

## What is 'nudge theory' and why should we care? Explaining Richard Thaler's Nobel economics prize-winning concept



Richard Thaler, the father of 'nudge theory', has been awarded the Nobel economics prize.

### ***But what is nudge theory? Does it actually work? And why should we care?*** **WHAT IS A 'NUDGE'?**

The concept is a relatively subtle policy shift that encourages people to make decisions that are in their broad self-interest.

It's not about penalising people financially if they don't act in certain way.

It's about making it easier for them to make a certain decision.

"By knowing how people think, we can make it easier for them to choose what is best for them, their families and society," wrote Richard Thaler and Cass Sunstein in their book *Nudge*, which was published in 2008.

### **FOR EXAMPLE?**

A good recent example can be found in UK pension policy.

In order to increase worryingly low pension saving rates among private sector workers the Government mandated employers to establish an 'automatic enrolment' scheme in 2012.

This meant that workers would be automatically placed into a firm's scheme, and contributions would be deducted from their pay packet, unless they formally requested to be exempted.

The theory was that many people actually wanted to put more money aside for retirement but they were put off from doing so by the need to make what they feared would be complicated decisions.

The idea was that auto enrolment would make saving the default for employees, and thus make it easier for them to do what they really wanted to do and push up savings rates.

### **HAS IT WORKED?**

Very much so.

Since auto enrolment was introduced by the Government in 2012, active membership of private sector pension schemes has jumped from 2.7 million to 7.7 million in 2016.

### **ANYTHING ELSE?**

Organ donation is another example of an area where nudge policy has worked.

Spain operates an opt-out system, whereby all citizens are automatically registered for organ donation unless they choose to state otherwise.

This is different from the UK where donors have to opt in.

The Spanish opt-out system is one of the reasons Spain is a world leader in organ donation.

France also switched to an opt-out regime this year. Theresa May said at the Tory Party conference that the UK would do the same.

The theory is the same as relates to pensions: deep down most people want to be donors if they die in an accident and their organs could be used to save someone else's life but for various reasons never get around to registering.

The opt-out system makes it easier for them to do what they really want to do.

However, Mr Thaler actually prefers a system of "prompted choice" on organ donations to opt out.

This would prompt people to register at various points, such as when they apply for, or renew, a driving licence.

### **DOESN'T THIS 'NUDGING' INFRINGE CIVIL LIBERTIES?**

The concept has certainly been criticised as paternalistic.

Yet it's hard for libertarians to make a persuasive cases against such policy nudges in relation to pensions and organ donation because the opt-out option always remains available for people.

## **SO POLITICIANS ARE ALL USING NUDGE NOW?**

It is proving increasingly popular.

The previous US president Barack Obama recruited Cass Sunstein as an adviser and exhorted US government departments to adopt behavioural economic concepts such as nudge.

In 2010 the UK Government set up a Behavioural Insights Team, commonly dubbed a “nudge unit”, to develop policies.

Administrations in Denmark, Australia, Canada and the Netherlands have also shown an interest.

**Source: The Independent**