

12 Behavioral Economics

12.1 Lecture 25: Behavioral Economics

12.1.1 Introduction of behavioral economics

- Key of behavioral economics is bringing psychological insights into our models to enrich them.
- Time inconsistency or self-control model: individuals are unable to carry out their optimal consumption plans.
- Exponential discounting:

$$U = u(C_1) + \sum_{i=2}^T u(C_i) \cdot \delta^i$$

- Hyperbolic discounting:

$$U = u(C_1) + \beta \sum_{i=2}^T u(C_i) \cdot \delta^i$$

- In response, policies include information, taxation, regulation, supply, “nudges”.

12.1.2 TO KNOW – Conceptual Understanding

- Write out (1) exponential discounting model and (2) the hyperbolic discounting model; contrast the models
- Explain what behavioral economics study and some important models
- Explain how corrective taxes can address time-inconsistency

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