

An Introduction to Behavioral Economics*

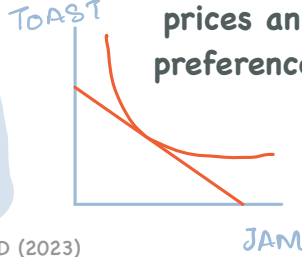
STEP 1

RATIONAL AGENTS MAXIMISE UTILITY

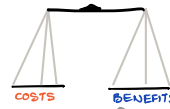
Neoclassical Theory

MAXIMISE WELFARE!

Given budget, prices and preferences



RATIONAL PREFERENCES!



COMPLETE: $x > y; y > x$ OR $y \sim x$

TRANSITIVE: $x > y; y > z$ then $x > z$

'Preferences are stable'

Developed for ECON 213 by F SAID (2023)

① THE CHALLENGE ②

BOUNDED RATIONALITY

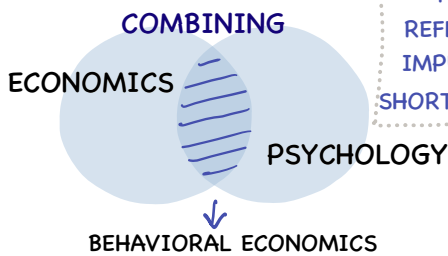


'ECONS' ARE TOO:

- RATIONAL
- WILLFUL
- SELFISH

STEP 2

Behavioral Economics



for more realistic theories and predictions.

SYSTEM 1 vs. SYSTEM 2

FAST	SLOW
REFLEXIVE	ANALYTIC
IMPULSIVE	EFFORTFUL
SHORTSIGHTED	DELIBERATE

SOME EXAMPLES:

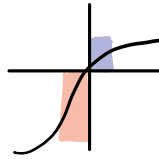
ULTIMATUM GAME: Efficiency \neq Fairness
'Inequality aversion' (Fehr & Schmidt 1999)

COMMITMENT DEVICES



SOCIAL NORMS, WARM GLOW & many others

KAHNEMAN & TVERSKY (1979)



PROSPECT THEORY: Losses loom larger than gains

HERDING BEHAVIOR



STATE DEPENDENT PREFERENCES AND SCARCITY

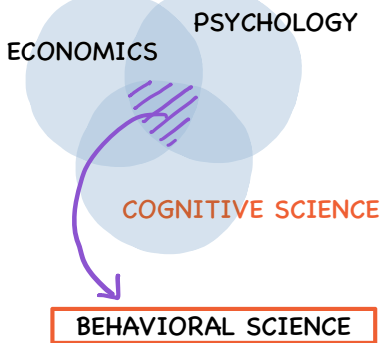


'HUMANS' ARE:

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

STEP 3

The Nudge Revolution



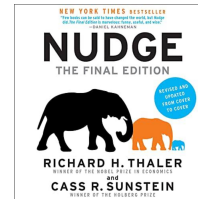
Letter reminders for paying TAX that invoked social norms increased tax revenue by £200m

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

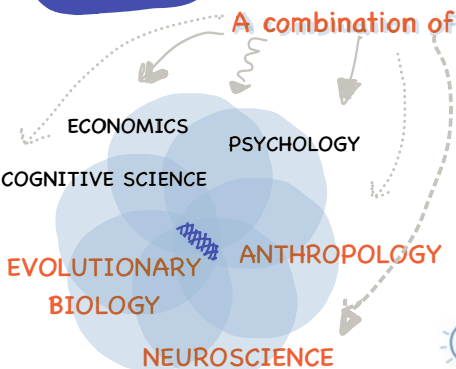
Developed world focus

Replication failures

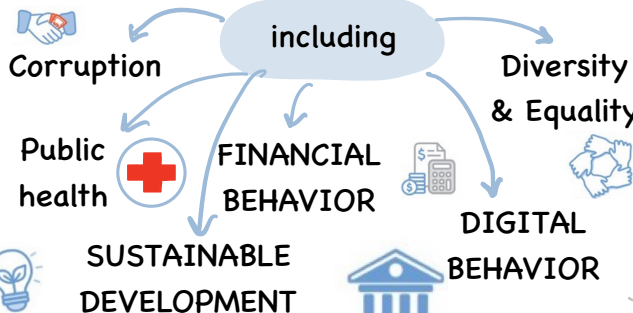
Paternalism?

STEP 4

Behavioral Science



WIDE ARRAY OF APPLICATIONS



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)