CENTRO DE ECONOMÍA APLICADA

Abstract

This paper presents a strategic model of referent-dependent social preferences where the reference point corresponds to the agent's rational expectation about equilibrium payoffs. These payoffs are determined by an Interpersonal Nash Equilibrium requiring strategies to be credible best responses: given the other agent's optimal strategy the agent must be willing to follow his own optimal strategy once it constitutes the reference, while only considering equally credible strategies as deviations. We show that (1) even low levels of concern about others' payoffs can have large effects on behavior (2) pure strategy equilibria are Pareto superior with respect to mixed-strategies equilibria (3) and in sequential environments out-of-equilibrium play triggers further deviations as it forces the agent to choose conditional on his unrealized expectation. We apply our model to the temporal behavior of the gift exchange and the crowding out of intrinsic motivation by monetary payments.