

An Introduction to Behavioral Economics*

STEP 1

RATIONAL AGENTS
MAXIMISE UTILITY



Neoclassical Theory

RATIONAL PREFERENCES!

COMPLETE $x > y; y > z$ OR $y \sim x$ TRANSITIVE $x > y; y > z$ then $x > z$

'Preferences are stable'

KAHNEMAN & TVERSKY (1979)

PROSPECT THEORY:

Losses loom larger than gains

HERDING BEHAVIOR

SOCIAL NORMS, WARM GLOW & many others

STATE DEPENDENT PREFERENCES AND SCARCITY

① THE CHALLENGE

BOUNDED RATIONALITY

LIMITED TIME INFO BANDWIDTH

'ECONS' ARE TOO:

- RATIONAL
- WILLFUL
- SELFISH

STEP 2

COMBINING ECONOMICS

PSYCHOLOGY

BEHAVIORAL ECONOMICS

for more realistic theories and predictions.

Behavioral Economics

SYSTEM 1 vs. SYSTEM 2

FAST
REFLEXIVE
IMPULSIVE
SHORTSIGHTED

SLOW
ANALYTIC
EFFORTFUL
DELIBERATE

SOME EXAMPLES:

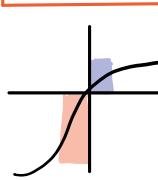
ULTIMATUM GAME:
Efficiency ≠ Fairness
'Inequality aversion'
(Fehr & Schmidt 1999)



COMMITMENT DEVICES



SOCIAL NORMS, WARM GLOW & many others



HERDING BEHAVIOR



SOCIAL NORMS, WARM GLOW & many others

STATE DEPENDENT PREFERENCES AND SCARCITY



'HUMANS' ARE:

- INTUITIVE DECIDERS
- PRONE TO GENERALIZING
 - USE SYSTEM 1
- WEIGH LOSSES GREATER THAN GAINS
 - IMPATIENT
- CONCERNED ABOUT FAIRNESS AND NORMS
 - ... (and more!)

STEP 3

ECONOMICS
PSYCHOLOGY
COGNITIVE SCIENCE

BEHAVIORAL SCIENCE

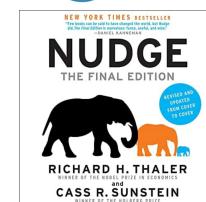


Letter reminders for paying TAX that invoked social norms increased tax revenue by £200m



The Nudge Revolution

Automatic enrolment in savings program, with option to opt-out increased savings from 3.5 to 13.5% in 3 years.



2020: most employer sponsored pension plans in US have automatic enrolment

Led to world's 1st Nudge Unit in UK in 2010

Now: 200+ units worldwide

NUDGES

Changes in presentation of choices to make people more likely to select particular options, without any coercion.

ISSUES IN NUDGE THEORY

Replication failures



Developed world focus



Paternalism?

STEP 4

ECONOMICS
COGNITIVE SCIENCE
EVOLUTIONARY BIOLOGY
NEUROSCIENCE
PSYCHOLOGY
ANTHROPOLOGY

Behavioral Science

WIDE ARRAY OF APPLICATIONS

Corruption

Public health

FINANCIAL BEHAVIOR

SUSTAINABLE DEVELOPMENT

including

Diversity & Equality

DIGITAL BEHAVIOR



these issues are resolved in

EXPERIMENTS THAT TRY TO UNDERSTAND

WHY? WHEN? HOW?
DO THINGS VARY?

&
WHAT WORKS
IN DIFFERENT CONTEXTS

*From PLANT, MUTHUKRISHNA & SCHIMMELPFENNIG (2022)