

RA Model (Becker and Murphy)

- Individuals weigh costs and benefits of smoking – initiate if benefits exceed costs- Behavioral Implications –
- Individuals responsive to price changes – long run elasticity greater than short run elasticity
- Individuals are responsive to new information
- Individuals exhibit forward looking behavior

Next Generation of Models (Gruber et al.)

- Hyperbolic discounting –future consequences of present consumption decisions do not receive enough weight.
- Future self has a willingness to pay for control of the present self that implies market failure and need for government intervention.
- Empirical implications are not a robust test of RA model

Internalities (Gruber, Laux)

- Externalities (spillover effects) - classic market failure - individual make decisions that affect others.
- Internalities: individual's present actions affect welfare of his/her future self.
- Market failure arises:
 - Under imperfect information
 - Hyperbolic discounting

Visceral States (Bernheim and Lowenstein)

- Decision maker is attached to a body – the body experiences hunger, sleep deprivation, cravings and so forth.
- When visceral states are dominant (“hot”), time horizon collapses and MRS of substitution for specific commodities (food, sleep, drugs) sharply rises.
- Welfare Implications Difficult to Assess.