

# Summary of Nobel Lecture: The Economic Way of Looking at Behavior

Howard Riady

December 18, 2012

## Part I

### The Approach

First of all, this is not a paper but Becker's Nobel lecture. Becker explains how he extended the traditional analysis of individual rational choice into a richer theory that includes attitudes, preferences, and calculations. He uses the economic approach to behavior (theory of individual choice) to derive implications at the macro or group level. Below are points that he emphasized:

- Behavior is driven not necessarily by self-interest but by a richer set of values (people have different goals). However, when we assume self-interest in models, it is a method of analysis, not an assumption.
- Behavior is forward-looking and consistent over time.
- Behavior constrained by income, time, imperfect memory and calculating capacities and other limited resources. Time becomes more valuable as goods become more abundant.

Becker explains how he uses this approach in four examples: discrimination against minorities, crime and punishment, human capital and, the structure of families.

## Part II

### Discrimination against Minorities

To study discrimination against minorities, it is necessary to widen preferences to accommodate prejudice and hatred of particular groups. Becker includes discrimination coefficients, which incorporate the influence of race, gender, and other personal characteristics on tastes and attitudes (widening the usual assumption that employers only consider productivity).

- Actual discrimination by firms or workers is measured by how much profits or wages they forfeit to avoid hiring or working with members of a group that is disliked.
- Actual discrimination by consumers is measured by the higher prices they pay to avoid products or services produced by members they disliked.

## Part III

# Crime and Punishment

Criminals are still bounded by rational behavior. Rationality does not necessarily mean narrow materialism but it recognizes that many people were constrained by moral and ethical considerations (some do not commit crime even if reward is profitable and there is no danger of detection). Rationality implied that some individuals become criminals because of the financial and other rewards from crime compared to legal work, taking account of the probability of getting caught and severity of punishment. Amount of crime is also determined by the economic and social environment (e.g. public spending on police, punishment for different crimes, schooling, etc).

- Theft is socially harmful because criminals spend on weapons and the value of time on planning crime which is unproductive (rent seeking activities). They do not create wealth but only redistribute wealth.
- Fines are preferred than imprisonment since they can deter criminals if they have sufficient financial resources. Also, fines imply revenue to the government.

## Part IV

# Human Capital

Human capital analysis assumes that individuals decide on their education, training, medical care, and other additions to knowledge and health by weighting the costs and benefits.

- Firm-specific knowledge is useful only in the firms providing it whereas general knowledge is useful also in other firms. This distinction explains why workers with highly specific skills are less likely to quit their jobs and are the last to be laid off during economic downturns. It also explains why most promotions are made from within a firm rather than through hiring.
- Gender gap in earnings can be explained by theory of human capital. In the past, women are less likely than men to work full-time because they

have to bear children (thus, less incentive to invest in education). However, things have changed. The decline in family size, growth in divorce rates, rapid expansion of service sector (where most women are employed) have raised the relative earnings of women.

## Part V

# Structure of Families

Rational choice of analysis of family behavior builds on maximizing behavior, investments in human capital, the allocation of time, and discrimination against women and other groups.

- When men and women decide to marry, they attempt to raise their welfare by comparing benefits and costs. People marry or divorce when they expect to be better off than otherwise so.
- Wealthier couples are less likely to divorce than poorer couples. Becker's approach can explain that richer couples tend to gain a lot from remaining married, whereas many poorer couples do not (for instance, a poor woman may doubt whether its worth it to remain married with someone who is chronically unemployed).
- Efficient bargaining between couples implies that no-fault divorce did not raise divorce rates. However, no-fault divorce hurts women with children whose marriages are broken up by their husbands.
- Fertility has been studied previously (Malthus) but did not incorporate time. Time spent on child care becomes more expensive when countries are more productive. Higher value of time raises the cost of children and thereby reduces the demand for large families. More industrialized economy emphasize more education on children so even higher costs for having children.
- Rotten kid theorem shows how behavior of selfish individuals is affected by altruism. Under some conditions, even selfish persons are induce to act as though they are altruistic toward their benefactors otherwise gifts from their benefactors would be reduced enough to make them worse off.
- Bequests: both children and parents would be better off if parents agreed to invest more in children in return for a commitment by children to care for them when they need help. However, they cannot enforce such commitment by a written contract. Instead, parents can manipulate the experiences of children. For example, parents worried about old-age support may try to instill in their children feelings of guilt, obligation and duty.