Nobel winner: We're more Homer Simpson than Mr. Spock

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In classical economics, individuals are highly intelligent, perfectly rational and capable of unemotionally analyzing all relevant data. They possess tremendous self-control, enabling them to make optimal decisions, unburdened by biases or other "supposedly irrelevant factors," or SIFs. Picture Mr. Spock in "Star Trek."

In reality, these "Econs" are mythical characters existing only in theory. Not only are humans highly emotional and lacking in self-control, they are influenced by all sorts of biases and SIFs. They act on biases in irrational and predictable ways, often leading to poor decisions. In fact, we're more like Homer Simpson.

So says Richard Thaler of the University of Chicago's Booth School of Business (my alma mater), a pioneer in the field of behavioral economics, the study of how psychology and economics intersect. He was awarded the Nobel prize in economics on October 9 because "by exploring the consequences of limited rationality, social preferences and lack of self-control, he has shown how these human traits systematically affect individual decisions as well as market outcomes."

If irrational behavior can be predicted, then it's possible to design interventions or "choice architectures" to "nudge" people to make better decisions. That's the insight of Nudge--Improving Decisions About Health, Wealth and Happiness, which Thaler wrote with Harvard's Cass Sunstein in 2009.

We know we need to save for retirement, so why is low savings a looming crisis?

Thaler and UCLA's Shlomo Benartzi devised the "Save More Tomorrow" plan to increase participation *and* savings rates in company retirement plans. Participation increased four-fold with the simple nudge of changing to automatic enrollment (with opt-out option) from the traditional opt-in requirement. Savings rates were also boosted by enabling participants to elect today to sock-away higher proportions of future raises.

This protects them from spending and becoming dependent on higher earnings, leading to what my friend Peter Dunn (aka "Pete the Planner") refers to as the insidious, retirement-wrecking disease of "lifestyle creep."

In 2015 Thaler followed-up with Misbehaving—The Making of Behavioral Economics, which traced his scholarly journey, much of which wasn't academic.

Thaler and Wharton's Cade Massey wrote "The Loser's Curse: Overconfidence vs. Market Efficiency in the NFL Draft" in 2010 because they were fascinated by teams paying a king's ransom of current and future draft picks to move-up (like the Redskins in 2012 and Bears this year).

They cited five factors, also applicable to investing. First, people are ***overconfident*** in their abilities to differentiate player potential (i.e. the first QB selected ends up better than the second only 56% of the time). Second, people make ***forecasts that are too extreme*** (i.e. "the next Peyton Manning"). Third, the **"winner's curse"** says the one bidding highest for a coveted player is likely overpaying. Fourth, the "**false consensus effect"** means a team falling in love with a certain player "knows" every other team also wants him. Fifth, teams are afflicted with a **"present bias,"** obsessing over the short-term and irrationally valuing current year picks much more highly than future draft picks.

Their advice: trade down in this year's draft and trade picks this year for better picks next year.

Humans have always been more Simpson than Spock, but it took Thaler and other behavioral economists to explain how we can overcome our systematic biases.
