Dynamic Inconsistency in Risky Choice: Evidence from the Lab and Field

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Discussion Marieke Bos
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Standard Economic model of risk attitudes cannot easily explain gambling

- Utility of gambling (Conlisk, 1993)
Overview

Two psychologists Kahneman and Tversky, 1992, introduced a different way people think about risk:

(Cumulative) Prospect Theory
Two psychologists Kahneman and Tversky, 1992, introduced a different way people think about risk: Prospect Theory.

1. Gains, Losses matter for value
2. Reference point
3. Concave in gains, convex in losses
4. More sensitive to losses
5. Overweighting the tails of a probability distribution
Explain joining Looong odds
Explain joining bets 50:50 Odds?

Predictions from the model

Time inconsistency allows segmentation into three types:

1. **Naive**
   - Will join the bet, and suffer from deviation

2. **Sophisticated without commitment**
   - Will likely not join the bet because he realizes he will deviate

3. **Sophisticated with commitment**
   - Will join the bet, and stick to his plan
Summary

Paper test this model in the field and experimental setting

- Unique data enables them to compare plans with actual behavior
- Influence of commitment
- Welfare analysis
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Find:
- Evidence of time inconsistency in risky choice both in the field and experiments
- Possibility to commit to initial plan increases risk taking
- Welfare loss for the Naive
Comments

Great paper!
• Excellent combination of field and experimental evidence.
• Many pre-registered sufficiently large sampled experiments
• Opportunity to learn about the mechanisms
• Very well written

Comments
• Flash-out the findings in the field more
• Explore commitment interpretation
• Policy Welfare implications
Mandated plan

Discuss Incentives of firm and clients to elicit ex-ante plans

KEY: Establish if this is indeed their preferred plan (they know it is a soft commitment)

Alignment with experimental setting, role of time at online experimental platform?
Mandated Plan

Why does the firm mandate?

1. Judiciary motives
2. Force individuals to plan
3. Maximize their transaction fees
4. ……

(btw add picture in the paper?)
When Clients set their parameters what do they think about:

1. Volatility relative to the market
2. How much time do I have to monitor (adjust)?
3. This investment relative to total wealth, portfolio
4. I can adjust and have time lets just put something conservative
5. ....
Discuss both sides more

Would clients trade less without an automatic stop?

- Can you observe a period before mandate?
- Potentially relevant for interpretation of what you elicit:

Empirically dig deeper:

1. Identify groups with more/less time?
2. Do you observe clients setting very wide parameters?
3. Are there correlations with characteristics?
4. Explore differences in plans, for periods with higher vs lower volatility relative to the market
5. Wealth? Other elements in their portfolio?
Describe implications of your sample selection:
• Only observe the investors that decided to take risk given their plan.
• Biased towards Naive/Sophisticated no commitment?

Table 2: More experienced traders still more likely to take risk with ‘Loss-exit’ plan
• No learning?
• Can you run conditional on previously deviated
• How to interpret this: conclude they are Naive
Naivité, Sophistication

For many policy or welfare analysis we would like to know what the share of sophisticated/naive individuals there are in the population

And how/if this correlates with their level of education

~15% rejects the bet without commitment (~sophisticated share?),

Role of the setting: Do ppl feel they are supposed to join experiments
If loss-exit preferred and policy that enables commitment, put default loss exit?
First formulate plan, then inform participants if it is binding or not.
• Soft-Hard plan equally likely to enter: Cool result!
• Would like to know if they would formulate different plans ex-ante
  • Relates to field they know it is a soft plan
Relative losses

Panel A. Round 1 Exit
Panel B. All Participants
Panel C. Participants Who Enter
Relative losses

Panel A. Round 1 Exit

Panel B. All Participants

Panel C. Participants Who Enter
Policy implications

Authors run very interesting experiment: ‘Outcome Frame’

(Too) Little attention in the paper, offers insights for policy

Reminding people about their longer run willingness to lose, get them out of their ‘risk-seeking’ in losses behavior

➢ Find this increases likelihood to exit.

Think more about examples:
Remind criminals, their willingness to lose XX when they commit another crime
Remind creditors, investors etc.
Examples in the world

Lesson from the paper:
Illusion of protection against losses can encourage people to accept risk, but then without commitment they will deviate

Your example:
• MiFID II, reminding when their portfolio loses 10% or more
  (Reminder vs deviation from their own set limit.)

Different example: Consumer Credit Market:
• Cost caps on high-cost short term credits, limit the total costs of the loan as a % of the principal loan amount.
  (Effect, people take larger loans, additional loans)
Great paper!

So much we can learn, flash out your finding in the field more.

Looking forward to the next draft!
Thank you