WHEN RATIONAL CHOICE ERASES OR MAGNIFIES BOUNDEDLY-RATIONAL CHOICES IN ECONOMICS: EVIDENCE FROM LUPI LOTTERY GAMES AND PRICE BUBBLE EXPERIMENTS

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ABSTRACT
The idea that traders should rationally respond to actions of others is a double-edged sword in economic systems. If some agents are boundedly-rational (in a plausible way), in some economic structures it is profitable for more rational agents to follow them and magnify their effects (strategic complements). We illustrate this possibility with lab data from experimental price bubbles, in which prices reliably rise above a buy-and-hold fundamental value, and then crash.

However, in other economic structures, if some agents are boundedly rational then it is profitable for more rational agents to bet against them, which can lead to population dynamics that are amazingly close to equilibrium outcomes that are barely computable. We illustrate this possibility with 2.5 million field choices and 3000 lab choices in a LUPI lottery in which the lowest positive unique integer wins. In these games, the aggregate distributions are close to those predicted by highly counter-intuitive game theory.