The debt to pleasure; Free exchange

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ABSTRACT

"Sovereign in tastes, steely-eyed and point-on in perception of risk, and relentless in maximisation of happiness." This was Daniel McFadden's memorable summation, in 2006, of the idea of Everyman held by economists. That this description is unlike any real person was Mr McFadden's point. The Nobel prizewinning economist at the University of California, Berkeley, wryly termed homo economicus "a rare species". In his latest paper* he outlines a "new science of pleasure", in which he argues that economics should draw much more heavily on fields such as psychology, neuroscience and anthropology. He wants economists to accept that evidence from other disciplines does not just explain those bits of behaviour that do not fit the standard models. Rather, what economists consider anomalous is the norm. Homo economicus, not his fallible counterpart, is the oddity. Mr McFadden believes that economists need to do things differently if they are truly to understand how people make decisions. Manipulating brain activity is one way of delving into where economic choices really come from. Analysing the information people get through social networks would help them understand the role of influence and identity in decision-making.

FULL TEXT

A Nobel prizewinner argues for an overhaul of the theory of consumer choice

"SOVEREIGN in tastes, steely-eyed and point-on in perception of risk, and relentless in maximisation of happiness." This was Daniel McFadden's memorable summation, in 2006, of the idea of Everyman held by economists. That this description is unlike any real person was Mr McFadden's point. The Nobel prizewinning economist at the University of California, Berkeley, wryly termed homo economicus "a rare species". In his latest paper* he outlines a "new science of pleasure", in which he argues that economics should draw much more heavily on fields such as psychology, neuroscience and anthropology. He wants economists to accept that evidence from other disciplines does not just explain those bits of behaviour that do not fit the standard models. Rather, what economists consider anomalous is the norm. Homo economicus, not his fallible counterpart, is the oddity.

To take one example, the "people" in economic models have fixed preferences, which are taken as given. Yet a large body of research from cognitive psychology shows that preferences are in fact rather fluid. People value mundane things much more highly when they think of them as somehow "their own": they insist on a much higher price for a coffee cup they think of as theirs, for instance, than for an identical one that isn't. This "endowment effect" means that people hold on to shares well past the point where it makes sense to sell them. Cognitive scientists have also found that people dislike losing something much more than they like gaining the same amount. Such "loss aversion" can explain why people often pick insurance policies with lower deductible charges even when they are more expensive. At the moment of an accident a deductible feels like a loss, whereas all those premium payments are part of the status quo.

Another area where orthodox economics finds itself at sea is the role of memory and experience in determining choices. Recollection of a painful or pleasurable experience is dominated by how people felt at the peak and the end of the episode. In a 1996 experiment Donald Redelmeier and Daniel Kahneman, two psychologists, showed that deliberately adding a burst of pain at the end of a colonoscopy that was of lower intensity than the peak made patients think back on the experience more favourably. Unlike homo economicus, real people are strongly influenced by such things as the order in which they see options and what happened right before they made a choice. Incorporating these findings into models of consumer behaviour should improve their power to predict everything from which loans people choose to which colleges they apply for.

Trust is something economists already incorporate into their models. But trust turns out to be not just a function of history and interactions, as dismal scientists tend to think, but also a product of brain chemistry. Pumping people with oxytocin, the so-called "love hormone", has been found to make them much more generous in games where they have to decide how much of their money to entrust to another person who has no real incentive to return any of it. Sovereign, indeed.

Much of this may be alien to modern-day economists, but it is in line with the conception that other disciplines have of human decision-making. Psychologists have long known that people's choices and preferences are influenced by others. Biologists have a much clearer understanding of altruism and kindness, whether to kin or strangers, than economists, who typically emphasise the dogged pursuit of self-interest. This way of thinking would also have been recognisable to their intellectual forefathers. Adam Smith wrote extensively about the central role of altruism and regard for others as motivators of human behaviour. The idea of loss aversion would have made sense to Jeremy Bentham, the founder of utilitarianism: he spoke of increased pleasure and reduced pain as two distinct sources of happiness.

Mr McFadden believes that economists need to do things differently if they are truly to understand how people make decisions. Manipulating brain activity is one way of delving into where economic choices really come from. Analysing the information people get through social networks would help them understand the role of influence and identity in decision-making.

Such tools have implications for policy. Plenty of poor people in America are wary of programmes like the Earned Income Tax Credit (EITC) because the idea of getting a handout from the government reinforces a sense of helplessness. Dignity is not something mainstream economics has much truck with. But creating a sense of dignity turns out to be a powerful way of affecting decisions. One study by Crystal Hall, Jiaying Zhao and Eldar Shafir, a trio of psychologists, found that getting poor people in a soup kitchen to recall a time when they felt "successful and proud" made them almost twice as likely to accept leaflets that told them how to get an EITC refund than members of another group who were merely asked about the last meal they had eaten.

A nudge and a think

Taking the path Mr McFadden urges might also lead economists to reassess some articles of faith. Economists tend to think that more choice is good. Yet people with many options sometimes fail to make any choice at all: think of workers who prefer their employers to put them by "default" into pension plans at preset contribution rates. Explicitly modelling the process of making a choice might prompt economists to take a more ambiguous view of an abundance of choices. It might also make them more sceptical of "revealed preference", the idea that a person's valuation of different options can be deduced from his actions. This is undoubtedly messier than standard economics. So is real life.

* "The New Science of Pleasure", NBER Working Paper No. 18687, February 2013

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