

● NOBEL MEMORIAL PRIZE IN ECONOMIC SCIENCES

A RICHard ThALer of human behaviour

Economic theory tells us we get direct satisfaction from buying a high-performance (and hence expensive) car, but behavioural theory tells us that such satisfaction will be limited if our neighbour owns a higher model of the same (or a greater) brand



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THE FIELD OF ECONOMICS has come a long way—from the employment of brilliant techniques of mathematical elegance in the past, to a greater application of common sense today. The economic agent of the past was believed to have Godlike abilities of perfect foresight, photographic memory, spiritual indifference, infinite cognition and, if I may add, a know-it-all kind of attitude. Therefore, it is safe to assume that economic theory back then had great merit for its general capacity to predict behaviour ... of all the *Vulcans* of *Star Trek*.

Then came a crisis in the profession when it was realised through formal techniques of empirical evaluation, that economic agents were, in fact, *humans*: even their economic actions were often driven by emotions, an admission of uncertainty and partial information, among other limitations. Clearly, our imperfect world wasn't good enough for Gods—there were observed departures from economic models. The subsequent growth of empirical evidence against the core axioms and predictions of economic theory became so dominant that the aggregate of the formerly *peripheral* issues were now too consequential to be ignored.

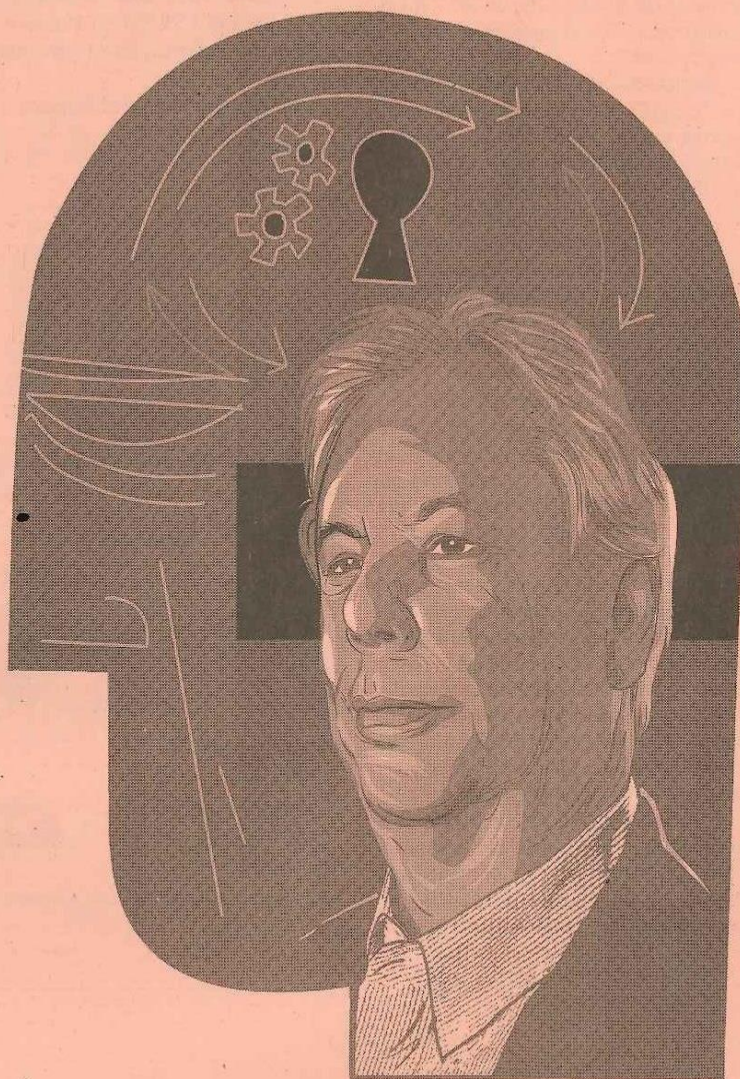


ILLUSTRATION: SHYAM

Richard Thaler, who received the Nobel Memorial Prize in Economic Sciences on October 9, played an important role in ensuring this dominance alongside the likes of Daniel Kahneman and Vernon Smith (both being joint recipients of the Nobel prize in 2002), that eventually led to the emergence of behavioural economics as a new discipline.

From economic theory, we learn that how many bottles of a certain brand of shampoo will be bought by consumers will immedi-

ately depend on its listed price, income levels, the availability and the prices of close substitutes, and so on. From behavioural economic theory, we additionally learn that all these economic determinants become less consequential if this shampoo isn't displayed at the eye-level of the consumers who are buying shampoo from the stores. Owners of Indian general stores have, for long, used this realisation to charge fees to firms that are willing to pay for more visibility of their

products. And today, Google auctions off the top positions of search results that correspond to certain keywords to large firms that are willing to pay for greater visibility.

Economic theory tells us that we get direct satisfaction from buying a high-performance (and hence expensive) car, but behavioural theory tells us that such satisfaction will be limited if our neighbour owns a higher model of the same (or a greater) brand. Economic theory further argues that the more choices of T-shirts we have to pick and buy from, the happier we can be, since we always have the option not to buy the T-shirts that we know wouldn't suit us, but behavioural studies dismiss this idea as the *paradox of choice*, by pointing out that the very activity of selecting from too many options could ultimately exhaust us mentally given our limited brain bandwidth.

Speaking of limited mental bandwidth, today we acknowledge that the human brain has evolved to account only a limited set of information that is deemed most important at any given point of time. This is the reason why you may forget your wallet when you are in a hurry to make it to an important meeting. The mind creates a *tunnel* to focus on the key objective at hand (in this case, to reach the meeting on time) and all your mental bandwidth is used up to think about booking a cab, organising the meeting briefs, etc. Therefore, even basic (and often *important*)

things that remain out of the tunnel (in this case, remembering to carry your wallet) are immediately ignored by your brain—the sense of urgency created in the limited time lead you to subliminally economise on your brain capacity. In a nutshell, classical economic theory would fail to explain why a well-known mathematician who felt the nature's call in the middle of his panel discussion excused himself and rushed out of the hall in no time ... and forgot to remove his

lapel mike.

Behavioural economics is an interdisciplinary field that looks at the influence of human psychology on key economic decision making, with a rather humbling thought that none of us economic agents are super humans. It can be thought of as a new field of the economics of brain resources that has inspired the establishment of Nudge Units in many developed and developing nations. These Units are policy-making bodies that use behavioural studies to influence economic behaviour in the most cost-effective manner. My own research in behavioural

economics has been influenced greatly by my reading of Thaler's pioneering work, which we members of the Queensland Behavioural Economics (QuBE) group frequently refer to, for our ongoing dialogue with the policy-makers in the governing bodies of Queensland (for example, the Department of Education).

Our actions are frequently dependent on the information that our senses can immediately access, leaving other important considerations out of our *tunnels*. For example, it is common for diabetic patients to forget their dietary restrictions momentarily when they see that chocolate cake right in front of their eyes. We want to nudge people to make the healthier choice by placing vegetables at the front of the long food queue. We want to make people pay their taxes honestly by making them sign the tax return document *before* they furnish their details. In short, we want to nudge people to tap into their inner senses of civility, morality and humanity through our better understanding of them.

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