



Assumptions of Behavioral Economics

- Bounded Rationality
– including bounded attention
- Bounded Willpower
- Bounded Self-interest
- Bounded Markets

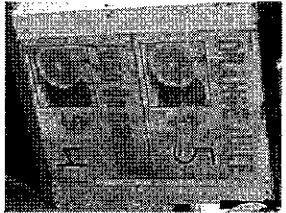



Goals and Objectives

- Apply the techniques of the psychology of decision making and behavioral economics to improve decisions without limited choices.
- Offer an approach new approach to public policy that is neither left nor right.




Are Markets Efficient?

What is Behavioral Economics

“The phrase behavioral economics appears to be a pleonasm. What non-behavioral economics can we contrast with it? The answer to this question is found in the specific assumptions about human behavior that are made in neoclassical economic theory.”

Herb Simon



One Approach to Policy: Libertarian Paternalism


Both terms are currently unpopular (at least in the US), and seemingly contradictory. But, neither concept should be controversial:

- **Libertarian:** protect the individual's right to choose
- **Paternalism:** do what you can to improve the welfare of people

And it is possible to achieve both goals.

Libertarian Paternalist policies are designed to improve and guide choices without coercion or the elimination of freedoms.

Achieve these goals with better **choice architecture**.



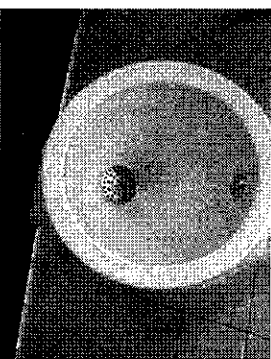
Choice Architecture

Anyone who designs the environment in which people make choices is a choice architect

- Menu
- Store layouts
- Curriculum



Urinal, Amsterdam Airport



What is the alternative?

Choice architects must choose *some* set of institutional arrangements. What design should planners pick?

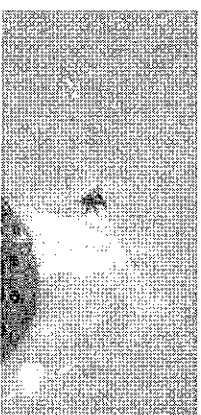
Example: cafeteria menu planning—In what manner (order, salience,) should the food be presented?

- The plan that make participants better off?
- The options that make the participants worse off? (e.g., fattest?)
- Random?
- The options that make the director best off?

Note that **some** choice has to be made.



Detail of Fly Painted on Urinal

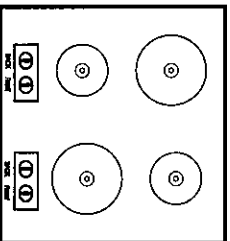


Results: 80% less "spillage"

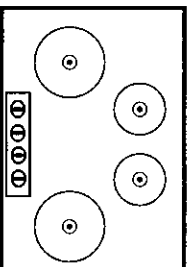


Some Designs are Better

Bad Design



Good Design



What Constitutes Good Design?

- **Defaults**
- **Expect Error**
- **Give Feedback**
- Understand Mappings
- Structure Complex Choices
- Incentives



Defaults: Padding the Path of Least Resistance

What happens when people do nothing?



Thoughts on Organs

- Unintended consequence of implied consent: family members may be more likely to overrule a donor's wishes if those were not expressed actively.
- One solution: Mandated choice: when you apply for a driver's license you *must* check one box or the other, donor or not.



One Example: Organ Donation

- Countries adopt two approaches to organ donation:
 - Opt in (as in US): To make your organs available you must take action.
 - Opt out or "presumed consent": To opt out you must take action.
- Does the rule matter?
 - Data from Johnson and Goldstein

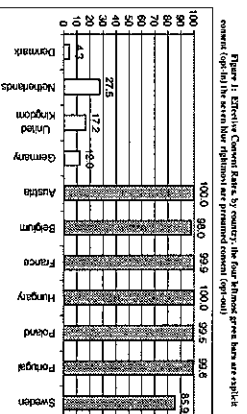


Application: Retirement Savings

- Automatic Enrollment
 - Changes the Default
 - Increase and speeds the participation rate
- Downside: default savings levels and investments are taken as "suggestions".



Organ Donation Consent Rates



Give Feedback

- Give users information on how they are progressing toward their goal.
- Pink Ceiling Paint



Give Feedback (cont.)

Ambient Orb (Clive Thompson, 2007)

A little ball that glows red when people are using lots of energy, but green when their use is modest. In a period of weeks, users of the Orb reduced their use of energy, in peak periods, by 40 percent.



Medicare Prescription Drug Plan

- 50+ plans per state
- Web site offering "help"
- Default for "dual eligibles"?
- Maine: intelligent assignment



Expect Error

- Paris Subway vs. Chicago Parking
- Email attachments. Rudeness warnings.
- Save More Tomorrow



Markets Über Alles

- Won't markets "solve" the problems caused by bounded rationality and willpower?
 - Catering vs. Teaching
 - Flight Insurance
 - Mortgages



RECAP: Record, Evaluate and Compare Alternative Prices

- Electronic, downloadable information.
 - Price formulas
 - Usage information
- Applications
 - Credit Cards
 - Mortgages
 - Medicare Part D



Objections

- Planners are boundedly rational too, and if they are government employees, may be captured by the political process.
 - But, there are economies of scale in acquiring information, Planners (both human, resource managers and bureaucrats) know more (or should) than the average participant.
 - Specialization is even blessed by Adam Smith.
- Slippery Slopes--first you use automatic enrollment, next thing you have prohibition.
 - No evidence that this slope is slippery
 - Same argument can be made to the the right. First you have courts and police, next you have Medicare.
 - The right answer is to evaluate proposals on their own merit.



Conclusions

Humans are imperfect. We need all the help we can get.

It is possible to improve choices without restricting options.

Don't use bans and mandates--just nudge.

