Misbehaving: The Making of Behavioral Economics

Richard H. Thaler. 2015. New York: W.W. Norton and Co. ISBN 978-0-393-08094-0. $27.95.

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As a young graduate student, reading Richard Thaler's stories about his journey "making" a "new" academic discipline is nothing short of exhilarating. Thaler writes with equal parts wit and precision, covering topics of economic research, finance, and public policy. In doing so he employs many more anecdotes and stories than empirical strategies and identification methodologies. The book is more a historical tell-all that reads like a personal memoir than a treatise summarizing a productive academic career.

Misbehaving presents a chronological history of the formation of behavioral economics, beginning in the 1970's while Thaler was a graduate student and lecturer at the University of Rochester. He writes about the blackboard in his office where he listed behaviors that seemed inconsistent with the typical economic model of rational choice, and the "supposedly irrelevant factors" economists seem to ignore. Moving to the 1980's, and on to Cornell University, Thaler summarizes his work with Daniel Kahneman and others on mental accounting, self-control, and fairness.

Near the end of the 1980's Thaler's research in behavioral economics started to gain the attention of some key players in the economics profession. Thaler writes of a colorful 1985 conference at the University of Chicago that pitted rationalists and behaviorists against each other for what may have been the first time ever. Present at this event were Herbert Simon, Amos Tverksy, Daniel Kahneman, Kenneth Arrow, Robert Shiller, Richard Zechhauser, Richard Thaler, Robert Lucas, Merton Miller, Eugene Fama and Sherwin Rosen – two existing Nobel laureates, six who have received Nobels since, and several more who are on the short list to be awarded a Nobel in the near future.

In the 1990's, as the insights of behavioral economics began to make a growing number of economists rethink the conventional wisdom of their profession, Thaler and others began to examine the efficient market hypothesis. In fact, it is in financial economics that the so-called behavioral approach may have made its largest impact. In hindsight, it is astonishing to look back on the 1980's when economists *knew* they knew that financial markets operated efficiently.

Most recently, since moving to Chicago's Booth School of Business as Professor of Behavioral Science and Economics, Thaler has focused on behavioral insights regarding law and public policy. This work has influenced many economists, researchers, and policy advisers who are now applying lessons of behavioral economics to our world's most puzzling problems.

Thaler presents behavioral economics as having three essential elements, called "the three bounds": bounded rationality, bounded willpower, and bounded self-interest (p. 258). Stemming from Herbert Simon's idea that humans are rationally *satisficing*, rather than rationally optimizing wants and needs, behavioral economics rejects the role of constrained optimization in human decision making (Simon, 1957). Additionally humans seem to experience a universal struggle with self-control, and many seem to possess an intuitive attraction to fairness. Simply stated, behavioral economics suggests that relationships matter when making economic choices, even when the stakes are relatively high.

The book is organized into eight sections, with several chapters under each heading. Sections include "Mental Accounting," "Self-Control," "Working with Danny," "Engaging the Economics Profession," "Finance," and several others. Chapters range from entertaining stories—there is a fun chapter on how the faculty from the Chicago Booth School of Business decided to allocate office space in their new building—to deeper descriptions of Thaler's empirical research on sunk costs, socio-emotional goods, and the 'Save More Tomorrow' program.

Christian Faith & Behavioral Economics

Some Christian economists, from whom who I've had the pleasure of learning, have suggested that the behavioral economics view of the human condition is much closer to the Christian understanding than is the traditional neoclassical framework (Hoksbergen, 2012). This suggestion is still vague, likely because there is little consensus as to what the Bible actually affirms as a 'good economy' (Wydick, 2013) or what Christian economists should actually do (Richardson, 1994; Tiemstra, 1994).

Rather than a new iteration of economic science, behavioral economics may be more accurately described as a rediscovery of the foundations of the discipline. Thaler mentions multiple times that Adam Smith, the so-called father of modern economics, was in fact a behavioral economist. In his *Theory of Moral Sentiments* Smith writes that "man naturally desires, not only to be loved, but to be lovely; or to be that thing which is the natural and proper object of love" (Smith, 1970). This sentiment may sit well with most Christians, but many may add that, in our best moments, we also desire to love others (Matthew 22:39). Put together, the idea that human nature is governed by tensions between desires to be loved, to be lovely, and to love challenges simple *homo economicus* with a much more rich and full theory of human behavior.

Economists, both secular and Christian, would benefit from recovering the philosophical roots of the discipline pushed aside by simplifying assumptions. Thaler points out that even in our most objective moments economists cannot *not* be doing philosophy. For example, businesses using simple cost-benefit analysis are employing a utilitarian moral philosophy popularized by John Stuart Mill. More broadly, when we think about the economy or society or economic development or poverty or inequality, what is the end purpose of it all? Is material wealth simply the only thing that matters, or is material wealth a means for something else and perhaps far greater, such as human dignity, restored relationships, and the freedom to love God and love others?

Freedom & Paternalism

The moral heart of economics is home to a fundamental belief in freedom. Indeed this is where undergraduate introductory courses in economics begin—with the idea that individuals are the best at ranking their own preferences. Next, a measure of this ranking, called utility, is introduced. From here the assumption is made that improvements in welfare occur when utility is improved. By this economists assume that people are better off with an increased set of choices.

Thaler and the generation of behavioral economists he has inspired are rethinking this assumption by showing that paternalism, carefully defined, is not necessarily the antithesis of freedom. As Esther Duflo discusses in a 2012 lecture, people who live in poor countries have the freedom to drink either clean water or dirty water. Rich countries, on the other hand, have taken the paternalistic action to effectively restrict their occupants to drink only clean water (Duflo, 2012). In this simple case, who has more freedom? Does less freedom lead to more prosperity? Was Amartya Sen wrong? Or do we benefit from having some choices taken away so that our limited mental bandwidth can be spent on other more complicated choices and aspects of life?

Keeping Thaler's political philosophy of 'libertarian paternalism' in mind, consider Paul's so-called paradox of freedom as he writes to the Galatian church: to be free, learn to be slaves to one another in love (Galatians 5:13-18). If freedom is radicalized and used to live a life of conspicuous consumption, envy, greed, and selfishness, these things will ultimately restrict your freedom. As N.T. Wright affirms, "They will create habits of mind and imagination, far more powerful than habits of the body" (Wright, 2013). The alternative is a fundamental Christian virtue and one that Smith wrote about at length in his *Theory of Moral Sentiments*: love. Enslaving yourself in love to other people means empathizing with them and making their joys and laments your own concern.

I applaud this recovery of philosophical roots, and hope it will be welcomed by other Christian economists also. I've heard some bemoan the humble task of Christian economics as simply being philosophy dressed up to look like economics. This statement may be intended to be a critique, but it very well may be the point. As Diane Coyle says in her 2012 Tanner Lecture: "It should not really be controversial among economists—although it will be—to suggest that economics as an intellectual discipline and professional practice has helped shape the economy" (Coyle, 2012). The world has been formed by the implicit values of "value-free" economic analysis so that the neoclassical model has become a self-fulfilling prophecy. Christian economists can and should apply moral philosophy to their work. A theologically grounded philosophical anthropology about "the good life" may help build God's Kingdom "on earth as it is in heaven".

Thaler's newest book is an excellent and at times riveting account of the rebirth of behavioral economics. For Christian economists this book can be helpful as an introduction and summary of the most mainstream critique of neoclassical economic theory of the past several decades. Furthermore, for Christian economists who either do Christian economics (Hoksbergen, 1994), do economics (Richardson, 1994), or who do economics differently (Tiemstra, 1994), this book provides an empirical foundation for future scholarship.

In closing, a general caution begs attention. Behavioral economics has seemingly become exponentially more popular in recent years. What's potentially alarming about this reality is the possibility that behavioral economics has simply become a new technocratic gadget to engineer society. Many are familiar with Friedrich Hayek's famous quote: "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design" (Hayek, 1988). It is healthy to remember that society and the economy are complex systems. Social, economic, and political changes are always tricky and often violent. This caution must not be taken to its extreme, however, as even Hayek expressed nuance about simply leaving the status quo untouched. In his free-market manifesto, *The Road to Serfdom* (1944), Hayek wrote: "There is, in particular, all the difference between deliberately creating a system within which competition will work as beneficially as possible and passively accepting institutions as they are" (1944, p. 71). Behavioral economics provides the insights and tools to live—in fact to make a career—by balancing the complexity of the world and the call to make it better.

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