Applying Nobel Prize Economist Richard H. Thaler's
Behavioral Economics to Divorce Negotiations

<u>Dr. Thaler vs. Mr. Spock</u>. The 2017 Nobel Prize in Economics was awarded to Professor Richard H. Thaler of the Booth School of Economics at the University of Chicago for his work in the field of behavioral economics. Until the last few decades of the 20th century, economic theory and research was built upon the idea that people make rational purchasing and financial decisions. The rationality model has been described as the "Mr. Spock theory," the assumption that people make economic and financial decisions using the pure logic of the emotion-free Vulcan from Star Trek.

<u>Behavioral economics and supposedly irrelevant factors (SIF)</u>. Dr. Thaler was one of the creators of behavioral economics, which incorporates evidence from the field of psychology that people also make important economic decisions that do not comport with the classic model. Rather than always refer to these kinds of decisions as categorically irrational, he coined the term SIF ("*supposedly irrelevant factors*"). An SIF economic decision is when somebody makes an economic decision that is based on psychological factors that did not fit the traditional rationality model.

<u>The familiar emotions of divorce</u>. Those of us who are divorce professionals are quite familiar with the irrational considerations that our clients use in making economic decisions about their divorces. We call them emotional decisions, especially since they are often made in the context of obvious emotions of the divorce process, such as anger, guilt, fear, vengeance and frustration. We are also aware of the emotions relating to the substantive provisions of a proposed agreement and to the steps in the legal process of divorce. These emanate wholly or partially in response to the legal side of the case, but they may also be related to the recognizable emotions of the divorce.

<u>Planning and impulse control</u>. Thaler's categories of predictable SIF-based responses do not correspond to the two kinds of emotions listed above, although they may overlap in some cases. One of the most basic patterns he identifies is that most people are more comfortable with short-range decisions and tend to avoid long-range planning. Another is many people often credit themselves with more impulse-control and willpower than they actually possess. He points out something that has always been obvious to divorce professionals, which is that many of our clients live from paycheck to paycheck.

<u>Fairness</u>. The impact of these tendencies on divorce economic decisions should be easy to identify. In the same vein, Thaler demonstrates that people have a general idea of *fairness* in economic decisions. However, their SIF response is that they hold to this notion even in situations where it does not serve their own economic interests. One of the things that often promotes litigation is a client's insistence on fairness, which he or she may frame as being a *matter of principle*. As we know from the world of politics, principle may sound like a noble idea, but when it precludes compromise it impedes progress.

<u>Gains and losses</u>. People like economic gains and hate losses. Rational economic theory holds that these are treated as equal in similar circumstances, but they are often not. Thaler's *endowmen*t principle is that it is more important to hold on to what one already possesses to acquire something additional, even where there is a benefit to the new acquisition. At times Thaler uses a different term, *entitlement*, to describe an emotional need to "hold on" to something. This of course is position that we often see argued in divorce negotiations.

Sunk costs. A related idea is that of *sunk costs*, meaning that when we have bought something that we can't use, we tend to hold on to it even when it doesn't make sense to do so. An example is when we pay for a year's membership in a sports club, we try to keep using it even when we know that we don't want to. Sometimes that also means "throwing good money after bad." This may be another pattern that promotes litigation in divorce cases, with the retainer fees being like the sports club membership.

Mental accounting. Another of Thaler's SIF concepts is *mental accounting*. This means that we tend to keep some budgeting ideas in our heads, but we do it in categories. For example, he has shown that when gasoline prices go down, people tend to splurge on more expensive grades of fuel rather than invest the savings in something else. It would be interesting to see the extent to which our clients deem child support payments as a category to be used exclusively for children's out-of-pocket expenses, even though a part of each payment is intended for housing costs.

The financial challenges of divorcing. Most of the divorces we see result in a reduced standard of living for both parties. The immediate challenge both parties face is how much this can be managed with less expenses, and what are the possibilities for more income. This suggests a need for more willpower and greater impulse control, and certainly some consideration of longer-range planning.

Using Mr. Spock to identify the SIF. Perhaps we can use a *Mr. Spock test* to check out Thaler's ideas in our divorce practices. If our client's decision or plans would differ from that of our Vulcan friend, then we can identify the SIF behind his or her preferences. What we do with that, of course, must depend on the context. Arguably, however, we should always raise issues of future planning and impulse control with our clients when these seem to be relevant.

Further reading. Dr. Thaler's most recent book is *Misbehaving: The Making of Behavioral Economics*, which was published in 2015. This is probably the best of his books to start with, especially since it takes you on a guided tour of the recent history of economic theory.