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Commentary

What is (not) behavioural in labour economics?

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Thomas Dohmen's survey on the impact of behavioural economics on labour economics is an impressive manifesto about the pervasiveness of behavioural assumptions in current labour economics research. Behavioural economics is typically defined via the inverse of the traditional economic agent, who is a self-interested, rational, and forward-looking homo economicus, with perfect foresight, whose utility function is stable and well-behaved. In some surveys of behavioural economics (Berg, 2006, Kaufman, 1999), the traditional agent is a representative agent who has no important personal characteristics as there is no heterogeneity, who lives in a world where only money matters, where sorting plays no role, and where only cognitive skills matter. Moreover, this agent has constant preferences over a long, often infinite, horizon. Looking at this description, one can without doubt paraphrase Milton Friedman in saying "we are all behavioural economists now".

According to such a definition of an economic agent, all current empirical labour economists qualify as behavioural economists, because no one believes in homogeneous effects or preferences which are fixed across different policy regimes or over long time periods. Gary Becker – as exemplarily shown in his Nobel lecture – stresses the explicit motivation to go beyond the traditional economic man: "… the economic approach I refer to does not assume that individuals are motivated solely by selfishness or material gain. It is a *method* of analysis, not an assumption about particular motivations. Along with others, I have tried to pry economists away from narrow assumptions about self-interest. Behaviour is driven by a much richer set of values and preferences" (Becker, 1993, 385). Still, few would claim Becker as a founder of behavioural economics or proclaim James Heckman as a frontrunner because he pioneered heterogeneous treatment effects and stresses the importance of cognitive skills.

Behavioural labour economists have made important contributions in the past decades: It is widely recognised – and modelled – that decision making is often situational and that reactions to policies are heavily influenced by circumstances. Current research recognises that inter-temporal optimization suffers from self-control problems and that it is difficult to optimise in complex situations, e.g., discounting, forming expectations or Bayesian learning. Behavioural aspects have entered policy design and feature on policy recommendations as it is possible, perhaps only in selected cases, to nudge individuals into different – better? – decisions. Modern labour economics does not shy away from non-selfish preferences; for example, fairness preferences have become a standard in the experimental labs. On a more macro-oriented way, labour economists use the insights from behavioural research to study the reasons for wage stickiness or related problems for wage setting, which might have consequences for a micro-foundation of business cycles or monetary theory. In short, one might say: Behavioural economics helped us to get rid of notions where homo economicus was taken too literally.

The integration of behavioural economics into labour issues is certainly a success story. Labour economics is probably a field where the assumptions and methods of behavioural economists were most welcome. I can only speculate on reasons for that: I suppose the highly empirical content of labour, the fact that labour economists were mostly concerned with the behaviour of individuals and their readiness to use micro data to analyse how persons (or firms) react to incentives in different forms might have made the adaptation to explicit behavioural assumptions much easier.

Thomas was perhaps a bit too optimistic when he counted the successes of behavioural economics and I want to mention some caveats which give rise to a more modest assessment of behavioural labour economics. As any other economic tribe, the behaviouralists use some convenient workhorses. Workhorses are useful shortcuts for models and empirical setups; still it should not be forgotten that not every horse is appropriate for every competition.[2] For example, cab drivers are the prototypical agents to model, and analyse, labour supply and inter-temporal substitution problems. Their incentives are easily observed and this makes the analysis convenient. However, cab drivers are perhaps not examples of ordinary workers but of residual claimants, i.e., small-scale entrepreneurs. Ultimatum games and public good games are typically used as primary test fields for the study of selfish vs. rational behaviour. However, participants in these experiments might not realise the implications of a one-shot game. There is also a large variation in the importance of fairness considerations across individuals and settings (Fehr et al., 2009).

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[1] Thanks to René Böheim for helpful comments.

[2] The rapid expansion of behavioural economics might also in part be due to the easy standardisation of these work horses. As in social psychology with standard test batteries or survey instruments, standardised experimental settings make international research much easier.

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Long-term employment relationships are associated with large stakes and many interacting agents in different roles. This makes the modelling of employment relations in the lab difficult and, in cases, questionable. For example, a very well received recent paper reports "field evidence" on the effects of wage cuts (Kube et al., 2013). In their field experiment, students had to work for 3 hours filing books. Although I find the study very interesting and well done, I doubt whether we really learn a lot from this experiment in relation to, say, wage cuts in an automobile factory.

Since we know that there is convincing evidence on people's preferences for non-selfishness or for fairness, should labour economists reject the standard assumptions used for the standard economic agents? When I look out of the window, I generally see more and more selfish behaviour: spot-market operations and contracts gain momentum, the prevalence of long-term relations is declining, and contracts are getting shorter and more precarious. For me, it seems a reasonable starting point to assume neither benevolent nor malevolent preferences in a baseline model—which ought to be expanded and improved with new evidence.

Summing up, I think Thomas Dohmen's (2014) survey shows nicely the influence of behavioural economics on labour economics; it stands almost on an equal footing with more traditional theories and is, in fact, more integrated as one might have thought. I am not convinced – as Thomas seems to suggest – that the inclusion of personality issues or non-cognitive skills is the most fruitful road to go in the future. This seems to me to be a more side issue. There are, in my view, two aspects which the survey does not cover which could help in evaluating behavioural economics' success. First, what is the influence of behavioural economics on psychology proper? Do psychologists take (labour) economists more seriously than before or are economists still perceived as peddling the homo economicus? The other aspect is the influence of behavioural economics on policy making (Babcock et al., 2012) and on macroeconomic issues (Driscoll and Holden, 2014). In my impression the causal treatment effect revolution in microeconometrics has had a much larger influence on actual policy making—or at least on policy advice. As macroeconomic models are concerned, the trend seems to go more towards super-rationality. It is also a bit surprising to me that the actual International Student Initiative for Pluralism in Economics (www.isipe.net) is unhappy with neo-classical economics, but does not acknowledge the extensive and far-reaching insights from behavioural economics.

Thomas Dohmen (2014) writes that behavioural economics led to a "… clear shift in topics addressed by members of EALE. Macro-labour topics such as macroeconomic models of unemployment, wage structure, wage inflation, working hours, labour market policies, unions and bargaining, labour market institutions, social security, or regional labour markets dominated the programme of early conferences. Around the turn of the millennium, topics like family and work, retirement behaviour, incentives, skills and technical change, or job satisfaction appeared on the conference programme. In recent years, issues relating to schooling choices, cognitive and non-cognitive skills, motivation and incentives, social preferences, risk preferences, and sorting based on skills, preferences and personality traits, are increasingly addressed. The growing concern for the implications of heterogeneity in preferences and personality traits is also apparent."

While personally, I am very interested in the latter topics as well, I would still consider it a pity if the labour economics profession would shift its attention away from topics such as unemployment, labour market institutions, and policy evaluation. Given the greatest number of unemployed persons in Europe since the 1930s, it would, in fact, be unwise.

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