Prospect theory and saving behaviors during the Great Recession: 2009 SCF Panel Survey results

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ABSTRACT

The purpose of this research is to examine the contribution of prospect theory (Kahneman & Tversky, 1979) to our understanding of saving behaviors by U.S. households. In its most simple form, prospect theory suggests that people experience, or "feel", losses more acutely than they experience similar-sized gains. Prospect theory helps explain why consumers prefer insurance rebates over lower premiums, why gain-framed messaging impacts health decisions, and why investors hold on to declining stocks too long but sell winning shares too soon. Specifically, this research examines the asymmetrical response of households to gains and losses in current income, anticipated income, and asset values which occurred as a result of the global economic decline beginning in late 2007, and how that asymmetrical response impacts saving behaviors. This research further separates households that experienced decreases in wealth between 2007 and 2009 from those that experienced increases in wealth, and considers how that loss or gain frame further mediates household saving decisions. The results from the 2009 Panel Survey of Consumer Finances suggest asymmetrical responses consistent with the tenants of prospect theory exist. Further, prospect theory and other behavioral variables contribute significantly to predicting saving behaviors. The author concludes by discussing the practical importance of understanding the behavioral influences on savings behaviors during times of significant financial uncertainty.

Keywords: prospect theory, loss aversion, saving behaviors, Panel Survey of Consumer Finances, behavioral finance