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The Nature of the BEast: What Behavioral Economics Is Not

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ABSTRACT

People are complex; they defy easy summary. Like Walt Whitman, we all contain multitudes. As a discipline, economics has been successful in part because it has ignored this complexity. Instead it has focused on explaining the institutions in which decisions are made — with institutions ranging from capitalism to communism, from perfect competition to monopolies, and from rock-paper-scissors to the prisoner's dilemma.

Behavioral economics differs from standard economics in that it uses a more realistic (and more complicated) model for people; it differs from psychology in that it maintains the focus on institutions and the contexts in which decisions are made. Behavioral economists study how the context of decisions interacts with our expanding understanding of human psychology. By combining the insights from these two very different perspectives, behavioral economists have been able to reveal new depths in ourselves.

There are more and more articles, books and websites explaining behavioral economics. But we've noticed something in our conversations. As people learn more about behavioral economics, misconceptions creep in. There are three misperceptions we see quite frequently:

- "Behavioral economics is about controlling behavior…"
- "Behavioral economics is liberal (or conservative)…"
- "Behavioral economics is about 'irrationality'…"

Just as a sculptor must chip away every part of a rock that is not an elephant, it may be useful to define behavioral economics by what it is not.

Behavioral Economics Is Not About Controlling Behavior

Some people are worried that behavioral economics will be used, whether by corporations or the government, to control behavior. This concern is not entirely invalid — tools from behavioral economics can be used for many purposes. Just as persuasive marketing can convince us to eat fatty foods, or legal prohibitions can stop us from swimming at a private beach, tools from behavioral economics can be used in ways that restrict freedom or choice — to "nudge" people to do what others want them to do.

What distinguishes the behavioral toolset, however, is that so many of the tools are about helping people to make the choices that they themselves *want* to make. You can see this most clearly in how many people apply behavioral solutions to their own problems. We set up automatic reminders on our phones. We make public commitments with our peers (sometimes using resources like StickK or gym-pact)[1]. We give ourselves deadlines and punish ourselves when we fail to meet them.

A good behavioral intervention helps people avoid making a decision that they themselves would consider a mistake. Elderly Americans who enroll in Medicaid Part D private drug plans are asked to choose from over 40 options. An intervention that reduced this overload—sending enrollees a letter with information about three alternative plans that would be cheaper for them—nearly doubled the proportion of enrollees who decided to switch plans and save money.[2] This simple nudge — one letter — saved $150 per year on average for each person who switched.

One of the most well-known interventions is default savings in 401(k)s. Simply by changing from "opt in" to "opt out," companies can increase enrollment rates from 13 percent to 80. This is not overriding a preference not to save — it's a convenience that allows existing preferences for saving to be realized.

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[1] *Gym-pact* [Accessed October 1, 2013] www.gym-pact.com.

[2] Jeffrey R. Kling et al, "Comparison Friction: Experimental Evidence from Medicare Drug Plans," The Quarterly Journal of Economics 127(1): 199–235.

Behavioral economists sometimes use the same tools as marketers. We can persuade and cajole. However, the most interesting and innovative tools are those that make it easier for people to do what they already want to do — to realize their own good intentions.

Behavioral Economics Is Not Liberal (Or Conservative)

Applied behavioral economics came of age after Richard Thaler and Cass Sunstein published "Nudge" in 2008. Not coincidentally, the incoming Obama administration started to use it, both in policy and in campaigning[3,4]. Therefore, many Americans have concluded that behavioral economics is a tool of liberal administrations.

But behavioral economics is being picked up and used everywhere. When liberals are in power, it's used by liberals. When conservatives are in power, it's used by conservatives. In fact, the political party that has most embraced behavioral economics is UK Prime Minister David Cameron's Conservative Party. Cameron explains the appeal of behavioral economics in his popular TED talk:[5]

Politics and politicians will only succeed if they actually try and treat with people as they are rather than as they would like them to be. Now if you combine this very simple, very conservative thought — go with the grain of human nature — with all the advances in behavioral economics, some of which we are just hearing about, I think we can achieve a real increase in well-being, in happiness, in a stronger society, without necessarily having to spend a whole lot more money.

Furthermore, while Cass Sunstein may have served as the "Nudger in Chief" during the Obama administration, the only US presidential candidate to have published an academic paper on behavioral economics is a Republican, the former governor of Arkansas, Mike Huckabee.[6] Libertarian economists are increasingly seeing behavioral economics as a way to curtail the power of the state, not just a tool the state can use on the people.[7]

Applied behavioral economics is ultimately about identifying and diagnosing problems to design tools. These tools can be used to pursue many different policy goals. For example, one strand of behavioral economics (including work by ideas42's academic affiliates Crystal Hall, Sendhil Mullainathan, and Eldar Shafir) has looked at "take up" problems. Why do many people in poverty fail to apply for welfare programs and benefits? Another strand (including work done by ideas42 with ACF and MDRC, and the Behavioral Insights Team in

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3 Mike Doring, "Obama Adopts Behavioral Economics," Bloomberg Business Week Magazine, June 24, 2010, www.businessweek.com/magazine/content/10_27/b4185019573214.htm

4 Michael Grunwald, "How Obama Is Using the Science of Change," Time Magazine, April 2, 2009, http://content.time.com/time/magazine/article/0,9171,1889153,00.html#ixzz2gTY00YqG.

5 TED, "David Cameron: The Next Age of Government," Ted Talks [video], February 18, 2010, www.youtube.com/watch?v=3ELnyoso6vI.

6 Brian Wansink and Mike Huckabee, "De-Marketing Obesity," *California Management Review* 47(4): 6.

7 Mike Rappaport, "Behavioral Economics and Liberty,"*Library of Law and Liberty* (blog), July 19, 2013, www.libertylawsite.org/2013/07/19/behavioral-economics-and-liberty/.

Britain) has looked in parallel at the opposite problem — how can we assist people on welfare to leave the program and return to work? Not only can behavioral economics assist in designing policies and programs that can be used for these (very different) goals, but a single type of intervention — positive affirmations — has been effective in both of them.

If anything, behavioral economics appeals to pragmatists and realists because it simply provides a set of tools. It does not rely on heavy-handed state solutions, or on the conceit that people are best left to their own devices. Instead, it charts a middle path, recognizing that a better understanding of human decision making can help solve a variety of problems, including both market and state failures. That's why it's being picked up and used by a wide range of governments as well as private companies.[8] Savings defaults can raise retirement savings without increasing payroll taxes. Social norm messages can reduce energy use without imposing a carbon tax. "Behaviorally" designed stimulus packages can be as effective for less money. Behavioral economics is not ideological; it works.

Behavioral Economics Is Not About "Irrationality"

When the word irrational is used in everyday language, it is almost always meant as an insult. Perhaps we use it to describe a poor decision by our boss, or to win an argument with our spouse. In this vein, it is used to shut down conversation, not to expand it. So why would we use such a word to describe humans in general?

Using "irrational" to describe humans is, ultimately, condescending. On the whole, the human brain is an amazing organ. We should think about the human brain as it is, not in comparison to some unachievable ideal. We are not computers, and we should not aspire to be them.

We believe that people are usually very clever. But the human brain is not a perfect problem solver in all situations. So when someone makes a mistake, it's important to understand the context that *led* that mistake to happen. From this, patterns begin to appear. People are not consistently lazy, or stupid, or hot-tempered. But in specific situations they may appear to be so. And though these errors are systematic, the successes are as well. So behavioral economists look for examples of both.

Furthermore, describing people as "irrational" is misleading. Rationality has a very specific meaning within economics; it refers to a set of mathematical assumptions economists use to describe our preferences, and how they lead to actions. Economists never meant for this model to be descriptive — it was simply a convenient way to substantially reduce mathematical complexity.

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[8] Joshua E. Keating, "The Nudgy State," *Foreign Policy*, January 2, 2013, www.foreignpolicy.com/articles/2013/01/02/the_nudgy_state?.

When economists use the term "irrational" they mean something very different than how we use it in everyday conversation. It's the mathematical inverse of the "rational actor" model — more closely linked with terms like convexity and transitivity than with impulsivity or emotionality. Economic "irrationality" has more in common with irrational numbers (those that cannot be represented as fractions, such as pi or $\sqrt{2}$) than it does with Tom Cruise, Charlie Sheen, or Miley Cyrus.

On the other hand, behavioral economics is built upon psychology, not mathematics. We know that our preferences do not necessarily determine our actions. Psychologists study the brain as it is, rather than trying to assume away the messy details.

Perfect "rationality," as economists define it, is an odd standard to hold humans up to. When we read about a prodigious feat of memory (such as Lu Chao memorizing the first 67,890 digits of pi) we should be astounded.[9] But we should not compare this achievement to the storage capacity of an 8 gigabyte iPhone (which can store a further 68 million digits!). Similarly, in any given day we resist countless temptations — so why should we only concentrate on the failures? We all may have trouble getting out of bed in the morning, but we rarely skip work to spend the day at the beach, despite the strong temptation on a warm summer day. If we are "irrational" it is only in the sense that the number pi is — we are infinitely complex, always changing, and scientists are always finding out more.

What Is Behavioral Economics?

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[9] Wikipedia, "Lu Chao," http://en.wikipedia.org/wiki/Lu_Chao