

The Hindsight Bias and Its Applications

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Abstract:

The hindsight bias, also known as the “I knew it all along” effect, is a psychological phenomenon in which a person believes they predicted the outcome of an event, even if they did not act on their “prediction.” Individuals can be affected by the hindsight bias to confidently overestimate their judgment, which can have severe consequences. Also, it can negatively affect all aspects of society to varying degrees. Social experiments have demonstrated that this phenomenon exists in the investment industry, politics, and the law. It can be detrimental to individuals, affect the outcome of political elections, and compromise the impartiality of police evaluations. Due to the impact of hindsight bias, there are several suggested ways to prevent this bias, and it is essential to understand how to prevent and account for it.

Keywords: Hindsight bias, Psychology, Investment, Politics

Introduction

Imagine a picture of a student making a decision that will directly affect the outcome of a competition. He considered option one, but after thoughtful hesitation, he chose option two. And after the answer is announced, he looks at the correct answer, option one, and muses, “I knew that! I should have gone with this option” . Since then, the student has participated in another competition, and when confronted with a relatively similar problem, he no longer hesitated but confidently selected the previous correct answer, declaring, “This must be correct.” But he misses the correct answer again because of not notice a different detail from the question and just quickly choose the one that he believes in. Such decision-making processes are very common in life, and they share a trait that is not restricted by age or gender: the feeling that “I knew it all along.”

This “I knew it all along” effect is also known as hindsight bias, a psychological phenomenon in which a person believes they predicted the outcome of an event, even if they did not act on their “prediction.” Sadly, individuals can be affected by the hindsight bias to confidently overestimate their judgment. Scholars have demonstrated that hindsight bias is a very significant and noteworthy psychological phenomenon due to its prevalence and the severe repercussions that can result from incorrect decisions in various fields. In this article, an analysis of hindsight bias will be presented, discussing its manifestations and applications in investment, politics, and laws, along with the reasons for the importance of paying attention to this form of decision-making bias.

Why it matters?

Hindsight bias is difficult to avoid and can easily occur in most people. Once formed, it is very difficult to change. It also has the potential to influence “decision-making” in various areas. In addition, the positive repercussions of having hindsight bias can enable people to have an excessive sense of self-efficacy, which can be a problem.

The research “Why Hindsight Can Damage Foresight” by Paul Goodwin, Professor of Management Science at the University of Bath, indicates that psychologists have identified three distinct mental processes that comprise hindsight bias. They are an impression of certainty, the impression of foreseeability, and memory distortion. Different psychological processes predominate in various situations, thereby easily triggering hindsight bias. Paul argues, based on additional research, that these three mental processes correspond to three conditions: the cause of the event is well-explained; there are no surprises when the event occurs; and people forget their initial prediction and believe it was closer to the actual outcome than it was. If any of these conditions are met, hindsight bias will occur.

Neal J. Roesse and Kathleen D. Vohs also endorse such a conclusion. They've conducted over 800 documentary studies and concluded that hindsight bias exists in people all over the world and among both young and old people, and has been documented in a variety of domains, including labor disputes, medical diagnoses, accounting and auditing decisions, business startups, public policy, etc. With such a wide variety of influences, hindsight bias will likely result in irreversible changes to outcome

knowledge, as Mark R. Leary's research explains through the concept of "creeping determinism." He argues that people tend to view outcomes as relatively irreversible and that this outcome will be assimilated into existing knowledge and attempted to be strung together into a coherent whole. Information that is already known will be filtered out, while information that does not fit into the whole will be forgotten, trivialized, or altered to suit. Therefore, once individuals develop a hindsight bias about something, recalling their previous perspectives on the possible outcomes will be difficult. In addition, "creeping determinism" contends that hindsight bias is not only governed by mental processes but is also occasionally personally motivated. Individuals can maintain or improve their self-esteem by exaggerating their ability to predict outcomes. In other words, "I knew it all along" is a way to express one's "true" opinion and demonstrate sound judgment and perception, thereby gaining respect and enhancing one's reputation. Driven by this motivation, people can unconsciously follow the path of decision bias, even if they do not fall into the trap of the mental process.

Application 1: Hindsight Bias in Investment

In the early years, the classical school of economics presumed that investors acted rationally. However, in recent years, the behavioral school of economics holds that investors are irrational and have come to dominate the investment industry. Tchai Tavor, a professor from The Max Stern Yezreel Valley College, works in economics, behavioral finance, and environmental economics. In his 2013 article "Investors' Short-Term Decision Making and Review of the Hindsight Bias Effect," he explains the application of hindsight bias in the investment industry, using both a literature review and an experimental approach. It has been discovered that investors do not always make consistent decisions or are always based on precise, regular mathematical algorithms. Psychology plays a substantial role in the investment market, and people's emotions have become a major factor in determining investment decisions. Several of these, including risk aversion and psychological fallacies, can substantially affect investment decisions.

Tchai investigates the phenomenon of hindsight bias, focusing on the capacity to make short-term investments. In his article, he notes that many investors make predictions based on past return performance and subconsciously block out the memory of poor past investment behavior, recalling only the positive ones. Hindsight bias can cause investors to become overconfident and make hasty investment decisions based

solely on experience, resulting in typically incorrect decisions. In this scenario, the investor is extremely confident in the integrity of the previous forecast and develops a comprehensive plan to implement it. In reality, however, the decision is much less certain than the investor had anticipated, increasing the investor's excessive exposure to risk. Due to the accompanying self-interested bias, investors confronted with a failed decision frequently view the situation as inevitable to avoid accepting responsibility and disregarding the failure. He could have identified the warning signs of a falling share price in the company's earnings report. Still, due to his prior experience, he confidently chose the risky stock and lost substantial money. This investor described his loss as "an inevitable consequence." In this instance, hindsight bias functions as a "distracting mechanism," enabling the investor's mind to accept only correct-appearing information and to bypass a rational evaluation of the pros and cons in favor of an immediate decision. To avoid hindsight bias, Tchai imparts investment advice, which is that investors must be sensitive to their emotions and objectively weigh the pros and cons of both positive and negative decisions before making a decision,

Application 2: Hindsight Bias in Political Elections

It is believed that hindsight bias has an impact on politics as well. People who are aware of the outcome of an event will mistakenly believe that the outcome they predicted is very near to the actual outcome and that the event was better predicted than they believed (Hartmut & Volkhard & Edgar, 2003).

Florian Schuett is the Associate Professor of Economics at Tilburg University, where he has been teaching since 2009. With Alexander K. Wagner, he conducted a study of public response to significant political events in the United States, inquiring about people's perceptions of the government's decisions at the beginning and end of the event. Comparing their findings, Florian and Alexander discovered that after an event, people's perspectives were significantly influenced by hindsight bias, and they tended to believe that their prior predictions were accurate. Since the president or senior government officials make most government decisions, people's hindsight bias can alter their perceptions of leaders, impacting the outcome of democratic elections. For instance, Florian mentions the 1991 Gulf War. The United States debated whether to launch military action against Iraq, and President George H.W. Bush chose to do so. In a public opinion poll conducted at the time, only one in two respondents believed sanctions should be imposed. However, when

these individuals were polled again after the conflict, they were more likely to believe that they had chosen the same outcome as the facts, namely that sanctions should have been imposed. This trend would have also significantly impacted the likelihood of George H.W. Bush's re-election because if more people had tended to believe that they had easily made the right choice, then President George's political ability would have been underrated. His chances of being re-elected will become less likely. And so it was, George H.W. Bush lost the post-Gulf War campaign. Despite the positive short-term effects of his decisions on his support, his post-war support was lower than his pre-war support. It is reasonable to suspect that the public underestimated George's ability and decided not to vote for him due to hindsight bias.

Although Florian and Alexander concur that voter hindsight bias is a tool to prevent politicians from wagering on ineffective policies, the results of their experiments indicate that such a bias can harm voter happiness. Low-capacity politicians will choose non-welfare-maximizing policies to attract attention during the election process to demonstrate their superior private message and garner votes; this can inhibit effective risk-taking to the detriment of the populace.

Application 3: Hindsight Bias in Laws

The influence of hindsight bias on the law is primarily negligence, liability, and accidents (Neal & Kathleen, 2012). Using social experiments, Alasdair M. Goodwill, Laurence Alison, Robert Lehmann, Ashley Francis, and Marie Eyre demonstrated that hindsight bias significantly negatively impacts how police officers assess and determine liability in emergencies. They invited people to comment on the shooting as “police officers,” “family members of the victims,” “Independent Police Complaints Commissioner,” and “police officers.” The results were compiled, and inconsistencies between police officers and commissioners were discovered. As officers of the Independent Police Complaints Commission (IPCC) are required to evaluate the performance of police officers in incident management, this inconsistency resulting from hindsight bias can significantly impact the reputation of police officers and the direction of public opinion.

In the legal profession, hindsight bias manifests quite differently than in the investment industry. As previously mentioned, experienced investors make simplified and faster decisions based on their prior experience, i.e., they are more susceptible to bias. Goodwill contends that senior officers, i.e., the more experienced officers, exhibit higher-order cognitive processes when making decisions in the face of threats. In contrast, novice officers rely more

on their discretion. Thus, officers with greater experience are less susceptible to hindsight bias. However, even if the officers had correctly determined how to respond to the threat, the IPCC commissioners would have been biased. They are meant to evaluate police officers based on the “reasonability of the process,” but they prefer to evaluate based on the outcome. Specifically, even if an experienced officer makes the best decision in a critical situation, commissioners may still conclude that the officer did not exercise the best judgment if the outcome is negative.

In response, Goodwill et al. suggest that the police use as many corroborating sources of information as possible when assessing threats and then use this information to support and defend their decisions to safeguard their professional reputation and guide public opinion appropriately.

Conclusion

As a psychological flaw, hindsight bias causes individuals to exaggerate the predictability of this event during the decision-making process and to increase their confidence in themselves. A phenomenon of this nature can have varying degrees of negative effects on all aspects of society. Social experiments have demonstrated this bias in the investment industry, politics, and the law. It can damage individuals, influence the outcome of political elections, and undermine the impartiality of police evaluations. Due to the influence of hindsight bias, we must comprehend how to prevent and account for it.

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