



THE BEHAVIORAL ECONOMICS GUIDE 2015

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Introduction by
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**Behavioral
Economics**
The Behavioral
Science Hub **.com**

The Behavioral Economics Guide 2015

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Cover design and layout adapted from Tilly Patsalis and Elina Halonen.

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Suggested citation:

Samson, A. (Ed.)(2015). *The Behavioral Economics Guide 2015 (with an introduction by Dan Ariely)*. Retrieved from <http://www.behavioraleconomics.com>.

Suggested citation for individual sections/authors:

[Author(s)] (2015). [Chapter/Section Title]. In A. Samson (Ed.), *The Behavioral Economics Guide 2015 (with an introduction by Dan Ariely)*(pp. nn-nn). Retrieved from <http://www.behavioraleconomics.com>.

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Acknowledgements

The editor would like to thank Benny Cheung, Pete Dyson, Ciosa Garrahan, Roger Miles, Giuseppe Veltri, and Ben Voyer for their helpful feedback. Special thanks to Dan Ariely for writing the introduction to this edition. I am particularly grateful for the support received by Behavioral Science Lab, Berkeley Research Group, BrainJuicer, Decision Technology, Decode Marketing, FehrAdvice & Partners, City University London, London School of Economics and Political Science, University of Warwick, University of Zurich, and the Behavioral Science & Policy Association.

INTRODUCTION

Behavioral Economics: An Exercise in Design and Humility

Dan Ariely

It is tempting to look at people in general and imagine a large body of reasonable and rational individuals out there, going about their lives in a reasoned, calculated and sensible way. Of course, this view is somewhat correct. Our minds and bodies are capable of amazing acts. We can see a ball thrown from a distance, instantly calculate its trajectory and impact, and then move our body and hands in order to catch it. We can learn new languages with ease, particularly as young children. We can master chess. We can recognize thousands of faces without confusing them (although as I get older I am less and less impressed with my own memory). We can produce music, literature, technology, and art—the list goes on and on.

As Shakespeare expressed in Hamlet:

“What a piece of work is a man! How noble in reason, how infinite in faculty! In form and moving how express and admirable! In action how like an Angel! In apprehension how like a god! The beauty of the world! The paragon of animals!”

The problem is that while this view of human nature is largely shared by economists, policy makers, and most of the general population, it is not perfectly accurate. Sure we can do many great things, but we also fail from time to time, and the costs of these failings can be substantial. Think for example about something like texting and driving: You don’t have to text and drive all the time for it to be dangerous and devastating. Even if we text and drive once in awhile, let’s say only 3% of the time, it can still injure or kill us and the people around us.

Texting and driving is a substantial problem, but it is also a useful metaphor to help us think about some of the ways in which we misbehave — acting in ways that are inconsistent with our long-term interests. Overeating, under-saving, crimes of passion, the list goes on and on. The big problem is that our ability to act in our long-term interest is only getting more and more difficult! Why? Because the way we design the world around us does not help us fight temptation and think long-term. In fact, if an alien would observe the way we design the world, the only sensible conclusion he could come to is that human beings are determined to design the world in a way that creates more and more temptations and makes us think more and more myopically. Think about it, will the next version of the doughnut (doughnut 2.0) be more tempting or less tempting? Will the next version of the smartphone get us to check it more or less throughout the day? And will the next version of Facebook make us check Facebook more or less frequently?

Basically, we can think about life as a tug-of-war. We are walking around with our wallets, our priorities and our thoughts — and the commercial world around us wants our money, time, and attention. Does the commercial world want our money time and attention at some time in the far future? Is it trying to maximize our wellbeing in 30 or 40 years from now? No. The commercial actors around us want our money, time, and attention now. And they are rather successful in their mission — partially because they control the environment in which we live (supermarkets, malls), partially because we allow them into our computers and phones (apps, advertising), partially because they know more about what tempts us than we know, and partially because we don't really understand some of the most basic aspects of our nature.

An important and rather depressing study by Ralph Keeney (a fellow researcher at Duke) explored the overarching impact of bad decision-making on our lives, or more accurately, our deaths. Using mortality data from the Center for Disease Control, Ralph estimated that about half of all deaths among adults 15-64 years old in the United States are caused or aided by bad personal decisions, particularly those relating to smoking, not exercising, criminality, drug and alcohol use, and unsafe sexual behavior.

Ralph carefully defined both the nature of personal decision and what can be considered premature death. For instance, if someone died after being broadsided by a drunk driver, it was not considered premature because the deceased did not make the decision that led to their death. However, if the drunk driver died then it was considered as a premature death because the decision to drive drunk, and dying as a result, are clearly connected. With this in mind we can examine a variety of instances where multiple decision paths are available (the drunk driver also has the option to take a cab, ride with a designated driver, or call a friend), and where these other decision paths are not chosen despite the fact that they are less likely to result in the same negative outcome (i.e., fatality).

To elaborate just a bit on just one example of a personal decision that can lead to death, let's examine the overconsumption of alcohol. This decision can lead to weight gain, which can lead to obesity, which can cause heart attacks, strokes, cancer, and other fatal health problems. It can also result in accidental injury, which, in some cases can be fatal to the person drinking. Drinking alcohol can also lead to having unprotected sex, which can result in the contraction of a fatal disease. It can also, though less common, result in suicidal behavior. And these are just a few of the ways that the decision to drink alcohol can be fatal. There are plenty of other potential consequences. Of course, overconsumption of alcohol is just one example of how bad decisions can lead to premature death, and sadly as society moves forward, the number and types of bad decisions increases, as does the number of their potential negative consequences.

Now, if people were simply perfectly rational creatures, life would be wonderful and simple. We would just have to give people the information they need to make good decisions, and they would immediately make the right decisions. People eat too much? Just give them calorie information and all will be well. People don't save, just give them a retirement calculator and they will start saving at the appropriate rate. People text and drive? Just let them know how dangerous it is. Kids drop out of school, doctors don't wash

their hands before checking their patients. Just explain to the kids why they should stay in school and tell the doctors why they should wash their hands. Sadly, life is not that simple and most of the problems we have in modern life are not due to lack of information, which is why our repeated attempts to improve behavior by providing additional information does little (at best) to make things better.

This is the basic problem: we have our internal software and hardware that has been developing over the years to deal with the world. And while we have some tremendous abilities, there are many cases in which these skills and abilities are incompatible with the modern world we have designed. These are the cases where we can veer dangerously off path and make serious mistakes. And these mistakes are getting more and more expensive to live with. Why? Think of these dangers as if they were terrorists. A thousand years ago, how much damage could a terrorist cause before they got caught? But today? With technologies such as explosives, chemical and biological warfare, even a very small group can cause tremendous damage. The same goes for falling to temptation. In a world where we don't have cell phones and cars the dangers of not paying attention is not that large -- at worst we will walk into a tree. But when we get a car that drives at 70 MPH, even a small mistake of attention can be very costly. The same goes for food. In a world where the caloric content of any food is not that high, eating for 10 minutes extra after we got our food intake need satisfied is not a big deal, but when a doughnut contains a few hundred calories, and we can scoff it down in less than a minute, eating for a bit too much time can be costly. Very costly.

There are lots of biases, and lots of ways we make mistakes, but two of the blind spots that surprise me most are the continuous belief in the rationality of people and of the markets. This surprises me particularly because even the people who seem to believe that rationality is a good way to describe individuals, societies and markets, feel very differently when you ask them specific questions about the people and institutions they know very well. On one hand, they can state all kinds of high order beliefs about the rationality of people, corporations, and societies, but then they share very different sentiments about their significant other, their mother-in-law (and I am sure that their significant other and mother-in-law also have crazy stories to share about them), and the organizations they work at. Somehow when we look at a particular example of life up close, the illusion of sensible behavior fades almost instantly. And the more we look at the small details of our own life, the more our bad decisions seem to multiply.

As an exercise let's each think about our own life and write down the number of time we have done the following activities in the last thirty days. Two more points to keep in mind: 1) If you don't fill in the numbers it will be much easier for you to keep the illusion of your own rationality, so it is up to you if you prefer to confront your own behavior or not. 2) If you leave lines empty, it feels very different from writing zero, so if you want to be truly honest with yourself, don't leave any line empty.

In the last thirty days the number of times I ...

Overate is _____

Texted while driving is _____

Read email while driving is _____

Spent money and regretted it later _____

Spent too much time on social media _____

Procrastinated _____

Stayed up too late and did not sleep well _____

Drank too much _____

Was not as kind to my significant other as I want to be _____

Did not spend enough time with my kids is _____

Did not exercise as much as I wanted to is _____

Did not take my medications _____

Lied (and not a white lie) _____

Mismanaged my time _____

Said yes to something that I should have said no to _____

Said something inappropriate and then regretted it _____

Took a non-optimal flight just to get a few more frequent flyer points _____

[Please add any additional misbehaviors below]

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

I did this exercise myself and for a few minutes I considered publicly posting my own answers but when I tallied the numbers, I did not want to admit my own failing or increase the number of times I lied – so I decided to keep the details of my own misbehaviors private. Maybe the extent of undesirable behaviors is only prevalent in my own life and maybe I am the most irrational person out there. But on the off chance that my experience is on par with the general human experience, maybe we all need to update our assessments of our abilities and think about how to improve our sorry state. And hopefully sooner rather than later.

The first question that comes directly from this somewhat sad analysis of the state of bad decisions and the modern world, is whether we should be depressed with all of these illustrations and personal anecdotes of substantial personal failings. And the second question that should follow it, is what are we to do?

In terms of being depressed, it might seem that the rational perspective is a much more optimistic view of life and that the behavioral economics perspective is depressing. After all, it seems wonderful to go about our daily life believing that the people around us are perfectly rational superhumans who always make the right decisions. Plus, this perspective has a certain level of respect for the marvel of humanity. In contrast, thinking about the people we interact with both professionally and socially as myopic, emotional, vindictive, unsure about what they want, easily confused, etc. seems rather sad. But let's take a different view on this — one that is rooted in the state of the world and not one that is focused on individuals.

Think about the world. We have somewhere between 7 and 8 billion people in the world, and as far as I can tell, things are far from ideal. We have wars, high crime rates, climate change, pollution, our oceans are unhealthy, we have a large amounts of poverty, we have obesity, smoking, etc, etc, etc. From this perspective, what is more optimistic? To think about the state of the world as the result of 7-8 billion rational people, or to think about it as the result of 7-8 billion irrational people? If we think about the world as an outcome of 7-8 billion rational people, then it means that this is the best we can hope for. But if we understand that the state of the world as an outcome of 7-8 billion irrational people, this means that we can do much better. It means that as long as we understand where we go wrong, we can improve things. This is the version of optimism – and I deeply believe in. True, we are flawed in many ways, and I'm sure that over the years we will find even more ways in which we are flawed. But for me, this only emphasizes the vast room for improvement. Now, this is optimism!

In terms of what to do next, in my mind the challenges are basically design challenges. As long as we build the world around us assuming that people have limitless cognitive capacity and no emotions to interfere with our decisions, we will fail, and we will fail often and on larger scales. But, if we truly understand human limitations and build around this understanding, we will end up with products and markets that are much more compatible with our human ability and will ultimately allow us to flourish. In the same way that we would never design a car assuming that people have an infinite amount of hands and legs to operate the car, we must also recognize our social, cognitive, emotional, and attention

limitations as we design our environment. This is a challenge, but this is also the path of hope.

And finally, I would like to remind us about the wisdom of the Romans. At the peak of Rome's empire, Roman generals who won significant victories paraded through the middle of the city displaying their spoils. The generals wore purple and gold ceremonial robes, a crown of laurels, and red paint on their face as they were carried through the city on a throne. They were hailed, celebrated and admired. But there was one more element to the ceremony: Throughout the day a slave walked next to the general whispering repeatedly in his ear "Memento mori," which means "Remember your mortality."

If I could create a modern version of this Roman phrase, I would probably pick "Remember your fallibility" or maybe "Remember your irrationality." Whatever the phrase is, recognizing our shortcomings is a crucial first step in the path to making better decisions, creating better societies and fixing our institutions.