

Price low and then price high or price high and then price low?

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Experimental Instructions

This is an experiment in the economics of decision making. It is divided in two stages.

Instructions for Stage 1

In the course of stage 1, over a number of *periods* you will be asked to choose between lotteries that pay returns in experimental *points* with given probabilities.

In the table below you see an example of a lottery of the kind a unit of which you can choose each period:

OUTCOME	PROBABILITY	RETURN
1	35%	50
2	15%	15
3	18%	80
4	22%	139
5	10%	10

Table 1: Example of Lottery

In this example, the lottery will give you the chance to earn the following returns at the end of the experiment: 50 points with a probability of 35% (Outcome 1); 15 points with a probability of 15% (Outcome 2); 80 points with a probability of 18% (Outcome 3); and so on.

If you see a lottery which provides a given return with a probability of 100%, this means that, if you choose this lottery, you will get that return for sure.

Stage 1 Earnings

At the end of the experiment the computer uses the probabilities attached to each lottery you chose and randomly selects a corresponding outcome in each case. This outcome determines the return for the corresponding lottery. Returns from each lottery are added up to determine your overall stage 1 earnings. Every 9.75 points you own are converted into 1 penny, and so for example 9750 points are worth 10 pounds.

Before starting to take decisions, we ask you to fill the enclosed questionnaire, with the only purpose of checking whether you have understood these instructions. Raise your hand when you have completed the questionnaire.

Instructions for Stage 2

1. Introduction

Stage 2 is divided in twenty periods. Each period you are given an endowment of 650 points, and a computerised seller will choose the price at which it is willing to sell a lottery. You will then be given the chance to buy one or more units of this lottery (if so you wish) from the seller at this offered price.

Lottery: On the computer screen you can view the lottery which is available for you to buy during the stage. It has exactly the same structure as the lotteries which you have been presented with in stage 1 of the experiment.

Practice: Before stage 2 gets started, you will do two periods just for practice with the example lottery shown in table 1 (in the instructions for stage 1). Since these periods are only for practice, they do not count towards final earnings.

2. Your Decision

Each period, after the computerised seller has made his or her decision about the price of the lottery, you have the chance to buy the lottery being sold. You are told the price at which the lottery is being sold. You are given an endowment of 650 points every period, and you can use it to buy units of the lottery if so you wish. You do so by stating how many units you are willing to buy from the seller.

3. Your Earnings

As a buyer, you earn money in stage 2 in two ways:

- By retaining **unspent endowment**. As noted earlier, each buyer is given an endowment of 650 points every period. Each unit bought in a given period will be paid with this endowment. Every unit of the endowment that is not used to buy units in the period is left unspent. This holds true for each period. At the end of the session, the sum of all the points left unspent in all periods is carried out.
- By buying **units of the lottery**. At the end of the experiment, the computer will add up all the units of the lottery bought in the 20 periods. The computer will then use the probabilities attached to the lottery outcomes and, given those probabilities, randomly select an outcome for the lottery that determines the returns on each unit owned. That is, each unit bought is worth the corresponding return, and the corresponding return is the same for all the units bought of each lottery.

Your overall earnings from stage 2 are then given by the sum of the returns of each lottery times the number of units of each lottery bought, plus the unspent endowment. Every 9.75 points you own are converted into 1 penny, and so for example 9750 points are worth 10 pounds.

4. Your Overall Experimental Earnings

Your overall experimental earnings will be equal to the sum of your overall earnings from stage 1 and your overall earnings from stage 2.

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