



Gallup Pakistan's Behavioral Insights

A monthly newsletter on Behavioral Economics

IN THIS EDITION

Page 2
What is Behavioral
Economics?

Page 6
Heuristic & Biases

Reading Time: 10 minutes

Welcome

to Gallup Pakistan's 1st edition of a series of monthly Behavioral Insights Newsletter. In this series, we principally aim to encourage an empirical understanding of Behavioral Economics and its related topics. *By disseminating international and local research findings, Gallup Pakistan aspires to create a knowledge hub that people in Pakistan can benefit from. In this regard, we would be borrowing extensively from external sources to keep our readers updated of the latest developments in this sector.*

This edition is an **Introduction to Behavioral Economics** and will serve as a guide to help understand the basics of this field. The first section focuses on explaining what behavioral economics is with the help of illustrative examples and research findings. The next section explains the terms commonly used in the field of Behavioral Economics. This would help the readers acclimatize to the terms and help them better understand articles in future newsletters.

Your valuable suggestions and ideas are much waited for and appreciated. We are also open for partnerships with other teams working in similar domain. Please feel free to write to us at caf@gallup.com.pk.

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What is Behavioral Economics?

What is behavioral economics?

Behavioral economics is usually described as being in contrast to traditional economics. Traditional economic theory assumes that all humans are rational and that they maximize their interest or "utility" at all times. Shakespeare wrote in Hamlet:

*“What a piece of work is a man! How noble in reason! How infinite in faculty! In form and moving how express and admirable! In action how like an angel! In apprehension how like a god!
(Act II, Scene 2, of Hamlet)”*

Idea in Brief

THE QUESTION

What are the differences between Traditional Economics and Behavioral Economics?

THE RESEARCH

Unlike the rational economic man in traditional economics, people seldom act in their best interest, even after they have been given all the information.

THE FINDINGS

According to Behavioral Science:

- Small changes can have significant effects.
- Psychology is critical as people cannot always explain why they do what they do, or what they want.
- Preference is relative, social and contextual, not absolute.

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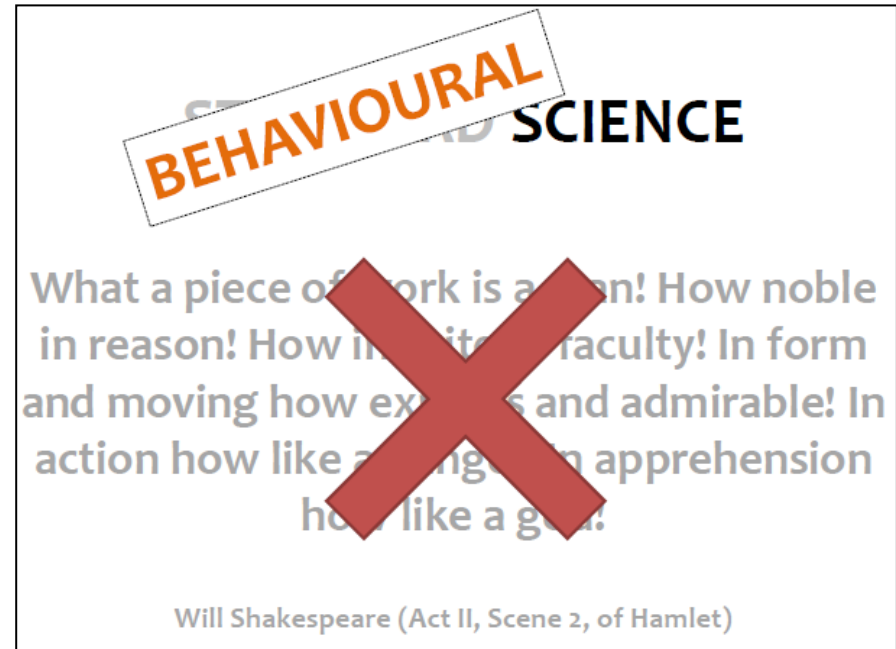
This can best be illustrated by the example that if humans did in fact always acted in their best interest, then no one would ever overeat and everyone would exercise regularly. All the people would then save a considerable amount for retirement, and no one would ever overspend.

In the traditional model of a rational economic man, a big reason why people do not act in their best interest is just a lack of information. By that logic, If people only knew how fattening that cake was, no one would ever eat it! If this were true, the logical response would be to educate people and teach people how to eat better, how to exercise, or how to save.

The problem with this is that in most domains, this does not work. Everyone knows that a salad is a better option than a hamburger. But giving someone that knowledge does not

magically make the person chose a salad over a burger, that just seems so juicy.

A recent study looked at over 200 financial programs that focused on education, and the largest effect any of them had was a 0.1% variance.



SALAD vs. BURGER

When choosing between a burger and a salad, most people would not chose salad despite the common knowledge that salad is a healthier option. People are not always rational!



The Study

A recent study looked at over 200 financial programs that focused on education, and the largest effect any of them had was a 0.1% variance.

Framing of Options Matter

An experiment was conducted where people were asked to choose between two alternative cases of treatment (Treatment A and Treatment B) for a rare disease which is likely to kill 600 people.

- **Treatment A:** If this is adopted, 200 people will be saved.
- **Treatment B:** If this is adopted, there is a $\frac{1}{3}$ probability that 600 people will be saved and a probability of $\frac{2}{3}$ that they will not be saved.

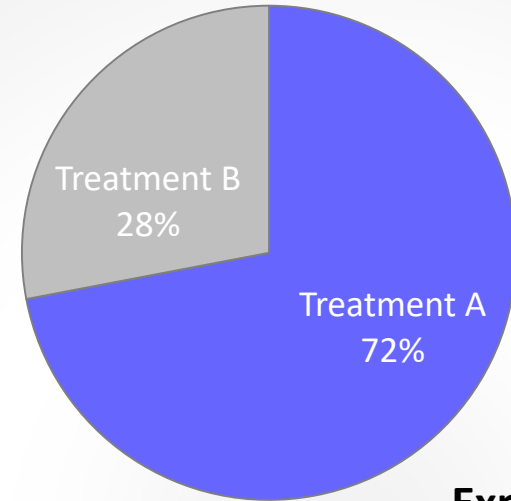
According to the results, 72% of the respondents chose Treatment A while only 28% opted for Treatment B (risk aversion for gains).



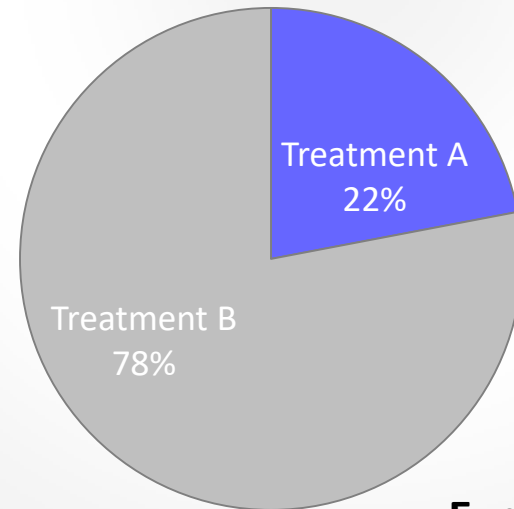
In a similar experiment, the options for the same problem were rephrased to the following.

- **Treatment A:** If adopted, 400 people will die.
- **Treatment B:** If adopted, there is a $\frac{1}{3}$ probability that no one will die and a probability of $\frac{2}{3}$ that 600 people will die.

This time the risk aversion for gains resulted in 22% of the respondents opting for option A while the remaining 78% opted for option B (Kahneman and Tversky (1984)).



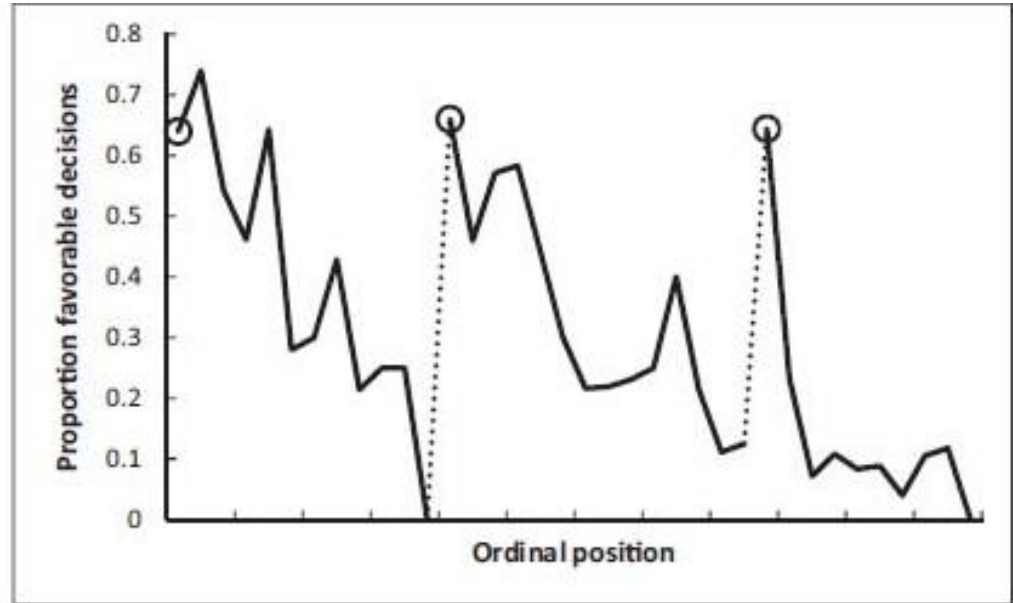
Experiment 1



Experiment 2

Judges Give More Favorable Decisions After Food Break

Figure: Proportion of rulings in favor of the prisoners by ordinal position. Circled points indicate the first decision in each of the three decision sessions; tick marks on x-axis denote every third case; dotted line denotes food break. Because unequal session lengths resulted in a low number of cases for some of the later ordinal position, the graph is based on the first 95% of the data from each session (Danziger, S., Levav, J., & Avnaim-Pesso, L. (2011)).



What really does work?

To date, scientists do not have a profound understanding of the shape of human brains as they do of the human bodies!

Moreover, for some strange but perhaps adaptive reasons, humans are also blind to their own level of ignorance about their psychology.

To understand this better, it is important to first enrich the vocabulary about Behavioral Economics.

A deeper understanding of judgments and choices that people make requires a richer vocabulary that is available in everyday language. The next section talks about this in detail.



Heuristics & Biases

There are distinctive patterns in the errors people make. People use Rules of Thumb to make judgments called '**Heuristics**.' Systematic errors are known as '**Biases**,' and they occur predictably in particular circumstances e.g. attraction effect. And these '**Biases**' are created because people believe they know what's going on in their minds – but most impressions and thoughts arise in their conscious experience without knowing how they got there. 95% of the decision-making happens in the subconscious.

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Here is an example to illustrate this effect. A group of people were shown a description of an individual by a neighbor and were asked to choose whether they think of that person as a librarian or a farmer:

"Steve is very shy and withdrawn, invariably helpful but with little interest in people or the world of reality. A meek and tidy soul, he has a need for order and structure, and a passion for detail."

Most of the participants replied with Librarian. However, when people were given the additional piece of information that for

Heuristics

- ✓ Rules of Thumb are called '**Heuristics**'
- ✓ Biases are created when people use these Rules of Thumb to make judgments
- ✓ Example: Resemblance

Biases

- ✓ Systematic errors are known as '**Biases**'
- ✓ They occur predictably in particular circumstances
- ✓ Example: Attraction effect

every 1 Librarian there are 20 Farmers in the US, their response changed. The human mind uses resemblance as a simplifying heuristic (rule of thumb) to make a difficult judgment, and the reliance on heuristic causes a predictable bias (systematic error) in the prediction.

***The human mind uses
resemblance as a simplifying
heuristic (rule of thumb) to
make a difficult judgment.***

Similarly, in another experiment people were asked to choose one of two options that they think best fits the description given about a girl Linda:

Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations.

The two options given were:

- 1) Linda is a bank teller
- 2) Linda is a bank teller and an activist in the feminist movement.

20% of the respondents chose the first option while the remaining 80% of the respondents chose the second option. This again shows that judgment was made by heuristic (Kahneman and Tversky (1984)).

Anchoring

A group of participants was asked to imagine a Wheel of Fortune that was spinning which eventually comes up pointing to 65 or 10. They were then asked if they think that the percentage of African countries in the UN is above or below this number? The respondents were then asked the percentage of African nations they think are in the UN. Most of the respondents replied with an answer between 47% and 28% (Kahneman (2011)).



This phenomenon is known as '**Anchoring**', which occurs during decision making when individuals use an initial piece of information to make subsequent judgments. Arbitrary, irrelevant numbers may influence our judgments about value and utility due to which anchoring is regularly used in marketing.

Attraction

The Economist

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68%

The Economist

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- ☐ **C. Print & web subscription** - US \$125.00
One-year subscription to the print edition of *The Economist* and online access to all articles from *The Economist* since 1997.

84%

Attraction

A group of 100 MIT students were asked to choose a subscription option (A or B) for *The Economist* in the first set. **68%** of the students chose option A while the remaining **32%** chose option B.

In the second set, another option was added and students now had to choose a subscription from the three given options: A, B and C. This time, **16%** chose option A, no one chose option B and the remaining **84%** chose option C.

This famous experiment conducted by Dan Ariely illustrates the **Attraction Effect**. Adding a third option to the second set increased the selection of the “Print and web subscription” option from 68% to 84%. This increase can be attributed to “the Attraction effect, a phenomenon in which adding an irrelevant alternative into an existing choice set increases the proportion of people choosing an alternative from the original set” (Huber, Payne, & Puto, 1982).

This can also be explained by a concept known as relativity. We not only tend to focus on comparing things with one another but also tend to focus on comparing things that are easily comparable.

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