

# Favorable Interpretations of Ambiguity in Other-Regarding Behavior

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**Abstract:** We demonstrate that people can adopt a favorable view of ambiguous risks – contrary to the usual attitude of ambiguity aversion – when doing so permits justifications for unfair behavior. We use simple binary dictator games in which one participant in a pair chooses between two allocation options for herself and a recipient. The “fair” option gives both participants relatively equal allocations, while the “unfair” option gives more to the dictator, less to the recipient, and also makes the recipient’s allocation dependent on a  $p=0.5$  lottery. Dictators choose the unfair option more frequently when the recipient’s allocation depends on an ambiguous lottery than on a lottery with a known probability – even though the objective distributions of outcomes are identical under the two kinds of lotteries. Further, dictators’ estimates of the expected value of their allocation are inflated under ambiguity, indicating that dictators manipulate their beliefs to hold favorable views of ambiguity. Finally, increased unfair behavior under ambiguity is extinguished when dictators are constrained by their own initial unmotivated, and negative, attitudes towards ambiguity.

**Keywords:** ambiguity, social preference, fairness, dictator game, altruism

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## Favorable Interpretations of Ambiguity in Other-Regarding Behavior

Suppose a manager must decide whether to layoff an employee in order to cut costs. If she does so, it will increase the manager's bonus. However, the employee may find it difficult to find another job and it will take time to do so, meaning that the employee will suffer harm if the layoff occurs. This decision involves the kind of tradeoff that social scientists often study between self-interest and the welfare of others. Considerable research – which we review below – suggests that people exhibit positive concern for others' welfare.

Now, compare a situation where the employee faces a  $p = 0.5$  likelihood of finding work in the next six months with a situation in which less is known about the job market: the probability is between 0 and 1, with all probabilities equally likely. This distinction is often studied as the difference between “risk” and “ambiguity” (or “Knightian” uncertainty). Considerable research on ambiguity aversion – also reviewed below – suggests that the employee would prefer to be laid off in the market with the known 0.5 probability than in the one characterized by ambiguity. Thus, if the worker's preferences matter positively to the manager in the layoff decision, the layoff should be *less* likely to occur in the ambiguous case.

In this paper, we argue the opposite. The situation with less precise probability allows the manager greater flexibility to manipulate her beliefs about the likely consequences for the employee. That is, in the case with an ambiguous probability it is plausibly much easier for the manager to convince herself that the employees will be able to find work quickly (i.e., that the actual probability is higher than 0.5) and that, therefore, enacting the layoff is not that harmful.<sup>1</sup>

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<sup>1</sup> There are other contexts in which subjective beliefs can be manipulated in the pursuit of self-interest. For example, a manager deciding whether to adopt a profit-maximizing strategy that might harm the environment could adopt a favorable view of the likely consequences under ambiguity. Similarly, an elected official deciding whether or not to take a bribe could adopt a favorable view of the harmful effects on society when the likelihood of negative consequences is less precisely defined. Finally, mortgage brokers who are motivated to sell loans might find it easy to adopt a favorable view of an applicant's creditworthiness.

Using an experiment that re-creates the key features of the above situation, we find self-interested manipulation of beliefs when the consequences of decisions are ambiguous. That is, we find that people considering tradeoffs between self-interest and others' welfare adopt favorable views of ambiguity in order to behave more selfishly (and unfairly). We demonstrate the adoption of a favorable view of ambiguity by eliciting subjective expectations of outcomes, with an incentive for accuracy. Moreover, we demonstrate that such a favorable view of ambiguity – and the accompanying increase in self-regarding behavior – can be extinguished by using participants' own initial, and negative, attitudes towards ambiguity to constrain their subsequent attitudes.

Thus, in applying our findings to the case of the manager considering a layoff, we demonstrate that: a) she will convince herself that the ambiguous job market is more favorable than it actually is, b) this will make her more likely to take the personally rewarding action that harms the employee, and c) asking her which kinds of job market she would prefer for herself, before she has a self-interested reason to view the ambiguous one favorably, will prevent her from subsequently adopting a favorable view of ambiguity in order to justify the layoff.

### **Review of Relevant Literature**

This paper addresses two important regularities in social science: 1) that people generally exhibit a positive concern for others' welfare and 2) that people generally exhibit aversion towards random processes with subjectively ambiguous (unknown) probabilities. Independently, there is ample evidence for both regularities.

People often sacrifice personal gain for others' welfare (Kahneman et al. 1986; Dawes and Thaler, 1988; Andreoni and Miller, 2002), a result most strongly demonstrated in the well-

known laboratory dictator game, in which one participant shares wealth with another despite the absence of any extrinsic incentives for doing so (Forsythe et al., 1994; see also Camerer, 2003). The extent of this regularity has led many researchers to model such social concern as a preference for fair or pro-social outcomes (Fehr and Schmidt, 1999; Bolton and Ockenfels, 2000, Charness and Rabin, 2002; Engelmann and Strobel, 2004; Benabou and Tirole, 2006).

People are also generally averse to lotteries about which they possess less precise information on the distribution of outcomes (often referred to as “ambiguous” lotteries),<sup>2</sup> even when such lotteries have objectively identical distributions to lotteries with “known” or “simple” risk. Thus, people prefer to bet on a lottery involving 10 red and 10 blue chips over betting on either color in a lottery involving an unknown combination of 20 red and blue chips, and are often willing to pay a premium for the unambiguous lottery (Curley et al., 1989; see also Sarin and Weber, 1993; Ho et al., 2002; Hsu et al., 2005). In fact, such “ambiguity aversion” is referred to as one of the most prominent violations of expected utility theory (Camerer and Weber, 1992),<sup>3</sup> and has led to models in which the value of (or expectation of favorable outcomes in) gambles involving ambiguity is lower than when distributions are defined more precisely (Einhorn and Hogarth, 1986; Sarin and Wakker, 1998; Schmeidler, 1989; Ghirardato and Marinacci, 2002).

To summarize the above two lines of research: in contexts pitting self-interest against social concerns, people typically place value on the latter, and in contexts involving ambiguous random processes, people typically exhibit ambiguity aversion. However, in this paper we show

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<sup>2</sup> There is some debate regarding whether “ambiguity” is the correct term to describe random processes about which there is less precise information – compared to, for instance, “vagueness” (e.g., Budescu et al., 2002) or using the terms “risk” and “uncertainty” to label the distinction (Epstein, 1999). We adopt the term ambiguity following the majority of the literature (see Ellsberg, 1961).

<sup>3</sup> There are a few situations in which ambiguity is preferred. Curley and Yates (1989) found ambiguity seeking at low probabilities ( $p=.25$ ) and Heath and Tversky (1991) found that when people feel confident in their own judgment they prefer to bet on their judgment over a lottery with a probability equal to their confidence, which is the inherently less ambiguous option.

that the combination of the two kinds of contexts yields evidence that questions the extent to which the above two regularities are indicative of robust underlying preferences (either for fairness or against ambiguity). More precisely, in choices that pit self-interest against others' welfare – as in the example at the beginning of our paper – we demonstrate that ambiguity becomes attractive in that it can be used to justify self-interested and unfair behavior. We find that more self-interested choices are made when the consequences for others involve ambiguous (unknown) probabilities than when they involve ones that are known – even though, objectively, the ambiguous and known random processes are identical.

Our work is the first to concretely demonstrate that people adopt favorable views of ambiguous risk in order to behave self-interestedly. We do so by directly measuring subjective beliefs, with incentives for accuracy, and by demonstrating that it is these modified beliefs that drive increased self-regarding choice. Moreover, we further demonstrate that these positive attitudes towards ambiguity can be prevented by using participants' own initial, negative, attitudes towards ambiguity to constrain their subsequent beliefs and behavior.

Our results are of general importance for three principal reasons. First, we provide an important caveat to the belief that people choose to share with others, in situations such as the dictator game, out of a genuine positive preference for others' welfare or for pro-social concerns. We find that our participants search for an excuse not to share, going as far as manipulating their subjective beliefs to justify self-regarding behavior. Our results suggest that self-interest, coupled with a desire to maintain the perception of behaving fairly, is a more likely motivator of behavior, and thus support other recent papers that claim much fair or pro-social behavior occurs without people really wanting to behave fairly (Rabin, 1995; Dana et al., 2006; Dana et al., 2007; Lazear et al., 2006; see also Bolton et al., 1998).

Second, we demonstrate that under certain conditions, attitudes towards ambiguity are malleable, based on what an individual wants to believe. Considerable evidence from psychology suggests that individuals tend to process information and arrive at conclusions in a manner influenced by what they *want* to hold true (see Kunda, 1990 for a review of “motivated reasoning”).<sup>4</sup> Bargaining and allocation decisions can also be influenced by “self-serving biases” that influence perceptions of fairness (Messick and Sentis, 1979; Babcock et al., 1995; Babcock et al., 1997; Wade-Benzoni et al., 1996; Diekmann et al., 1997; Konow, 2000). Thus, our participants, who are motivated by self-interest to believe that the lotteries for the recipient are more attractive than they actually are, find it easier to do so with less precise information about the distributions of outcomes under ambiguity.

Third, we demonstrate how the interaction of “regularities” in social science can produce reversals of the underlying phenomena, thus yielding valuable insights. For instance, research on ambiguity aversion and on other-regarding concerns would predict that the manager in our motivating example would be less likely to lay off the employees in the case with ambiguity. However, our research reveals that the malleability of attitudes towards ambiguity allows for the justification of self-interested decisions in contexts involving others’ welfare. Understanding when, and how, such attitude change occurs is important for predicting the behavior of economic agents. Moreover, our finding that participants’ initial – and unmotivated – attitudes can be used to constrain their subsequent behavior yields an important prescription for how to limit people’s ability to engage in self-interested belief manipulation.

A few previous studies suggest that when people are faced with tradeoffs between self-interest and fairness, they may capitalize on uncertainty in order to behave self-interestedly. For

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<sup>4</sup> Relatedly, people maintain higher perceptions of their own abilities or quality under greater ambiguity (e.g., Dunning 1999; Klein, 2001; Santos-Pinto and Sobel, 2005; Klein et al., 2006).

example, Schweitzer and Hsee (2002) found that participants gave more selfishly deceitful advice to another, concerning an unknown value, when the range of their private information about the true value was wide compared to when it was narrow. Dana et al. (2007) found that dictators chose to remain ignorant about consequences of their decisions for a recipient – even when this information was freely available – in order to behave self-interestedly. However, none of these studies elicits participants’ beliefs of the distributions over uncertain outcomes, as we do, to test whether subjective beliefs actually change in order to justify the increased self-interested behavior. Moreover, we are the first to show a means to prevent people from capitalizing on uncertainty to justify self-interested decisions, using only their own previous attitudes. Finally, unlike in the above research, the degree of uncertainty in our experiment is objectively unchanged.

### **Theoretical Framework and Hypotheses**

Our study directly examines the influence of favorably-biased perceptions of uncertainty on fair behavior. We manipulate uncertainty through the distinction between simple (known) risk and ambiguity, which increases *subjective* uncertainty by decreasing the knowledge of the precise probability distribution that determines outcomes. In what follows, we present a simple model to describe the choice environment in our motivating example and in our experiment. We use this model to develop our main hypothesis.

We consider a situation in which two individuals,  $A$  and  $B$ , are both influenced by  $A$ 's choice between two actions ( $x \in \{0,1\}$ ). Both individuals receive payoffs resulting from the action and the outcome of a binary lottery ( $L \in \{0,1\}$ ), where  $p$  denotes the probability that  $L = 1$

and  $1-p$  the probability that  $L = 0$ . Denote the individuals' respective payoffs from the action choice and the lottery by  $\pi_A(x, L)$  and  $\pi_B(x, L)$ .

Assume that  $A$ 's payoffs are uninfluenced by the lottery (i.e.,  $\pi_A(x, 0) = \pi_A(x, 1)$  for either value of  $x$ ) and that  $B$ 's payoffs only depend on the lottery when  $A$  chooses  $x = 1$  (i.e.,  $\pi_B(0, 0) = \pi_B(0, 1)$ ). We therefore use  $\pi_A(x, \cdot)$  and  $\pi_B(0, \cdot)$  to refer to the cases in which payoffs are uninfluenced by the lottery.

We allow  $x = 0$  to represent the other-regarding choice and  $x = 1$  the self-interested choice by assuming that  $\pi_A(0, \cdot) < \pi_A(1, \cdot)$  and that  $\pi_B(0, \cdot) > \pi_B(1, 1) > \pi_B(1, 0) = 0$ . Therefore, as in the example at the beginning of this paper,  $A$  can increase her own payoff by taking action  $x = 1$ , but this both lowers  $B$ 's payoff and makes it dependent on a lottery.

Assume that  $A$ 's utility is given by

$$U_A = \pi_A(x, \cdot) + \beta \pi_B(x, L), \quad (1)$$

where  $0 \leq \beta \leq 1$  represents  $A$ 's concern for  $B$ 's payoff. If  $\tilde{p}$  is  $A$ 's subjective probability for lottery  $L$ , then it follows that a subjective expected utility maximizing individual  $A$  will chose  $x = 1$  only when

$$\pi_A(0, \cdot) + \beta \pi_B(0, \cdot) \leq \pi_A(1, \cdot) + \tilde{p} \beta \pi_B(1, 1) \quad (2)$$

Consider two individuals,  $A_1$  and  $A_2$ , with identical other-regarding preferences ( $\beta_1 = \beta_2$ ). Assume that they each face the above decision problem, but that their subjective probabilities for lottery  $L$ ,  $\tilde{p}_1$  and  $\tilde{p}_2$ , may differ. The following proposition follows immediately:

**Proposition:** Consider two individuals,  $A_1$  and  $A_2$ , with identical other-regarding preferences ( $\beta_1 = \beta_2$ ), then  $x_1 = 0$  and  $x_2 = 1$  if and only if  $\tilde{p}_1 \leq \tilde{p}_2$ .

This states that if two equally other-regarding individuals confronted with the same objective decision behave differently, with one individual choosing  $x = 0$  and the other  $x = 1$ , then the individual choosing self-interestedly must have a (weakly) higher subjective probability for the lottery. (If we assume a deterministic process for making choices under indifference, then the weak inequality becomes strict).

Our experiment tests the above comparison between (statistically) identical individuals. We predict that participants, who want to maximize their own wealth but also want to believe they are behaving fairly, will adopt a higher subjective probability for lottery  $L$  when  $L$  is described as “ambiguous,” in order to justify self-interested behavior. Therefore, we predict that, under ambiguity, more participants will choose self-interestedly and will demonstrate increased subjective expected values for lotteries.

However, we also predict that such positively-biased motivated perceptions of ambiguity will be influenced by whether participants have an incentive to view ambiguity favorably and by their own previously developed attitudes towards ambiguity. Therefore, neither participants making hypothetical choices without real consequences nor participants who have previously expressed preferences between ambiguity and simple risk (who in doing so have adopted a lower subjective probability of ambiguous lotteries vs. lotteries involving simple risk) will demonstrate increased self-interested behavior under ambiguity.

Hypothesis: Participants will behave more self-interestedly and will reveal higher subjective expected values for lotteries when the consequences for the other party involve ambiguity instead of simple risk. These relationships will not occur with hypothetical stakes or with previously constrained attitudes.

## Experimental Design

We conducted an experiment to test the above hypothesis. As in the model, participants in our experiment made binary choices involving stochastic payoffs for the other party. Our treatments varied whether the random process involved *ambiguity* or *simple risk*, whether the choices involved *real* or *hypothetical* consequences, and whether participants' attitudes were *unconstrained* or *constrained* by previously expressed attitudes towards ambiguity. Table A1 in the appendix describes the procedures, in sequence, for our experiment.

### *Choices and estimates*

In all of our treatments, participants made four choices involving a tradeoff between self-interest and fairness in line with those in the model (see Table 1). We modified the standard dictator game to a binary choice with a potentially uncertain outcome for the recipient. In this modified game, one participant in each pair (the dictator) chose between a “self-interested” allocation and an “other-regarding” allocation for herself and an anonymous other participant (the recipient).

These choices were made both by the dictators (for real consequences) and by the recipients (for hypothetical consequences). Following these four choices, all participants (including recipients) estimated the expected value to the other party of their four allocation choices. All participants received a monetary incentive for accuracy (\$1 for providing an estimate within \$0.10 of the actual expected value).

### *Lotteries*

Each session involved lotteries with either known (simple risk) or unknown (ambiguity) probabilities. For simple risk lotteries, a chip was drawn from a bag containing precisely 10 red and 10 blue chips. For ambiguous lotteries, the bag contained unknown numbers of red and blue chips, totaling 20 chips; the composition was determined by a random draw from 0 to 20, with uniform probability, prior to the experiment. Although the ambiguous lottery might appear subjectively more uncertain than the lottery involving simple risk, the two lotteries are normatively identical: the probability of drawing either a red or a blue chip is 0.5 in both cases.

At the beginning of each session, participants were informed that they would be making decisions involving lotteries. The distinction between the simple risk lottery (termed “Lottery 1”) and the ambiguous lottery (termed “Lottery 2”) was explained.<sup>5</sup> Lotteries were implemented using bags containing red and blue poker chips (participants decided which color they wanted to correspond to a win). Participants were informed that the contents of Lottery 2 were determined by selecting a new random number every time the lottery was played. Participants were then told which kind of lottery would be used in their session.

### *Unconstrained Treatment*

Participants were randomly assigned to the role “A” or “B” and paired with a participant in the opposite role. Participants were assured that their identity and the identity of the person with whom they were paired would be anonymous. Role A participants made decisions with consequences for themselves and for their matched Role B participant. Role B participants made similar decisions, but their decisions were hypothetical and did not impact outcomes or payoffs

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<sup>5</sup> The rationale for describing both lotteries to each session was based on evidence that ambiguity is only perceived in a comparative context (Fox and Tversky, 1995).

(participants knew this). A's and B's were moved to opposite sides of the room following role assignment.

Each participant made the four choices presented in Table 1. The labels “self-interested” and “other-regarding” were not used; instead the choices were presented neutrally, as follows:

*Please select **one** of the following:*

*You receive \$2 for certain and the person you are matched with receives \$1.75 for certain*

*OR*

*You receive \$3 for certain and the person you are matched with wins \$.50 if a winning chip is drawn in his/her lottery*

All participants received a stack of four sheets, each containing one of the decisions in Table 1. We counterbalanced the order of decisions; roughly one half of participants in each condition received the decisions in the inverse order. Participants were told to go through the sheets one by one, and not to return to previous sheets.

The experimenter collected these sheets and distributed another response sheet, which asked *all* participants to estimate the expected dollar amount that the recipient of the previous four choices (real or hypothetical) would receive after the resolution of any lotteries.<sup>6</sup> They were told that for an estimate within \$0.10 of the actual expected value they would receive \$1.

Finally, to measure attitudes towards ambiguity, all participants were asked to decide between playing Lottery 1 or 2 for the chance to win \$5 for themselves (and to chose a winning color in the lottery). They were informed that one person would be selected at random to play this lottery at the end of the session.

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<sup>6</sup> We explicitly asked participants for the “expected value.” To illustrate the concept, we informed participants that for every combination of choices there is a correct estimate, based on the laws of probability, and this is the best guess one could make given that the outcomes of the lotteries are not yet known.

All lotteries were then resolved sequentially by drawing either a red or blue chip out of a bag. For each lottery, a new bag was used and the result was announced publicly. Participants were then paid privately, in cash.<sup>7</sup> One participant stayed behind to play the additional \$5 lottery.

### *Constrained Treatment*

The Constrained Treatment was identical to the Unconstrained Treatment, except that participants first made decisions involving risk and ambiguity with no conflict between self-interest and fairness. These decisions were made prior to participants having any knowledge of the binary dictator game.

After the explanation of lotteries at the beginning of the experiment, participants each made four decisions for themselves. Participants made these decisions under either simple risk or ambiguity. Table 2 lists the payoff structure for each of the four decisions, which were presented in the following format:

*Please select **one** of the following:*

*You receive **\$.75** for certain*

*OR*

*You receive **\$1.50** if a winning chip is drawn in a lottery*

Participants received a stack of sheets containing the four decisions in Table 2 and were instructed to go through them one at a time. After the experimenter collected the choices, participants received a sheet on which they estimated the expected value of their own payoff. These choices primarily serve as a control to ensure that participants are not naturally ambiguity-loving for the stakes and probabilities associated with the allocations in the binary dictator game.

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<sup>7</sup> Prior to payment, participants filled out a brief questionnaire asking them to rate the fairness of their own choices and how fair they viewed themselves in general. We thought that dictators who made decisions under ambiguity might view self-interested allocations as less unfair. Previous versions of this paper found moderate support for this hypothesis. However, after collecting additional data, this result was not replicated and we exclude the analysis.

Participants in the Constrained Treatment then made another choice intended to establish participants' unmotivated and negative attitudes towards ambiguity. They chose which kind of lottery (1 or 2) they would like to play for the chance to win \$5 and were informed that one participant would be selected at the end of the session at random to play the lottery. (In the Unconstrained Treatment, this decision was made at the end of the experiment.)

The Constrained Treatment then proceeded identically to the Unconstrained Treatment, beginning with random assignment to the role of A (dictator) or B (recipient) and instructions for the binary dictator game.

### *Participants*

Participants were recruited from a subject pool of undergraduate students taking business classes at Carnegie Mellon University. They received extra credit in one of their business courses in exchange for participation in an hour-long experiment. In addition, participants received their cash earnings privately at the end of the experiment. For the Unconstrained Treatment, we used 89 pairs of A and B participants (43 under simple risk, 46 under ambiguity), while in the Constrained Treatment, we used 36 pairs (29 under simple risk, 29 under ambiguity). Thus, a total of 294 participants participated in the experiment.

### **Results**

Our primary variables of interest are the four allocation choices made by each individual participant ( $X_i = \{x_i^j : j = 1, \dots, 4\}$ ) and participants' subjective estimates of the expected value of the total allocation (real or hypothetical) to the other party across the four decisions:

$$\tilde{E}_i[\pi_B | X_i] = \sum_{j=1}^4 (1 - x_i^j) \pi_B^j(0, \cdot) + x_i^j \tilde{p}_i^j \pi_B^j(1, 1). \quad (3)$$

We compare a participant's estimate to the actual expected value of the allocation to the other party ( $E_i[\pi_B | X_i]$ ) – which is the same as in the equation above, but with the actual probability for each lottery ( $p^j$ ) in place of the subjective probability ( $\tilde{p}_i^j$ ). For each individual participant, we construct a measure of bias in estimates:

$$\text{Bias}[\tilde{E}_i] = \tilde{E}_i[\pi_B | X_i] - E_i[\pi_B | X_i] = \sum_{j=1}^4 x_i^j (\tilde{p}_i^j - p^j) \pi_B^j(1,1). \quad (4)$$

Recall that our main hypothesis can be summarized as follows: *Ambiguity* will increase unfair behavior and overestimation of expected value, relative to simple risk, only for *Real* choices made by *Unconstrained* dictators. Table 3 presents, for each treatment, the frequency of unfair ( $x = 1$ ) choices made by participants. Figure 1 and Table 5 and present summaries of the bias in estimates by condition.

The results support our hypothesis. For example, as Table 3 reveals, Unconstrained-Real participants choosing under Ambiguity chose the self-regarding option 73 percent of the time (an average of 2.93 out of 4 choices). This frequency was higher than in *all* other conditions. Most importantly, the frequency of unfair choices was lower for Unconstrained-Real participants under Simple Risk (59 percent, or 2.35 of 4 choices) and this difference is statistically significant. There is no statistically significant difference in the proportions of self-interested choices between Ambiguity and Simple Risk in any of the other conditions. Moreover, the proportion of self-interested choices in the top left cell in Table 3 (Real-Unconstrained-Ambiguity) is significantly higher than in any other cell ( $p < 0.06$  in one instance,  $p < 0.02$  in all others).

To control for repeated observations from each participant, we conducted ordered probit regressions in which the dependent variable was the number of self-interested choices made by

each participant. Table 4 reports the results. Again, we see that the only condition in which Ambiguity produces significantly more self-interested behavior is for Real-Unconstrained participants.

Turning to bias in estimates of the expected value of the allocation, Figure 1 and Table 5 also reveal a pattern consistent with our hypothesis.<sup>8</sup> On average, Unconstrained-Real participants under Ambiguity (the leftmost bar in Figure 1) overestimated the expected value of their total allocation to the recipient by \$0.89, which is higher than the mean bias of \$0.29 under Simple Risk. This difference in estimate bias is statistically significant. However, in none of the other conditions do we observe a statistically significant difference between estimates under Ambiguity and Simple Risk. Moreover the mean estimate bias under Ambiguity-Unconstrained for Real Dictators is higher than the mean estimate bias in any other condition.

The results support our main hypothesis of increased unfair choices and positively biased estimates of generosity when consequences for the other party are ambiguous. Participants choose the unfair option more frequently under Ambiguity than under Simple Risk and this increase is accompanied by an overestimation of the expected value of the allocation to the recipient. However, when participants are not motivated to view ambiguity favorably (i.e., the recipients who make hypothetical choices) or when participants' attitudes are constrained by

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<sup>8</sup> In the first session we conducted (Simple Risk-Unconstrained; 5 participants in each role), estimates were very low. We realized that participants were providing the average expected earnings per choice rather than the expected earnings summed across all four choices. We changed the instruction wording for the remaining sessions to be more precise. To avoid making comparisons across wording formats, we omit these responses. Since the mean *underestimation* among dictators in this group was \$1.33, including their responses would dramatically strengthen the significance of the comparison in the direction we hypothesized.

We also omit the estimate of one recipient who gave an estimate of \$14, which is well above the possible maximum value of the allocation to the recipient (\$5) and over 3 standard deviations above the next highest estimate. Again, since this participant was in the Simple Risk-Constrained condition, where we predict Ambiguity would not produce higher estimates than Simple Risk, including this estimate would strengthen support for our hypothesis.

their own previously formed-beliefs,<sup>9</sup> we find no relationship between ambiguity and either increased unfair behavior or favorably biased expectations.

Our hypothesis is based on the idea that biased subjective probabilities under ambiguity – when stakes are real and participants’ attitudes are unconstrained – lead to increased self-interested behavior. Thus, it is not ambiguity *per se* that should produce a change in behavior, but rather the bias in subjective beliefs. Table 6 explores the relationship between behavior and estimate bias in the Real-Unconstrained condition. The first regression replicates the first regression in Table 4, demonstrating a relationship between Ambiguity and self-interested behavior, using only participants for whom we have estimate data (see footnote 8). The second regression demonstrates that self-interested behavior is also positively and significantly related to estimate bias. The final regression demonstrates that the relationship between estimate bias and self-interested behavior is much stronger than that of Ambiguity alone. While a comparison between models 1 and 3 reveals that including estimate bias produces significantly improved fit ( $\chi^2(1) = 27.58, p < 0.001$ ), the same is not true for the inclusion of Ambiguity in a comparison of models 2 and 3 ( $\chi^2(1) = 1.90$ ). Thus, these results indicate that the effect of Ambiguity on behavior operates primarily through biased subjective beliefs, as we predicted.

Finally, if participants in the Real-Unconstrained condition are really manipulating their beliefs concerning Ambiguous vs. Simple Risk lotteries, we might expect our treatment effect to persist into the lottery choice that each participant made later in the experiment between the two kinds of lotteries for the chance to win \$5 for themselves. Considering only Real-Unconstrained

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<sup>9</sup> As we expected, a majority of participants in the Constrained condition exhibited ambiguity aversion in the initial choice between lotteries (85 of 116, or 73 percent, preferred the Simple Risk lottery; significantly different from 50 percent using a binomial test ( $p < 0.01$ , one-tailed)).

The initial choices between four lotteries and their certainty equivalents (see Table 2) were similar between Simple Risk and Ambiguity (67 percent choose the lottery in each condition). Thus, we can reject the possible confound that, for this level of stakes and probability, the ambiguous lotteries are more attractive than those involving simple risk.

participants, we find that only 5 of 42 (12%) of those who had earlier made binary dictator choices under Simple Risk chose to play the Ambiguous lottery for themselves,<sup>10</sup> but this lottery was preferred by a much larger proportion of participants who had previously made binary dictator decisions with Ambiguous consequences (16 of 46, 35%). This difference is statistically significant ( $z = 2.51, p = 0.01$ , two-tailed). Thus it appears that the effect of our Ambiguity vs. Simple Risk treatment on beliefs has lasting consequences on participants' attitudes towards the two kinds of lotteries.

## **Discussion**

This study presents evidence that people can manipulate their beliefs about ambiguity when doing so allows them to behave self-interestedly. That is, people can view ambiguity as favorable when it allows them to view what they are doing to others as “not that bad.” Participants are more likely to give low-paying lotteries to others when these lotteries involve ambiguity compared to simple risk, and they subsequently treat these lotteries as more attractive, reflected by higher estimates of the lotteries' expected value and by increased willingness to bet on an ambiguous lottery with their own money at stake.

We demonstrate that the effects of ambiguity on behavior operate mostly through participants' biased subjective beliefs. First, we show that the change in behavior due to ambiguity is accompanied by an increase in the subjective valuations of lotteries given to the other party. It is these modified beliefs, rather than the use of ambiguity lotteries *per se*, that drive the change in behavior. Moreover, we show that constraining participants' ability to

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<sup>10</sup> One participant did not answer this question.

manipulate their beliefs, using their own natural attitudes towards ambiguity, eliminates the relationship between ambiguity and self-interested behavior.<sup>11</sup>

A large majority of previous research on ambiguity indicates that people interpret ambiguity unfavorably. Our results indicate that how people interpret ambiguity is more complicated. In contexts where there exists a motivation to view ambiguity favorably, people will adopt a more favorable view if they are unconstrained by other factors, such as their own previous attitudes. Thus, people's overall attitudes towards ambiguity may be more accurately described by "ambiguity distortion" rather than ambiguity aversion.

Our findings are also consistent with previous evidence suggesting that people will engage in "moral wiggling," seizing justifications to behave self-interestedly without explicitly appearing so to themselves or others (see Dana et al., 2007). In this paper, we show that ambiguity about decision consequences presents just such a justification.

Our research also has implications for economic and organizational contexts. Frequently in such settings, individuals must make choices pitting self-interest against the welfare of others, and such decisions in the real world often involve uncertainty about the resulting consequences. We show here that the degree of subjective uncertainty exerts a strong influence on the resulting behavior in the direction of self-interested choice. Our results thus stress the non-obvious importance of uncertainty reduction in maintaining ethical standards in organizations and economic transactions.

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<sup>11</sup> The results of the Constrained treatment also help to rule out the possibility that the bias in expectations is driven by a simple *post hoc* justification or an excuse for selfish choices, rather than the actual belief in the favorability of ambiguous lotteries. If the observed bias in expectations merely reflected excuses for selfish choices, there is no reason why dictators should not give these excuses after the adoption of an unfavorable view of ambiguity in the Constrained treatment. Yet, dictators do not show this bias in the Constrained treatment.

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**Table 1:** Payoffs for each allocation decision

Allocation Decision	<i>Other-regarding Choice (x=0)</i>		<i>Self-interested Choice (x=1)</i>	
	$\pi_A$	$\pi_A$	$\pi_A$	$\pi_B$
1	\$2.00	\$1.75	\$3.00	Lottery: (½, \$0.50)
2	\$2.00	\$1.50	\$2.25	Lottery: (½, \$1.00)
3	\$1.00	\$0.75	\$1.50	Lottery: (½, \$0.50)
4	\$1.50	\$1.00	\$2.25	Lottery: (½, \$0.50)

**Table 2:** Initial choices in Constrained Treatment

Decision	<i>Choice 1</i>	<i>Choice 2</i>
1	\$0.75	Lottery: (½, \$1.50)
2	\$0.50	Lottery: (½, \$1.00)
3	\$1.00	Lottery: (½, \$2.00)
4	\$0.25	Lottery: (½, \$0.50)

**Table 3:** Frequencies of self-interested choices by treatment (proportion of  $x_i^j = 1$ )

	Real (A Participant)		Hypothetical (B Participant)	
	<i>Unconstrained</i>	<i>Constrained</i>	<i>Unconstrained</i>	<i>Constrained</i>
Ambiguity	135 / 184 (73%)	69 / 116 (59%)	112 / 184 (61%)	70 / 116 (60%)
Simple Risk	101 / 172 (59%)	73 / 116 (63%)	103 / 172 (60%)	62 / 116 (53%)
	$z = 2.92$ $p < 0.01$	$z = 0.54$ $p = 0.59$	$z = 0.19$ $p = 0.85$	$z = 1.06$ $p = 0.29$

**Table 4:** Regressions of participant behavior by treatments (ordered probit)

	<i>Dependent variable: number of self-interested choices by participant (<math>X_i</math>)</i>			
	Real (A Participant)		Hypothetical (B Participant)	
	<i>Unconstrained</i>	<i>Constrained</i>	<i>Unconstrained</i>	<i>Constrained</i>
Ambiguity (=1)	0.474** (0.230)	-0.023 (0.287)	0.022 (0.227)	0.174 (0.286)
N	89	58	89	58
Pseudo-R <sup>2</sup>	0.016	0.000	0.000	0.002

Standard errors in parentheses ( \*\* -  $p < 0.05$ , two-tailed)

**Table 5:** Summary of estimate bias by condition

	Real (A Participant)		Hypothetical (B Participant)		
	<i>Unconstrained</i>	<i>Constrained</i>	<i>Unconstrained</i>	<i>Constrained</i>	
Ambiguity	Mean	\$0.89	\$0.20	\$0.44	\$0.40
	(Std. Err.)	(\$0.24)	(\$0.24)	(\$0.24)	(\$0.37)
	Median	\$0.55	\$0.25	\$0.25	\$0.00
	N	46	29	46	29
Simple Risk	Mean	\$0.29	\$0.23	\$0.51	\$0.28
	(Std. Err.)	(\$0.21)	(\$0.35)	(\$0.22)	(\$0.35)
	Median	\$0.38	\$0.00	\$0.25	\$0.38
	N	38	29	38	28
		$t_{82} = 1.78$	$t_{56} = 0.08$	$t_{82} = 0.21$	$t_{56} = 0.22$
		$p = 0.08$	$p = 0.94$	$p = 0.84$	$p = 0.83$

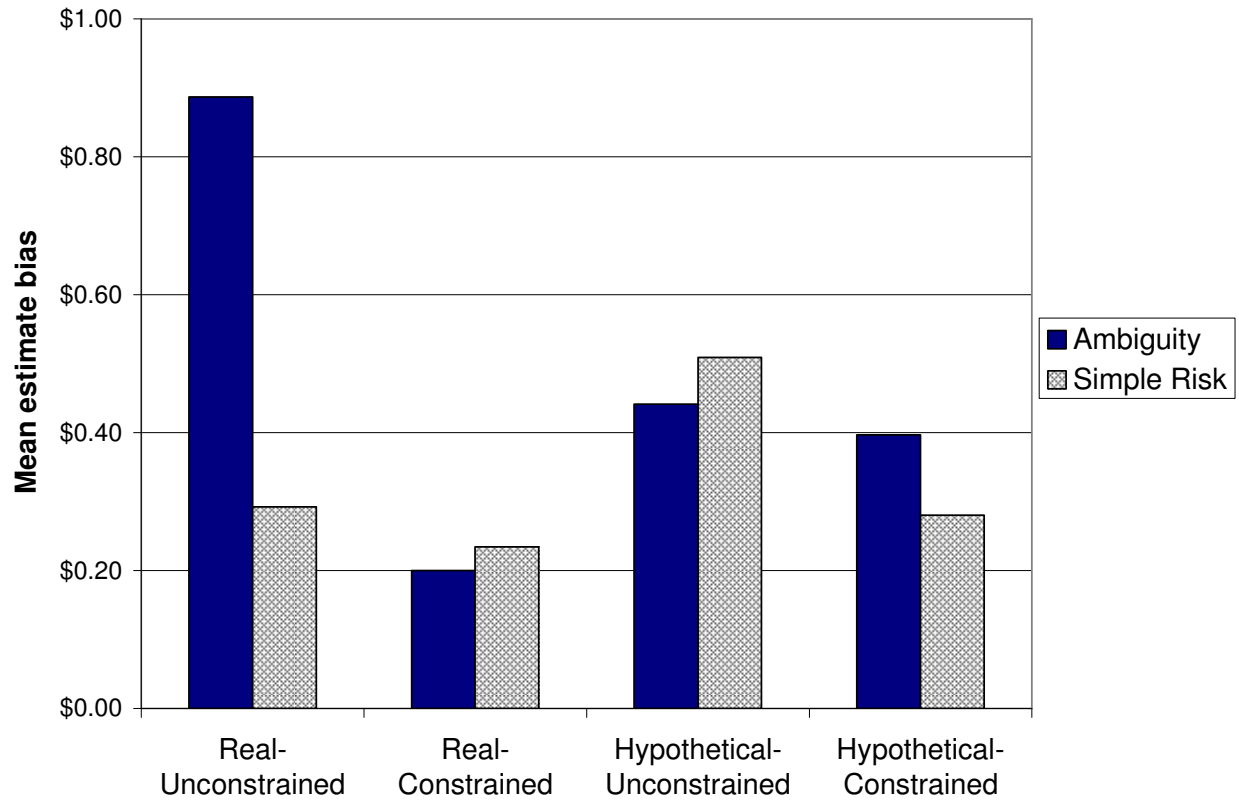
**Table 6:** Regressions of participant behavior in Real-Unconstrained treatment (ordered probit)

*Dependent variable: number of self-interested choices by participant ( $X_i$ )*

	(1)	(2)	(3)
Ambiguity (=1)	0.502 <sup>**</sup> (0.237)		0.337 (0.245)
Estimate bias		0.472 <sup>***</sup> (0.090)	0.458 <sup>***</sup> (0.090)
N	84	84	84
Log likelihood	-123.34	-110.50	-109.55
Pseudo-R <sup>2</sup>	0.018	0.120	0.128

Standard errors in parentheses ( <sup>\*\*</sup> -  $p < 0.05$ , <sup>\*\*\*</sup> -  $p < 0.001$ , two-tailed)

**Figure 1: Mean estimate bias by condition**



**Appendix: Table A1**

Sequence of procedures by treatment in experiment 1

<b>Unconstrained Treatment</b>	<b>Constrained Treatment</b>
<u>Lotteries</u> <ul style="list-style-type: none"> <li>• Description of two kinds of lotteries: simple risk (“Lottery 1”) and ambiguity (“Lottery 2”).</li> <li>• Participants told which lottery will be used in experiment</li> </ul>	<u>Lotteries</u> <ul style="list-style-type: none"> <li>• Description of two kinds of lotteries: simple risk (“Lottery 1”) and ambiguity (“Lottery 2”)</li> <li>• Participants told which lottery will be used in experiment</li> </ul>
	<u>Choices involving risk</u> <ul style="list-style-type: none"> <li>• Description of choices between a lottery and certainty equivalent (Table 2)</li> <li>• All participants make 4 choices</li> </ul>
	<u>Ambiguity attitude:</u> Choice of <u>Lottery 1</u> vs. <u>Lottery 2</u> for \$5 (one participant selected at end of experiment to play)
<u>Dictator choices (<math>X_i</math>)</u> <ul style="list-style-type: none"> <li>• Description of binary dictator game (Table 1)</li> <li>• A participants make 4 real choices</li> <li>• B participants make 4 hypothetical choices</li> </ul>	<u>Dictator choices (<math>X_i</math>)</u> <ul style="list-style-type: none"> <li>• Description of binary dictator game (Table 1)</li> <li>• A participants make 4 real choices</li> <li>• B participants make 4 hypothetical choices</li> </ul>
<u>Estimates</u> of expected payoff to recipient based on own (real or hypothetical) choices $(\tilde{E}_i[\pi_B   X_i])$	<u>Estimates</u> of expected payoff to recipient based on own (real or hypothetical) choices $(\tilde{E}_i[\pi_B   X_i])$
<u>Ambiguity attitude:</u> Choice of <u>Lottery 1</u> vs. <u>Lottery 2</u> for \$5 (one participant selected at end of experiment to play)	
Resolution of all lotteries and payment	Resolution of all lotteries and payment