Summary for Habits, Addictions, And Traditions

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1 Introduction

This paper relax the assumption that choices today are not directly dependent on choices in the past, and hence, studies questions related to addictions, work habits, preference formation, why children support their elderly parents, preference solutions to the problem of future commitments, and the evolution of stability of institutions.

2 Habits

Essentially all goods are substitutes if the time intervals are sufficiently close and quantities consumed are big enough but it might be the opposite for many goods when the time periods compared are not very close.

<u>Habitual behavior</u> : displaying a positive relation between past and current consumption, or complements.

Habits are harmful if greater present consumption lowers future utility.

Habits are beneficial if greater present consumption raises future utility.

Necessary condition for a rational forward-looking consumer (who takes into account future consequences of their actions) to develop a habit:

- Greater past consumption raise the marginal utility from present consumption ("reinforcement").

- The larger the rate at which either the future or past is discounted, the more likely that a good with a given amount of reinforcement is habitual, and the stronger is the habit. (intuitively, smaller effects on future utility of greater present consumption, and reinforcement has the more dominating effect). It also depends on the rate of decay or depreciation in the contribution of past consumption to current utility.

An <u>addiction</u> is a strong habit.

Demand for addictive: people either consume a lot or abstain

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True/False/Uncertain: A habit maybe raised into a addiction by exposure to the habit itself. (True: an increase in discount rate strengthens commitments to all habits, further induced increases in discount rates.)

People who heavily discount the future and past care less about the future consequences, and less likely to be deterred from "harmful" activities that reduce future utility, and less attracted to beneficial activities. Therefore, we expect addictions to be associated with harmful activities.

True/False/Uncertain: Forward-looking utility-maximizing consumer maximize their expected utility. So some people become addicted simply because events turn out to be less favorable than was reasonable to anticipated. (True:the teenager started out experimenting with drugs by maximizing expected utility in hope that with some probability his life will turn out better, but the realized state is bad, which only reinforce him to consume more drugs and turn into addiction.)

Traditional behavior are habits that are sensitive to choices in the more distant past.

3   Invidious Comparisons

Most people get mental and physical comfort and reassurance in continuing to do what they did in the past. On the other hand, a given standard of living usually provides less utility to persons who had grown accustomed to a higher standard in the past $\implies$ goods that involve invidious comparisons with the past are harmful since greater consumption now lowers future utility. True/False: a good must be habitual if utility from the good depends on the different between current consumption and a weighted sum of the amounts consumed in the past. (sufficient condition) Application: new rich are the happiest, new poor the most miserable, and long-term rich may not be so much happier than the long-term poor.

4   Price and Wealth Effects

An unexpected fall in the price of a habitual good may have only slight impact on demand as long as past consumption has not changed much. But the magnitude of the response to a permanent fall in price would grow over time as consumption continues to increase. Therefore, long run price elasticity of demand is larger for the more strongly habitual goods. Application: everyone agrees that legalization of drugs would reduce the retail price of drugs, hence this analysis implies that demand for drugs may not increase much shortly after legalization, but it would increase by a lot in the long run.

Peer pressure: like positive social multiplier, convert moderately habitual behavior into a strong habit or even an addiction. $\implies$ Peer pressure and habit reinforces each other.

Other example: High taxes on incomes and other taxes on work effort do not have large effects on the hours worked by men, since work is a tradition-habit that builds up very slowly over time.

5 Preference Formation

Childhood experiences can greatly influence behavior over a person's entire life because it may not pay to try to greatly change habits when the environment changes. Becker then model the influence of parents on children by dividing up 2 types of parents:

- Altruistic parents maximize their own utility by maximizing their children's. They would try to direct the evolution of children's preferences toward raising the utility of children. For example, they may stop smoking or take their children to church.

- Selfish parents do not care about the welfare of children but will try to shape formation of children's preferences to raise chances their children will take care of them when old or ill. Parents can help make the children altruistic, or can make grown children feel guilty when they don't help. Hence, selfish parents do not necessarily neglect or abuse children.

T/F/U: Selfish parents become meaner when they need not rely on their children, perhaps because the government becomes committed to helping out the elderly in need.

"Endowment" effect is the attachment effect, for example, a family may refuse to sell for half-a-million dollars the house it has lived in for twenty years, even though it would be unwilling to spend anywhere near that amount for an otherwise equivalent house.

6 Commitment, Instituions, and Culture

Commitment example: a firm charge a lower price now if they agree to buy more of the good for some time into the future. Less strong if a good is habitual. Application on optimal pricing of a a monopolist who sells a habitual goods: wealth-maximizing prices are below the prices where MR = MC. Another example: a firm may help finance investments in a worker's general skills if the worker will remain with the firm.

Institution: preferences are also formed by behavior of past generation of peers. Interesting application: young people asked to contribute heavily to social security may not have to worry that the next generation will refuse to support them when they become elderly. Institution is a kind of tradition-habit.

7 Conclusion

"The past casts a long shadow on the present through its influence on the formation of present preferences and choices."

Appendix

$$U(t) = U\big(y(t), c(t), S(t)\big)$$

where y is a non habitual good, c is habitual and $S = c(t) - \delta S(t)$, δ is the depreciation rate on past consumption of c.

A good is habitual if $\frac{dc(t)}{dS(t)} > 0$ Addiction if $\frac{dc(t)}{dS(t)} > \delta$ At steady state, $c = \delta S$