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The Ultimatum Game

Over the last 4 weeks I have become increasingly intrigued by the irrational psychological responses typical of players in a game economists call the Ultimatum Game. The game was developed in 1982 by Guth, Werner, Schmittberger and Schwarze.

The game works like this: Player A, receives \$100 and is asked to share it with Player B in a ratio at his/her discretion. The twist in the game is Player B the receiver of Player A's discretionary donation has the right to accept the donation or interestingly decline it so that neither player A or B is entitled to hold onto any of the \$100 windfall.

I decided to put my laboratory jacket on and conduct the experiment with my 2 children aged 9 (girl) and 6 (boy) so that I could witness first hand their behaviour. Having studied some of the vast literature I had a strong feeling how the experiment would turn out; unfortunately I wasn't surprised.

The essence of this simple experiment is to check the axiomatic construct of Classical Economics - "*rational man or Homo economicus*". Once again you will see by extrapolation that to rely on what the mainstream economic experts predict for the economy using their models, is to rely on theory so riddled with contradiction that not questioning its economic reality is probably similar to the way the fund of funds behaved whilst investing with Bernard Madoff. The Austrian School deals with this by basing their thesis on the "acting man" principle which Mises describes as the study of Praxeology in his magnum opus, "Human Action". I will leave a comprehensive look at this subject for another time, save to say that there is no 1 size that fits all, rather human action is the process of subjective marginal utility.

So what happened with the kids, I can hear you asking? Gabriella was given \$10 and I asked her to please share it with her brother and I explained to David that he had the choice to accept or reject the offer with the consequences described above. Gabriella chose to keep \$9 and share \$1 with her brother (incidentally, this split is the most typical offer in the research), David in keeping with the typical response to an offer in this ratio (75% of respondents voted in this manner) chose to decline the offer so that neither of them got anything. The explanation I got from my son without any shame or rhetoric is exactly the same as what the literature suggested. He said, "if she gets more than me then I would rather that we both get nothing". Interestingly the more equitable the split, in other words the closer to a 50:50 split, the more willing Player B is to accept the offer.

Now I ask you as rational human beings does it make logical sense to reject an offer that makes you better off. The logical answer is NO, but who said we are logical/rational. Game theorists have tried to devise complex models for



predicting outcomes to similar problems with varying degrees of success. So why am I sharing the Ultimatum Game with you? My reasons are to expose you to the idea that the world does not behave according to a formulae of logic; rather selfishness and perceptions of equity play powerful roles in our decision making process. So in conclusion when economic pundits, Chairman of The Federal Reserve, Presidents of Countries tell you with conviction that the economy is developing "green shoots" and we are about to sprout into an economic recovery, at least realize that the models they are using tell them that David Berman will accept the offer of \$1 from his sister Gabriella.

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