What are behavioural nudges and how can policy makers effectively uses them to overcome market inefficiencies?

Surname: Liang

First name(s):Yimiao

Reg number:2107889

Tutor's name: Thomas Cornelissen

Table of Contents

Introduction

The traditional economic policy concentrates on the economic solutions to the issues developed by the market-level factors, for example, misaligned incentives, externalities, and information asymmetries (Hausman, and Welch, 2010). On the contrary, the nudges offer behaviour solutions for the issues which are commonly presumed to be originated from the constraints in hominoid decision-making, likely known as bias. The policymakers have reasons to exploit the power of behavioural nudges. The application of the nudges in the extremes has left large space in policy options that had less economic literature (Bruns et al., 2018). The present paper is going to offer a reminder to the policymakers that behavioural economics has an influential capacity on policies where nudge is the prominent, not most powerful tool necessarily. The present study will discuss the behavioural nudges concept and will offer the potential behaviour nudges to overcome the market inefficiency by the policymakers. It is a contrasting analysis of the efficacy of nudges in market inefficiency. The successful and unsuccessful examples of the policy nudges can demonstrate the applications in real life.

Analysis

Behavioural nudges

The concept of "nudges" has been coined by the researchers Thaler and Sunstein (2008) and described as the various instruments set that utilise behaviour insights for affecting the individual behaviour with the choice architecture of nudges in a printable manner without prohibiting any adoptions or significantly altering the economic incentives. Nudges are not mandatory; like keeping fruit at a superior level is a nudge but banning the junk foods is not. Consequently, in the "*standard choice model,*" the nudge does not change the income or raise prices or restrict the consumer choices; instead, it influences the human behaviour by shifting the circumstances where the choices are made (Hansen and Jespersen, 2013). The nudges have become the alternative options in economic interventions. It primarily depends on automatic decision processes while impacting the behaviour by altering context. Instead, the incentives seemed to change cognition and focused on mindful decision-making as per Dolan *et al.,* (2012). Nudges have been evolving into multiple fields as *"a form of soft regulation*", such as environmental protection, health and finance (Lourenco *et al.*, 2016; World Bank, 2014).

Even recently, the UK coalition government, as well as other global governments, have appeared to be attracted by "*the behavioural economics and the idea of nudging the citizens towards better choices*" (Impact of Social Sciences, 2022). Behavioural economics has used psychological insights to make rational decisions by humans that are refined over decades. However, the usage of behavioural nudges in policymaking is subjected to criticism even with its grown popularity. A criticized aspect and most remarkable one is that nudges can influence the individual behaviour deprived of being noticed by the impacted subject (Rebonato, 2014; Sunstein, 2016). It has raised a concern about nudges which mention it covertly disrupt individual autonomy, which is unethical. Hence, the regulation lacks of transparency which characterizes regulatory instruments. Supposedly, if a government has imposed taxes for diminishing the product consumption like carbon dioxide or cigarettes, then people know about these taxes and induce governments for justifying them. However, if governments instead of the opt-in system, set out an opt-out system for promoting specific behaviour, then it can exploit multiple psychological biases even without the awareness of people (Owens *et al.,* 2014). Thereby, according to the vignette study of Felsen *et al.,* (2013), a proportion of personalities has restrictions toward nudges. Recent research has offered evidence of autonomy and intrinsic value of the decision rights.

Henceforth, in recent years policy methods have been using the policy tool nudges as a most visible tool. There are multiple interventions which are featured as nudges; however, the most influential one is the "*notion of defaulting people into a retirement savings plan*" (Bartling *et al.,* 2014). Hence, in effect, the policymakers move human behaviour automatically from one choice to another set, but the process is completely costless for the person who is making the optimal choices. Sometimes, the other policies and nudges boundaries are indistinct. Therefore, nudges are the explicit rule out obligations of the consumer behaviour; however not legislation for the firm's behaviour.

Policymakers effectively use Nudges to overcome market inefficiencies.

In neoclassical economics, the market inefficiency takes place in which the segregation of goods and services by "*a free market which is not Pareto efficient*". It might lead to a net loss of economic value. Hence, in market inefficiency, the individual pursues only self-interest leads to the outcomes which are inefficient but can be amended from a social point of view (Wuthisatian and Thanetsunthorn, 2018). The existence of market inefficiencies can occur from supranational and government institutions that intervene in a specific market or selfregulatory organisations. Microeconomics is generally concerned with market inefficiency and its causes in the mean of correction (Sunstein, 2015). These analyses of the market inefficiency play a central part in constructing public policy decisions. The market inefficiency takes place when there are no external impacts of transactions, the market is adequately competitive, purchasers are completely informed about credit goods, and the associated goods are not consumer goods. If the four assumptions do not hold, it indicates market inefficiency/ failure (Sunstein, 2014). Multiple government policy interventions are there like subsidies, taxes, prices, and wage control, as well as regulations for controlling the inefficiency of the market, which can lead to government failure. These behaviours act as the "*alternative standard government intervention options*" for utilising subsidies and taxes to influence the individual choices in the market inefficiency. The present section will explain how the policymakers use nudges to mitigate or resolve the dysfunctions from the behaviour causes of market inefficiency. In light of the research of Tomer (2017), typically, nudges act as warnings, disclosures, or default rules as the most significant responses to mitigate or eliminate the market inefficiencies (p.512).

It implies that the consumers are tricked into paying heavily for the products which are not for their well-being. However, all the market inefficiencies do not consider behavioural economics. Hence, the sovereignty of consumers does not exist if the following assumptions of behaviour do not hold; if the consumers know which things are offered well-being to them, the consumers allow organisations to influence them. On the contrary, organisations are motivated strongly for supplying goods that have consumer well-being-without making only profits; consumers interact with organisations through marketing behaviour (Low, 2011). However, surprisingly behaviour like this typically does not exist in the real markets. Generally, the consumers only purchase the products which typically reflect their preference and are unaware of preferences that offer well-being (Tomer, 2011). Secondly, in behavioural economics, predictably, the consumers are irrational and biased in taking decisions. As a result, the organisations having adverse opportunity orientation likely to seize and gain opportunities at the cost of consumers.

According to the nudge theory, consumer behaviour is influenced by positive reinforcement and minimal suggestions. The proponents of the theory suggest that behavioural nudges can minimise the market inefficiency, encourage desirable actions and save the government consumption from increasing the efficiency of the market (Haggag and Paci, 2014). Again, Akerlof and Shiller (2015) believe that nudges can be a non-transparent and mis-usable tool in the form of social engineering to encourage obtaining products to consumers that are not needed. However, in US and UK, public policymakers are using behavioural nudges in a prompt of changing the desired behaviours for meeting social, economic, and environmental targets of the market.

Considering an example of the behavioural market inefficiencies where the sellers take opportunities of the consumers, whereby increases the profitability of the sellers in a manner which diminishes the consumer well-being (Akerlof and Shiller, 2015). A fascinating instance of behavioural market inefficiencies is the "shrouded attributes" of goods. It engages an additional cost on goods that the purchasers do not pay attention to since they are not salient or observable. Another instance is a person who likes to purchase a new car and attempt to know the fuel economy of multiple car models to help himself make better choices about car purchasing. Certainly, the purchaser can consult energy efficiency and fuel economy information offered by vendors, and it conceivably helps purchasers to make good decisions (Sunstein, 2014b, p.41).

If only the purchasers provide adequate attention and understand the details of the fuel economy, then they may save potential money on the vehicle. However, the situations are not typically the same, and the issue of the consumer is that the data are shrouded. Therefore, it is not presented or salient in a form which draws the attention of consumers to the variation in the fuel cost among different car models (Bruns *et al.,* 2018). Most of the time, the consumers are not willing to make energy-efficient investments understanding the entire information even if the investment can pay off in the short run considerably. Therefore, the vehicle purchasers keen to purchase the cars which are not energy-efficient for the users but significantly consume more fuel are preferable for them in the auto preferences (Sunstein, 2014, p.44). In the present case, the consumer wellbeing is potentially lower, so the educative nudging can act as improving the full economy information presentation to the consumers and make it easily accessible in the form of disclosure to consumers that can pay off. The nudging in the present case not only offers better vehicle purchasing decisions and also minimises the decision bias of consumers; otherwise the vendors take advantage of it.

In the present case, the market inefficiencies are explained with the example of the worst, where organisations and vendors take advantage of vulnerable and unsophisticated consumer purchasing to make a profit. The vendors and businesses apparently have adverse opportunities orientation for the consumers, and the vendors have self-interested motivation at an excessive level. The present example is a minimal level of applicating nudges where it is designed for helping the individuals to navigate their well-being successfully (Tomer, 2017). In a broader perspective, the high application of Nudges is designed for fostering the informed actions and decisions from the organisations and groups of people who deal with multiple difficult issues or obstacles in their well-being for the citizens living in a specific society, communities, and regions. For example, such wider nudges counter a nation's socio-economic forces that contribute to chronic disease growth in a country (Tomer, 2018). The high application of nudges can counter market dysfunction related to the large-scale behavioural market inefficiencies. The behavioural nudge is an intervention to rectify the market inefficiencies and dysfunctions to understand its contribution to the wellbeing of consumers in the nation. In most cases, the application of nudging on a large scale is more imperative than the lower level, especially if the issue has a complex adverse behaviour pattern.

However, according to the researchers Leicester, Levell and Rasul (2012), the policymakers in the market inefficiency have to manage the transaction cost, information asymmetries, human emotion, and market psychology with the interventions to overcome the problems. The behavioural nudges and their functions may act as guidance for making informed decisions for consumers. The policymakers in the market inefficiency cannot address these issues adequately. Multiple cumulative research body has questioned the ethical approaches of nudging, and a broad consensus has appeared in the literature that "*the democratic government can refrain with nudging as it is a practical liberal democracy which is committed to the free-market choices*". The political theoreticians believe that nudges can act as inherent choice limiting, conservative, and elitist techniques that the government in power impose with a good life, conception as per fiercest opponents (Haggag and Paci, 2014). Even the researchers have mentioned that the behavioural nudges may trigger the insolent behaviour of reactance, particularly if any information is perceived from the distrusted sources or it challenges the way of life or identity of individuals. Consequently, the consumers will restrict the use of nudges if they are misled about the true purpose of this activity.

Successful and unsuccessful policy nudges

For instance, obesity in the socio-economy consider a negative influence on eating a high amount of food and contributes to the obesity and poor health of the consumers for the eating habits. It is significant to market inefficiency, and the food vendors take advantage of this lack of knowledge, biases, and vulnerability of consumers. The actions affect the wellbeing of the population segment due to their magnitude (Vogelaar and Stam, 2021). In the present case, it is one of the inefficiencies of the market under behaviour economics, and the government can take action with nudging due to the scope of the problem. The issue is deeply embedded in human behaviour, and using nudging directly is unlikely to put any pressure on the social-economic dysfunction. Hence the anti-obesity nudging can help by influencing the food buyers with the appropriate information, labelling the warnings about unhealthy diets, influencing them to eat healthy foods, and offering examples of negative issues to show the positivity. For food suppliers, the government can use nudging by ceasing the processes and ingredients used for food preparation that make unhealthy food items, offering more knowledge about unhealthy ingredients, applying the healthy default regulations for food preparation, and offering socially responsible food examples (Owens et al., 2014). Arguably, the present anti-obesity nudges can be successful if the government can change and improve the eating pattern of as many people and improve their health. It will lessen the obesity issues of the nation, raise the awareness among the people and also food vendors; thirdly, it will improve a motivational balance between empathy and self-interest.

An example of unsuccessful nudging is the initiation of benefits and rewards for unemployed people. It can minimise the efforts of the population essentially and reduce their job searching in the nation. Another example is offering the population "easy access to the credit", perhaps discouraging the population from administrating the finances for saving (Tomer, 2017). The positive examples of nudging are very unusual in reality. Most companies use nudging for their own interest and profit purely. According to Akerlof et al., (2015), behavioural nudging is discussed as "*phishing for phools".* They have mentioned that in the private sector, nudging is more dangerous than government intervention since, in the private sector, they have more choices over the products than the government with coercive power in monopoly. Even the nudge studies have conducted a systematic review which shows that 18% of the interventions are unsuccessful due to the confusion among the target audience; it offers short term benefits. Few nudges are inaccurate for making the choice of architecture.

Conclusion

The concept of nudge has turned out to be an essential intervention in behaviour economics, substituting the government interventions applied by the policymakers. The country US, the UK and other developing countries are getting attracted by the behavioural economics and the application of nudges for making informed choices for the individuals or groups. The present paper has discussed the concept and further built critical analysis on its application according to multiple critics. It is evident from the present report that the nudges aim to improve the wellbeing of people and such improvement needs efforts, intelligent reflection, and wisdom which will offer beneficial outcomes. However, the report has also addressed the issue of market inefficiencies and the capacity of nudges to address this market inefficiency instead of the other government interventions. The report has given both successful and successful applications of nudges in real life. The present research due to lack of scope, did not penetrate the components of market inefficiencies and address them individually with the behaviour nudges. It needs future research to confirm whether nudges can overcome the market inefficiencies or not.

Reference List

Akerlof, George A. and Shiller, Robert J. (2015). Phishing for phools: The economics of manipulation and deception. https://link.springer.com/article/10.1007/s00712-016-0471-y

Bartling, B., Fehr, E. and Herz, H., 2014. The intrinsic value of decision rights. *Econometrica*, *82*(6), pp.2005-2039. https://www.zora.uzh.ch/id/eprint/77758/4/econwp120.pdf

Bruns, H., Kantorowicz-Reznichenko, E., Klement, K., Jonsson, M.L. and Rahali, B., 2018. Can nudges be transparent and yet effective?. *Journal of Economic Psychology*, *65*, pp.41-59. https://www.researchgate.net/profile/Elena-Kantorowicz-Reznichenko/publication/323645668_Can_Nudges_Be_Transparent_and_Yet_Effective/links/5aa7f192458515b024faed9c/Can-Nudges-Be-Transparent-and-Yet-Effective.pdf

Bruns, H., Kantorowicz-Reznichenko, E., Klement, K., Jonsson, M.L. and Rahali, B., 2018. Can nudges be transparent and yet effective?. *Journal of Economic Psychology*, *65*, pp.41-59. https://www.researchgate.net/profile/Elena-Kantorowicz-Reznichenko/publication/323645668_Can_Nudges_Be_Transparent_and_Yet_Effective/links/5aa7f192458515b024faed9c/Can-Nudges-Be-Transparent-and-Yet-Effective.pdf

Felsen, G., Castelo, N. and Reiner, P.B., 2013. Decisional enhancement and autonomy: public attitudes towards overt and covert nudges. *Judgment & Decision Making*, *8*(3). http://journal.sjdm.org/12/12823/jdm12823.pdf

Haggag, K. and Paci, G., 2014. Default tips. *American Economic Journal: Applied Economics*, *6*(3), pp.1-19. https://academiccommons.columbia.edu/doi/10.7916/D8GF12TT/download

Hagman, W., Andersson, D., Västfjäll, D. and Tinghög, G., 2015. Public views on policies involving nudges. *Review of philosophy and psychology*, *6*(3), pp.439-453. https://www.diva-portal.org/smash/get/diva2:818442/FULLTEXT01.pdf

Hansen, P.G. and Jespersen, A.M., 2013. Nudge and the manipulation of choice: A framework for the responsible use of the nudge approach to behaviour change in public policy. *European Journal of Risk Regulation*, *4*(1), pp.3-28. https://www.cambridge.org/core/services/aop-cambridge-core/content/view/D1ED64479FF868BD79FFE90E76A4AB54/S1867299X00002762a.pdf/nudge_and_the_manipulation_of_choice.pdf

Hausman, D.M. and Welch, B., 2010. Debate: To nudge or not to nudge. *Journal of Political Philosophy*, *18*(1), pp.123-136. https://www.researchgate.net/profile/Daniel-Hausman/publication/229562409_Debate_To_Nudge_or_Not_to_Nudge/links/570a43bf08ae8883a1fbc6f4/Debate-To-Nudge-or-Not-to-Nudge.pdf

Impact of Social Sciences. 2022. *'Nudges' may be effective at times, but policymakers can't rely on them to tackle entrenched social problems.*. [online] Available at: <https://blogs.lse.ac.uk/impactofsocialsciences/2015/04/25/nudges-effective-policymaking/> [Accessed 3 May 2022].

Leicester, A., Rasul, I., and Levell, P., 2012. Tax and Benefit Policy: Insights from Behavioral Economics. *London: The Institute for Fiscal Studies*. https://ifs.org.uk/conferences/hmrc24jul_al.pdf

Lourenço, J.S., Ciriolo, E., Almeida, S.R. and Dessart, F.J., 2016. *Behavioural insights applied to policy-country overviews 2016* (No. JRC100547). Joint Research Centre (Seville site). https://ideas.repec.org/p/ipt/iptwpa/jrc100547.html

Low, D., 2011. *Behavioural economics and policy design: Examples from Singapore*. World Scientific.
https://books.google.com/books?hl=en&lr=&id=RHekx7f79j0C&oi=fnd&pg=PR7&dq=Low,+Donald+(ed.).+2012.+Behavioural+Economics+and+Policy+Design:+Examples+from+Singapore.+London:+World+Scientific&ots=fso5P2E3fE&sig=reVBiO_DataLyqmRbQoWf9rCAQ8

Owens, D., Grossman, Z. and Fackler, R., 2014. The control premium: A preference for payoff autonomy. *American Economic Journal: Microeconomics*, *6*(4), pp.138-61. https://escholarship.org/content/qt5bg845s1/qt5bg845s1.pdf

Rebonato, R., 2014. A critical assessment of libertarian paternalism. *Journal of Consumer Policy*, *37*(3), pp.357-396. https://www.academia.edu/download/37911818/version2.pdf

Sunstein, C.R., 2014. Nudging: a very short guide. *Journal of Consumer Policy*, *37*(4), pp.583-588.
https://dash.harvard.edu/bitstream/handle/1/16205305/shortguide9_22.pdf?sequence=4&bcgovtm=SYS2017Q101%20-%20List%20Buy%20Opt-In%20Email

Sunstein, C.R., 2014. *Why nudge?: The politics of libertarian paternalism*. Yale University Press. https://books.google.com/books?hl=en&lr=&id=89BpAwAAQBAJ&oi=fnd&pg=PA1&dq=Sunstein,+Cass+R.+2014b.+Why+Nudge%3F:+The+Politics+of+Libertarian+Paternalism.+New+Haven:+Yale+University+Press&ots=Bx9uLb8CnX&sig=4ifGn_jOpyUVfVKMIhmmAOOBjC8

Sunstein, C.R., 2015. Fifty shades of manipulation. https://dash.harvard.edu/bitstream/handle/1/16149947/manipulation2_18.pdf

Sunstein, C.R., 2016. Do people like nudges. *Admin. L. Rev.*, *68*, p.177. https://dash.harvard.edu/bitstream/handle/1/16147874/likenudges5_8%5B2%5D.pdf?sequence=1

Thaler, R.H. and Sunstein, C.R., 2008. Following the herd. *Nudge: Improving decisions about health, wealth and happiness*, pp.53-73.

Tomer, J., 2011. What causes obesity? And why has it grown so much?. *Challenge*, *54*(4), pp.22-49. https://www.tandfonline.com/doi/abs/10.2753/0577-5132540402

Tomer, J.F., 2017. Why consumers are not sovereign: the socio-economic causes of market failure. *Real-World Economics Review*, *81*, pp.76-90. http://www.paecon.net/PAEReview/issue81/Tomer81.pdfb

Tomer, J.F., 2018. Realizing nudging's potential: improving wellbeing and reducing socio-economic dysfunction. *Real-world Economics Review*, (86), pp.66-82. http://www.paecon.net/PAEReview/issue86/Tomer86.pdf

Vogelaar, J.J. and Stam, E., 2021. Beyond market failure: rationales for regional governmental venture capital. *Venture Capital*, *23*(3), pp.257-290. https://www.tandfonline.com/doi/pdf/10.1080/13691066.2021.1927341

World Bank, 2014. *World development report 2015: Mind, society, and behavior*. The World Bank. https://elibrary.worldbank.org/doi/abs/10.1596/978-1-4648-0342-0

Wuthisatian, R. and Thanetsunthorn, N., 2018. The Asian financial crisis: market inefficiency and speculative bubbles. *International Journal of Financial Markets and Derivatives*, *6*(3), pp.240-267. https://www.inderscienceonline.com/doi/abs/10.1504/IJFMD.2018.091686