Chapter Fourteen Exercises

1. In 1948, a distinguished economist proclaimed that, "Never in the lifetime of anyone in this room will government two-and-a-halves [2.5 percent coupon bonds] sell below par." Was he right?

2. Explain why you either agree or disagree with the following quotation:

> The [stock] market depends on error for its very existence. If people weren't wrong, there could be no stock market.
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> Suppose everybody knew the future perfectly. Suppose everybody knew with absolute certainty, for example, that the fortunes of a certain company were about to improve. Nobody would then want to sell that company's stock. There would be a world full of buyers but no sellers. And when the shape of the future changed, when everybody knew for sure that the company was heading for trouble, there would be a world of sellers but no buyers. There would be no stock market. There could be none.

3. When one hundred MIT MBA students were offered these three subscription choices to *The Economist*,

    1-year online subscription $59
    1-year print subscription $125
    1-year print and online subscription $125

   sixteen chose the online subscription, none chose the print subscription, and eighty-four chose the combination print and online subscription.

   When one hundred other MIT MBA students were offered just two choices,

    1-year online subscription $59
    1-year print and online subscription $125

   sixty-eight chose the online subscription and thirty-two chose the combination print and online subscription.

   Is this observed difference in the online and print/online subscription choices between these two offers statistically persuasive?

4. Daniel Kahneman, a psychologist who won a Nobel prize in economics, once told Israeli flight instructors that their trainees would progress faster if they were praised instead of punished. A senior instructor strongly objected:

> On many occasions I have praised flight cadets for clean execution of some aerobatic maneuver, and in general when they try it again, they do worse. On the other hand, I have often screamed at cadets for bad execution, and in general they do better the next time. So please don't tell us that reinforcement works and punishment does not, because the opposite is the case.

   What would you have said in response?

5. Here is a description of an experiment designed by a psychology professor:

> Let's say you were one of the participants. You walk in and sit down and he explains the rules. You are to play the role of a teacher. You will be able to punish a student for being late and reward him for being on time. Or you can choose to do nothing at all. You are presented with a series of the arrival times of a student for fifteen days in a row, one day at a time. Sometimes your student arrives late and sometimes he arrives on time.
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> You want to get a good result so you punish the lateness and reward the punctuality. Almost everyone in the experiment does this. What you don't know is that the student is arriving late and on time *at random*. The arrival times were all decided before the experiment started and your punishment and rewards are not influencing the student at all.
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> But it very much *seems* to you that your rewards and punishments are having an influence — a *bad* influence. Your student seems to do *better* after being punished, and *worse* after being rewarded. Most of the participants in this experiment concluded that punishment works better than rewards. It was the obvious conclusion, given what they experienced.
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> But their conclusions were wrong.

Why do you think their conclusions were wrong?