

Applications of Psychology and Economics – Econ 219B  
Spring 2004  
Wednesday 12-3, 639 Evans  
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Homework 1.  
Due on February 1

The first weekly homework will be a brief (one- to two-pages overall) report linking the Madrian and Shea paper to one of the papers below.

\*Madrian, Brigitte and Shea, Dennis. “The power of suggestion: Inertia in 401(k) Participation and Savings Behavior”, *QJE*, 2001.

<http://mitpress.mit.edu/catalog/item/default.asp?ttype=6&tid=7463>

Answer one of the two following questions:

1. I would like you to think of a theory that can rationalize the behavior exhibited by employees in the paper. How easy is it to rationalize it with a standard model with time-consistent preferences? How about a model of sophisticated agent with present-biased (hyperbolic) preferences? How about a model of (partially) naïve agent with present-biased (hyperbolic) preferences?

Suppose now that you are a guest of Casey Mulligan in Chicago and you are forced to believe in time-consistent exponential discounting lest you are condemned to starve for a week. Present three ‘rational’ explanations of the findings in the paper. (not all of them have to be equally convincing) How would you test these explanation with additional data?

2. Again, think of a theory that can rationalize the behavior in the Madrian-Shea paper. How easy is it to rationalize it with a standard model with time-consistent preferences? How about a model of sophisticated agent with present-biased (hyperbolic) preferences? How about a model of (partially) naïve agent with present-biased (hyperbolic) preferences?

How do these explanations fare with the additional facts in the two papers below? Are these explanations consistent with the main finding in the Choi et al. paper that I distributed? How about with those in the health club paper by Ulrike and myself?

\*Choi, James, Laibson, David, Madrian, Brigitte and Metrick, Andrew. “Optimal Defaults and Active Decisions”. Working paper, December 2004.

<http://kuznets.fas.harvard.edu/~jchoi/AD-Dec1.pdf>

\*DellaVigna, Stefano and Malmendier, Ulrike. “Overestimating Self-control: Evidence from the Health Club Industry”, November 2003.

[http://emlab.berkeley.edu/users/sdellavi/wp/self\\_control\\_nov03.pdf](http://emlab.berkeley.edu/users/sdellavi/wp/self_control_nov03.pdf)

Remember, the homework is due on Tuesday February 1 by noon. See you next week!