DISSERTATION ABSTRACT

My dissertation carries the title "Economic Behavior and Public Policy: Essays from a Behavioral Perspective". It is concerned with matters of public policy and economic behavior that is relevant for the outcomes of different policies. I approach the research questions from a behavioral perspective, that is, I am not exclusively concentrating on the behavior of fully rational agents. As soon as full rationality is no more taken for granted, experiments become a very useful tool to test the predictions of different models and to provide a test bed for policy variations with maximal control. Therefore, experiments play an important role in my thesis, which consists of multiple chapters. The chapters are discussed in more detail below.

Choosing Voting Systems behind the Veil of Ignorance: A Two-Tier Voting Experiment (Job Market Paper)

There are many situations in which different groups make collective decisions by committee voting, with each group represented by a single person. A natural question is what voting system such a committee should use. Concepts based on voting power provide guidelines for this choice. The two most prominent concepts require the Banzhaf power index to be proportional to the square root of group size or the Shapley-Shubik power index to be proportional to group size. Instead of studying the choice of voting systems based on such theoretical concepts, in this paper, I ask which systems individuals actually prefer. To answer this question, I design a laboratory experiment in which participants choose voting systems. I find that people behind the veil of ignorance prefer voting systems following the rule of proportional Shapley-Shubik power; in front of the veil subjects prefer voting systems benefiting their own group. Participants' choices can only partially be explained by utility maximization or other outcome based concepts.

The Non-Equivalence of Labor Market Taxes: A Real-Effort Experiment

Under full rationality, a labor market tax levied on employers and a corresponding income tax levied on employees are equivalent. With boundedly rational agents, this equivalence is no longer obvious and the different reactions to these two taxes become important for policy making, political economics, and optimal taxation theory. In a real effort laboratory experiment, we study the differential effects of the two taxes on preferences concerning the size of the public sector, subjective well-being, labor supply, and on-the-job performance. Our findings suggest that employer-side taxes induce preferences for a larger public sector. In addition, subjective well-being is higher when the taxes are levied on employers while labor supply is lower, at least at the extensive margin. We discuss three mechanisms that may underlie these results. (with Arthur Schram)

Macroeconomic Behavior and Monetary Policy under Behavioral Expectations: Theory and Experiment

Expectations play a crucial role in modern macroeconomic models. We replace the common assumption of rational expectations in a New Keynesian framework by the assumption that expectations are formed according to a heuristics switching model that has performed well in earlier experiments. We show how the economy behaves under these assumptions with a special focus on inflation volatility. Then we derive implications for monetary policy. We compare the results of the behavioral model to the results arising from full rationality and conduct a learning to forecast experiment to test the opposing theoretical predictions in the laboratory. (with Cars Hommes and Domenico Massaro)

Bond Markets and Credit Default Swaps: Experimental Evidence

Though bond market interest rates and credit default swaps played an important role in the recent financial crisis, little is known about how they interact and affect the probability of bankruptcy. We experimentally investigate how the regulation of credit default swaps influences price formation in a bond market and the likelihood of defaults. Our experimental bond market is different from previous experimental asset markets in that the price of the bond feeds back into the default probability of the issuer as is the case in actual bond markets. In this environment, we investigate the working of credit default swaps when (i) no credit default swaps are available, (ii) when they are available exclusively as insurance, and (iii) when they can be freely traded for insurance motives and speculative purposes. We investigate this with increasing and decreasing fundamental prices in the bond market. (with John Duffy and Arthur Schram)