



## Misbehaving – The Making of Behavioral Economics

### Richard H. Thaler

**On September 17, 2015, the Department of Economics – together with the Müller-Möhl Foundation – had the great honor of hosting a speech by Richard H. Thaler, who is Ralph and Dorothy Keller Distinguished Service Professor of Behavioral Science and Economics at the University of Chicago Booth School of Business.**



A couple of 100 people gathered in the main auditorium of the University of Zurich in order to hear Professor Thaler's arresting, frequently hilarious account of the struggle to bring an academic discipline back down to earth. Thaler has written a number of books intended for a popular audience with which he succeeds in shaking up the reign of traditional economics that had dominated thought for the fifty previous years. His recurrent theme is that market-based approaches are incomplete. This is also true for his recently published book, entitled "Misbehaving: The Making of Behavioral Economics". In his public speech, Thaler took the audience with him on a long journey, describing his personal development from the student learning conventional economic theory to a questioning young teacher to an absolute advocate of behavioral economics.

#### **Of irrational students and impossible bubbles**

Thaler began his journey by explaining why the traditional view of the rational "homo oeconomicus" – whom

he lovingly calls "Econ" – should be replaced with the image of an irrational, skittish "Human". He illustrated his theory by sketching a totally irrational response by students. They were outraged at a test that awarded an average of 72 points out of 100, but quite satisfied with one that awarded an average of 96 out of 137 points. Although this stemmed from the age before the pocket calculator, these supposedly clever and rational economics students did not notice that the latter test actually corresponded to an average grade of only 70. No rational "Econ" would ever accept this situation, but the grade of 96 seemed to placate his very human students of economics.

Thaler continued his journey by elaborating on several phenomena which are not taken into account by traditional economics, such as social norms and framing. For every new argument, he provided the audience with an example, perfectly wrapped in an entertaining story. The next stage of Thaler's journey took him into the area of behavioral finance. Existing theories, such as the efficient market hypothesis that terrorized many an economic student in the past century, do not always conform to the reality on the financial markets. Behavioral biases appear to exist in markets, and in theory at least, the "Econs" should be able to pounce on them. An im-



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portant aspect of the efficient market hypothesis is the fact that “correct” prices cannot actually be tested – who after all, can really determine what shares are really worth? Bubbles are theoretically not possible under the efficient market hypothesis.

### Keep on nudging

2 The last stage of Thaler’s journey took him to one of the main issues of his book called “Nudge” which was published in 2008. Nudge is a concept in behavioural science which argues that positive reinforcement and indirect suggestions can influence the motives, incentives, and decision making of individuals, at least as effectively – if not more effectively – than direct instruction, legislation, or enforcement. Thaler introduced a policy approach to his audience, an approach which he calls liberal paternalism. It is based on the idea that it is both possible and legitimate for private and public institutions to affect behavior while also respecting freedom of choice, as well as the implementation of that idea. To his surprise, the concept was well received and several countries have started to apply the concept in their policies. In fact, only on day before his lecture in Zurich, President Obama announced that he will make the «Behavioral Insights Team», also called “nudge squad”, a permanent unit of his government.

As his journey continues, the question arises, where the road will lead him. As president of the American Economic Association (since 2015), governing with vice-president Bob Shiller, another behavioralist, Thaler mentions that the lunatics will actually be running the asylum. He hopes that the emphasis on behavioral issues will move to new territories, like macroeconomics. He adds that virtually every field of economics can gain by including more of the human side of it.



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[🔗 Watch Thaler’s speech on youtube](#)

[🔗 Professor Thaler’s webpage](#)