

Today we finish our mini-tour of economists, by talking about DANIEL KAHNEMAN (pronounced 'Caan - uh - mun'), an economist who was born in Israel in 1934, and is still alive today. He is most famous for undermining one of the most basic beliefs that underlies the subject of economics - which is that people, if given sufficient information, do what is in their interests. Kahneman has spent his life arguing that this is not true - that our brains suffer from certain biases which mean that in quite a lot of situations we don't do what is in our interests.



The idea that people - if they are well-informed - do what is in their interests is absolutely fundamental to the study of economics. It's this idea that allows economists to formulate certain economic 'laws', which predict how people will behave. For example, suppose that you set up business cutting people's hair. Economists will tell you that if you want lots of people to come to your shop to get their hair cut, you should charge less for cutting people's hair than other hairdressers in the area. If you charge less, people see that it is in their interests to have their hair cut by you, rather than one of your competitors, because that way they will save more money. And as people - if they have the right information as to how much you are charging to cut people's hair, and how much other people are charging - will act in their interests and flock to your shop to have their hair cut by you.

But if you have set up your hairdressing shop and find that not that many people are coming to have their hair cut by you, you might find that you will get more customers by INCREASING your prices. If this happens, this seems to violate the idea that people will always act in their interests - why would people come to your shop to have their hair cut now that you are charging MORE to cut people's hair than you were in the past? But the economists - who are very clever people - have an explanation for this. They will say, 'Ah, this doesn't violate our belief that people act in their interests. What is happening here is that by increasing your prices you have made people believe that you are an amazing hairdresser who deserves to be paid top dollar for cutting people's hair. And so they are coming to your shop to have the experience of having their hair cut by an amazing hairdresser - which is in the interests, even though it will cost them a lot of money.'

So this example - of getting more customers by increasing your prices - doesn't show that the economists are wrong to believe that people, if properly informed, will always act in their interests. But Kahneman - along with his long term collaborators AMOS TVERSKY and RICHARD THALER - attempted to come up with examples of people not acting in their interests, because they suffer from internal biases that stop them realising what is in their interests, even though they have all the information they need to know what it is in their interests to do.

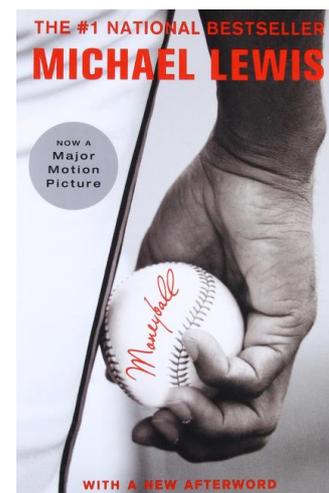
One of the most famous biases that Kahneman identified is the ENDOWMENT EFFECT, which goes like this. Imagine these two different situations. The first is that I have a chocolate bar, which you want to buy. How much would you be willing to pay for it? Think of a number - and maybe write it down. The second situation is that YOU have a chocolate bar (the same kind as in the first situation), which I want to buy. How much would you be willing to sell it to me for? Think of a number and compare it with the first number. Is the second number higher? When Kahneman and his friends asked loads of people this sort of

question, they found that the second number was normally higher. This is an odd result, if people always act in their interests - if you would be happy to pay (say) £2 for a chocolate bar, you should be willing to sell the same chocolate bar to me for £2. Kahneman argued that what is going on here is that people get attached to what belongs to them (even if they have only just bought it) and so want to be paid more for giving up a chocolate bar that belongs to them than they would be willing to pay to acquire the exact same chocolate bar. And that's the endowment effect - where 'endowment' means 'what belongs to you'.

The endowment effect results in another cognitive bias, which is LOSS AVERSION. Suppose that I say to you, 'I am going to toss this coin in the air and see how it lands. If it lands heads up, then I will pay you £30. But if it lands tails up, then you will pay me £10. Deal?' You inspect the coin and it seems perfectly fair to you - there is a 50-50 chance of the coin coming up heads or tails. So basically, I am suggesting that you take a 50% chance of losing £10 in order to get a 50% chance of winning £30. If you did what was in your interests, you would take the bet - a 50% chance of winning £30 is worth more than a 50% chance of losing £10. But a lot of people wouldn't take the bet. They are loss averse. They prefer to keep the £10 that they already have in their pocket, rather than take a 50% chance of losing it in order to obtain a 50% chance of winning £30. Would you take the bet? If not, how much would I have to offer to pay you if the coin lands heads up to make it worth your while to take a 50% chance of losing £10 that you already have? £50? £100? The more money you would need me to offer you to take the bet, the more loss averse you are. And Kahneman argues that EVERYONE is loss averse to some degree - it is built into our brains to be like that. And that leads us to refuse bets that it is actually in our interests to make.

The idea that people don't necessarily act in their interests, even if they have all the information they need to act in their interests, has become a very powerful theme in the books of the financial writer MICHAEL LEWIS, who wrote a whole book about Daniel Kahneman called THE UNDOING PROJECT (terrible title, and actually not that interesting a book). His best two books on this theme have both been turned into brilliant films - MONEYBALL and THE BIG SHORT.

'Moneyball' is about an American baseball team, the Oakland Athletics, which had very little money to spend on acquiring players compared with big baseball teams like the Boston Red Sox or the New York Yankees. But it saw something that the Red Sox and the Yankees didn't - that there were players available who would make brilliant baseball players, but because they didn't fit the image of what a great baseball player looked like, no one wanted to buy them and so they could be acquired really cheaply. So the ingrained bias among the big baseball teams in favour of thinking that baseball players were powerful and athletic meant that they didn't actually act in their interests - they ended up ignoring players who might actually have done a really good job for them, leaving them to be picked up by the Oakland Athletics, under their general manager BILLY BEANE.

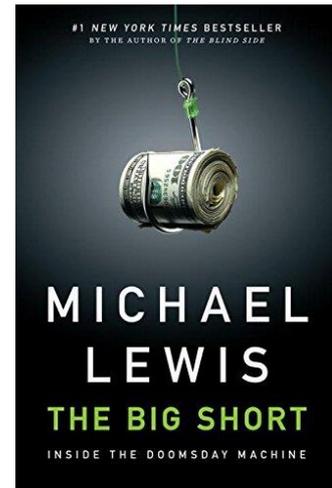


'The Big Short' is about a small group of investors who saw what no one else could in the run up to the economic crisis in 2008 that I told you about on Wednesday - that the American housing market was about to crash. They found a way of betting on the American housing market crashing and made millions of dollars when that happened. No one else saw the crash

coming (the Queen even asked the British Prime Minister Gordon Brown why no one saw it coming) because they simply assumed that house prices always go up. Their ingrained bias to think that house prices were somehow immune from going down prevented them from seeing what this small group of investors could see - when it was hugely in their interests to be able to see the crash coming.

While the film of 'The Big Short' might be a bit complicated for you to follow, you can easily and should definitely watch 'Moneyball' - one of the best films made in the last 25 years. Here is a small taste of it:

<https://www.youtube.com/watch?v=Tzin1DgexIE>



Kahneman's work has proved hugely influential - in fact he is credited with having founded a whole new branch of economics, known as BEHAVIOURAL ECONOMICS, which involves studying how people actually behave rather than imagining (as economists did before Kahneman) that people will do whatever it is in their interests to do, provided that they are properly informed. Kahneman's ideas have been particularly popular with governments, who like the idea that they can take advantage of the biases in our brains to encourage, or NUDGE, us to act in particular ways. For example, there now exists in the UK a BEHAVIOURAL INSIGHTS TEAM, which is partly owned by the British government, which advises the government on how to FRAME our choices in a way that will encourage us to make the choices that the government wants us to make. As you'll see from their website:

<https://www.bi.team/>

the Behavioural Insights Team has been particularly active in advising the government in the recent coronavirus crisis.

For example, if the government wants to encourage us all to wear masks, one way in which it could do it is by emphasising the positive effects of wearing masks - if we all wear masks, the virus will have nowhere to go and will soon die out. But the existence of the endowment effect, and loss aversion, indicates that a much more powerful strategy is to emphasise that you will personally lose something if you don't wear a mask. And that's why government ministers say things like if you don't wear a mask, you will kill your grandmother. By framing the choice whether or not to wear a mask in that kind of way, the government tries to take advantage of the endowment effect and loss aversion, in order to get them to wear a mask.

## Don't kill granny with virus, warns Hancock

Health secretary blames new spike in Covid cases on middle-class youth

Chris Smith, *Westminster Editor*  
Rosamund Bennett, *Education Editor*

Young people have been urged by the health secretary not to "kill your gran" through spreading coronavirus after an increase in cases led to calls for mass testing of students.

Matt Hancock said that "different younger people" were behind a sudden rise in infections that has caught ministers by surprise and raised fears over the start of the university year this month.

A further 2,548 confirmed cases of coronavirus were announced yesterday after 2,388 were reported on Sunday, a sharp rise from 183 on Saturday and up from a low of 250 daily cases in the middle of July.

Mr Hancock said that he was concerned by the imminent arrival of a million students at universities and revealed that data from the Joint Biosecurity Centre, due to be published this week, would show that the highest infection rates were in people aged

between 17 and 25. While younger people were less likely to die, he said that infections would not stay in this age group. He warned: "Don't kill your gran by sticking coronavirus and then passing it on. And you can pass it on before you've had any symptoms at all."

Student and lecturer leaders called for tougher action to keep student halls, including regular testing which is at present planned by very few universities. Fresh guidance for universities is due this week and government sources

said that precautions already planned would be sufficient to get students back safely.

Jonathan Van-Tam, deputy chief medical officer for England, spoke last night of his "great concern" over the infection figures, saying that "people have relaxed too much" and that there was now a "general sweeping geographic trend across the UK". He warned: "If we are not careful we are going to have a bumper ride over the next few [months]." *Continued on page 2, col 3*

But a lot of people object to this, and say that the government shouldn't MANIPULATE people into acting in particular ways - that it should just give us the facts and let us decide. But Kahneman's work indicates that if you do that, people won't act in their own best interests. MILTON FRIEDMAN used to say that we don't have to choose, as a society, between being free and being wealthy - by being free, we can be wealthy. But what if that's

not true? What if there is a choice to be made? The existence of something like the Behavioural Insights Teams shows that the government has been persuaded by Kahneman and his collaborators that a choice does have to be made and that it would rather that we be made wealthy by being nudged into making good choices, than that we be left free to choose for ourselves what to do, even if that means making poor choices. Is the government right? What do you think is more important (if we have to choose between them) - liberty or wealth?