

Prepared Statement for CFPB Symposium on Behavioral Law and Economics

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September 19, 2019

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Behavioral economics arose from the behavioral decision-making tradition in psychology that sought to identify deviations from normative standards of decision-making. These fun, “predictably irrational” systematic anomalies documented in effects such as [anchoring](#), [the endowment effect](#), [the compromise effect](#), and many others have captured the imagination of businesspeople, policymakers, and the public. In part, the attraction was (and is) that through subtle changes in how information is presented these effects could be used to induce large behavioral changes. Yet, through a bit of bait-and-switch, “boring” old (but important) information design—and other interventions (like sending people text reminders)—have been sold under the fun and exciting label of behavioral economics. Indeed, the term behavioral economics appears to have expanded to include any intervention that makes assumptions about psychology—in other words any intervention intended to influence behavior—rendering the term essentially meaningless.

At the same time, from a policy perspective it is important to note that the fun and interesting “irrational” anomalies that gave rise to behavioral economics don’t inherently reveal any suboptimal behavior that needs to be corrected. Take the case of the endowment effect. In one example of the effect, the majority of people given a mug kept it rather than trade it for a chocolate bar, whereas the majority of people given the chocolate bar kept it rather than trade it for the mug (Knetsch 1989). This apparent preference inconsistency is commonly viewed as an irrational mistake, typically explained via loss aversion. However, the mistake is not in the behavior but in the assumption that preferences are stable and well-defined. If, instead we assume preferences are fuzzy then the effect can be trivially explained without any resort to error: many people might have no clear preference between the mug and the chocolate bar and default to the one they already own out of inertia (Gal 2006; Gal and Rucker 2018b). Indeed,

most of the systematic preference inconsistencies documented by psychologists and behavioral economists can more parsimoniously be explained by fuzzy preferences than by invoking errors in decision-making.

Moreover, when policymakers have sought to take advantage of these effects, the impacts have been small and unreliable. For instance, policymakers have sought to nudge consumers towards lower electricity consumption by informing them when they use more electricity than their neighbors. However, when tested, the impacts have been small to negligible (Abrahamse and Shwom 2018).

Does this mean that the psychological insights frequently relied upon or derived by behavioral economists or those in related fields are not of value? Not at all. It's that these ideas--such as the fuzziness of preferences, that people often lack insight into their preference, that identity often drives choice and behavior, or confirmation bias--don't lend themselves to obvious, simple answers, or even to obvious questions.

For example, I agree with John Lynch's comment (in his statement prepared for this symposium) that the more important mistake made by people that lost their homes in the financial crisis of the last decade was buying the wrong house—i.e., a house that put them in a precarious financial position—not picking the wrong mortgage. Accordingly, framing information in a way that would have allowed them to pick a better mortgage, while of value, would have had comparatively little impact on their financial wellbeing. So why did people pick the wrong house? This likely involved a mix of factors, including the lay belief—reinforced by social proof—that house prices always go up, trust in institutions that promoted mortgages and home ownership, status-seeking, cultural factors, low financial literacy, and low future orientation. Understanding such factors and considering policy to address them requires stepping

well outside the heuristics and biases tradition of decision-making on which behavioral economics was founded.

As another example, lottery winners (Hankins, Hoekstra, and Marta Skiba 2011) and well-compensated professional athletes (Torre 2009) routinely end up in financial distress or bankrupt—what explains this? Again, it is unlikely that heuristics or biases associated with how information is presented has anything to do with this phenomenon or can do much to correct it (and, by way of inference, with why many other people don't save). Instead, we might consider as factors low financial literacy, status seeking, and low future orientation, *inter alia*, with the latter likely a function of personality, culture, family environment, social validation, the structure of incentives in society, and others.

Both the examples above illustrate the point that psychological insights have potentially important policy implications, but that these insights are not well realizable through simple changes in how information or choices are presented. Instead, successful interventions are likely to take advantage of psychological insights, but to be much more multifaceted, complex, heavy-handed, and sustained—and to require a more careful evaluation of uncertainty and tradeoffs—than the ones advocated till now by behavioral economists.

To take yet another example, the reality of confirmation bias—the tendency of people to interpret new information to be in line with their existing, strongly held beliefs—suggests no easy fixes, but it does offer potential insights for policy. For instance, it suggests the need for structures that facilitate redundancy in policy evaluation and for creating paths for contrarian ideas to receive a hearing (Gal and Rucker 2018a).

I thank the CFPB for providing this forum for such ideas.

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