

BOOKS

‘If someone tells you he is going to make a “realistic decision” . . . he has resolved to do something bad.’ —MARY MCCARTHY

Irrational Actors

The Winner’s Curse

By Richard H. Thaler and Alex O. Imas
Simon & Schuster, 352 pages, \$30

By DANIEL AKST

BEHAVIORAL economics, like “lived experience,” existed long before anyone thought a special and seemingly redundant name was required. To Adam Smith, economics was made of human behavior in all its glorious complexity. Any number of his professional descendants thought likewise, not least among them Thorstein Veblen, the author of “The Theory of the Leisure Class” (1899). Herbert Simon wasn’t officially an economist, yet the Nobel laureate could have taught anybody a thing or two about human decision-making (and nearly anything else).

But somewhere along the line, economics was all but consumed by math, and things everybody had always known—that humans are fickle, emotional, bad at reasoning, captives of their prior mistakes, etc.—were forgotten or cast aside. There are always dissidents, but it took a pair of Israeli psychologists—Daniel Kahneman and Amos Tversky—to finally make it impossible for economists to ignore human folly. A number of Americans carried the ball from there, perhaps none more single-mindedly than Richard Thaler.

In 1992 Mr. Thaler published “The Winner’s Curse,” a compendium of his quarterly columns (each a meaty academic article) from the Journal of Economic Perspectives, many written with co-authors such as Kahneman, Tversky, George Loewenstein, Matthew Rabin and other behavioral all-stars. The focus, Mr. Thaler writes, was on “on economics anomalies, which would be defined as empirical observations that were inconsistent with standard economic theory.”

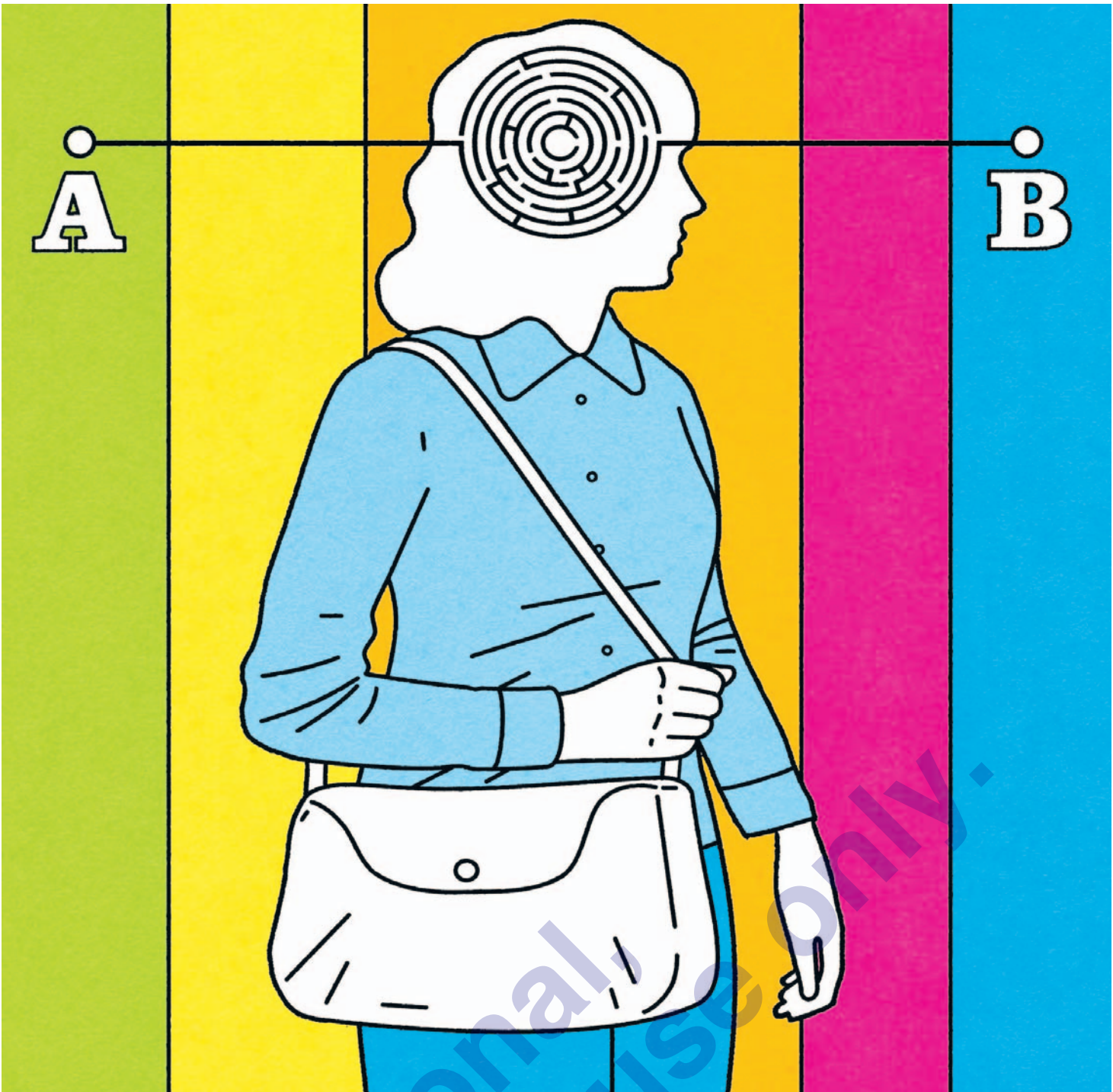
It was a fruitful and rewarding line of research. Twenty-five years later, Mr. Thaler was awarded the Nobel Prize, following in the footsteps of his mentor Kahneman (death had made Tversky ineligible). The ascent of behavioral economics was complete, or at least so it seemed.

Now, with the help of Alex O. Imas, a colleague in behavioral science and economics at the University of Chicago, Mr. Thaler has brought out a revised and expanded version of “The Winner’s Curse,” subtitled “Behavioral Economics Anomalies, Then and Now.” In addition to reprinting the original articles, the book provides updates on how well the originally selected anomalies have stood the test of time. “We found,” the authors write, “that all the critical conclusions about anomalies have held up remarkably well, even after decades of subsequent research.”

This seems largely to be the case. The book’s title is an example of the sort of paradox that behavioral economists relish. The concept of the “winner’s curse,” the authors report, originated with Atlantic Richfield Co., an oil company that sometimes bid in government auctions for the right to drill in various places. ARCO relied on experts to predict how much oil it would find, and therefore how much it should pay. But when it won an auction, it usually found less oil than expected.

Why? Because a winning bid always anticipates more oil than the average of all the other firms’ predictions, and that average tends to be more accurate. The more bidders, the more likely the winning bid is too high. The authors quote oil engineers: “If one wins a tract against two or three others, he may feel fine about his good fortune. But how should he feel if he won against 50 others? Ill.”

Other such paradoxes will strike closer to home. Logically, consumers carrying credit-card debt should pay off the highest-interest cards first, but they don’t. “People tend to repay a credit card,” the authors say, “by allo-



cating their debt repayments proportionally to the relative sizes of their balances.” Not only that, but they will keep cash parked in a low-interest bank account rather than using it to pay down credit-card debt at interest rates of 20% or more.

On health insurance, the authors pose this simple question. “Option A fully covers all claims and costs \$300 a month. Option B costs

Logic is not always the driving force behind human decisions.

only \$100 per month but makes you pay for claims until you have reached a total of \$2,000 within a year, after which everything is covered. Everything else is the same. Which would you choose?” If you chose A, you have some reading ahead of you.

The list goes on. The authors note that money is fungible, yet the source matters; windfalls get special treatment, and larger windfalls are treated differently than smaller ones. But my favorite example of such “mental accounting” is unmentioned here, which is that people will drive a few extra minutes to save \$5 on a pot roast but not on a new car, even though the savings are the same.

Humans do not have consistent preferences, especially when it comes to weighing current

advantage against much greater gains from deferred gratification. It’s remarkable how much future benefit people will forego for a little instant gratification. People (and countries) also honor sunk costs, which are irrecoverable no matter what happens next. The authors’ advice: “Ignore sunk costs, but assume others will not.”

These anomalies, repeatedly affirmed by behavioral economists on the lookout for such bad judgments by the rest of us, have by now formed the basis of a popular literature on the subject, and in truth most readers will find that literature more accessible than much of the material in this book. Mr. Thaler says the articles were “written in a way that any economist, or even undergraduate economics major, could understand them.” In quite a few places the rest of us will struggle, just as we do in trying to make sensible financial choices.

The anomalies in “The Winner’s Curse” do not inspire faith in humanity’s logical powers. But it’s important to remember that irrationality is often in the eye of the beholder. In George Bernard Shaw’s play “Pygmalion” (1913)—and in the better-known movie version, “My Fair Lady” (1964)—the roguish Alfred Doolittle wants 5 pounds for “one good spree for myself and the missus,” and Prof. Higgins is so charmed he offers 10. Doolittle politely declines. “Ten pounds is a lot of money,” he explains. “It makes a man feel prudent like; and then goodbye to happiness. You give me what I

ask you, Governor: not a penny more, and not a penny less.” A behavioral economist might say Doolittle is making sophisticated use of pre-commitment, the technique of acting in advance to make an unwanted choice impossible. Before Ozempic, some dieters had their jaws wired shut.

That said, Mr. Thaler and his fellow behavioral economists have made an enormous contribution by helping their profession, along with the rest of us, understand the ways real people differ from the dispassionate Homo economicus who stood in for us for so long. Thanks to this research, policymakers can design programs so that people find better choices easier to make. The great example has been the now-widespread practice of making 401(k) plans “opt out” rather than “opt in.” Default enrollment evidently has boosted participation and improved retirement security.

Yet the work of behavioral economists does not appear to have revolutionized the field. As Mr. Thaler reports, “despite the empirical robustness and conceptual importance of these findings, insights from behavioral economics remain largely absent from mainstream economics textbooks.”

Proof, if any were needed, that the authors of those textbooks are not only economists, but also human beings.

Mr. Akst is the publisher of Tivoli Books.

Deep Down At the Root Of It All

The Tree of Life

By Max Telford
Norton, 320 pages, \$29.99

By ADRIAN WOOLFSON

PERHAPS the most remarkable feature of all species, living and extinct, is their extraordinary interconnectivity. Each species on Earth can trace its roots back to the same cluster of ancestral organisms and occupies a distinct position on a single, complex, prolifically branching, unfathomably extensive and largely invisible tree of life.

In his enjoyable and ambitious “The Tree of Life,” Max Telford, an evolutionary biologist at University College London, takes us on an exhilarating cartographic journey in which he attempts to map out the various rivers and tributaries that make up the basic infrastructure of life’s evolutionary history. Go back far enough and these pathways invariably converge, leading to life’s ultimate source and origin—

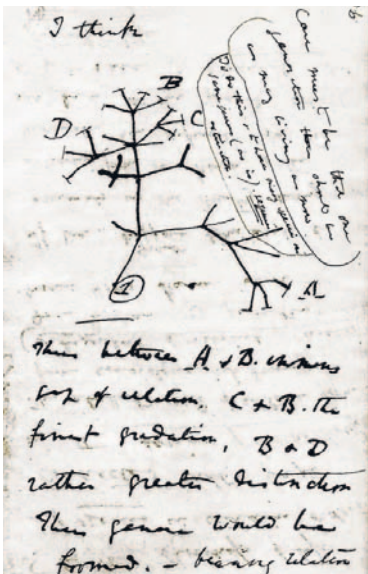
the last universal common ancestor, or LUCA.

As the majority of this evolutionary terrain no longer exists, this charting of life’s history, we learn, relies on our ability to create the rudiments of an engine that can facilitate travel back in evolutionary time. Remarkably, it turns out, the trunk, branches, twigs and leaves of the tree itself—the species populating it—furnish the mechanical components of such a device.

The branching evolutionary relationships between species were anticipated by Charles Darwin in his 1837 Notebook B sketch, in which he fashioned a minimalistic tree-like diagram that depicted the descent and diversification of species from common ancestors. He later referred to these branches in “On the Origin of Species” (1859), as forming “a great tree” of related beings. But it was Ernst Haeckel, the German biologist, in “Generelle Morphologie der Organismen” (“General Morphology of Organisms,” 1866), who first represented the branching evolutionary relationships in the form of a tree rooted in common descent. Haeckel was himself inspired, Mr. Telford writes, by August Schleicher, a University of Jena colleague who believed that it was possible to “travel back in time, down the branches of his language tree” to construct the precursor of Indo-European languages.

The possibility of a genealogical tree of life is predicated on the existence of

an underlying process of heredity. This enables the essential information defining an organism’s core features—represented in the nucleotide sequences of DNA—to be passed down



BRANCHING OUT An 1837 sketch by Charles Darwin.

to its offspring. While in the past it was the often-misleading morphological features of organisms—dentition, skeletal anatomy or the number of petals in the flowers of plants—that were used to infer their presumed evolutionary relationships, the modern ability to

read select parts of a species’ genome sequence has allowed for the construction of a robust time machine that can calibrate both the temporal and genealogical relationships between species and enable an imperfect but meaningful form of navigation back to life’s earliest incarnations.

Unlike the deliberate, premeditated approach of human engineers, the natu-

Properly deciphering the genealogy of species could unlock the evolutionary history of biology.

ral process for generating life has no preconceived plan. It is obliged, instead, to adopt what François Jacob, a French biologist, referred to in 1977 as a strategy of “tinkering.” In contrast to a designer, a tinkerer must, Jacob argued, manage with odds and ends. In so doing, an old bicycle wheel may be fashioned into a roulette, or a broken chair transformed into the cabinet of a radio. Evolution has similarly purloined existing features and modified them, using great thrift, for example, to transmute a piece of jaw into an ear or to transform a leg into a wing.

If comprehensively deciphered, the relationships between the species popu-

lating the genealogical tree of life, Mr. Telford argues, offer the possibility of understanding the evolutionary history of every component of natural biology. As such, this enterprise could reveal the underlying rules-based nature of organismal construction and diversification. Mr. Telford and his colleagues have devised systematic and often painstaking methods of tree-building that rationalize confounding factors, such as convergence, wherein similar traits may evolve independently of one another, and the paradoxical loss of complexity seen in some species. Relying on the principle of parsimony—which emphasizes simplicity and efficiency when configuring evolutionary pathways—and a focus on specific morphological and biochemical characteristics, Mr. Telford rationalizes this complexity and teases out life’s overarching themes and major evolutionary transitions.

With the emerging developments in AI and molecular genomics, humankind may soon progress from “received” life, generated by natural engineering, to designing and constructing synthetic life that is disconnected from history and heredity. In so doing, we may one day generate forests of trees whose ancestry does not intermingle with that of the species generated by the historic evolutionary process.

Mr. Woolfson’s “On the Future of Species” will be published in April.