Psychology and Economics
(Lecture 13. Part 2)

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1 Rationality

- Economic discourse: beliefs and actions are rational if they are internally consistent

- Using this definition of rationality...
  - it is possible to be a rational cocaine addict
  - it is possible to rationally commit suicide
  - it is possible to rationally get married in a Las Vegas chapel to someone you met six hours ago
  - it is possible to be a rational violent offender

- Indeed, in mainstream economics, rationality is a **maintained assumption**, so it is the job of the researcher to identify the preferences that are consistent with observed human behavior (including the behaviors listed above)

2 Decision utility

- Economists use the word "utility" to describe the preferences that rationalize observed choices.

- Kahneman calls these revealed preferences "decision utility".

- These are the preferences that rationalize decisions.

- These are the preferences that coincide with "wanting" and "choosing."

- For an addict the decision utility of drug consumption exceeds the decision utility of quitting.

3 Experienced utility

- Kahneman also measures the hedonic consequences of choices.
- He calls these actual hedonic experiences, “experienced utility.”
- These are the preferences that coincide with “doing.”
- This is how Jeremy Bentham (1748-1832) conceived of utility (pleasure and pain)
- How do you measure hedonic experiences (e.g., well-being)?

- How do you discount these experiences over time?