

Nudge by Richard H. Thaler and Cass R. Sunstein
New Haven and London: Yale University Press, 2008

Reviewed by Mark Evans
Associate Dean, School of Business and Public Administration
Professor of Economics, CSUB

“Rational choice modeling” has been the economists’ dominant method for explaining and predicting human behavior since Adam Smith. This method assumes the individual has a computer-like ability to calculate trade-offs and an imperative to choose the course of action most aligned with self-interest. Sophisticated users of this method do not believe individuals are fully rational; rather they use the method to explain or predict changes in aggregate-level behavior. If the personal benefits of an activity increase or if its personal costs decrease, economists predict increased activity at the market level. Likewise, if an activity has decreased, economists seek to explain the change in terms of a decrease in benefit or increase in cost to the typical decision maker. Simply put, farmers can be expected to plant more corn when the price increases and less when it decreases. It is granted that not all decision makers are rational, but presumed that cognitive errors are random and cancel one another out at the aggregate level.

An emerging field, behavioral economics, departs from this orthodoxy and focuses on identifying situations where decision making is systematically biased. Daniel Kahneman, 2002 co-recipient of the Nobel Prize in Economics has called an early paper by Richard Thaler, co-author of this book, “the founding text in behavioral economics.”

Nudge presents a behavioral economics approach to policy making that authors Thaler and Sunstein label “libertarian paternalism.” Their approach is paternalistic in that it builds on findings that decision makers are sometimes their own worst enemies and proposes interventions to protect people from themselves. It is libertarian in that their proposals maintain freedom of choice and value outcomes from the perspective of those making the decisions. This is not an oxymoron in that they propose interventions that affect how decisions are framed, but leave the freedom to make decisions intact. They argue that policy makers should become “choice architects,” using the findings of cognitive psychology and behavioral economics to explicitly frame decisions in a way that will “nudge” them to be more consistent with desired outcomes.

For example, inertia is a systemic bias in decision making. Anything that is a “default option” will be frequently chosen. In most organizations, the default option for 401k contributions by a new employee is zero contribution. In the absence of an overt action by the worker, nothing goes into the 401k. Over the life cycle, workers would agree they should increase the percentage contribution as their kids are raised and shift portfolios toward fixed assets as retirement approaches. Inertia prevails. In most cases, none of this happens or too little happens too late. Thaler and Sunstein propose that all of this happen automatically as the default option with employees retaining authority to make choices departing from the default.

The first part of this highly readable book summarizes various types of systemic decision making bias and enumerates a toolkit of strategies for choice architects. The second half has chapters on various social problems in which the authors propose nudges that can be used by choice

architects to improve outcomes. These chapters primarily cover topics relating to personal finance, health care, and education. It will not surprise me if their chapter on privatizing marriage wins converts on both sides of the gay marriage issue.

The rational choice model has served economics well and is here to stay. However, there is growing receptivity to new approaches and the economics discipline is being enriched as a result.