

Book Review - Misbehaving : The Making of Behavioral Economics

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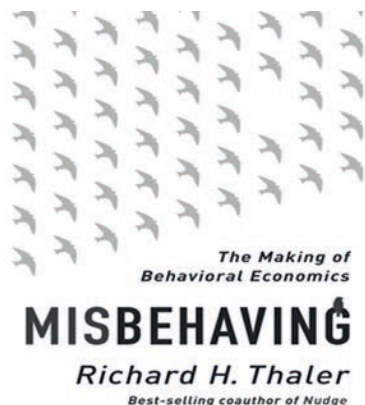
Abstract

Traditional economics assumes that market forces directed by the rational forces shape economic activity in the economy. Nevertheless, in real times, people generally succumb to biases and make decisions that deviate from the assumption of rationality. Hence, people do not behave expectedly and simply misbehave. Richard Thaler in his book, *Misbehaving : The Making of Behavioral Economics* brings in hardcore application of economics and its deviations from the economic theories while penning his experience of understanding economics as a student and as an academician. Coupling the recent behavior in human psychology with a practical understanding of market behavior, Thaler, co-author of the seminal work *Nudge* entertains the reader through the fun way, but yet gives a highly intellectual comprehension of various aspects of behavioral economics – an un-dismal science. The book brings in new lessons about how to change the way people think about things, especially when they have a lot invested in maintaining the status quo.

Keywords : behavioral economics, nudge, rationality, endowment effect, decision making

JEL Codes : A20, B50, Y30

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The economic theories of the past century are dominated by the notion of rationality. The edifice of economics is on the assumption that the decision-making process is based on making a choice that is at an optimal level of benefit or utility. Whether the decision is about what to purchase or when to purchase or where to purchase, or a calculative decision on how much to spend and how much to save for retirement or be it about people's new year resolution of reducing body weight or maintain a healthy weight, people are assumed to behave in a logical and rational manner. However, in actual, people may not behave in a very rational way as assumed and suggested by economic theories.

People are often driven by emotions, which makes it difficult for them to behave in a perfectly rational manner. To deal with such a trend of capriciousness, a few sets of economists along with other social scientists started to question the standard economic model. The critical discussions and deliberations on the relevance of the age-old economic models made way to a new stream of economics and came to be aptly named as Behavioral Economics.

The study of behavioral economics began with a group of economists and researchers in psychology researching better ways to understand decision-making. Since the recent past decade, behavioral economics is gaining popularity with a fewer group of behavioral economists and practitioners now being part of policymaking establishments. The business has realized in a hard way that a deeper understanding of human behavior is as important as learning to understand the financial statements and operations management to make a successful business. Thanks to the notable knowledge contributions from distinguished economists like Gary Becker (motives, consumer mistakes, 1992), Herbert Simon (bounded rationality, 1978), Daniel Kahneman (the illusion of validity, anchoring bias, 2002), and George Akerlof (procrastination, 2001), the works of whom form strong pillars of behavioral economics.

Daniel Kahneman's *Thinking Fast and Slow* complements *Misbehaving*, wherein it covers some of the profoundly important concepts around how people make decisions, which helps to understand why human beings sometimes make errors in judgment. *Thinking Fast and Slow* conveys that people spend most of their time in thinking that is related to gut reactions and many make wrong judgments and decisions due to biases and heuristics illusions of understanding. Robert Thaler also, at various points of discussion, highlights the presence of an illusion of understanding to be a major reason for weaker decision-making.

Robert H. Thaler, through his book *Misbehaving: The Making of Behavioral Economics*, attempts to help solve a variety of business and increasing public policy issues in his style of discussion drawn from psychology and other social sciences. The book is a good blend of his life experiences and observations as a professor, stories from other economists, and history of behavioral economics. The book is divided into eight sections that are majorly oriented towards the author's personal experiences and observations of understanding economics and decision-making processes presented chronologically. He starts with quoting his personal experience of application of economics models as a student and a young economist and dedicates a good amount of discussion to his intellectual connect with Daniel Kahneman, whom he very fondly calls Danny. He closes the deliberations with a very vivid and candid discussion on nudging in the UK wherein, he passionately discusses the presentability of the policy aspects to have higher success rates. With a catchy marketing title of his book, Thaler retains the curiosity of the reader through a lighter way by bringing in a good sense of humour based on his experiences and observations, supplemented by stories of other economists and anecdotes. While giving the reader a fun feeling, Thaler very much covers various aspects of behavioral economics like endowment effect, an act of an individual valuing a thing more once he/she owns it rather than when he/she doesn't and mental accounting, which is a normal behavioral thought of individuals wherein they believe that money is non-replaceable and money is everything. To illustrate this, Thaler explains the common behavior of people doing part payments of bills while they could afford to pay the full payments and ending up paying interest on debt, which happens to be higher than the interest earned on their savings.

Recounting his self-deprecating humour and skilful storytelling, Thaler explains two important concepts of self-control emphasizing on individuals' present bias in their decision making and transaction utility.

Transactional utility is derived from the concept of consumer surplus and is the utility that an individual experiences from a perceived value of the deal. Nevertheless, the author has tried to popularize the relevance and application of behavioral economics in the policy discourse through quoting instances of the National Football League team's irrational behavioral of overpricing the value of the players and instances of financial market experts making wrong decisions like any other layman investor.

The author devotes a good amount of his writing on the most important part of behavioral economics, that is, "nudge," demonstrating how policymakers can nudge individuals into behaving optimally. Taking an example of an exercise of the policymakers to get more and more people enrolled into retirement plans, Thaler gave one solution to the problem by suggesting to change the way employees participate in a plan from "opt-in" to "opt-out," which eventually made most of the employees to stay with the retirement plan.

Misbehaving is a unique contribution to the area of behavioral economics — a book that is well crafted with all the important concepts getting their due focus and makes reading joyous yet comprehensive. This reading along with Daniel Kahneman's *Thinking Fast and Slow* would be a good mode to unravel all about behavioral economics, and they complement each other. *Misbehaving's* discussion majorly rotates around the understanding of how people make decisions, rather than how they ought to make decisions. Key takeaways from *Misbehaving: The Making of Behavioral Economics* is — individuals invariably suffer from illusions of understanding, irrespective of how well they are trained.

References

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About the Author

Dr. Kavita Mathad is currently working as an Associate Professor, Institute of Management, CHRIST (Deemed to be University). She has been in academics for around 14 years and her areas of research interest include international trade and policy, FDI, FTAs, e-waste management, health care, and medical tourism.