

Reply by Earl to Referee 2

I would like to thank Referee 2 very much indeed for this report, and I intend in the final version of the paper to address all the points he made, even though this referee was happy for the paper to go forward in its original form.

I will certainly be trying to add some less 'exotic' examples at the end, though I shall also be noting how, in a social world, the seemingly rare instances of questionable responses to probability information may have much wider consequences for well-being – which is precisely why the medical profession are worried about even small decreases in immunization rates. The referee's comments about the 'exotic' nature of this example have usefully prodded me in to reflecting on why I thought it an example worth including in the first place.

I like the industrial organization perspective that Referee 2 brings into the discussion, especially how it may turn the Frey and Gallus argument on its head, and I was already realizing I ought to discuss the competitive process more after seeing the example Frey and Gallus offered in their own comment on my paper. It is important that I take care in following through the implications of incompetence versus predatory behavior, which indeed I hadn't properly separated in the original version, and I have some examples ready to run here from the home renovation and mobile phone service provision areas, with the latter bringing in the 'confusopoly' perspective.

In the light of the referee's comments, I believe I need to be clearer on what my agenda is in offering this paper. I'd certainly be happy to see Frey and Gallus doing further empirical work on the welfare outcomes of real-world ways of making decisions in different kinds of contexts. I think we should be prepared for surprises: in the work I'm currently writing up with colleagues on choices of mobile phone connection services, it has been clear that many consumers are wasting substantial sums on their phone plans and yet in our work using protocol analysis it has been evident that access to market institutions can enable subjects to end up doing far better than one might expect from how they go about the choice process, a critical factor being how competently they make use of these institutions and how the institutions have been designed. But this kind of work is very demanding in terms of time and resources, as I'm sure Frey and Gallus would agree. So my big concern is that it will not get done on the scale that it needs to be and that the Frey and Gallus argument that twisted micro-level choices *might* not have dysfunctional macro-level outcomes in some constitutional contexts may therefore be used as a basis for returning to the 'as if' strong rationality perspective that dominated before modern behavioural economics took off.

My aim was indeed to contribute to pre-empting such an outcome -- partly by revisiting the perspective of the old behavioural economics (e.g. the work of Herbert Simon) that has been neglected during the rise of the new behavioural literature, and partly by suggestion that the implications of the heuristics and biases literature, particularly the notion of anchoring, are much more profound than modern behavioural economists have mostly been willing to accept. The

chances of avoiding a retreat to a full rationality approach will, I think, be enhanced if more attention is devoted to the tricky question of how we can appraise outcomes if we accept the path-dependent and rule-driven nature of much choice and don't view choices generally 'as if' they are based on 'given' convex preference systems.

In short, think Frey and Gallus have raised a very important research question but because they used the conventional reference point there is a risk that their research agenda will not get the traction it deserves. But I can also see why Frey and Gallus might be opting to be less radical than I would like them to be: I hope that my case for decouple that question from rational choice theory will not contribute to it being put into the 'too hard' and conservative economists misusing the Frey and Gallus analysis in precisely the way I am hoping to preempt. I need to acknowledge this dilemma in the final version of the paper.