What Behavioral Economics Is Not

by ideas42, November 19, 2013

Since the release of 2008′s Nudge, behavioral economics (BE) has quietly invaded the public's perception. Some of the most well-known examples include the creation of the Behavioral Insights Teamin the UK, Cass Sunstein's appointment in the Obama Administration, and the rise of popular economics books like Daniel Kahneman's *Thinking, Fast and Slow* (and to a certain extent *Freakonomics*, which is not actually about BE).

This prominence has led to gut reactions, polarized opinions, and popular misconceptions. However ideas42's Matt Darling and Saugato Datta, as well as ideas42 co-founder Sendhil Mullainathan, recently published an essay with the Center for Global Development to tackle this very topic.

They identify three common misconceptions, and delve into the nuances of each. The first, that **"behavioral economics is about controlling behavior:"**

Some people are worried that behavioral economics will be used, whether by corporations or the government, to control behavior. …What distinguishes the behavioral toolset, however, is that so many of the tools are about helping people to 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 saved $150 per year on average for each person who switched.

The point?

…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.

So while the field of applied behavioral economics is indeed *partly* about persuasion, it's *largely* concerned with the intention-action gap. We have the good intention to save money for retirement, or to exercise three days a week, but things get in the way of these good intentions translating into real actions. These intention-action gaps are where there is the greatest untapped, or partially tapped, scope for useful applications of behavioral economics.

This leads us to the second common misconception, that **"behavioral economics is liberal (or conservative)**," which stems from the Obama administration's use of BE, both in campaigning and policy. But Obama's administration is not acting alone here:

…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…

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.

But there's a reason why BE's acceptance is politically wide-ranging:

…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. …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.

So BE takes a sort of middle ground, recognizing that both market and state failures occur, but it stops short of imposing heavy, structural change or restrictive regulation.

This takes us to the final misconception the essay discusses, that **"behavioral economics is about irrationality."** The use of "irrationality" stems from a simplification of the field's experimental findings that distinguish real-world human behavior from the predictions of traditional economic theory. This simplification makes it easy to think that BE counters the discipline of economics. However appealingly provocative this might be, it's not exactly accurate:

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. …When economists use the term "irrational" they mean something very different than how we use it in everyday conversation. …Economic "irrationality" has more in common with irrational numbers (such as pi or √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.

When people label human behavior as "irrational," they are "assum[ing] away the messy details." Behavioral economics avoids this mistake because of its recognition that context heavily affects the way we make decisions and take action. And the traditional model of decision-making cannot account for the infinite complexity of context.

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.

So behavioral economics is not a tool for controlling the behavior of people, it is not an intrinsically political discipline, and it is not founded on the belief that people are irrational. But what exactly *is* behavioral economics?

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.

The foundational principle of behavioral economics lies in the understanding of the power of context; specifically, the idea that the context around which decisions and actions are made and taken has huge effects on outcomes. Its applications vary widely, from the near-trivial (the placement of items in a grocery store affects the popularity of items), to the ubiquitous (providing information about the energy use of neighbors influences people to reduce their own use), to the profound (introducing a lottery helped at-risk patients to increase the regularity at which they took heart medicine).

But did you notice a pattern? None of these applications involved controlling the behavior of people, none of them are explicitly partisan, and none of them come from the perspective that people are fundamentally irrational. Instead they come from an understanding that we don't just act in certain ways because of who we are, but we also act in certain ways because of *the environment around us*. And *that* is behavioral economics.