If one assumes that individuals have Fehr-Schmidt preferences, the preferred tax rate  $\tau^*$  is given by

$$\tau_i^* = 1 - \frac{1}{\bar{y}} \left( y_i - \alpha_i \frac{1}{n-1} \sum_{j \neq i} \max(y_j - y_i, 0) - \beta_i \frac{1}{n-1} \sum_{j \neq i} \max(y_i - y_j, 0) \right)$$

where  $\alpha_i$  captures the aversion against disadvantageous inequality (“envy”) and  $\beta_i$  the aversion against advantageous inequality (“empathy”). The above solution for  $\tau_i^*$  suggests that the preferred tax rates for a selfish and an inequality averse individual may look like those in Figure 8 below.

**Figure 8: Preferred tax rate as a function of gross income and social preferences**



More precisely, the model yields the following predictions and implications for empirical research: (i) Low-income individuals obviously have a selfish reason for choosing redistributive taxation, i.e., even in case of  $\alpha_i = \beta_i = 0$  they favor a high tax rate.

(ii) Selfish individuals ( $\alpha_i = \beta_i = 0$ ) generally demand less redistribution, i.e., have a lower preferred tax rate. However, at low incomes this non-pecuniary driver of redistribution may be difficult to identify empirically because selfish reasons already demand a high tax rate.

(iii) A higher gross income  $y_i$  will generally lower the demand for redistribution but this effect will be mitigated for inequality averse individuals. In fact, the term that multiplies  $(1/\bar{y})$  may become close to zero for very inequality averse individuals, implying that their demand for redistribution does not decline with gross income.

(iv) For individuals with a relatively low income, disadvantageous inequality aversion  $\alpha_i$  is the main non-pecuniary driver of the demand for redistribution because the social comparisons involve many individuals who earn more than the low-income individual.

(v) For individuals with a relatively high income,  $\beta_i$  is the main non-pecuniary driver of the demand for redistribution because the social comparisons involve many individuals who earn less than the high-income individual.

To what extent do individuals in laboratory experiments vote for redistribution? Sausgruber and Tyran (2009) recruited students for a voting experiment in which purely redistributive taxation on the basis of the majority rule was possible. Because low income recipients have a selfish reason to vote for redistribution, they show that even only a little bit of inequality aversion can generate a majority vote in favor of redistribution. Assuming the same distribution of disadvantageous and advantageous inequality aversion in their subject population that assumed in Fehr and Schmidt (1999), they show that the inequality aversion model predicts voting outcomes quite accurately.

Durante, Putterman and van der Weele (2014) conducted perhaps the most extensive lab study on preferences for redistribution in a tax policy setting. Undergraduate students were assembled in groups of 21 subjects. Pre-tax incomes were calibrated to proportionally reproduce the actual US pre-tax income distribution. Each subject made a decision on the preferred proportional tax rate  $t \in \{0.1, 0.2, \dots, 0.9, 1\}$  that generated tax revenue that was equally redistributed as a lump sum to all 21 members of the group. The final group outcome was not determined by voting but by the decision of one randomly chosen subject from the group. This has the advantage that every subject's decision had the same probability of being decisive, i.e., incentive compatibility also held for subjects with extreme preferences.

Durante et al. varied (i) the source of pre-tax income (earned or randomly assigned), (ii) whether the preferred tax had to be chosen before or after pre-tax income is known and (iii)

the direct costs and deadweight losses of taxation. They find that (i) higher direct costs of taxation and higher pre-tax income reduce the demand for redistribution, (ii) subjects more confident about their performance in the task used to determine earned pre-tax incomes also demand lower redistribution, (iii) subjects take deadweight losses of taxation into account when deciding about tax rates, and (iv) most subjects are willing to pay to reduce income inequality among others. Durante et al. also estimate the parameters of a Charness and Rabin model and find that the weight given to increasing the income of the worst-off player in the group is about 3 times higher than the weight given to aggregate earnings.

To what extent are individuals' social preferences predictive of their political behaviors outside the laboratory, i.e., their preferences for left versus right wing parties and their demand for redistribution in the broader society? One problem that arises here is that objective information about individuals' voting behavior is typically not available because individual votes cast are secret. Researchers must therefore rely on non-incentivized surveys. However, as shown below, there are ways to validate individuals' survey answers.

Kerschbamer and Müller (2020) measured the social preferences of a large representative sample of the German population (the German Internet Panel, GIP, see Table 1) that also contained various questions indicating individuals' views on redistribution spread over several survey waves. These are questions like "Should the government mitigate income differences?" or "Should people, who work more and consequently earn more, pay more or less taxes than they currently do?". Kerschbamer and Müller show that, compared to selfish subjects, inequality averse and altruistic subjects have (i) a higher propensity to vote for left-wing parties, (ii) self-report that they more left-leaning, and (iii) are more in favor of redistribution as measured by the first principal component of the bundle of redistribution questions in the GIP. These results also hold when the authors control for age, gender, income, education, risk aversion and patience.

Yet there could be many other potential reasons why people might be for or against redistribution such as their expected future income, their history of misfortunes (i.e., unemployment or negative health shocks), their (false) beliefs about the prevailing inequality, their beliefs about their relative incomes, or their beliefs about the role of luck and effort for economic success in life. All of these reasons have been intensely discussed and examined in the political economy literature on redistribution, which raises the question whether distributional preferences are also predictive of people's demand for redistribution if one controls for these motives. In addition, there is the question of the extent to which answers to

non-incentivized survey questions such as whether the government should mitigate income differences validly capture the demand for redistribution.

Fehr, Epper and Senn (2021) tackle these problems by measuring social preferences in a broad sample of the Swiss population that is representative in terms of age, education, income, and gender. In addition, they elicit measures of the motives for redistribution mentioned in the previous paragraph that allows them to control for these motives. Moreover, they exploit the fact that many strongly redistributive referenda were put to vote under the rules of Swiss direct democracy during the last 10-12 years. Several of these proposals such as the “fair taxes initiative” would have involved substantially higher taxation of high incomes if they had been implemented. Because these redistributive proposals were put to vote in a national referendum, they were broadly discussed in the population and the media. This has the advantage that the people have some memory about the discussed benefits and costs of the proposals and that the survey results on people’s attitudes towards the proposals could be validated with the actual voting results by examining the geographic and sociodemographic distribution of votes with the distribution of survey answers. In addition, Fehr, Epper and Senn (2021) validated the survey results with people’s actual donations to organizations that support or oppose redistributive proposals.

Fehr, Epper and Senn document that their population is characterized by three distinct types of social preferences – a relative majority of inequality averse individuals, a smaller but still large group of altruistic individuals, and a relative minority of predominantly selfish individuals (see panels a and c in Figure 2). They report the following findings: (i) At low incomes, differences in the support for redistribution across the different preference groups is very small. (ii) The support for redistribution declines sharply with increasing income for selfish individuals. (iii) As depicted in Figure 8, social preferences strongly mitigate the decline in support for redistribution. (iv) As a consequence of (ii) and (iii), inequality averse individuals with incomes above the median have a much higher demand for redistribution (0.57 standard deviations higher) than selfish individuals. (v) Inequality averse individuals generally also have a higher demand for redistribution compared to altruistic individuals, but this difference is not significant. However, altruistic individuals demand significantly more redistribution than the selfish ones do. All these results hold when controlling for a host of socio-demographic variables and the other motives for redistribution mentioned above. Taken together, the results thus suggest that social preferences play an important role in the demand for redistribution.

The results discussed above do, however, not yet exhaust the role of fairness concerns and social preferences for the demand for redistribution. The reason for this is that both the Kerschbamer & Müller paper and the Fehr, Epper and Senn paper used a distributional measure of social preferences that does not account for people's concern for meritocracy. In section 3.2 on “who are the meritocrats?”, we reported data that indicate that selfish people show little concern for meritocracy, while altruistic and inequality averse people displayed a relatively strong respect for meritocracy. Thus, when discussing the influence of social preferences on redistribution, it is also necessary to acknowledge the influence of the meritocratic dimension of social preferences.

Starting with Fong (2001), there is a sizeable literature that shows that people's beliefs about the role of effort and luck in economic success in life is a key factor in their demand for redistribution (Alesina and La Ferrara 2005; Alesina and Giuliano 2011). In particular, individuals who believe that effort (and not luck) is a primary driver for success in life often attribute low income to a lack of effort, i.e., people with low income are considered responsible for their situation and do not deserve help through redistributive legislation. The combination of beliefs about the important role of effort with meritocratic concerns thus reduces the demand for redistribution. Moreover, because selfish individuals (see section 3.2) show few meritocratic concerns, a belief about the role of effort should predominantly inhibit the demand for redistribution by altruistic and inequality averse individuals. This is exactly what Fehr, Epper and Senn (2021) found. In other words, other-regarding individuals who believe that effort is a primary driver of economic success behave as if their  $\alpha_i$  and  $\beta_i$  parameters are smaller than those who believe that luck is a primary driver. Thus, taking the meritocratic dimension into account leads to a more nuanced view about the role of social preferences in redistributive politics. The widespread existence of meritocratic other-regarding preferences has been documented not only in the laboratory but also in several survey experiments conducted with general population samples (Almas, Cappelen and Tungodden 2020; Cappelen et al. 2022), and can, in particular, also explain the popularity of workfare programs (Fong, Bowles and Gintis (2005); Drenik & Perez-Truglia (2018)). Survey experiments have also documented how social preferences and demand for redistribution in general, and meritocratic preferences in particular, are sensitive to the (mis)perceptions a person holds about society, and her own place (e.g., rank) in it (Cruces, Perez-Truglia and Tetaz 2013; Karadja, Mollerstrom and Seim 2017; Fehr, Mollerstrom and Perez-Truglia 2022).



## 5. Summary and Outlook

Over the previous two to three decades a lot has been learned about the properties, the prevalence and the consequences of social preferences but there is also still a lot that needs to be learned. In the following, we outline several open questions that offer exciting research opportunities.

Perhaps, the most fundamental question is related to the determinants of social preferences. There is already initial evidence suggesting that they are formed in childhood through different role models or different early childhood education practices (Van Lange et al. 1997; Cappelen et al. 2020; Kosse et al. 2020) but the set of societal determinants is probably much larger. For example, is it possible for companies and other organizations to shape the social preferences of their employees by structuring rewards, incentives, and the overall company culture in different ways? What is the effect of detrimental health and income shocks on social preference? How does the break-up of marriages or other events that disrupt or improve the relation between family members or members of a community affect social preferences? A recent paper (Cassar et al. 2022) suggests, for example, that allomaternal care increases prosocial preferences in a community. And how do a society's governance institutions shape individuals' social preferences.

Very little is known about these determinants although Rustagi (2022) recently has made some advances in understanding how a history of self-government and democratic interactions tends to favor preferences for cooperation. He exploits a natural experiment in Switzerland, where during the middle-ages, the absence of an heir resulted in the extinction of a prominent noble dynasty, which enabled some Swiss municipalities to become self-governing whereas others remained under feudalism for another 600 years. Rustagi shows that individuals from self-governing communities display stronger preferences for conditional cooperation (measured in a behavioral experiment) as well as higher voter turnout and higher charitable donations.<sup>47</sup> These findings are also consistent with those of Guiso, Sapienza and Zingales (2016) who show that Northern Italian cities that experienced a period of independence in the Middle Ages have significantly higher prosocial behaviors in terms of

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<sup>47</sup> Because Switzerland tracks every family's place of origin in registration data, Rustagi can identify the "cultural origin" of individuals and document the persistence of cultural transmission at the individual level in a context of historically low migration rates.

organ/blood donations, the frequency of cheating in national exams taken by children in each Italian town and the number of non-profit organizations.

When discussing the potential determinants of social preferences, the relationship between intrinsic social preferences and social norms may also become important. We define a social norm as a commonly known standard of behavior that is based on a widely shared view how individual group members *ought* to behave in a given situation. Thus, in contrast to preferences, which are a property of individuals, social norms are a property of whole groups of people. They constitute an external normative constraint on individuals' behavior that arises from the fact that the normative standard is widely shared and deviations from the standard are met with disapproval, ridicule, and other forms of sanctioning. However, over time external normative constraints may be internalized which turns them into preferences but very little is known conceptually and empirically about these internalization processes, the factors that shape them, and ways to model them (although see Enke (2019); Schulz et al. (2019); Ellingsen and Mohlin (2022)). In addition, there is very little empirical research that simultaneously elicits and measures social norm driven and social preference driven behaviors (for an exception see Carpenter and Robbett (2022)).

Another important unresolved question concerns the determinants of individuals' reference points for their fairness and equity judgements. In the absence of reliable empirical knowledge, models like those of Fehr and Schmidt (1999) have pragmatically assumed that (at least in experiments) equality between the involved parties is a good first-order approximation of individuals' actual reference point. As the section on the role of merit, luck and risk in social preferences has made clear, however, there are many situations in which equality may be the wrong reference point for many individuals. It is therefore important to develop methods that enable the reliable empirical identification of individuals' reference points and reference outcomes. An interesting step in this direction has recently been undertaken by Hvidberg, Thustrup-Kreiner and Stantcheva (Forthcoming) and Xu et al. (2023).<sup>48</sup>

Finally, as already pointed out at the beginning of the section on economic consequences, it would be desirable to study the deeper implications of heterogeneous social

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<sup>48</sup> There exists also an older literature in labor economics that discussed reference points such as one's own past wages, peer wages in the company, the company's ability to pay, workers' perceived contributions, etc. as potential reference points (e.g., Levine (1993)). It is, however, probably fair to say that no firm conclusions have been reached by this literature.

preferences for normative (public) economics. What are optimal institutions, incentives and tax-transfer schedules when the population is characterized by heterogeneous social preferences or if individuals care for equality of opportunity? To answer these questions it is important to move beyond measuring social preferences in bilateral settings and consider how these preferences change when there are many recipients. An interesting step in this direction has recently been made by Charite, Fisman and Kuziemko (2021) who show that people exclusively care of the very poor (positively), the very rich (negatively) and their local “income neighbors” directly above them (negatively). Overall, the role of social preference research for normative and positive public economics may be substantial and, perhaps, change what economists recommend to policy makers.

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# **Online Appendix for**

## **Social Preferences**

### **Fundamental Characteristics and Economic Consequences**

**Ernst Fehr & Gary Charness**

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## Appendix 1

### Heterogeneity in Altruistic Distributional Preferences between Individuals and Subject Pools

This appendix describes the characterization of individual heterogeneity in terms of individuals' estimated CES utility functions. Andreoni and Miller (2002) dug deeper into *individual* heterogeneity by recruiting 176 student subjects who make between 8 – 11 choices in dictator games with varying prices of giving, allowing them to check for violations of the generalized axioms of revealed preferences (GARP).<sup>1</sup> They find that less than 2% commit GARP violations, meaning that the choices of the remaining 98% can be represented by a quasi-concave utility function. They also classify individuals into one of three *predefined* categories: selfish subjects, egalitarian subjects who maximize  $U_i(\pi_i, \pi_j) = \min(\pi_i, \pi_j)$ , and utilitarians who maximize  $(0.5 \pi_i + 0.5 \pi_j)$ . While 43 percent of their subjects display choices that perfectly fit these preference categories, the remaining 57 percent are allocated to these categories by minimizing the distance from the three pre-specified utility functions. Based on this procedure, they classify 47.2% of the 176 subjects as selfish, 30.4% as egalitarian and 22.4% as utilitarian.

To what extent do the 57% of “impure” subjects actually fit the three predefined preference categories? To answer this question, the authors estimate a representative CES function (2) for the “impure” individuals in each category. The results indicate that the estimated parameters deviate quite substantially from the parameters of the ideal types. For example, the average  $\alpha'$  of the “impure” selfish subjects is 0.24, indicating a non-negligible deviation from selfishness, and the average  $\rho$  of the egalitarian types is  $-0.35$  which is a long way from  $-\infty$  which would indicate strict egalitarianism. While such deviations from the

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<sup>1</sup> There is a considerable literature on social value orientation (SVO) in psychology that uses the so-called ring measure of SVO (Liebrand 1984; Liebrand and McClintock 1988) and/or the triple-dominance measure of SVO (Van Lange et al. 1997; Van Lange 1999) or the slider task (Murphy, Ackermann and Handgraaf 2011; Murphy and Ackermann 2014). These measures are based on generalized dictator games but they do not lend themselves easily to the estimation of utility functions. Instead, they assign individuals to predefined SVO types such as “cooperative” (= desire to maximize joint gains), “altruistic” (= desire to maximize the other player's payoff), and “competitive” (= desire to maximize the payoff difference) or they use the ratio between the total payoff given to the other player and the total payoff assigned to “self” (across all dictator games) as an individual SVO measure. In addition, these SVO measures cannot identify inequality aversion as defined in Fehr and Schmidt (1999) or Bolton and Ockenfels (2000) and they do not capture the fundamental difference in the slope of indifference curves between the domains of advantageous and disadvantageous inequality. For this reason, we do not include them in the following review of distributional preferences.

pure types are inevitable when people are classified into subgroups it is important to keep them in mind.

Two further observations related to Andreoni and Miller (2002) are worth mentioning. First, even those individuals who perfectly fit the selfish preference assumption in their choice data may not be perfectly selfish because the smallest relative price of giving was 0.25 – for every dollar given, the partner received \$4. Thus, we do not know what would have happened if the relative price had been lower.<sup>2</sup> Second, 34 subjects in one of their sessions also faced upwards sloping budget line in  $(\pi_i, \pi_j)$ -space that involved disadvantageous inequality. Subjects could reduce inequality in these budget lines by decreasing both players' payoffs, and 8 of the 34 subjects (23.5%) actually did so. Thus, they observed some evidence in favor of inequality aversion when behind but no strong inferences can be made here given the small sample size, and the CES utility function is not capable of capturing these preferences.

The Fisman-Jakiela-Kariv-Markovits group undertook one of the most systematic characterizations of individual heterogeneity in altruistic distributional preferences in a series of papers (Fisman, Kariv and Markovits 2007; Fisman, Jakiela and Kariv 2015; Fisman et al. 2015; Li et al. 2022). Subjects in their experiments faced many different budget constraints in the material payoff space, giving them substantial power to estimate the individual preference parameters  $\alpha'$  and  $\rho$  of the CES utility function. In Fisman, Kariv and Markovits (2007) and Fisman, Jakiela and Kariv (2015), they report the parameter estimates of 76 and 72 Berkeley undergraduates, respectively; moreover, they estimate the distributional preferences of 208 Yale Law School (YLS) students in Fisman et al. (2015) as well as of 503 US medical students in Li et al. (2017). In Figures 2a and 2b we show the cumulative distribution of the estimated  $\alpha'$  and  $\rho$  parameter for the Berkeley and the Yale Law School students and Appendix Table A1 classifies the individuals into three categories: those close to selfishness ( $\alpha' > 0.95$ ), intermediate altruists ( $0.55 \leq \alpha' \leq 0.95$ ) and egalitarian altruists ( $0.45 < \alpha' < 0.55$ ). The figures and Table A1 illustrate that between 30 and 40 percent of the students put literally a weight of zero or a weight close to zero on other individuals' payoffs ( $\alpha' > 0.95$ ), while only between 8 and 25 percent of them are egalitarian altruists. Moreover, the student

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<sup>2</sup> Some people may be inclined to discount situations in which the cost of altruistic acts is low, but social life is in fact pervaded by situations in which low-cost favors can be given to other people. When a colleague in the workplace asks for help, when a stranger in a city asks for directions, or when students help each other answer questions, the costs involved are often very low, while the benefits for the receiving party are high.

subject pools appear to be more oriented towards efficiency compared to equality because only between 30 and 37% of them reveal a  $\rho < 0$ .

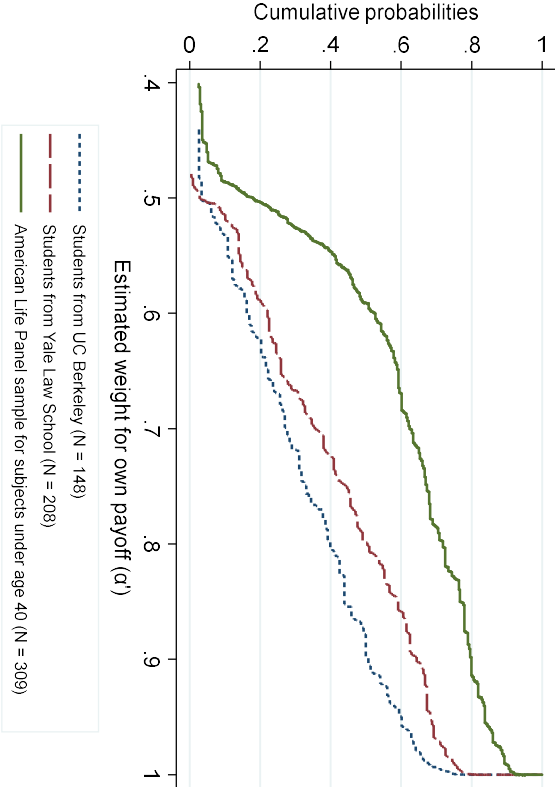
Are these results from student samples generalizable to the general population? To answer this question, the Fisman-Jakiela-Kariv-Markovits group also conducted experiments with a large sample of roughly 1000 Adult Americans from the American Life Panel (ALP). The ALP subjects are broadly comparable with the US population in terms of demographic and socio-economic characteristics. To control for age, Fisman et al. (2015) use only the ALP subjects under age 40 for the comparison with the student sample. The figures show that the ALP sample under age 40 displays a much higher concern for the payoff of others (Figure 2a) and a much higher concern for equity compared to efficiency (Figure 2b) than the student sample. The following facts displayed in Table A1 are, in particular, noteworthy: (i) Among the ALP subjects under age 40, the share of individuals that are close to selfishness is only 16.2% which is much smaller than the 30-40% among the students. (ii) The share of egalitarian altruists is with 37.2% of ALP subjects under age 40 much larger than the 8-26% among the students. (iii) The share of equality-oriented individuals ( $\rho < 0$ ) is with 47% of ALP subjects under 40 much larger than corresponding share among the students.<sup>3</sup>

These large differences between student samples and the broader population are consistent with research reported in Snowberg and Yariv (2021) and Cappelen et al. (2015). Snowberg and Yariv document that subjects from a representative sample of the US population transfer a much higher share of income (39%) to recipients in simple dictator games compared to the transfers given by a large sample of all Caltech undergraduate students, who gave only 14%. Likewise, Cappelen et al. (2015) report that in a representative sample of the Norwegian population the share transferred was 40.3% for men and 41.7% for women, while male students only gave 22.6% and female students gave 32.2%.

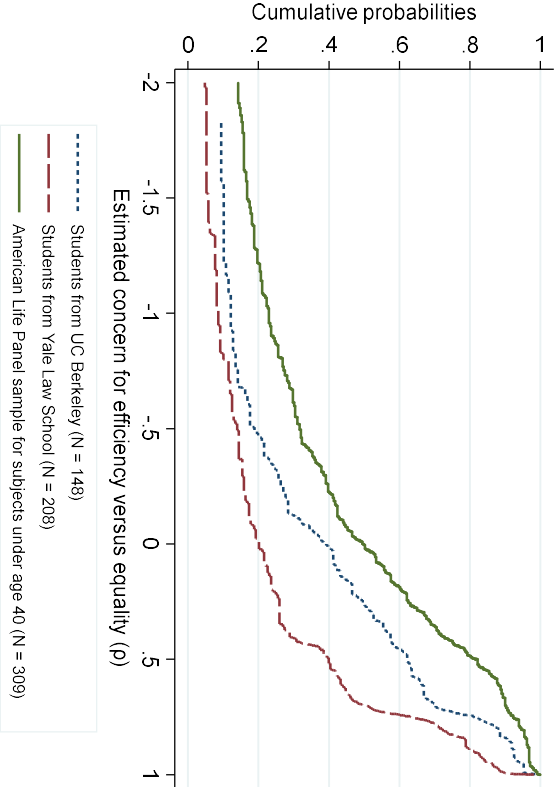
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<sup>3</sup> The FJKM group also shows that the much higher degree of other-regardingness and the much higher equality orientation of the broad population sample does not depend on socio-economic status. In other words, the individuals with high education and income in the ALP sample ( $N = 152$ ) display very similar parameters compared to the rest of the ALP sample.

**Figure A1a**  
The estimated weight on self-payoff ( $\alpha'$ ) among students and in a broad sample of the US population under age 40. High  $\alpha'$  means a low concern for others' payoff.  
(based on data from FKM 2007, FJK 2015, FJKM 2015)<sup>4</sup>



**Figure A1b**  
The estimated weight of efficiency relative to equality concerns ( $\rho$ ) among students and a broad sample of the US population under age 40. High  $\rho$  means a low concern for equality.  
(based on data from FKM 2007, FJK 2015, FJKM 2015)



<sup>4</sup> FKM (2007) indicates Fisman, Kariv and Markovits (2007), FJK (2015) indicates Fisman, Jakiela and Kariv (2015) and FJKM indicates Fisman, Jakiela, Kariv and Markovits (2015). See also Table A1 for the type classification that follows from the estimates displayed in Figures 2a and 2b.

**Table A1: Empirical Properties of Altruistic Distributional Preferences**

Study	Subject Pool	Egalitarian altruism $0.45 < \alpha' < 0.55$	Intermediate altruism $0.55 \leq \alpha' \leq 0.95$	Close to Selfishness $\alpha' > 0.95$	$\rho < 0$
FKM 2007 & FJK 2015	N = 148 UC Berkeley students	8.1%	49.3%	39.9%	37.0%
FJKM 2015	N = 208 Yale Law School Students	14.5%	53.9%	31.8%	20.3%
JDK 2017	N = 503 Students from US medical schools	25.7%	41.5%	28.2%	29.2%
FJKM 2015	N = 309 Adult Americans under 40 (ALP subjects)	37.2%	42.7%	16.2%	47.3%
	N = 693 Adult Americans over 40 (ALP subjects)	27.7%	50.5%	16.0%	57.0%
LDK 2017	N = 208 US Physicians	36.8%	42.8%	15.1%	48.3%

Note. The table shows key components of the distribution of individuals' estimated weights ( $\alpha'$ ) on other persons' payoffs based on studies co-authored by D (Dow), F (Fisman), J (Jakiela), K (Kariv), L (LI) and M (Markovits). Thus, FKM (2007) indicates the paper by Fisman, Kariv and Markovits (2007). The estimates are based on the assumption that distributional preferences can be captured by a CES utility function like in equation (3) and on each subjects' distributional choices in 50 randomly chosen budget sets. The efficient frontier of the budget set (i.e., the "budget line") is always negatively sloped such that one cannot measure the willingness to pay *to reduce* others' income for the sake of equality ("inequality aversion"). However, the CES function enables the identification of individuals' preference for equality *within the class of altruistic preferences* with the parameters  $\alpha'$  and  $\rho$ .  $\alpha' = 1/2$  indicates that individuals put equal weight on others' payoff, and  $\rho < 0$  implies that the income share spent on others' payoff rises as the price of giving rises, i.e., subjects are equality-oriented ( $\rho < 0$ ) and not efficiency-oriented ( $0 < \rho < 1$ ).

One noteworthy feature of the experimental design on which the data in Figure 2a and 2b and Table A1 are based is that the price of giving is randomly determined for every subject, i.e., different subjects see different prices. This means that some subjects may have seen a relatively large number of low prices for giving, which makes identification of purely selfish subjects very precise, while other subjects may have seen only a few low prices of giving, so that their assignment to the selfish versus intermediate category may be coarser.

Another important feature of the data collected by the Fisman-Jakiela-Kariv-Markovits group is that the subjects do not face upwards sloping budget lines in  $(\pi_a, \pi_b)$ -space. Thus, by construction, the subjects do not face a situation in which they can decrease both players' payoffs to reduce disadvantageous inequality. Given this restriction, the CES approach is a powerful tool for identifying *altruistic* distributional preferences, but it cannot capture spiteful, envious, or inequality averse preferences<sup>5</sup>.

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<sup>5</sup> In Fisman, Kariv, Markovits (2007), the authors had budget constraints with vertical and horizontal segments, but their student subjects never made pareto-damaging choices on these segments, which led the authors to believe that inequality aversion is not important.



## Appendix 2

### The Equality Equivalence Test

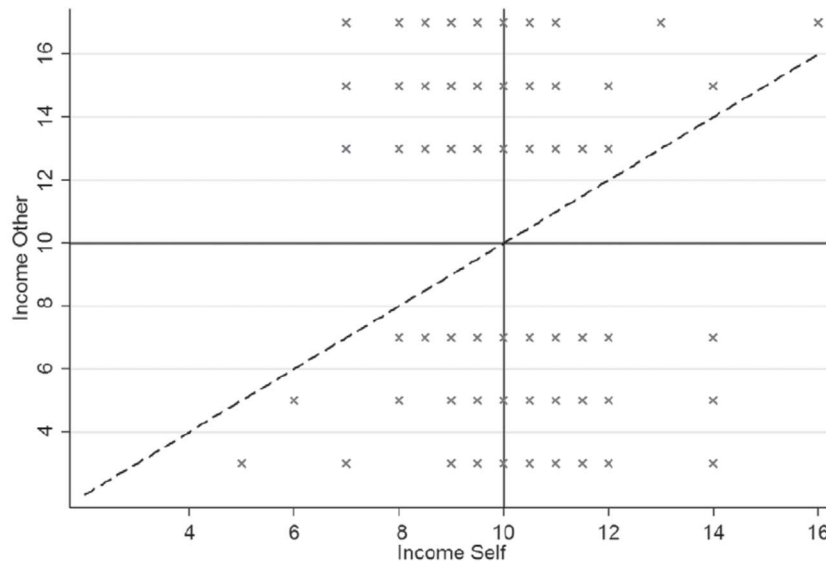
In the equality equivalence test subjects are presented choice lists in the domain of advantageous payoffs (A-lists) and the domain of disadvantageous payoffs (DA-lists). In a disadvantageous list (DA-list, see Figure A2 below), the equal payoff allocation E is always paired with a list of alternative allocations in which the other subject's payoff is kept constant at a level of  $\pi_j > \pi_i$ , while  $\pi_i$  systematically varies across alternative allocations. In an advantageous list (see Figure A2), E is always paired with a list of alternative allocations in which the other subject's payoff is kept constant at a level of  $\pi_j < \pi_i$  while  $\pi_i$  systematically varies across alternative allocations.

Starting the binary choice list with the choice between the  $(\pi_i, \pi_j)$ -combination and E where  $\pi_i$  is *lowest* (and hence, below the egalitarian payoff, see Figure A1), the decision maker is more benevolent towards the other subject (i.e., willing to pay to increase the other's payoff) in the DA domain, the earlier he or she moves from E towards an alternative allocation  $(\pi_i, \pi_j)$ . In the advantageous domain, the decision maker is more benevolent if he or she, starting the binary choice list with the choice between the  $(\pi_i, \pi_j)$ -combination and E where  $\pi_i$  is *highest* (and hence, above the egalitarian payoff), moves earlier to the equal payoff allocation E. However, the EET can also identify inequality aversion in the DA domain because some binary choice pairs essentially imply a choice on a positively sloped "budget line". Likewise, the EET can also identify positively sloped indifference curves in the A domain ("spite") because some binary choice pairs in this domain are located on positively sloped "budget lines".

A potential drawback of the EET is that the equal payoff allocation is part of every binary choice the subjects face, which may render equality very salient and thus induce a behavioral bias towards equality. However, a study by Krawczyk and Lee (2021) indicates that the results are robust to the introduction of a reference allocation that does not involve equality. In addition, the results of the EET by Kerschbamer (2015) indicates that 48.9% of his student subjects reveal selfish preferences (see Table 1 below), which is even higher than the 39.9% of selfish students in Fisman, Kariv and Markovits (2007) or the 31.8% of selfish students in Fisman et al. (2015). Likewise, Table 1 presents the data from several other studies with student samples that indicate a relatively high share of selfish subjects that approaches 60% in some student samples. Moreover, among the student subjects with other-

regarding distributional preferences, those with altruistic preferences are far more prevalent compared to inequality averse or envious preferences. The share of altruistic student subjects varies between 28 and 48%, while the share of inequality averse subjects is between 7 and 12%. Typically, envious/spiteful subjects are the least frequent across the student data with 3-10%.

**Figure A2: Choice Alternatives in the Equality-Equivalence Test**



The figure illustrates how the Equality Equivalence Test (EET) works by depicting the alternatives to the equal payoff allocation which is at (10, 10). The figure is taken from Kerschbamer and Müller (2021). It shows three binary choice lists in the disadvantageous domain (DA-lists) and three lists in the advantageous domain (A-lists). The DA-lists enable the identification of the slope of a subject's indifference curve in the DA domain ( $\alpha$ ), while the A-lists enable identification of the slope in the A domain ( $\beta$ ).

### Appendix 3: Endogenous Distributional Preference Clusters

Figure A3: Example Decision Screen and Budget Line

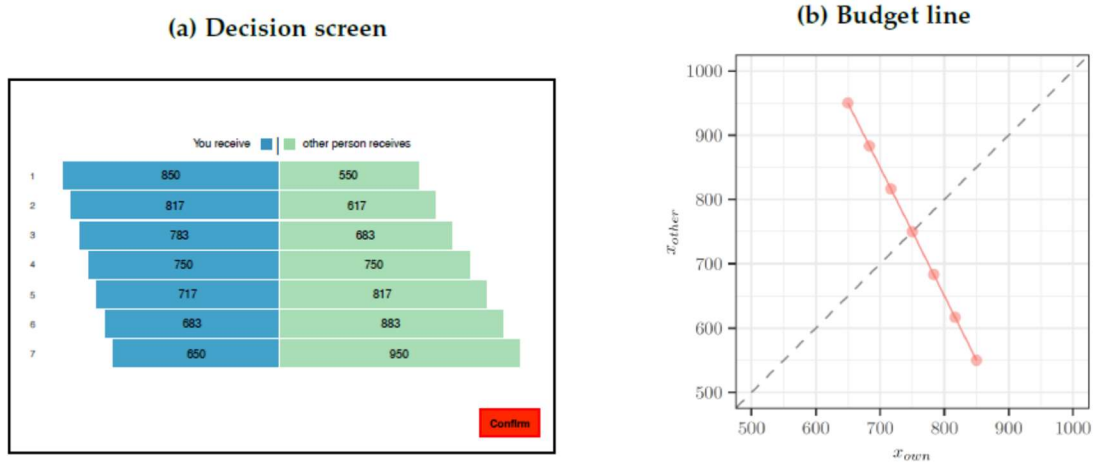
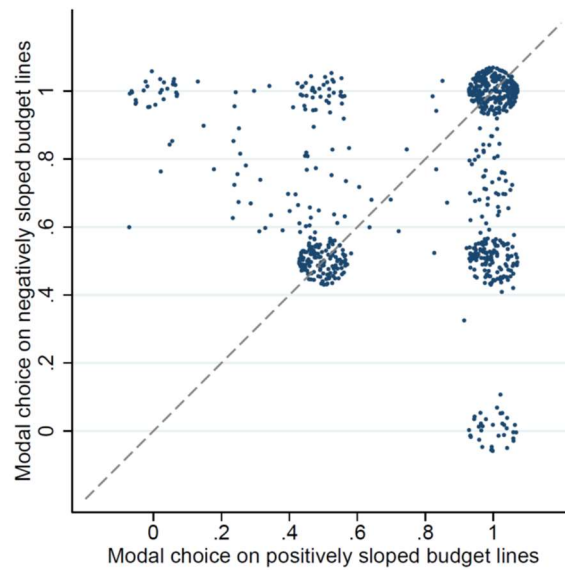


Figure A3a shows the decision screen in Fehr®Epper®Senn (2022). Figure A3b illustrates the negatively sloped budget line that corresponds to the set of alternatives depicted on the decision screen. Subjects faced many positively sloped and many negatively sloped budget lines.

**Table A2: Empirical Frequency of Endogenous Distributional Preference Clusters**

			<b>Endogenous Preference Clusters</b>		
<b>Study</b>	<b>Subject Pool</b>		<b>Altruistic</b>	<b>Inequality Averse</b>	<b>Predominantly selfish</b>
	Swiss Student Sample	Univ. of Zurich N = 66	60.1%	1.5%	36.4%
Fehr®Epper®Senn (2022)	Broadly representative Swiss Samples	Swiss Panel Sample (2017) N = 467	42%	48.1%	9.9%
		Swiss Panel Sample (2020) N = 467	38.7%	45.2%	16.1%
		Swiss Sample (Only 2017) N = 348	29.6%	53.7%	16.7%
		Swiss Sample (Only 2020) N = 916	30.5%	45.5%	24.0%
Epper et al. (2020)	Broad Danish Sample (2017) N = 3691		30.2%	37.3%	32.5%

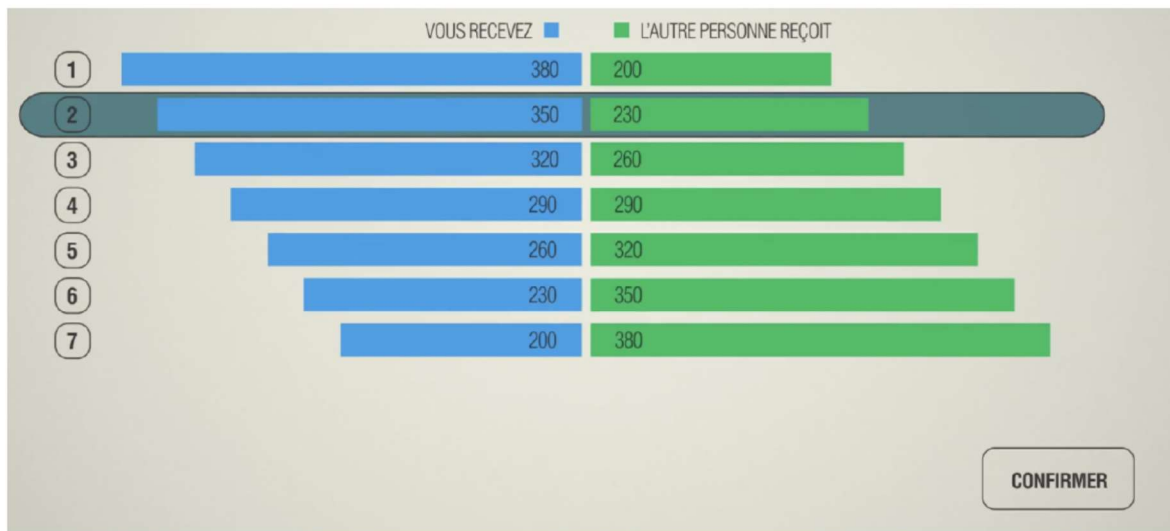
Note: The data of the broad Swiss population samples is taken from Fehr®Epper®Senn (2022). Each of the four data sets is broadly representative of the German and French language areas in Switzerland in terms of age, gender, income, and education. The Danish data consist of a broad sample of Danish individuals collected in 2017 by Epper et al. (2020). The roughly 3700 subjects in this study are from the Copenhagen area and have an age between 32-42. The data from the Swiss student sample is taken from unpublished work by Epper, Fehr and Senn. The table is based on choice problems in which subjects could choose one of 7 payoff allocations that are equidistantly placed on linear budget lines with different positive and negative slopes in  $(\pi_i, \pi_j)$  space. A non-parametric Bayesian clustering algorithm assigns subjects to one of three preference types. Importantly, these preference types are not assumed a priori but arise endogenously from the empirical properties of the data sets. Interestingly, qualitatively similar preference types emerge in all of the data sets above.

**Figure A4: Preference types in in a large Danish population sample (N = 3691)**

Note: The figures depict subjects' median choices  $z$  among negatively sloped budget lines and among positively sloped budget lines. Each dot represents five individuals whose median choice is identical\*. Dots are jittered to make the median choice of the five-person groups visible. For each budget line,  $z = 1$  indicates an own-payoff maximizing choice,  $z = 0$  indicates an own-payoff minimizing choice, and  $z = 0.5$  indicates a payoff-equalizing choice. Thus, five-person groups whose  $z$ -value is close to 0.5 on positively and negatively sloped budget lines display inequality averse behaviors, individuals whose  $z$ -value is close to 1 on both types of budget lines display selfish behaviors, and individuals whose  $z$ -value is close to 0.5 on negatively sloped budget lines but  $z = 1$  on positively sloped budget lines display altruistic behaviors. The data are taken from Epper et al. (2020).

## Appendix 4: Material for the Section on “Who are the Meritocrats?”

**Figure A5: Example of a Decision Screen in the Merit and Luck condition of Epper, Fehr and Senn (2023)**



Note: Subjects in the merit and luck condition faced exactly the same negatively sloped budget lines illustrated in the above screen. The initial allocation was highlighted but subjects were completely free in choosing any of the seven available allocations.

## Appendix 5: Distributional Preferences under Risk

When individuals care for others' payoffs, a whole new set of questions arises if outcomes are risky. A key issue concerns the question whether people care for others' expected payoffs or for their realized payoffs. This also concerns the issue whether individuals care for equality of opportunity, i.e., have a preference for lower inequality in ex-ante expected payoffs or whether they have a preference for more equal ex-post realized payoffs. Another issue when risk is present is how individuals' own risk preferences and their beliefs about others' risk preferences affect their other-regarding behavior.

The problem of ex-ante expected payoffs versus ex-post realized payoffs comes into sharp focus in a dictator game that involves the sharing of chances to win an indivisible resource that has a value of  $R = 100$  for both parties. The dictator chooses  $x$ , which determines the probability  $\frac{x}{100}$  with which the recipient wins  $R$ , while the dictator wins  $R$  with probability  $(1 - \frac{x}{100})$ . Here, equality of opportunity implies the equalization of chances but there will always be inequality ex-post. An individual with utility function  $U(\pi_a, \pi_b)$  that obeys the plausible restriction  $U(R, 0) > U(0, R)$  will always choose  $x = 0$ . Not only inequality averse players, but players with Charness-Rabin preferences as well, may plausibly obey the restriction  $U(R, 0) > U(0, R)$  and thus choose  $x = 0$ .

This prediction contrasts, however, with the results of experiments showing that many dictators are willing to transfer some chance of winning to the recipients (Krawczyk and Le Lec 2010; Brock, Lange and Ozbay 2013). Models that are solely based on the realized ex-post payoffs have a hard time explaining this fact, whereas models in which players also care about the ex-ante expected payoffs of others can explain it.

Now suppose that the above-described game is slightly changed so that the payoff to the two players is no longer exclusive, i.e., if the dictator transfers a chance  $x$ , then the dictator wins  $R$  with probability  $(1 - \frac{x}{100})$  and the recipient can simultaneously also win  $R$  with  $\frac{x}{100}$ , i.e., there are two independent draws. Note that there may not be any ex-post inequality in this game because both players can end up with 0 or with  $R$ . Therefore, inequality averse dictators have less reason to worry about inequality, implying that they are more likely to be willing to share chances with the recipient. Krawczyk and Le Lec (2010) indeed show that dictators transfer more chances in the dictator game with independent draws

compared to the game with exclusive payoffs. This result suggests that players also care about ex-post payoffs.

Further evidence for the relevance of ex-post payoffs is provided by Brock, Lange and Ozbay (2013), who designed six different dictator games where they systematically varied the risk for the dictators and the recipients across games in such a way that if players' cared only about ex-ante expected payoffs, they would behave identically across all six games. Their find treatment differences, however, that are indicative for the relevance of ex-post payoff concerns. For example, subjects in the standard dictator game without any risk (and a dictator endowment of 100) transfer a significantly higher  $x$  to the recipient compared to a dictator game where the dictator's payoff is still certain, but a transfer of  $x$  gives the recipient a payoff of 100 with probability  $\frac{x}{100}$ . Note that a positive transfer  $x$  in the game where the recipient faces a risky payoff implies that the dictator may end up with a lower payoff than the recipient. Inequality averse dictators, who care for ex-post inequality, will thus tend to give less in the risky dictator game.<sup>6</sup> Another key result documented in Brock, Lange and Ozbay (2013) is that subjects' giving in the standard dictator game is highly predictive for their willingness to equalize ex-ante expected values in dictator games involving risks.

The question whether subjects care for equality of opportunity or for equality of ex-post payoffs was also addressed in Cappelen et al. (2013). In their experiments, there was first a risk-taking phase and then a distribution phase. Subjects made 4 decisions in the risk-taking phase between the payoff  $y$  of a sure alternative ( $y \in \{25, 200, 300, 400\}$ ) and a 50:50 chance of receiving nothing or 800 NOK. In the distribution phase, each subject was paired sequentially with 8 different subjects who participated in the risk-taking phase, and one of the four risk-taking problems was drawn randomly for each pair. Then, an "impartial" spectator, who was informed about subjects' choices and outcomes in the drawn risk-taking problem, was asked to distribute the pair's total earnings between the two subjects.

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<sup>6</sup> Alternatively, because the certainty equivalent of a given transfer  $x$  is less valuable for risk averse recipients, dictators who care for the total payoff may give less in the risky dictator game. However, based on this logic risk averse dictators should give *more* in a dictator game in which their own payoff is risky – they receive a payoff of 100 with probability  $\left(1 - \frac{x}{100}\right)$  – while the recipient receives the transfer  $x$  with certainty. The reason is that a transfer of  $x$  decreases the certainty equivalent of the dictator's payoff by less than  $x$ , i.e., giving is surplus-enhancing. The evidence strongly suggests the opposite, as dictators give much less in this game compared to the standard dictator game (Freundt and Lange 2017). Moreover, Freundt and Lange also find that the dictators who believe that recipients are risk averse do not give less to the recipients.



Before presenting the results, it is important to emphasize that complete equality of opportunity existed between the two paired subjects in the risk-taking phase. If spectators redistribute ex-post from the richer to the poorer subject, they thus explicitly express a preference for less ex-post inequality. Almost all of the spectators' redistributive choices involved redistribution from the poorer to the richer subject.<sup>7</sup> If the pair consisted of two risk takers where one was lucky while the other was unlucky, the spectators strongly redistributed from the lucky to the unlucky one – they chose the equal split in more than 40% of the cases and they did not redistribute at all in only roughly 30% of the cases. In contrast, if an unlucky risk-taker was paired with an individual who chose the safe option, the unlucky risk-taker received much fewer transfers and the equal split was only chosen in roughly 15% of the cases. Spectators thus made the unlucky risk takers more responsible for their choices compared to a situation where both were unlucky. Finally, there is also a substantial amount of redistribution when a lucky risk-taker is paired with an individual who chose the safe payoff, but the lucky risk-taker was nevertheless given a higher payoff in roughly 80% of the cases.

Thus, taken together, the literature suggests that subjects on average care about both ex-ante equality of opportunity and ex-post equality of outcomes but there is strong heterogeneity in the weight that individual subjects put on the different conceptions of equality. Cappelen et al. (2013) estimate a mixture model that enables them to assign individuals to three different types – individuals who care only for ex-post equality (“ex-post egalitarians”, EPs), individuals who do not care about ex-post equality (“ex-ante egalitarians”, EAs), and individuals who care about ex-post equality among those who made the same choice in the risk-taking task (“choice egalitarians”, CEs). Roughly 30% of their subjects (students from the Norwegian School of Economics) are EPs, 27% are CEs and 43% are EAs.

In this section we have so far mainly dealt with the question how social preferences are affected by outcome risks. However, the perceived sources of inequality may also be subject to risk and uncertainty. If individuals do not know whether a particular inequality is due to luck or differential performance, how does this affect their willingness to redistribute income? Cappelen et al (2022) study this situation, and document that this kind of uncertainty

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<sup>7</sup> In case that a lucky risk-taker met a subject who chose the safe payoff it would have been possible to redistribute from the poorer to the richer subject.

can push meritocrats towards behaving more egalitarian – with more risk averse spectators exhibiting a stronger drive towards egalitarian behavior.

Finally, we deal with the question how to combine concerns for equality of opportunity and equality of outcomes in theoretical modelling. Saito (2013) addresses this issue, providing an axiomatic foundation for “expected inequality-averse” preferences. Individuals with such preferences put a weight of  $\delta$  ( $0 \leq \delta \leq 1$ ) on preferences for equality of opportunity and a weight  $(1-\delta)$  on preferences for equal ex-post outcomes.<sup>8</sup>

To make things concrete, let  $\mathbf{x} = (x_1, x_2, \dots, x_n)$  denote an allocation of material payoffs to individuals. Assume that there are  $m$  different states of the world, each one of which is obtained with probability  $p_s$ ,  $s \in \{1, \dots, m\}$ , and denote the allocation obtained in state  $s$  by  $\mathbf{x}^s = (x_1^s, x_2^s, \dots, x_n^s)$ , then the *expected* material payoff allocation is given by

$$E(\mathbf{x}) = \sum_{s=1}^m p_s \mathbf{x}^s = (\sum_{s=1}^m p_s x_1^s, \sum_{s=1}^m p_s x_2^s, \dots, \sum_{s=1}^m p_s x_n^s),$$

where  $\sum_{s=1}^m p_s x_i^s$  denotes the expected material payoff of individual  $i$  across states. Likewise, the allocation of expected utilities is given by

$$E(U(\mathbf{x})) = \sum_{s=1}^m p_s U(\mathbf{x}^s)$$

Saito shows that if and only if a decision-maker obeys “his” axioms, the preferences of a decision-maker are represented by the following preference function  $V$ :

$$V = \delta U(E(\mathbf{x})) + (1 - \delta)E(U(\mathbf{x})), \quad (11)$$

where  $U(\mathbf{x})$  is given by the Fehr-Schmidt Utility function. Thus, the utility of an expected inequality averse player is affected by the inequalities in the expected material payoffs with weight  $\delta$  and by the inequalities in realized ex-post payoffs with weight  $(1 - \delta)$ . It is also noteworthy that the preference function (8) also applies under further plausible assumptions if  $U(\mathbf{x})$  is given by Charness-Rabin type preferences.

It is easy to see that an individual who puts a sufficiently high weight  $\delta$  on equality of opportunity is willing to share the chances of receiving an indivisible resource in a dictator game although this creates chances for high ex-post inequality. Overall, however, the Saito model has undergone very little empirical testing. For example, it would be interesting to know to what extent the behavior of individual subjects in the six different treatment conditions of Brocks, Lange and Ozbay (2013) are consistent with the Saito model and which

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<sup>8</sup> Several other authors have also provided axiomatic foundations of inequality averse preferences (Neilson 2006; Rohde 2010) but none of them involves preferences for equality of opportunity.

parameters  $(\alpha, \beta, \delta)$  explain their behaviors.<sup>9</sup> To our knowledge, there is no paper that jointly estimated  $\delta$  and the parameters in  $U(\mathbf{x})$ . One complication in applying (8) to data is that the distributional preference models – such as Fehr-Schmidt or Charness-Rabin – assume risk neutrality, but it is well known that risk aversion also exists at the typical experimental stake levels. This means that behavior in distributional problems under risk is affected by a complicated mix of risk aversion as well as by preferences for equality of opportunity and other-regarding preferences for ex-post outcomes.<sup>10</sup>

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<sup>9</sup> Recall that in their experiments an individual with  $\delta = 1$  would behave identically across all treatments. Thus, behavioral variation across treatments may provide at least some qualitative insights with regard to the parameter constellations that may explain their data.

<sup>10</sup> Cettolin, Riedl and Tran (2017) and Freundt and Lange (2017) have independent measures of dictators' and recipients risk aversion and can relate them to the dictators' behavior in risk-involving dictator games. Cettolin, Riedl and Tran (2017) show that dictators' risk aversion strongly predicts lower transfers in both dictator games that render the payoff of the recipients risky and in dictator games that render the payoff of the dictators risky. Freundt and Lange (2017) also show that a rise in dictators' risk aversion is associated with a decline in generosity in games where the dictators' payoff is subject to risk.

## Appendix 6: Payoff Matrices used in Bolton, Brandts and Ockenfels (1998)

Table 1. Payoff rows for the three test matrices (payoffs in Spanish pesetas).

	<i>c1</i>	<i>c2</i>	<i>c3</i>	<i>c4</i>	<i>c5</i>	<i>c6</i>
<i>t</i>	<i>C</i> gets 2050	<i>C</i> gets 2000	<i>C</i> gets 1950	<i>C</i> gets 1900	<i>C</i> gets 1850	<i>C</i> gets 1800
	<i>R</i> gets 800	<i>R</i> gets 1000	<i>R</i> gets 1200	<i>R</i> gets 1400	<i>R</i> gets 1600	<i>R</i> gets 1800
<i>m</i>	<i>C</i> gets 1650	<i>C</i> gets 1600	<i>C</i> gets 1550	<i>C</i> gets 1500	<i>C</i> gets 1450	<i>C</i> gets 1400
	<i>R</i> gets 900	<i>R</i> gets 1100	<i>R</i> gets 1300	<i>R</i> gets 1500	<i>R</i> gets 1700	<i>R</i> gets 1900
<i>b</i>	<i>C</i> gets 1250	<i>C</i> gets 1200	<i>C</i> gets 1150	<i>C</i> gets 1100	<i>C</i> gets 1050	<i>C</i> gets 1000
	<i>R</i> gets 1000	<i>R</i> gets 1200	<i>R</i> gets 1400	<i>R</i> gets 1600	<i>R</i> gets 1800	<i>R</i> gets 2000

## Appendix 7: Belief-Dependent Social Preferences and Emotions

Psychological game theory (Battigalli and Dufwenberg 2009; Battigalli and Dufwenberg 2022) is a powerful and flexible tool for modelling emotions and their effect on social preferences. This appendix discusses a few papers that provide evidence for the role of emotions in experimental games.

An article by Khalmetski, Ockenfels, and Werner (2015) considers “surprising gifts”, a concept related to experiencing elation or joy and so seems to be the flip side to guilt. Their model generalizes the guilt-aversion model to capture positive surprises, and an extension of the model permits choosers to care about the intentions of others behind surprises. The authors provide experimental tests using a series of dictator-game experiments. Interestingly, their design featured the Ellingsen et al. (2008) notification feature, but had different results. The responder made a guess about how much the dictator will give; the recipient who guessed closest to the average received by all recipients received a substantial bonus. In the meantime, the dictator completed a form stating how much she will give for each (rounded) guess possibly made by the recipient. In the PUBLIC treatment, dictators were told that recipients would later be informed that their guesses were revealed to the dictators before they made their choices, while in the PRIVATE treatment dictators were told that the recipients would not be so informed.

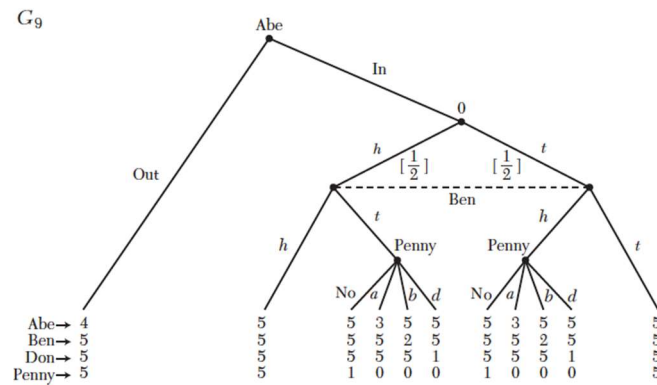
This study finds evidence that dictators do consider what recipients know about the dictators’ intentions behind surprises. In support of their model, they find smaller amounts given if the inference concerning a dictator’s intentions is unclear. In one experiment, the average amount sent in PUBLIC was 16.8%, substantially higher than the 10.1% average in PRIVATE. The share of dictators who exceeded the recipient’s expectation was more than twice as high in the PUBLIC treatment, 28.4% versus 11.7%. The experimental results suggest that guilt aversion can be an important motivation for giving in dictator games. Their analysis highlights that many subjects also like to exceed others’ expectations, perhaps a surprising result.

Battigalli, Dufwenberg, and Smith (2019) provide a model of frustration and anger. Anger and aggression are certainly prevalent in our world, and it is often frustration that leads to anger and aggression. This phenomenon has been useful for some “populist” demagogues; the 2016 and 2020 U.S. presidential elections are cases in point. Battigalli,

Dufwenberg, and Smith (2019) assume that a frustrated player is inclined to hurt those deemed blameworthy, formalizing types of blame. With simple anger, all others are blamed equally regardless of the choices made. With anger-from-blame, others are blamed to the extent that they could have avoided a player's frustration with different choice behavior. Regarding anger-from blame intentions, others are blamed to the extent that the player believes they *intended* to cause her frustration.

An example taken from Battigalli and Dufwenberg (2022) illustrates this notion.

### Battigalli and Dufwenberg (2022) example



In this game, if Penny's anger sensitivity is sufficiently high, simple blame indicates she would choose  $d$ , targeting the person that she can most efficiently punish. Here this would be Don. With anger from blaming behavior, Penny would choose  $b$  with a sufficiently high blame sensitivity, since Don (who had no choice) is not blameworthy. Anger from blaming intentions is a bit trickier because intention must be inferred. Here Penny would choose  $a$ ; Ben is not blameworthy because he had no way to know the actual chance move and so could not have bad intentions.

Battigalli and Dufwenberg (2022) discuss an array of other emotions from the standpoint of psychological game theory and belief-dependent preferences. These include elation, regret, and anticipatory feelings. Given space limitations, we only sketch these out briefly. Elation is the opposite of disappointment. While elation is indeed rare in the economics profession and the literature Gill and Prowse (2012) present evidence that disappointment is stronger than elation, much as negative reciprocity seems stronger than positive reciprocity), this can be readily modeled in the same manner as is disappointment but with a negative term replaced by a positive one. With regret, one must assess what would have happened if she had chosen differently. One may also have anticipatory

feelings that provide current positive or negative utility (Loewenstein et al. 2001). Anxiety is one such anticipatory feeling. Since future outcomes depend on one's own actions, as well as those of others), this allows psychological utility to depend on one's own plan. Caplin and Leahy (2001) provide a nice example of a doctor who must choose whether to reveal information to a patient, anticipating the patient's anticipatory feelings.

## Appendix 8 – Responsibility and Delegation

Feelings of responsibility may have substantial effects on social preferences. When one has the responsibility for determining an outcome that may affect the well-being of others, one may respond more positively than when this responsibility is borne by another entity. The flip side of the coin is that being able to delegate a decision may weaken the effect on one's image, so that one might expect more selfish behavior.

To the best of our knowledge, the first research on this topic in the field of economics is Charness (2000). The intuition is that one will be more honest (or pro-social) when one bears the responsibility of making the determination: "The responsibility-alleviation effect states that a shift of responsibility to an external authority dampens internal impulses towards honesty, loyalty, or generosity." The article uses gift-exchange evidence to demonstrate that participants are more generous (provide higher effort) when wages are determined by draws from a bingo cage than when assigned by a third party, so that even a modest shift in perceived responsibility affects behavior. Charness and Jackson (2009) identify the same principle in a Stag Hunt. They make a comparison to what players do unilaterally to what they do when what they do when making a choice on behalf of another party as well. While only one-third of the population choose differently in these two cases, almost 90 percent of these people ( $p = 0.001$ ) plays a less risky strategy (Hare) when choosing for a group than when playing only for themselves. So, responsibility-alleviation applies to strategic situations as well as to honesty. Being held responsible (either by yourself or by others) does affect one's social preferences.

A notion quite related to responsibility-alleviation is *delegation*. Here one formally shifts at least the appearance of responsibility to another party, trying to evade being held responsible for decisions by other people (and perhaps even to self-deceive about this responsibility). The model makes the same predictions with delegation as with responsibility-alleviation. To the extent that one is perceived to be less responsible by having delegated an action or choice, one can be selfish at a lower cost.

Fershtman and Gneezy (2001) note that employing a messenger to deliver bad news is quite common and considers strategic delegation in the ultimatum game. In the second half of some sessions (the first half was the basic game), there were four delegation environments varying whether the delegation was available to the dictator or to the responder and whether the delegation contract was observable (the delegator can provide the delegate with an



incentive scheme and can, for example, specify the proposal to be made). Proposers' profits were higher in this case, perhaps because proposers were perceived to be less selfish. However, there is no significant difference when the delegation contract was observable. When responders could delegate, they benefited from doing so. Here, "the responders induced the agents to be tough, and as a result the proposers indeed made more generous offers". Interestingly, the effect of responder delegation with an unobservable contract goes in the opposite direction, with higher proposals and higher proposer profit. The authors conclude that delegation impacts the outcome of the game.

Hamman, Loewenstein, and Weber (2010) also find that delegation can foster self-interest, suggesting an additional benefit for the principal-agent relationship. They state: "Through the use of agents, therefore, accountability for morally questionable behavior can become vertically diffused, with no individual taking responsibility". In one experiment, the Baseline treatment was a standard \$10 dictator game. In the Agent treatment (fixed payments for agents), one of three agents made the choice. In the Agent/Choice treatment, the dictator could choose whether to delegate the choice to an agent in periods 8-12 of the 12-period session. Their Figure 1 presents the results.

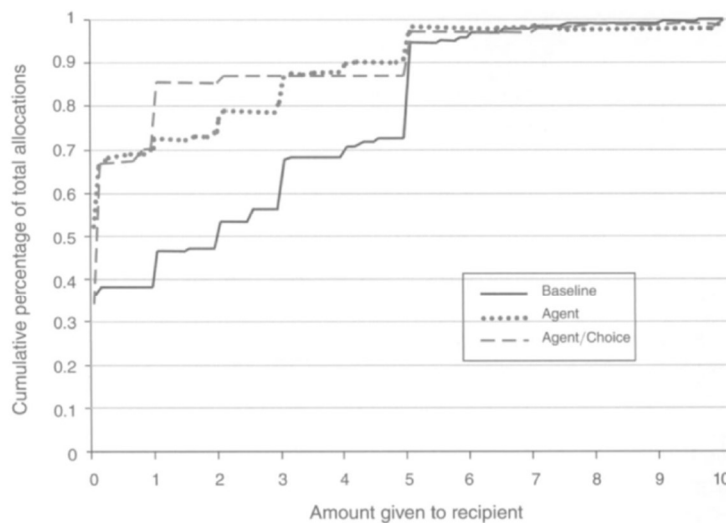


FIGURE 1. DISTRIBUTIONS OF AMOUNT SHARED BY CONDITION (*Experiment 1, rounds 5-8*)

In the Baseline, dictators allocated an average of \$2.26 over the first eight rounds, while principals in the Agent conditions shared significantly less (\$1.70); this difference was considerably larger in periods 5-8 (\$2.32 versus \$1.11). In the Agent treatments, dictators demonstrated self-interest, showing a preference for agent's who made small offers (the history of each agent was given). When agents gave \$0, they were retained by the dictator

93% of the time; in contrast, when agents gave \$5, they were retained 39% of the time. In a second experiment, agents sent messages to dictators concerning the amount they indicated (cheap talk) they would give to recipients. Dictators were very sensitive to the announcements when selecting an agent. Giving was 62% lower in this treatment than in the Baseline.

In summary, "... acting through agents allows principals to maintain positive impressions of their own behavior and role in determining outcomes. Agents serve this function through a subtle interplay of psychological factors. Principals do not feel that they are behaving unfairly because they do not directly take immoral actions; they simply hire agents. They also do not feel responsible for the ultimate outcomes." Thus, once again, alleviating a sense of responsibility leads to more selfish actions, since one's self-image suffers less by using an intermediary. This is therefore a viable strategy in some environments.

Bartling and Fischbacher (2013) discuss delegation and responsibility in the context of being blamed. A perceptive quote from Machiavelli is mentioned: "Princes should delegate to others the enactment of unpopular measures and keep in their own hands the means of winning favors". The article considers responsibility attributions in delegated choices. Participants could choose to "either choose a fair allocation or an unfair allocation or delegate the choice", with punishment measuring responsibility attribution. A key result is that one can effectively shift this attribution using delegation and that this can be a strong motivation for delegating decisions. It is also found that intention and responsibility matter significantly.

The experimental design involves a dictator game with punishment and delegation possibilities. In each group, there is a dictator (A), a possible delegee (B), and two recipients (C). Either the dictator or the delegee chooses to allocate 20 tokens fairly amongst the four parties (five each) or unfairly (nine each for the dictator and possible delegee and only one for each of the recipients). When punishment was possible, one of the recipients is randomly chosen and can assign punishment points by sacrificing one point to reduce the payoffs of others by up to seven points.

There were three treatments that varied the punishment environment. In the *random* treatment, the dictator can delegate the decision between the fair and the unfair allocation to only a die roll. It is common information that there is a 40% chance that the die chooses the

unfair allocation matching the observed behavior in *D&P*). In the *asymmetric* treatment, the dictator must either choose the fair allocation or delegate the choice. In the *asymmetric* treatment, the dictator can choose the fair allocation or delegate, but he cannot choose the unfair allocation.

Their Figures 2 and 3 show the punishment results in *D&P* (left panel) and in the two treatments described above (right panel). In *D&P*, the punishment rate when A cannot delegate and is unfair is slightly lower than when A could delegate and is instead unfair. When A delegates and B is unfair, B gets the lion's share of the punishment. The same pattern holds when the punishment points assigned are instead considered.

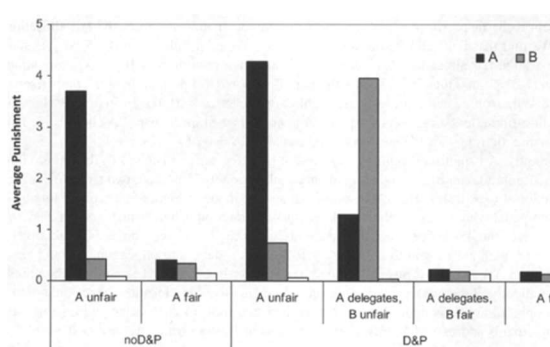


FIGURE 1  
Punishment pattern in treatments *noD&P* and *D&P*

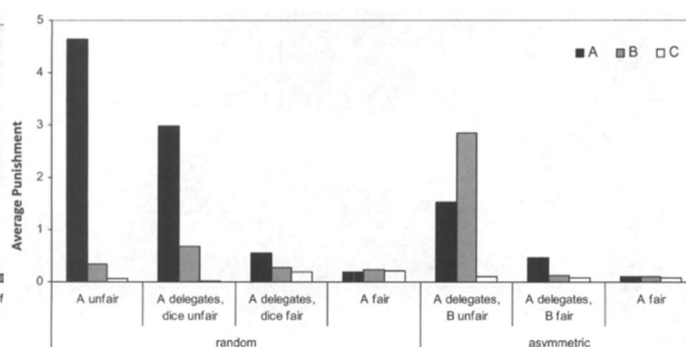
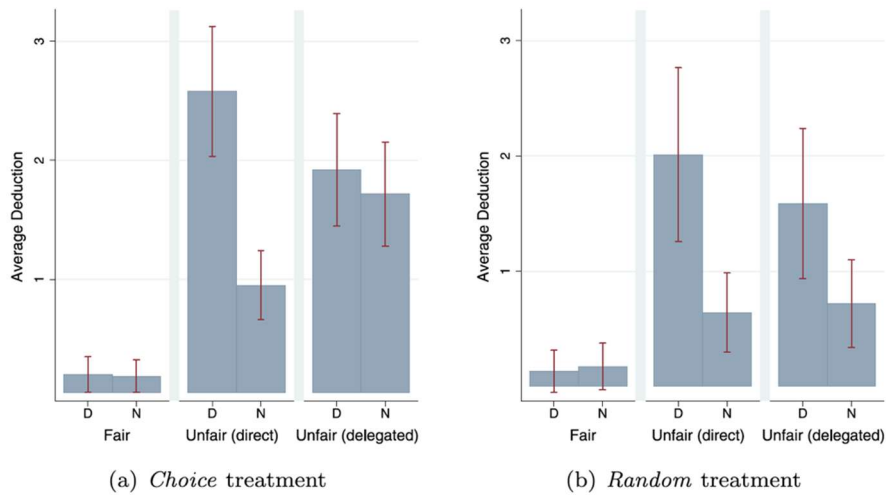


FIGURE 3  
Punishment pattern in treatments *random* and *asymmetric*

There are two main points illustrated in Figure 3. First, A is successfully able to diminish punishment by delegating. A is blamed when A is unfair, but the rate drops considerably when A delegates. Compare the punishment rates: about 45% when A does not delegate to about 16% (the average of the rates for dice fair + dice unfair) when A delegates. Second, when A delegates and B is unfair, B receives the bulk of the punishment and the rate for A is about 15%. These Figures make it clear that delegating shifts the blame to the intermediary. Here, the image is primarily social, although the dictator might also feel better by delegating than by being unfair.



Recipients do blame the dictator less for a delegated unfair outcome, but only in the Choice treatment is the blame directed to the intermediary. Delegation (significantly) reduces the average punishment by 25%. The results for the dictator are similar in the Random treatment, where the dictator punishment by around 21%. Dictators hardly being helpful by foregoing the equal split. Since they bypassed the punishment-minimizing equal split, it is difficult to argue that they are being helpful, yet they are punished less. They conclude that their results “illustrate just how easily a person may avoid negative judgment by delegating.” Of course, this presumes that the dictator manages to escape the knowledge that she was being selfish by delegating.

## Appendix 9 – The Stability of Social Preferences

In this appendix, we review evidence that examines the extent to which social preferences are relatively stable. Measuring the stability of social preferences over time appears straightforward as long as the measurement tools indeed deliver a preference measure and not merely a behavioral measure that is confounded by beliefs and other types of preferences (as discussed in the section on external validity), and as long as the measurement tool at different points in time is identical. In addition, the preference measure is ideally not just based on a single behavioral measure like the choice of the transfer in a standard dictator game but instead on many choice situations across which the costs and benefits of the transfer vary. Otherwise, the recovered preferences contain a lot of measurement errors and noise, which may generate spurious preference instability.

Measuring social preferences across contexts is trickier because the notion of stability is theory-dependent. To illustrate this point, consider the behavior of responders in two versions of the ultimatum game (Blount 1995). In version 1, a random mechanism determines the first-mover's offer exogenously while the first-mover herself makes the offer in version 2. Suppose that the responders are negatively reciprocal but *not* inequality averse. Then responders reject low offers in version 2 of the game but not in version 1 because a low offer does not indicate an unkind intention in version 1 but it does so in version 2 of the game. If one erroneously assumes that responders are inequality averse, one would conclude that the responders' inequality averse preferences are highly unstable because inequality averse responders should reject low offers regardless of whether they are randomly determined or volitionally chosen. However, if one correctly assumes that the responders are negatively reciprocal, their *change in behavior* across the two games is exactly what a stable preference for negative reciprocity predicts. Thus, the extent to which one can interpret changes in behavior across different contexts as changes in preferences is strongly dependent on the assumption about the underlying psychological mechanism. For this reason, care needs to be exercised when preference stability is assessed by examining behaviors across contexts.

With the above caveats in mind, what does the evidence on the stability of social preferences show? Bruhin et al. (2019) estimated the structural parameters twice for advantageous ( $\beta'$ ) and disadvantageous ( $\alpha'$ ) inequality aversion in a sample of  $N = 196$  students three months apart with the same experimental paradigm. They found that the intertemporal correlation of individuals'  $\alpha'$  is 0.48 while the correlation for  $\beta'$  is 0.56.

Fehr®Epper®Senn (2022) also measured individuals' social preferences in a broad Swiss sample ( $N = 415$ ) at two points in time that were three years apart (in 2017 and 2020). The subjects faced the exact same large set of budget lines which makes it possible to study preference stability (i) at the level of choice for individual budget lines, (ii) at the level of individuals' estimated structural preference parameters and (iii) at the level of individuals' assignments to different preference types. At the choice level, roughly 55% of the choices are perfectly identical across time points and 67% of the choices are identical or coincide with the closest neighboring allocation on the budget line. At the level of individuals' structural parameters, they find an intertemporal rank correlation of 0.458 for  $\alpha'$  and 0.428 for  $\beta'$ . Finally, at the level of type assignment, they find that 68% of the individuals are assigned to the same preference type (altruistic, inequality averse, selfish) across the two points in time, and that among the individuals classified as other-regarding (altruistic or inequality averse) in 2017, 89% are again classified as other-regarding in 2020. Among the individuals classified as selfish in 2017, 60% are again classified as selfish in 2020.

Moreover, two waves of the German Internet Panel implemented the same equality equivalence Test (Kerschbamer and Muller 2020). In total  $N = 2583$  individuals participated twice in this test, 2 years apart (2016 and 2018). This permits an analysis of the stability of individuals' assignment to four pre-defined preference types (selfish, altruistic, inequality averse, envious; see Table 2). This analysis shows that 60% of individuals remain assigned to the same preference type across the two years, and that among the 76% of individuals who were classified as altruistic or inequality averse in 2016, 84.5% were again assigned to these two preference types.

Chuang and Schechter (2015) also report significantly positive intertemporal correlations between 0.21 and 0.32 involving survey measures of negative reciprocity taken in 2007, 2009 and 2010. Likewise, Carlsson, Johansson-Stenman and Nam report significantly positive intertemporal correlations of social preference related behaviors (voluntary money and labor contributions to a natural public good) at four different points in time spread across six years.

Thus, taken together, the data suggest a reasonable degree of stability in social preference when measured at the level of choices, structural parameters, or preference type assignment. However, the data also suggests a non-negligible degree of noisiness and/or measurement error. Nevertheless, the observed degree of stability appears sufficiently strong to suggest that workers with different degrees of prosociality may self-select into different

sectors or to make it worthwhile for employers to screen potential employees based on certain social preference characteristics.

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