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Elgar Encyclopedia of Public Management

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38 Behavioral Strategies in Public Management: Nudges Versus Incentives

Behavioral strategies in public management focus on including citizens' psychological response to policy measures, through the design of interventions such as nudges and incentives, which take into account the wide array of human motivations.

Public policies are the system of laws, regulatory measures and other actions that governments design and implement in response to their citizens' problems, seeking to improve their well-being. In a certain way, the objective of public policies can be defined as reducing suboptimal decisions by individuals and correcting the possible negative effects of such decisions for society. However, the success of public policies depends crucially on citizens' responses to them. Therefore, the acceptance, understanding and compliance by citizens of such policies is crucial to their success. However, contrary to the traditional postulates of economics, there is ample evidence that human beings are not rational and, therefore, our decisions do not always benefit ourselves or our societies.

As early as Adam Smith's *Theory of Moral Sentiments* (1759) and Jeremy Bentham's *Introduction to Moral and Legislative Principles* (1789), rationality in economics was defined as the process that leads to optimizing decisions that result in one's own benefit. This implies that, when choosing between various options, individuals are able to correctly assess the benefit (the "utility") that derives from the consequences of each of the available options and that we always choose the one that gives us the highest satisfaction.

In the last 50 years, Behavioral Economics has shown that many of the actions by human beings are not always governed by the principle of rationality. On the contrary, we often make mistakes regarding actions that maximize our well-being. As Kahneman, Slovic and Tversky (1982) argue, our decision-making process frequently does not consist of a cold calculation evaluating alternatives, but is based on automatic decisions ("biases" or "heuristics"), influenced in turn by our own emotions, our inability to process information, our behavior in the face of uncertainty or by our ignorance about what is best for us, either in the short or long term. Behavioral economics has therefore based part of its success on taking as a starting point what individuals actually do, instead of a simplified "theoretical" idealization of how they behave (or should behave), to study the decision-making process as a potentially sub-optimal process, in which the influence of psychological biases can be important.

Taking into account the lessons learned from Behavioral Economics, the success of public policies faces two challenges. Not only must public policies provide a context that maximizes individual well-being, even when those same individuals may be unaware of what is best for them, but they must anticipate how individuals will react to such context in order for their actions not to contradict the purpose for which they were designed.

Behavioral strategies include two types of instruments to influence the behavior of individuals in order to coordinate individuals' actions with the objective of a, hopefully well intended, public policy objective: nudges and incentives. Nudges are small psychological pushes that change the environment of the decision making process so that they may radically affect individual behavior. Behaviorally designed incentives take into account a wide array of human motivations to behave in a particular manner, and try to alter the cost benefit analysis, tipping the decision in the direction of the intended policy. Let's see a simple example. Imagine the government is interested in citizens following a healthier diet, owing to the high economics costs unhealthy diets may have for a public health system. A nudge may imply changing the "architecture of decision" by changing the order in which different items of a menu are displayed in cafeterias where individuals may be queueing to have lunch. This nudge may work if individuals are first presented with healthier items, so that when they see the unhealthier ones, their tray is already full and they decide not to take them. On the other hand, a behaviorally designed incentive would offer rewards or penalties, not necessary monetary although they can of course also be taxes and subsidies, depending on the food choices selected.

Nudges are an especially attractive instrument for those who design and implement public policies: on the one hand, nudges assume what is best for the individual or for society, impose an objective function without the need for its members to question it and, if they are effective, they get citizens to subconsciously respond and behave as is anticipated. Obviously, nudges also have two sorts of problems, related to ethics and effectiveness. From the ethical point of view, assuming that public administrations know better than citizens what is best for society as a whole raises a deep moral debate on the foundations of our democratic system. From the point of view of effectiveness, the question is not so much whether the nudges should be used, but whether they work and whether they are the most efficient tool in terms of cost–benefit in each case to achieve the desired objectives.

It is possible to distinguish between four classes of nudge-type interventions: (1) provision of information; (2) changes in the physical environment; (3) changes in the options offered "by default"; and (4) the use of social norms and the relevance of the options offered ("salience").

Provision of information implies interventions that use references to other behaviors, feedback, the way of presenting or framing the information ("framing") or even the simplification of messages, so that the individual decides in line with the design of an informational campaign.

Changes in the physical environment involve interventions that alter the decision context, such as the already mentioned example of changing the order in which meals are presented in a student cafeteria to try to promote healthier choices.

Third, changes to the "default" option involve consciously choosing what happens if the individual does not make any decision, so that by not acting they behave in the manner the public manager intends in the first place. A classic example of the use of default options is allowing citizens to choose whether or not they want to be organ donors when they die, such as in the case where they do not do any paperwork to express their preference, they are treated by default as donors. The use of default options could in fact explain the enormous differences in the effective rate of organ donation between countries where there are no major cultural differences, but in which the default option, whether or not to be a donor if no decision is made, may lead a high percentage of individuals behaving according to what is established, without incurring the minimum administrative cost that may or may not have to declare whether to be an organ donor.

Finally, the use of social norms and the relevance of the information that is presented implies using comparative information about what others are doing, so that, in the absence of knowledge about how one should behave in a certain situation, individuals end up behaving as indicated by the social norm or how it has been emphasized that others behave. A typical example of the use of social norms is to inform taxpayers about the percentage of citizens who have already paid their taxes on a certain date, so that taxpayers who have been late in paying, have greater knowledge about other citizens who have already paid, so end up paying earlier.

All the cited examples use knowledge about the psychology of individuals to alter their behavior in a way that individuals are not fully conscious of, but which is caused by impulse. Although many of these examples are widely known and have proven to be effective in inducing certain behaviors, behavioral economics intends to deepen the study of the decision-making process of individuals and their behavior beyond the use of nudges. To put it plainly: not all "behavioral" interventions are nudges, nor are nudges necessarily the most effective and durable instrument in all circumstances to achieve the objectives pursued by public policy.

We can use the Bemelmans-Videc et al. (1998) model to try to classify nudges as an instrument available to public managers. This typology classifies public policies as "sticks", "carrots" or "sermons". Sticks are regulatory tools that seek to force the behavior of citizens. Carrots provide incentives to seduce individuals, while sermons seek to persuade them. Classifying the nudges into one of these three groups is not an easy task. Nudges are clearly not sticks, since they do not restrict the options available to the individual or punish them if they do not behave as the regulator intends. Nor are they carrots, since they seek to guide the citizen in an unconscious way that does not make them weigh the pros and cons of their actions, without changing their incentives. Still, they share with carrots the fact that they allow freedom of choice. Finally, nudges are not sermons either, since they do not intend to openly persuade citizens through the provision of information, although they do use what and how they give that information to achieve their objectives. Nudges are somewhere between carrots and sermons, since they use the information and the physical structure of the decision environment to influence rather than to persuade, so that individuals decide freely between the options that are presented to them.

As Lobel and Amir (2008) highlight in their critique of two of the classic books of Behavioral Economics, *Nudge* by Thaler and Sunstein (2009) and *Predictably Irrational* by Ariely (2010), to evaluate the effectiveness of a public policy instrument based on psychology and behavior, it is essential to understand well what is the mechanism that causes the individual's decision to be suboptimal and, therefore, if the intervention should seek to eliminate the intuitive (and perhaps wrong) response of an individual by appealing consciously to the rational mind or letting the power of intuitive processes change behavior without involving it. The argument is based on Kahneman's theory that classifies decision processes (in a simplified way) into those that use the impulsive part of our mind ("system I") and those, slower and more deliberate, which involve consciously weighing the consequences of the different alternatives ("system II"). This way of classifying decision processes, instinct versus rationality, is perhaps a bit crude, since it ignores the possible existence of a continuum between what is purely intuitive and what is rational, but it is useful to, in turn, categorize the different types of psychological interventions that can be used to influence the behavior of citizens. On the one hand, if we believe that the initially unwanted behavior of individuals is fundamentally due to the fact that they are making an intuitive and non-meditated decision, using system I, the most direct thing may be to use a nudge, which changes that immediate instinctual behavior. On the contrary, a deep knowledge of the motivations of individuals in more considered decisions that use system II, can lead us to the design of an incentive mechanism, which obviously need not be only monetary, but can take into account the broad spectrum of human motivations, providing additional conscious reasons to behave in the direction desired by the designer of the measure.

The nudge movement, started by Sunstein and Thaler, defends the virtues of "libertarian paternalism". A great virtue of libertarian paternalism is that it occupies an intermediate point between two ways of approaching public policy. One is traditional left-wing dirigisme or classic *Fordism* ("you can buy a Model T in any color you want … as long as it's black"). The other is the classic *laissez faire*, which assumes that governments who do not intervene at all actually preserve the freedom of the individual and, if anything, the government's mission is to increase the range of consumer options, because "the market is the best solution to any problem." The nudge movement replies by saying that traditional dirigisme does not take into account the diversity intrinsic to human beings, and that not everyone, or not always, falls into the cognitive biases that give basis to their prescriptions. Advocates of nudges remind traditional libertarians that there is no such thing as the "inviolable preferences" of the individual. If we are going to choose A if this is the privileged option, or B if we change our mind, what is really the "inviolable" preference that the individual has? How can it be so volatile and influential? Libertarian paternalism realizes that the relative ease with which the decision between options can be influenced implies that there is no neutral way of presenting different options and, therefore, since authorities must present diverse possibilities anyway, it is better to try to decide according to what society accepts (or in effect the authority decides) what is best for the individual (or society).

There is a second, more pragmatic reason for the popularity of nudging. When they work, nudges produce positive results at little or no cost. Take for example the changes in the letter that was sent to British taxpayers who were late in paying their taxes. Modifying the text of that letter, adding a phrase that would create social pressure ("X% of taxpayers have already paid their taxes") had little cost, but it did manage to significantly raise the revenue of the treasury and helped the creation and consolidation of the first public agency to use Behavioral Economics concepts to suggest policy, the Behavioral Insights Team (BIT), created in 2010.

Thaler and Sunstein's book was published in 2009, at the beginning of the "great recession" and David Cameron's accession to power. The prime minister faced a bankrupt country and the need to show that his government could achieve results for its citizens. What better than to empower a group of economists and psychologists to achieve effective improvements at zero cost? While, at the same time, cuts were made in education, or in the national health system (NHS). The Behavioral Insights Team (BIT) had numerous successes in its early years, and gained enough reputation so that at one point it was decided to become a non-profit company selling its services to the public and private sectors. The BIT, or as it is more popularly known, the "Nudge Unit", employs experts in various fields related to the socio-economic spectrum, from unemployment and tax collection to medical specialists in mental health.

In recent years, the BIT has expanded its reach to other countries such as Australia or the United States. In 2009, the Obama administration appointed Cass Sunstein director of its Office of Information and Regulatory Affairs (OIRA) and later they created their own Nudge Unit. Similar agencies were created in Denmark (INudgeYou). According to the report "Nudging All Over the World" (2014) of the Economic and Social Research Council (ESRC), up to 136 countries, including France and the Netherlands, have used behavioral sciences to design social policy initiatives.

However, a serious obstacle to the expansion of nudging agencies may be that the evidence itself may not be as strong as some of the more well-known and flashy nudging anecdotes seem to suggest. The success of nudges depends on a thousand contextual details. We have discovered in recent times that all sciences suffer from a problem of replicability of their empirical results. But psychology has been particularly affected by this problem. Dozens of famous experiments have been questioned one after another. Reading behavioral economics books today, knowing the evidence thoroughly, leads us to be much more cautious. There seems to still exist a publication bias in favor of "surprising" results that seem to dismantle "the myth of human rationality." These biases exist, but their effect is heterogeneous in the population, highly dependent on contexts that we still do not understand well and with limited power.

This is important because even interventions that really work may have a shortened duration, something that, for example in areas such as education, is a serious problem. And they could be affected by the passage of time. For example, a standard nudge-type intervention such as reminders to perform an unwanted action (for example, because of boredom), can sometimes work but, in general, their effect is very limited in time once they lose their novelty.

Furthermore, the pragmatic and political arguments in favor of the nudge approach also have problems. Remember that the success of the approach stems in part from the fact that the interventions are (almost) "free." This has two negative consequences. The most immediate is that the BIT was used by the British government in part to "whitewash" budget cuts in many social policies and not make enough effort to really attack the deep roots of important social problems. The most serious impact that comes from getting used to free results can make us lose the perspective that most behavior change interventions will not be free.

The creation of government agencies that use behavioral sciences to effectively achieve their objectives is one of the essential requirements in the modernization of public policies. In addition, requirements which go hand in hand with other necessary steps in the modernization process are independent and rigorous evaluations of public policies, public availability of data from the different levels of administration, the design of public interventions in such a way that they can really be evaluated, and an attitude favorable to experimenting and testing what works and why. The behavioral economics approach has shown success in all these pending tasks, and therefore we should not stick only to the use of nudges, however attractive they may be.

Pedro Rey-Biel

See also

Budgeting and Budget Types, Information Use in Public Management, Philosophy for and of Public Administration and Management

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