

Barack Obama and the Promise of Behavioural Economics

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Since voting for change, it is uncertain whether the American people are really prepared to change themselves. President Barack Obama has an opportunity to really change America for the better, he has already begun to embrace behavioural economic ideas and can continue to do so. For someone who is recognised as an excellent orator, the promise of behavioural economics is great, as so much of it relies on being aware of the knowledge gap between model and reality. Behavioural economics is applicable to many areas of President Obama's challenge in America from healthcare to the environment.

When Barack Obama took up office in January 2009, the world expected great things. His ambitious campaign slogan, 'Change, we need' was popular amongst Americans. However, wanting things to change is easy, the difficulty comes when people are required to actively decide to make changes to their own lives. The field of behavioural economics looks at reason to explain why people make seemingly irrational decisions, including this paradox of wanting change but not enacting it. Barack Obama's economic advisers showed him how to use behavioural economic theory to help him win the presidential election and now his main priorities as president; the environment and healthcare can both benefit from its insights. Whilst some critics have accused President Obama of using his skills as an orator to say much and mean very little, in this essay I intend to show that in today's world perhaps Obama's style of rhetoric can be as important and effectual as action. A major problem is that the old economic theories use perfect knowledge, whereas in reality there is often very little information available. President Obama's skill at speaking and most importantly being listened to, means he can make best use of the promise of behavioural economics in order to bridge a gap between economic theory and economic reality and encourage Americans to see the benefit in changing some aspects of their lifestyles.

The first hurdle for Barack Obama was motivating voters to go to the polls. Whilst his message of change was popular, nobody could be sure if America was ready for a black president and it was likely many would vote republican in protest at the very concept. To win the election, Barack Obama needed to ensure that voter turnout was high. In recent times, many theorists have explained voting behaviour using economic theory. Antony Downs (1957) put forward a theory, that voter turnout is falling in most countries not because of disillusion or apathy, but because voting is in fact an irrational act. A rational act is one where the marginal benefit is more than the marginal cost. In a world where we do not have perfect knowledge, the cost of voting includes not just the physical effort of travelling to a polling

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station, but also the effort of gathering the information relevant in order to vote wisely. The marginal benefit is the gain a person gets from casting a deciding vote for the winning party. It must be a deciding vote, otherwise the outcome would have been the same whether or not the person had cast their vote, rendering voting would have been unnecessary. Comparing the expected cost of becoming well informed about politics and the expected benefit in the event of casting the deciding vote in the election where it seems that each vote bears an insignificant effect on the outcome, the cost far outweighs even the possible benefit. Thus ‘the incentive to become well-informed is practically non-existent’ (Downs (1957)) and a rational agent would choose not to vote.

In ‘The New Economics’ David Boyle and Andrew Simms (2009) have applied a more behavioural theory, suggesting that the voter turnout is low in areas where there is less community spirit using. Specifically, they claim that near to a Wall-Mart store a lower proportion of the population will vote. In areas where there are smaller, local shops people will be part of the community, they will know each other and talk with each other. When it comes to voting they will discuss politics together be more inclined to vote because everyone else in the community is doing so. In contrast, when there is a Wal-Mart store nearby, ‘opportunities for dialogue and interaction among local citizens may be reduced.’ (Goetz and Rupsingha (2006) Subsequently, voter turnout falls as people are less acquainted with political ideas and have no community to take lead from. Barack Obama embraced the ideas of behavioural economics in order to get as many people to vote as possible. He uses the theory that people want to act in a way that is socially acceptable. In order to increase the vote he encouraged the message that “A Record Turnout Is Expected.” (Grumwald (2009)) According to psychologist Robert Cialdini, “People want to do what they think others will do” (Grumwald (2009)) and reading that there will be a high turnout rallies people into voting in order that they will not be seen to be deviating from the social norm. This principle is one the new economics foundation calls the first basic principle of behavioural economics, “Other people’s behaviour matters: people do many things by observing others and copying; people are encouraged to continue to do things when they feel other people approve of their behaviour”.¹

By the time Barack Obama became president one of the major problems facing him was the state of the economy yet, it was important for him not to forget the larger plans that he has for America. Part of Barack Obama’s plan for the economy, for example, centres on the environment, through the a “green stimulus package”. (Margonelli (2009)) Another basic principle of behavioural economics according to the new economics foundation is that, “people need to feel involved and effective to make a change: just giving people the incentives and information is not necessarily enough.”² This is taken into account in the green stimulus plan, which suggests that “America cannot limit carbon emissions without reinventing the grid” (Margonelli (2009)). The suggestion is creating something called a smart-grid, which will “let people control how much power they buy, when and at what price” (Margonelli (2009)). By allowing people to take direct control of how much energy they use people will feel they have more power and control, more say over what their energy use. Crucially, they are provided with more information to use in analysing the decision to use energy. If people are more clearly aware of how

¹ <http://neweconomics.org/publications/behavioural-economics>

² <http://neweconomics.org/publications/behavioural-economics>

much energy they consume, they are also consciously aware of the opportunity cost of using that energy. Once a person realises that it costs them money to leave a light on in an empty room, they will consider the other things that they could buy with the money that would give them more satisfaction. Suddenly, the benefit of saving electricity far outweighs the cost of exerting energy by turning off light and power switches when leaving a room.

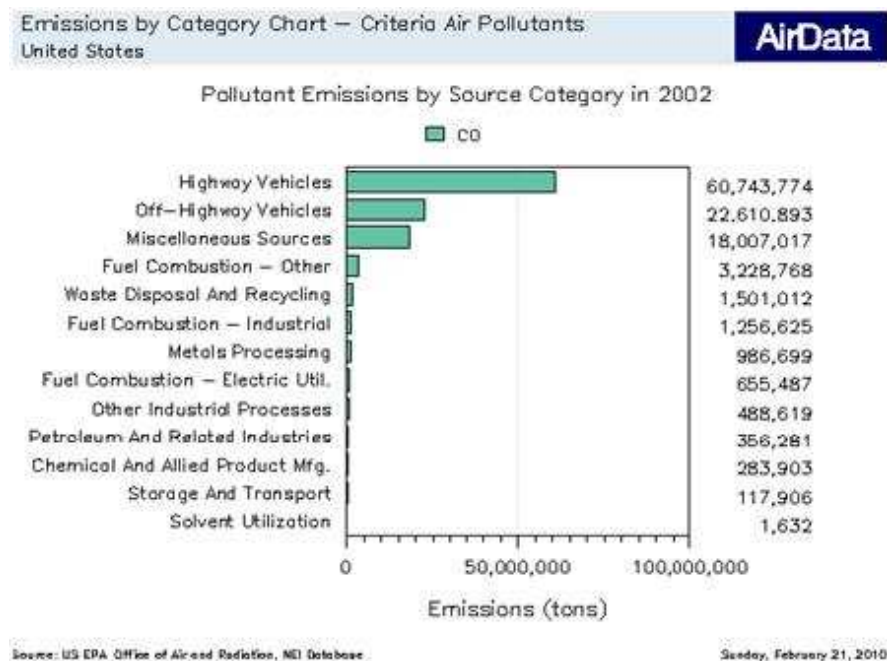


Figure 1 - Breakdown of sources of CO emissions in US 2002

It is no surprise that Barack Obama is using the economic crisis as a chance to implement green policies, one of his hardest tasks is convincing the American people that the environment is vital. More than anywhere else in the world, society in the United States revolves around practices that are detrimental to the environment. Figure 1 shows the proportion of carbon emissions, specifically CO emitted by different sources in the US in 2002.³ Over 83 million tons are emitted by vehicles on the roads of the US, more than three times the amount released from all other sources. The number of cars owned per person is significantly higher in the United States than anywhere else in the world⁴, as demonstrated in figure 2, which shows 765 cars are owned per 100 people. These figures demonstrate the reliance of American society on the car. This is one reason why people find it hard to change their behaviour – status quo bias. Due to the lack of perfect knowledge the decision maker does not always know which is the most rational decision to make. The decision maker is likely to “stick with their current choice if the utility is sufficiently high” (Samuelson and Zeckhauser (1988)) for fear that any other decision may provide less utility. This creates a problem in encouraging the people of the United States to use more fuel-efficient cars or public transport. Recognising this theory however also suggests

³ <http://www.epa.gov>

⁴ http://www.nationmaster.com/red/graph/tra_mot_veh-transportation-motor-vehicles&b_map=1

the solution. Providing more information on the alternative choices will make them seem less ominous and make it easier to compare rationally. This in itself may not be enough, as people are often dubious to accept what they are told. Another potential solution would be allowing people to try out the alternatives at less cost before committing to it. For example, free public transport day, or tokens or a month when a company is allocated money to spend on subsidising its employees public transportation to the office. Equally giving people free trial periods with electric or hybrid cars. These solutions all allow the consumer to see the alternatives and in the future, when the subsidy has been stopped or the trial finished, they will be more inclined to make that decision at the full cost.

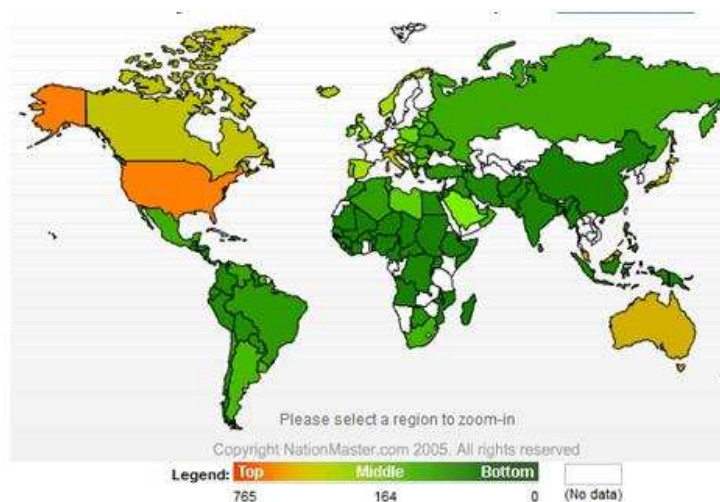


Figure 2 – Car ownership per 100 people in the United States 2005

With the healthcare bill providing more and more problems, Barack Obama could turn his attention to finding ways of putting less strain on the existing health service. Once again, this involves changing people's behaviour, recognising that they do not make rational decisions currently and helping them to re-evaluate those decisions and make more rational ones. The strain put on the health service by self-inflicted health problems, for example those who need treatment due to problems arising from smoking or over-eating. In traditional economics, the idea of externalities is used to discourage harmful behaviours like smoking. A negative externality is an extra cost that is not recognised by the consumer - a cost both to the individual and to society. Government can put a tax on the product in order to shift the supply curve and consequently cause a movement along the demand curve. This is partly effective, as a higher price will ration the product to those with enough money to consume it.

The problem is that people underestimate the cost more than is taken into account in the theory of externalities. As the bottom of figure 3 illustrates, in order to move the purchased down to Q2 the tax (t) on cigarettes would have to be much higher than calculated originally. This is because of time inconsistency. This theory suggests that even when a person has all of the information and knows that they are likely to suffer negative effects from something in the future they value the present much more than the future and still make the decision to smoke or eat fast food for the benefit in the short term. To demonstrate to extent of this, consider that it is often said that smoking shortens your life. A New York

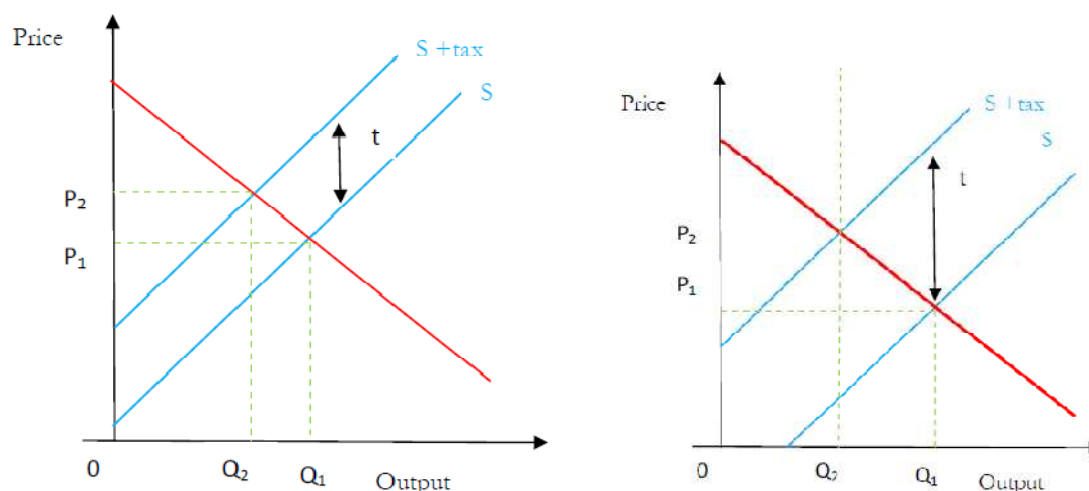


Figure 3 – Externalities and time inconsistency

health guide suggests that each cigarette a person smokes shortens their life by 11 minutes⁵. With information of this kind it is hard to understand why any rational person would decide to smoke. Figure 4 shows an indifference curve between cigarettes and life. A rational human's indifference curve would not show a willingness to trade life for a cigarette, however given that people do not value the future as high as the present many consumers' do just that. Recognising this inconsistency shows that certain things will not be discouraged using taxes and probably not even through increasing information, as even with the knowledge of what is to come, people act with a bias towards the present. This is an important thing for Barrack Obama to use in America. Publicity telling of the problems with smoking, alcohol or fast food is unlikely to discourage it, rather it could be seen by people as an attempted encroachment on personal liberty and engender feelings of animosity towards the government, reducing their efficacy and authority in other areas.

Another important problem with healthcare in America can be enlightened with the concept of herd behaviour. This theory claims that often the decisions that people make are not entirely rational, but simply based upon the assumption that what other people are doing is what they should be doing. Opt out schemes are an effective way of using this, for example when it comes to saving for retirement or becoming an organ donor. If the default option in something is changed to the one that is better for people, it is unlikely that people will change back to the original option because they believe that everyone must be picking the default option and therefore they should do the same. This is a very simple but very effective way of encouraging a change in behaviour. When a clean energy plan was created in Germany it was almost entirely ignored. When it became the default option 94% of people stuck with the decision that had been made for them. (Grumwald (2009)) If being an organ donor became the default in America, perhaps there would be an equally overwhelming change in the supply of organs for those who could not be discouraged from smoking or drinking in excess.

⁵ <http://www.nyc.gov/html/doh/downloads/pdf/chi/chi24-4-pktguide.pdf>

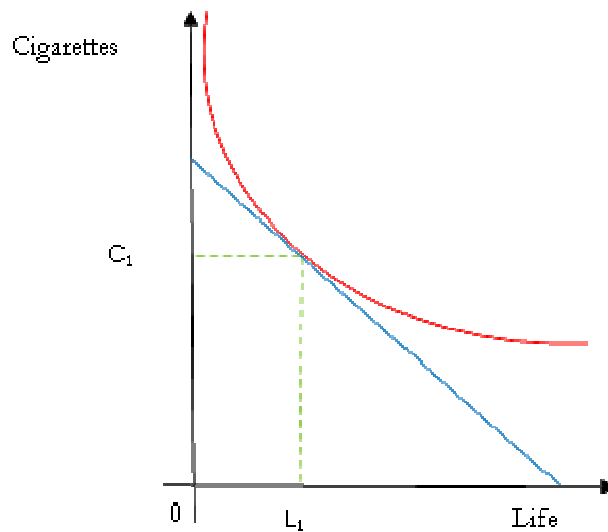


Figure 4 – Indifference curve showing smoking and life

Traditional economic theory presumes perfect knowledge. This is rarely, if ever the case when the model is applied to reality. The task of behavioural economics can be explained as trying to “replace the global rationality of economic agents with a kind of rational behaviour that is compatible with the access to information and the computational capacities that are actually possessed” (Simon (1955) by real people. The promise of behavioural economics lies in its recognition of the impossibility of completely rational choices, due largely to lack of knowledge, communication and information. Barack Obama’s skill as a speaker mean he is in a perfect position to use behavioural economics to bridge this gap between theory and reality. He has embraced new technologies like youtube in order to connect with the American people. This takes an important step in improving the knowledge of people, making them feel more involved. Whilst honesty is not always the best political strategy, President Obama has committed to it. Such a focusing on providing as much information as possible can bridge the gap between economic theory with its perfect knowledge and economic reality. Providing this information along with being aware of certain irrationalities in decision making as exemplified by herd behaviour, status quo bias and time inconsistency could be the difference between failure and success for Barack Obama. The United States of America has voted for change, now they must be shown that in their everyday lives the benefit of striking out from the crowd and changing their decisions today far outweighs any expected cost. The rhetoric and ambitious talk that can lead to President Obama being labelled an idealist are not empty words, but aspects of the wider promise of behavioural economics and attempts at increasing the knowledge of the American people.

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