

The Importance of Irrelevant Factors

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Lawyers, Guns and Money

- The U.S. government is run by lawyers who are advised by economists (and more lawyers).
- Economists generally think that monopolies are bad for consumers. Should economists have this unique role?
- What is the source of this power (to advise)?
- Economists do know stuff.
- Some of which is true.

Successes and Failures

- Big Success
 - All volunteer military
- Moderate Success
 - Cost benefit analysis (though hated by both parties)
- Surprising Failures
 - Free Trade
 - Pigouvian taxes
 - Financial Crisis ...

Two Main Tools of Economics

- **Agents optimize.** So a good model of behavior is Max (•).
 - It does not depend on how hard the problem is.
 - It does not matter who the agent is. All agents are as good at economics as the smartest economist. Call him X.
- **X *is* the representative agent.**
- But non-X don't Max.
- Maybe Meh(•)?
- **Supply and Demand**—in reasonably competitive markets, prices adjust.
 - Key: Agents respond to incentives optimally.
 - Do they?

What is Missing?

- The strongest predictions derived from economic theory are that some things do not matter at all.
 - Problem difficulty
 - Framing
 - Explicit payment (or bill) vs. adjustment on taxes
 - Sludge (mental burden of applying for some benefit)
- I call these supposedly irrelevant factors (SIFs)

They are not irrelevant. Three policy examples:

- Retirement Savings
- ACA (Obamacare)
- Moving to Opportunity

Retirement Savings

- How can (or should) the government help people save for retirement?
- One Answer: Don't! They are already saving the optimal amount. (Modigliani)
- But most developed economies do encourage savings.
 - U.S. Social security—mandatory and defined benefit.
 - Private pensions: now mostly defined contribution, 401k etc.

Accidental Economics Innovation: 401(k)s

- Were they a good idea?
- Should retirement savings be subsidized via tax deferral?
- Answers from economic theory: No and no.
 - Already saving enough. (See above)
 - Don't know whether the subsidy it helps or hurts (Income and substitution effects).
 - Tax arbitrage for the wealthy
- Old UChicago qualifying exam question: “Prove that 401(k)s will not increase savings.”

How about investment options?

- Economists: Just give lots of choices (including low cost funds) and let people choose.
- But:
 - Many employees failed (or were slow) to enroll, even with a generous match from the employer.
 - Those who failed to join were low income.
 - Contribution rates were often low.
 - Investment choices were poor.
 - Buy high-sell low
 - Until 2006 the only default option blessed by the DoL was a money market account.

What did help? Irrelevant factors

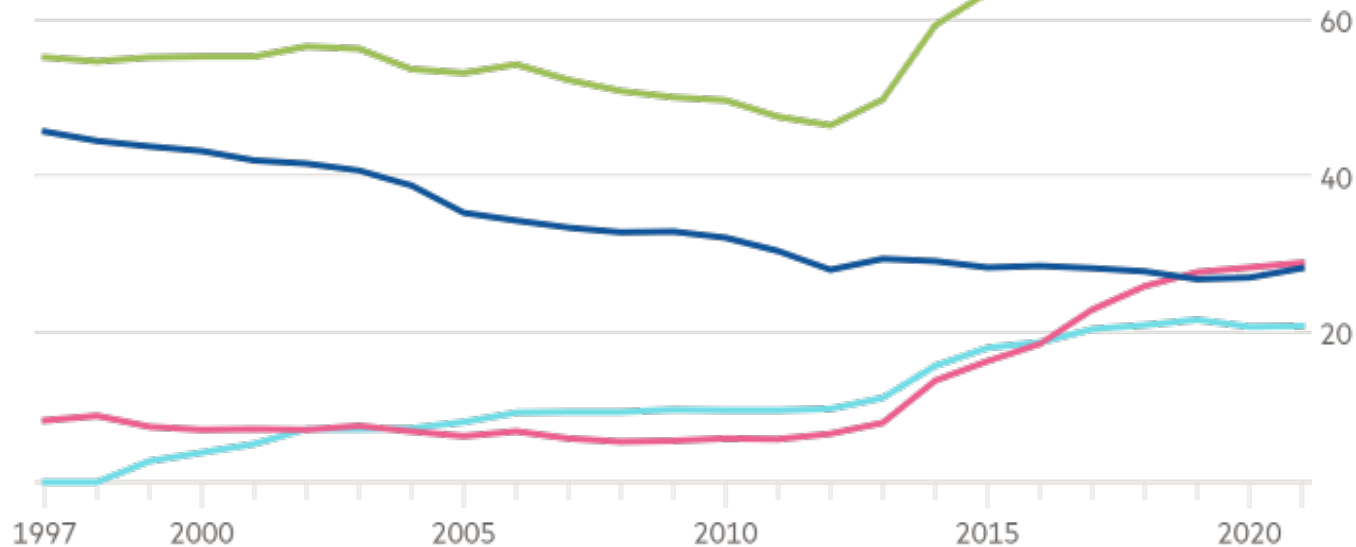
- Automatic enrollment.
- Automatic escalation (save more tomorrow).
- Well designed default investment options. (E.g., Target Date Funds)
- The tax subsidy (the possibly relevant factor) is expensive, ineffective, and highly regressive.
- The supposedly irrelevant features are now widespread. They were encouraged (not required) by a 2006 law that offered sludge reduction to firms as a carrot.

Experience in the UK

Auto-enrolment has been a success

% of UK employees with workplace pension (by type of pension)

■ Occupational defined benefit ■ Occupational defined contribution
■ Group personal, stakeholder and self-invested personal pensions ■ Any pension



Source: ONS

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Affordable Care Act

- Obamacare was based on the Massachusetts plan passed by then Gov. Romney. Three pillars:
 - No pre-existing conditions
 - Large subsidies
 - Mandates
- Economists: without a mandate, consumers will wait until they get sick to buy insurance, and the market will go into a **death spiral**.

Habits of Insurance Buyers

- Buyers of auto and home insurance choose deductibles that are too low.
- Extended warranties are a big business.
- In the employer sponsored health insurance plans, many (often a majority) of workers elect a dominated option. This mistake can cost \approx \$1000 per year or more.
- The dominated plans have low deductibles.
- Do these consumers seem like they are maximizing?
- Are they likely to successfully “game the system”?

Some Irrelevant Factors

- Plans were given metal labels. Platinum, gold, silver, bronze.
- Except very high deductible plans (for under 30) were not given a metal label. They were branded “catastrophic”.

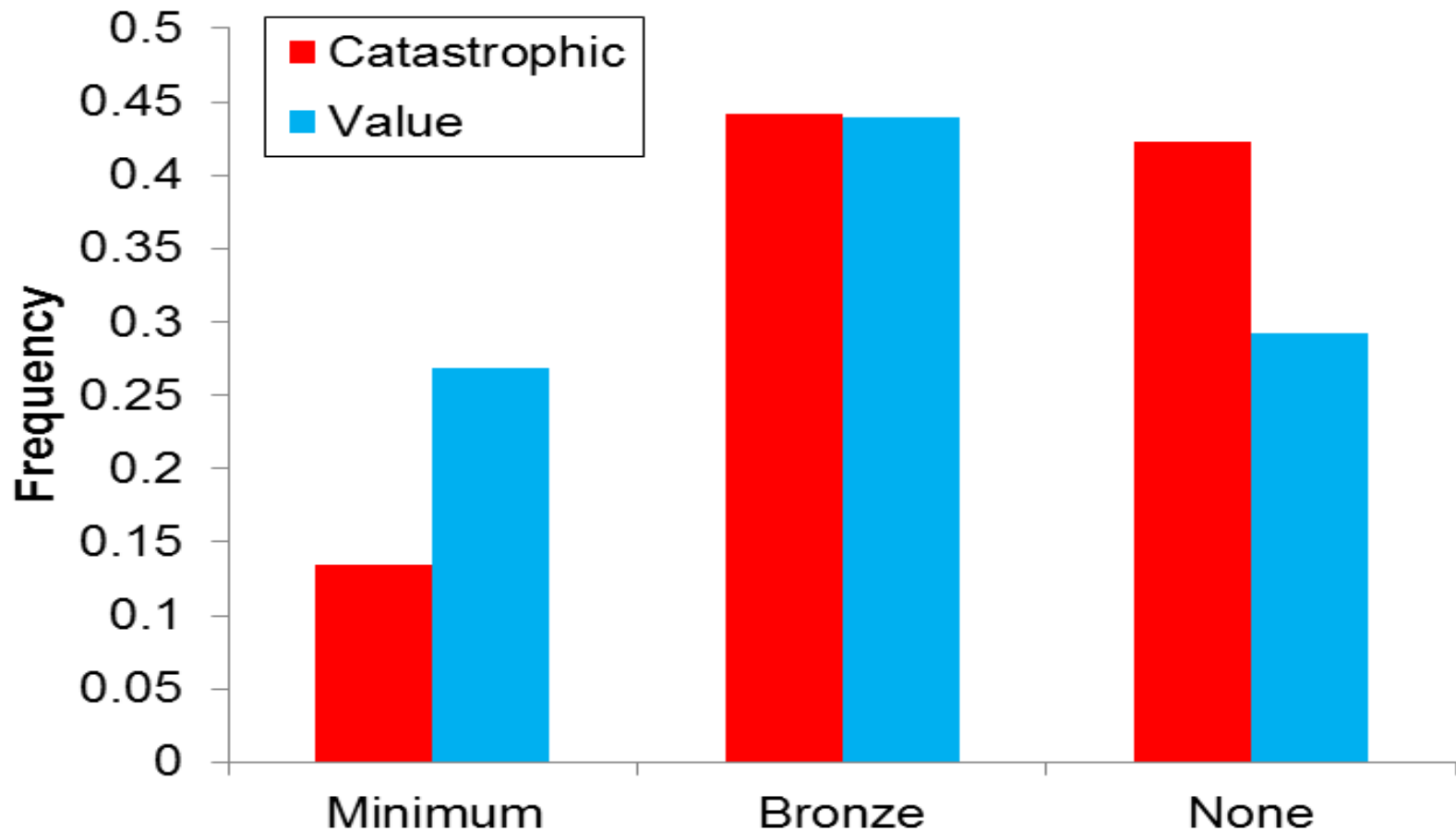
Health Plan	Monthly Premium	Annual Deductible
Platinum	\$327	\$0
Gold	\$282	\$1000
Silver	\$232	\$2500
Bronze	\$172	\$4000
Catastrophic	\$141	\$6400

Could a rebranding matter?

- Young Americans (18-30) with no health insurance were asked: “For the purposes of this survey we would like you to imagine that for the next two years you are taking a low-paid job with no health insurance. Given your budget you have decided to only consider the two lowest priced options [Catastrophic/Value] and Bronze, as well as the possibility of going without insurance altogether.”

Health Plan	Monthly Premium	Annual Deductible
Catastrophic/Value	\$141	\$6400
Bronze	\$171	\$4000

Change Catastrophic to Value Reduces Uninsured by 10 percentage points



What About the Mandate?

- The mandates were eliminated in 2017.
- No death spiral in the health insurance market has been observed.
- Jon Gruber: “The mandate made a difference, but not a huge difference in terms of the numbers of people signing up,...it was not as effective as anticipated.”

Sludge Removal

- A large increase in coverage was made possible by the ACA's **streamlining of the application process** for Medicaid, removal of onerous asset tests for determining eligibility for most applicants, and increased public awareness about insurance coverage options.

Source: Freaan, Gruber, Sommers NEJM

Is it perfect? No

- 30+% of workers do not have a workplace retirement savings plan. They hardly save at all.
- The UK dealt with this problem by requiring all firms with more than X employees to either offer a retirement savings plan or automatically enroll workers in a government run plan.
 - Minimum contribution rates were initially low then gradually raised.
 - Opt out rates are less than 10%
- Some states have done the same: IL, OR, CA...
- Some would prefer to take the Australian approach and make some savings mandatory.
 - That would make some worse off. (Pay off student debt first?)
 - Australia also banned guns and bought all the guns back.
 - The U.S. ≠ Australia ☹️

Going Beyond Nudging

- Sometimes we need to work a little harder to make it easy.
- Maybe spend some money.
- Example: Move to Opportunity
 - Families are offered housing vouchers.
 - Moving to a “good” neighborhood makes families happy and their kids make more money as adults.
 - But low take up.
 - #sludge
- *Source: Bergman, Chetty, DeLuca, Hendren, Katz, Palmer (2020)*

Creating Moves to Opportunity

Randomized trial to develop and test strategies to reduce barriers that housing choice voucher recipients may face in moving to high-opportunity areas



Source: Bergman, Chetty, DeLuca, Hendren, Katz, Palmer (2020)

Treatment Interventions



CUSTOMIZED SEARCH ASSISTANCE

On average, non-profit staff spend **6 hours** with each household

DIRECT LANDLORD ENGAGEMENT

47% of rentals in high-opportunity areas made through links via non-profit staff

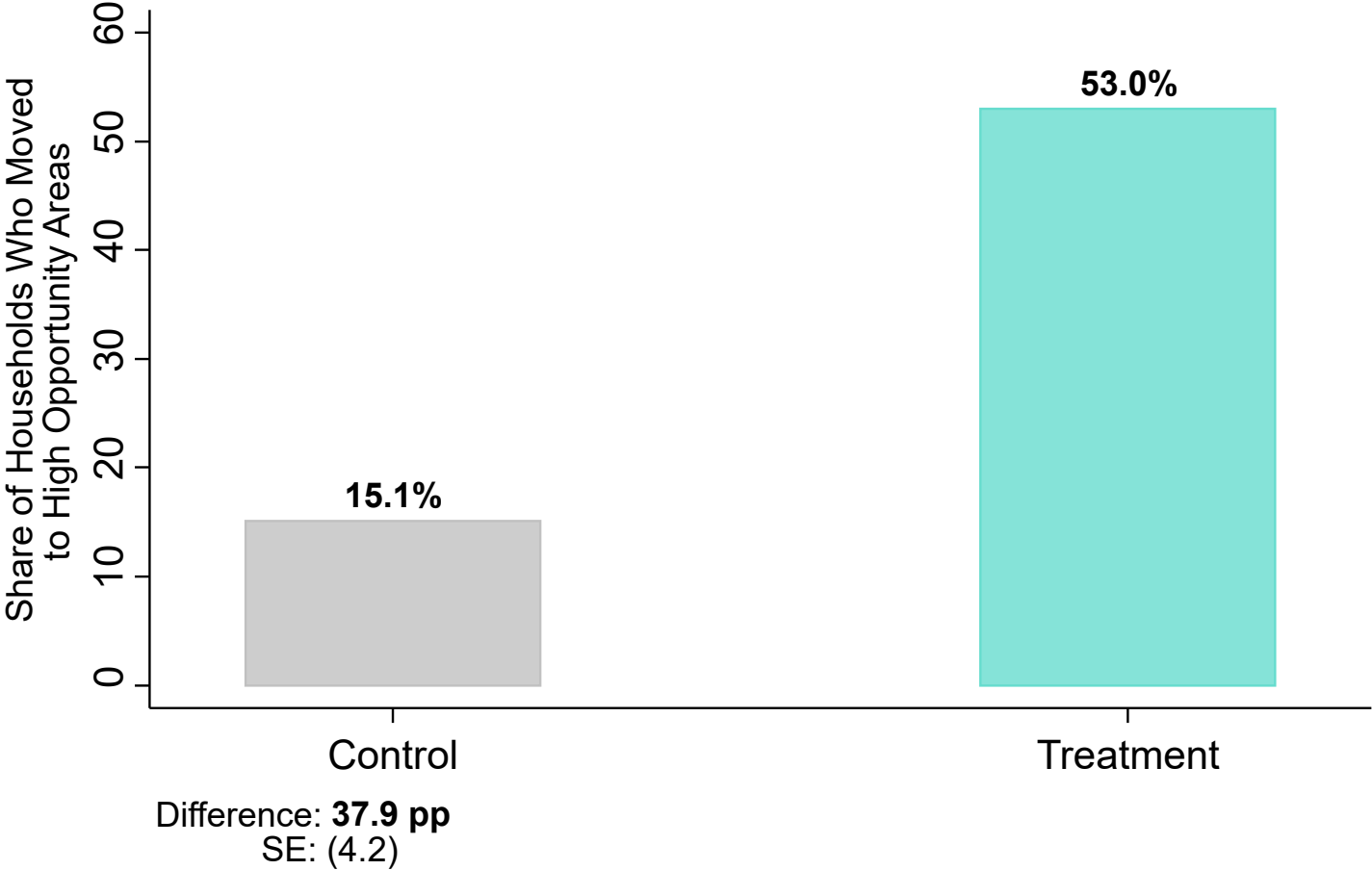
SHORT-TERM FINANCIAL ASSISTANCE

Average financial assistance of **\$1,000** for security deposits, application fees, etc.

Program Cost: \$2,660 per family issued a voucher
(2.2% of average voucher payments over 7 years)

*Note: Families **not** required to move to high-opportunity areas*

Experimental Results: Fraction of Families Who Leased Units in High Opportunity Areas



Important Note

- This experiment was *expensive* and required grants from numerous private foundations. Call it Ultra Nudging?
- Not an option for “nudge units”.
- But more evidence against the “Field of Dreams” hypothesis for economic policy: offer people something that will make them better off and they will take it up.

Conclusion

- Economic factors are often important.
- But so are a lot of stuff economists consider to be irrelevant.
- Good policy analysis requires an informed view of behavioral science.