THE NEW YORKER

John Cassidy

The Making of Richard Thaler's Economics Nobel

October 10, 2017 9:01 A.M.

In the world of mainstream American economics, Richard Thaler's study of behavioral quirks like loss aversion and the status-quo bias was seen as subversive.
Photograph by Vicki Couchman / Camera Press / Redux

Daniel Kahneman, the Princeton psychologist who shared the 2002 Nobel Prize in economics for his role in developing the field of behavioral economics, is a night

person. Early on Monday morning, he went to sleep at around 3 *A.M.*,which meant that he missed the call at 6:49 *A.M.* from his closest friend and longtime research collaborator, the University of Chicago economist Richard Thaler, who had just been named the sole recipient of the 2017 prize. When Kahneman finally woke up and learned the news, he called up Thaler to congratulate him. "I am overjoyed," he said on the phone, later in the day. "I think it is wonderful."

Kahneman isn't the only one celebrating. Many economists believe that Thaler's award was long overdue. The Nobel announcement credited Thaler, whose work has explored mental quirks such as loss aversion and the status-quo bias, for building "a bridge between the economic and psychological analyses of individual decision-making." That's true. But Thaler's greatest achievement may have been in persuading economists—a notoriously hidebound lot—to question the "rational economic man" assumption that they once held so dear. These days, most decent universities offer classes in behavioral economics, and some of the top schools in the U.S., such as Harvard and Berkeley, have made major commitments to the field. Meanwhile, governments around the world, and multinational institutions such as the World Bank, look to behavioral economics to inform policymaking.

This outcome was far from preordained. "We were worried that he might not get tenure," Kahneman said, in recalling the work that Thaler did with him early in his career. "Everybody knew that he was bright, that he was brilliant. But he wasn't doing anything that they considered to be economic research. He wasn't doing anything that was mathematical. His story is the success story of behavioral economics. Going from the outside to the mainstream. And that was largely due to him."

Thaler and Kahneman met in 1977, at Stanford University. Thaler, who had obtained his Ph.D. in 1974, was still finding his way as a researcher, while Kahneman and his fellow-psychologist Amos Tversky had already identified many of the systematic biases that they would become famous for. These included anchoring (the tendency to rely too heavily on initial information); confirmation bias (the tendency to interpret evidence as supporting preëxisting beliefs); and loss aversion (feeling the pain of losing ten dollars more intensely than the joy of winning ten dollars). "We spent a lot of time walking the hills discussing things," Kahneman recalled of Thaler. "He already knew a lot of things that didn't fit in the orthodox economic framework. What he got from us was the theoretical framework to fit them into."

In 1980, Thaler published a paper entitled "Toward a Positive Theory of Consumer Choice,," in which he bluntly asserted, "This paper argues that in certain well defined situations, many consumers act in ways that are inconsistent with economic theory."

As an example, he wrote, "Mr. R bought a case of good wine in the late '50's for about $5 a bottle. A few years later his wine merchant offered to buy the wine back for $100 a bottle. He refused, although he has never paid more than $35 for a bottle of wine." Thaler argued that people have a general tendency to value items more highly if they own them. He called this the "endowment effect." He also related this type of behavior to the work of Kahneman and Tversky. "I think that is the founding text of behavioral economics," Kahneman said to me. "It is short. And it is extremely funny."

In the world of mainstream American economics, Thaler's paper was also seen as subversive. This was the era when Chicago School economics ruled, and the rational economic man seemed to be triumphant. Passed over by some top economics departments, Thaler eventually got a tenure-track job at the Cornell University Graduate School of Management. Helped by some financial support from the Russell Sage Foundation, he continued to collaborate with Kahneman, and to do his own research.

Things began to change, Kahneman told me, in the second half of the nineteen-eighties, after the *Journal of Economic Perspectives* asked Thaler to contribute a regular column about findings that didn't fit into the mainstream model of people as selfish, rational-utility maximizers. Thaler, sometimes writing with other researchers (including Kahneman), published more than a dozen pieces, covering topics like loss aversion, the "winner's curse" (the tendency of winning bidders to overpay in auctions), calendar effects in the stock market, preference reversals, and the fact that many people value fairness so highly that they are willing to punish people who make unfair offers even if doing so harms them, too. In 1992, Princeton University Press published Thaler's columns in a book titled "The Winner's Curse: Paradoxes and Anomalies of Economic Life."

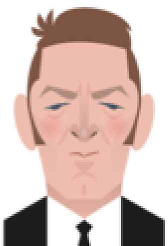
The columns and the book garnered Thaler quite a bit of attention. Eventually, the University of Chicago Graduate School of Business offered him a professorship. According to legend, the school approached Thaler over the strenuous objections of Milton Friedman and other members of the university's economics department—the birthplace of Chicago School thinking. Thaler accepted the post, and he has been in Chicago since 1995, thoroughly enjoying the irony of his position. "The most striking thing about Dick is his sense of humor," Kahneman said. "That is the first thing you see. He is laughing all the time. The world strikes him as funny and absurd. That is the key to his character and his intellectual achievement. It is wit. He lives by his wit."

As behavioral economics became more popular, Thaler also turned into an influential figure in policy circles. In 2004, together with Shlomo Benartzi, a behavioral economist

at U.C.L.A., he proposed a way to raise savings rates by allowing workers to commit a portion of their future salary increases to savings accounts. Thaler and Benartzi called this idea "Save More Tomorrow," and Kahneman described it to me as "a seminal contribution." In 2008, Thaler teamed up with Cass Sunstein, of Harvard Law School, to write "Nudge," a book that generalized the insight about how making seemingly small changes to the way choices are framed could have big beneficial effects. After Sunstein joined the Obama Administration, in 2009, the "nudge" approach proved influential. In 2010, the British government even set up a "Nudge Unit," which was headed by a psychologist. As recently as last week, Kahneman told me, Thaler was in Sweden discussing with officials how they organize the country's savings.

Despite all this, the significance of behavioral economics is still debated. Some critics say there are too many biases and heuristics involved. Others—myself included—have questioned whether Thaler's "nudge" approach goes far enough in tackling market failures. But if behavioral economics doesn't overcome every shortcoming of traditional economics, it at least acknowledges these shortcomings, and grapples with them in ways that have yielded important insights in areas ranging from finance to international development to sports. As Peter Gärdenfors, a member of the Nobel Prize committee, said of Thaler, on Monday, "He made economics more human."

Thaler will be back in Scandinavia, in December, to collect his award. Kahneman, who is eighty-three, will also be going to Stockholm to see his friend receive the Nobel. "He owes me," he joked. "He was the first person I called when I won."



John Cassidy has been a staff writer at ***The New Yorker*** *since 1995. He has written many articles for the magazine, on topics ranging from Alan Greenspan and Ben Bernanke to the Iraqi oil industry and the economics of Hollywood. He also writes a column for* ***The New Yorker***'s *Web site. He is the author of "How Markets Fail: The Logic of Economic Calamities" and "Dot.Con: The Greatest Story Ever Sold." Cassidy is also a contributor to* The New York Review of Books *and a financial commentator for the BBC. He came to* The New Yorker *after working for newspapers on both sides of the Atlantic. He joined the* ***Sunday Times****, in London, in 1986, and served as the paper's Washington bureau chief for three years, and then as its business editor, from 1991 to 1993. From 1993 to 1995, he was at the* **New York *Post***, *where he edited the Business section and then served as the deputy editor.*