Behave!

Insightful – or just Inciteful? – Contributions from Behavioral Economics

Fifteen years ago the Royal Swedish Academy of Sciences bestowed economics Nobel medals jointly to psychologist Daniel Kahneman "for having integrated insights from psychological research into economic science" and to economist Vernon Smith "for having established laboratory experiments as a tool in empirical economic analysis."

This explicit recognition of the role psychological factors play in human decision making and complementary methods—experiments, especially "randomized controlled trials"—seemingly opened the 21st-century floodgates for research and even public-policy actions in what is known as Behavioral Economics, thus bringing together, based on undergraduate and graduate degrees awarded, the most male of the social sciences—economics—and psychology, the most female discipline, to challenge and test the core assumptions and theories of mainstream economics.

BY ALLEN R. SANDERSON

So, what have we learned from this, other than we humans are imperfect creatures who lack self-control, do dumb things, are impulsive and inconsistent, don't always weigh the costs and benefits of our actions, can behave irrationally, make mistakes on occasion, tend to be overconfident, can be manipulated by advertisers (and academics), and, of course, that the economist's assumption of a rational, dispassionate, calculating ***homo economicus*** guided solely by self-interest is arguably an outdated and not very useful construct?

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To wit:

Avoiding a loss – **loss aversion** – is a more powerful motivator than an opportunity for a gain. (But a question: Would you really bend over to pick up a quarter you had just dropped – a loss – but bypass one you spied laying on the sidewalk – a gain?)

How an option or outcome is expressed – **framing** – influences one's choices. For example, does labeling a transaction a "discount" rather than a "surcharge" make any difference?

Anchoring, prospect theory, and **endowment effects** are closely related behavioral concepts that address real-life situations, including why we're averse to part with a valued possession – and maybe overvalue it; thus a baseball team might not trade one of its own players or someone might be reluctant to sell a stock that has dropped in value.

Behavioral Finance is one extension of these principles. It attempts to assess why people make irrational, systematic errors in the stock market, employing familiar concepts such as animal spirits, herding instincts, and bubbles. (Critics of these claims include my colleague and 2013 Nobel laureate Eugene Fama, godfather of the Efficient-Market Hypothesis.)

Economic man is also not very good at math and exhibits cognitive biases. Thus, the ubiquitous appearance of the number 9 in pricing – $3.99 or $39.95 instead of $4.00 or $40, respectively – reflects a **left-digit bias** that marketers exploit.

Want people to save more for their retirement? Have employers switch from "opt in," or voluntary plans, to "opt out," or **automatic enrollment programs**, therefore taking advantage of inertia (but recall those Book-of-the-Month-Club automatic selections that we all loathed!). Want more organs for transplants? Move from an opt-in model – you sign the back of your driver's license if you want to be a donor – to one in which if you don't sign the back you are automatically a donor. Of course, that means that unless you take an active step, Springfield or Washington DC now owns your body by default.

For cafeteria lines, the behavioral bunch would **nudge** (trick?) us into eating healthier by putting fresh fruits and vegetables at the beginning and sweets at the end, using smaller plates and eliminating trays. If that doesn't work, then they can always nag, and in the end, of course, the nanny will just say **No!** (Think Michael Bloomberg and large sodas.)

Moving from the abstract to modern-day political reality: an Obama-era newspaper headline, "Government knows best? White House creates 'nudge squad' to shape behavior." And in 2010, the UK established a Behavioral Insights Team to "help" its citizens.

Intrigued and want to learn more in depth? Some of the best behavioral literature of the last 10 years: *Thinking Fast and Slow, Predictably Irrational, Misbehaving, Phishing for Phools, Nudge, The Why Axis,* and *The Undoing Project*.

Bottom line:

Behavioral Economics may be able to improve our decision making, though the intellectual contest is between a model of descriptive accuracy (but with significant shortcomings on reproducibility) that makes for cute, small-potatoes classroom fodder and the "Econs" with their emphasis on accurate predictions rather than realistic assumptions.

Lastly, behavioral economics has a decidedly pessimistic view of we humans and our shortcomings. And they know we could benefit from third-party interventions, and that logical entity, one that knows what's best for us, starts with a G. So the social sciences Super Brawl may be between a team composed of imperfect people and imperfect markets against the squad with an imperfect government and its bureaucratic apparatus. It's your choice. For the moment. ❏