COMMENTARY

Your Own Private Fiscal Cliff

The idea of committing one's future self to something dates back to Homer's Odyssey.

By Dean Karlan

Jan. 8, 2013 6:42 p.m. ET

Making a New Year's resolution is easy. Keeping one isn't. When it comes to losing weight or quitting smoking, a commitment contract, wherein one publicly agrees to achieve a certain goal, can help. The commitment contract is based on two well-known principles of behavioral economics: 1) People don't always do what they claim they want to do; and 2) incentives get people to do things.

The "fiscal cliff" was a huge self-imposed commitment contract, timed for the end of the year. Politicians, to please shortsighted voters, are tempted by tax breaks and spending splurges. Much like chocolate causes our waistlines to bulge, tax breaks and spending splurges are costly in the long run. They raise the debt, which eventually must get paid.

So what to do? Somehow we must raise the price of vice, we must commit our future selves. Politicians couldn't agree to a sensible budget a year ago but instead agreed to agree in a year, or else. Whether one likes the final outcome or not, a resolution was reached.

The idea of committing one's future self to something dates back at least to Homer's Odyssey. Knowing he wouldn't be able to resist the temptation of the sirens' song, Odysseus had his crew tie him to the mast of his ship. Perhaps the even more fitting historical analogy is Cortez's decision to scuttle his ships in the attack on Mexico to keep his soldiers charging ahead, not able to retreat.

Ulysses and the Sirens, 1909. GETTY IMAGES/THE BRIDGEMAN ART LIBRARY

Most of us don't have crews and soldiers at our disposal, but many people still find ways to influence their future selves. Some compulsive shoppers will freeze their credit cards in blocks of ice to make sure they can't get at them too readily when tempted. Some who are particularly prone to the siren song of their pillows in the morning place their alarm clock far from their bed, on the other side of the room, forcing their future self out of bed to shut it off. When MIT graduate student Guri Nanda developed an alarm clock, Clocky, that rolls off a night stand and hides when it goes off, the market beat a path to her door.

Economists call these methods for a past self to force one's future self to do something—knowing one might not have the willpower when the time comes—"commitment devices." My colleagues and I at the nonprofit Innovations for Poverty Action do research around the world to find ways to help the poor. This includes what we call "the science of commitment."

One of our early initiatives took place in the Philippines, where savings rates are much lower than in other East Asian countries. Partnering with a local bank, we offered customers a "commitment" savings account that was identical to a traditional account but limited withdrawals until a stated time or savings goal had been reached. The experiment worked. Those offered a commitment account saved 81% more than those in our control group not offered one.

We also tried pairing commitment savings with another long-term goal, smoking cessation, which is often undermined by short-term temptation. We offered smokers a commitment savings account where they put the money they usually spent on cigarettes. After six months, those who failed a urine test for smoking would forfeit the money they'd saved.

Those who used the account were roughly 50% more likely to pass both their six-month nonsmoking test to get their money back, as well as a 12-month test after the contract ended. So the behavior lasted. The commitment device worked for those who took it up.

IPA researchers have also studied commitment devices with farmers in Africa who could grow more if they invested more money into better seeds and fertilizer during planting season. The farmers generally have cash right after the harvest but often don't have it two to four months later at the start of the next planting season.

Researchers tried a couple of commitment devices. In Kenya they found that allowing farmers to commit in advance, paying for fertilizer in the harvest season to be delivered later, during the planting season, was as effective at encouraging fertilizer use as cutting the price in half.

In Malawi, when farmers were given the chance to direct some of their harvest profits into a commitment savings account, keeping it out of reach until the following planting season, they invested more back into their crop, ultimately netting a 20% increase in profits.

In the developed world, websites exist where individuals can commit money as a way of achieving a goal, such as running a marathon or shedding 20 pounds. (Full disclosure, I helped found such a website.) Attaining goals is trickier for politicians, who have constituents to keep happy and elections to win. They may vote for a tax cut or spending increase today, but often the effects won't be felt until later, when they're out of office and settled into a lobbying job. Even if they're still in office, it is usually hard to attribute changes in the economy to any one piece of legislation or policy.

So for all the mess in Congress and the White House, kudos to our elected officials for the foresight to write a commitment contract. Instead of mocking them for nearly going over the fiscal cliff, we should learn from them and make a credible plan to resist our temptations in this New Year. Just one request—when choosing a way to increase the price of your vice, try not to pick one that risks the national economy.

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