“Self-control and liquidity: How to design a commitment contract”

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How can you build institutions that help people constructively tie their own hands? In other words, how can you design an effective commitment contract? We report the results of an experiment in which subjects allocate money between a liquid account and a partially or fully illiquid commitment account. On average, subjects put about half of their money in the commitment accounts. Willingness to invest in the commitment account varies sharply with the characteristics of the illiquid account. The study examines willingness to commit across seven different commitment contracts, including perfect illiquidity (no opportunity to withdraw money) and penalty-based withdrawals. Subjects prefer commitment that is more extreme -- the perfectly illiquid commitment accounts attract far more savings than the imperfectly illiquid commitment accounts. This finding is predicted by present-biased preferences. Our results call into question the institutional design features of most defined contribution pension accounts.