

IPAA PERTH

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Behavioural Economics and the
Policy Challenge

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The ‘policy challenge’

Any policy, or changes to policy, even for fully rational decision makers, will have both:

- **Intended** consequences, and
- **Unintended** consequences

Unintended effects can’t be eliminated, but the rational policy maker will **anticipate** and **mitigate** them

But human policy makers are biased, often seriously so, in myriad ways, often unconsciously so. The policy challenge is then even greater:

- **Unintended** consequences are now *unanticipated* and *unmitigated*!

Our limitations undermine good policy-making, then blind us to the evidence and our role in it

‘Success has a thousand fathers, but failure is an orphan’

J.F. Kennedy

Too many sources of bias to do much more than scratch the surface today...

(from *Business Review Weekly*, 2016)

One example: How has the decision been framed?

“Shall we implement policy X, or not?”

The question may even be ‘leading’ ...

Tick one option:

a) I believe in freedom and democracy and wish to privatise Western Power

b) I do not believe in freedom and democracy

Your preference?

20 COGNITIVE BIASES THAT SCREW UP YOUR DECISIONS

1. Anchoring bias.

People are **over-reliant** on the first piece of information they hear. In a salary negotiation, whoever makes the first offer establishes a range of reasonable possibilities in each person's mind.



2. Availability heuristic.

People **overestimate** the importance of information that is available to them. A person might argue that smoking is not unhealthy because they know someone who lived to 100 and smoked three packs a day.



3. Bandwagon effect.

The probability of one person adopting a belief increases based on the number of people who hold that belief. This is a powerful form of **groupthink** and is reason why meetings are often unproductive.



4. Blind-spot bias.

Failing to recognize your own cognitive biases is a bias in itself. People notice cognitive and motivational biases much more in others than in themselves.



5. Choice-supportive bias.

When you choose something, you tend to feel positive about it, even if that **choice has flaws**. Like how you think your dog is awesome — even if it bites people every once in a while.



6. Clustering illusion.

This is the tendency to **see patterns in random events**. It is key to various gambling fallacies, like the idea that red is more or less likely to turn up on a roulette table after a string of reds.



7. Confirmation bias.

We tend to listen only to information that confirms our **preconceptions** — one of the many reasons it's so hard to have an intelligent conversation about climate change.



8. Conservatism bias.

Where people favor prior evidence over new evidence or information that has emerged. People were **slow to accept** that the Earth was round because they maintained their earlier understanding that the planet was flat.



9. Information bias.

The tendency to **seek information when it does not effect action**. More information is not always better. With less information, people can often make more accurate predictions.



10. Ostrich effect.

The decision to **ignore dangerous or negative information** by “burying” one's head in the sand, like an ostrich. Research suggests that investors check the value of their holdings significantly less often during bad markets.



11. Outcome bias.

Judging a decision based on the **outcome** — rather than how exactly the decision was made in the moment. Just because you won a lot in Vegas doesn't mean gambling your money was a smart decision.



12. Overconfidence.

Some of us are **too confident about our abilities**, and this causes us to take greater risks in our daily lives. Experts are more prone to this bias than laypeople, since they are more convinced that they are right.



13. Placebo effect.

When **simply believing** that something will have a certain effect on you causes it to have that effect. In medicine, people given fake pills often experience the same physiological effects as people given the real thing.



14. Pro-innovation bias.

When a proponent of an innovation tends to **overvalue its usefulness** and undervalue its limitations. Sound familiar, Silicon Valley?



15. Recency.

The tendency to weigh the **latest information** more heavily than older data. Investors often think the market will always look the way it looks today and make unwise decisions.



16. Saliency.

Our tendency to focus on the **most easily recognizable features** of a person or concept. When you think about dying, you might worry about being mauled by a lion, as opposed to what is statistically more likely, like dying in a car accident.



17. Selective perception.

Allowing our expectations to **influence how we perceive** the world. An experiment involving a football game between students from two universities showed that one team saw the opposing team commit more infractions.



18. Stereotyping.

Expecting a group or person to have certain qualities without having real information about the person. It allows us to quickly identify strangers as friends or enemies, but people tend to **overuse and abuse** it.



19. Survivorship bias.

An error that comes from focusing only on surviving examples, causing us to **misjudge a situation**. For instance, we might think that being an entrepreneur is easy because we haven't heard of all those who failed.



20. Zero-risk bias.

Sociologists have found that **we love certainty** — even if it's counterproductive. Eliminating risk entirely means there is no chance of harm being caused.



SOURCES: Brain Biases; Ethics Unwrapped; Explorable; Harvard Magazine; HowStuffWorks; LearnVest; Outcome bias in decision evaluation, Journal of Personality and Social Psychology; Psychology Today; The Bias Blind Spot: Perceptions of Bias in Self Versus Others, Personality and Social Psychology Bulletin; The Cognitive Effects of Mass Communication, Theory and Research in Mass Communications; The less-is-more effect: Predictions and tests, Judgment and Decision Making; The New York Times; The Wall Street Journal; Wikipedia; You Are Not So Smart; ZhurnalWiki

“On the folly of rewarding A while hoping for B...” S. Kerr, 1995

Do policymakers anticipate unintended consequences and take mitigating steps?

Often we respond to the *letter* of some new policy incentive, rather than the *spirit*

- Soviet industry: targets sometimes set by **total weight** of output – **factories produced heavy dresses, screws that were too big to use, etcetera**

A thing of the past? Unfortunately not...

‘When we start quantifying and measuring everything, we soon begin to change the world to fit the way we measure it’

Tim Harford, *Messy*, 2016

“Obviously, it shouldn’t work like that...”

A few examples from Tim Harford’s book, *Messy*, 2016:

- Tony Blair and his **48-hour wait limit** for GP appointments
- Volkswagen and cheating the ‘very predictable’ emissions tests
- US College rankings: selectivity rank raised by boosting, then rejecting, unsuitable applications
- Basel II, bank capital requirements which
 - ‘rewarded banks for making investments that had low risk on paper but high market return...seek out places where the rules seem wrong’*
 - Examples included massive borrowing and investing in Greek Government bonds, CDO’s etc.,*
- Heart surgeon & hospital report cards in New York...reject the sickest, operate on the healthiest!

Solutions?

‘Making targets more complex merely leads to them being gamed in more complex and unpredictable ways’

Many of our biases interact with unintended consequences of policy, making the problem ubiquitous, but some insights can help: checklists, scorecards etc., (think pilots).

Encourage people to express their doubts in the **policy design/planning stage**; best not in **execution stage**!

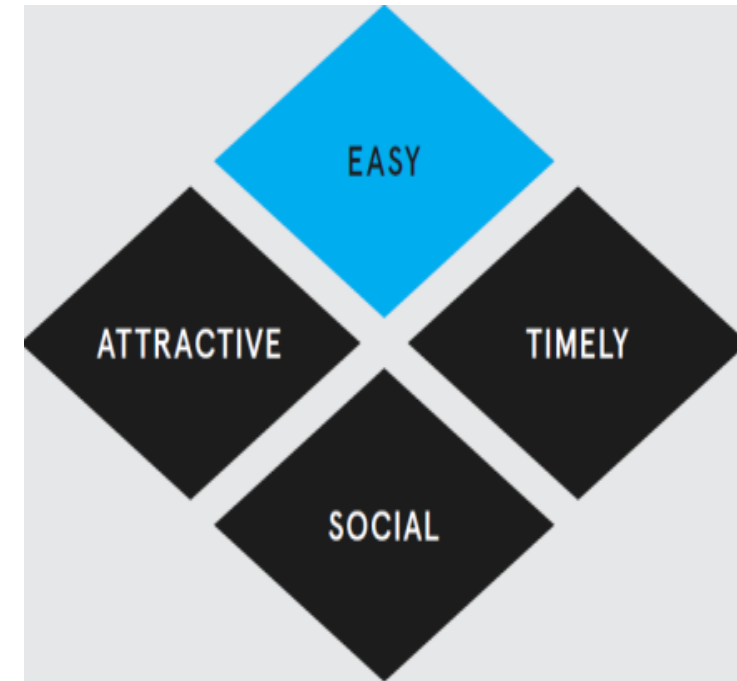
One method is to insist on a ‘**pre-mortem**’: just before confirming your big decision, imagine that in 12 months it is a major failure.

Ask the planners to each, separately, write a brief but most likely explanation why the plan failed.

Their reasons can help anticipate, then mitigate, some of the unintended consequences of our human biases

More generally, try the BITS Framework for better policy...

Idea	
Messenger	It matters who sends the message (A)
Incentives	Rewards and penalties work if used correctly (A)
Norms	We care about behavioural standards in our society (S)
Defaults	Changing something is “hard” (E)
Salience	Make sure it is clear what you want (E,A)
Priming	Decisions are affected by frames, previous experiences (T)
Affect	Even unconscious emotions matter (A,S)
Commitments	Commitment overcomes procrastination (T)
Ego	We care about how others see us (A,S)



Example: Staff Fundraising

S - ‘Social Proofing’ at universities

E - Google’s one click RCT

*Be sure it is also **T**!*

Business is already onto all this, but *quietly*...

Ariely (2008) uses the example of subscription to the Economist magazine. It offers three options:

- a) Internet only, \$59/yr
- b) Print only, \$125/yr
- c) Print and internet, \$125/yr

His students chose 16% for a), 0% for b) and 84% for c)

Now suppose we eliminate b),

- a) Internet only, \$59/yr
- b) Print and internet, \$125/yr

This time his students chose 68% for a) and 32% for b)!

Adding a ‘decoy’ option raises much more revenue for the *Economist*!

Choice architecture is widely used to raise profits, business just doesn’t talk about it!

On a brighter note, some useful books....!!

