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Who benefits from behavioural economics?

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A R T I C L E I N F O

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A B S T R A C T

Interpreted by a sociologist, this paper intends to sketch and discuss the main ideas behind behavioural economics, asking who will ultimately benefit from this field of knowledge; the consumers through authorities' implementation of supportive measures; or marketing people taking advantage of this knowledge? While sociologists try to understand how individual choices are affected, restricted or determined by structures, traditions and norms; behavioural economists point to cognitive mechanisms *within* individuals to explain non-rational choices. This article claims that behavioural economics would improve by incorporating sociological knowledge and approaches.

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1. Introduction

Our interpretations and understandings of consumers and societies depend heavily on the methods and theories that we apply. After the 2008 financial crisis – which was hard to predict by traditional economic theory – the field named *behavioural economics* has gained attention from both policy makers and social scientists. Behavioural economics' main objective is to explain choices. Contrary to rational choice theory, behavioural economics demonstrate and explain why free choices often appear *not* to be in the chooser's own interests.

I think behavioural economics is a pragmatic field wishing to solve real problems in the real world. Accordingly, if suitable and useable, the field does not hesitate to borrow insights and approaches from neighbouring disciplines. Many of their favourite mechanisms relate to central sociological phenomena, like the importance of contexts, traditions, norms and significant others. A sociologist, however, will often miss standard sociological references in their literature. This paper discusses this new field, claiming that a turn towards sociology would improve this field, a lot. Finally asking who will ultimately benefit from this new knowledge, the consumer-citizens or the producers and providers?

1.1. Fighting the omniscient, calculating rational actor

Over the years, Adam Smith's classical rational choice approach has been challenged from rival social science approaches as well as from fellow economists. Several Nobel laureates in economics, like Herbert A. Simon in 1978, Amartya Sen in 1998 and Joseph Stiglitz in 2001, have questioned the traditional rational man and his rationality assumptions.[1] Many would agree that the one who has contributed the most to the development of the economic field is Herbert Simon (1916–2001) who

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[1] My anonymous referee adds that anomalies have been discussed by many economists. Important ancestors to behavioural economics are e.g. Kantona, Leibenstein, Scitovsky, Allais, Ellsberg, Markowitz, a.o.

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coined the terms bounded rationality[2] and satisficing[3] (Simon, 1957, 1982). Amartya Sen's capability-concept[4] (Sen, 2009) and Joseph Stiglitz' information paradigm[5] (Stiglitz, 2002) are other important contributions to the development of renewed economic theory. The social scientist Jon Elster has provided important contributions on how phenomena like norms and trust, people's tendency to yield to temptation, and inconsistent time preferences, all challenge the explanatory power of neoclassical economic theory (Elster, 1979, 1989a,b, 1990, 1998).

Sociologists, including those who in their work are inspired by economic theory and the clarity of economic models, have been at the forefront of criticism of traditional rational choice theory and its omniscient, instrumental, rational actor. The classical economic model of society, grounded on the idea of a rational man, has been described as *beautiful, but without roots in reality*. According to Aage B. Sørensen (1941–2001);

> *neoclassical economy generates very powerful hypotheses, but for a non-existing world*. Sociologists, he claimed: *have a very important role to fill, namely to empirically observe and explain what is going on* (Sørensen, 1990).

Richard Swedberg once asked James Coleman (1927–1995) if he expected that sociology would end up as a subdiscipline of economics. Coleman then forecasted that: *the economists have shown certain kinds of fundamental narrowness and blindness, and [that] it will rather turn out that economics will become a kind of subdiscipline of sociology in the future* (Interview with Coleman in Swedberg (1990)). At the present stage of development of economics the high profile of behavioural economics indicates that instead of sociology, it was cognitive psychology – helped by the financial crisis in 2008 – that first succeeded in considerably dislocating the power of the rational man.

The sociologists referred to above can all be said to belong to the branch of sociology named analytical sociology (see; Hedstrøm and Swedberg, 1998, Hedstrøm and Bearman, 2009, Tufte, 2009, Manzo, 2010). This sociological field is rather similar to behavioural economics in their critics and distance-markings to rational choice theory. Both fields urge their scholars to open up the so called *black box* in search for better explanations. While behavioural economists give importance to the *decision process* and try to increase the explanatory power by providing the black box with more realistic psychological foundations, analytical sociologists have a wider project. They search for *the mechanisms*[6] that explain how and why things happen, and how these mechanisms at the individual level affect and promote changes at the societal level.

2. Behavioural economics

The development of the field *behavioural economics* accelerated when The Russell Sage Foundation offered a grant designed to bring the fields of economics and psychology together to study decision-making processes. The first grant was received by the economist Richard Thaler, who spent one year (1984–1985) with the psychologist Daniel Kahneman at the University of British Columbia in Vancouver (Kahneman, 2002). While Kahneman later received the Nobel prize, Richard Thaler of the University of Chicago Business School (not the Economics Department of the University of Chicago) made behavioural economics applicable and policy relevant when he together with Cass Sunstein wrote the frequently referenced book *Nudge*.

To a sociologist, the term *behavioural* economics gives associations to non-reflected behaviour (contrary to intentional, rational and reflected action). But behavioural economics do not reject intentional rationality. They agree that humans sometimes reflect and make rational choices, nevertheless reject the one-dimensional, insensitive, omniscient, ever-calculating rational man. Central in their choice theory is the separation between more or less automatic choices based on intuition on the one hand, and active choices based on reflection and reasoning on the other. Still they keep referring to *behaviour*. It is easy to agree with Sage President Erik Wanner – one of the promoters of this field – who now claims that the field is misnamed and that it would be more appropriate to name it *cognitive economics* (Wanner referred in Lambert (2006)).

2.1. Guiding ideas

The field combines ideas from economics and cognitive psychology. Behavioural economics is the study of how individuals behave and how thinking and emotions affect individual – mostly economic – decisions (Thaler et al., 2008). The

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[2] The concept *bounded rationality* means that decision-makers have to work under three unavoidable constraints: (i) only limited, often unreliable, *information* is available regarding possible alternatives and their consequences, (ii) the human mind has only *limited capacity* to evaluate and process the information that is available, and (iii) only a limited amount of *time* is available to make a decision. Therefor even individuals who intend to make rational choices are bound to make satisficing (rather than maximising or optimising) choices in complex situations. These limits (bounds) of rationality also make it nearly impossible to draw up contracts that cover every contingency, and accordingly we have to rely on *heuristics*. (www.business.dictionary.com).

[3] *Satisficing* means that instead of searching for the best alternative (which is unrealistic) the first satisfactory alternative is chosen.

[4] Stressing that 'free choices' are restricted by a persons' *capabilities*.

[5] Information is unevenly distributed. Customers are more strategically intricate than the neoclassical economists' view took into account, and market actors can *create* information imperfections in their attempt to exploit market power.

[6] A mechanism is the explanation, or the reason why 'a' (often) causes 'b'. Contrary to physical laws, we cannot predict when a mechanism will be at work and when it will not. In real life, several mechanisms pulling in different directions can be at work simultaneously; like 'opposite attract' and 'birds of a feather flock together'. 'When we have identified a mechanism whereby *p* leads to *q*, knowledge has progressed because we have added a new item to our repertoire of ways in which things happen' (Elster, 1989a, 10).

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