

# BRIEF CONTENTS

List of Figures	xiii
List of Tables	xv
Preface	xvii
Acknowledgements	xx
About the Author	xxi
<b>1 Introduction</b>	<b>1</b>
<b>PART 1 CHOICE UNDER CERTAINTY</b>	
<b>2 Rational Choice under Certainty</b>	<b>10</b>
<b>3 Decision-Making under Certainty</b>	<b>32</b>
<b>PART 2 JUDGMENT UNDER RISK AND UNCERTAINTY</b>	
<b>4 Probability Judgment</b>	<b>72</b>
<b>5 Judgment under Risk and Uncertainty</b>	<b>96</b>
<b>PART 3 CHOICE UNDER RISK AND UNCERTAINTY</b>	
<b>6 Rational Choice under Risk and Uncertainty</b>	<b>126</b>
<b>7 Decision-Making under Risk and Uncertainty</b>	<b>149</b>
<b>PART 4 INTERTEMPORAL CHOICE</b>	
<b>8 The Discounted Utility Model</b>	<b>178</b>
<b>9 Intertemporal Choice</b>	<b>192</b>

BRIEF CONTENTS

**PART 5 STRATEGIC INTERACTION**

**10 Analytical Game Theory** 218

**11 Behavioral Game Theory** 238

**PART 6 CONCLUDING REMARKS**

**12 Behavioral Policy** 256

**13 General Discussion** 270

Appendix: Answer Key 273

Bibliography 310

Index 317

# CONTENTS

List of Figures	xiii
List of Tables	xv
Preface	xvii
Acknowledgements	xx
About the Author	xxi
<b>1 Introduction</b>	<b>1</b>
1.1 Economics: Neoclassical and behavioral	1
1.2 The origins of behavioral economics	3
1.3 Methods	5
1.4 Looking ahead	7
Further reading	8
<b>PART 1 CHOICE UNDER CERTAINTY</b>	
<b>2 Rational Choice under Certainty</b>	<b>10</b>
2.1 Introduction	10
2.2 Preferences	10
2.3 Rational preferences	12
2.4 Indifference and strict preference	16
2.5 Preference orderings	21
2.6 Choice under certainty	22
2.7 Utility	24
2.8 Discussion	29
Additional exercises	30
Further reading	31
<b>3 Decision-Making under Certainty</b>	<b>32</b>
3.1 Introduction	32
3.2 Opportunity costs	32
3.3 Sunk costs	39
3.4 Menu dependence and the decoy effect	44
3.5 Loss aversion and the endowment effect	51
3.6 Anchoring and adjustment	63

CONTENTS

3.7 Discussion	66
Additional exercises	67
Further reading	70
<b>PART 2 JUDGMENT UNDER RISK AND UNCERTAINTY</b>	
<b>4 Probability Judgment</b>	<b>72</b>
4.1 Introduction	72
4.2 Fundamentals of probability theory	73
4.3 Unconditional probability	77
4.4 Conditional probability	82
4.5 Total probability and Bayes's rule	86
4.6 Bayesian updating	89
4.7 Discussion	91
Additional exercises	92
Further reading	95
<b>5 Judgment under Risk and Uncertainty</b>	<b>96</b>
5.1 Introduction	96
5.2 The gambler's fallacy	96
5.3 Conjunction and disjunction fallacies	100
5.4 Base-rate neglect	104
5.5 Confirmation bias	108
5.6 Availability	111
5.7 Overconfidence	114
5.8 Discussion	118
Additional exercises	119
Further reading	123
<b>PART 3 CHOICE UNDER RISK AND UNCERTAINTY</b>	
<b>6 Rational Choice under Risk and Uncertainty</b>	<b>126</b>
6.1 Introduction	126
6.2 Uncertainty	126
6.3 Expected value	130
6.4 Expected utility	137
6.5 Attitudes toward risk	142
6.6 Discussion	146
Additional exercises	147
Further reading	148
<b>7 Decision-Making under Risk and Uncertainty</b>	<b>149</b>
7.1 Introduction	149
7.2 Framing effects in decision-making under risk	149
7.3 Bundling and mental accounting	155

7.4	The Allais problem and the sure-thing principle	161
7.5	The Ellsberg problem and ambiguity aversion	164
7.6	Probability weighting	167
7.7	Rabin's calibration theorem	171
7.8	Discussion	173
	Additional exercises	174
	Further reading	176
<b>PART 4 INTERTEMPORAL CHOICE</b>		
<b>8</b>	<b>The Discounted Utility Model</b>	<b>178</b>
8.1	Introduction	178
8.2	Interest rates	178
8.3	Exponential discounting	182
8.4	What is the rational delta?	188
8.5	Discussion	190
	Additional exercises	190
	Further reading	191
<b>9</b>	<b>Intertemporal Choice</b>	<b>192</b>
9.1	Introduction	192
9.2	Hyperbolic discounting	192
9.3	Choosing not to choose	199
9.4	Preferences over profiles	203
9.5	Misprediction and miswanting	208
9.6	Discussion	213
	Additional exercises	213
	Further reading	216
<b>PART 5 STRATEGIC INTERACTION</b>		
<b>10</b>	<b>Analytical Game Theory</b>	<b>218</b>
10.1	Introduction	218
10.2	Nash equilibrium in pure strategies	219
10.3	Nash equilibrium in mixed strategies	225
10.4	Equilibrium refinements	230
10.5	Discussion	234
	Additional exercises	236
	Further reading	237
<b>11</b>	<b>Behavioral Game Theory</b>	<b>238</b>
11.1	Introduction	238
11.2	Social preferences: Altruism, envy, fairness, and justice	238
11.3	Intentions, reciprocity, and trust	244
11.4	Limited strategic thinking	248

CONTENTS

11.5 Discussion	250
Additional exercises	251
Further reading	253
<b>PART 6 CONCLUDING REMARKS</b>	
<b>12 Behavioral Policy</b>	<b>256</b>
12.1 Introduction	256
12.2 Behavioral welfare economics, libertarian paternalism, and the nudge agenda	257
12.3 Assessing the nudge agenda	262
12.4 The economics of happiness	265
12.5 Discussion	268
Further reading	269
<b>13 General Discussion</b>	<b>270</b>
Further reading	272
Appendix: Answer Key	273
Bibliography	310
Index	317

# 1 INTRODUCTION

## Learning objectives

*After studying this chapter you will:*

- Know the difference between descriptive and normative theories of decision
- Understand how behavioral economics differs from standard (neoclassical) economics – and why
- Appreciate the variety of methods used by behavioral economists

## 1.1 Economics: Neoclassical and behavioral

This is a book about **theories of decision**. To use the language of the epigraph, such theories are about the negotiation of “the thorny career of life”: they tell us how we make, or how we should make, decisions. Not that the Marquis de Sade would have spoken in these terms, living as he did in the eighteenth century, but the theory of decision seems to be exactly what he had in mind when he imagined “the master-piece of philosophy.”

Developing an acceptable theory of decision would be an achievement. Most human activity – finance, science, medicine, arts, and life in general – can be understood as a matter of people making certain kinds of decisions. Consequently, an accurate theory of decision would cover a lot of ground. Maybe none of the theories we will discuss is the masterpiece of which de Sade thought so highly. Each theory can be, has been, and perhaps should be challenged on various grounds. However, decision theory has been an active area of research in recent decades, and it may have generated real progress.

Modern theories of decision (or **theories of choice** – I will use the terms interchangeably) say little about what goals people will or should pursue. Goals may be good or evil, mean-spirited or magnanimous, altruistic or egoistic, short-sighted or far-sighted; they may be Mother Teresa’s or the Marquis de Sade’s. Theories of decision simply take a set of goals as given. Provided a set of goals, however, the theories have much to say about how people will or should pursue those goals.

Theories of decision are variously presented as descriptive or normative. A **descriptive** theory describes how people *in fact* make decisions. A **normative** theory captures how people *should* make decisions. It is at least theoretically possible that people make the decisions that they should make. If so, one and the same theory can simultaneously be descriptively adequate and normatively correct. However, it is possible that people fail to act in the manner in which they should. If so, no one theory can be both descriptively adequate and normatively correct.

**Exercise 1.1 Descriptive vs. normative** Which of the following claims are descriptive and which are normative? (Answers to this and other exercises can be found in the Appendix.)

- (a) On average, people save less than 10 percent of their income for retirement.
- (b) People do not save as much for retirement as they should.
- (c) Very often, people regret not saving more for retirement.

It can be unclear whether a claim is descriptive or normative. “People save too little” is an example. Does this mean that people do not save as much as they should? If so, the claim is normative. Does this mean that people do not save as much as they wish they did? If so, the claim is descriptive.

**Example 1.2 Poker** Suppose that you are playing poker, and that you are playing to win. Would you benefit from having an adequate descriptive theory, a correct normative theory, or both?

A descriptive theory would give you information about the actions of the other players. A normative theory would tell you how you should behave in light of what you know about the nature of the game, the expected actions of the other players, and your ambition to win. All this information is obviously useful when playing poker. You would benefit from having both kinds of theory.

Some theories of decision are described as **theories of rational choice**. In everyday speech, the word “rationality” is used loosely; frequently it is used simply as a mark of approval. For our purposes, a theory of rational decision is best seen as a **definition** of rationality, that is, as specifying what it means to be rational. Every theory of rational decision serves to divide decisions into two classes: rational and irrational. Rational decisions are those that are in accordance with the theory; irrational decisions are those that are not. A theory of rational choice can be thought of as descriptive or normative (or both). To say that a theory of rational decision is descriptive is to say that people in fact act rationally. To say that a theory of rational decision is normative is to say that people should act rationally. To say that a theory of rational decision is simultaneously descriptive and normative is to say that people act and should act rationally. Typically, the term **rational-choice theory** is reserved for theories that are (or that are thought to be) normatively correct, whether or not they are simultaneously descriptively adequate.

For generations now, economics has been dominated by an intellectual tradition broadly referred to as **neoclassical economics**. If you have studied economics but do not know whether or not you were taught in the neoclassical tradition, it is almost certain that you were. Neoclassical economics is characterized by its commitment to a theory of rational choice that is simultaneously presented as descriptively adequate and normatively correct. This approach presupposes that people by and large act in the manner that they should. Neoclassical economists do not need to assume that all people act rationally all the time, but they insist that deviations from perfect rationality are so small or so unsystematic as to be negligible. Because of its historical dominance, I will refer to neoclassical economics as standard economics, and to neoclassical economic theory as standard theory.



This is an introduction to **behavioral economics**: the attempt to increase the explanatory and predictive power of economic theory by providing it with more psychologically plausible foundations, where “psychologically plausible” means consistent with the best available psychology. Behavioral economists share neoclassical economists’ conception of **economics** as the study of people’s decisions under conditions of scarcity and of the results of those decisions for society. But behavioral economists reject the idea that people by and large behave in the manner that they should. While behavioral economists certainly do not deny that some people act rationally some of the time, they believe that the deviations from rationality are large enough, systematic enough, and consequently predictable enough to warrant the development of new descriptive theories of decision. If this is right, a descriptively adequate theory cannot at the same time be normatively correct, and a normatively correct theory cannot at the same time be descriptively adequate.

## 1.2 The origins of behavioral economics

Behavioral economics can be said to have a short history but a long past. Only in the last few decades has it emerged as an independent subdiscipline of economics. By now, top departments of economics have behavioral economists on their staff. Behavioral economics gets published in mainstream journals. Traditional economists incorporate insights from behavioral economics into their work. In 2002, Daniel Kahneman (one of the most famous behavioral economists) won the Nobel Memorial Prize “for having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty.” And then, in 2017, Richard Thaler (another leading figure) won the Prize for his contributions to behavioral economics. In spite of its short history, however, efforts to provide economics with plausible psychological foundations go back a long way.

The establishment of modern economics is marked by the publication in 1776 of Adam Smith’s *The Wealth of Nations*. Classical economists such as Smith are often accused of having a particularly simple-minded (and false) picture of human nature, according to which people everywhere and always, in hyper-rational fashion, pursue their narrowly construed self-interest. This accusation, however, is unfounded. Smith did not think people were rational:

How many people ruin themselves by laying out money on trinkets of frivolous utility? What pleases these lovers of toys is not so much the utility, as the aptness of the machines which are fitted to promote it. All their pockets are stuffed with little conveniences ... of which the whole utility is certainly not worth the fatigue of bearing the burden.

Smith wrote these words 200 years before the era of pocket calculators, camera phones, iPads, and smartwatches. Nor did Smith think people were selfish: “[There] are evidently some principles in [man’s] nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.” Smith and the other classical economists had a conception

of human nature that was remarkably multi-faceted; indeed, they did not draw a sharp line between psychology and economics the way we do.

Early neoclassical economics was built on the foundation of **hedonic psychology**: an account of individual behavior according to which individuals seek to maximize pleasure and minimize pain. In W. Stanley Jevons's words: "Pleasure and pain are undoubtedly the ultimate objects of the Calculus of Economics. To satisfy our wants to the utmost with the least effort ... in other words, to *maximise pleasure*, is the problem of Economics." The early neoclassical economists were inspired by the philosopher Jeremy Bentham, who wrote: "Nature has placed mankind under the governance of two sovereign masters, *pain* and *pleasure* ... They govern us in all we do, in all we say, in all we think." Because it was assumed that individuals have direct access to their conscious experience, some economists defended the principles of hedonic psychology on the basis of their introspective self-evidence alone.

After World War II, however, many economists were disappointed with the meager results of early neoclassicism in terms of generating theories with predictive power and so came to doubt that introspection worked. Similar developments took place in other fields: behaviorism in psychology, verificationism in philosophy, and operationalism in physics can all be seen as expressions of the same intellectual trend. Postwar neoclassical economists aimed to improve the predictive power of their theories by focusing on what can be publicly observed rather than on what must be experienced. Instead of taking a theory about pleasure and pain as their foundation, they took a theory of preference. The main difference is that people's feelings of pleasure and pain are unobservable, whereas their choices can be directly observed. On the assumption that choices reflect personal preferences, we can have direct observable evidence about what people prefer. Thus, postwar neoclassical economists hoped to completely rid economics of its ties to psychology – hedonic and otherwise.

In spite of the relative hegemony of neoclassical economics during the second half of the twentieth century, many economists felt that their discipline would benefit from closer ties to psychology and other neighboring fields. What really made a difference, however, was the cognitive revolution. In the 1950s and 1960s, researchers in psychology, computer science, linguistics, anthropology, and elsewhere rejected the demands that science focus on the observable and that all methods be public. Instead, these figures advocated a "science of cognition" or **cognitive science**. The cognitive scientists were skeptical of naive reliance on introspection, but nevertheless felt that a scientific psychology must refer to things "in the head," including beliefs and desires, symbols, rules, and images. Behavioral economics is a product of the cognitive revolution. Like cognitive scientists, behavioral economists – though skeptical of the theories and methods of the early neoclassical period – are comfortable talking about beliefs, desires, rules of thumb, and other things "in the head." Below, we will see how these commitments get played out in practice.

To some, the fact that behavioral economists go about their work in such a different way means that they have become economists in name only. But notice that behavioral economics is still about the manner in which people make choices under conditions of scarcity and the results of those choices for society at large – which is the very definition of economics. **Behavioral science** refers to the scientific study of behavior, which makes behavioral economics a kind of behavioral science.

**Psychology and economics** is also a broader category, referring to anything that integrates the two disciplines, and which therefore does not need to be about choice at all.

### 1.3 Methods

Before we explore in earnest the concepts and theories developed by behavioral economists in the last few decades, I want to discuss the data that behavioral economists use to test their theories and the methods they use to generate such data. I also want to assuage some skepticism that people may have about those methods.

Some of the earliest and most influential papers in behavioral economics relied on participants' responses to hypothetical choices. In such studies, participants were asked to imagine that they found themselves in a given choice situation and to indicate what decision they would make under those conditions. Here is one such question: "Which of the following would you prefer? A: 50% chance to win 1,000, 50% chance to win nothing; B: 450 for sure." Other early papers relied on readers' intuitions about how people might behave under given conditions. Thus, they offered scenarios such as: "Mr S. admires a \$125 cashmere sweater at the department store. He declines to buy it, feeling that it is too extravagant. Later that month he receives the same sweater from his wife for a birthday present. He is very happy. Mr and Mrs S. have only joint bank accounts." These thought experiments were apparently inspired in part by the author's observations of the behavior of fellow economists, who argued that people were always rational but at times behaved irrationally in their own lives.

Soon enough, hypothetical choice studies were almost completely displaced by **laboratory experiments** in which laboratory participants make real choices involving real money. Such experiments have been run for decades. In the early 1970s, for example, psychologists Sarah Lichtenstein and Paul Slovic ran experiments at a Las Vegas casino, where a croupier served as experimenter, professional gamblers served as participants, and winnings and losses were paid in real money. More frequently, behavioral economists use college undergraduates or other easily accessible participants. When behavioral economists engage in experimental studies, they can be hard to distinguish from neoclassical experimental economists, that is, neoclassical economists who use experiments to explore how people make decisions. Experimentalists agree that decisions performed by laboratory participants must be real, and that actual winnings must be paid out.

Behavioral economists, during the last two decades, have increasingly relied on data gathered "in the field." In one famous **field study**, Colin F. Camerer and colleagues studied the behavior of New York City cab drivers by using data from "trip sheets" – forms that drivers use to record the time passengers are picked up and dropped off as well as the amount of the fares – and from the cabs' meters, which automatically record the fares. Researchers in this study simply observed how participants behaved under different conditions. In **field experiments**, researchers randomly assign participants to test and control groups, and then note how (if at all) the behavior of individuals in the two groups differs. In one prominent field experiment, Jen Shang and Rachel Croson tracked how voluntary donations to a public radio station varied when prospective donors were given different social information, that is, information about how much other people had given.

To some extent, behavioral economists use what psychologists call **process measures**, that is, methods that provide hints about cognitive and emotional processes underlying decision-making. Some rely on **process-tracing** software to assess what information people use when making decisions in games. Others employ brain scans, typically functional magnetic resonance imaging (fMRI), which allows researchers to examine, albeit crudely, which parts of an individual's brain are activated in response to a task or decision. Imaging methods have already been applied to a diversity of economic tasks, including decision-making under risk and uncertainty, intertemporal choice, buying and selling behavior, and strategic behavior in games. Even more exotic neuroscience methods are sometimes employed. For example, a tool called transcranial magnetic stimulation can be used to temporarily disable a part of participants' brains as they make decisions. The increasing use of methods borrowed from neuroscience is, not coincidentally, connected to the rise of **neuroeconomics**, which integrates economics with neuroscience.

The use of multiple methods to generate evidence raises interesting methodological problems. This is particularly true when evidence from different sources points in slightly different directions. Sometimes, however, evidence from multiple sources points in the same direction. When this is true, behavioral economists have more confidence in their conclusions. It can be argued that part of the reason why behavioral economics has turned into such a vibrant field is that it successfully integrates evidence of multiple kinds, generated by a variety of methods.

Recently, social and behavioral science has been thrown into something called the “replication crisis,” as several well-known empirical results have proven difficult to replicate. It may turn out that these findings were mere experimental artifacts all along. The lack of reproducibility is obviously unwelcome news for the researchers invested in the results, and has fueled skepticism about the methods of social and behavioral science – and perhaps the entire enterprise of trying to understand human behavior with scientific methods. But it is important to note that (at least within bounds) the fact that some alleged findings are revised in light of new evidence is not as such devastating for social and behavioral science. In fact, what makes science different from other kinds of human activity is that *it is supposed to be* open to revision in light of new data. On statistical grounds alone, we should expect that some of the results generated by behavioral economists – and consequently some of the results discussed in the below – will not hold up. That said, systematic studies of reproducibility in psychology and economics suggest that economics is doing reasonably well by comparison. A 2016 report in the prestigious journal *Science* concludes that results from laboratory experiments in economics are at least as robust (and maybe more robust) than any other empirical result in economics, and moreover that laboratory experiments published in top economic journals have relatively high rates of replicability. The authors conclude on a positive note: “There is every reason to be optimistic that science in general, and social science in particular, will emerge much improved after the current period of critical self-reflection.”

## 1.4 Looking ahead

As stated in the Preface, this book is arranged in six main parts: (1) choice under certainty, (2) judgment under risk and uncertainty, (3) choice under risk and uncertainty, (4) intertemporal choice, (5) strategic interaction, and (6) policy applications and conclusions. As suggested in Section 1.1, the ultimate goal of behavioral economics is to generate novel insights into people's decisions under conditions of scarcity and the results of those decisions for society. Behavioral and neoclassical economists alike try to attain this goal by building abstract, formal theories. In this book we will explore increasingly general theories, both neoclassical and behavioral.

Studying behavioral economics is a non-trivial enterprise. For one thing, the level of abstraction can pose an initial challenge. But as we will see below, it is the very fact that economics is so abstract that makes it so very useful: the more abstract the theory, the wider its potential application. Some readers may be prone to putting down a book like this as soon as they notice that it contains mathematics. Please do not. There is no advanced math in the book, and **numeracy** – the ability with or knowledge of numbers – is incredibly important, even to people who think of themselves as practically oriented.

**Exercise 1.3 Numeracy** In a 2010 study on financial decision-making, people's answers to three quick mathematics questions were strong predictors of their wealth: households where both spouses answered all three questions correctly were *more than eight times* as wealthy as households where neither spouse answered any question correctly. So if you have ever struggled with math, be glad that you did. You can try answering the three questions for yourself:

- (a) If the chance of getting a disease is 10 percent, how many people out of 1000 would be expected to get the disease?
- (b) If five people all have the winning numbers in the lottery, and the prize is 2 million dollars, how much will each of them get?
- (c) Let us say you have \$200 in a savings account. The account earns 10 percent interest per year. How much would you have in the account at the end of two years?

You will find the correct answers in the answer key at the end of the book.

There's also evidence that people who fall prey to the specific fallacies and mistakes that behavioral economists study are more likely to experience poor outcomes in their own lives. In a widely cited 2007 study, researchers assessed people's decision-making competence by checking to what extent they make mistakes such as honoring sunk costs (see Section 3.3) in pen-and-paper questionnaires. The study found that people with low decision-making competence were more likely to report poor real-world decision outcomes, such as having gotten a divorce, declared bankruptcy, lost one's driver's license, gotten oneself kicked out of a bar, and so on. The authors suggest that decision-making competence should be considered a separate cognitive skill that helps us avoid negative real-world outcomes.

To underscore the usefulness of behavioral economics, the book discusses a variety of applications. Among other things, you will learn how to choose a wingman or

wingwoman, how to design a marketing scheme that works, how not to fall for such marketing schemes, how to compute the probability that your love interest is seeing somebody else, how to sell tires, and how to beat anyone at rock-paper-scissors. Ultimately, behavioral economics sheds light on human beings living in society – the way they really are, as opposed to the way great thinkers of the past have thought they should be – and on the nature of the human condition. Behavioral economics helps us live better lives – and to improve the world to boot.



### Further reading

Kahneman's *Thinking, Fast and Slow* (2011) and Thaler's *Misbehaving: The Making of Behavioral Economics* are must-reads for anyone interested in behavioral economics, both for their unparalleled understanding of the theory and for their illuminating personal reminiscences. Angner and Loewenstein (2012) and Heukelom (2014) discuss the nature, historical origins, and methods of behavioral economics; Angner (2015a, 2019) explores further the relationship between behavioral and neoclassical economics. *The Wealth of Nations* is Smith (1976 [1776]); the quotations in the history section are from Smith (2002 [1759], p. 211) and Smith (2002 [1759], p. 11), Jevons (1965 [1871], p. 37), and Bentham (1996 [1789], p. 11). The sample questions in the methods section come from Kahneman and Tversky (1979, p. 264) and Thaler (1985, p. 199). The psychologists who went to Vegas are Lichtenstein and Slovic (1973). The study of NYC cabdrivers is Camerer et al. (1997); the one about social information is Shang and Croson (2009). Camerer et al. (2005) provide a widely cited overview of neuroeconomics, and Camerer, Dreber, et al. (2016, pp. 1435–6) examine the reproducibility of economics. The study on financial decision-making is Smith et al. (2010); the three numeracy questions were adapted from the University of Michigan Health and Retirement Study.

# INDEX

*30 Rock*, 13

## A

ace of spades, 84–85  
actuarially fair lottery, 136  
adaptation, 209  
addiction, 192, 214  
    rational, 184  
Adler, Alfred, 110, 123, 216  
advertising campaign, 37  
affect heuristic, 117, 119, 123  
Affordable Care Act, 61  
Afghanistan, 108, 122, 273  
African nations, 63, 64  
afterlife, 191  
air fares, 158  
airplane crashes, 100, 113, 117, 168  
Alabama, 106  
alarm clocks, 97–98, 203  
alcohol, 113, 193  
Allais problem, 161–164  
alternatives, set of, 12, 22, 24–26, 28, 29, 38  
altruism, 238–244  
ambiguity aversion, 164–167, 175  
American Economic Association (AEA), 67  
analytical game theory, 218–238, 240, 250, 251, 271  
    and neoclassical economics, 238  
anchor, 63–66, 103, 117, 285, 288  
anchoring and adjustment, 63–66, 69–70, 83, 98, 99, 103, 113, 117, 123, 287  
AND rule, 78–80, 84–87, 132  
ant and the grasshopper, the, 184  
anti-symmetry, 18, 45  
anti-vaccination, 113  
Apollo 11, 116  
Aristotle, 41, 266  
Armstrong, Neil, 116  
aspiration treadmill, 58–59, 287  
asymmetric paternalism, 257, 259  
asymmetrical domination, 46, 49, 67, 282  
athletes, 59  
attitudes to risk, 143–144

attraction effect, 48  
Auburn, 106  
auxiliary assumptions, 28, 143, 270–271  
availability, 111–114  
    bias, 113, 114, 116, 117, 121  
    cascades, 113  
    heuristic, 112–114, 117  
aviation safety, 103  
axiomatic theory, 10, 72  
axioms, 10  
    of probability, 74, 91  
    of unconditional probability, 77–82

## B

backward induction, 224, 233  
Ball, George, 42  
base rate, 105, 111, 112  
    base-rate fallacy, 105, 114  
    base-rate neglect, 104–108, 121  
basketball game, 40–41  
battle of the sexes, 221, 226–227, 231  
Bayesian updating, 89–91, 108, 114  
Bayes's rule, 86–89, 91, 104, 106, 108  
Bayes's theorem, 87, 92, 270  
*Beautiful Mind, A*, 223  
beauty-contest game, 248, 250, 251  
Becker, Gary, 29, 147, 184  
Beckett, Samuel, 272  
beer, 138, 199  
behavior detection, 107–108  
behavioral economics, 3, 256, 263, 265  
    and data, 262  
    descriptive vs. normative claims, 2  
    methods of, 5  
    vs. neoclassical economics, 257, 261  
    origins of, 3–5  
behavioral game theory, 238–253  
behavioral welfare economics, 257–262, 267  
behavioral-insights (BI) teams, 261  
behaviorism, 4  
Bentham, Jeremy, 4, 242, 266, 268  
beta–delta function, 195–196, 198  
beta–delta model, 195

## INDEX

- bias, 64, 99, 117
  - availability, 113, 114, 116, 117, 121
  - confirmation, 108–111, 116, 121
  - diversification, 209
  - hindsight, 116, 121
  - impact, 210, 211
  - projection, 209–211
  - status quo, 60–62, 260, 284
- binary relations, 11
- Binmore, Ken, 251
- Biometric Identity Management, 108
- birthday problem, 103
- Blackjack, 100
- Blackburn, Simon, 265
- bliss, 140
- Bloomberg ban, 261
- Boeing 747–400, 100–101
- Boethius, 174
- bonds, 174
  - market, 56
- Bonds, Barry, 58
- bonuses, 58
- booksellers, online, 159
- boyfriends, and sunk-cost fallacy, 41
- brain tumors, 111–112
- breast cancer, 104–105
- brinkmanship, 229
- British police, 106
- Brooks, David, 256
- Brown, Jerry, 43–44
- Brutus, 14
- Bryant, Kobe, 190
- budget line, 22, 46, 278
- budget set, 22–24, 28, 38, 45, 46, 280
- buffer lines, 211–212
- Bugatti, 48, 50
- bullet trains, 43–44
- bundles
  - consumption, 12
  - in indifference curves, 21
- bundling, 55, 155–160
- Buridan's ass, 30
- Burroughs, William S., 192
- C**
- cab company, 105–106
- cab drivers, 5, 37
- Caesar, 14
- cake, 196–197
  - division of, 239–240
- calculator/jacket problem, 36, 152
- calibration, 115
- California, 20, 93, 94
- California Medical Association, 163
- Camerer, Colin F., 5
- Cancellation, 159, 175
- cancer, 87, 88, 104–105
- cancer screening, 105, 198
- Caplan, Bryan, 264, 265
- car, used, 63
- carpe diem*, 189
- cash bonuses, 57
- cash-back offers, 160
- centipede game, 234, 250
- Central Intelligence Agency (CIA), 120
- certainty effect, 163–164, 170, 175
- certainty equivalent, 143–146
- charitable donations, 240–243
- cheap talk, 223, 246
- chemical substances, regulation of, 146
- chess, 64–65, 218, 229
- Chetty, Raj, 268, 269
- Chicago, 129
- chicken, 229–230
- choice, paradox of, 39
- choice, reason-based, 50, 66–67
- choice, theories of, 1
- choice architect, 259
- choice under certainty, 10, 16, 22–24, 32, 33, 50, 66, 72, 92, 141
- choice under risk, 126–148
- choice under uncertainty, 126–131, 141, 146
- Christmas, 156, 182
  - presents, 156, 182
- Clapton, Eric, 67
- cleaning, 204–205
- climate change, 190
- clutter, 62–63
- Coase Theorem, 61
- coding, in prospect theory, 169
- coffee shops, 57, 220–221, 226
- cognitive revolution, 4
- cognitive science, 4
- coin toss, 166
- Coke, 39–40
- Cold War, 229
- colon cancer, 198
- colonoscopy, 198, 206
- combination, in prospect theory, 169
- competence, 7, 117–118
  - hypothesis, 166, 175



- competitors, 49  
 completeness, 14, 15, 21, 29  
 compound interest, 180–181  
 compromise effect, 49, 50, 287  
 concavity, 137, 152  
 Concorde fallacy, 40  
 conditional probability, 82–86, 104, 105  
 confidence, 114.  
     *See also* overconfidence  
 confirmation bias, 108–111, 116, 121  
 confirmation theory, 89  
 conjunction fallacy, 80, 100, 103, 121  
*Consolations of Philosophy, The*, 174  
 conspiracy theories, 110  
 consumer choice  
     problem, 23, 28  
     theory, 28, 30, 141  
 Consumer Federation of America, 82  
 consumption bundles, 12  
 contacts, 113–114  
 contagious disease problem, 149–151  
 context effects, 50  
 contract killing, 224, 225  
 contradiction, proofs by, 18, 19  
 convexity, 28, 139, 150–152  
 cooling-off periods, 260–261  
 cooperation, 224, 246, 247  
 coordination game  
     impure, 221, 227  
     pure, 220, 221, 227  
 cost–benefit analysis, 53, 135, 190, 213  
 costs  
     of credit, 179–180  
     explicit, 33  
     opportunity, 32–39, 57, 66, 69, 280, 281,  
     286, 287  
     sunk, 7, 39–44, 57, 66, 67, 69, 271, 281,  
     282, 286, 287  
 course selection, 41–42  
 covenant, 225  
 crack cocaine, 50, 168, 184  
 credible vs. non-credible threats, 231–233  
 credit cards, 57, 158, 160, 175, 179–180  
 credit scores, 190–191  
 Croson, Rachel, 5  
 CT scans, 112–113  
 curvatures, 151–152  
 cycling preferences, 21
- D**
- Daily Show, The*, 75  
 Dante, 182  
 dating, 88, 128  
 Dawes, Robyn M., 246  
 de Menezes, Jean Charles, 106–107  
 de Morgan's law, 19, 102  
 de Sade, Marquis, 1  
*Dead Poets Society*, 189  
*Deal or No Deal*, 134–135, 147–148  
 Dean, James, 229  
 death  
     causes of, 114  
     penalty, 108  
 decision, theories of, 1–3  
 decision trees, 33–35, 39, 41, 131  
 decoys, 46–50  
 default options, 260  
 defection, 223, 224  
 deforestation, 223  
 delta function, 183, 195  
 delta model, 183  
 Democrats, 61  
 Department of Defense (DoD), 42  
 Department of Homeland Security, 108  
 Depp, Johnny, 202–203  
 descriptive theory, 1–3, 72, 118, 138,  
     173, 270  
 diagnosticity, 105  
 dictator game, 238, 240–245  
 dieting, 196–197  
 discount factor, 182–184, 188–190  
 discount rate, 188  
 discounting, hyperbolic, 192–199  
 diseases, 114  
 disjunction fallacy, 101–103, 121  
 diversification, 96, 205  
     bias, 205, 209  
*Divina Commedia*, 182  
 dominance, 46, 140  
     asymmetrical, 46  
     strict, 223  
     weak, 230  
 Donald Duck's nephews, 11  
 Donner, Andrew, 166  
 doomsday machine, 233  
 Down syndrome, 190  
*Dr Strangelove*, 233  
 drugs, 184, 197  
 Du Bois, W.E.B., 69  
 Dulles International Airport, 107  
 Dulles, John Foster, 229  
 Dunning–Kruger effect, 118  
 duration neglect, 206  
 Dylan, Bob, 67, 286

## INDEX

### E

economics, 1–3  
behavioral, 1–4  
behavioral *vs.* neoclassical, 257, 261  
criticism of, 29, 148  
definition of, 4  
and law, 136  
nature of, 29  
neoclassical, 1–3  
and psychology, 4  
economics professors, 205–206  
*Economist, The*, 35, 44, 49  
editing phase, of prospect theory, 169  
eggs and the basket, 97  
Einstein, Albert, 181  
*Either/Or*, 128  
Ellsberg problem, 164–167  
empathy gap, 210, 211  
empirical–reflective method, 212  
endowments, 58, 59, 151, 155  
effect, 52  
engine failure, 103, 292  
engineering, 97  
envy, 238–244  
Epicurus, 204, 215  
equilibrium, 219  
mixed strategy, 225–230  
Nash, 219–233, 235, 236, 240, 241, 246,  
248, 249, 251, 270  
refinements of, 230–234  
subgame-perfect, 232–234, 236, 240,  
243–246, 250, 253  
trembling-hand-perfect, 231, 235  
uniqueness of, 233–234  
equiprobability, 74, 75, 78  
ergonomics, 268  
escalation situation, 42  
Europe, 61  
evaluation phase, of prospect theory, 170  
even odds, 81  
EVERYTHING rule, 78  
evidence, 89  
evolutionary game theory, 230  
exam scores, 58–59  
exhaustive options, 22  
expansion condition, 45, 46, 48  
expected utility, 137–141, 161–162  
expected value, 130–139, 142, 145,  
168, 173, 175  
expected-utility maximization, 138  
expected-utility theory, 126, 139–142, 150, 151,  
161–168, 171–173

experimental economics, 186  
explicit costs, 33  
exponential discounting, 182–188, 190, 192,  
193, 195, 199, 204, 213, 272  
extensive form games, 232  
extremeness aversion, 49

### F

F-35, 42–43  
fairness, 242  
fasting, 210–211  
field experiments, 5  
field study, 5  
flooding, 104  
Florida, 20, 54, 120  
focal points, 235  
focusing illusion, 211  
four-card swindle, 76  
Fox News, 121  
framing effects, 52, 149–155  
Freakonomics, 168–171  
free trade, 62  
freedom, 39  
fridge, 41, 252  
Friedman, Milton and Rose, 61–62  
frisbee factory, 86–87, 105  
functional magnetic resonance  
imaging (fMRI), 6  
fungibility, 160

### G

gains, 151–152, 155, 157–158  
gambler's fallacy, 96–100  
gambling, 136, 138, 142, 154  
vs. insurance, 167–168  
game shows, 137, 148  
game theory, 218  
analytical, 218–237  
behavioral, 238–253  
descriptive *vs.* normative, 234  
evolutionary, 230  
games, 219  
dictator, 238, 240–245  
impure coordination, 221, 227  
pure coordination, 220, 221, 226  
sequential, 232  
ultimatum, 238–245  
Gandhi, Mahatma, 251  
Gangnam Style, 35  
gasoline prices, 241  
gelato, 10  
gender discrimination, 93, 119

*General Theory of Employment, Interest and Money, The*, 248

genetic enhancement, 62  
 genetically modified organisms (GMOs), 121  
 Gervais, Ricky, 118  
 Gilbert, Daniel, 189, 212  
 Goodreads.com, 41  
 Google, 96, 263–265  
 Greenspan, Alan, 256

## H

Halloween candy, 204  
*Hangover: Part IV, The*, 219  
 Hanukkah, 156  
 happiness, 27, 67, 211, 212, 257  
 Harsanyi, John C., 129  
 having and losing, 55  
 hawk & dove, 230  
 Hayek, Friedrich A., 250, 257  
 health care, 61, 285  
 hearing loss, 140  
 hedonic psychology, 4  
 hedonic-editing hypothesis, 160  
 Hendrix, Jimi, 98  
 heuristics, 64, 98, 117  
   affect, 117, 119  
   availability, 112–114, 117  
   representative, 117  
 heuristics-and-biases program, 64, 66, 98, 112, 117–119  
 hiking, 101–102  
 hindsight bias, 116, 121  
 Hobbes, Thomas, 224–225  
 Homer, 199  
 honoring sunk costs, 40  
 Horace, 189  
 hot yoga, 68  
 hot–cold empathy gap, 210  
 house cleaning, 204–205  
 human-factors engineering, 268  
 Hume, David, 24  
 humiliation show, 148  
 hyperbolic discounters, naifs vs. sophisticates, 199–200  
 hyperbolic discounting, 192–203, 206, 213  
 hypothesis, 89  
 hypothetical choices, 5

## I

impact bias, 210, 211  
 impartial spectator, 185–186  
 impatience, 183, 197–198

implicit costs, 33  
 implicit interest, 180  
 impulsivity, 197–198  
 impure coordination game, 221, 227  
*In Search of Lost Time*, 227  
 in vitro fertilization (IVF), 119–120  
 incomplete relations, 14  
 increasing utility profiles, preference for, 204  
 independence, 79, 85–86, 96–97, 141–142  
   conditions, 85–86  
 index, 25  
 India, 223, 251  
 indifference, 16–20, 141, 186  
 indifference curves, 22, 30  
   and loss aversion, 59–60  
   reversible, 59  
   and utility, 27  
 indifference maps, 21  
 indirect proofs, 19  
 inequality aversion, 245  
 inevitability, 118  
 inside information, 110  
 insurance vs. gambling, 167–168  
 integration, 156  
 intelligence quotient (IQ), 62  
 intentions, 244–245  
 interactions, strategic, 218, 228, 234, 235, 238, 248, 250  
 interest, 178–182, 191  
   simple vs. compound, 180–181  
 intransitive relations, 13  
 investments, 245–248  
   failed, 41  
   managing, 96  
   opportunity costs of, 34  
   and trust games, 245  
 Irish Republican Army (IRA), 102  
 Iron Bowl, 106  
 Iroquois, 184  
 irreflexivity, 18, 30

## J

jacket/calculator problem, 36, 152  
 jackpot, 92  
 jealousy, 110  
 Jesus nut, 100  
 jet, private, 103–104  
 Jevons, W. Stanley, 4  
 Jobs, Steve, 122, 189  
 Johnson, President Lyndon B., 42  
 Joplin, Janis, 98  
 judgment, theory of, 67, 91, 96

## INDEX

Juliet, 15  
junk bonds, 56  
*Junky*, 192  
jury, 108  
justice, 128, 242

### K

Kabul, Afghanistan, 108  
Kahneman, Daniel, 3, 117, 159, 170, 211, 266  
Keynes, John Maynard, 248, 249, 268  
Kierkegaard, Søren, 128  
“known knowns,” 167  
Kong Ming, 252–253  
Krugman, Paul, 256  
Kubrick, Stanley, 233

### L

laboratory experiments, 5  
Langford, Larry, 93, 99, 290  
Large Hadron Collider, 75  
Larry and Janet, 69  
latte discounts, 57–58  
law and economics, 136  
    behavioral, 257  
*Law and Order*, 122  
law of small numbers, 99  
layaway, 200–203  
Leviathan, 224–225, 259  
liability, 179  
libertarian paternalism, 257–262  
    and slippery slope, 264–265  
Lichtenstein, Sarah, 5  
life coaching, 175  
light/soft paternalism, 257  
Linda problem, 74–75, 79–80, 103  
Loewenstein, George, 271  
logical symbols, 15  
London, 106  
loss aversion, 51–63, 128  
losses, 55, 151–152, 158–159  
lottery, 98, 155, 171, 211  
Lotto 6/49, 83–84, 100, 130–131, 136,  
    139, 146  
love, 15, 79  
luck, 79  
luggage, 122  
Lyubomirsky, Sonja, 212

### M

magnitude effect, 213  
makeup exam, 219–220  
malaria, 122

mammograms, 104–105  
mandatory drug testing, 120  
marginal utility, diminishing, 62, 142  
market equilibrium, 29  
marriage, 42  
*Marshmallow Test, The*, 189  
Marx brothers, 12–13  
matching pennies, 226  
materialism, 24, 29, 270  
Matthew, Book of, 121  
maximax criterion, 127  
maximin criterion, 127–128, 146  
maximization, 29  
MBA students, 46  
measure, 25  
mental accounting, 160, 175  
menu dependence, 44–50  
menus, 22  
meteorology, 115–116  
microeconomics, 59, 238  
minimax-risk criterion, 127  
misprediction, 208–212  
miswanting, 208–212  
mixed strategy equilibrium, 217  
money  
    diminishing marginal utility of, 142  
    illusion, 52  
*Moneyball*, 52  
Monty Hall Problem, 76–77  
morality, 44  
Morrison, Jim, 98  
*Most Dangerous Man in America, The*, 164  
Mother Teresa, 1  
movies, 69  
Mr Humphries, 68  
mugs, 51–52, 63  
multiple-choice tests, 93  
multiplication, 63–64  
Muslims, 121  
mutually assured destruction (MAD), 233  
mutually exclusive options, 22  
mutually exclusive outcomes, 77

### N

naifs, 200, 203  
Nash equilibrium, 219–220, 232–233  
    convergence on, 249  
    in mixed strategies, 225–230  
    in pure strategies, 219–225  
    and rationality, 223  
    refinements of, 230–234

Nash, John, 223, 228  
 Nash's Theorem, 228  
 National Public Radio (NPR), 121  
 nature preserves, 53  
 negative reciprocity, 245  
 negative time preference, 204  
 negative transitivity, 19  
 negotiations, failure of, 57  
 neighborhood cleanup, 247  
 neoclassical economics, 1–3, 148, 270  
     *vs.* behavioral economics, 257, 261  
     and game theory, 238, 243–244  
     and social preferences, 244  
 neuroeconomics, 6  
 Nevada's boom and bust, 166–167  
 New York City, 5, 37, 129, 261  
*New York Times*, 44, 59  
 newsletters, 94  
 newspaper boxes, 138  
*No Exit*, 13  
 Nobel Memorial Prize, 3, 247  
 non-diagnosticsity, 105  
 non-satiation, 28  
 normative theory, 1, 66, 72  
 NOT rule, 78, 80, 103  
 nuclear arms races, 223  
 nuclear facilities, Iranian, 122  
 nuclear meltdowns, 97, 113  
 nudge agenda, 257–265, 268, 269  
 nudges, 259  
 numeracy, 7

## O

Obamacare, 61  
 objectivism, 256  
 Oblomov, Ilya Ilyich, 193  
 Oblomovitis, 196  
 odds, 74, 81, 115  
 Oliver, John, 75  
*On the Shortness of Life*, 189  
 online booksellers, 159  
 operationalism, 4  
 ophthalmologist, 113  
 opposite arrangement, 158  
 opportunity costs, 32–39, 57  
 optometrist, 113  
 OR rule, 77, 98  
 ordinal utility, 27  
 ostrich farms, 153  
 Ostrom, Elinor, 247  
 outcome bias, 174

outcome bundling, 155–160  
 outcome space, 73  
 outcomes, 73, 97–98, 146, 155  
     equiprobable, 74  
 outlet malls, 43  
 overconfidence, 114–118, 121

## P

pain, 4, 52  
 Pakistan, 223  
 paradox of choice, 39, 50  
 paradoxes of rationality, 237  
 Pareto dominance, 223  
 Pareto optimality, 223  
 parking, 133–136  
 Pascal, Blaise, 140  
 Pascal's wager, 140  
 paternalism, libertarian, 258, 259, 262–264,  
     268, 269  
 patience, 183  
 payday loans, 181–182  
 payoff matrix, 219  
 peak–end rule, 207–209  
 Pear Corporation, 68  
 Pentagon Papers, 164  
 Pepsi, 39–40  
*Picture of Dorian Gray, The*, 128  
 Piggly Wiggly, 39  
 Pigou, A.C., 188  
 Pitt, Brad, 52  
 plane accident, 129  
 planning, 100  
     fallacy, 100–101, 106  
 plastic bags, 69  
 players, 219  
 pleasure, 3–4, 27, 188  
 poker, 2–3  
 policy, and nudge agendas, 262  
 political campaigns, 49  
 political reform, 37  
 pollution, 223  
 polyps, 198  
 Pope, Alexander, 116  
 Popper, Karl, 110–111  
 positive psychology, 266  
 positive reciprocity, 245  
 positive time preference, 204  
 posterior probability, 89  
 predictability, *vs.* rationality, 269  
 preface paradox, 103  
 preference cycling, 21

## INDEX

- preference ordering, 21, 24
  - preference relations, 13
    - anti-symmetric, 18
    - complete, 14
    - incomplete, 14
    - intransitive, 13
    - irreflexive, 18
    - rational, 12–16
    - reflexive, 15
    - strict/strong, 16–20
    - symmetric, 16
    - transitive, 12
    - weak, 11, 16
  - preferences, 4, 10–12, 203–208
    - altruistic, 241
    - continuity, 28
    - convexity, 28
    - and decision making, 208
    - vs.* happiness, 261
    - inequality-averse, 242
    - Rawlsian, 242
    - social, 238–244
    - stable, 29, 213
    - theory of, 4
    - utilitarian, 242
  - pregnancy tests, 94–95
  - preproperation, 203
  - President of the US, 14
  - principal, 179
  - prior probability, 89
  - priors, washing out of the, 108
  - prisoners' dilemma, 222–225, 243–246
  - private jet shopping, 103–104
  - probability, 74
    - axioms of, 74
    - conditional, 82–86, 105
    - function, 74
    - matching, 119
    - posterior, 89
    - prior, 89
    - theory of, 72, 91, 118
    - total, 86–88
    - unconditional, 77–82
    - weighting, 167–170
  - probability-weighting function, 168–169, 171
  - procedure invariance, 65
  - process measures, 6
  - process-tracing software, 6
  - procrastination, 178, 199, 203
  - profiles, preference over, 208
  - projection bias, 209
  - projects, failed, 154
  - proof by contradiction, 18
  - proofs, 16, 20, 27
    - indirect, 19
  - proposer, 238
  - prospect evaluation, 153–154
  - prospect theory, 53, 169, 260
    - and bundling, 155
    - and probability weighting, 165
  - Proust, Marcel, 110
  - psychology, 4, 266
  - Psychology of Intelligence Analysis*, 120
  - public economics, behavioral, 257
  - public health, 149
  - public safety, 37
  - public-goods games, 245–246
  - Publix, 39
  - pure coordination game, 220, 221
  - pure strategies, Nash equilibrium in, 219–225
- ## Q
- quasi-hyperbolic discounting, 195
- ## R
- racism, 110
  - rail projects, 101
  - rain, 126
  - raises, 58
  - Ramsey, Frank P., 188–189
  - Rand, Ayn, 256
  - range of probabilities axiom, 74
  - rational addiction, 184, 192
  - rational preference relation, 12–16
  - rational-choice theory, 2, 43, 50, 66
  - rationality, 2, 22–24
    - and analytical game theory, 243
    - definition of, 2
    - and discounting, 188
    - of having children, 147
    - and maximizing utility, 27
    - and Nash equilibrium, 222
    - nature of, 173
    - and opportunity costs, 32, 34
    - and outcomes, 147
    - vs.* predictability, 269
    - and time discounting, 213
    - under uncertainty, 128–129
  - rationality, paradoxes of, 237
  - ratios, 37
  - Rawls, John, 128–129, 248
  - Rawlsian preferences, 242

- reading habits, 41  
 real estate, 32–33, 38  
     markets, 249  
     sales, 49, 57  
 reasons to accept vs. reasons to reject, 67  
 reason-based choice, 50  
*Rebel Without a Cause*, 229  
 receiver, 245  
 reciprocity, 245  
 reference-point phenomena, 52  
 reflexivity, 15, 30  
 regret, 127  
     aversion, 128, 161, 163  
 regulation, 146  
 relations, 10–11  
     binary, 11  
     ternary, 11  
     *see also* preference relations  
 relationships, failed, 41  
 relative income, 155  
 representation theorem, 25–26  
 representativeness heuristic, 98–99, 117  
 reputation, 110–111  
 research and development (R&D), 39  
 responder, 238  
 retirement savings, 213–214, 260  
 return policies, 57  
 reversible indifference curves, 59  
 reward points, 160  
 risk, 127, 130, 146–147  
     assessment, 102  
     aversion, 142, 154, 155  
     and expected-utility theory, 150  
     framing effects and, 151  
     preference, 142  
     proneness, 142  
 robbery, 56  
 rock-paper-scissors, 228, 249–250  
 Roma, 121  
 Romeo, 15  
 room service, 37  
 root beer, 14  
 roulette, 97, 133–134, 161, 170–171, 178  
 Rousseau, Jean-Jacques, 230  
 rule of total probability, 86–87  
 Rumsfeld, Donald H., 167  
 Russell, Bertrand, 229  
 Russian roulette, 170–171
- S**
- salary comparisons, 59–60  
 Sartre, Jean-Paul, 13  
 SAT test, 92  
 satisfaction, 29  
 Save More Tomorrow (SMarT) Program, 260  
 savings, 174, 213–214  
     behavior, 178  
 Schelling, Thomas C., 235  
 Schumpeter, Joseph, 121  
 Schwartz, Barry, 38–39  
 Schwarzenegger, Governor Arnold, 93, 94  
 scuba diving certification, 87, 88  
 segregation, 156  
 self-control problems, 200  
 self-interest, 24  
 selfishness, 24, 29  
     axiom, 244, 270  
 sender, 245  
 Seneca, 58, 69, 189, 214–215  
 sequential games, 232  
 set of alternatives, 12, 25–26  
 sex, unsafe, 143, 184  
 sexism, 110  
 sexual arousal, 210  
 Shang, Jen, 5  
 S-shaped value function, 151–152, 174  
 Sidgwick, Henry, 211, 212  
 sign effect, 213  
 silver lining, 160, 175  
 simple interest, 180  
 simplification, in prospect theory, 169  
 slippery slope, 264, 265, 269  
 Slovic, Paul, 5  
 small numbers, law of, 99  
 Smith, Adam, 3, 52, 118, 185, 210–212, 223  
 smoking, 193, 197  
 snacks, 199  
 social comparisons, 59  
 social preferences, 238–244  
 soda ban, 261  
 soft drinks, 199  
 softball, 93  
*Sophie's Choice*, 30  
 sophisticates, 199  
 speed vs. safety, 48  
 speeding, 52, 122  
*Spousonomics*, 228  
 spread, preference for, 204  
 St Petersburg gamble, 136, 138, 145  
 St Petersburg paradox, 136–137, 145  
 stable preferences, 29  
 stag hunt, 230  
 Stalin, Joseph, 158  
 standard economics, 2

## INDEX

state of nature, 224–225  
state of the world, 127  
status quo bias, 60–62  
stereotypes, 110  
Stevenson, Betsey, 67  
stitch in time, 186  
stock market, 56, 110, 247  
stocks, 96, 174, 218  
Stora Rör Swimming Association, 244  
storytelling, 113–114  
strategic interaction, 217–237  
strategy, 219  
    profile, 219  
strict/strong preference, 18  
subgame, 232  
subgame-perfect equilibrium, 224–225, 240  
substitution, 117  
suggested retail price, 65, 66  
sunk costs, 39–44, 57  
    honoring, 40  
sunk-cost fallacy, 40, 44  
sunset provisions, 61  
Sunstein, Cass R., 262–265, 268  
sure thing, 162  
sure-thing principle, 161–164  
SUV owners, 241  
Sydney Opera House, 101  
symbols, logical, 14  
symmetry, 16, 30

## T

targets, 46  
taxes, 56–57, 61, 159  
tea, cups of, 20  
tennis, 166, 228  
Tennyson, Alfred, Lord, 128  
ternary relations, 11  
terror, war on, 38–39, 106  
terrorism suspect, 106  
terrorism, probability of, 102–103  
terrorist attacks, 113  
test, multiple-choice, 93  
testimony, 105–106  
Thaler, Richard H., 3, 246, 268  
Thanksgiving, 140  
Thatcher, Margaret, 102  
theories of choice, 1  
theories of decision, 1–3  
theory  
    axiomatic, 10, 72

    confirmation, 89  
    evolutionary game, 230  
    of expected value, 138, 146  
    game, 218  
    of judgment, 67, 91, 96  
    normative, 72  
    of preference, 4  
    of probability, 73–77, 91–92, 118  
theory of choice  
    under certainty, 16, 32, 66, 92  
    of choice under risk, 126, 147, 149  
    of choice under uncertainty, 127–129, 146  
theory of expected utility, 137–141,  
    146–147, 172  
    and ambiguity aversion, 166  
    and Ellsberg problem, 164–166  
    and risk, 143  
*Theory of Moral Sentiments*, 185  
theory of rational choice, 2, 12, 66  
    and maximizing utility, 29  
    and opportunity costs, 34–36, 39  
    under uncertainty, 10–31, 128–129  
thievery, 56  
third-party candidate, 49  
threats, credible vs. non-credible, 231–233  
three-card swindle, 76  
ties, in preference relations, 16  
Tim and Bill, 68–69  
time  
    consistency, 193  
    and decision making, 178, 218  
    discounting, 182, 213  
    inconsistency, 192  
    preference, 182, 205  
tire sales, 43  
toasters, 65–66  
*Top Five Regrets of the Dying, The*, 128  
total probability, 86–88  
Toyota/Toy Yoda, 54–55, 60  
traffic signs, 259  
traffic signals, 260  
transcranial magnetic stimulation, 6  
transitivity, 14–15, 17, 19, 21  
Transportation Security Administration (TSA),  
    107  
trembling, 231  
trembling-hand perfection, 230–231, 269  
trinkets, 3  
trust, 245  
trust games, 245



Tversky, Amos, 170  
twins, 99

## U

Ubel, Peter, 265  
ultimatum game, 238–239  
Ulysses, 199  
umbrella, 140  
uncertainty, 126–129, 146  
unconditional probability, 77–82  
underprediction of adaptation, 209  
unicorns, 138  
United Nations (UN), 11, 63  
universe, 11–12  
unpaid work, 37  
unsafe sex, 143, 184  
US-VISIT program, 108  
usury, 182  
utilitarian preferences, 242  
utility, 24–28  
    expected, 137–141, 162  
    functions, 24–27, 51, 53, 127, 128, 139, 145–148, 271  
    marginal, 63, 138  
    maximization, 29, 138  
    and opportunity costs, 34–36, 38–39  
    ordinal, 27  
    streams, 182–183, 186

## V

vaccines, 113  
value  
    expected, 130–137, 146  
    function, 53–56, 151–153, 155, 161  
    function, S-shaped, 151–152, 174  
variation, preference for, 204  
veil of ignorance, 128  
Vietnam War, 120  
violent crime, 113, 122  
volunteer's dilemma, 252

## W

Wagner, Walter, 75  
*Wall Street Journal*, 138  
“war of all against all,” 225  
warranties, 136, 168  
wars, losing, 42, 154  
washing dishes, 246  
washing out of the priors, 108  
watch collection, 252  
weak preference relations, 11, 16, 27  
wealth effects, 155  
*Wealth of Nations, The*, 3  
weights and shackles, 214–215  
welfare criterion, 261, 267, 268  
welfare economics, behavioral, 257–262, 267  
White, Richard, 44  
Wicksteed, Philip, 198  
Wicksteed's blanket, 198  
Wilde, Oscar, 128  
Williams, Juan, 121  
Williams, Robin, 189  
willingness-to-accept (WTA), 53–55, 146  
willingness-to-pay (WTP), 52–54, 144  
windfalls, 36  
wine, 30, 65  
wingman or wingwoman, 8, 49–50  
Wolfers, Justin, 67  
World Health Organization, 114  
*Worstward Ho*, 272

## Y

yoga, 68  
YOLO (You Only Live Once) criterion, 127  
York, Byron, 61  
youth sports, 190

## Z

zero expected value, 175  
zero-sum game, 226