

## IPS Corporate Associates Breakfast: Why Nudge?

By Paveena Seah  
*IPS Research Analyst*

There is growing interest worldwide in using behavioural economics to achieve public policy goals. On 1 August 2014, Professor Cass Sunstein, co-author of the book *Nudge: Improving Decisions About Health, Wealth and Happiness*, spoke to members of the Institute of Policy Studies (IPS) Corporate Associates programme over breakfast on how behavioural economics can be used to shape better outcomes for both government and business.

A former Administrator of the White House Office Information and Regulatory Affairs, Professor Sunstein is also the Founder and Director of the Program on Behavioral Economics and Public Policy at Harvard Law School. Around 50 business leaders and IPS researchers attended the breakfast session, which was chaired by Donald Low, Associate Dean (Research and Executive Education) and Senior Fellow at the Lee Kuan Yew School of Public Policy.

### ***Nudges and Public Policy***

Professor Sunstein's presentation focused on what has been termed "nudges". He defined a nudge as "a feature of the social environment that influences people's choices without imposing coercion or any material incentive". He explained that nudges direct people towards better-informed decisions through policy mechanisms, rather than implementing economic incentives, criminal or civil penalties. Often, he said, resistance to direct suggestions is due to confusion and lack of expertise. Nudges are a low-cost but high-benefit form of intervention, he said. Examples of nudges include framing issues in a certain way, automatic enrolment into plans, default rules, warnings and reminders.

Drawing on real-world evidence, Professor Sunstein candidly shared how nudges were applied in policymaking. For example, in Denmark, automatic enrolment had a much bigger effect than significant tax incentives on increasing workers' participation in retirement savings schemes. By making enrolment the default option, more workers were "nudged" into retirement savings schemes while still keeping the choice to opt out.

The nudging approach can also help governments sharpen policymaking by incorporating regulatory look-back mechanisms into the policy review process, said Professor Sunstein. Examples of regulatory look-back mechanisms include collecting public feedback; conducting periodic reviews of rules and regulations; and making data publicly available. He

shared in the United States, regulatory look-back mechanisms have resulted in considerable savings in monies and time for several government agencies.

However, nudging has been criticised as soft paternalism and being manipulative. In response, Professor Sunstein reasoned that nudging is inevitable; the act of active choosing is a form of libertarian paternalism. Human errors often affect decision-making, and people tend to neglect the long-term and have unrealistic optimism. Moreover, not every situation calls for the use of coercion or economic incentives. Nudges guide people into making choices that are in their best interests without infringing greatly on their freedom of choice. For example, the disclosure of information about credit cards helps consumers make informed decisions by highlighting the financial consequences of the decisions. The professor maintained that nudging is public and transparent, instead of manipulative, as it ultimately allows people to make their own choices.

Wrapping up, Professor Sunstein described how public and private institutions can explore the potential of “nudges”. There are several ways to do this, such as simplifying programme requirements and application forms; increasing empirical assessments through randomised controlled trials; and conducting more retrospective analysis.

### **Question-and-Answer Session**

The presentation was followed by a robust discussion, with participants raising questions on the extent to which behavioural economics can be applied; the use of nudges in philanthropy; and the effects of paternalistic nudging.

Behavioural economics can be applied to both developed and less developed economies, Professor Sunstein explained. Human behaviour is generally universal and people living in developed and less developed economies both suffer from present bias and unrealistic optimism.

While nudges, mandates, bans and economic incentives form the repertoire of public policy mechanisms, of particular concern was when policymakers should apply compulsion over nudges, and vice versa. Compulsion should be applied when the behaviour harms others, and when the cost-benefit analysis presents compelling results, Professor Sunstein explained. Moreover, nudges complement the use of compulsion. Citing an example of retirement savings schemes, the professor suggested that policymakers could make a minimum level of contribution compulsory over automatic enrolment.

Besides governments, the private sector can also benefit from the use of the nudging approach. In particular, philanthropic organisations could benefit from using nudges to guide more people into supporting their good causes. For example, charitable organisations could “nudge” people to donate regularly by setting up automated arrangements for deducting monies from donors’ bank accounts.

While governments may seek soft paternalism to promote better decision-making, there is a growing concern that a paternalist state may coddle citizens so much, leading to the “infantilisation” of the people. In response, Professor Sunstein pointed out that it is crucial to first identify areas important for people to practise active choosing and learn through experience. Learnt experience gained in one domain helps people develop a stock of

knowledge which is transferable to other domains. Rather than infantilising people, the professor contended that such a paternalistic nudging approach encourages people to take initiative in exercising decision-making. Nudges provide information to people, treating them as adults able to make better choices for themselves.

While episodic nudges may change people's behaviour temporarily, evidence shows prolonged exposure to nudges can shape people's behaviour, eventually becoming habits. For good habits to form, first, nudges must be found to be acceptable and useful; second, people must be exposed to the nudge for a period of time. Citing the example of energy use reminders, Professor Sunstein shared how energy use reports motivate recipients to reduce their household energy usage and its associated cost, ultimately making energy conservation a habit over time.

*Paveena Seah is a Research Analyst with the IPS Social Lab, an independent centre for social indicators research.*

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