book review

Nudge: improving decisions about health, wealth and happiness

by Richard Thaler and Cass Sunstein

(2008 Penguin, London)

Reviewed by Scott Donald SF Fin Chair, JASSA Editorial Board.

Some choice is good, but too much may be bad for your health, or your wealth or, ultimately, your happiness. With the appeal of the neo-liberal mantra badly shaken by the global financial crisis, Thaler and Sunstein have captured the post-GFC zeitgeist, suggesting that, in some circumstances, it may be appropriate for the government to intervene to promote better choices on the part of individuals. Their proposals will seem sensible to many readers.

THE CONSUMER REVOLUTION of the second half of the 20th century has spawned a wider range of choices across more areas of human activity than anybody could have imagined. There are many simple examples, such as how many varieties of 'milk' someone entering a corner shop will encounter, the number of candidates that appear on a typical ballot paper or the number of investment options from which a super fund member can choose.

Choice has also permeated into areas more traditionally reserved for 'paternalistic' government involvement, such as education, health care and social security. This takes the phenomenon to a new level of complexity. It makes clear that the provision of choice is itself the result of other choices.

The most obvious of these 'meta-choices' is the determination of what is to appear on the menu of choices. Should parents be able to choose not only between the local public school and a private school alternative, but between alternative local public schools? Should home education be one choice? What types of investment options ought the trustees of super funds be permitted to include on the member investment choice 'menu'?

More difficult is whether it is acceptable to force a person to make a choice in the first place. Australia is, for instance, one of the few democracies in which voting across all levels of government is mandatory. Failure to vote in federal, state or local level elections in Australia attracts state-enforced sanction.

There is also the question of who makes the different choices, and on what basis? When a retailer makes a decision to place certain goods in more favourable positions, they are clearly acting in their own self-interest – they want to sell more of that good. When a secondary school decides to offer only certain specialist subjects, it may be responding partly to student demand, but also to the teaching resources it has or can acquire. When the government acts to constrain or facilitate choice, it may do so for any one of a number of social or economic policy reasons.

Quite clearly, these are all decisions imbued with normative content. There is no 'right' answer. A person's values and beliefs will influence strongly their answers to these sorts of questions. In addition, economists since Hebert Simon in the 1950s have been acutely aware of what Schwarz has more recently termed the 'paradox of choice'. Some choice is often (though not always) welcome. But there comes a point where more choice actually impedes the decision and, moreover, reduces the satisfaction individuals feel about exercising that choice. The choice itself becomes stressful and post-decision dissonance looms large.

Richard Thaler and Cass Sunstein, economist and lawyer respectively, confront these conundrums in *Nudge: improving decisions about health, wealth and happiness*.

Their starting point is to recount the insights about individual decision making collected under the rubric of 'behavioural finance'. They run through the familiar litany: heuristic biases (anchoring, availability and representativeness); optimism and over-confidence; asymmetric utility functions; status quo bias and framing. Each is claimed to cause decision makers to make what are, both objectively and subjectively, sub-optimal decisions.

This material is not new, but it is not intended to be. Its role, rather, is to justify what follows. Undermining the validity of *homo economicus* as a positive approximation of individual behaviour is a key step in their argument. If people not only make 'poor' decisions when confronted by choice, but they agree after the fact that they made a poor choice, then gentle 'guidance' from a better-informed, dispassionate hierarch might appear to be more morally defensible. This is where 'choice architecture' comes in.

Choice architecture arises like a phoenix from the ashes of economic rationality. If institutional and psychological factors combine to cause individuals to make decisions that are not only irrational but also subjectively unsatisfying, then perhaps government has a role to play in regulating to ensure the choices they make occur in an environment specifically designed to secure a 'better' decision? Supermarkets have been doing it for years, placing the products they most want to sell at eye-level on shelves, so why not government agencies? At least government could be guided by 'public interest' and insulated from some of the more myopic and self-interested motivations that might afflict private enterprise. Or so the argument goes.

This, of course, is anathema to neo-liberal thought. From a neo-liberal perspective, the provision of choice is essential. It has a moral dimension in that it emancipates individuals from the coercion of state intervention. It is also a precondition for consumer sovereignty, the idea that a market peopled by actors who are self-interested, independent and well-informed, is the most efficient mechanism for allocating society's resources optimally.

But Thaler and Sunstein have chosen their time well. The appeal of the neo-liberal mantra has been badly shaken by the global financial crisis (GFC). Though much of the book precedes the GFC, the authors were able to append a final chapter specifically dealing with the GFC to illustrate their point.

The 'libertarian paternalism' suggested by Thaler and Sunstein is quite deliberately positioned to be a compromise, a 'New Path' as they put it; a bridge across what the authors perceive to be a 'political divide'. Choice architecture is about creating an environment that facilitates choice but attempts to mitigate unwelcome biases and promote 'healthier' ones. (In fact, the authors' favourite example, to which they return several times in the book, relates to the placement of different types of food in a school cafeteria.) To employ an Antipodean metaphor, in other situations, choice architecture may simply amount to a sort of 'swim between the flags' notion. In those situations, individuals are free to choose whether to participate in either the protected or unprotected arenas, recognising that they bear the consequences of that choice.

Some will no doubt be concerned about the presence of a hidden agenda, subsumed into the underlying architecture of the system. They may even challenge Thaler and Sunstein's assertion that for the government to influence choices in this way is not 'coercive'. In fact, though, the choice architecture proposals are more often about what happens to those who do not make a choice at all; the so-called 'default'. That, for instance, is the rationale for the Cooper Review's controversial use of the choice architecture notion in its preliminary report, *Clearer super choices: matching governance solutions*. However, as Thaler and Sunstein point out, it would be naive to assume that even market-derived equilibria do not have some underlying decision-structure embedded within them. Thaler and Sunstein's point is simply that in some circumstances it may be appropriate for the government to influence or even override the outcome that would otherwise be achieved by the market.

The one thing that *Nudge* does not do is delve deeply into the normative dimensions of what the authors are proposing. Readers seeking a detailed discussion of the libertarian theories of Mill, Locke, Bentham and the like, will be disappointed. Similarly, the authors of *Nudge* devote little time to a discussion of the various models of pluralism, or of sociological perspectives on choice, risk and responsibility. This, then, is not a book for the armchair philosopher.

The book is also not value-neutral. It is informed by what, from the Antipodes, might be considered a constrained-libertarian sensibility. (Commentators from North America have tended to position Thaler and Sunstein's work firmly to the left of centre. However, this would appear to reflect their frame of reference. It might reasonably be expected that Continental European commentators might come to a different conclusion.) In this respect, it is a challenge to economists and others who pretend their work is value-neutral; that somehow neo-classical economics (or whatever other theoretical construct is being applied) does not privilege certain values over others. In this, too, Thaler and Sunstein have captured the post-GFC *zeitgeist*.

Importantly, *Nudge* aspires to being of immediate practical value. The authors clearly hope that some, at least, of their ideas will be applied. The book includes chapters that focus on saving for retirement (Chapters 6 and 7), mortgages and credit cards (Chapter 8), social security (Chapter 9), prescription drugs (Chapter 10), organ donations (Chapter 11), the environment (Chapter 12) and marriage (Chapter 13, an unlucky number for some). It concludes with what the authors term 'A Dozen Nudges'; practical proposals they believe might exploit the ideas they have presented. Their publisher has also sponsored a website dedicated to eliciting more, www.Nudge.org.

Nudge then, is perhaps just that: a nudge to encourage people, especially policy makers, to consider whether there are certain circumstances in which it may be appropriate for the government to intervene in markets. It is a beguilingly compelling read. The authors, both highly credentialled academics, have gone to great lengths to subsume their skills as analysts and theoreticians beneath a veneer of civic-mindedness. Many of their proposals will seem sensible to many readers (including this reviewer) and, possibly, even desirable. And, for those readers who find the proposals unattractive, *Nudge* challenges them to state why.