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Ranching For Profit
Healthy Land, Happy Families & Profitable Businesses

Why Economics Doesn't Work *or, Why we can't make ourselves do what we want to do*

True or False?

I want to be dependant on my children when I am too old to work. _____

I want to live in poverty. _____

I really think I'm going to win the lottery. _____

Most of us would answer "False" to each of these questions, yet most of us behave as though the answers were all "True." How else could we justify spending more than we make? In 2006, our personal average savings was -1% of our income and the average American family had 6 credit cards. The average monthly credit card debt was \$9,000/family costing the average family over \$1,500/year just to finance their credit card debt.



Most people say they want to save and that they want to build a secure future. Yet most people don't save and don't take the actions necessary to provide for the future they say they want.

Behavioral Economics

Economics assumes that we all make rational, informed decisions. It assumes that we have an accurate concept of the worth of all goods and services and of the amount of happiness and utility all of our decisions will produce. If we really are making informed decisions and have an accurate picture of the short and long term costs and benefits of our decisions, then I guess we really do want to experience poverty and be dependant on our kids. Of course we don't want that to happen and that's why traditional economics doesn't work.

It's hard to blame ourselves for not making rational economic decisions. After all, the value we receive 30 years from now from saving \$100 this month is more difficult to grasp than the cost of saving that \$100. As a result we say we will start saving next year, do the WOTB work later and go on that diet tomorrow...of course tomorrow never comes.

Predictably Irrational, Dr. Dan Ariely's book introducing the relatively new field of Behavioral Economics, shows that, while economically irrational, our behavior is also systematic and predictable.

Behavioral economics takes into account our tendency for procrastination, our short sightedness and our proclivity to make decisions based on emotion rather than logic. In *Predictably Irrational*, Dr. Ariely shares some of the findings from his fascinating, if somewhat unconventional, research.

The Dog Ate My Homework

In Ariely's classes, students were required to submit three term papers. In some of his classes he dictated the due dates. The first paper would be due at the end of 4 weeks, the second at the end of 8 weeks and the final paper due at the end of the 12th week. In the other classes he told students they could turn in the papers whenever they wanted provided all of the papers were submitted by the end of the semester. In either case, students were told that if they missed a deadline, one point would be deducted for each day a paper was late. Which group of students received more penalties?

The students in the classes without mid-term deadlines for their papers could have turned their papers in at any time. They had more freedom than the students in classes in which Ariely imposed mid term deadlines. It is likely that they were relieved and even grateful for the increased flexibility. Yet, in the end, it worked to their disadvantage and they suffered poorer grades.

When students didn't have deadlines during the semester, they waited until the last minute to do their work. As a result, there were many late papers and students received more late penalties than the students who had deadlines throughout the semester. Even without the penalties students would have received poorer grades because the papers that were submitted, being rushed, were not as good as those submitted when deadlines were set at intervals during the semester.

Of course this tendency for procrastination doesn't only apply to students. We all tend to procrastinate. EL members benefit by having their boards help them identify actions they need to take, establish completion deadlines and hold them accountable for getting things done on time. Actions tend to be consistently completed when participants schedule deadlines through out the interval between meetings. In contrast, the completion rate goes down when members use the day before the next meeting as the deadline for all of their actions.

A distinct deadline is better than no deadline, but breaking projects into smaller steps and spacing the deadlines can improve your performance.

Being Aware Of Our Tendencies is Half The Battle

Ariely did not cause his students to submit their papers late. Like our decision to spend rather than save, start the diet tomorrow, or put off the WOTB until next week, it was the students' decision to procrastinate that led to their poorer grades. We don't want to be poor, or fat, or suffer the consequences of not getting the WOTB done any more than the students

wanted poorer grades. So why don't people who want to do something, just do it? Why do we procrastinate?

The problem is that we have a false sense of reality. The information we use to make our decisions is filtered by our eyes, our ears and our brain. By the time we process reality through these filters, it is no longer reality. It is our representation of reality. That representation is what we base our decisions on and that representation is never completely accurate. Compounding the problem, we usually aren't even aware that we are filtering the information.

There isn't a lot we can do about these filters (paradigms). After all, we are only human. However, being aware of how powerfully our paradigms influence our perception of reality can help us create systems through which we can make better decisions. One practical manifestation of this is the Executive Link program where people are held accountable to act on their good intentions. Another is called "*Save More Tomorrow*."

Several companies have retirement plans in which an employee's contribution to their plan is matched by their employer. Predictably, many new employees who know they *ought* to save for the future don't sign up for the plan. That's understandable. It is hard to sacrifice consumption today for benefit tomorrow.

It is psychologically easier to sacrifice consumption in the future, and even easier to sacrifice income from a salary increase you don't yet have. *Save More Tomorrow* gives employees the option to allocate a percentage of their future pay raises to invest in their retirement plan. Employee savings rates in companies that offered *Save For Tomorrow* increased nearly 400% (from 3.5% to 13.5%). That benefits the employees and their families by increasing their security and benefits the company by having a more stable, vested employee.

You can achieve similar results by implementing a *Save More Tomorrow* strategy in your business. It requires setting firm deadlines for taking action and achieving your goals, and creating an accountability mechanism. In *Save More Tomorrow*, the accountability mechanism was a contract. For Ariely's students it was a grade. For EL members it is their board.

Do you remember the "old woman/young woman" picture we show at the Ranching For Profit School? We see one picture or the other, but we rarely see the whole picture. Just as that is a visual illusion, we are constantly confronted with decision illusions. We think we are in the driver's seat when it comes to making decisions, but according to Ariely, it is more accurate to picture ourselves in the back seat while the car is being driven by emotions, social norms, and other factors that we aren't always aware of and that we don't understand. We tend to ignore or drastically underestimate the influence of these factors.

Knowing that we aren't rational in predictable ways can serve us well. Being aware of how our paradigms affect our perception of reality can help us create systems to guide us to better decisions and more profitable results.