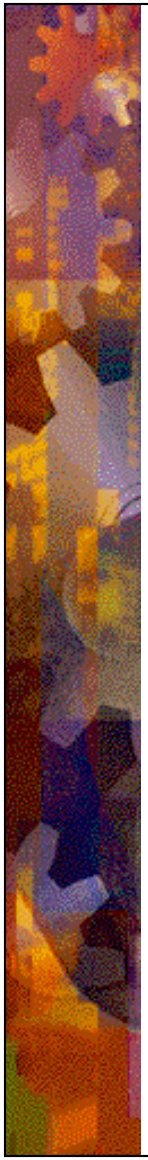
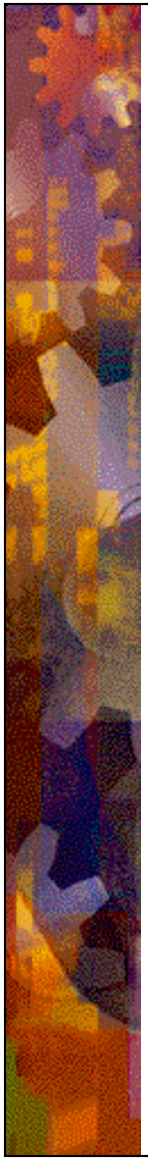
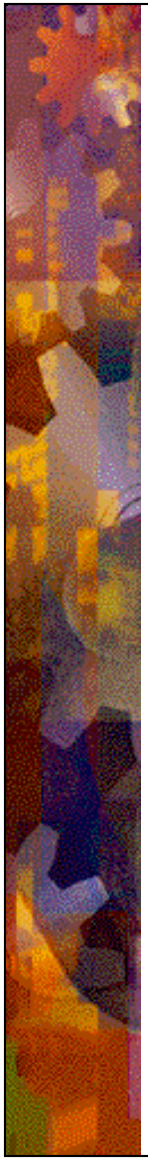


A short introduction to Decision Making & Behavioral Economics



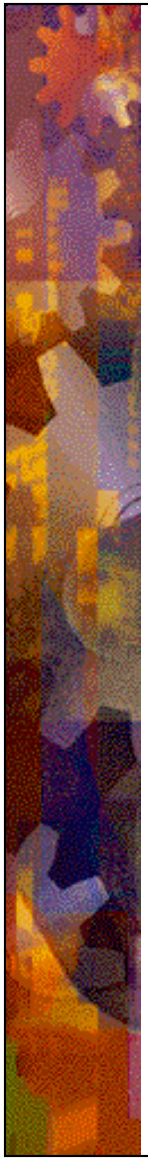
An overview:

- What is decision making?
- The economic vs. psychological approach
- Visual illusions as an analogy
-
- Examples and implications



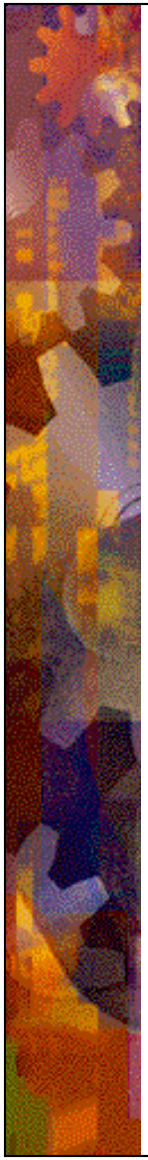
What is decision making?

- The study of decision-making attempts to describe the principals people use to make decisions in day to day life.
  - Where to eat?
  - What to eat?
  - How much to pay?
  - What job to take
  - Who to marry
  - Etc.



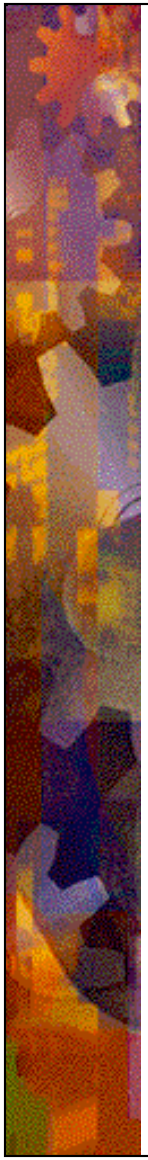
The econ vs. psych approach

- Economics is a science that describes how people should behave ➔ rationality
- Sometimes it is confused with how people behave
  - Mostly by economists
- Psychologists attempts to describe how people behave! (and why)



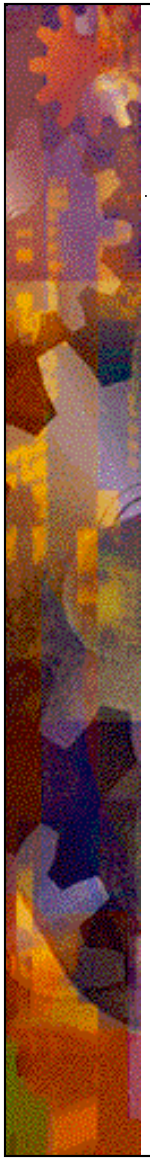
Our goal

- To illustrate some fundamental differences between rationality and behavior
-
- From expected utility to prospect theory and the likes
- Different assumptions / effects



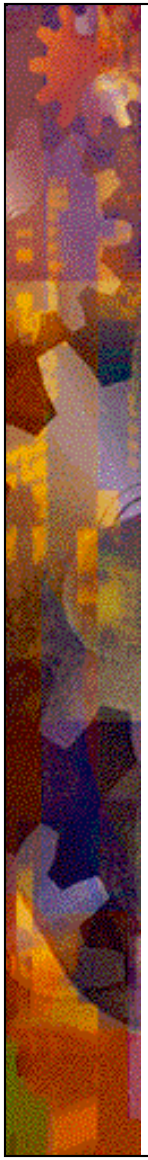
The Rational agent model

- Calibrated
- Well informed
- Ordered preferences
- Stable preferences (mostly about tangibles)
- Controlled
- Selfish
- Calculating
- Implications
  - People maximize
  - What's knowable is known
  - All opportunities exploited
  - Need no protection from themselves



The "Boundedly rational" model

- Mediocre judgments
- Incoherent preferences
- Impulsive and myopic
- Reciprocating, trusting and vindictive
- Variable tastes (poorly predicted)
- Malleable preferences
- Implications
- People "solve" local decisions
- (context dependent, reference dependent, myopic, biased)
- Require paternalistic attention and help???



Visual illusions as an analogy

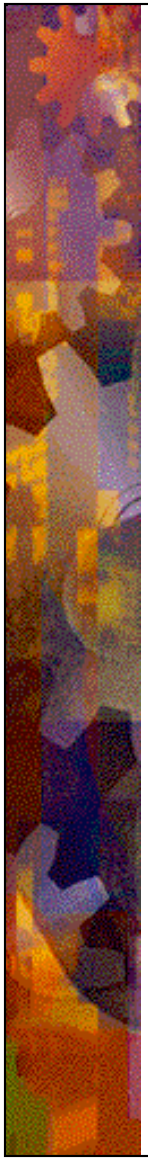
- Why do we see what we see?
- Why do we decide what we decide?
-
- Structural effects?
- Learning effects?
- Useful shortcuts? (Heuristics)

The Stroop I

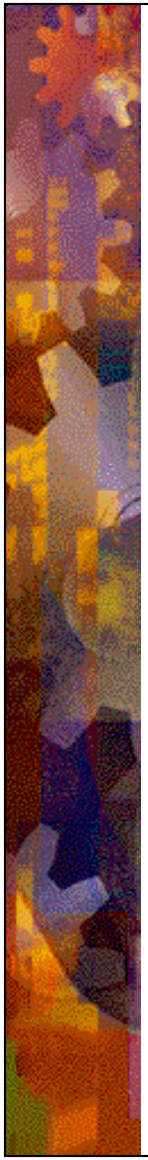
Red	Blue	Green	Yellow
White	Pink	Red	Black
Red	Green	Blue	Yellow
Gray	White	Gray	Green
Blue	Yellow	Black	Gray
Yellow	Blue	White	Blue
Black	Pink	Green	White

The Stroop II

Red	Blue	Green	Yellow
White	Pink	Red	Black
Red	Green	Blue	Yellow
Gray	White	Gray	Green
Blue	Yellow	Black	Gray
Yellow	Blue	White	Blue
Black	Pink	Green	White

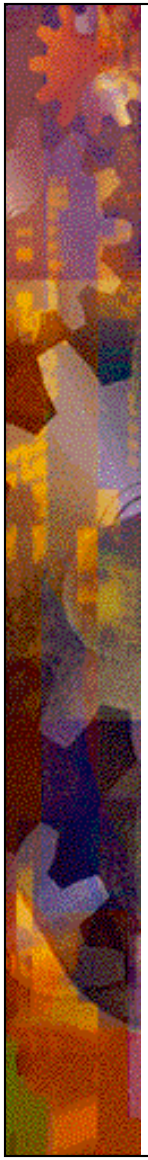


Contrasts & continuity

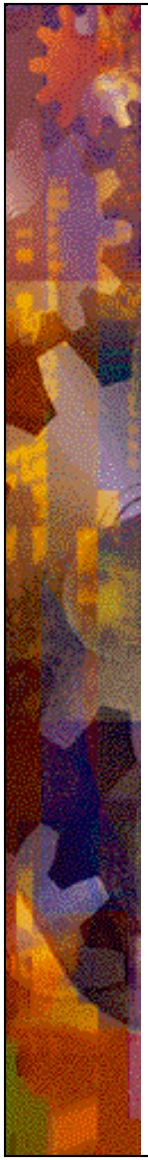


Basketball

- Count the number of times that the players in the white pass the ball…

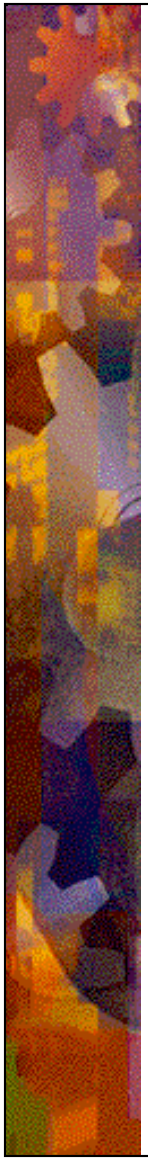


Some demos....



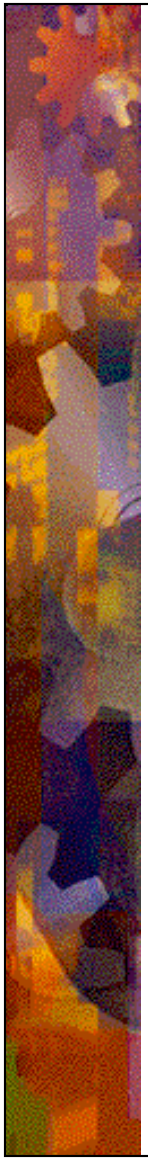
A partial list of: effects / phenomenon (I)

- Perception
- Adaptation
- Context effects
- Regret



Adaptation I

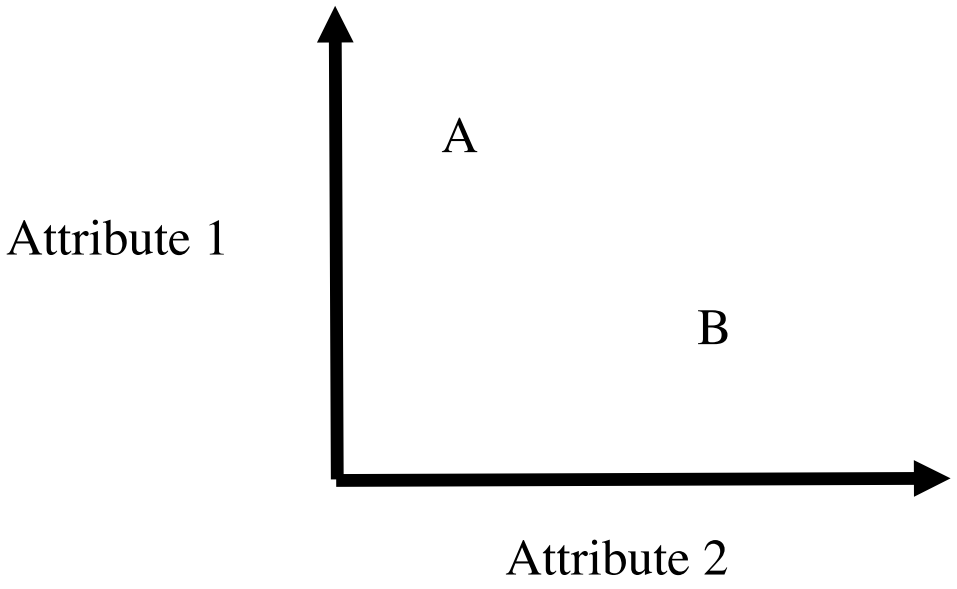
- People are sensitive to changes
  - With diminishing marginal differences
- People get used to stuff
- People don't predict their level of adaptation
-
- The "hedonic treadmill"

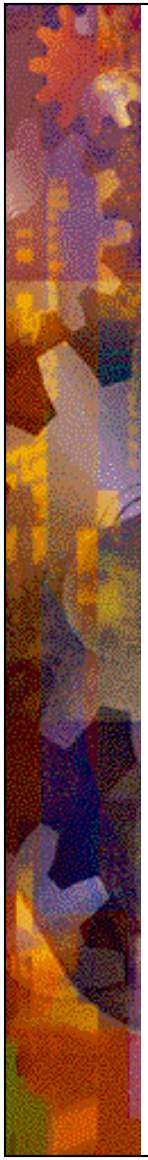


Adaptation II

- Examples:
  - Tenure
  - People who win the lottery are not as happy as they expect to be ...
  - California …
  -
- Other examples?
- implications....

Context effects

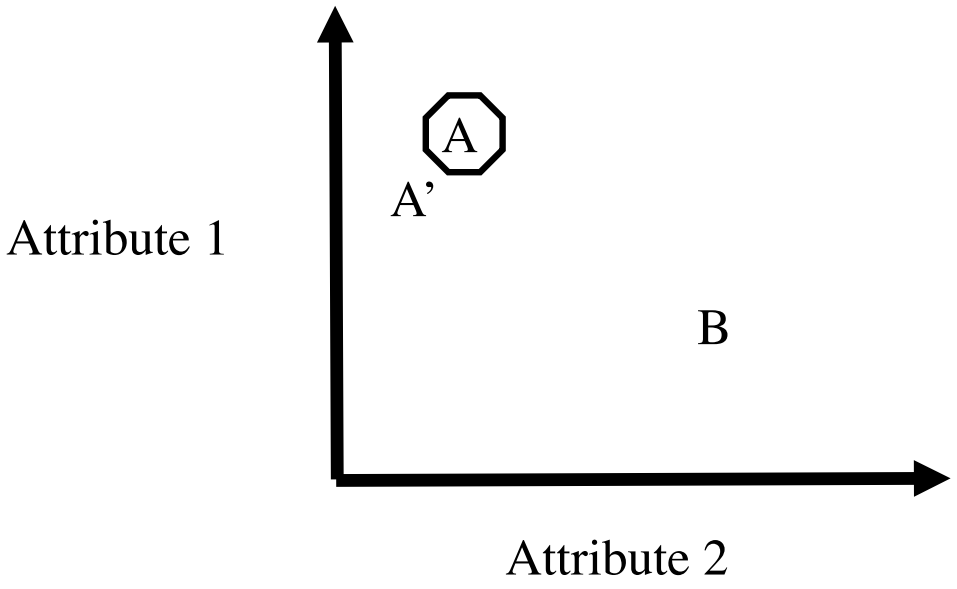




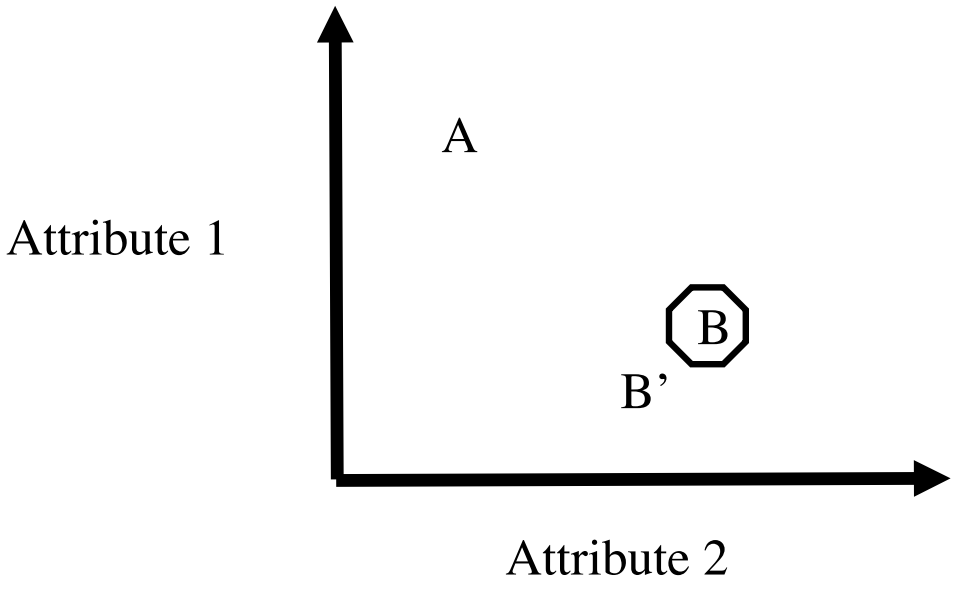
Asymmetric dominance effect

- Introducing a dominated alternative
  - An alternative that is worse on every attribute
  - Should have no effect on choice
  -
  - Vanilla, chocolate, strawberries

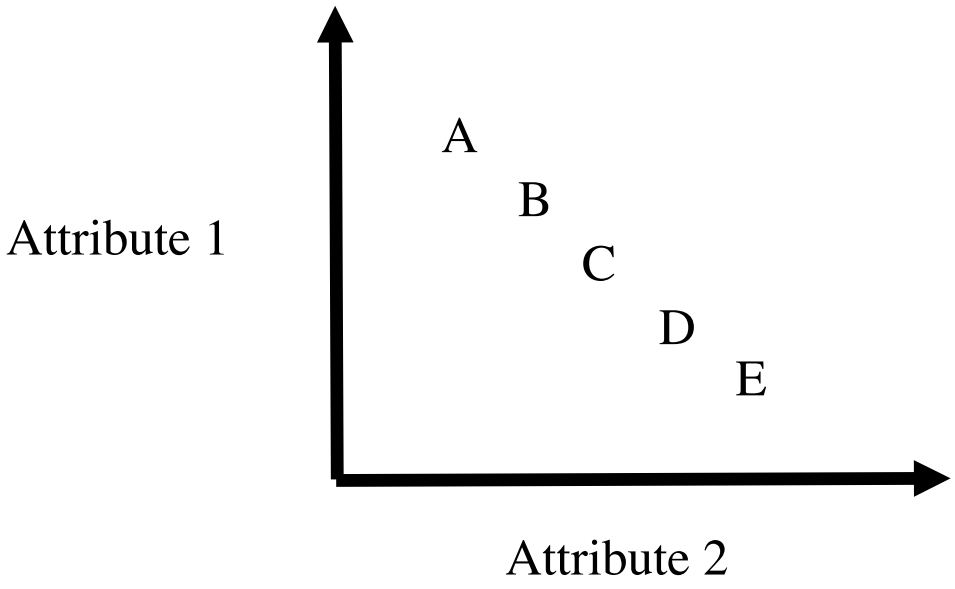
Asymmetric dominance effect



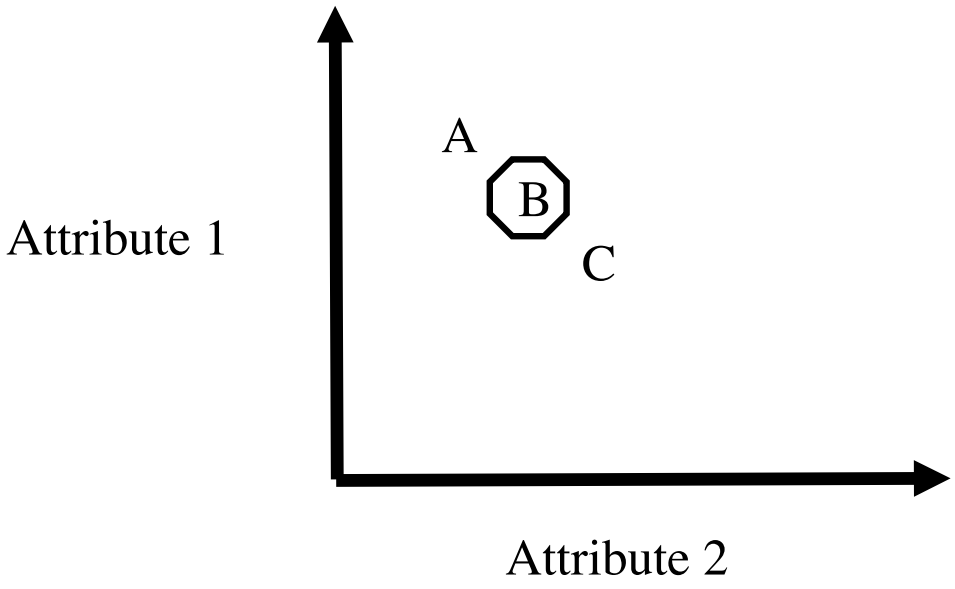
Asymmetric dominance effect



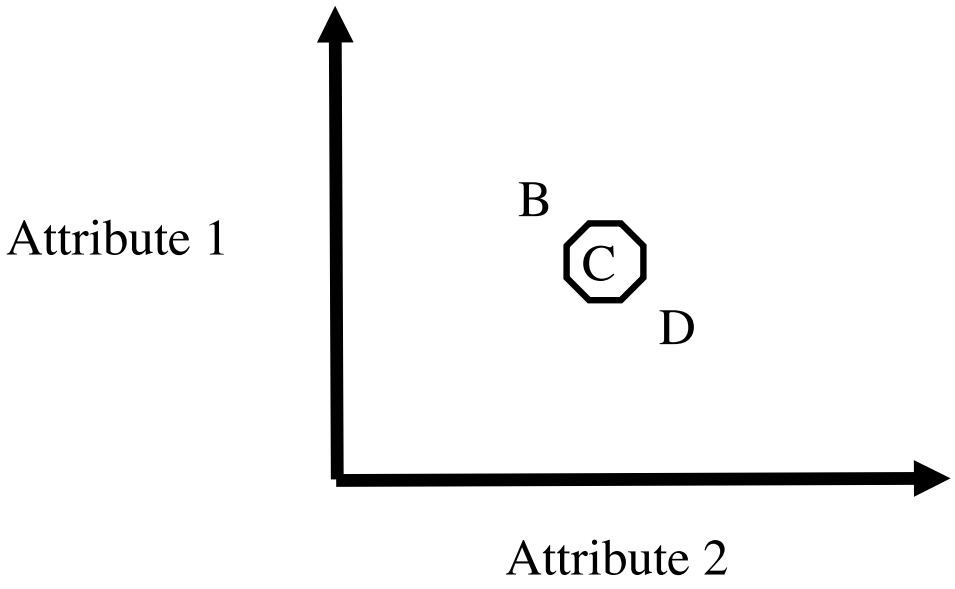
Compromise effect



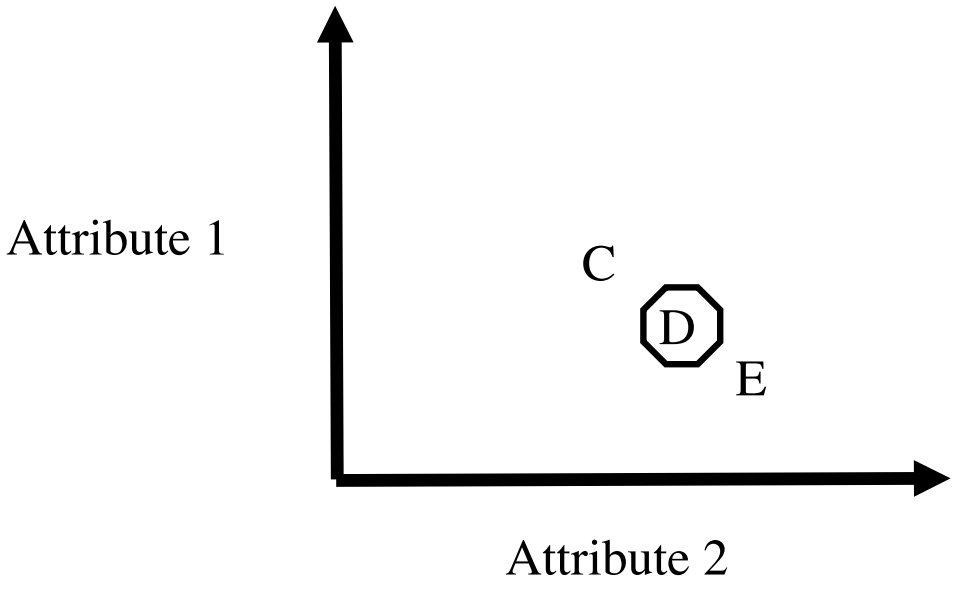
Compromise effect

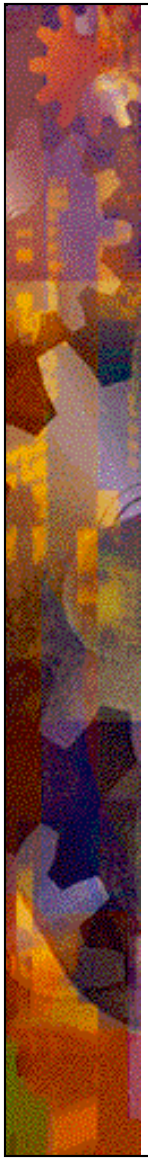


Compromise effect



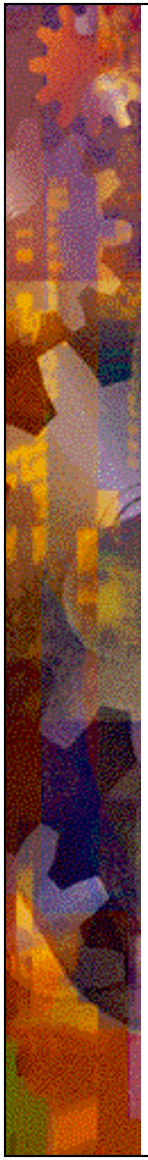
Compromise effect





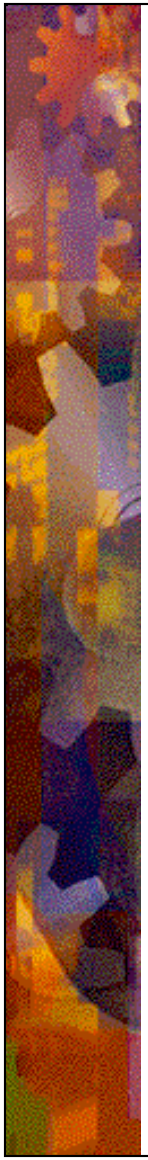
Context effects

- People use context to evaluate the focal options.
-
- Implications.....



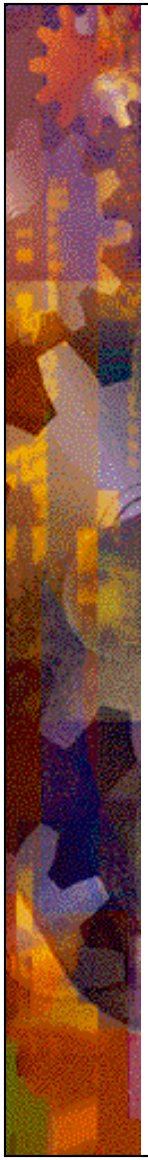
Context effects

- Lessons:
-
- Evaluations and choices are relative
- People use the context to infer value
-
- Decisions are hard, relative decisions can be easy



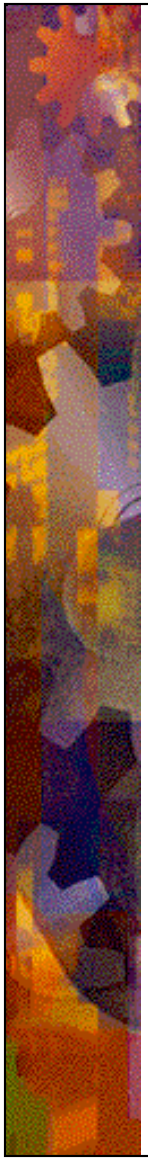
Regret I

- Who would feel more regret
  - Person A who missed his plane by 2 min
  - Person B who missed his plane by 2 hours and 2 min
  -
  - Winner of the silver or bronze medal?



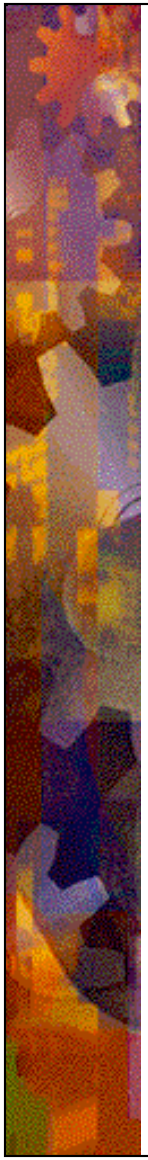
Regret II

- Who would feel more regret
  - Person A who had a tree fall on their car
  - Person B who took a different drive home and had a tree fall on their car
- Why????
- Counterfactuals !!!



Regret!

- Is regret a big motivational force in decisions?
-
- Implications .....



Summary

- Decision making
  - We do it all the time, but how?
  - One analogy: visual illusions -- fast, most efficient, but susceptible to mistakes
- Some specific examples:
  - Perception & Adaptation
  - Context effects
  - Regret