

## About Behavioral Economics

### What is Behavioral Economics?

- Behavioral economics (also known as “behavioral finance”) has gained popularity as economists recognize that traditional economic theory fails to fully explain human behavior.
- The standard economic model is based on the idea of a wholly rational “economic man,” who analyzes all options and makes decisions based on self-interest, ultimately making the choices that are of the greatest utility to himself. However, real human beings often act counter to the rationality of economic man, for example “discounting” delayed rewards relative to more immediate but smaller rewards – \$10 today versus \$20 a year from today.<sup>1(p.3,l.131)</sup>
- According to behavioral economists, these choices that may at times appear irrational – smoking now versus the delayed risks of cancer and heart disease – are actually rather consistent and have their own rules and logic. The study of the systematic ways in which people make economic and other choices, drawing on insights from both psychology and economics, is behavioral economics.<sup>1(p.1,l.19-21)</sup>
  - The standard economic model of human behavior includes three unrealistic traits—unbounded rationality, unbounded willpower and unbounded selfishness—all of which behavioral economics modifies.<sup>2</sup> Standard economics looks at the way people *should* act while behavioral economics looks at the way people *do* act.
  - For example, in contrast to unbounded rationality in which all choices are valued against long-term net value, actual choices are bounded by the favoring of more immediate over delayed goods or consequences.
- The integration of economics with psychology and behavior science is a two-way street.
  - Insights from psychology enhance the understanding of how choices are governed by factors other than total net value. For example, the same risky investment may be much more likely if presented as a possible gain of substantial value than if presented as a risk for appreciable loss.
  - Insights from economics help us understand choices that are not generally viewed as economic. For example, the easy availability (i.e., low cost) of attractive alternatives such as convenient walking paths or affordable healthy foods may influence choices of unhealthy behaviors such as a sedentary lifestyle or the consumption of high-fat foods.

### Behavioral Economics and Healthcare

- Healthcare costs are the single most important factor influencing the federal government’s budget trajectory. Behavioral economics has been embraced by the White House Administration in healthcare policy, budget planning and other areas to help reduce these costs.
- Behavioral economics is important to diabetes, and to healthcare in general, because it helps explain why people make decisions that impact their health, like choosing to smoke, overeat or forego needed medication despite the negative consequences of doing so. It also sheds light on how these behaviors can be changed.

- People’s choices and behavior are some of the biggest culprits behind major illness and healthcare expenses.<sup>3</sup> Smoking, obesity and other preventable conditions contribute to 40 percent of premature deaths.<sup>4</sup> Behavioral economics may help people make decisions that lead to better health outcomes by suggesting alterations in incentives or other strategies (e.g., “healthy defaults”) to improve the reach and overall effectiveness of chronic disease management.

### **About the Behavioral Economics Roundtable on Diabetes**

- The American Academy of Family Physicians Foundation (AAFPF), with support from sanofi-aventis U.S., is convening thought leaders for a Behavioral Economics Roundtable on Diabetes on June 2, 2011. The event is an output of the National Conference on Diabetes, which was held April 28, 2010.
- The Roundtable will address practical applications of behavioral economics to diabetes prevention, diagnosis, treatment and management. The event will focus on promoting the role of primary care and community support for people with diabetes, as well as the use of behavioral economics to move them toward this goal.

*The Behavioral Economics Roundtable on Diabetes is made possible with support from sanofi-aventis U.S.*

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<sup>1</sup> Lambert C. The Marketplace of Perceptions. *Harvard Magazine*. March-April 2006: 50-7, 93-5. <http://harvardmagazine.com/2006/03/the-marketplace-of-perce.html>. Accessed May 10, 2011.

<sup>2</sup> Thaler R, Mullainathan S. Behavioral Economics. *The Concise Encyclopedia of Economics*. Library of Economics and Liberty; 2008. <http://www.econlib.org/library/Enc/BehavioralEconomics.html>. Accessed May 10, 2011. p.1,l.11-3.

<sup>3</sup> Fisher E, Fitzgibbon M, Glasgow R, Haire-Joshu D, Hayman L, Kaplan R, et al. Behavior Matters. *American Journal of Preventive Medicine*. May 2011;40(5): E15-30. p.2,l.A20-B3.

<sup>4</sup> Fuhrmans V. Training the Brain to Choose Wisely. *Wall Street Journal*. April 28, 2009: D1. <http://online.wsj.com/article/SB124087787244061601.html>. Accessed May 10, 2011. p.1,l.16-7.