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Book reviews

The Psychology of Economic Decisions

Rationality and Well-Being, Vol. 1; Isabelle Brocas, Juan D. Carrillo (Eds.); Oxford University Press, Oxford, UK, 2003, xxxii + 323 pp., ISBN 0-19-925106-1 (30 figures, 3 tables)

Isabelle Brocas and Juan D. Carillo present a collection of 15 articles on the basic topic in economic psychology: human decision making, specifically cognitive and emotional aspects in decision making. Written by economists and psychologists, the collection of papers demonstrates convincingly that the field of research benefits highly from joint interdisciplinary theoretical reflections and empirical work. As the editors state in their introduction, common interests and different perspectives taken by economists and psychologists promise stimulating and productive cooperation.

In the introduction over 20 pages, the editors provide a detailed and most useful framework for the contributions, and give highly informative overviews of the collected papers. The editors also link different papers and show how the authors' perspectives are interrelated. The main concern regards different perspectives taken by psychologists and economists. Psychologists often criticize economists' excessive degree of formalism and underestimate its advantages, clarity and precision; they criticize the "as if" approach of economics and devaluate their models as too simplistic. Economists, on the other hand, criticize psychology for providing numerous, small and loosely—if at all connected theories, hypotheses and assumptions, and not providing a general framework in which psychological contributions can be embedded. While psychologists investigate individual, often case by case behavior, economists focus on behavior on a general, aggregate level where individual variation is assumed to be "washed out". The classical economic model of human behavior, despite being a highly abstract construction with mainly normative value, represents a benchmark against which theories can be tested. In psychology such a model is missing and the numerous descriptions of behavior in various situations and by different individuals leads to "numerous trees, which prohibit seeing the forest".

The collection of contributions convinced us of the necessity of collaboration between scholars of both fields, but definitely they do not close the gap between economics and psychology. The different perspectives remain un-bridged and the feeling of having an incomplete collection of viewpoints, hypotheses and theories stressing different aspects in human decision making remains strong after having read the book. This is definitely not to blame the editors and authors of the volume. The way to an economic–psychological model of human behavior may still be long; however, the joint research demonstrated by the 15 contributions, is in our view at least the start to approach that goal.

The contributions are categorized in five groups: (a) causes and consequences of "irrational" conducts, (b) imperfect self-knowledge and the role of information, (c) imperfect memory

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and limited capacity to process information, (d) time and utility, and (e) experimental practices in psychology, economics, and finance.

In the first chapter, Roy Baumeister investigates why people make bad decisions and sometimes depart from rational self-interests. He argues that self-defeating activities can be an inevitable by-product of something good individuals are striving for, or self-defeating activities are the results of counterproductive strategies and, thus, opposite to intended results. He also argues, that there is little evidence supporting Sigmund Freud's assumption of an innate drive to suffering, failure, and death. In this contribution, the importance of emotions on cognitive processes is discussed: Distress and negative feelings, and perceived ego threat and impression management are linked to propensity of risk taking and inability to correctly evaluate the consequences of choices. In the next contributions, Kent C. Berridge looks to rationality from the perspective of a neuroscientist, and Jonathan W. Schooler, Dan Ariely, and George Loewenstein discuss specific problems that interfere with individuals' inability to optimize their interests: first, in decision making situations access to the utilities that one derives from experiences is limited, and therefore optimal choices are almost impossible; second, when assessing one's own level of utility or when evaluating one's own well-being, the well-being changes due to the costs of measuring it; third, happiness-seeking may be a self-defeating goal. Happy people are less introspective than less happy ones or, as George B. Shaw said, "The only way to avoid being miserable is not to have enough leisure to wonder whether you're happy or not."

The next chapter focuses on imperfect self-knowledge and imperfect memories. Andrew Caplin and John Leahy discuss policy questions such as the provision of medical information and savings and portfolio choices, under the influence of future events and stimulated emotions that influence individuals' choices. Isabelle Brocas and Juan D. Carillo discuss strategic ignorance in self-control, time-inconsistent preferences, impulsive behavior etc., and Ronit Bodner and Drazen Prelec argue that decisions and choices do not only reveal something about utilities to others but are also a signal to the individual himself or herself. In the third chapter on imperfect memories and limited capacity to process information, Itzhak Gilboa and Eva Gilboa-Schechtman, Roland Bénabou and Jean Tirole, and Xavier Gabaix and David Laibson, respectively, discuss mental accounting, imperfect self-knowledge and willpower, and—in the last contribution—present a model to process complex information.

Daniel Kahneman opens chapter four on time and utility proposing an innovative way of assessing the utility over a period of time. He distinguishes between experienced utility which is about enjoyment, and decision utility which is about wanting, and argues that experienced utility can be measured using a moment-based approach. Referring to Bentham's concept of experienced utility, which is assumed to determine future decisions, Kahneman argues that memory based evaluations of experience are biased, see for instance the peak/end rule. Measurement of experienced utility is possible by continuously assessing experiences. We enjoyed Kahneman's article very much because the arguments and proposed solutions correspond highly with our own view of chances to measure emotions, well-being and experiences in general. Diary techniques, which are more and more used in psychology (see Bolger et al., 2003), are promising instruments to overcome memory biases and most useful to capture the aggregation of experiences. Thimthy D. Wilson, Daniel T. Gilbret, and David B. Centerbar discuss in their contribution on "making sense and emotional evanescence" the fundamental human motives of reducing uncertainty and obtaining pleasure and the duration of negative and positive emotions, respectively. While individuals are quite accurate in predicting the valence and intensity of feelings, they are systematically overestimating the duration of their future emotions. Yaacov Trope and Nira Liberman's contribution to time and utility is related to the time-inconsistent mental representation of events. According to temporal construal theory, if events lay in the long future, individuals focus on central, abstract features, if events are in the near future, focus is and choices are regulated by the peripheral, concrete characteristics.

Although in almost all contributions methodological aspects are discussed, the last chapter is especially dedicated to differences in economic and psychological research. Ralph Hertwig and Andreas Ortmann point to economists' and psychologists' experimental practices, the importance of financial incentives and deception. Denis J. Hilton stresses the importance of close collaboration between psychology and economics. He discusses psychological concepts and theories and their relevance for the understanding of financial markets. Finally, Ernst Fehr and Jean-Robert Tyran make an important contribution to the discussion of the level of analyses in psychology and economics, individual and aggregate levels. The authors investigate money illusion as an explanation of nominal inertia, emphasizing the importance of psychological contributions on individual levels. As shown by experimental approaches, these individual level phenomena are not necessarily corrected by the forces of markets, but result in anomalies also on the aggregate level.

Reference

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Morals, Markets and Money. Ethical, Green and Socially Responsible Investing
Alan Lewis, Financial Times/Prentice-Hall, Pearson, London, 2002, 212 pp. (including 22 pages of appendix and 12 of references), ISBN: 0-273-65323-7

In this book the author provides an overview of the results of an economic psychology research project conducted, with colleagues and a collaborator (i.e. Paul Webley, Adrian Winnett and Craig Mackenzie), over some years about the birth and the development of