

An Attention-Based Theory of Mental Accounting

Botond Koszegi and Filip Matejka

August 14, 2018

Abstract

We analyze how an agent with costly attention optimally attends and responds to shocks in basic consumption decisions, explaining several types of mental accounting, and making additional predictions. When allocating consumption among goods with different degrees of substitutability, the agent may create budgets for the more substitutable products. But if the goods are complements, the agent — consistent with naive diversification — may choose a fixed, unconsidered mix of products. When managing her consumption from and transfers between an investment account and a checking account, the latter of which she has an incentive to balance, the agent's marginal propensity to consume (MPC) out of shocks to the checking account is greater than her MPC out of shocks to the investment account. Furthermore, because paying attention to her budgeting is costly, the agent prefers to reduce spending risk, and she is more averse to risk in the checking account than in the investment account. As a result, she may optimally switch to a cheaper substitute product when a random price increase occurs.