

NEW INTERNATIONAL EDITION

‘Hot stuff’

*SUNDAY TIMES*

‘Hugely influential’

*GUARDIAN*

# nudge

Improving decisions  
about health,  
wealth and happiness

THALER & SUNSTEIN



# Goals and Objectives

- Apply the techniques of the psychology of decision making and behavioral economics to improve decisions without limited choices.
- Offer a new approach to public policy that is neither left nor right.



# What is Behavioral Economics

*“The phrase behavioral economics appears to be a pleonasm. What non-behavioral economics can we contrast with it? The answer to this question is found in the specific assumptions about human behavior that are made in neoclassical economic theory.”*

Herb Simon



# Assumptions of Behavioral Economics

- Humans vs. Econs
- Bounded Rationality
  - including bounded attention
- Bounded Willpower
- Bounded Self-interest
- Bounded Markets



# Are Markets Efficient?



# One Approach to Policy: Libertarian Paternalism

Both terms are currently unpopular (at least in the US), and seemingly contradictory. But, neither concept should be controversial:

- *Libertarian*: protect the individual's right to choose
- *Paternalism*: do what you can to improve the welfare of people

And it is possible to achieve these goals with better **choice architecture**.



# Choice Architecture

Anyone who designs the environment in which people make choices is a choice architect

- Menus
- Store layouts
- Curriculum



# What is the alternative?

Choice architects must choose *some* set of institutional arrangements. What design should planners pick?

**Example:** cafeteria menu planning—in what manner (order, salience..) should the food be presented?

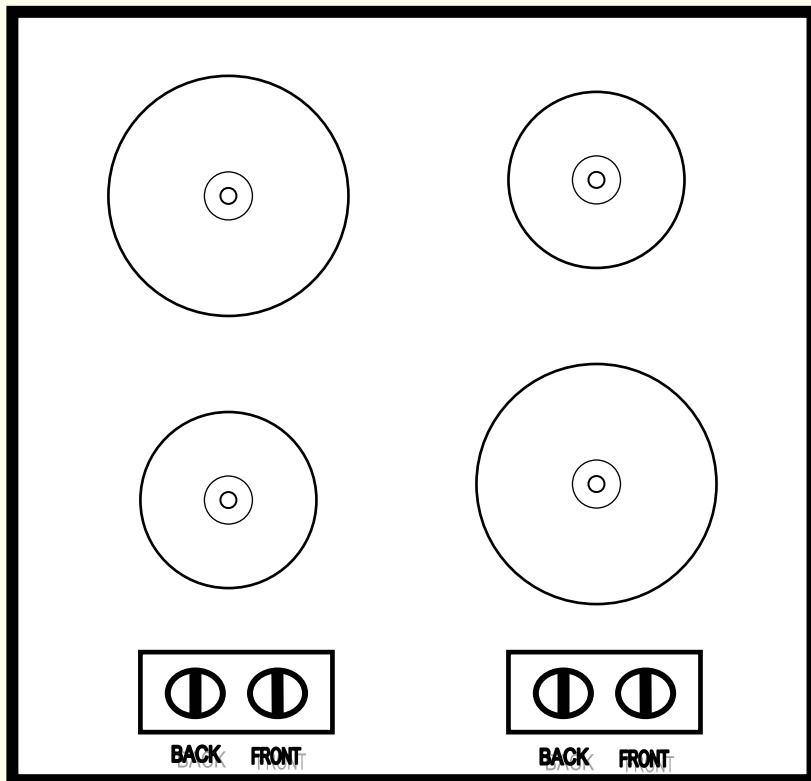
- The plan that make participants better off?
- The options that make the participants worse off? (e.g., fattest?)
- Random?
- The options that make the director best off?

Note that **some** choice has to be made.

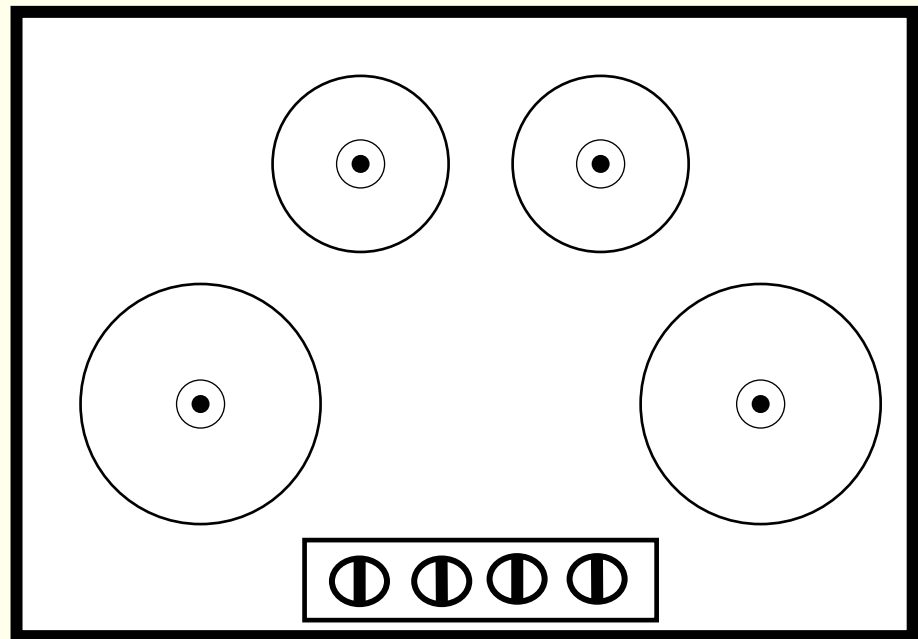


# Some Designs are Better

## Bad Design



## Good Design



# Urinal, Amsterdam Airport



# Detail of Fly Painted on Urinal



Results: 80% less “spillage”



# Principles of Good Choice Architecture

- **Defaults**
- **Expect Error**
- **Give Feedback**
- Understand Mappings
- Structure Complex Choices
- Incentives



# Defaults: Padding the Path of Least Resistance

- What happens when people do nothing?
- Computer settings
- TV schedule
- Main lesson: defaults are sticky



# Good Example

- 401(k) Automatic Enrollment
  - Changes the Default
  - Increases and speeds the participation rate
- Incorporated by Lord Turner's National Pension Savings Scheme



# Give Feedback

- Give users information on how they are progressing toward their goal.
  - Pink Ceiling Paint
  - Digital Cameras



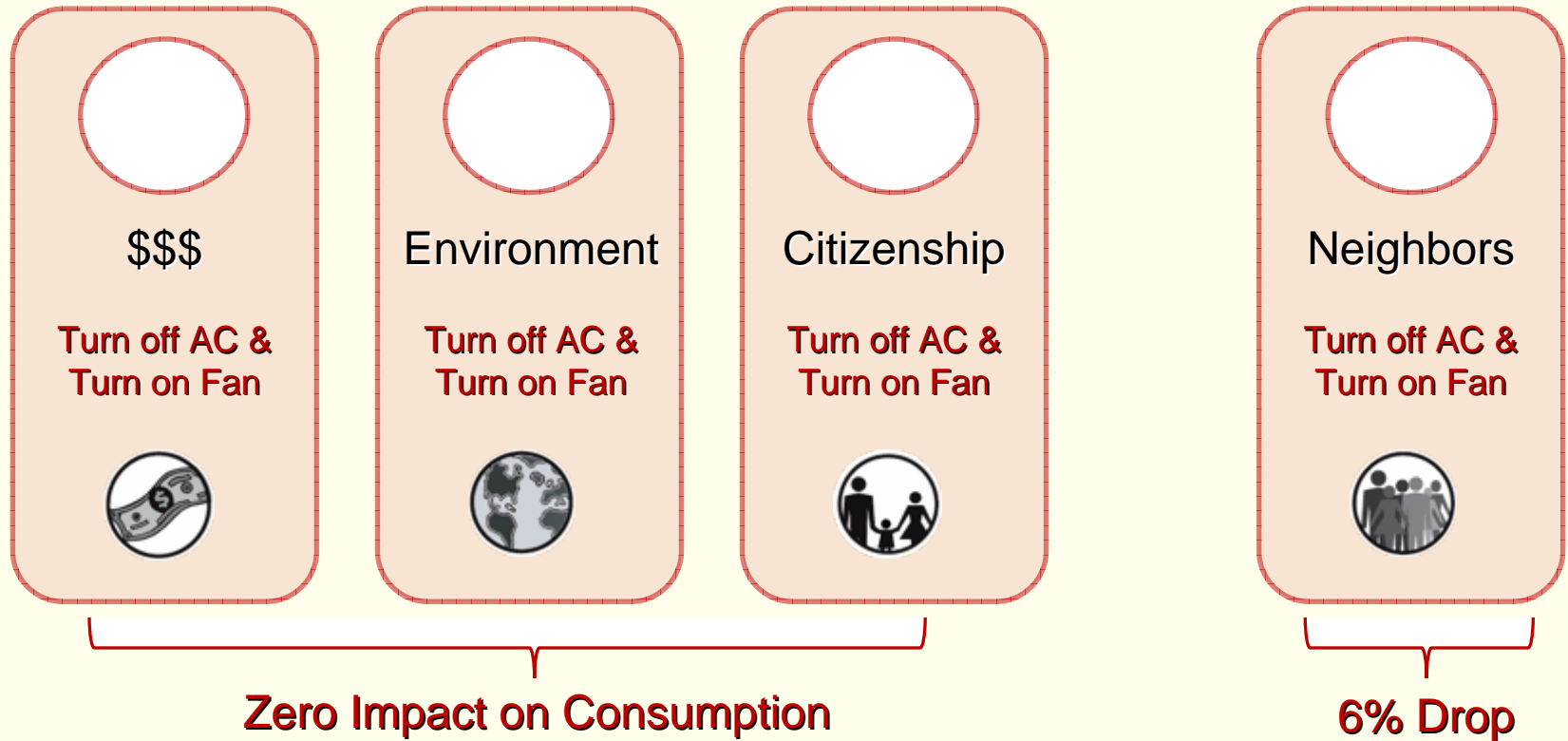
# Give Feedback (cont.)

## **Ambient Orb (Clive Thompson, 2007)**

A little ball that glows red when people are using lots of energy, but green when their use is modest. In a period of weeks, users of the Orb reduced their use of energy, in peak periods, by 40 percent.



# The Power of Social Comparison



Date of study: 2003



# RECAP:

## Record, Evaluate and Compare Alternative Prices

- Electronic, downloadable information.
  - Price formulas
  - Personal usage information
- Applications
  - Credit Cards
  - Mortgages
  - Cell phones



# Example: Credit Cards

- Once a year credit card issuers would have to supply each customer with two electronic files.
  - Personal usage information
  - Price formulas
- Web sites would emerge to help process this information.



# Greenspan's Error

- “Those of us who have looked to the self-interest of lending institutions to protect shareholder’s equity (myself especially) are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets’ state of balance. If it fails, as occurred this year, market stability is undermined.”
- On mortgage backed securities “ To the most sophisticated investors in the world, they were wrongly viewed as a ‘steal.’”



# Diagnosing the Error

- Bounded Rationality
  - Households
  - CEOs
- Bounded Willpower
  - Households: norms, envy
  - CEOs: risk control costs money



# Solutions?

- One trap is to conclude that we need to give lots of power to regulators.
- But if the CEOs of these companies did not understand what was going on, what hope is there for regulators?
- Goal: improve disclosure enough to impose market discipline while still allowing companies to make money.
- In some cases, disclosure to outsiders will improve disclosure inside the firm.



# Conclusions

Humans are imperfect. We need all the help we can get.

It is possible to improve choices without restricting options.

Don't use bans and mandates--just **nudge**.



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