Behavioral economics should be the study of the heuristics humans use in making judgments about their economic situations and the resulting choices and actions. The field seems to be moving in that direction, but its development has been distorted by its own situation within economics.

From the point of view of a conventionally trained economist, behavioral economics has turned out to be the study of the mistakes people occasionally make in their daily lives. A curious field, but not very interesting or important, because overwhelmingly people behave rationally in the service of their own material interests. Furthermore, these quirks, if taken seriously, complicate an already-difficult body of theory; they are an unnecessary complication.¹

So in this context behaviorists have tended to orient their work as a series of challenges to conventional theory. Particular attention has been devoted to expected utility theory whose convex expected utility functions imply risk aversion in decision making. Behaviorists have found a lot of instances of behaviors contradictory to expected utility theory; they have not established that in sum the contradictions mandate dropping the theory, which after all constitutes a set of assumptions that even if somewhat flawed lead to theorems, that is, results, that are fundamental to the field in its current form. This remains the basic challenge to the field of behavioral economics, since challenging assumptions is a weak challenge to a body of theory the behaviorists are not yet prepared to reject.²

This difference about assumptions cannot be resolved at the present time. In looking at a sampling of behavioral work we will take an intermediate position. Having rejected highly mathematicized economic theory as not supporting the goals science requires of scientific fields, little weight will be placed on studies that are focused on placing behavioral results into that theory. The same applies to studies that do not deal directly with economic issues. Economics is centrally interested in the functioning of markets and systems of markets, and the role of price-mediated behavior.
among market participants. The more interesting and useful results will be those that fall within economics as just defined. This view will then be challenged in Part III, which follows.

Finally it should be noted that the new behaviorism is oriented toward the individual and his judgments and choices. Economic theory, however, is oriented toward the household. It seems that as yet no attempt has been made to bridge this gap, which prima facie would seem to be important.

A Behavioral Experiment

Here’s an example of one of the literally hundreds that psychologists have cooked up and administered over a period of decades. It’s called an ultimatum game, and involves two players, a Proposer and a Responder. The Proposer is given, say, a twenty dollar stake, and is told that he can propose a sharing proportion with the Responder of anything from zero to 100 percent. The Responder can accept or reject the offer. Accept it and the money is shared out as proposed; reject it and both parties get nothing.3

There is some regularity in the outcomes reported from the ultimatum game that has been played thousands of times with a variety of players. Proposers very rarely offer more than half the stake to Responders, and Responders usually reject a share of less than a fifth; most commonly a third to a half is offered and accepted.

There are intuitive interpretations of this game’s outcomes that require no theory to appreciate.

1. Proposers are self-centered enough not to offer to reward Responders more favorably than themselves.
2. Responders are not prepared to be patsies for a relative pittance.
3. Proposers and Responders are aware of the relative power the game confers on the Proposer, and, up to a point, both parties are prepared to accept that power as a fact.

The assumption of material self-interest is adequate to explain the first and third points, but point number two requires something more. This is a one-shot game, so even a pittance is better than nothing, but it is rarely chosen. It would seem that Responders are not indifferent to the size of the payoff to Proposers; at least they are willing to sacrifice a relatively small amount to prevent a much larger relative gain to Proposers. This result is usually interpreted as showing a general human willingness to sacrifice at least a bit materially in the interest of fairness.

Unfortunately for the theorists, fairness is not the only way to interpret the second point above. The game is a one-shot affair, but the participants