Federal Reserve Forum on Consumer Research & Testing: Tools for Evidence-based Policymaking in Financial Services, November 9, 2010
Panel One: Exploring the root disciplines for studying consumer behavior

Robert Hunt:
Jeanne, thank you for asking me to participate in this fantastic event. Let me start with the usual disclaimer for Fed economists, anything I say are my views and not those of the Federal Reserve Bank of Philadelphia. I do this even in this building.

The way we'll do the panel is we will have four set presentations of about 15 minutes and then will open it up for questions from you all at the end. The order of the presentations will start with Susan and then go to John and then Daniel and then Margaret.

Before we start up I just wanted to make a couple of observations of my own and these shouldn't be attributed to our speakers because I didn't talk to them about it but our panel is a very interesting group -- we've got an economist, we have two psychologists who are at business schools and we have a sociologist who is in a school of social work. And what's interesting about this panel today is that we don't even think about organizing a panel like this anymore. It seems like a very natural thing to do as opposed to ten years ago when this would have seemed very radical. In fact if you went to a business school ten years ago and you had a conversation with a financial economist they would be explaining...they would be rationalizing why they focus on the financial decisions made by companies as compared to studying the financial decisions by consumers using arguments such as businesses have a lot of money on the line; they have to take these kinds of decisions seriously; they can't afford to make suboptimal decisions; consumers, well you don't know. So implicit in this reasoning was that consumers were making inconsequential decisions, which is clearly not true. They weren't always paying attention, and that might be true, and that the mistakes being made were often immaterial, and of course we know that is also not always true.

The real differences today were directly studying these consumer choices rather than dismissing this is an oddity of random errors in our data -- this is the topic of analysis. We do observe a lot of rationality in consumer decisions but there's also systematic evidence of departures from the kind of optimizing behavior that we think of as what we would attribute to a stylized consumer in or neoclassical models. So a crucial goal is to put some structure on these observations. It's not enough to say that consumers are whacky; it's not enough to say that our standard models are found wanting. It may be the case that because our standard models are found wanting that we are a little less reluctant to have our standard position about being reluctant to engage in substantive regulation -- either of products or financial markets -- but even that's not sufficient for good policy. What we need to rethink is the question of market failure as those instances in which the market either doesn't act to address the cognitive limitations or biases we're going to talk about today, or even exploits them. To do that is going to require a very deep understanding of how consumers actually make decisions and the consequences. In this panel today what you're going to see is a discussion of some very concrete examples.

And this is where Susan is going to kick it off by describing what is learned when consumers are making important decisions, that is, choosing their mortgage. Susan is studying a metaphor for these kinds of choices. The puzzles that we're trying to understand, the need to think very carefully about what market interventions are going to help and hurt. And with that I'll turn it over to Susan.