

Optimism as a source of danger

NZZ article covering the keynote of
Nobel laureate Daniel Kahneman

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Abstract

Nobel laureate Daniel Kahneman has repeatedly addressed the consequences of risk aversion and excessive optimism in his work. In his lecture at the University of Zurich, he focused on the economic consequences of decisions made by risk-averse and risk-taking individuals, drawing on his famous book *Thinking, Fast and Slow*. This article summarizing the UBS Center Opinions event was published in the *Neue Zürcher Zeitung*.

The Israeli-American psychologist Daniel Kahneman is living proof that economics is not dogmatic. In numerous works, he has also addressed the consequences of risk aversion and excessive optimism.

“Alas, two souls dwell in in my breast, and one wants to separate from the other,” wrote Johann Wolfgang von Goethe in his “Faust. Part 1”. An example of two contradictory souls in one’s breast is the contrast between risk aversion and excessive optimism. They are both part of human nature, contradict each other, but still make sense, said Nobel Laureate economist Daniel Kahneman at a lecture at the University of Zurich.

Fear of loss

During his lecture, which bore the title of his book “Thinking, Fast and Slow”, the Israeli-born psychologist also addressed the economic consequences of decisions made by risk-averse and risk-loving individuals. He referred to a study in a Chinese company in which some employees were promised bonuses if they met targets. The other part of the workforce received the bonus in advance – but was told that they would lose it again if they failed to meet their targets.

According to Kahneman, people weigh losses twice as heavily as profits on average, so the employees in the Chinese company reacted “like humans”. The pressure they were under because they were at risk of losing the bonus they had been paid gave them wings. Their productivity was 1 % higher than that of their colleagues who should have received the bonus only after meeting their targets. Risk aversion is a key reason why many people shy away from change and remain in the status quo. When changing jobs, the risks of the new challenge often dominate rather than

the opportunities. Optimists occupy the opposing pole from risk-averse people. They are less aware of the risks of their actions than more anxious people. However, this characteristic also has advantages and disadvantages. Optimists are more resistant to setbacks. However, they also run the risk of taking risks that they could avoid if they were better informed about the prospects of success. Kahneman was skeptical of the theory that excessive optimism can be overcome at an individual level through training. Organizations, on the other hand, could tame optimism better than individuals.

However, he did not elaborate precisely on this point in his lecture, which he discusses in more detail in his brilliant book “Thinking, Fast and Slow”. In this magnum opus on his work over the past decades, the 79-year-old Kahneman recommends a “pre-mortem method”, according to which people in organizations who are familiar with the topic should meet first before making important decisions.

The meeting should begin with a short speech to those gathered with the following wording: “Imagine we are one year in the future. We have implemented the plan as it stands. The result was a disaster. Please take five to ten minutes to write a short history of this disaster.”

Less would be more

Kahneman writes in his book that the advantage of this method is that it is possible to express doubts before making decisions. It also encourages supporters of the decision to look for possible dangers that they had not previously considered. Possible over-optimistic biases could therefore be reduced. This is an approach that the audience would certainly have liked to learn more about. But Kahneman had no time for such aspects in the quick dash through his book. Sometimes less would be more.

Source

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You can find a recording of Kahneman's speech and other material on the topic on the Center's website: www.ubscenter.uzh.ch

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About the speaker



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