

The impact of non-standard preferences and bounded rationality on markets and market design

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 - Unconditional belief in unregulated markets, held also by many economists.

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- Belief in unregulated markets seems to be supported by the first and the second welfare theorem.
- "The first and the second welfare theorem of GE theory prove that a free market economy constitutes the best of all possible worlds."
(introductory statement in a graduate macrocourse by a prominent macroeconomist, 1991)

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 - Are the unconditional arguments in favor of unregulated markets convincing?

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 - importance of confidence: multiple pareto-ranked equilibria ("sunspot equilibria")
 - other regarding preferences like fairness, in particular in labor markets; see also seminal paper by Akerlof 1980, Akerlof and Yellen 1990, Dufwenberg and Kirchsteiger 2000, experimental evidence by Fehr, Kirchsteiger and Riedl 1993/1998, among others.

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 - Can we expect that actual trading rules promote market clearing when traders are have to learn which set of trading rules to use?

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- Due to time limitations: Presentation verbal

The impact of other regarding preferences

Standard Arrow-Debreu GE framework:

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- But overwhelming experimental and empirical evidence for other regarding preferences (ORPs) like envy, altruism, fairness considerations (see e.g. Gueth et al 1982, Bewley 1998 etc.)
- Which of the positive and normative properties of GE survive incorporation of ORPs?

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 - distribution of consumption bundles (well-being externalities)
 - distribution of choice sets (opportunity based externalities)

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 - Intuition: Even if equilibrium prices and allocations are unaffected by ORPs, ORPs allow for paretoimproving redistributions.
 - Even when the impact of ORPs on prices and allocations is wiped out by competition, ORPs cannot be neglected for welfare analysis.

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- Standard Arrow-Debreu GE framework but
- several trading platforms are feasible for each good.
- Before actual trade takes place, agents have to choose one trading platform for each of the goods
- Then, each agent trades only at platforms chosen by him.

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- To close model: numeraire good, that is only traded at a market clearing platform (Dreze 1973)

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- Solution concept - Stochastic Stability: A distribution of agents over the platforms is stochastically stable, if this distribution is observed in the long run in a non-negligible number of periods.

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- 3 Which platforms are used more often in the long run depends on supply and demand, relative speed of learning, and relative size of agents.

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- 3 In case of constant returns to scale production technology: Only coordination on non-market clearing institutions is stochastically stable - only non-market clearing platforms will exist if platforms are designed by platform designers.

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- There is nothing that guarantees that agents learn to avoid inefficient market institutions.
- **Unconditional belief in unregulated markets is not justified.**