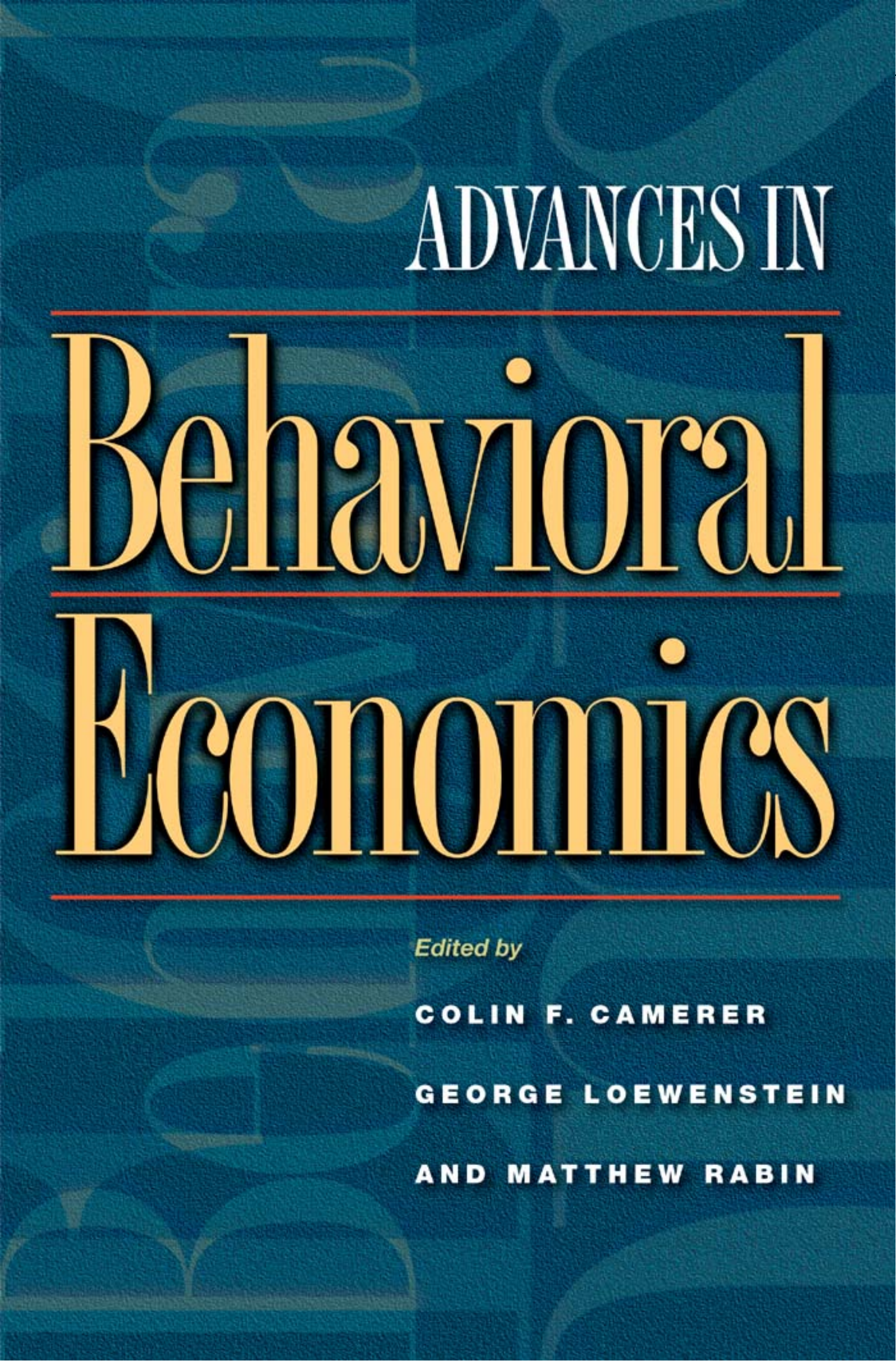
ADVANCES IN
Behavioral
Economics
Edited by
COLIN F. CAMERER
GEORGE LOEWENSTEIN
AND MATTHEW RABIN

Advances in Behavioral Economics

The Roundtable Series in Behavioral Economics

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To Daniel Kahneman, Richard Thaler, Amos Tversky, *and* Eric Wanner

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C O N T E N T S

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PREFACE

THIS BOOK was conceived several years ago when the editors, along with Drazen Prelec and Dick Thaler, spent a year as a working group at the Center for Advanced Study in Behavioral Sciences (CASES). When we weren't playing volleyball or hiking, we spent a lot of time taking stock of our field, making lists of what the main contributions were, and idly speculating about the future. We also contemplated various group projects, such as coediting a *Handbook of Behavioral Economics*. But none of us wanted to commit the time and energy it would take to ride herd on a group of authors who regard procrastination as such a regular feature of human behavior that they would be unembarrassed to procrastinate themselves. So the idea of a book of readings emerged, and eventually evolved into a collection of recent, important papers in the field.

The title of this collection deliberately bears the word "Advances" because we omitted many classic articles (which, by the way, any serious student of behavioral economics should read; our introductory chapter is partly designed to be an annotated guide to these influential classics). Including all of the deserving classic articles and newer contributions in one volume just stretched coverage of either type of article too thin. Fortunately, the early classics are available in many other places, including Kahneman, Slovic, and Tversky *Judgment under Uncertainty: Heuristics and Biases* (1982) on judgment; Kahneman and Tversky *Choices, Values and Frames* (2001) on choice; Elster and Loewenstein, *Choice over Time* (1992) on intertemporal choice; and Thaler's essential *The Winner's Curse* (1992). More recent compilations include Gilovich, Kahneman, and Miller, *Heuristics of Judgment: Extensions and Applications* (2002) on judgment; and Loewenstein, Read, and Baumeister, *Time and Decision: Economic and Psychological Perspectives on Intertemporal Choice* (2003) on the latest thinking about intertemporal choice.

The fact that we had to make a hard choice, and leave so many worthy papers out of the volume—not only classics, but also current works—is a testament to the progress of the field. Twenty years ago, behavioral economics did not exist as a field. There were scattered works by authors such as Duesenberry, Galbraith, Katona, Leibenstein, and Scitovsky, which received attention, but the general attitude of the field toward psychology was one of hostility and skepticism. Many economists simply didn't think it was necessary to try to model psychological limits (since errors would be extinguished by market, advice, evolution, etc.), or that it was even possible to do so parsimoniously. The older two of us experienced this hostility first-hand, from faculty members during graduate school, and later even more extremely when we attempted to publish. In fact, until about 1990, it was not uncommon to get a paper returned from a journal (usually after a delay of about a year) with a three sentence referee report saying "this isn't economics." Fortunately, hostility switched to curiosity and acceptance rather rapidly and completely in the past few years.

How did we get here from there? A big part of the credit should go to the people to whom this book is dedicated. Kahneman and Tversky provided the raw materials for much of behavioral economics—a new line of psychology, called behavioral decision research, that draws explicit contrasts between descriptively realistic accounts of judgment and choice and the assumptions and predictions of economics. Richard Thaler was the first economist to recognize the potential applications of this research to economics. His 1980 article "Toward a theory of consumer choice," published in the first issue of the remarkably open-minded (for its time) *Journal of Economic Behavior and Organization*, is considered by many to be the first genuine article in modern behavioral economics. (Thaler's 1999 article, which updates the earlier one and extends it, is included here in *Advances*.) Thaler's "anomalies" column published in the *Journal of Economic Perspectives* was another critical element in getting people to pay attention to behavioral economics. The anomalies column helped to shift many economists from the attitude "if it works don't try to fix it" to "it's broken; how can we fix it?"

Needless to say, numerous other scholars played important roles, including the psychologists Ward Edwards, Hillel Einhorn, Baruch Fischhoff, Robin Hogarth, Ken Hammond, Sarah Lichtenstein, and Paul Slovic. Herb Simon—the only psychologist before Kahneman to win the Nobel prize in economics—coined the terms "bounded rationality" and "procedural rationality" and urged economists to model the implications of bounds and procedures.

Behavioral economics also flourished because it was encouraged and done early on by economists who were better-known for other kinds of work, including George Akerlof, Ken Arrow, Peter Diamond, Bob Shiller, Lawrence Summers, Sidney Winter, and Richard Zeckhauser. (Our apologies for omitting many other important contributors in these lists. Can we plead guilty to "availability" bias?)

All these scientists played important roles in the advancement of behavioral economics. Our dedication includes one other person who played an unusual and vital role—Eric Wanner, the president of the Russell Sage Foundation. Wanner was first exposed to behavioral economics in the mid-1980s as a program officer at the Sloan Foundation. Sloan sponsored a small conference on psychology and economics that was attended by two of us (Camerer and Loewenstein) Kahneman, Tversky, Thaler, and others. While Sloan did not bet heavily on the emerging field, Wanner did make a big bet after taking the job of president of the Russell Sage Foundation (RSF).

RSF's official charge is to fund social science research to help the poor. Wanner, an accomplished cognitive psychologist early in his career, felt that rational-choice economics provided a limited scientific language in which to talk about sources of poverty and about policy solutions. He saw in behavioral economics the chance for a small foundation to have a big impact in social science and to broaden the language of economics to say more about poverty. He funded research in behavioral economics and invited many behavioral economists to the foundation as fellows in residence, including two of us (Camerer and Loewenstein).

A brilliant RSF investment was a series of biannual "summer camps," started in 1994 to teach behavioral economics to advanced graduate students in economics and other social sciences. Like other summer camps in economics, these have been hugely effective in conveying a body of knowledge that campers could not get in

Ph.D. courses at their home schools, until recently. The rosters of guest speakers and camper alumni are both impressive indeed. The camps have also sharpened our own thinking, and created a social network of students from around the world.

The most recent program of RSF's support for behavioral economics has been the copublication, with Princeton University Press, of a Behavioral Economics Roundtable Series. This book is the second of many planned volumes in that series. The field is progressing so rapidly that an advanced *Advances* is not far away.