

Behavioral Economics: Theory & Practice

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What is it all about?

- Read *et al.* (1999) choice of videos
- Either 'high-brow' (e.g. *Schindler's List*)
- Or 'low-brow' (*Four Weddings and a Funeral*)
- Some chose for tonight, some for two weeks hence
- For two weeks, 29% chose low-brow

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- For tonight, 66% chose low-brow!



The Dismal Science

- Economics concerns **incentives** of all kinds
- Prices provide an incentive to trade
- Labor contracts provide an incentive to work
- Crying provides an incentive to breastfeed
- The threat of foreclosure provides an incentive to repay loans (*cf* the Bolivian constitution)

The Dismal Science 2.0

- **Behavioral** economics incorporates ideas and theories from psychology & elsewhere
- E.g. bounded rationality, heuristics, and emotions
- Methods include:
 - Mathematical models
 - Observational empirical work
 - Laboratory experiments
 - Field experiments
- Now part of the mainstream: Kahneman's Nobel

Playing games in the field



Time Preferences

- Choice of how much to save or invest may depend on information and on risk tolerance, but also on how much weight people give to the future
- Neoclassical economics assumes that these **discount rates** vary across individuals, but that they are fixed across the lifespan
- Testing an intervention that tries to teach young adults to [want to] plan for their future selves
- Importantly, this will be interacted with small grants to start a business

Time Inconsistency

- Different from not caring about the future is getting it wrong: recall the video choices!
- Extensive literature in psychology ('affective forecasting') showing that people are bad at predicting their future preferences
- I'm going to start exercising regularly... tomorrow!
- Introduces a rationale for commitment devices, like William the Conqueror burning all his ships

A Commitment to Saving

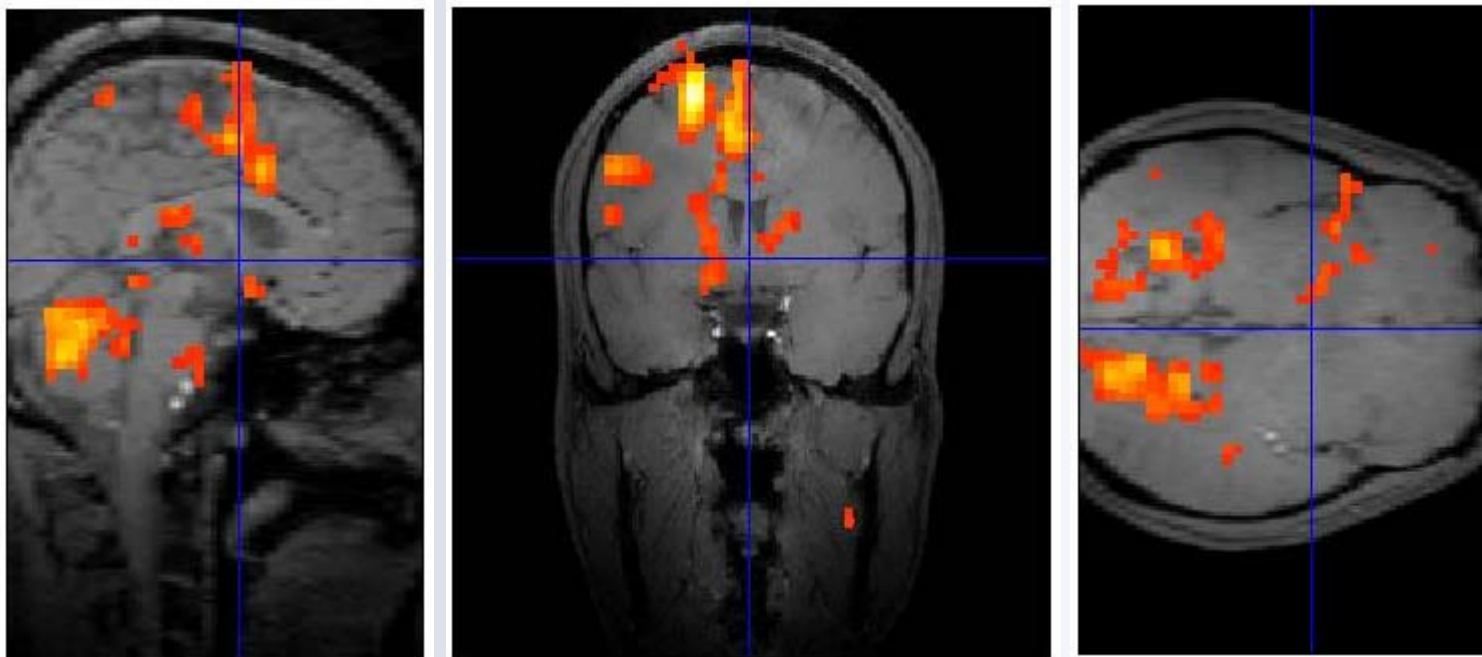
- Here the strategic interaction is with yourself!
- Giné/Karlan/Zinman (2010) mixes the idea of regular savings deposits with smoking cessation, finding that the combination works amazingly well
- Now there's a website (www.stickk.com) where you can write contracts regarding your future actions



Applications

- There exists a demand *from users* for products that apply behavioral principles to improve welfare
- Another example is the recent success of 'savings lotteries' (instead of gambling) in Michigan
- You'll see lots more from our great panelists
- One last fun instantiation of behavioral work is the new field of **neuroeconomics** (& neuromarketing)

Brain of a Confused Economist



Images courtesy D. Krawczyk