

Biases and Heuristics in Policymaking

From behavioural economics to behavioural political economics

People are affected and afflicted by:

- Imperfect self-control;
- Anchoring
- Framing
- Loss aversion
- Availability or saliency bias
- Endowment effect and status quo bias
- Information and choice overload
- Poor grasp of probabilities



From behavioural economics to behavioural political economics

But what happens when policymakers *themselves* are affected by cognitive biases and heuristics?

What confidence can we have that their policies will be welfare-improving

Biases and heuristics of policymakers

- Hyperbolic discounting and populist policies
- Availability bias and the risks of over-reacting in the short-term and under-reacting in the long-term
- Sunk-cost fallacy or the problem of escalating commitment

The problem of escalating commitment

“He (Dani Rodrik) thinks that industrial policy can work if it is designed cleverly. But that is a big if. ... (Rodrik) thinks that what matters is not whether government can pick winners but whether they have the good sense to let losers fall by the wayside. The problem, of course, is that this rarely happens. In effect, Mr Rodrik and others are arguing that industrial policy requires disinterested, benevolent policymakers who can do it well. Unfortunately, they do not yet have a recipe for how such policymakers can be created.”

The Economist, 1 October, 2011

Biases and heuristics of policymakers

- Confirmation bias and our love for consistency and coherence
- Overconfidence



Consistency bias and Overconfidence

“...the exaggerated expectation of consistency is a common error. We are prone to think that the world is more regular and predictable than it really is, because our memory automatically and continuously maintains a story about what is going on, and because the rules of memory tend to make that story as coherent as possible and to suppress alternatives. Fast thinking is not prone to doubt.

The confidence we experience as we make a judgement is not a reasoned evaluation of the probability that it is right. **Confidence is a feeling, one determined mostly by the coherence of the story and by the ease with which it comes to mind, even when the evidence of the story is sparse and unreliable. The bias toward coherence favours overconfidence.** An individual who expresses high confidence probably has a good story, which may or may not be true.”

Daniel Kahneman, New York Times, 23 October 2011

What can we do?

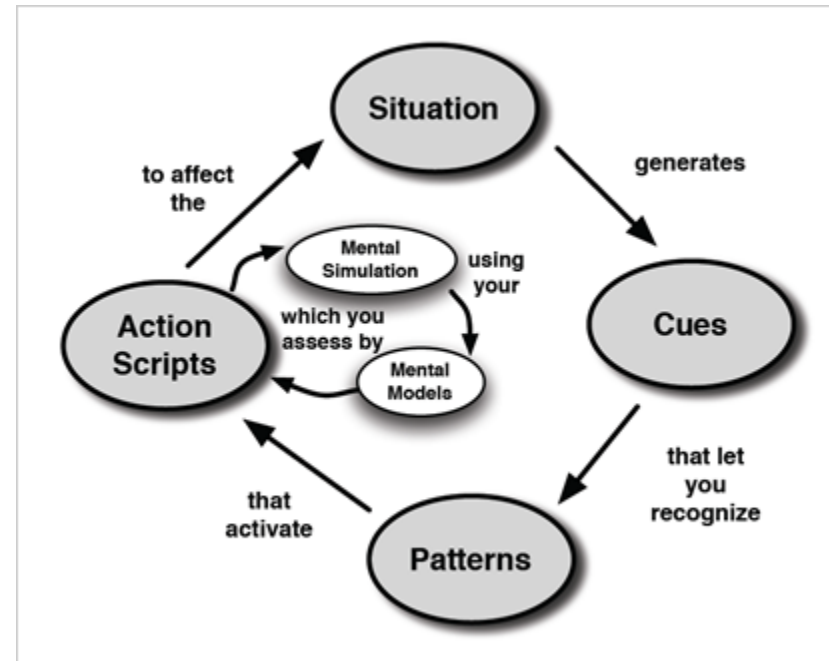
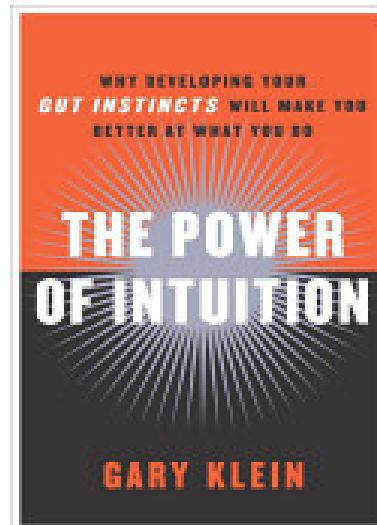
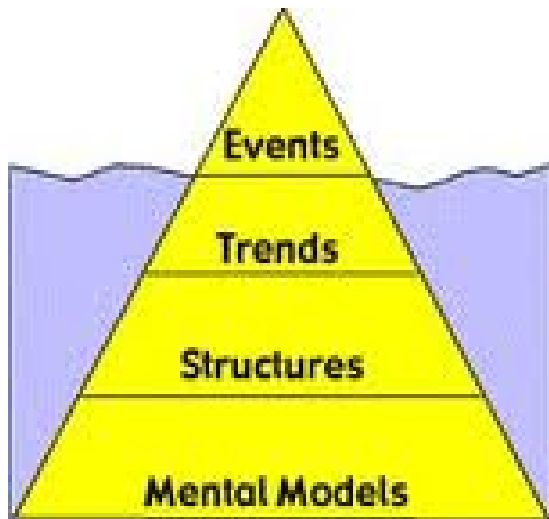
*Predictably **Irrational**: The Hidden Forces that Shape our Decisions*

*Everyday **Irrationality**: How Pseudo-Scientists, Lunatics, and the Rest of Us Systematically fail to Think Rationally*

*Sway: The Irresistible Pull of **Irrational** Behaviour*

What can we do?

Help our people develop experience and expertise so that they form richer mental models



Developing expertise

“People come up with coherent stories and confident predictions even when they know little or nothing. Overconfidence arises because people are often blind to their own blindness.

True intuitive expertise is learned from prolonged experience with good feedback on mistakes... To know whether you can trust a particular intuitive judgment, there are two questions you should ask: Is the environment in which the judgment is made sufficiently regular to enable predictions from the available evidence?... Do the professionals have an adequate opportunity to learn the cues and the regularities?... In general, however, you should not take assertive and confident people at their own evaluation unless you have independent reason to believe that they know what they are talking about. Unfortunately, this advice is difficult to follow: overconfident professionals sincerely believe they have expertise, act as experts and look like experts. You will have to struggle to remind yourself that they may be in the grip of an illusion.”

Daniel Kahneman, New York Times, 23 October 2011

What can we do?

Help our people develop experience and expertise so that they form richer mental models

Force ourselves to take an “outside view”, especially in an environment of uncertainty and disruptive change.

Leadership and organisational cultures matter

Leadership and organisational culture

“Undoubtedly there are organisational constructs and cultures that create more favourable conditions for wilful blindness than others. Heroic leadership styles, companies highly focussed on the power and influence of a single individual, provoke the kind of second-guessing among executives that stops them thinking or analysing what they know to be true. It is always intrinsically difficult for leaders to know what is going on in their organisations, but never more so than when their personalities or egos quash debate and dissent... The more elevated (the leader’s) status, the less likely that anyone will dare to articulate an uncomfortable truth to them.”

Margaret Heffernan,
Wilful Blindness: Why We Ignore the Obvious at Our Peril