

They Thought We Were Ridiculous:

The Unlikely Story of Behavioral Economics Episode 2: Importing Psychology

Synopsis

Daniel Kahneman and Amos Tversky were two psychologists with big ideas about how people made decisions. Their careful research launched a brand new way of understanding people's choices, and it helped fan the flames of Behavioral Economics.

- Two psychologists showed how people make systematic mistakes in judgment.
- People rely on quick mental shortcuts in decision-making.
- A single question could short-circuit the rational mind.
- We understand people better when we marry psychology and economics.

DANIEL KAHNEMAN: I remember discovering that economists actually believe that stuff. I mean, I remember that as a, you know, because they were in the building next door and it seemed, you know, that something that to a psychologist would look ridiculous, was doctrine and, you know, that's, that's what their theory was based on. But we were not thinking of changing economic theory.

Introduction

ANDY: Welcome back to They Thought We Were Ridiculous, a podcast series about young social scientists who dared to challenge the most basic assumptions of their field...and won. I'm Andy Luttrell.

KURT: I'm Kurt Nelson.

TIM: And I'm Tim Houlihan.

ANDY: And this time, this scrappy field of behavioral economics picks up steam with a few critical insights and collaborations. In the last episode, we met Richard Thaler, the guy who kept noticing that his beloved field of economics couldn't actually explain what he saw his friends and family doing, and we saw how the stage was set for him by the economist Herb Simon, who as far back as the 1940s was writing about how people don't always make choices in the strictly rational way economists say they do. But why didn't his ideas catch on back then? Here's Richard Thaler.

RICHARD THALER: Herb Simon came along well before me and was talking about bounded rationality, but he kind of gave up talking to economists. He found them too annoying. And the reason that he didn't make any headway is he didn't have the idea of systematic bias

ANDY: Systematic bias. He's saying that it wasn't enough to just claim that people stray from being rational. What was missing was a keen sense of *how* people were irrational. Sure, people make choices that aren't optimal, but do they consistently make the same kind of mistakes over and over again? If we could crack that nut, we'd be in business. And luckily, two young psychologists had some bright ideas at exactly the right time.

The Story of Kahneman and Tversky

AMOS TVERSKY [Archival¹]: Hi, my name is Amos Tversky from Stanford University.

TIM: Amos Tversky grew up in Israel, went to college at Hebrew University of Jerusalem, and finished a PhD in psychology at the University of Michigan. Unfortunately, he died in 1996 when he was just 59. We would have loved to talk to him.

KURT: But what he's almost certainly best known for was the work he did with his friend and longtime collaborator, who we did get to talk to: Daniel Kahneman.

DANIEL KAHNEMAN: By the way, you should call me Danny, because that's, that's what everybody calls me.

KURT: Danny was also from Israel and spent much of his childhood in Paris where he and his family survived the Nazi occupation during World War II.² He experienced first hand how very brutal German soldiers could also be very kind to a child – even a Jewish one. Fast forward to 1969, and he was teaching a psychology class at the Hebrew University of Jerusalem. He'd heard that Amos Tversky was a rising star in the field.

TIM: They actually overlapped for six months at the University of Michigan before this, but never had occasion to get to know each other. They were just swimming in their own lanes.

KURT: So now they were both at Hebrew University and still not having much to do with each other. By the way, there *was no* competition here – as some students were guessing at the time. It really was just two brilliant guys doing their own thing on separate tracks.

TIM: That is until one day Kahneman invites Tversky to present to his students in this seminar. Kahneman said he could present on whatever he wanted, so Tversky decided to talk about some work by his old colleagues at Michigan: research looking into whether people's intuitions match the laws of probability and statistics.

ANDY: Um...spoiler alert: they don't. But we'll come back to that.

TIM: Anyhow, Kahneman was intrigued, and the two met for lunch later that week to keep the conversation going. One lunch turned into another, and by the end of the year, you could usually find them together, talking and laughing, and debating.

DANIEL KAHNEMAN: We, we did everything together. I mean, we, for the first few years, we actually were not working on the problem when we were alone. We only worked together.

KURT: But from the outside, it was hard to see where this chemistry came from. In his biography of the two, Michael Lewis writes: "Danny was always sure he was wrong. Amos was always sure he was right. Amos was the life of every party; Danny didn't go to the parties. Amos was loose and informal; but Danny had an heir of formality. Danny was a pessimist. Amos was not merely optimistic; he willed himself to be optimistic. Danny took everything seriously; Amos turned much of life into a joke."

¹ https://www.youtube.com/watch?v=zO0oLX_WEYQ

² Biographical details are drawn largely from Kahneman's book, *Thinking Fast and Slow*, and Michael Lewis' book, *The Undoing Project*.

TIM: And yet...it just worked.

DANIEL KAHNEMAN: We wrote every word of every paper together. We would go to a particular place in Jerusalem and sit together for hours and, you know, and, and do a few sentences a day. It's, it's called the Van Leer Institute. It's a very nice place. And at the time, you know, there was coffee at lib and cookies and we were great consumers of coffee and cookies. Uh, and, and it was a lovely place.

ANDY: How many coffee and cookies would you estimate went into that paper?

DANIEL KAHNEMAN: A lot, a lot.

Heuristics and Biases

KURT: But what was it that this inseparable intellectual duo spent all the time working on? What was their big breakthrough? Well, let's start with a question for *you*. What's more common? Death by homicide or death by stomach cancer? The right answer is death by stomach cancer. But a lot of people wrongly think that homicide is a more common cause of death.

TIM: And why is that?

KURT: Because we tell those stories more. We remember those stories more. So when we're cornered, and asked to guess what's more common, we quickly get the sense that we've heard plenty of news reports about shootings and other violent events, so that feels like it's more common. Even though there are more stomach cancer patients of the past, they don't come to mind as easily. Kahneman and Tversky called this the "availability heuristic." A heuristic is like a mental shortcut people take when they make estimates or judgments and they don't already know the right answer.³

DANIEL KAHNEMAN: What you do instead of computing probability, the way it ought to be done. What do you do instead...

KURT: Or in other words...

DANIEL KAHNEMAN: When you answer an easy question instead of a harder one.

KURT: So in this case, the hard question is which cause of death is actually more common, but the easier question is which of these evokes a more vivid memory.

TIM: And it's not like this is a terrible strategy. Most of the time, things come to mind easily because they're actually more common. But we apply this mental trick a little too exuberantly and we find ourselves making mistakes when the trick breaks down.

KURT: Like the research on asking people about cause of death statistics. In the grand scheme, the more common some ailment really is, the more common people think it is. Cancer, car accidents, and heart disease are tragically common, and intuitively we generally recognize that that's the case. We also know that smallpox, lightning, and botulism are uncommon because we reasonably don't have many examples of them to turn to. But tornados, drowning, homicide, those don't actually happen that often, but those cases are quick to make the news and spread through stories.⁴ So this mental trick, if you remember something easily, it probably happens a lot. It's

³ <https://doi.org/10.1126/science.185.4157.1124>

⁴ <https://doi.org/10.1037/0278-7393.4.6.551>

generally a smart way to save mental effort, but at the end of the day, it's still just a trick.

TIM: So that's the "availability heuristic," and they told the world about it in 1974 in a research article in the journal *Science*, which is a huge, important journal across all the sciences.⁵ But they actually reported their discovery of *three* heuristics...not just availability.

ANDY: Yep, and to appreciate the second heuristic, let's do another question. I want you to estimate the total number of babies born in the United States each year. I can tell you it's more than 100. Have a guess: number of babies born in the US every year. Do you have a number in mind?

ANDY: Okay, I actually don't know the real answer and that's not really the point anyway. The point is: how did you come up with your answer? Just a pure, unbiased estimate based on the things you know to be true about babies in the United States? Probably not. Because I gave you some leading information: I said it was more than 100. Now that's objectively *not* helpful or relevant, really. Of course, it's more than 100. You should just dismiss that bit of information completely. But that's not what people do. And we know this because sometimes researchers will ask people the same question but a little differently. Like, "How many babies are born in the United States each year – I can tell you it's less than 50,000." Okay, less than 50,000 is also not helpful. If we're being rational, we just make our guess the same way we would if you say it's more than 100.

ANDY: But in a recent study that asked those questions, people's guesses depended a lot on the question itself.⁶ If the researcher noted the answer is more than 100, people on average guessed that about 3,000 babies were born in the U.S. each year. But if the researcher noted the answer is less than 50,000, now people's average guess was that almost 27,000 babies were born in the U.S. each year. To swing from 3,000 to 27,000 based on some meaningless information? Now, *that's* a bias.

ANDY: Kahneman and Tversky called this the *anchoring heuristic*. When we estimate a number we don't already know, we will anchor on a starting point and move in the direction of the right answer until they feel like they've gotten there. This is reasonable enough, but the problem is that people usually don't adjust far enough away from their starting point. If I start at 100 babies, I'll mentally increase that number ... one thousand...two thousand...until hitting 3,000 babies born each year. And that seems about right. But if I start at 50,000 babies, I'll mentally decrease that number down ... forty thousand ... thirty-five thousand... until I hit 27,000 babies born. That seems right too, but it's clear from comparing different ways of framing the question that people are overly influenced by their starting points. Just like an actual anchor keeps a boat from straying too far in the ocean, our mental starting points when we make judgments, anchor us from straying too far.

KURT: Okay, we've seen availability, We've seen anchoring. Their third key heuristic was representativeness.

DANIEL KAHNEMAN: For me, representativeness was always the more interesting one.

⁵ <https://doi.org/10.1126/science.185.4157.1124>

⁶ These values come from a recent replication effort by Klein et al. (2014), but the original study was published by Jacowitz and Kahneman (1995).

ANDY: So to introduce us to this one, you should meet Linda, probably the most famous hypothetical lady in the social sciences. Here's what you need to know about Linda...

KURT: 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.

ANDY: Ok, what I want you to estimate, though, is which thing is more likely. Is it more likely that Linda is a bank teller? Or is it more likely that Linda is a bank teller and active in the feminist movement?

ANDY: If you're like most people, you thought the latter was more likely--that Linda was a bank teller and active in the feminist movement.⁷ But here's the thing...that *cannot* be true! Like everyone else, you're ignoring what statisticians call "base rates." Meaning, how many people in the whole world are bank tellers? And how many people in the whole world are bank tellers and active in the feminist movement? The second group *has* to be smaller. The base rate – the probability before we know anything else – is lower. Imagine there a 1,000 bank tellers in the world. The number of those bank tellers who are also active feminists *cannot* be bigger than 1,000. Rationally, Linda cannot be more likely to be in the second group than the first.

KURT: But it just *feels* like she has to be! You just said she's outspoken, politically active, and concerned with social justice. Come on.

ANDY: That's the thing: how it *feels* and how it *is* are different things. This is what Kahneman and Tversky called the representativeness heuristic. Just like everyone else, we find ourselves answering a question we were never actually asked.

DANIEL KAHNEMAN: This is just something that happens to you that instead, you are asked a question about probability, and you answer a question about similarity. But you think you have answered the correct question.

ANDY: Linda seems similar to feminists. She matches our stereotype of that group. She just has to be. But we get swindled by that similarity and ignore basic probability.

ANDY: Here's another classic research problem to consider. This one is about Linda's buddy Tom W, who is also a popular hypothetical character. Here's how Kahneman and Tversky described Tom to research participants in the early 70s⁸:

KURT: Tom W is of high intelligence, although lacking in true creativity. He has a need for order and clarity, and for the neat and tidy systems in which every detail finds its appropriate place. His writing is rather dull and mechanical, occasionally enlivened by somewhat corny puns and flashes of imagination of the sci-fi type. He has a strong drive for competence. He seems to have little feel and sympathy for other people, and does not enjoy interacting with others, he nonetheless has a deep moral sense.

TIM: They said this was a personality portrait of Tom W in high school, but now he's in grad school. How likely is it that he's studying Social Work? OR Medicine? OR Computer Science? They gave a list of 9 areas and had people rank them from what Tom was most likely to be doing to what he was least likely to be doing.

KURT: At the top of people's list? Computer Science. And I mean, come on. Mechanical writing? Sci-fi? A loner? This guy's a computer scientist for sure.

⁷ <https://doi.org/10.1037/0033-295X.90.4.293>

⁸ <https://doi.org/10.1037/h0034747>

TIM: But remember, they were asking this question in the early 70s. There were not a lot of computer scientists. And people knew it. But introduce them to Tom W, and they think "statistics be damned, this guy's a computer scientist if I've ever seen one." Substituting plausibility for probability. And it's not just these research participants who are biased. Kahneman knew he was onto something from the moment he let Tom W loose in the world.

DANIEL KAHNEMAN: I put an all-nighter at, at the Oregon Research Institute, and my task was to come up. I mean, I, I came up with Tom W. I wrote Tom W that night, and then the first person to arrive was Robyn Dawes.

TIM: Robyn Dawes was another psychologist who studied human judgment, and he was a "sophisticated statistician." No way he'd make an error in reasoning.

DANIEL KAHNEMAN: And I asked him, "Robyn, answer that question," and then he read carefully and then he had a slight smile, like somebody who solved the problem. And he said, "Computer scientist?"

KURT: Ah! So, even the smartest rational thinkers fall prey to the representativeness heuristic. We all ignore base rates.

DANIEL KAHNEMAN: And, of course, Robyn was an expert on base rates. So clearly, he was not using base rates, and he was completely aware of them.

TIM: So we've got three heuristics, or mental shortcuts, that people use to make judgments when they aren't in the mood to be perfectly rational: availability, anchoring, and representativeness. All of these make at least some sense, but they often result in wrong answers, biased judgments.

ANDY: But we should highlight something important about how Kahneman and Tversky told the world about these biases. There are a lot of big, important ideas in the social sciences that do not catch on. What made these heuristics different? It's that instead of devising complicated, intricate experiments, they instead developed...

DANIEL KAHNEMAN: The psychology of single questions.

ANDY: Single questions. How common is homicide? How many babies are born in the U.S.? Is Linda more likely to be a bank teller and an active feminist? That's the whole study. One question asked in a slightly different way to different people. And people's answers to a single question told the whole story.

DANIEL KAHNEMAN: It turns out that was essential to the success of the enterprise, which now is quite surprising. But, and that's because when we wrote the paper in *Science*, to people outside the profession, reading those questions could feel that this was working on them. They would not have believed it if we had described it in the language of experiments, but we were using these questions as demonstrations. I mean, you could sense what is going on immediately. And that's really, I think that's a story of why this particular work had so much impact. It is an accident of the medium that we chose.

ANDY: And this might make it seem like the research was easy. Oh, you just ask people one question and you're done? No, it had to be the *perfect* question. A question that lives right in the pocket of bias, that seems to make sense to people but holds a secret hiding in plain sight, some feature that tickles irrational brains so precisely that we're compelled to get the answer wrong. And to get it wrong everytime. That's what Kahneman and Tversky were doing with all that time they spent hanging out together.

DANIEL KAHNEMAN: You know, we spent our days talking and finding things very amusing and, and looking for irony in the way our own thinking went. So we were, we were looking for questions that we would find tempting to answer wrongly. And that was our heuristic for searching for heuristics. We had that general idea, and then we were looking for examples, and the examples turned out to be quite neat.

Prospect Theory

TIM: Okay, so Danny Kahneman and Amos Tversky rocked the social sciences with their landmark 1974 paper on heuristics and biases. It’s difficult to convey the incredible impact that paper had on the field. Analysts put it in the 10 most cited social science papers *ever*.⁹ That means other scientists are constantly referring back to it in their own work. But wouldn't you know it, Kahneman and Tversky have another paper in the top 10. They were only just getting started.

DANIEL KAHNEMAN: Prospect Theory, basically, is an attempt to describe realistically the main elements of people's choices under risk.¹⁰

TIM: Your brain is already soaked with a lot of ideas, and we don’t want to give you any more homework. But to appreciate the gist of Prospect Theory, think about whether you would prefer if I just gave you \$20 or if I gave you a lottery ticket with a 20% chance of winning \$100 and an 80% chance of winning nothing. So, either \$20 for sure, or a 20% chance of winning \$100. In cases like this, people tend to choose the sure deal. I’d rather take less of a sure thing than let the gods decide!

TIM: But here’s another question: Would you rather take a sure loss of \$75 – you just have to give me \$75 of your own money? Or would rather place a bet – take a lottery ticket – with a 25% chance that you don’t lose anything, but a 75% chance that you’ll actually have to give up \$100? So, either give me \$75 for sure, or a 25% chance of giving me nothing, but a 75% chance you’ll have to give me \$100, instead. In this case, people tend to take the bet.

TIM: But of course, rationally, there’s no real difference between the two questions and yet when it’s about getting money, people want the sure deal. And when it’s about losing money, people will try their luck to get out of it.

TIM: So, Prospect Theory came about as a way to make sense of these funny ways people grapple with risk and uncertainty.

DANIEL KAHNEMAN: You know, this could be an important paper. And if it turns out to be an important paper, we want a distinctive name for it. And so, Prospect Theory was just a distinctive name for a theory. But, but that really came because just in case it turns out to be important. We wanted to be distinctive.

Making Behavioral Economics

COLIN CAMERER: It was, it was that it was kinda like importing this product from psychology into the island of economics.

⁹ <https://blogs.lse.ac.uk/impactofsocialsciences/2016/05/12/what-are-the-most-cited-publications-in-the-social-sciences-according-to-google-scholar/>

¹⁰ <https://doi.org/10.2307/1914185>

DANIEL KAHNEMAN: Economists, thought that the whole thing was ridiculous. And they also thought that the work on heuristics was ridiculous because they didn't think that everybody does everything right, but they thought that errors were random. That is it's the idea that errors are systematic that violated their view of the world because their view of the world with the people are rational plus random perturbation. And that, by the way, was the key insight of Dick Thaler. That's what Dick Thaler – he read our paper – that's what struck him: errors are systematic.

TIM: Ah...Dick Thaler. The economist we met in the last episode. The economist who said...

RICHARD THALER: My biggest discovery was discovering Kahneman and Tversky.

TIM: Thaler had been keeping notes on how people in the real world didn't make decisions like the people in economic models. The models say people are rational. But people in the real world aren't rational – at least not always. And for a time, this was a curiosity. A set of anomalies. The main thing he was interested in was simply...

RICHARD THALER: These departures from rationality.

TIM: But these departures might just mean that people make random errors. They're not thinking clearly and so they're throwing darts at the board of economic decision-making.

KURT: But what if it's not random? What if, as Kahneman just emphasized...

DANIEL KAHNEMAN: Errors are systematic.

RICHARD THALER: That was a big light bulb going on. If you could predict when they were gonna happen, then you were in business.

TIM: So, Thaler was obviously excited when he was reading the early work on heuristics and Prospect Theory. It's one of those perfect moments where lightning struck twice at the same time. Thaler and other young economists were pushing back on the assumption that people are rational, and Kahneman and Tversky were studying the psychology of cognitive biases.

KURT: It was the perfect peanut butter and jelly moment.

RICHARD THALER: It was good because they didn't know any economics and I didn't know any psychology. So, as economists said there were gains from trade. Yeah.

Thaler Meets Kahneman

TIM: The foothills of the Santa Cruz mountains around Stanford University in California are chocked full of beautiful views and rolling hills. And this is where we find The Center for Advanced Study in the Behavioral Sciences: C.A.S.B.S or sometimes just called "CASBS."¹¹ Since 1954, behavioral scientists have gathered for extended stays at CASBS to develop big ideas. And in 1977, one of those researchers was Danny Kahneman. The same year, Amos Tversky was visiting the psychology department at Stanford. And it was at CASBS in 1977 that they finished writing their paper on Prospect Theory, walking for hours and sitting down together to perfect every sentence.

¹¹ <https://casbs.stanford.edu/casbs-history-behavioral-economics>

ANDY: The summer before, Dick Thaler was visiting a colleague at Stanford and heard that his new idols were visiting the United States, staying in Stanford for a year. He hit the pavement, trying to cobble together any formal reason to keep him in Stanford for a while longer, just hoping to spend some time with Kahneman and Tversky. He lucked out and landed a visiting position at the National Bureau of Economic Research.¹²

RICHARD THALER: It was a very complicated year. Danny was at the Center. Amos and Barbara...

ANDY: Barbara was Amos' wife.

RICHARD THALER: ...were visiting the psychology department. Anne Treisman, who was not yet married to Danny, she and Danny were at the Center. Her husband was at Berkeley. So they had five psychologists converging on the Bay Area for a year.

MIKE GAETANI: I would guess that Amos Tversky would have either walked or ridden the bike up to the CASBS hill several times a week. Thaler would have had like a two minute walk from the NBER satellite office at that time to CASBS. So there was a physical proximity.

ANDY: That's Mike Gaetani, Communications Director for CASBS.

MIKE GAETANI: We have lots of beautiful rolling hills behind us that you can walk through. Both Thaler and Kahneman, separately described walking through the hills together, having conversations, one a psychologist, one an economist.

RICHARD THALER: I was about a hundred meters down the hill from where Danny was, and Amos used to come visit often. And Danny and I would walk around; there's just wilderness up there, and we would take long walks and think big thoughts.

DANIEL KAHNEMAN: I mean, you know, he was he's much younger, But he was just super smart and very funny. And he and I were neighbors and we would spend a lot of time walking together. And, there was also, it was very fun because Dick is very funny. He always was. And so it was a joy and and we learned economics.

ANDY: Richard Thaler, Danny Kahneman, and Amos Tversky forged a unique and lasting bond that year as they took walks, exchanged ideas, and became close friends. You can't miss their respect and affection for each other all these years later. We asked Thaler to describe Danny Kahneman and Amos Tversky.

RICHARD THALER: Danny was the worrier of the two. He always expects the worst. Amos was more confident and brilliantly analytic. His talks were stunning. And his desk. There was a legal pad, a pencil, nothing else.

ANDY: And we asked Kahneman to describe Richard Thaler.

DANIEL KAHNEMAN: I think of him as a genius. I mean, I, I think he is just extraordinary. And he has a flare and a sense for what's important. We have that running joke that I call him lazy. And he doesn't spend any time on things that do not matter. And he's very wise, and he is both irony and wisdom, and you know, that's a very powerful combination.

ANDY: So let's just recap: the setting was CASBS in 1977. Thaler is regularly talking with Kahneman and Tversky. And, seeing Kahneman and Tversky work on their

¹² Kahneman and Thaler both discuss this time in their books, “Thinking Fast and Slow” and “Misbehaving” (respectively).

landmark theory and thinking hard about economics and psychology, Richard Thaler describes that it was this that pushed him to go "all in" on his heretical perspective. He later called it "the most important year of [his] life."¹³ But he was only getting started.

Russell Sage Foundation 1988/1989

KURT: Kahneman, Tversky, and Thaler were exchanging ideas in the late 70s, and they continued to meet and talk and...

RICHARD THALER: Think big thoughts.

KURT: But the engine needed a little more steam before it could become the kind of movement with enough force to really push back against the old guard. They needed someone who could provide more formal support for the growing revolution. Luckily, there was such a guy: Eric Wanner.

TIM: Wanner did a PhD in psychology at Harvard in the 1960s, started life as a professor, but gradually transitioned away from doing the science himself. By the early '80s he joined the Alfred P. Sloan Foundation, a non-profit that makes grants for research and education. And in 1983, he suggested that the program consider an initiative to support what might be called "the psychological foundations of economic behavior." Like so many others, he was enamored with Kahneman and Tversky's work and had gotten to know them a bit when he was an editor at the Harvard University Press. He even pitched the idea to them early on.¹⁴

DANIEL KAHNEMAN: We met him at the bar and we had a drink together.

ERIC WANNER: It's true we met in a bar. I mean don't let him sound we were just drinking and we thought this up in our alcoholic haze.

DANIEL KAHNEMAN: And he said he wanted to put some money into bringing psychology and economics together.

ERIC WANNER: I said, 'Well, how about this little program – I had this idea: we'll try to get psychologists and economists together and we'll call it behavioral economics. So what would you think about that?'

DANIEL KAHNEMAN: And I remember what the answer was. There were two. One was that this is not a project on which you can spend a lot of money on, honestly. I remember that phrase. And the other one was that you should not give that money to psychologists who want to reform economics. You should give that money, spend that money on economists who want to learn psychology.

ERIC WANNER: I had to convince him that money could be spent responsibly and that responsible science could be done between economics and psychology. Just because it had failed so often – I mean that psychologists had been yelling that the rational economic man is a myth forever and ever! And just yelling is not enough. More yelling would not really help. So, what they said to me was, "Well, okay. We won't say 'no.' We'll show up, but we don't think a lot of money could be spent very responsibly." So it was kind of a very cautious yes.

¹³ <https://casbs.stanford.edu/casbs-history-behavioral-economics>

¹⁴ Most of the background information about Wanner and his Sloan and Russell Sage programs comes from our interview with him and from Floris Heukelom's book, "[Behavioral Economics: A History](#)" (2014).

TIM: They ended up setting up a small fund and calling the program "Behavioral Economics."

DANIEL KAHNEMAN: I think the very first grant was for Dick Thaler to spend a year with me. I think that was one of the first grant. Certainly, the first grant in behavioral economics was to Dick to spend a year with me. And that was an important year.

TIM: Eventually, Wanner moved to the Russell Sage Foundation, where he became its president.

ERIC WANNER: I was going to get to run a foundation the way I wanted to run it. You know, give me a little freedom, and I can make a mess of a lot of things.

TIM: The behavioral economics grant program came with him. The people who would become some of the movers and shakers in this world assured us that this was a crucial moment.

GEORGE LOEWENSTEIN: It really played an essential role. I'm not sure if behavioral economics would even exist without the Russell Sage Foundation.

DRAZEN PRELEC: The Russell Sage Foundation was very important in the history of behavioral economics.

TIM: That was George Loewenstein and Drazen Prelec. Each of them spent time in workshops and summer camps sponsored by the Russell Sage Foundation. What they all point to is the importance of bringing together smart people with different backgrounds to solve big problems. As head of Russell Sage, Wanner wasn't so much of a matchmaker as he was the party host, so to speak. Russell Sage manifested the funding for creative researchers to explore their work. This funding allowed relationships to bloom, time to think, and new ideas to bubble up and be refined. It fueled a train that was starting to pick up speed.

ERIC WANNER: My board at Russell Sage said, "Well, you do behavioral economics, what's the next thing?" And you know: ha-ha! Exactly! It's worth a big laugh. Because, you know, you have to be extremely lucky. You can't just upset science any ol' time you want and make a go of it.

CASBS 1997/1998

KURT: The movement was growing. Emerging research was pushing back at the assumptions of rationality that classical economists were still clinging to. More and more people were doing important work on the psychological and biased side of economics. By the 1990's, it was time for a meeting of the minds, and what better place than CASBS: that spot in the foothills surrounding Stanford University where Thaler finagled his way into face time with Danny Kahneman years ago? Here's Mike Gaetani again, Communications Director for CASBS.

MIKE GAETANI: For years running in the 1990s, they tried to get all these guys in together. But it's just so hard to get people's schedules to align. Anyway, things just lined up with the '97-'98 year.

KURT: Five rising stars in behavioral economics spent that year together, most of whom you'll hear from in this series: Richard Thaler, Colin Camerer, George Loewenstein, Drazen Prelec, and Matthew Rabin. Danny Kahenman even popped by to give a talk that year.

TIM: That year was super generative. People worked on books, they finished papers that would go on to make a big impact, and they discussed the seeds of things that would grow into major developments, like how neuroscience can explain human decision-making, how behavioral economics could inform public policy, and the ethical dilemma of nudging people to make more optimal choices for themselves.¹⁵

KURT: One of the attendees, Drazen Prelec, pinpoints exactly what made the year so magical.

DRAZEN PRELEC: I think it was really the fact that we had endless hours of unstructured time together. You really need time without agendas without structure. It's the kind of conversation that is really priceless that these centers are built to sustain.

COLIN CAMERER: And the other thing that was interesting was the only thing you had to do at that center was to go to lunch.

KURT: That's Colin Camerer.

COLIN CAMERER: They didn't want like people traveling a lot and using this as their home base. You were expected at lunch. And occasionally, you know, get a little note like, "Oh, we really missed you. We had such a lively lunch last week with Doug Bernheim and we, we missed you. I hope you hope, hope you're able to attend the future." You know, it was very soft. Anyway, and the other thing was you had to give us talk in the evening. There was, there was these once a week, evening talks. And when someone would say something we thought was really wrong in terms of basic economics, we would all raise our hands. And suddenly we were like ambassadors from rational choice economics. Right? Even though our presence at the center was to do exactly the opposite, you know. And again, I think that's another way you could recognize a behavioral economist is that there's certain, like if somebody says money incentives don't really work very reliably to change behavior. It's like, no, no, no, no, no. Like that's the one thing that's reliable. It just that it costs money, you know? And so it. It was really interesting. There was this almost like a common enemy effect, you know, when somebody said something that, that we thought was really against basic economics, which we all kind of believe in, we just think the enhancement is even better, you know, it kind of came together.

Conclusion

ANDY: So behavioral economists understood classic economics inside and out. And their movement was growing. What started as a frustration with the idea that people are rational became psychologically savvy with the help of Kahneman and Tversky. This ushered in an era of collaboration, new research, and mathematical models that showed classic assumptions were wrong because people play by different rules. They were all in, drinking their own Kool-Aid. But what did everyone else think? Were psychologists okay with economists edging onto their turf? And did traditional economists take the criticism and update their views, no problem?

COLIN CAMERER: At one point, Merton Miller gave an interview, I think, in the Chicago Tribune or something and they said, you know, "What do you think of Dick Thayer's work in behavioral finance?" He said, "Well, you know, I don't think it's, I

¹⁵ <https://casbs.stanford.edu/casbs-history-behavioral-economics>

don't think it's a serious theory. It hasn't helped us explain anything, you know, but every generation has to make its own mistakes."

ANDY: That's next time on They Thought We Were Ridiculous.

[CREDITS]

They thought we were ridiculous is written and reported by Andy Luttrell, Kurt Nelson, and Tim Houlihan. Editing and Sound Design by Andy Luttrell. Thanks to Ben Granlund, Alex Belanger, and Alexa Cover for design and marketing. And thanks to Mary Kaliff and Caroline Schaeffer for other assistance along the way. Music licensed by Blue Dot Sessions and Epidemic Sound. Transcripts with key source citations are available, check out the episode webpage. Thanks to the guests whose voices you heard, including Richard Thaler, Colin Camerer, Richard Nisbett, Liam Delaney, Linda Babcock, and George Loewenstein. This miniseries is a co-production of two podcasts: Opinion Science is hosted by Andy Luttrell and explores the science of people's opinions, where they come from and how they talk about them. Behavioral Grooves is hosted by Tim Houlihan and Kurt Nelson and explores our human condition through a behavioral science lens. You can find more information on both of those shows in the episode description. Thanks for listening. We'll see you next time.