

The 2nd European Colloquia

29th November 2007

*What Experimental Economics Teach us About how to
Improve the Outcome of Individual Choice*

Vernon Smith

Nobel Laureate 2002

I. Principles

1. Wealth comes from specialization—skill (“know how”), innovation, tools:
 - No exchange (markets),
 - No specialization,
 - No wealth creation.

I. Principles

2. The forms of innovation are unpredictable:

- Arise from generating lots of entrepreneurial experiments
- Most fail to profit from new technologies/products
- Bottom up process--thrives amidst freedom to innovate, and discover

I. Principles

3. Wealthy societies follow liberal principles:

- rule of law
- choice regulated by markets,
- by actions of others;
- constrained by property
- (human) rights.

I. Principles

4. Freedom's role in socioeconomic evolution:

- Ideas/plans are sources of **variation** for the grist mill of cultural change
- But such schemes are not good at **selection**
- Decentralized discovery processes (free exploration) are essential

I. Principles

5. You cannot redistribute wealth not created
- Nobody gets any if there isn't any!
 - Redistribution must protect wealth creation.
 - Minimize unintended negative consequences.

I. Principles

6. Savings: the forgone consumption of surplus is society's only means of investment and of growing its future resource base.

II. Pension Policies

The Status Quo and Default Decision Making

II. Pension Policies

1. Inertia-Default is No Change.

- But change is required to satisfy individual's own mindful goals.
- Why this default inertia?
- It's how our brains work
- Contrary to economic theory, most actions do not flow from mindful deliberation.

II. Pension Policies

2. This argues for simple “default in” policy rules like auto enrollment in new pension and savings plans.
3. Are “default in” rules enough?
 - Will people’s inertia trick them into achieving the desired savings?
 - No one knows until we observe their long term effects.

II. Pension Policies

4. Baselines vs Outcomes

- Will only the latter change?

Example: Welfare altered family structure
females became heads of existing and
new households.

III. Are there Potential Unintended Consequences of New Savings Policies?

- 1. More savings require more investment/innovation opportunities; where will these come from?**
- 2. How will easy money (more savings) impact due diligence of fund managers?**

III. Are there Potential Unintended Consequences of New Savings Policies?

3. More passive investment; if all flows go into Index Funds, who discovers the index prices?

4. Increased liquidity, bigger bubbles?
 - Clinton authorized zero tax on home capital gains (up to \$500,000) Everyone applauded, but Now we have the mother of all housing/mortgage market bubbles. More homes (second or third?), more consumption.
 - Is this the path to innovation? For helping the poor?

III. Are there Potential Unintended Consequences of New Savings Policies?

- **Question for Europe:** Why are the large European economies; Ger, UK, Fr, Italy, Sp, not among the best ten in:
 - Human Development Index
 - Innovation Index
 - Information Technology Index
 - Low Brain Drain
 - Global Competitiveness
 - Economic Freedom Index (UK tied for #5)
 - Low # days to register new bus. (FR tied for #8)
 - Favorable Business Environment (UK#10)

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