

Economic Analysis of Law in European Legal Scholarship 3

Klaus Mathis
Avishalom Tor *Editors*

Nudging – Possibilities, Limitations and Applications in European Law and Economics

 Springer

Economic Analysis of Law in European Legal Scholarship

Volume 3

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Foreword

Once again, it was a pleasure to welcome as the Vice-Dean of the Faculty of Law at the University of Lucerne numerous academics and practitioners from around the world to the 4th Law and Economics Conference here in Lucerne. The issue of “Nudging – Theory and Applications” seemed to be the rational consequence of last year’s issue “Behavioural Law and Economics”, since nudging is about influencing behaviour. Although nudging has already been part of marketing strategies of private enterprises for decades, it is only recently that this instrument has found its way into the discourse on intelligent regulation. In that context, nudging is about influencing decisions of persons for the sake of objectives of the public welfare without command or prohibitions. A basic example given by Thaler and Sunstein is – forgive me – a urinal with the picture of a fly right in its centre, nudging a male person to try to hit it with the liquid jet and thereby avoiding any unwanted loss of this liquid material by distraction. Obviously, this serves the common welfare of providing for a clean environment in the toilet. Furthermore, the instrument works just by focusing the individual on its own action. It is debatable whether the nudge in this example refers to the hunting instinct or rather to the play instinct. Surely, the play instinct is concerned, when some years ago in Germany, I had the chance to try a nudge replacing in our example the picture of the fly by a little soccer goal with a soccer ball attached to the crossbar by a little string. Thaler and Sunstein state that due to the nudge of the fly toilets have become cleaner by 80 %. In Germany, for the nudge of the soccer goal, I lack any figures. However, we all know, that in 2014 Germany won the world championship in soccer.

To be serious again, both, in the USA and in the UK, the governments have established administrative ‘Teams on Behavioural Sciences or Behavioural Insights’. With due delay, in Germany, the Federal Government tries to establish a similar team. However, in Germany the concept faces strong criticism – citation: ‘is the gawk the new concept of the civilian in regulation?’ – and likewise in Switzerland, the well-known NZZ asked, whether we all should now become petty bourgeois (‘kleine Spiesser’).

For governments the concept of nudging has some obvious advantages. People are led to make ‘better’ decisions and are pushed towards contributing to the public

welfare without feeling suppressed that is without blaming the government for interfering with their rights. When relying on advantages for the individual, regulation might overcome hurdles seen by systems theory for steering different systems, like economic behaviour being influenced by politics and law. The thought of nudging is especially attractive where major changes have to be put into effect, like the energy strategy in Switzerland calling for decarbonization and an exit from nuclear power in its present shape.

However, a myriad of questions remain:

- What is the underlying picture of the individual under that approach, an enlightened person or a lazy ‘gawk’ looking for convenience? And does a regulatory approach form persons according to its underlying picture of them?
- Where are the boundaries of nudging when the precautionary principle calls for immediate action?
- Is nudging acceptable, even if it makes the state use non-transparent strategies of marketing?

Furthermore, in literature it has been doubted that nudging is really libertarian: There is an interesting example from the community of Zurich asking people to make a choice between energy supply from hydropower or a mix of energy resources, nudged by the use of colours. A warning red and a calming blue colour were chosen to nudge people towards the hydropower. The next year the ‘general mix’ was replaced by ‘nuclear energy mix’ and a year later, the option for choice has vanished: sorry, there is only blue energy available in Zurich left. This has been described as ‘nudging on a slippery slope’.

On the contrary, some might regard nudging simply as deregulation in disguise.

I would like to add a question concerning the underlying rationale of nudging. Is it really about paternalism, acting in conformity with the objectives of the individual in the long run? Some authors differentiate between the objectives of an individual in the short run (enjoying sweets or smokes) and in the long run (suffering from health issues). Thaler and Sunstein state that nudging aims at the common welfare. In my analysis, intelligent regulation is only interested in nudging for the sake of common welfare. The individual behaviour only raises the interest of the regulator, if it might cause more costs to society, like costs for the public health system or costs for the social welfare system. Interestingly, if that is true, then nudging shows that ‘better’ behaviour is something outside the thoughts of the so-called rational homo economicus limited to egoistic-economical views in traditional economic science.

Further, the question may be raised how successful nudging really is. As already mentioned, in their example, Thaler and Sunstein state that after the use of the picture of the fly, toilets have become cleaner by 80 %. In German public toilets the fly has vanished, but a pay and voucher system has taken over. So, under the approach for intelligent regulation, nudging not only has to qualify by results, but by better results than gained by concurring instruments. This is the threshold by the test of proportionality.

As the managing director of the Center for Law and Sustainability at the University of Lucerne, I am very proud that my distinguished colleague, Klaus Mathis, has succeeded in bringing together so many big academic elephants – if you kindly let me exploit the logo of this conference with the big and the small elephants – together in this room at the small University of Lucerne to discuss some of the many questions raised by the concept of nudging. Obviously, the logo works in the other direction as well: even a small elephant can nudge the big ones.

Faculty of Law
University of Lucerne
Lucerne, Switzerland
December 2015

Sebastian Heselhaus

Preface

This anthology, ‘Nudging – Possibilities, Limitations and Applications in European Law and Economics’, is the result of the 4th Law and Economics Conference held at the University of Lucerne on 17th to 18th of April 2015. The conference was organized in partnership with Notre Dame Law School and the Notre Dame Program on Law and Market Behavior (ND LAMB). The main focus of the conference lay on European legal questions as presented by European legal scholars. They were complimented by insights from distinguished scholars from the USA in order to foster the dialogue between the two different legal cultures. The thematic scope of this volume spans both the theoretical and practical developments of nudging.

We take this opportunity to thank all those who have contributed to the organization of the conference and to the successful completion of this volume. First of all, we would like to thank Uta Dietrich and Julia Wetzel, MLaw, for their flawless coordination and organization of the conference. Furthermore, we wish to thank Gareth Hunt, BSc, and Lynn Gummow, MLaw, for their diligent proofreading. A special thank goes to the Swiss National Science Foundation (SNSF), the Research Commission (FoKo) of the University of Lucerne, the Institute *lucernaiuris*, as well as the Rectorate of the University of Lucerne for supporting the conference. Finally, we are grateful to Neil Olivier and Diana Nijenhuijzen at Springer Publishers for overseeing the publishing process.

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Introduction

Cass R. Sunstein and Richard Thaler proposed in their book ‘Nudging – Improving Decisions About Health, Wealth and Happiness’, that altering people’s behaviour in a predictable way without forbidding any option or significantly changing economic incentives can and should be used to help people make better decisions. This has sparked interdisciplinary debates in academia as well as in the public sphere.

People can be ‘nudged’ in the desired direction, for instance, by means of default rules. One example for a default rule is the objection clause in the case of organ donations, according to which every human being is considered to be a donor after death unless they explicitly opt out. The use of nudges, however, raises a number of questions: who decides what behaviour is desired? Do nudging and the so-called libertarian paternalism threaten the autonomy of people? Does the state not pretend to have knowledge which it does not have, as Friedrich August von Hayek would argue? Should we not better trust the spontaneous order, even if it will not always be perfect? At the extreme, might nudging not pave the way to serfdom, to allude to Hayek again? The present anthology analyses and discusses the issues surrounding nudging and its use in intelligent legislation, regulation, and policy making more generally.

In Part I the authors discuss the foundations of nudging theory from different perspectives:

First, Avishalom Tor discusses the Nudge policy framework and draws attention to the fact that many other policy instruments are equally suited to promoting the goal encouraging boundedly rational people to better achieve their own ends. Furthermore, he highlights that the tools of nudging are equally suited to promoting goals that are excluded by Nudge’s own framework. This problem of fit between Nudge’s goals and tools causes some of Thaler and Sunstein’s own applications to breach the boundaries of what they define as legitimate nudges and, more significantly, obscures the broader potential of behaviourally informed policies and the substantial trade-offs involved in their implementation.

Bruno S. Frey and Jana Gallus state that the effectiveness of nudges in raising the welfare of the population hinges on the policymakers employing them. They argue that rather than being concerned about policymakers’ incapacity to raise the

population's welfare we should be concerned about their unwillingness to do so. As a possible solution, they argue that a legal framework for the use of nudges should be implemented on a constitutional level. Nudging should not be considered as an innocuous exception to constitutionally based decision-making even if it appears as beneficial at first sight. According to them, even '*Liberal Paternalism*' may not be imposed on the population of a democratic society without its consent.

One of the main criticisms aimed at liberal paternalism is the question of an individual's self-interest. In his contribution, Mark D. White argues that self-interest has been neglected in recent scholarship aimed at defending paternalism by means of a behavioural approach. In particular, he disputes claims that paternalism of means can be meaningfully separated from paternalism of ends, and argues that modern paternalism does not respect people's true interests but instead adopts a perfectionist or objective conception of well-being.

In his contribution Malte Frederic Dold revisits the meaningfulness of the Condorcet Jury Theorem (CJT) and applies it to the recent debate on liberal paternalism and consumer protection. In his paper, he outlines a case for the application of a Condorcet jury voting procedure in consumer law in order to nudge rational consumers.

From a human rights perspective, Peter Kirchschräger argues that nudging could seem to be attractive if it would lead to a better realization of human rights. However, he cautions that it is at the heart of human rights to protect the individual from the collective, respectively from abuse of power by the collective. This therefore raises the question if the argument that the ends justify the means should apply in order to justify the use of nudging.

Ariel Steffen argues that nudges always entail *ex-ante* value judgements. He sees this as troublesome when viewed from the perspective of a collapsed fact/value dichotomy as this means that facts and values are always inextricably entangled. As a result, the normative concept 'rationality' is maximized under the guise of it being a positive concept while 'autonomy' is rejected as a legitimate concept for maximization on grounds of it being normatively laden. He argues for the use of pragmatic ethics as a basis to make the normative transparent while at the same time not exclude it from scientific discourse.

In Part II various applications of nudges are illuminated:

From the perspective of the governmental 'Choice Architects', Mark Schweizer examines the potential limits the German Federal Constitutional Court imposes through their principle of proportionality. While nudges as such generally do not interfere with fundamental rights, their implementation will often interfere with the fundamental rights of citizens other than the decision makers and therefore trigger constitutional scrutiny. He concludes that the proportionality principle does not compel the use of nudges.

Klaus Mathis and Philipp Anton Burri discuss various interpretations of the function of non-mandatory contract law along with the requirements with regard to adequate formulation of a contract. From this basis they then proceed to discuss the behavioural economic analysis of non-mandatory contract law, especially in view of using it as a nudging instrument. Non-mandatory law, they argue, could be used to

steer behaviour of individuals. They support their thesis by discussing labour law and surety contract law as two examples.

Moving from contracts to the financial sector, Geneviève Helleringer explores the psychology of disclosure in the context of advised financial investment decisions. She investigates how information about the financial advisor's potential conflict of interest impacts on the participants' judgement. The implications of her findings for public policy are that, contrary to what is commonly suggested, problems of conflict of interest in the financial investment context may efficiently be treated by means of disclosures, provided that such disclosures explicit the consequences of the conflict for the decision maker.

Staying in the financial sector, Piotr Tereskiewicz discusses the idea of neutral counselling as a measure of improving decisions of borrowers when choosing a mortgage loan. The developments regarding foreign-currency mortgage loans, popular in Central and Eastern Europe in recent years, illustrate how incorrect mortgage choices may have detrimental effects on borrowers and their families. Taking a sceptical approach towards mandated pre-contractual disclosure as a protection measure for borrowers, the paper advocates neutral counselling of mortgage applicants in case they are offered risky types of mortgages. Drawing on the experience of an American mortgage counselling programme, a set of recommendations is made regarding the design of a possible neutral mortgage counselling scheme. While the counselling solution has imminent limitations, it displays clear potential towards improving the process of financial decision-making.

Nudges also play an important role in health and nutrition. In their contribution Kai Purnhagen, Erica van Herpen and Ellen van Kleef argue that in order to protect consumers in the context of making healthy food choices, internal market regulation should focus more on pictorial health and nutrition claims and representations. They back up their claim by research from behavioural sciences. The main focus of attention of the misleading potential of health and nutrition claims in the EU is on textual claims.

In his contribution, Rainer Baisch discusses the traditional disclosure paradigm based on the assumption that transparent and effectively processed information will enable investors to make well-founded investment decisions. In particular, he analyses human flaws with regard to how information is processed and how the provision of data for consumers of financial products should be further optimized.

Nudges also play a role in both constitutional and environmental law. Felix Ekardt's and Jutta Wieding's contribution addresses nudges in both areas. They discuss the criticism that nudges are too paternalistic and argue that many forms of nudging are not paternalistic, because they do not protect an individual from themselves, but rather protect others from negative effects of the actions of an individual. Especially in environmental policies, nudging therefore proves to be legitimate approach. Unfortunately, they claim that nudging might not be as effective as policy instrument for environmental issues, as many hope.

Georgios Dimitropoulos' contribution proposes to recast a big part of international trade law as behavioural regulation. The Sanitary and Phytosanitary and Technical Barriers to Trade Agreements of the WTO include provisions on disclosure

of better information, on legal default rules and on debiasing through law that are similar to the ones proposed in Behavioural Law and Economics literature to nudge governments towards specific directions. Therefore, he argues that the current international trade law is already based on using nudges.

To examine nudges from an empirical point of view, Mariusz J. Golecki, Marcin Romanowicz and Jerzy W. Wojciechowski conduct an experiment on the verification of the hybrid based categorization hypothesis in context of the tax law regulation. Their paper concentrates on the possibility and cognitive effectiveness of nudging in a very narrow field of legislative design rather than on the debate on the normative implications of this strategy. However, their approach to illuminating the descriptive aspects of cognitive processes presupposes the debate on the legitimacy of nudging from the wider normative, legal and moral perspectives. Nevertheless, this paper provides some very useful insights on cognitive behaviour.

In her contribution, Mira Burri explores the use of nudges in Media Policy. Using the Internet as an example, she outlines how the use of nudges as a subtle form of state intervention is effective intervention aimed at maintaining diversity. She argues that some form of governance is essential if the individual's rights are to be protected and views nudges as an effective tool in the move to develop new Media Policy.

Finally, the use of nudges in academic fraud is discussed by Rute Saraiva using the situations or criteria presented by Harry Potter novels. By implying the identification of the costs and benefits behind the motivation of cheating and of the risk taken both in an individual and collective perspective, the decision to cheat can be nudged in one direction or another. Furthermore, it is necessary to recognize the biases behind the decision of cheating, including an eventual distortive institutional framework. Using Hogwarts School of Witchcraft as an example, she proposes a correct and preventive architecture of choice and nudging behaviours to decrease academic fraud.

As this anthology highlights, nudges have a wide scope of application. While many argue that nudges do indeed steer individuals to greater social or personal welfare, it is also clear that there are many pitfalls and risks as discussed by the contributors to this anthology. The 17 essays provide startling insights into the multifaceted debate surrounding the use of nudges in European Law and Economics.

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Part I
Foundations

Chapter 1

The Critical and Problematic Role of Bounded Rationality in Nudging

Avishalom Tor

Abstract Nudging has become an increasingly popular policy tool on both sides of the Atlantic, even while scholars and commentators continue to debate its appropriate boundaries, efficacy, and legitimacy. The present chapter outlines a sympathetic, ‘internal’ critique of Nudge’s policy framework (Thaler and Sunstein 2008. *Nudge: Improving decisions about health, wealth, and happiness*. New Haven: Yale University Press) identifying a fundamental problem that has received little attention to date. Thaler and Sunstein define their key concept as the use of a particular toolkit (rationally-neutral behavioural interventions) to promote a specific policy goal (individuals’ self-judged well-being). To remain within the boundaries of these defining parameters, the chosen toolkit must nudge only by helping boundedly rational people better achieve their own ends. However, a closer look at this intuitively appealing approach reveals a fundamental problem of fit that should trouble even those who support Nudge’s mission. Namely, while the tools of nudging can sometimes promote its declared goals, other tools can often do so equally well or even more effectively. And the tools of nudging are equally suited to promoting goals that are excluded by Nudge’s own framework. This problem of fit causes some of Thaler and Sunstein’s own applications to breach the boundaries of what they define as legitimate nudges and, more significantly, obscures the broader potential of behaviourally-informed policies and the substantial trade-offs involved in their implementation.

1.1 Introduction

The publication of Thaler and Sunstein’s “Nudge: Improving Decisions About Health, Wealth, and Happiness” [‘Nudge’] in 2008 brought to international, popular attention the developing academic discourse about behaviourally-informed legal

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interventions, which until then took place primarily within the pages of U.S. law reviews.¹ In the years that followed, scholars from law,² economics,³ political science,⁴ philosophy,⁵ psychology,⁶ and more have been joined by numerous commentators in discussing the merits and demerits of nudging and related approaches. Despite the explosion of interest in Nudge, many questions remain about the appropriate contours and boundaries of such interventions and their normative justification. Scholars have challenged the nudge enterprise on a variety of grounds, from public choice,⁷ to welfare,⁸ autonomy,⁹ and beyond.¹⁰

The present remarks contribute to this conversation by considering an important set of foundational problems with the policy framework offered by Nudge that have not received much attention to date. Specifically, to qualify as a nudge according to Thaler and Sunstein, a policy intervention must use only economically-neutral behavioural interventions. Moreover, not all economically-neutral behavioural interventions qualify as nudges, only those employed to improve individuals' self-judged well-being. Yet Individuals require such nudging only insofar as they fail to use the best means to achieve their own ends—that is, only when they fail to act rationally. Hence, the need for nudging as defined by Thaler and Sunstein arises only through deviations from rational action and the goal they assign to nudging can be accomplished only by making people act more rationally (or as if they were more rational).

Upon closer inspection, both the logic and appeal of Nudge thus ultimately rest on a critical link among its behavioural toolkit, its well-being goal, and rationality. Once revealed, however, the role of rationality in nudging exposes a fundamental weakness of its framework that this chapter outlines and begins to explore.

1.2 The Tools and Goals That Define Nudging

The universe of policy interventions that qualify as nudges can be described along two dimensions: the policy *tools* that aspiring nudgers legitimately may employ and the policy *goals* towards which they legitimately may aim.

¹E.g., Camerer et al. 2003; Glaeser 2006; Klick and Mitchell 2006; Rachlinski 2006; Sunstein and Thaler 2003; Zamir 1998.

²E.g., Bubb and Pildes 2015; Sibony and Alemanno 2015; Willis 2013.

³Bernheim 2009; Spiegel 2015.

⁴Hausman and Welch 2010; Maloberti 2012.

⁵Bovens 2010; Conly 2012; Hausman and Welch 2010; White 2013.

⁶Glaeser 2006; Johnson et al. 2012.

⁷Mitchell 2005; Mongin and Cozic 2014; Rebonato 2014.

⁸Bernheim 2009, Wright and Ginsberg 2012.

⁹Mitchell 2005; Wright and Ginsberg 2012; Rebonato 2014; Baldwin 2015.

¹⁰Mitchell 2005; Menard 2010.

Thaler and Sunstein define nudges as “any aspect of the choice architecture that alters people’s behaviour in a predictable way without forbidding any option or significantly changing their economic incentives.”¹¹ And choice architecture in the authors’ terminology is synonymous with “the context in which people make decisions.”¹² In other words, any aspect of the context of choice can qualify as a nudge, so long as it fulfils two additional, cumulative conditions—namely, the *predictable behavioural effect* condition and the *rational neutrality* condition.

The first condition requires nudges to produce a *predictable behavioural effect*. Yet to count as nudges, behavioural decision phenomena also must fulfil the second condition of *rational neutrality*. The effects they exert on behaviour must not be achieved by substantially constraining people’s choices or changing their economic incentives—the only types of intervention that are normatively relevant for a rational economic actor.¹³

Behavioural research has shown how actual human behaviour is shaped by the limited cognitive resources that individuals have at their disposal and subject to the effects of motivation and affect. These and similar factors that are irrelevant to the hypothetical rational actor describe individuals’ ‘bounded rationality’.¹⁴ Notably, the same processes of bounded rationality that lead to deviations from rational action also offer new tools with which behaviourally-informed approaches to policy making, such as Nudge, can try to shape the behaviour of boundedly rational individuals.

Thaler and Sunstein seek to constrain the tools and goals of nudging further to allow only ‘libertarian paternalistic’ behavioural interventions. Nudge explains that: “libertarian . . . simply mean[s] liberty-preserving. . . .”,¹⁵ so it is largely covered already by the definition of nudging as using only rationally-neutral behavioural tools. The second, ‘paternalism’ component, on the other hand, addresses the goals of nudging. The book understands “a policy [to be] ‘paternalistic’ if it tries to influence choices in a way that makes choosers better off, as judged by themselves.”¹⁶ This definition substantially limits the universe of legitimate nudges, excluding a great many behavioural interventions that aim to promote social welfare without regard to the well-being of the nudged individuals or even those traditionally paternalistic policies that seek to make people better off according to policy makers’ judgments.

Nudge aims to make people better off as they themselves judge the matter. As long as people choose the best available means to further their ends, there is no room for nudging. This observation is important because suiting means to ends is a basic characteristic of rational action.¹⁷ Hence, when boundedly rational individuals

¹¹ Thaler and Sunstein 2008, p. 6.

¹² Thaler and Sunstein 2008, p. 3.

¹³ Hausman 1992.

¹⁴ Tor 2002, 2008.

¹⁵ Thaler and Sunstein 2008, p. 5.

¹⁶ Thaler and Sunstein 2008, p. 5.

¹⁷ Posner 2010.

fail to suit means to ends they necessarily deviate from the normative model of rationality.

Because the opportunity for nudging arises only when actual behaviour deviates from the standards of rationality, the purpose of nudging can be translated to the promotion of (some) rational action.¹⁸ However, Thaler and Sunstein instead simply note that “. . . in many cases, individuals make pretty bad decisions—decisions they would not have made if they had paid full attention and possessed complete information, unlimited cognitive abilities, and complete self-control.”¹⁹ Because these decisions must be bad from the actor’s perspective (the only perspective that should be relevant for nudging) they can be bad only when failing to promote the actor’s own ends. In Nudge’s terminology, then, bad decisions are synonymous with the consequences of deviations from rational action and the goal of nudging turns out to be simply the promotion of more rational behaviour.

Thaler and Sunstein’s statements regarding the definition of nudging can be summarized as follows: True nudging employs (a) *only* rationally-neutral behavioural tools and (b) does so *only* to accomplish the goal of helping individuals act more rationally in suiting means to ends. The problem with this framework is that while nudging can be used to address the consequences of bounded rationality, it is not necessarily always or only the best tool for accomplishing this goal. Similarly, the tools of nudging can be used equally well and perhaps even more effectively to promote policy goals other than the improvement of individual rationality. Nudge’s framework thus suffers from a problem of fit between its selected tools and chosen goal.

This problem of fit is not only cosmetic, but has significant consequences for the book’s agenda. For one, the focus on fitting the tools offered by bounded rationality to help overcome the consequences of bounded rationality limits the scope of Nudge’s stated ambition and practical relevance. These strictures mean that faithful nudging cannot use behavioural tools to advance social welfare goals (say, environmental protection) or even traditionally paternalistic goals that do not necessarily promote individuals self-judged well-being (e.g., increasing seat-belt use or reducing drug abuse). In the same vein, nudging cannot legitimately involve the use of non-behavioural means, such as incentives or legal mandates, to address the negative consequences of bounded rationality. Faithful nudging therefore is highly truncated with respect to both its tools and its goals. Moreover, the book’s framing of the policy problems it seeks to address and the cures it offers also obscures the potentially superior fit of other tools to Nudge’s task and of its own behavioural toolkit to other policy goals.

¹⁸At best, successful nudging diminishes individuals’ deviations from rationality, helping them to overcome their errors of judgment or choice and thereby promotes their rationality in fact. Effective nudging, however, may lead people to avoid the consequences of their bounded rationality and therefore appear *as if* they were more rational even without facilitating their rationality in fact, an important distinction that is outside the scope of the present analysis.

¹⁹Thaler and Sunstein 2008, p. 5.

1.3 Non-nudge Tools and Extra-nudge Goals

The problem of fit combines with the desire to exploit the tools of nudging more broadly and address the goals of nudging more effectively to lead the book to cover much ground that is outside its own framework. Many of the applications it offers, in fact, end up transgressing its self-imposed boundaries for legitimate nudging. For present purposes, however, two examples—one concerning non-nudge tools, the other involving extra-nudge goals—will suffice to illustrate this point.

Some of Nudge's applications aim to shape behaviour using tools that are not rationally-neutral and therefore do not qualify as nudges. One example concerns the power of social norms to shape behaviour. In one case, Thaler and Sunstein (2008) praise the web page used by the Illinois' organ donation program to attract prospective donors. According to their description, the page draws on the power of social norms and social influence by suggesting that social norms favour organ donations. But why should people be more inclined to donate organs just because they believe that such behaviour better comports with the social norm?

The book points to two main reasons for the power of social norms to shape behaviour: First, social norms may convey meaningful information about what is right, good, and so on. Second, deviations from social norms may incur social consequences. However, both of these reasons in fact reveal that influencing behaviour through social norms may exceed the boundaries of legitimate nudging. Norms that provide meaningful information about appropriate standards influence behaviour by shaping preferences. Arguably, though, interventions that shape individuals' preferences by providing previously unknown social norm information are not rationally neutral.²⁰ Even more obviously problematic is the second reason, since social norms that operate by imposing costs are changing people's incentives and therefore are also not rationally neutral. A rational actor may well change her behaviour to avoid incurring the wrath of peers or to obtain their favour. And the costs and benefits of such social interaction often extend to the economic domain as well (e.g., people may be reluctant to transact with those who violate social norms).

Much like it affects the tools of nudging, the problem of fit also leads the book to advocate some extra-nudge goals. Indeed, the organ donation example above already offers a case on point. Some may consider increasing the rate of organ donations to be a socially valuable policy goal; others may disagree. Those who consider organ donations important may also wish to donate their own organs if the opportunity arises. Individuals who oppose organ donations and perhaps even some of those who are supportive of them in the abstract may not judge their own well-being to be best served by joining a donor registry. Yet the social-norm nudge described above may well result in leading some such individuals to join the registry and thereby make them worse rather than better off.

²⁰Although technically, Nudge's definitions may be read to allow the shaping of preferences, so long as such interventions do not literally constrain choice or affect economic incentives.

Similar problems arise with respect to the use of standard nudge tools towards extra-nudge goals. One of the paradigmatic nudges in the book involves using defaults (e.g., of a higher rate of deduction from one's salary paycheck) to increase the rate of retirement savings. Even this nudge, however, already aims at an extra-nudge goal. To wit, some individuals may wish to save more for retirement at the cost of reducing their present disposable income but others may hold different judgments of how the trade-offs involved impact their well-being. Of course, policy makers may wish to increase retirement savings to limit the negative social effects of retirees with limited savings who consume a great deal of public resources. But this reasonable policy goal is one of social welfare, not a goal of self-judged individual well-being. And even policy makers who believe that the retirees who will have saved more will be better off than if they depended more on public resources still are implementing a traditional, extra-Nudge paternalistic policy. The default savings nudge in this case makes retirees better off according to the beliefs of policy makers. It may even promote the self-judged well-being of some retirees. But the nudge here cannot be said to promote the well-being of those employees who judge themselves better off with more disposable income pre-retirement and lower retirement savings.²¹

1.4 Conclusion

All in all, this brief analysis of book's framework reveals a problem of fit between the tools of nudging and its goals. This problem turns out to have implications beyond mere concerns of analytical clarity. The broader significance of behavioural interventions for policy making renders efforts to faithfully limit nudging to libertarian paternalistic interventions quite frustrating. It also generates an inexorable pressure on scholars and policy makers to nudge towards traditional paternalistic goals or even social welfare ones. Similarly, the focus on nudging as a means for improving individual rationality obscures the potentially superior fit of more traditional policy tools to this task.²² This aspect of the problem of fit also exerts its own additional pressure on Thaler and Sunstein's (2008) policy prescriptions, thereby facilitating the inclusion of applications that draw on tools beyond nudging.

The sometimes subtle deviations from Nudge's self-imposed constraints described here are significant for at least two reasons. First and most obviously, the couching of the book's (and similar) policy recommendations as low-risk nudges can obscure some of the significant trade-offs involved. For example, a traditionally paternalistic nudge may require more careful justification than a nudge that truly

²¹Note that this analysis concerns the *goals* of nudging and stands irrespective of the fact that rational employees would be indifferent to the savings default and save exactly as much as needed to achieve their self-judged goals. After all, boundedly rational employees may be nudged by the default irrespective of their self-judgments of well-being.

²²Bubb and Pildes 2014.

makes people better off as they themselves judge the matter. And a nudge, that aims to promote social welfare goals without regard to individual well-being, involves more complex trade-offs among individuals in society that require close examination and additional justification.

Second, the book's implicit agenda of fighting the consequences of bounded rationality (i.e. those 'bad decisions') with the nudging tools offered by bounded rationality is intuitively appealing. But the effects of the problem of fit also divert attention from some fundamental questions regarding the Nudge enterprise and its relationship to rationality and bounded rationality that the book leaves unanswered. For instance, when should deviations from rational action truly be considered 'bad decisions'? Does it matter whether the policies that seek to address such bad decisions only aim to facilitate behaviour that resembles rational action or instead try to promote the actual rationality of individuals in society? And when are either *as if* or actual rationality appropriate goals for policy making?

These questions, both regarding the trade-offs involved in nudging towards various policy goals and concerning the role of rationality as a goal for nudging or other interventions, demand further attention and study. Nudge's detractors may find here further arguments against the desirability and feasibility of behaviourally-informed policy making. Yet these questions should be of even greater interest to those who identify with the book's overall ambition. After all, the recognition that we cannot avoid facing boundedly rational individuals as they are also means that policy makers must grapple with the complexity and challenges involved in this effort.

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Chapter 2

Beneficial and Exploitative Nudges

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Abstract The effectiveness of nudges in raising the welfare of the population hinges on the policymakers employing them. A frequent criticism based on a logical inconsistency questions policymakers' immunity from the psychological biases of individuals that are the very foundation of nudging interventions. We argue that, rather than being concerned about policymakers' incapacity to raise the population's welfare, we should be concerned about their unwillingness to do so. We offer a solution to this problem. We resort to the constitutional level of decision-making in which voters are able to determine the procedures or processes by which governments may resort to nudging. Nudging should not be considered as an innocuous exception to constitutionally based decision-making. It must be admitted, though, that at first sight most nudges do seem to be beneficial to people. In a democracy, even 'Liberal Paternalism' may not be imposed on the population without its consent in principle.

2.1 Nudging as a Concept

Nudging is an attractive idea. With low or even zero-cost interventions paternalists help individuals overcome their limitations and act in their own best interest, as if they had complete information and the perfect willpower and cognitive abilities of the *homo oeconomicus*. The deviations from the standard economic model of rationality have been empirically identified and extensively analysed in 'Psychology and Economics'.¹ It has now been securely established that human beings are not always and in every respect perfectly maximizing their utility under complete information. They are subject to biases or distortions defined as systematic (i.e. non-random)

¹ 'Psychology and Economics' is often labelled 'Behavioural Economics'. We use the former expression since economics has always dealt with human behaviour. Surveys of this literature can be found in several books (e.g., Frey 1999, 2001; Kirchgässner 2008; Kahneman 2011) and journal articles (e.g., Conlisk 1996; Rabin 1998; DellaVigna 2009). Congdon et al. (2011) and DellaVigna (2009) offer useful albeit slightly different categorizations of psychological biases.

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deviations from the standard model of rationality. Individuals take shortcuts and decide on the basis of heuristics.² Such heuristics work well in most routine situations,³ but they may also fail and lead to value-destroying outcomes.⁴

Nudging provides an elegant solution to the limitations of the *homo oeconomicus*⁵: Individuals are ‘softly’⁶ induced, or nudged, to make better decisions. The government, i.e., politicians and public officials, offer solutions guiding people in the right utility maximizing direction. Importantly, individual decision makers are not forced to pursue that option if they choose not to do so. Nudging does not reduce individuals’ freedom of choice. Hence these policy interventions are often subsumed under the label of ‘liberal paternalism’.⁷ The intervention by a ‘social planner’ is considered to be benign; the ‘choice architects’⁸ act paternalistically by designing the environment so that individuals are steered towards welfare promoting decisions. Individuals would arrive at the same decision if they cognitively reflected them with sufficient information instead of relying on intuitive, or automatic, decision procedures.⁹

There are other concepts similar to Thaler and Sunstein’s liberal paternalism, such as ‘asymmetric paternalism’.¹⁰ All of them are designed to help people improve their decisions and come closer to acting according to their own best interest.

Nudging, or liberal paternalism, has become highly popular in economics and far beyond. The interventions, it is assumed, are cheap if not costless. So even if their effect may not always be substantial, nudges can be more cost-effective than other policy interventions. Nudging is convincingly applied in particular in the areas of retirement savings, organ donation, and health (e.g., healthy diets, vaccination).¹¹ The interventions offered by liberal paternalists immediately stand to reason and appear totally acceptable. It is, for instance, difficult to reject nudging when applied to securing a reasonable material standard in old age. It is well known that most individuals find it difficult to look sufficiently into the future; they are subject to ‘hyperbolic discounting’.¹² As a consequence, they are reluctant to take the initiative

² See Tversky and Kahneman 1974, Gigerenzer et al. 1999, and, more recently, Camerer 2004.

³ Gigerenzer, Hertwig and Pachur 2011.

⁴ Conlisk 1996, Rabin 1998, and Kahneman 2003.

⁵ In contrast, ‘hard paternalism’ as proposed, e.g., by Conly 2012, seeks to induce people to act in the desired way by forcing them to do so by laws and regulations whose violation is punished.

⁶ Although in several cases nudging does not provide a solution to, but rather exploits, behavioral biases.

⁷ The idea has been propagated by Sunstein and Thaler 2003, Thaler and Sunstein 2003, 2008, and Sunstein 2014. See also Binder and Lades 2015. The term ‘liberal’ is used in the classical sense as discussed by Mill 1859 in his book *On Liberty*.

⁸ A term coined by Thaler and Sunstein 2008.

⁹ Although several policy interventions pursue social rather than individual optimality.

¹⁰ Camerer et al. 2003. Related concepts have been proposed by Gruber and Koszegi 2001, O’Donoghue and Rabin 2003, 2006, Jolls and Sunstein 2006, Bernheim and Rangel 2007.

¹¹ Excellent discussions are given e.g. by Schnellenbach 2011, 2012, Kirchgässner 2014, Madrian 2014, and Schnellenbach and Schubert 2014.

¹² Laibson 1997.