What Comes to Mind

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Abstract

We present a model of intuitive inference, called "local thinking," in which an agent combines data received from the external world with information retrieved from memory to evaluate a hypothesis. In this model, selected and limited recall of information follows a version of the respresentativeness heuristic. The model can account for some of the evidence on judgment biases, including conjunction and disjunction fallacies, but also for several anomalies related to demand for insurance.

Key words: local thinking, representativeness, stereotypes, insurance

1. Introduction

Since the early 1970s, Daniel Kahneman and Amos Tversky (hereafter KT 1972, 1974, 1983) published a series of remarkable experiments documenting significant deviations from the Bayesian theory of judgment under uncertainty. While KT's heuristics and biases program has survived substantial experimental scrutiny, models of heuristics have proved elusive.[2] In this paper, we present a memory based model of probabilistic inference that accounts for quite a bit of the experimental evidence.

Heuristics describe how people evaluate hypotheses quickly, based on what first comes to mind. People may be entirely capable of more careful deliberation and analysis, and perhaps of better decisions, but not when they do not think things through. We model such quick and intuitive inference, which we refer to as "local thinking," based on the idea that only some decision-relevant data come to mind initially.

We describe a problem in which a local thinker evaluates a hypothesis in light of some data, but with some residual uncertainty remaining. The combination of the hypothesis and the data primes some thoughts about the missing data. We refer to realizations of the missing data as scenarios. We assume that working memory is limited, so that some scenarios, but not others, come to the local thinker's mind. He makes his judgment in light of what comes to mind, but not of what does not.

Our approach is consistent with KT's insistence that judgment under uncertainty is similar to perception. Just as an individual fills in details from memory when interpreting sensory data (for example, when looking at the duck-rabbit or when judging distance from the height of an object), the decision maker recalls missing scenarios when

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[2] Partial exceptions include Griffin and Tversky (1992), Tversky and Koehler (1994), Barberis et al. (1998), Rabin and Schrag (1999), Mullainathan (2000), and Rabin (2002), to which we return in Section 3.3.

he evaluates a hypothesis. Kahneman and Frederick (2005) describe how psychologists think about this process: "The question of why thoughts become accessible – why particular ideas come to mind at particular times – has a long history in psychology and encompasses notions of stimulus salience, associative activation, selective attention, specific training, and priming (p. 271)."

Our key assumption describes how scenarios become accessible from memory. We model such accessibility by specifying that scenarios come to mind in order of their representativeness, defined as their ability to predict the hypothesis being evaluated relative to other hypotheses. This assumption formalizes aspects of KT's representativeness heuristic, modelling it as selection of stereotypes through limited and selective recall. The combination of both *limited* and *selected* recall drives the main results of the paper, and helps account for biases found in psychological experiments.

In the next section, we present an example illustrating the two main ideas of our approach. First, the data and the hypothesis being evaluated together prime the recall of scenarios used to represent this hypothesis. Second, the *representative* scenarios that are recalled need not be the most *likely* ones, and it is precisely in those instances when a hypothesis is represented with an unlikely scenario that judgement is severely biased.

In Section 3, we present the formal model, and compare it to some earlier theoretical research on heuristics and biases.

In section 4, we present the main theoretical results of the paper, and establish four propositions. The first two deal with the magnitude of judgment errors. Proposition 1 shows how judgment errors depend on the likelihood of the recalled (representative) scenarios. Proposition 2 then shows how a local thinker reacts to data, and in particular

overreacts to data that change his representation of the hypothesis he evaluates. The next two propositions deal with perhaps the most fascinating judgment biases, namely failures of extensionality. Proposition 3 describes the circumstances in which a local thinker exhibits the conjunction fallacy, the belief that a specific instance of an event is more likely than the event itself. Proposition 4 then shows how a local thinker exhibits the disjunction fallacy, the belief that the combined probability of several independent events is lower than the sum of the probabilities of the constituent events.

In section 5, we show how the propositions shed light on a range of experimental findings on heuristics and biases. In particular, we discuss the neglect of base rates, insensitivity to predictability, as well as the conjunction and disjunction fallacies. Among other things, the model accounts for the famous Linda (KT 1983) and car mechanic (Fischoff et al. 1978) experiments.

In section 6, we apply the model, and in particular its treatment of the disjunction fallacy, to individual demand for insurance. Cutler and Zeckhauser (2004) and Kunreuther and Pauly (2005) summarize several anomalies in that demand, including over-insurance of specific narrow risks, under-insurance of broad risks, and preference for low deductibles in insurance policies. Our model sheds light on these anomalies.

Section 7 concludes by discussing some broader conceptual issues.

2. An Example: Intuitive Reasoning in an Electoral Campaign

We illustrate our model in the context of a voter's reaction to a blunder committed by a political candidate. Popkin (1991) argues that intuitive reasoning plays a key role in this context and helps explain the significance that ethnic voters in America attach to the

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candidates' knowledge of their customs. He further suggests that, although in many instances voters' intuitive assessments work pretty well, they occasionally allow even minor blunders such as the one described below to influence their votes.

"In 1972, during New York primaries, Senator George McGovern of South Dakota was courting the Jewish vote, trying to demonstrate his sympathy for Israel. As Richard Reeves wrote for *New York* magazine in August, 'During one of McGovern's first trips into the city he was walked through Queens by city councilman Matthew Troy and one of their first stops was a hot dog stand. "Kosher?" said the guy behind the counter, and the prairie politician looked even blanker than he usually does in big cities. "Kosher!" Troy coached him in a husky whisper. "Kosher and a glass of milk," said McGovern." (p. 2). Evidently, McGovern was not aware that milk and meat cannot be combined in a kosher meal.

We use this anecdote to introduce our basic formalism and to show how "local thinking" can illuminate the properties of voters' intuitive assessments. We start with the case in which intuitive assessments work well, and then return to hotdogs.

Suppose that a voter only wants to assess the probability that a candidate is qualified. Before he hears the candidate say anything, he assesses this probability to be 1/2. Suppose that the candidate declares at a Jewish campaign event that Israel was the aggressor in the 1967 war, an obvious inaccuracy. How does the voter's assessment change? For a Bayesian voter, the crucial question is the extent to which this statement – which surely signals the candidate's lack of familiarity with Jewish concerns – is also informative about the candidate's overall qualification. Suppose that the distribution of candidate types conditional on calling Israel the aggressor is described by Table 1.A:

Calls Israel aggressor in 1967 war		Familiarity with Jewish Concerns	
		Familiar	*unfamiliar*
qualification of candidate	*qualified*	0.15	0.025
	unqualified	0.025	0.8

Table 1.A

Not only is "calling Israel the aggressor in the 1967 war" very informative about a candidate's unfamiliarity with Jewish concerns (82.5% of the candidates who say this are unfamiliar), but unfamiliarity is in turn very informative about qualification, at least to a Jewish voter (relative to a prior of 1/2 before calling Israel aggressor). The latter property is reflected in the qualification estimate of a Bayesian voter, which is equal to:

$$\Pr(qualified) = \Pr(qualified, familiar) + \Pr(qualified, unfamiliar) = 0.175, \qquad (1)$$

where we suppress conditioning on "calling Israel aggressor". The Bayesian reduces his assessment of qualification from 50% to 17.5% because the blunder is so informative.

Suppose now that Table 1.A, rather than being immediately available to the voter, is stored in his associative long term memory and that – due to working memory limits – not all candidate types come to mind to aid the voter's evaluation of the candidate's qualification.[3] We call such a decision maker a "local thinker" because, unlike the Bayesian, he does not use all the data in Table 1.A, but only the information he obtains by sampling from memory specific examples of qualified and unqualified candidates.

Crucially, we assume in KT's spirit that the candidates who first come to the voter's mind are *representative*, or stereotypical, qualified and unqualified candidates. Specifically, the voter's mind automatically fits the most *representative* familiarity level – or "scenario" – for each level of qualification of the candidate. We formally define the

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[3] Throughout the paper, we take the long term associative memory database (in this example, Table 1.A) as given. Section 3 discusses how, depending on the problem faced by the agent, such a database might endogenously change and what could be some of the consequences for judgments.

representative scenario as the familiarity level that best predicts, i.e. is *relatively* more associated with, the respective qualification level. These representative scenarios for a qualified and an unqualified candidate are then given by:

$$s(qualified) = \underset{s \in \{familiar, unfamiliar\}}{\arg\max} \Pr(qualified|s), \qquad (2)$$

$$s(unqualified) = \underset{s \in \{familiar, unfamiliar\}}{\arg\max} \Pr(unqualified|s). \qquad (3)$$

In Table 1.A, this means that a stereotypical qualified candidate is familiar with Jewish concerns, whereas a stereotypical unqualified one is unfamiliar with such concerns.[4] This process reduces the voter's actively processed information to the circled diagonal:

Calls Israel aggressor in 1967 war		Familiarity with Jewish Concerns	
		familiar	*unfamiliar*
qualification of candidate	*qualified*	0.15	0.025
	unqualified	0.025	0.8

Table 1.B

Since a local thinker considers only the stereotypical qualified and unqualified candidates, his assessment (indicated by superscript *L*) is equal to:

$$\Pr^{L}(qualified) = \frac{\Pr(qualified, familiar)}{\Pr(qualified, familiar) + \Pr(unqualified, unfamiliar)} \approx 0.158 \qquad (4)$$

Comparing (4) with (1), we see that a local thinker does almost as well as a Bayesian, and the reason is that in Table 1.A stereotypes capture a big chunk of the respective hypotheses' probabilities. Although the local thinker does not recall that some unfamiliar candidates are nonetheless qualified, this is not a big problem for assessment because in reality, and not only in stereotypes, familiarity and qualification largely go together.

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[4] Indeed, Pr(*qualifiedl*|*familiar*)= (.15/(.15+.025))=.86>.14= (.025/(.15+.025))=Pr(*qualified*|*unfamiliar*). The reverse is true for an unqualified candidate.

The same idea suggests, however, that sometimes local thinkers make very biased assessments. Return to the candidate unaware that drinking milk with hotdogs is not kosher. Suppose that, after this blunder, the distribution of candidate types is:

Drinks milk with a hotdog		Familiarity with Jewish Concerns	
		Familiar	*unfamiliar*
Qualification of candidate	*qualified*	0.024	0.43
	unqualified	0.026	0.52

Table 1.C

As in the previous case, in Table 1.C the candidate's drinking milk with hotdogs is very informative about his unfamiliarity with Jewish concerns, but now such unfamiliarity is extremely uninformative about the candidate's qualification. Indeed, 95% of the candidates do not know the rules of kashrut, including the vast majority of both the qualified and the unqualified ones. In this example a Bayesian assesses Pr(*qualified*) = 0.454; he realizes that drinking milk with a hotdog is nearly irrelevant for qualification.

The local thinker, in contrast, still views the stereotypical qualified candidate as one familiar with his concerns and the stereotypical unqualified candidate as unfamiliar. Formally, the scenario "familiar" yields a higher probability of the candidate being qualified [.024/(.024+.026) = .48] than the scenario "unfamiliar" [.43/(.43+.52) = .45]. Likewise, the scenario unfamiliar yields a higher probability of the candidate being unqualified (.55) than the scenario familiar (.52). The local thinker then estimates:

$$\text{Pr}^{L}(qualified) = \frac{\text{Pr}(qualified, familiar)}{\text{Pr}(qualified, familiar) + \text{Pr}(unqualified, unfamiliar)} \approx 0.044 \quad (5)$$

which differs from the Bayesian's assessment by a factor of nearly 10! In contrast to the previous case, the local thinker grossly overreacts to the blunder and misestimates probabilities. Now local thinking generates a massive loss of information and bias.

Why this difference in the examples? After all, in both examples the stereotypical qualified candidate is familiar with the voter's concerns, while the stereotypical unqualified candidate is unfamiliar since, in both cases, familiarity and qualification are positively associated in reality. In the initial, more standard, example, almost all qualified candidates are familiar and unqualified ones are unfamiliar, so stereotypical qualified and unqualified candidates are both extremely common. When stereotypes are not only *representative* but also *likely*, the local thinker's bias is kept down.

In the second example, in contrast, the bulk of both qualified and unqualified candidates are unfamiliar with the voter's concerns, which implies that the stereotypical qualified candidate (familiar with concerns) is very uncommon while the stereotypical unqualified candidate is very common. By focusing only on the stereotypical candidates, the local thinker drastically underestimates qualification because he forgets that many qualified candidates are also unfamiliar with the rules of kashrut! When the stereotype for one hypothesis is much less *likely* than that for the other hypothesis, the local thinker's bias is large.

With respect to Popkin's (1991) original question on the accuracy of voters' intuitive judgements, our example shows that after seeing a blunder the local thinker always downgrades qualification by a large amount because the stereotypical qualified candidate is very unlikely to commit *any* blunder. This process leads to good judgments in situations where the blunder is informative not only of the dimension defining the

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stereotype (familiarity) but also about qualification (Table 1.A), but it leads to large biases when the blunder is informative about the dimension defining the stereotype but *not* about the target assessment of qualification (Table 1.C). We capture this dichotomy with the distinction between the representativeness and likelihood of scenarios. This distinction plays a key role in accounting for the biases generated by the use of heuristics.

A further connection of our work to research in psychology is the idea of attribute substitution. According to Kahneman and Frederick (2005, p. 269), "When confronted with a difficult question, people may answer an easier one instead and are often unaware of the substitution." Instead of answering a hard question "is the candidate qualified?," the voter answers an easier one, "is he familiar with my concerns?" We show that such attribute substitutions might occur because, rather than thinking about all possibilities, people think in terms of stereotypical candidates, which associate qualification and familiarity. In many situations, such substitution works, as in our initial example where familiarity is a good stand-in for qualification. But in some situations, the answer to a substitute question is not the same as the answer to the original one, as when lots of candidates unfamiliar with the rules of kashrut are nonetheless qualified. It is in those situations that intuitive reasoning leads to biased judgment, as our analysis seeks to show.

3. The Model

The world is described by a probability space (X, π), where $X \equiv X_1 \times ... \times X_K$ is a finite state space generated by the product of $K \geq 1$ dimensions and the function $\pi : X \to [0,1]$ maps each element $x \in X$ into a probability $\pi(x) \geq 0$ such that $\sum \pi(x) = 1$. In the tables of Section 2, the dimensions of X are the candidate's

qualification and his familiarity with voter concerns, i.e. K = 2 (conditional on the candidate's blunder, which is a dimension kept implicit), the elements $x \in X$ are candidate types and the entries in the tables represent the probability measure π.

An agent evaluates the probability of $N > 1$ hypotheses $h_1, \ldots, h_N$ in light of data d. Hypotheses and data are events of X. That is, h_r ($r = 1, \ldots, N$) and d are subsets of X. If the agent receives no data, $d = X$: nothing is ruled out. Hypotheses are exhaustive but may be non-exclusive. Our focus on exhaustive hypotheses is not crucial, but avoids trivial cases where a hypothesis is over-estimated simply because the agent cannot conceive of any alternative to it. In (X, π), the probability of h_r given d is determined by Bayes' rule as:

$$\Pr(h_r | d) = \frac{\Pr(h_r \cap d)}{\Pr(d)} = \frac{\sum_{x \in h_r \cap d} \pi(x)}{\sum_{x \in d} \pi(x)} . \tag{6}$$

In our example, (1) follows from (6) since in Table 1.A the probabilities are normalized by Pr(calls Israel aggressor). As we saw in Section 2, a local thinker may fail to produce the correct assessment (6) because he only considers a subset of elements x, those belonging to what we henceforth call his "represented state space".

3.1 The Represented State Space

The represented state space is shaped by the recall of elements in X prompted by the hypotheses h_r, $r = 1, \ldots, N$. Recall is governed by two assumptions. First, working memory limits the number of elements recalled by the agent to represent each hypothesis. Second, the agent recalls for each hypothesis the most "representative" elements. We formalize the first assumption as follows:

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A1 (Local Thinking): Given d, let M_r denote the number of elements in $h_r \cap d$, $r = 1,\ldots,N$. The agent represents each $h_r \cap d$ using a number $\min(M_r, b)$ of elements x in $h_r \cap d$, where $b \geq 1$ is the maximum number of elements the agent can recall per hypothesis.

The set $h_r \cap d$ includes all the elements consistent with hypothesis h_r and with the data d.   When $b > M_r$, the local thinker recalls all of these elements, and his representation of $h_r \cap d$ is perfect. The more interesting case occurs when at least some hypotheses are broad, consisting of $M_r > b$ elements.[5]   In this case, the agent's representations are imperfect.

In particular, a fully local thinker, with $b = 1$, must collapse the entire set $h_r \cap d$ into a single element. To do so, he automatically selects what we call a "scenario." To give an intuitive but still formal definition of a scenario, consider the class of problems where h_r and d specify exact values (rather than ranges) for some dimensions of X. In this case, $h_r \cap d$ takes the form:

$$h_r \cap d \equiv \left\{ x \in X \,|\, x_i = \hat{x}_i \right\}, \text{ for a given set of } i \in [1,\ldots,\text{K}] \text{ and } \hat{x}_i \in X_i \qquad (7)$$

where $\hat{x}_i$ is the exact value taken by the i-th dimension in the hypothesis or data. The remaining dimensions are unrestricted. This is consistent with the example in Section 2, where each hypothesis specifies one qualification level (e.g., *unqualified*), but the remaining familiarity dimension is left free (once more leaving the blunder implicit). In this context, a scenario for a hypothesis is a specification of its free familiarity dimension (e.g., *unfamiliar*). More generally, when a hypothesis $h_r \cap d$ belongs to class (7), its possible scenarios are defined as follows:

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[5]A1 is one way to capture limited recall. Our substantive results would not change if we alternatively assumed that the agent discounts the probability of certain elements.

Definition 1. Denote by F_r the set of dimensions in X left free by $h_r \cap d$. If F_r is non empty, a scenario s for $h_r \cap d$ is any event $s \equiv \{x \in X | x_t = x'_t\}$ for all $t \in F_r$. If F_r is empty, the scenario for $h_r \cap d$ is $s \equiv X$. S_r is the set of possible scenarios for $h_r \cap d$.

A scenario fills in the details missing from the hypothesis and data, identifying a single element in $h_r \cap d$, which we denote by $s \cap h_r \cap d \in X$. How do scenarios come to mind? We assume that hypotheses belonging to class (7) are represented as follows:

A2 (Recall by Representativeness): Fix d and h_r. Then, the *representativeness* of scenario $s_r \in S_r$ for h_r given d is defined as:

$$\Pr(h_r | s \cap d) = \frac{\Pr(h_r \cap s \cap d)}{\Pr(h_r \cap s \cap d) + \Pr(\overline{h_r} \cap s \cap d)}, \tag{8}$$

where $\overline{h_r}$ is the complement $X \backslash h_r$ in X of hypothesis h_r. The agent represents h_r with the b most "representative" scenarios $s_r^k \in S_r$, $k = 1, \ldots, b$, where index k is decreasing in representativeness and where we set $s_r^k = \phi$ for $k > M_r$.

A2 introduces two key notions. First, A2 defines the representativeness of a scenario for a hypothesis h_r as the degree to which that scenario is associated with h_r relative to its complement $\overline{h_r}$. Second, A2 posits that the local thinker represents h_r by recalling only the b most "representative" scenarios for it. The most interesting case arises when $b = 1$, as the agent represents h_r with the most "representative" scenario s_r^1. It is useful to call the intersection of the data, the hypothesis, and the scenario (i.e. $s_r^1 \cap h_r \cap d \in X$) the "stereotype" that immediately comes to the local thinker's mind.

Expression (8) then captures the idea that an element of a hypothesis or class is stereotypical not only if it is common in that class, but also – and perhaps especially – if

it is uncommon in other classes. In our model, the stereotype for one hypothesis is independent of the other hypotheses being explicitly evaluated by the agent: expression (8) only refers to the relationship between a hypothesis and its complement in X.

From A2, the represented state space is immediately defined as:

Definition 2 Given data d and hypotheses h_r, $r = 1,\dots,N$, the agent's representation of any hypothesis h_r is defined as $\tilde{h}_r(d) \equiv \bigcup_{k=1,\dots,b} s_r^k \cap h_r \cap d$, and the agent's represented state space $\tilde{X}$ is defined as $\tilde{X} \equiv \bigcup_{r=1,\dots,N} \tilde{h}_r(d)$.

The represented state space is simply the union of all elements recalled by the agent for each of the assessed hypotheses. Definition 2 applies to hypotheses belonging to the class in (7), but it is easy to extend it to general hypotheses which, rather than attributing exact values, restrict the range of some dimensions of X. Appendix 1 shows how to do this and to apply our model to the evaluation of these hypotheses as well. The only result in what follows that relies on restricting the analysis to the class of hypotheses in (7) is Proposition 1. As we show in Appendix 1, all other results can be easily extended to fully general classes of hypotheses.

3.2 Probabilistic Assessments by a Local Thinker

In the represented state space, the local thinker computes the probability of h_t as:

$$\Pr{}^L(h_t|d) = \frac{\Pr(\tilde{h}_t(d))}{\Pr(\tilde{X})}, \tag{9}$$

which is the probability of the *representation* of h_t divided by that of the represented state space $\tilde{X}$. Evaluated at $b = 1$, (9) is the counterpart of expression (4) in Section 2.

Expression (9) highlights the role of local thinking. If $b \geq M_r$ for all $r = 1,..,N$,

then $\tilde{X} = X \cap d$, $\tilde{h}_t(d) \equiv h_t \cap d$ and (9) boils down to $\Pr(h_t \cap d)/\Pr(d)$, which is the

Bayesian's estimate of $\Pr(h_t|d)$. Biases can only arise when the agent's representations

are limited, that is, when $b < M_r$ for some r.

When the hypotheses are exclusive $[h_t \cap h_r = \phi \ \forall t \neq r]$, (9) can be written as:

$$\Pr^L(h_t|d) = \frac{\left[\sum\limits_{k=1}^{b}\Pr(s_t^k|h_t \cap d)\right]\Pr(h_t \cap d)}{\sum\limits_{r=1}^{N}\left[\sum\limits_{k=1}^{b}\Pr(s_r^k|h_r \cap d)\right]\Pr(h_r \cap d)} ,$$ (9')

where $\Pr(s|h_r \cap d)$ is the *likelihood* of scenario s for h_r, or the probability of s when h_r is

true. The bracketed terms in (9') measure the share of a hypothesis' total probability

captured by its representation. Equation (9') says that if the representations of all

hypotheses are equally likely (all bracketed terms are equal), the estimate is perfect, even

if memory limitations are severe. Otherwise, biases may arise.

3.3 Discussion of the Setup and the Assumptions

In our model, the assessed probability of a hypothesis depends on i) how the

hypothesis itself affects its own representation, and ii) which hypotheses are examined in

conjunction with it. The former feature follows from assumption A2, which posits that

representativeness shapes the ease with which information about a hypothesis is retrieved

from memory. KT (1972, p. 431) define representativeness as "a subjective judgment of

the extent to which the event in question is similar in essential properties to its parent

population or reflects the salient features of the process by which it is generated."

Indeed, KT (2002, p.23) have a discussion of representativeness related to our model's

definition: "Representativeness tends to covary with frequency: common instances and frequent events are generally more representative than unusual instances and rare events," but they add that "an attribute is representative of a class if it is very diagnostic; that is the relative frequency of this attribute is much higher in that class than in a relevant reference class." In other words, sometimes what is representative is not likely. As we show below, the use of *representative* but unlikely scenarios for a hypothesis is what drives several of the KT biases.[6]

In our model, representative scenarios, or stereotypes, quickly pop to the mind of a decision maker, consistent with the idea – supported in cognitive psychology and neurobiology – that background information is a key input in the interpretation of external (e.g., sensory) stimuli.[7] What prevents the local thinker form integrating all other scenarios consistent with the hypothesis, as a Bayesian would do, is assumption A1 of incomplete recall. This crucially implies that the assessment of a hypothesis depends on the hypotheses examined in conjunction with it, as the latter affect recall and thus the denominator in (9). In this respect, our model is related to Tversky and Koehler's (1994) support theory, which postulates that different descriptions of the same event may trigger different assessments. Tversky and Koehler characterize such non-extensional probability axiomatically, without deriving it from limited recall and representativeness.

The central role of hypotheses in priming which information is recalled is neither shared by existing models of imperfect memory (e.g., Mullainathan 2002, Wilson 2002)

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[6] This notion is in the spirit of Griffin and Tversky's (1992) intuition that agents assess a hypothesis more in light of the *strength* of the evidence in its favour, a concept akin to our "representativeness", than in light of such evidence's *weight*, a concept akin to our "likelihood."

[7] In the model, background knowledge is summarized by the objective probability distribution $\pi(x)$. This clearly need not be the case. Consistent with memory research, some elements x in X may get precedence in recall not because they are more frequent but because the agent has experienced them more intensely or because they are easier to recall. Considering these possibilities is an interesting extension of our model.

nor by models of analogical thinking (Jehiel 2005) or categorization (e.g., Mullainathan 2000, Mullainathan et al. 2008). In the latter models, it is data provision that prompts the choice of a category, inside which all hypotheses are evaluated.[8] This formulation implies that categorical thinking cannot explain the conjunction and disjunction fallacies because inside the chosen category the agent uses a standard probability measure, so that events with larger (equal) extension will be judged more (equally) likely. Although in many situations categorical and local thinking lead to similar assessments, in situations closely related to KT anomalies, they diverge.

To focus on the impact of hypotheses on the recall of stereotypes, we have taken the probability space (X, π) on which representations are created as given. However, the dimensions of X and thus the space of potential stereotypes may depend on the nature of the problem faced and the data received by the agent.[9] We leave the analysis of this additional, potentially interesting source of framing effects in our setup to future research.

Our model is related to research on particular heuristics, including Barberis et al. (1998), Rabin (1999), Rabin and Schrag (2002), and Schwarzstein (2009). In these papers, the agent has an incorrect model in mind, and interprets the data in light of that model. Here, in contrast, the agent has the correct model, but not all parts of it come to mind. Our approach also shares some similarities with models of sampling. Stewart et al. (2006) study how agents form preferences over choices by sampling their past experiences; Osborne and Rubinstein (1998) study equilibrium determination in games

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[8] To give a concrete example, in the context of Section 2 a categorical Jewish voter observing a candidate drinking milk with a hotdog immediately categorizes him as unfamiliar with his concerns, and within that category he estimates the relative likelihood of qualified and unqualified candidates. He would make a mistake in assessing qualification, but only a small one when virtually all candidates are unfamiliar.

[9] As an example, Table 1.A in Section 2 could be generated by the following thought process. In a first stage, the hypotheses render the "qualification" dimension (i.e. the table's rows) salient to the voter. Then the candidate's statement about Jewish issues renders the familiarity dimension (i.e. the table's columns) salient, perhaps precisely because the statement is informative about familiarity with Jewish concerns.

where players sample the performance of different actions. These papers do not focus on judgment under uncertainty. More generally, our key innovation is to consider the model in which agents sample not randomly but based on representativeness, leading them to systematically over-sample certain specific memories and under-sample others.

4. Biases in Probabilistic Assessments

4.1 Magnitude of Biases

We measure a local thinker's bias in assessing a generic hypothesis h_1 against an alternative hypothesis h_2 by deriving from expression (9') the odds ratio:

$$\frac{\Pr^L(h_1|d)}{\Pr^L(h_2|d)} = \left[\frac{\sum_{k=1}^{b}\Pr(s_1^k|h_1 \cap d)}{\sum_{k=1}^{b}\Pr(s_2^k|h_2 \cap d)}\right]\frac{\Pr(h_1|d)}{\Pr(h_2|d)}, \tag{10}$$

where $\Pr(h_1|d)/\Pr(h_2|d)$ is a Bayesian's estimate of the odds of h_1 relative to h_2. The bracketed term captures the likelihood of the representation of h_1 relative to h_2. The odds of h_1 are over-estimated if and only if the representation of h_1 is more likely than that of h_2 (the bracketed term is greater than one). In a sense, a more likely representation induces the agent to over-sample instances of the corresponding hypothesis, so that biases arise when one hypothesis is represented with relatively unlikely scenarios.

When $b = 1$, expression (10) becomes:

$$\frac{\Pr^L(h_1|d)}{\Pr^L(h_2|d)} = \frac{\Pr(s_1^1 \cap h_1 \cap d)}{\Pr(s_2^1 \cap h_2 \cap d)} = \left[\frac{\Pr(s_1^1|h_1 \cap d)}{\Pr(s_2^1|h_2 \cap d)}\right]\frac{\Pr(h_1|d)}{\Pr(h_2|d)}, \tag{11}$$

which highlights how *representativeness* and *likelihood* of scenarios shape biases. Over-estimation of h_1 is the strongest when the representative scenario s_1^1 for h_1 is also the most likely one for h_1, while the representative scenario s_2^1 for h_2 is the least likely one for

h_2. In this case, $\Pr(s_1{}^1|h_1 \cap d)$ is maximal and $\Pr(s_2{}^1|h_2 \cap d)$ is minimal, maximizing the bracketed term in (11). Conversely, under-estimation of h_1 is the strongest when the representative scenario for h_1 is the least likely but that for h_2 is the most likely.

This analysis illuminates the electoral campaign example of Section 2. Consider the general distribution of candidate types after the local thinker receives data *d*.

Data d	familiar	Unfamiliar
qualified	π_1	π_2
unqualified	π_3	π_4

Table 2

We assume that, irrespective of the data provided, $\pi_1/(\pi_1+\pi_3) > \pi_2/(\pi_2+\pi_4)$: being qualified is more likely among familiar than unfamiliar types, so familiarity with Jewish concerns is at least slightly informative about qualification. As in the examples of Section 2, then, the representative scenario for $h_1 = $ *unqualified* is always $s_1{}^1 = $ *unfamiliar*, while that for $h_2 = $ *qualified* is always $s_2{}^1 = $ *familiar*. The voter represents h_1 with (*unqualified*, *unfamiliar*) and h_2 with (*qualified*, *familiar*), estimating $\Pr^L(unqualified) = \pi_4/(\pi_4+\pi_1)$. The assessed odds ratio is thus equal to π_4/π_1, which can be rewritten as:

$$\frac{\Pr^L(unqualified)}{\Pr^L(qualified)} = \left[\frac{\pi_4}{\pi_4+\pi_3} \middle/ \frac{\pi_1}{\pi_1+\pi_2} \right] \frac{\pi_3+\pi_4}{\pi_1+\pi_2}, \qquad (12)$$

which is the counterpart of (11). The bracketed term is the ratio of the likelihoods of scenarios for low and high qualifications $[\Pr(unfamilar|unqualified)/\Pr(familiar|qualified)]$.

In the example of Table 1.A (where $d = $ calling Israel the aggressor), judgments are good because π_2 and π_3 are small. The extreme version of this case arises when $\pi_2 = \pi_3 = 0$, in which case all probability mass is concentrated on stereotypical candidates, local thinking entails no informational loss, and there is no bias. In this stark case, stereotypes are not only representative but also likely for both hypotheses.

In contrast, in Table 1.C (where d = drinks milk with a hotdog), judgements are bad because π_1 and π_3 are small whereas π_2 and π_4 are large. If, at the extreme, π_1 is arbitrarily small, the overestimation factor in (12) becomes infinite! Now h_2=*qualified* is hugely under-estimated precisely because its representative "familiar" scenario is very unlikely relative to the "unfamiliar" scenario for h_1 = *unqualified*. The point is that in thinking about stereotypical qualified candidates – who are both qualified *and* familiar – the local thinker views evidence against "familiarity" as strong evidence against qualification, even if Table 1.C tells us that this inference is unwarranted.

To see more generally how representativeness and likelihood determine the direction and strength of biases in our model, consider the following proposition, which is proved in Appendix 2 and is restricted to the class of hypotheses described in (7):

Proposition 1. Suppose that the agent evaluates two hypotheses h_1, and h_2 where the set of feasible scenarios for them is the same, namely $S_1 = S_2 = S$. We then have:

1) <u>Representation</u>: scenarios rank in opposite order of representativeness for the two hypotheses, formally $s_1^k = s_2^{M-k+1}$ for $k = 1,\ldots,M$ where M is the number of scenarios in S.

2) <u>Assessment bias:</u>

i) If $\pi(x)$ is such that $\Pr(s_1^k | h_1 \cap d)$ and $\Pr(s_1^k | h_2 \cap d)$ strictly decrease in k (at least for some k), the representativeness and likelihood of scenarios are positively related for h_1, and negatively related for h_2. The agent thus over-estimates the odds of h_1 relative to h_2 for every $b < M$. One can find a $\pi(x)$ so that such over estimation is arbitrarily large. The opposite is true if $\Pr(s_1^k | h_1 \cap d)$ and $\Pr(s_1^k | h_2 \cap d)$ strictly increase in k.

ii) If $\pi(x)$ is such that $\Pr(s_1^k | h_1 \cap d)$ decreases and $\Pr(s_1^k | h_2 \cap d)$ increases in k, the representativeness and likelihood of scenarios are positively related for both hypotheses. The agent over- or underestimates the odds of h_1 relative to h_2 at most by a factor of M/b.

Proposition 1 breaks down the roles of assumption A2 and of the probability distribution $\pi(x)$ in generating biases.[10] With respect to representations, A2 implies that, when considering two exhaustive hypotheses, the most representative scenarios for h_2 are the least representative ones for h_1 and vice-versa. This property (which does not automatically hold in the case of three or more hypotheses) formally highlights a key aspect of representativeness in A2, namely that stereotypes are selected so as to maximize the contrast between the representation of different hypotheses. Intuitively, the stereotype of a qualified candidate is very different from that of an unqualified one even when most qualified and unqualified candidates share a key characteristic (unfamiliarity).

What does this property of representations imply for biases? Part 2.i) says that this reliance on different stereotypes causes pervasive biases when the most likely scenario is the same under both hypotheses. In this case, the use of a highly likely scenario for one hypothesis precludes its use for the competing hypothesis, leading to overestimation of the former. The resulting bias can even be huge, as in Table 1.C, and infinite in the extreme.

In contrast, part 2.ii) captures the case where the representativeness and likelihood of scenarios go hand in hand for both hypotheses. Biases are now limited (but possibly still large) and the largest estimation bias occurs when the likelihood of one hypothesis is fully concentrated on one scenario, whereas the likelihood of the competing hypothesis is

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[10] The proof of Proposition 1 provides detailed conditions on classes of problems where $S_1 = S_2 = S$ holds.

spread equally among its *M* scenarios. This implies that hypotheses whose distribution is spread out over a larger number of scenarios are more likely to be underestimated, the more so the more local is the agent's thinking (i.e., the smaller is *b*).

4.2 Data Provision

Local thinkers' biases described in Proposition 1 do not rely in any fundamental way on data provision. However, looking more closely at the role of data in our model is useful for at least two reasons. First, as we show in Section 5, the role of data helps illuminate some of the psychological experiments. Second, interesting real-world implications of our setup naturally concern agents' reaction to new information.

To fix ideas, note that for a Bayesian provision of data *d* is informative about h_1 versus h_2 if and only if it affects the odds ratio between them [i.e., if $\Pr(h_1 \cap d)/\Pr(h_2 \cap d) \neq \Pr(h_1)/\Pr(h_2)$]. To see how a local thinker reacts to data, denote by s_i^1 the representative scenario for hypothesis h_i ($i = 1,2$) if no data is provided, and by $s_{i,d}^1$ the representative scenario for h_i ($i = 1,2$) when $d \subset X$ is provided. This notation is useful because the role of data in expression (11) depends on whether *d* affects the agent's representation of the hypotheses. We cannot say *a priori* whether data provision enhances or dampens bias, but the inspection of how expression (11) changes with data provision reveals that the overall effect of the latter combines the two basic effects:

Proposition 2. Suppose that $b = 1$ and the agent is given data $d \subset X$. If *d* is such that $s_i^1 \cap d \neq \phi$ and $s_i^1 \cap \overline{d} = \phi$ for all *i*, then stereotypes and assessments do not change. In this case, the agent under-reacts to *d* when *d* is informative. If, in contrast, *d* is such that

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$s_i^1 \cap d = \phi$ for some i, then the stereotype for the corresponding hypothesis must change. In this case, the agent may over-react to uninformative d.

In the first case, stereotypes do not change with d [i.e. $s_i^1 \cap h_i = s_{i,d}^1 \cap h_i \cap d$ for all i], and so data provision affects neither the representation of hypotheses nor - according to (11) – probabilistic assessments. If the data are informative, this effect captures the local thinker's *under-reaction* because – unlike the Bayesian – the local thinker does not revise his assessment after observing d.

In the second case, the representations of one or both hypotheses must change with d. This change can generate *over-reaction* by inducing the agent to revise his assessment even when a Bayesian would not do so. This effect increases over-estimation of h_1 if the new representation of h_1 triggered by d is relatively more likely than that of h_2 [if the bracketed term in (11) rises]. We refer to this effect as data "destroying" the stereotype of the hypothesis whose representation becomes relatively less likely.

4.3. Conjunction Fallacy

The conjunction fallacy refers to the failure of experimental subjects to follow the rule that the probability of a conjoined event C&D cannot exceed the probability of event C or D by itself. For simplicity, we only study the conjunction fallacy when $b = 1$ and when the agent is provided no data, but the fundamental logic of the conjunction fallacy does not rely on these assumptions. We consider the class of problems in (7), but in Appendix 2 prove that Proposition 3 holds also for general classes of hypotheses.

We focus on the so-called "direct tests", namely when the agent is asked to simultaneously assess the probability of a conjoined event $h_1 \cap h_2$ and of one of its constituent events such as h_1. Denote by $s_{1,2}^1$ the scenario used to represent the conjunction $h_1 \cap h_2$ and by s_1^1 the scenario used to represent the constituent event h_1. In this case, the conjunction fallacy obtains in our model if and only if:

$$\Pr(s_{1,2}^1 \cap h_1 \cap h_2) \geq \Pr(s_1^1 \cap h_1), \tag{13}$$

i.e., when the probability of the *represented* conjunction is higher than the probability of the *represented* constituent event h_1. Expression (13) is a direct consequence of (9), as in this direct test the denominators are identical and cancel out. The conjunction fallacy then arises only under the following necessary condition:

Proposition 3. When $b = 1$, in a direct test of hypotheses h_1 and $h_1 \cap h_2$, $\Pr^L(h_1 \cap h_2) \geq \Pr^L(h_1)$ only if scenario s_1^1 is not the most likely for h_1.

The conjunction fallacy arises only if the constituent event h_1 prompts the use of an unlikely scenario and thus stereotype. To see why, rewrite (13) as:

$$\Pr(s_{1,2}^1 \cap h_2 | h_1) \geq \Pr(s_1^1 | h_1). \tag{14}$$

The conjunction rule is violated when scenario s_1^1 is less likely than $s_{1,2}^1 \cap h_2$ for hypothesis h_1. Note, though, that $s_{1,2}^1 \cap h_2$ is itself a scenario for h_1 since $s_{1,2}^1 \cap h_2 \cap h_1$ identifies an element of X. Condition (14) therefore only holds if the representative scenario s_1^1 is not the most likely scenario for h_1, which proves Proposition 3.[11]

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[11] Proposition 3 implies that, if a hypothesis h_1 is not represented with the most likely scenario, one can induce the conjunction fallacy by testing h_1 against the conjoined hypothesis $h_1^* = s_1^* \cap h_1$, where s_1^* is the

4.4 Disjunction Fallacy

According to the disjunction rule, the probability attached to an event A should be equal to the total probability of all events whose union is equal to A. As we discuss in Section 5.3, however, experimental evidence shows that subjects often under-estimate the probability of residual hypotheses such as "other" relative to their unpacked version. To see under what conditions local thinking can rationalize this fallacy, compare the assessment of hypothesis h_1 with the assessment of hypotheses $h_{1,1}$ and $h_{1,2}$ where $h_{1,1} \cup h_{1,2} = h_1$ (and obviously $h_{1,1} \cap h_{1,2} = \phi$) by an agent with $b=1$. It is easy to extend the result to the case where $b>1$. Formally, we compare $\Pr^L(h_1)$ when h_1 is tested against $\overline{h_1}$ with the sum $\Pr^L(h_{1,1}) + \Pr^L(h_{1,2})$ obtained when $h_{1,1}$ and $h_{1,2}$ are tested against their complement $\overline{h_1}$. The agent then attributes a higher probability to the unpacked version of the hypothesis, thus violating the disjunction rule, provided $\Pr^L(h_{1,1}) + \Pr^L(h_{1,2}) > \Pr^L(h_1)$.

Define s_1^1, $s_{1,1}^1$, $s_{1,2}^1$ and s_0^1 to be the representative scenarios for hypotheses, h_1, $h_{1,1}$, $h_{1,2}$, and $\overline{h_1}$ respectively. Equation (9) then implies that h_1 is underestimated when:

$$\frac{\Pr(s_{1,1}^1 \cap h_{1,1}) + \Pr(s_{1,2}^1 \cap h_{1,2})}{\Pr(s_{1,1}^1 \cap h_{1,1}) + \Pr(s_{1,2}^1 \cap h_{1,2}) + \Pr(s_0^1 \cap \overline{h_1})} > \frac{\Pr(s_1^1 \cap h_1)}{\Pr(s_1^1 \cap h_1) + \Pr(s_0^1 \cap \overline{h_1})} . \qquad (15)$$

Equation (15) immediately boils down to:

$$\Pr(s_{1,1}^1 \cap h_{1,1}) + \Pr(s_{1,2}^1 \cap h_{1,2}) > \Pr(s_1^1 \cap h_1) , \qquad (15')$$

meaning that the probability of the representation $s_1^1 \cap h_1$ of h_1 is smaller than the sum of the probabilities of the representations $s_{1,1}^1 \cap h_{1,1}$ and $s_{1,2}^1 \cap h_{1,2}$ of $h_{1,1}$ and $h_{1,2}$, respectively. Appendix 2 proves that this occurs if the following condition holds:

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most likely scenario for h_1 and $h_1^* \subset h_1$ is the element obtained by fitting such most likely scenario in hypothesis h_1 itself. By construction, in this case $\Pr^L(h_1^*) \geq \Pr^L(h_1)$, so that the conjunction rule is violated.

Proposition 4. Suppose that $b = 1$. In one test, hypothesis h_1 is tested against a set of alternatives. In another test, hypotheses $h_{1,1}$ and $h_{1,2}$, are jointly tested against the same set of alternatives as h_1. Then, if s_1^1 is a feasible scenario for either $h_{1,1}$, $h_{1,2}$ or both, it follows that $\Pr^L(h_{1,1})+\Pr^L(h_{1,2}) > \Pr^L(h_1)$.

Local thinking leads to underestimation of implicit disjunctions. Intuitively, unpacking a hypothesis h_1 into its constituent events reminds the local thinker of elements of h_1 which he would otherwise fail to integrate into his representation. The sufficient condition for this to occur (that s_1^1 must be a feasible scenario in the explicit disjunction) is very weak. For example, it is always fulfilled when the representation of the implicit disjunction $s_1^1 \cap h_1$ is contained in a sub-residual category of the explicit disjunction such as "other."

5. Local Thinking and Heuristics and Biases, with Special Reference to Linda

We now show how our model can rationalize some of the biases in probabilistic assessments. We cannot rationalize all of the experimental evidence, but rather show that our model provides a unified account of several findings. At the end of the section, we discuss the experimental evidence that our model cannot directly explain.

We perform our analysis in a flexible setup based on KT's (1983) famous Linda experiment. Subjects are given a description of a young woman, called Linda, who is a stereotypical leftist, and in particular was a college activist. They are then asked to check off in order of likelihood the various possibilities of what Linda is today. Subjects estimate that Linda is more likely to be "a bank teller and a feminist" than merely "a bank

teller", exhibiting the conjunction fallacy. We take advantage of this setup to show how a local thinker displays a variety of biases, including base rate neglect and the conjunction fallacy.[12] In Section 5.4, we examine the disjunction fallacy experiments.

Suppose that individuals can have one of two possible backgrounds, college activists (A) and non-activists (NA), be in one of two occupations, bank teller (BT) or social worker (SW), and hold one of two current beliefs, feminist (F) or non-feminist (NF). The probability distribution of all possible types is described in tables 3.A and 3.B:

A	F	NF
BT	$(2/3)(\tau/4)$	$(1/3)(\tau/4)$
SW	$(9/10)(2\sigma/3)$	$(1/10)(2\sigma/3)$

Table 3.A

NA	F	NF
BT	$(1/5)(3\tau/4)$	$(4/5)(3\tau/4)$
SW	$(1/2)(\sigma/3)$	$(1/2)(\sigma/3)$

Table 3.B

Table 3.A reports the frequency of activist (A) types, Table 3.B the frequency of non-activist (NA) types. (This full distribution of types is useful to study the effects of providing data $d = A$). τ and σ are the base probabilities of a bank teller and a social worker in the population, respectively, namely $\Pr(BT) = \tau$, $\Pr(SW) = \sigma$.

Table 3 builds in two main features. First, the majority of college activists are feminists, while the majority of non-activists are non-feminist, irrespective of their

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occupations [Pr(X,F,A) ≥ Pr(X,NF,A) and Pr(X,F,NA) ≤ Pr(X,NF,NA) for X = BT, SW].

Second, social workers are relatively more feminist than bank tellers, irrespective of their

college background (e.g., among activists, 9 out of 10 social workers are feminists while

only 2 out of 3 bank tellers are feminists; among non-activists, half of social workers are

feminists while only 1 out of 5 are non-feminists).

Suppose that a local thinker with $b = 1$ is told that Linda is a former activist, $d =$

A, and asked to assess probabilities that Linda is a bank teller (BT), a social worker (SW),

or a feminist bank teller (BT, F). What comes to his mind? Because social workers are

relatively more feminist than bank tellers, the agent represents a bank teller with a "non-

feminist" scenario and a social worker with a "feminist" scenario. Indeed, Pr(BT|A,NF) =

$(\tau/12)/[(\tau/12)+(2\sigma/30)]$ > Pr(BT|A,F) = $(2\tau/12)/[(2\tau/12)+(9\sigma/15)]$, and Pr(SW|A,NF) <

Pr(SW|A,F). Thus, after the data that Linda was an activist are provided, ''bank teller'' is

represented by (BT, A, NF), and ''social worker'' by (SW, A, F). The hypothesis of

"bank teller and feminist" is correctly represented by (BT, A, F) because it leaves no gaps

to be filled. Using equation (11), we can then compute the local thinker's odds ratios for

various hypotheses, which provide a parsimonious way to study judgement biases.

5.1 Neglect of Base-Rates

Consider the odds ratio between the local thinker's assessment of "bank teller"

and "social worker". In the represented state space, this is equal to:

$$\frac{\text{Pr}^L(BT|A)}{\text{Pr}^L(SW|A)} = \frac{\text{Pr}(BT,A,NF)}{\text{Pr}(SW,A,F)} = \left[\frac{1/3}{9/10}\right]\frac{3}{8}\frac{\tau}{\sigma}. \tag{16}$$

As in (11), the right-most term in (16) is the Bayesian odds ratio, while the bracketed

term is the ratio of the two representations' likelihoods. The bracketed term is smaller

than one, implying not only that the local thinker under-estimates the odds of Linda being a bank teller, but also that he neglects some of the information contained in the population odds of a bank teller, τ/σ. The local thinker under-weights the base-rate by a factor of $(1/3)/(9/10) = 10/27$ relative to a Bayesian.

Neglect of base-rates arises here because the local thinker represents the bank teller as a non-feminist, forgetting that many formerly activist bank tellers are also feminists. The use of an unlikely scenario for "bank teller" renders biases more severe, but it is not necessary for base-rate neglect, which is rather a natural consequence of the local thinker's use of limited, stereotypical information and can arise also when both hypotheses are represented with the most likely scenario.

5.2 Conjunction Fallacy

Consider now the local thinker's odds ratio between "bank teller" and "bank teller and feminist". Using parameter values in Table 3.A, this is equal to:

$$\frac{\Pr^L(BT|A)}{\Pr^L(BT,F|A)} = \frac{\Pr(BT,A,M)}{\Pr(BT,A,F)} = \left[\frac{1/3}{1}\right]\frac{3}{2} = \frac{1}{2} < 1 \qquad (17)$$

The conjunction rule is violated because the local thinker represents the constituent event "bank teller" with a scenario, "non-feminist", which is unlikely given that Linda was a former activist. Why does the agent fail to realize that among former activists many bank tellers are feminists? Our answer is that the term "bank teller" brings to mind a representation that excludes feminist bank tellers since "feminist" is a characteristic disproportionately associated with social workers, which does not match the image of a stereotypical bank teller.

One alternative explanation of the conjunction fallacy discussed in KT (1983) holds that the subjects substitute the target assessment of $\Pr(h|d)$ with that of $\Pr(d|h)$.[13] In our Linda example, this error can indeed yield the conjunction fallacy because $\Pr(A|BT) = 1/4 < \Pr(A|F,BT) = 10/19$. Intuitively, being feminist (on top of being bank teller) can increase the chance of being Linda. KT (1983) addressed this possibility in some experiments. In one of them, subjects were told that the tennis player Bjorn Borg had reached the Wimbledon final, and then asked to assess whether it was more likely that in the final Borg would lose the first set or whether he would lose the first set but win the match. Most subjects violated the conjunction rule by stating that the second outcome was more likely than the first. As we show in Appendix 3, our model can explain this evidence, but a mechanical assessment of $\Pr(d|h)$ cannot. The reason, as KT point out, is that $\Pr(\text{Borg has reached the final}|\text{ Borg's score in the final})$ is always equal to one, regardless of the final score.

Most important, the conjunction fallacy explanation based on the substitution of $\Pr(h|d)$ with $\Pr(d|h)$ relies on the provision of data d. This story cannot thus explain the conjunction rule violations that occur in the absence of data provision. To see how our model can account for those, consider another experiment from KT (1983). Subjects are asked to compare the likelihoods of "A massive flood somewhere in North America in which more than 1000 people drown" to that of "An earthquake in California causing a flood in which more than 1000 people drown." Most subjects find the latter event, which is a special case of the former, to be nonetheless more likely.

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[13] In a personal communication, Xavier Gabaix proposed a "local prime" model complementary to our local thinking model. Such a model exploits the above intuition about the conjunction fallacy. Specifically, in the local prime model an agent assessing $h_1, \ldots, h_n$ evaluates $\Pr^{L'}(h_i|d) = \Pr(d|h_i)/[\ \Pr(h_1|d) + \ldots + \Pr(h_n|d)]$.

We discuss this example formally in Appendix 3, but the intuition is straightforward. When earthquakes are not mentioned, massive floods are represented by an unlikely scenario of disastrous storms, as storms are a stereotypical cause of floods. In contrast, when earthquakes in California are explicitly mentioned, the local thinker realizes that these can cause much more disastrous floods, changes his representation, and attaches a higher probability to the outcome because earthquakes in California are quite common. This example vividly illustrates the key point that it is the hypothesis itself, rather than the data, than frames both the representation and the assessment.

The general idea behind these types of conjunction fallacy is that either the data (Linda is a former activist) or the question itself (floods in North America) bring to mind a representative but unlikely scenario. This general principle can help explain other conjunction rule violations. For example, Kahneman and Frederick (2005) report that subjects estimate the annual number of murders in the state of Michigan to be lower than that in the city of Detroit, which is in Michigan. Our model suggests that this might be explained by the fact that the stereotypical location in Michigan is rural and non-violent, so subjects forget that the more violent city of Detroit is in the state of Michigan as well.

5.3 The Role of Data and Insensitivity to Predictability

Although base rates neglect and the conjunction fallacy do not rely on data provision, previous results illustrate the effects of data in our model. Suppose the agent assesses the probabilities of bank teller, social worker, and feminist bank teller before being given any data. From Table 3.B, we see that in this case "social worker" is still represented by (SW, A, F) and "bank teller and feminist" by (BT, A, F). Crucially,

however, "bank teller" is now represented by (BT, NA, NF). This representation changes after d = A is provided. Before data are provided, then, we have:

$$\frac{\Pr^L(BT)}{\Pr^L(SW)} = \frac{\Pr(BT,NA,M)}{\Pr(SW,A,F)} = \frac{(2/3)(6\tau/8)}{(9/10)(2\sigma/3)} = \frac{5}{6}\frac{\tau}{\sigma}, \qquad (18)$$

$$\frac{\Pr^L(BT)}{\Pr^L(BT,F)} = \frac{\Pr(BT,NA,M)}{\Pr(BT,A,F)} = \left[\frac{3/5}{10/19}\right]\frac{60}{19} = \frac{18}{5} > 1. \qquad (19)$$

Biases now are either small or outright absent. Expression (18) gives an almost correct unconditional probability assessment for the population odds ratio of τ/σ. In expression (19), not only does the conjunction rule hold, but the odds of "bank teller" are overestimated. So what happens when data are provided?

As in Proposition 2, this is a case where data provision "destroys" the stereotype of only one of the hypotheses, "bank teller." Before Linda's college career is described, a bank teller is "non activist, non-feminist." This stereotype is very likely. However, after d = A is provided, the representation of "bank teller" becomes an unlikely one, because even for bank tellers it is extremely unlikely to have become "non feminist" after having been "activist". The probability of Linda being a bank teller is thus underestimated, generating both severe base-rates neglect and the conjunction fallacy.

This analysis illustrates the role of data not only in the Linda setup but also in the electoral campaign example. In both cases, the agent is given a piece of data (d = A or d = drink milk with hotdog) that is very informative about an attribute defining stereotypes (political orientation or familiarity). By changing the likelihood of the stereotype such data induce drastic updating, even when the data themselves are scarcely informative about the target assessment (occupation or qualification).

This over-reaction to scarcely informative data provides a rationalization for the "insensitivity to predictability" displayed by experimental subjects. We formally show this point in Appendix 3 based on a famous KT experiment on practice talks.

In sum, a local thinker's use of stereotypes provides a unified explanation for several KT anomalies. To rationalize many other judgmental anomalies, we need to go well beyond the logic of representativeness and stereotypes as defined here. For instance, our model cannot directly reproduce the Cascells et al. (1978) evidence on physicians' interpretation of clinical tests or the KT's blue versus green cab experiment (KT 1982, p. 154). KT themselves (1982, p. 154) explain why these anomalies cannot be directly attributed to representativeness. We do not exclude the possibility of accounting for even these anomalies as a product of local thinking. But progress in understanding of different recall processes is needed to establish the connection.

5.4. Disjunction and Car Mechanics Revisited.

Fischhoff, Slovic and Lichtenstein (1978) document the violation of the disjunction rule experimentally. They asked car mechanics, as well as lay people, to estimate the probabilities of different causes of a car's failure to start. They document that on average the probability assigned to the residual hypothesis – "The cause of failure is something other than the battery, fuel system, or the engine" – went up from 0.22 to 0.44 when that hypothesis was broken up into more specific causes (e.g., the starting system, the ignition system). Respondents, including experienced car mechanics, discounted hypotheses that were not explicitly mentioned. The under-estimation of

implicit disjunctions has been documented in many other experiments and is the key assumption behind Tversky and Koehler's (1994) support theory.

Proposition 4 allows us to consider the following model of the car mechanic experiment. There is only one dimension, the cause of a car's failure to start (i.e., $K=1$) so that $X \equiv \{battery, fuel, ignition\}$, where *fuel* stands for "fuel system" and *ignition* stands for "ignition system." Assume without loss of generality that $\Pr(battery) > \Pr(fuel) > \Pr(ignition) > 0$. This case meets the conditions of Proposition 4 because now no dimension is left free, so all hypotheses share the same scenario $s = X$.

The agent is initially asked to assess the likelihood that the car's failure to start is not due to battery troubles. That is, he is asked to assess the hypotheses $h_1 = \{fuel, ignition\}$, $h_2 = \{battery\}$. Since $K=1$, there are no scenarios to fit. Yet, since the implicit disjunction $h_1 = \{fuel, ignition\}$ does not pin down an exact value for the car's failure to start, by criterion (8') in Appendix 1 the agent represents it by selecting its most likely element, which is *fuel*. The local thinker then attaches the probability:

$$\Pr^L(h_1) = \frac{\Pr(fuel)}{\Pr(fuel) + \Pr(battery)} \tag{20}$$

to the cause of the car's failure to start being other than *battery* when this hypothesis is formulated as an implicit disjunction.

Now suppose that the implicit disjunction h_1 is broken up into its constituent elements, $h_{1,1} = fuel$ and $h_{1,2} = ignition$ (e.g., the individual is asked to separately assess the likelihood that the car's failure to start is due to ignition troubles or to fuel system troubles). Clearly, the local thinker represents $h_{1,1}$ by *fuel* and $h_{1,2}$ by *ignition*. As before, he represents the other hypothesis h_2 by *battery*. The local thinker now attaches greater probability to the car's failure to start being other than the battery because:

$$\Pr{}^{L}(ignition) + \Pr{}^{L}(fuel) = \frac{\Pr(ignition) + \Pr(fuel)}{\Pr(ignition) + \Pr(fuel) + \Pr(battery)}$$

$$> \Pr{}^{L}(h_1) = \frac{\Pr(fuel)}{\Pr(fuel) + \Pr(battery)} \qquad (21)$$

In other words, we can account for the observed disjunction fallacy. The logic is the same as that of Proposition 4: the representation of the explicit disjunction adds to the representation of the implicit disjunction ($x = fuel$) an additional element ($x = ignition$), which boosts the assessed probability of the explicit disjunction.

6. An Application to Demand for Insurance

Buying insurance is supposed to be one of the most compelling manifestations of economic rationality, in which risk-averse individuals hedge their risks. Yet both experimental and field evidence, summarized by Cutler and Zeckhauser (2004) and Kunreuther and Pauly (2005), reveal some striking anomalies in individual demand for insurance. Most famously, individuals vastly overpay for insurance against narrow low probability risks, such as those of airplanes crashing or appliances breaking. They do so especially after the risk is brought to their attention, but not when risks remain unmentioned. In a similar vein, people prefer insurance policies with low deductibles, even when the incremental cost of insuring small losses is very high (Johnson et al. 1993, Sydnor 2006). Meanwhile, Johnson et al. (1993) present experimental evidence that individuals are willing to pay more for insurance policies that specify in detail the events being insured against than they do for policies insuring "all causes."

Our model, particularly the analysis of the disjunction fallacy, may shed light on this evidence. Suppose that an agent with a concave utility function $u(.)$ faces a random wealth stream due to probabilistic realizations of various accidents. For simplicity, we

assume that at most one accident occurs. There are three contingencies s = 0, 1, 2, each occurring with an ex-ante probability π_s. Contingency $s = 0$ is the *status quo* or no loss contingency. In this state, the agent's wealth is at its baseline level w_0. Contingencies 1 and 2 correspond to the realizations of distinct accidents, which entail wealth levels $w_s < w_0$ for $s = 1, 2$. A contingency $s = 1,2$ then represents the income loss caused by a car accident, a specific reason for hospitalization, or a plane crash from a terrorist attack. We assume that $\pi_0 > \max(\pi_1, \pi_2)$, so that the status quo is the most likely event.

We first show that a local thinker in this framework exhibits behaviour consistent with Johnson et al.'s (1993) experiments. The authors find, for example, that, in plane crash insurance, subjects are willing to pay more in total for insurance against a crash caused by "any act of terrorism" plus insurance against a crash caused by "any non-terrorism related mechanical failure" than for insurance against a crash for "any reason" (p. 39). Likewise, subjects are willing to pay more in total for insurance policies paying for hospitalization costs in the events of "any disease" and "any accident" than for a policy that pays those costs in the event of hospitalization for "any reason" (p. 40).

As a starting point, note that the maximum amount P that a rational thinker is willing to pay to insure his status quo income against "any risks" is given by

$$u[w_0 - P] = E[u(w)]. \tag{22}$$

The rational thinker would pay the same amount P for insurance against *any risk* as for insurance against either $s = 1$ or $s = 2$ occurring, since he keeps all the outcomes in mind.

Suppose now that a local thinker of order one ($b = 1$) considers the maximum price he is willing to pay to insure against *any risk* (i.e., against the event $s \neq 0$). For a local thinker, only one (representative) risk comes to mind. Suppose without loss of

generality that $\pi_1 > \pi_2$. Then, just as in the car mechanic example, only the more likely event $s = 1$ comes to the local thinker's mind. As a consequence, he is willing to pay up to P^L for coverage against *any risk*, defined by:

$$u[w_0 - P^L] = E[u(w)|\ s = 0, 1] \qquad . \tag{23}$$

The local thinker's maximum willingness to pay directly derives from his certainty equivalent wealth conditional on the state belonging to the event "$s = 0$ or 1". If, in contrast, the local thinker is explicitly asked to state the maximum willingness to pay for insuring against either $s = 1, 2$ occurring, then both events come to mind and his maximum price is identical to the rational thinker's price of P.

Putting these observations together, it is easy to show that the local thinker is willing to pay more for the unpacked coverage whenever:

$$u(w_2) \leq E[u(w)|\ s = 0, 1] \tag{24}$$

That is, condition (24) and thus the Johnson et al. (1993) experimental findings would be confirmed when, as in the experiments, the two events entail identical losses so that $w_1 = w_2$ (plane crash due to one of two possible causes). In this case, insurance against $s = 2$ is valuable, and therefore the local thinker is willing to pay less for coverage against "any accident" than when all the accidents are listed because, in the former case, he does not recall $s = 2$. This partial representation of accidents leads the agent to under-estimate his demand for insurance relative to the case in which all accidents are spelled out.

The same logic illuminates over-insurance against specific risks, such as a broken appliance or small property damage, as documented by Cutler and Zeckhauser (2004) and Sydnor (2006). A local thinker would in fact pay more for insurance against a specific

risk than a rational thinker. Consider again insurance against the wealth loss in state $s = 1$. A rational thinker's reservation price P_1 to insure against $s = 1$ is given by:

$$(\pi_0 + \pi_1)\, u[w_0 - P_1] + \pi_2\, u[w_2 - P_1] = E[u(w)]. \qquad (25)$$

Consider now a local thinker. When prompted to insure against $s = 1$, the local thinker perfectly represents this state; at the same time, he represents the state where no accident occurs with the status quo $s = 0$ due to the fact that $\pi_0 > \pi_2$. A useful (but not important) consequence in this example is that a local thinker's reservation price turns out to be given by the same condition (23) as his price for insurance against *any risk*. It follows immediately that $P^L > P_1$; the local thinker is willing to pay more for insurance against a specific risk than the rational thinker. Intuitively, with narrow accidents, the no-accident event becomes the residual category. The disjunction fallacy implies that the local thinker under-estimates the probability of states in which such narrow insurance is *not* valuable, paying more for it than a rational agent would do.

This logic also illustrates the observation of Cutler and Zeckhauser (2004) and Kunreuther and Pauly (2005) that individuals do not insure low probability risks, such as terrorism or earthquakes, under ordinary circumstances, but buy excessive amounts of such insurance immediately *after* an accident (or some other reminder) occurs that brings the risks to their attention. In our model, small probability or otherwise not salient events are the least likely to be insured against because they are not representative, and hence do not come to mind. Unless explicitly prompted, a local thinker considers either the status quo or high probability accidents that come to mind. Once an unlikely event occurs, however, or is explicitly brought to the local thinker's attention, it becomes part of the representation of risky outcomes and is over-insured.

Local thinking can thus provide a common explanation of two anomalous aspects of demand for insurance: over-insurance against narrow and well-defined risks, as well as underinsurance against broad or vaguely defined risks. The model might also help explain other insurance anomalies, such as the demand for life insurance rather than for annuities by the elderly parents of well-off children (Cutler and Zeckhauser 2004). We leave a discussion of these issues to future work.

7. Conclusion

We have presented a simple model of intuitive judgment in which the agent perceives some data and combines it with information retrieved from memory to evaluate a hypothesis. The central assumption of the model is that, in the first instance, information retrieval from memory is both *limited* and *selective*. Some, but not all, of the missing scenarios come to mind. Moreover, the hypothesis in question primes the selective retrieval of scenarios from memory, with scenarios most predictive of the hypothesis itself relative to the other hypotheses – the representative scenarios -- being retrieved first. In many situations, such intuitive judgment works well, and does not lead to large biases in probability assessments. But in situations where the representativeness and likelihood of scenarios diverge, intuitive judgment becomes faulty. We showed that this simple model accounts for a significant number of experimental results, most of which are related to the representativeness heuristic. In particular, the model can explain the conjunction and disjunction fallacies exhibited by experimental subjects. The model also sheds light on some puzzling evidence concerning demand for insurance.

To explain the evidence, we took a narrow view of how recall of various scenarios takes place. In reality, many other factors affect recall. Both availability and anchoring heuristics described by Kahneman and Tversky (1974) bear on how scenarios come to mind, but through mechanisms other than those we elaborated.

At a more general level, our model relates to the distinction, emphasized by Kahneman (2003), between System 1 (quick and intuitive) and system 2 (reasoned and deliberate) thinking. Local thinking can be thought of as a formal model of System 1. However, from our perspective, intuition and reasoning are not so radically different. Rather, they differ in what is retrieved from memory to make an evaluation. In the case of intuition, the retrieval is not only quick, but also partial and selective. In the case of reasoning of the sort studied by economists, retrieval is complete.

Indeed, in economic models, we typically think of people receiving limited information from the outside world, but then combining it with everything they know to make evaluations and decisions. The point of our model is that, at least in making quick decisions, people do not bring everything they know to bear on their thinking. Only some information is automatically recalled from passive memory, and − crucially to understanding the world − the things that are recalled might not even be the most useful. Heuristics, then, are not limited decisions. They are decisions like all the others, but based on limited and selected inputs from memory. System 1 and System 2 are examples of the same mode of thought; they differ in what comes to mind.

Appendix 1: Local thinking with general hypotheses and data

Hypotheses and data may merely constrain some dimensions of the state space X without restricting them to particular values, as we assumed in (7). Generally:

$$h \cap d \equiv \{x \in X \mid x_i \in H_i\}, \ for \ some \ i \in I \tag{7'}$$

where $I \subseteq \{1,...,K\}$ is the set of dimensions constrained by $h \cap d$, and $H_i \subset X_i$ are the sets they specify for each $i \in I$. Dimensions $i \notin I$ are left free. The class of hypotheses in (7) is a special case of that in (7') when the sets H_i are singletons.

To generalize the definition of representation of a hypothesis, we assume that agents follow a three stage procedure. First, each hypothesis $h \cap d$ is decomposed into all of its constituent "elementary hypotheses", defined as those that fix one exact value for each dimension in I. For each elementary hypothesis, agents then consider all possible scenarios, according to Definition 1. Finally, agents order the set of elementary hypotheses (together with the respective feasible scenarios) according to their conditional probabilities.[14] An agent with $b = 1$ would simply solve:

$$\max_{x_I, s} \Pr[x_I \mid s \cap d], \tag{8'}$$

where $x_I \equiv \{x \in X : x_i = \hat{x}_i\}$ where $\hat{x}_i \in H_i$, $\forall i \in I$. Thus, conditional on fixing x_I, scenario s is the exact equivalent of the scenario in Definition 1. A solution to problem (8') always exists due to finiteness of the problem. This procedure generates a representation $s_r^1 \cap x_{I,r}^1 \cap d$ for hypothesis h_r which is the general counterpart of the representation $s_r^1 \cap h_r \cap d$ used in the class of problems in (7). Accordingly, (8') yields a ranking among all possible representations $s_r^k \cap x_{I,r}^k$ of h_r that in turn ranks all elements in $h_r \cap d$ in terms of their order of recall. Formula (9) can now be directly applied to calculate the local thinker's probabilistic assessment. In the case of exhaustive hypotheses in the general class (7'), the local thinker's probabilistic assessment can be written as:

$$\Pr^L(h_t \mid d) = \frac{\left[\displaystyle\sum_{k=1}^{b} \Pr(s_t^k \cap x_{I,t}^k \mid h_t \cap d)\right] \Pr(h_t \cap d)}{\displaystyle\sum_{r=1}^{N} \left[\displaystyle\sum_{k=1}^{b} \Pr(s_r^k \cap x_{I,r}^k \mid h_r \cap d)\right] \Pr(h_r \cap d)} \tag{9''}$$

Expression (9'') is an immediate generalization of (9'). Except for Proposition 1, which is proved only for problems in (7), all the results of the paper are generalized to

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[14] This assumption captures the idea that dimensions explicitly mentioned in the hypothesis are selected to maximize the probability of the latter. We could assume that filling gaps in hypotheses taking form (7') is equivalent to selecting scenarios, in the sense that the agent maximizes (8) subject to scenarios $s \in h \cap d$. Our main results would still hold in this case, but all scenarios $s \in h_r \cap d$ would be equally representative, as expression (8) would always be equal to 1. Assumption (8') captures the intuitive idea that the agent also orders the representativeness of elements belonging to ranges explicitly mentioned in the hypothesis itself.

hypotheses of type (7'), with the only caveat that in this case stereotype $s_r^k \cap h_r \cap d$ should be read as the intersection of the set of specific values chosen by the agent for representing h_r with the data and the chosen scenario, i.e. as $s_r^k \cap x_{I,r}^k \cap d$, which is the k'th ranked term according to objective (8').

Appendix 2: Proofs

Proof of Proposition 1. This proof is restricted to the case where hypotheses h_1 and h_2 belong to class (7). Note first that any finite state space can be represented as $X = \{0,1\}^K$ generated by the product of K binary dimensions. We assume $K>2$ to allow for hypotheses, data and scenarios. If h_1 and h_2 have the same set of feasible scenarios, $S_1 = S_2$, then they necessarily fix the same set of dimensions, $I_1 = I_2$. Since all dimensions are binary, it follows that $h_2 = \overline{h_1}$. For simplicity, focus on the class of problems where: i) the hypotheses h_1, h_2 fix the value of only one dimension and ii) the data d fix the value of N-1 other dimensions, $N<K$. The condition $S_1 = S_2 = S$ still holds.

We next prove claim 1). Applying Definition 1 and Assumption A2, the representativeness of $s \in S$ for h_1 is equal to $\Pr(h_1|s \cap d) = \Pr(h_1 \cap d \cap s)/[\Pr(h_1 \cap d \cap s) + \Pr(h_2 \cap d \cap s)]$. The representativeness of $s \in S$ for h_2 is equal to $\Pr(h_2|s \cap d) = 1 - \Pr(h_1|s \cap d)$. The representativeness of scenarios for the two hypotheses is thus perfectly inversely related, formally $s_1^k = s_2^{M-k+1}$ for $k = 1,\ldots,M$.

Consider now claim 2.i). For any $b < M$, h_1 is represented with scenarios $\{s_1^k\}_{k \leq b}$, while h_2 is represented with $\{s_1^{M+1-k}\}_{k \leq b}$. From (9), the odds of h_1 are (weakly) over-estimated if and only if:

$$\sum_{k=1}^{b} \Pr(s_1^k|h_1 \cap d) \geq \sum_{k=1}^{b} \Pr(s_1^{M+1-k}|h_2 \cap d)$$

Suppose that $\Pr(s_1^k|h_1 \cap d)$ and $\Pr(s_1^k|h_2 \cap d)$ strictly decrease in k. It then follows that the above condition is met for every $b < M$. Suppose for contradiction that for a certain $b^* < M$ the above condition is not met, that is

$$\sum_{k=1}^{b^*} \Pr(s_1^k|h_1 \cap d) < \sum_{k=1}^{b^*} \Pr(s_1^{M+1-k}|h_2 \cap d) \tag{26}$$

Then, for some $b^{**} \leq b^*$, it must be the case that $\Pr(s_1^{b^{**}}|h_1 \cap d) < \Pr(s_1^{M+1-b^{**}}|h_2 \cap d)$. But since $\Pr(s_1^k|h_1 \cap d)$ and $\Pr(s_1^k|h_2 \cap d)$ are strictly decreasing in k, it must also be the case that $\Pr(s_1^b|h_1 \cap d) < \Pr(s_1^{M+1-b}|h_2 \cap d)$ for all $b > b^*$. This implies that (26) holds for all $b > b^*$, including $b = M$, but this is inconsistent with the fact that

$$\sum_{k=1}^{M} \Pr(s_1^k | h_1 \cap d) = \sum_{k=1}^{M} \Pr(s_1^{M+1-k} | h_2 \cap d) = 1.$$

The same logic allows to show that if $\Pr(s_1^k | h_1 \cap d)$ and $\Pr(s_1^k | h_2 \cap d)$ are strictly increasing in k, the odds of h_1 are (weakly) underestimated for any $b < M$.

To see how in the first case the overestimation of h_1 may be infinite, consider a probability distribution $\pi(x)$ such that:

$$\Pr(s_1^k \cap h_1 \cap d) = \Pr(h_1 \cap d)\frac{1-\varepsilon^2}{1-\varepsilon^{2M}}\varepsilon^{2(k-1)}, \ \Pr(s_1^k \cap h_2 \cap d) = \Pr(h_2 \cap d)\frac{1-\varepsilon}{1-\varepsilon^M}\varepsilon^{(k-1)}$$

for all $k \geq 1$, where $0 < \varepsilon < 1$. Then, for all $b \leq M$, we have that:

$$\sum_{k=1}^{b} \Pr(s_1^k | h_1 \cap d) = \frac{1-\varepsilon^{2b}}{1-\varepsilon^{2M}}, \quad \sum_{k=1}^{b} \Pr(s_1^{M+1-k} | h_2 \cap d) = \frac{\varepsilon^{M-b} - \varepsilon^M}{1-\varepsilon^M}$$

Inserting these expressions into (11), we see that as $\varepsilon \to 0$ the extent of overestimation becomes arbitrarily large for any $b < M$.

Finally, to prove claim 2.ii), recall that h_1 and h_2 are represented with scenarios s_1^1 and s_1^M respectively. If $\pi(x)$ is such that $\Pr(s_1^k | h_1 \cap d)$ decreases and $\Pr(s_1^k | h_2 \cap d)$ increases in k, the two hypotheses are represented with their most likely scenarios. Thus, the greatest overestimation of h_1 relative to h_2 is reached when h_1 is concentrated on its most likely scenario while the distribution of h_2 is fully dispersed among all scenarios, that is $\Pr(s_1^1 | h_1 \cap d) = 1$ and $\Pr(s_1^M | h_2 \cap d) = 1/M$. In this case, the agent overestimates the odds of h_1 by a factor of $\left(\sum_{k=1}^{b} 1/M\right)^{-1} = M/b$.

Proof of Proposition 2. We prove the proposition by focusing on hypotheses of the form in (7), but all of the results are easily extended to the case where hypotheses take the general form (7') by simply substituting h_i with $x_{1,i}^k$ when scenario s_i^k is used. The central part of the argument amount to proving that if $s_i^1 \cap d \neq \phi$ and $s_i^1 \cap \overline{d} = \phi$ for all i, then stereotypes do not change. Formally, $s_i^1 \cap h_i = s_{i,d}^1 \cap h_i \cap d$ for all i, where $s_{i,d}^1$ is the most representative scenario after data d is provided. We prove this property by contradiction. If $s_i^1 \cap h_i \neq s_{i,d}^1 \cap h_i \cap d$ for some i, then it must also be that $s_i^1 \neq s_{i,d}^1 \cap d$:

$$\frac{\Pr(h_i \cap s_i^1)}{\Pr(\overline{h}_i \cap s_i^1)} = \frac{\Pr(h_i \cap s_i^1 \cap d)}{\Pr(\overline{h}_i \cap s_i^1 \cap d)} < \frac{\Pr(h_i \cap s_{i,d}^1 \cap d)}{\Pr(\overline{h}_i \cap s_{i,d}^1 \cap d)}. \tag{27}$$

Condition (27) follows from three considerations. First, since $s_i^1 \cap d \neq \phi$ and $s_i^1 \cap \overline{d} = \phi$ for all i, we have that $\Pr(h_i \cap s_i^1) = \Pr(h_i \cap s_i^1 \cap d)$, which implies the equality on the left

hand side in (27). Second, since $s_i^1 \cap d \neq \phi$, then $s_i^1 \cap d$ contains a scenario for $h_i \cap d$ [this scenario is identified by the subvector s of elements in s_i^1 not fully pinned down by d]. This is because $s_i^1 \cap h_i \cap d$ identifies an element in X. Third, the scenario s identified in $s_i^1 \cap d$, must be less representative than $s_{i,d}^1$ because the latter is defined as the most representative scenario for $h_i \cap d$. But then, since $s_{i,d}^1 \cap d$ is also a scenario for h_i, the relationship between the first and third terms in condition (27) contradicts the fact that s_i^1 is the most representative scenario for h_i. This proves that $s_i^1 \cap h_i = s_{i,d}^1 \cap h_i \cap d$, which directly implies that assessments do not change, upon provision of d, even if d is informative. If, in contrast, $s_i^1 \cap d = \phi$ for some i, then the stereotype for the corresponding hypothesis must change. Then assessments can change even if the data is barely informative, as Section 5.3 and Appendix 3.A show. Here we show that the local thinker may even react to completely uninformative data. Consider the example below:

Data = d_1	s_1	s_2
h_1	ε_1	$\pi_1 - \varepsilon_1$
h_2	0	π_2

Data = d_2	s_1	s_2
h_1	0	π_1
h_2	ε_2	$\pi_2 - \varepsilon_2$

The tables represent the distribution $\pi(x)$ on hypotheses h_1 and h_2 such that the data d_1, d_2 are completely uninformative (and ε_1, ε_2 are small positive numbers). When no data is provided, the local thinker represents h_1 with (s_1, d_1) and h_2 with (s_1, d_2), assessing $\Pr^L(h_1) = \varepsilon_1/(\varepsilon_1 + \varepsilon_2)$. After for instance d_1 is provided, the representation for h_1 does not change but the one for h_2 switches to (s_2, d_1). As a result, $\Pr^L(h_1|d_1) = \varepsilon_1/(\varepsilon_1 + \pi_2) \ll \Pr^L(h_1)$ even if the data is completely uninformative. This example is obviously extreme, but it gives an idea of the forces towards over-reaction in our model.

Generalization of Proposition 3 to the Class of Problems in (7'). Since $b=1$, each hypothesis h_i is represented by $x_{I_{i,i}}^1 \cap s_i^1$, where $x_{I_{i,i}}^1, s_i^1$ satisfy (8'). Then condition (13) translates directly into $\Pr(s_{1,2}^1 \cap x_{I_{1,1}}^1 \cap x_{I_{2,2}}^1) \geq \Pr(s_1^1 \cap x_{I_{1,1}}^1)$. Since both arguments in this condition are representations of h_1, we can rewrite this as $\Pr(s_{1,2}^1 \cap x_{I_{2,2}}^1 \cap x_{I_{1,1}}^1 | h_1) \geq \Pr(s_1^1 \cap x_{I_{1,1}}^1 | h_1)$. This in turn implies that representation

$s_{1,2}^1 \cap x_{I_{1},1}^1$ must not be the most likely one for h_1, since $s_{1,2}^1 \cap x_{I_{1},1}^1 \cap x_{I_{2},2}^1$ is itself a more likely representation for h_1.

Proof of Proposition 4. We assume the implicit disjunction hypothesis $h_1 = h_{1,1} \cup h_{1,2}$ specifies a range of values, as this more general setting simplifies the analysis of the car mechanic experiment. In condition (15), the expression $s_r^1 \cap h_r$ should be read as $s_r^1 \cap h_r(x_I^1)$ where $h_r(x_I^1)$ and s_r^1 satisfy (8'). Note that representations follow a "revealed preference" logic: if the local thinker represents h_1 with $\{x_I^1, s_1^1\}$, then he will always use the same representation for any hypothesis $h_0 \subset h_1$ as long as $x_I^1 \in h_0$ and s_1^1 is a feasible scenario for h_0, in the sense that h_0 and h_1 constrain the same set of dimensions I. To see this, suppose that the representation of h_0 is equal to some other element $\{x_I^*, s_0^*\}$, so that:

$$\Pr\left(x_I^* \mid s_0^* \cap d\right) > \Pr\left(x_I^1 \mid s_1^1 \cap d\right).$$

But this leads to a contradiction, since $\{x_I^*, s_0^*\}$ would then be a representation of h_1 with higher conditional probability (8') than $\{x_I^1, s_1^1\}$. Continuing the proof, recall that by assumption s_1^1 is a scenario for either $h_{1,1}$ or $h_{1,2}$, or both. Therefore, $\{x_I^1, s_1^1\}$ is the representation of the hypotheses for which s_1^1 is a scenario. As a result, condition (15) holds and the disjunction fallacy follows.

Appendix 3. Additional Experiments

A. Insensitivity to Predictability

KT (1974) presented subjects with descriptions of the performance of a student-teacher during a particular practice lesson. Some subjects were asked to evaluate the quality of the lesson, other subjects were asked to predict the standing of the student-teacher five years after the practice lesson. The judgments made under the two conditions were identical, irrespective of subjects' awareness of the limited predictability of teaching competence five years later on the basis of a single trial lesson.

To explore the consequences of local thinking on insensitivity to predictability, consider a local thinker who assesses the quality of a candidate based on the latter's job talk at a university department. The state space has three dimensions: the candidate' quality, which can be high (H) or low (L), the quality of his talk, which can be good (GT) or bad (BT), and his expressive ability, which can be articulate (A) or inarticulate (I). The distribution of these characteristics is as follows:

Good Talk (GT)	Inarticulate (I)	Articulate (A)
High Quality (H)	0.005	0.25
Low Quality (L)	0.005	0.24

Table A.1

Bad Talk (BT)	Inarticulate (I)	Articulate (A)
High Quality (H)	0.24	0.005
Low Quality (L)	0.25	0.005

Table A.2

In tables A.1 and A.2, the quality of the talk is highly correlated with expressive ability, but the latter dimension is only barely informative of the candidate's quality. Still, the candidate's expressive ability is always representative of his quality, i.e. after listening to the talk the local thinker represents low quality candidates as inarticulate, and high quality ones as articulate. The tables are admittedly extreme, but they illustrate the point in the starkest manner.   The local thinker then assesses:

$$\frac{\Pr^{L}(H|GT)}{\Pr^{L}(L|GT)} = \frac{\Pr(H,GT,A)}{\Pr(L,GT,I)} = 50$$

$$\frac{\Pr^{L}(H|BT)}{\Pr^{L}(L|BT)} = \frac{\Pr(H,BT,A)}{\Pr(L,BT,I)} = 0.02$$

The local thinker grossly over-estimates the quality of the candidate after a good talk and under-estimates it after a bad talk. Indeed, in this example a Bayesian would estimate $\Pr(H|GT)/\Pr(L|GT) = 1.04$ and $\Pr(H|BT)/\Pr(L|BT) = 0.96$!!

Over-reaction here is due to the fact that the data (quality of the talk) are scarcely informative about the target attribute (quality of the candidate), but very informative about an attribute defining the stereotype for different hypotheses (expressive ability). As in the Linda example, Tables A.1 and A.2 exploit the divergence between representativeness and likelihood to illustrate this phenomenon in the starkest manner, but over-reaction to data is a natural and general consequence of the use of stereotypes.

B. Conjunction Fallacy in the Bjorn Borg Experiment

Suppose that a local thinker is give d = "Bjorn Borg is in the Wimbledon Final" and he is asked to assess Pr(Borg wins 1st set), Pr(Borg loses 1st set), Pr(Borg loses 1st and wins the match). The first hypothesis ensures exhaustivity, but it is not necessary to obtain the result. When prompted to assess these hypotheses, the agent fits an overall evaluation of Borg's game which can take two values: Borg loses the match (LM), Borg wins the match (WM). Suppose that the distribution of these characteristics is as follows:

Borg is in Wimbledon Final	Loses the Match (LM)	Wins the Match (WM)
Loses First Set (LF)	3/16	4/16
Wins First Set (WF)	2/16	7/16

The Table above reports the actual fraction of each possible outcome observed in the 16 Grand Slam finals that Borg played between 1974 and 1981. The table reveals that the probability that Borg wins the final is large (equal to 11/16) irrespective of what happens in the first set, but losing the first set is relatively more likely if Borg loses the match (3 out of 5 rather than 4 out of 11). Crucially, the latter property implies that the agent represents the event WF with scenario WM and the event LF with scenario LM. By contrast, the hypothesis "Borg loses 1st set and wins the match" leaves no gap and is perfectly represented by (LF, WM). In this sate space it is easy to find that:

$$\frac{\Pr^{L}(LF,WM)}{\Pr^{L}(LF)} = \frac{\Pr(LF,WM)}{\Pr(LF,LM)} = \frac{4/16}{3/16} = \frac{4}{3} > 1 .$$

Thus, the conjunction rule is violated. Intuitively, the stereotypical condition in which the first set is lost is when also the match is lost. Thus, in computing Pr(LF) the local thinker overlooks that Borg could lose the first set but actually win the match. The source of the conjunction fallacy here is that it is very unlikely for Borg to lose a Grand Slam (and thus Wimbledon final), even if he loses the first match.

C. Conjunction Fallacy Without Data Provision: Floods in California

Consider a state space with the following three dimensions: the type of flood, which can either be severe (S) or disastrous (D), the cause of flood, which can either be a earthquake (E) or a rainstorm (R), and the location of the flood, which can either be California (C) or the rest of North America (NC). The distribution is as follows:

S ╲ D	E	R
C	$(1-x)e_C$ ╲ xe_C	$r_C/2$ ╲ $r_C/2$
NC	$e_{NC}/2$ ╲ $e_{NC}/2$	$(1-z)r_{NC}$ ╲ zr_{NC}

Table A.3

e_L and r_L capture the probabilities of an earthquake and a rainstorm in location $L = C, NC$, while $x > 1/2$ and $z > 1/2$ are respectively the share of earthquakes causing disastrous floods in California and of rainstorms causing disastrous floods in the rest of North America. Probabilities must add up to 1. Table B captures two features of a subject's beliefs: i) earthquakes are milder in the rest of North America than in California so that they cause fewer disastrous floods (only 1/2 of earthquakes cause disastrous floods in North America, x >1/2 earthquakes cause disastrous floods in California), and ii) rainstorms are milder in California than in the rest of North America so that they cause fewer disastrous floods (only 1/2 of rainstorms cause disastrous floods in California, z > 1/2 rainstorms cause disastrous floods in the rest of North America). We make the natural assumption that $z > x$, so that rainstorms are more likely to cause disastrous floods than earthquakes.

Table A.3 and equation (8) imply that a disastrous flood (D) is represented with scenario (R,NC), namely as a disastrous flood caused by a rainstorm in the rest of North America $\Pr(D|R,NC) = z > \Pr(D|E,C) = x > \Pr(D|R,C) = \Pr(D|E,NC) = 1/2$. The event "Disastrous flood caused by an earthquake in California" instead uniquely identifies the scenario (D, C, E). Given these representations, the assessed odds of (D,C,E) relative to (D) are:

$$\frac{\Pr^L(D)}{\Pr^L(D,C,E)} = \frac{\Pr(D,R,NC)}{\Pr(D,C,E)} = \frac{zr_{NC}}{xe_C}.$$

If the probability of disastrous earthquakes in California is sufficiently high relative to that of disastrous rainstorm in North America, (i.e., $xe_C > zr_{NC}$), the conjunction fallacy arises without data. Intuitively, although rainstorms mainly cause mild floods, they are a stereotypical cause of floods. Hence, disastrous floods are represented as being caused by rainstorms, even though agents hold the belief that earthquakes in California can be so severe as to cause more disastrous floods. The problem, though, is that agents retrieve this belief only if earthquakes and California are explicitly mentioned.

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