The Stepping Stone

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Discover Your Inner Economist: A Summary

by Mary Pat Campbell

Prof. Tyler Cowen's new book, *Discover Your Inner Economist: Use Incentives to Fall in Love, Survive Your Next Meeting, and Motivate Your Dentist* is an interesting departure from the other pop-economics books that have hit the bestseller lists in recent years. For example, *The Undercover Economist and Freakonomics* explain some broad concepts from economics applied to extremely specific situations, such as incentives and econometric techniques applied to the concept of collusion amongst sumo wrestlers. While such "Gee whiz!" aspects are entertaining, they're not terribly useful.

To contrast, *Discover Your Inner Economist* is a self-help book with very practical advice for dealing with particular situations, informed by hard data. Even more, it shows the limits of economics when it comes to certain human problems: sometimes you should just shut up about sunk costs, and sometimes you should buy that extended warranty to please your wife.

I am trying to take Prof. Cowen's own advice here, by appealing to the "Me Factor," which he uses as a method to cut through scarcity of attention and interest. Since you're reading *The Stepping Stone*, I assume you're interested in development and management concerns in the actuarial profession, so I pulled out the "good bits" that directly address these interests. But these are mere morsels from a smorgasbord that you will want to feast upon in the book.

- **Incentives for doing a good job:** sometimes offering cash is counterproductive—when it undermines motivation (e.g., paying a daughter to do the dishes undermines the motivation of familial duty), when it's a high-pressure situation (people often choke), or when expending extra effort doesn't necessarily turn into better results (i.e., incentives don't align with performance).
- **How to deal with meetings:** there are gimmicks (no chairs) and reasonable methods (requiring an agenda ahead of time) for trying to cut down on time-wasting meetings. Unfortunately, many meetings aren't about getting business done, but rather are about determining the pecking order. If you reduce those meetings, other time-wasting behavior will likely replace them to serve that function.
- **Looking good through signaling:** one can use hard-to-fake signals, such as a degree from a prestigious university, to display one's intelligence and competence in a certain field. Unfortunately, sometimes one ends up with unproductive "signaling" arms races, where one is required to get useless graduate degrees due to the dilution of undergraduate degrees. (Undergraduate degrees are now required for all sorts of positions due to a similar dilution of a high school diploma.)
- **Motivations behind insurance consumers:** some types of insurance don't make sense from a rational utility-maximizer point-of-view (e.g. extended warranties), so something else is going on. Many people buy insurance to show they care to protect somebody else. Also, people like to feel like they're in control.

(continued on page 10)

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Discover your Inner Economist ... • from page 9

- **Brainstorming sessions:** often counterproductive, as no one person has responsibility for generating new ideas. To generate more ideas, have people come up with ideas on their own, and then get together.

Useful business advice occurs in the second and third chapters, in which Cowen describes how incentives can play out in different situations. As noted above, sometimes the traditional incentives backfire. An example given is a daycare center that was having problems with late-arriving parents, causing inconvenience and extra cost; the daycare manager decided to impose a fine on the tardy parents. However, after the new fine was instituted, more parents were tardy. When the cost of lateness went from social disapproval and a reputation for being unreliable to a given dollar amount, people decided it was worth that monetary cost. Perhaps a public shaming of tardy parents would have been a better incentive.

Let's see how this applies to actuarial work. Actuarial students put a lot of effort into passing the exams; putting in a bit more effort can result in a pass, where less diligent studying will result in failure. So incentives such as raises, bonuses and keeping your job will help. However, tying compensation to professional integrity, or how well one hews to the ASOPs—which are part of our professional ethos—would erode the current underlying motives. Accordingly, managers need to realize that money is not necessarily the prime mover for all of the things they want done.

A discussion of how signaling functions, and how it can be wasteful, brings to mind arguments over the latest exam changes in the SOA: with higher pass rates on the FAP, people are worried that the ASA credential is being diluted. However, were the exams replaced by the FAP modules and assessments a wasteful barrier to entry, where people were being tested on esoterica unrelated to their effectiveness on the job? (Why would I, an American actuary working with annuities, need to know the details of the Canadian Medicare system?)

As for control, one often finds that people may not annuitize because they feel like they're losing control over their money. Yet many of these same people may not feel that same loss of control when it comes to payroll taxes going into a program where they can't control the cash flow, either. Keeping the emotional motivations of customers in mind when we develop products may help us meet those needs as well as guide people into better options. We are seeing this now with regard to automatic 401(k) enrollment, with lifecycle mutual funds as a default allocation, as well as other programs to more actively steer people into what we would consider optimal behavior from a utility-maximizing standpoint.

These are insights useful for business and actuarial purposes, but there's far more here: how to get more enjoyment out of art, how to maximize the effectiveness of your charitable giving and how to find the best ethnic restaurants. Imagine that! An economics book giving practical advice on how to live the good life (at least, "good" as Cowen sees it)!

He also writes about living the bad life in a chapter on markets in the seven deadly sins; he's not advocating for this, but it does point out that economics will not provide you with values. He also shows you that you can't always use economics to get what you want—and that using these economic concepts may not be a good idea in the first place. Economic reasoning can improve outcomes on some things, though, even if it's only finding an excellent dim sum place for lunch. ❒

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