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The Nudge Theory and Choice Architects

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Abstract: **Behavioural Economics studies the psychological aspects of human behaviour which governs the demand and supply of the commodities in the market. The traditional school of thought completely ignored the possibility of human bias and preference. Prof. Richard H Thaler, explains the same in his "Nudge Theory", whereby he talks about the econs or the agents, the primary policy makers and the role they play in macro-economic theory. This article aims at explaining aspects Nudge Theory as propounded by Prof. Richard H Thaler. This article takes into consideration his perspective and explains that every individual at all times does not put forth their best rational behaviour when it comes to making individual choices. They are always subjected to limited rationality, bound by consciousness, suffer from lack of self-control and are driven by social preferences.**

Keywords: **Nudge Theory, Thaler, Behavioural Economics, buying behaviour.**

1. INTRODUCTION

Richard H Thaler, economist and professor at the University of Chicago Booth School of business was awarded the Economics Nobel Prize on Monday, 9th October 2017. Thaler is also considered as the founding leading proponent of behaviourism of behavioural economics. Known for his book "Nudge" co-authored by Cass Sunstein, he has been in the spotlight for his recent and much acclaimed book- "Misbehaving- the making of behavioural economics".

Professor Richard Thaler in one of his lectures mentioned four economists who had initiated the concept of behavioural economics much ahead of their time. Adam Smith as he quoted explained the concept in relation to overconfidence, aversion and self-control of individuals, whom Thaler refers to as agents. Later, Professor JM Keynes observed that day to day fluctuations in the profits of leading corporates in 1981 could be an outcome of behavioural economics. Further in 1906, Pareto used the psychology of the individuals in explaining his concept of welfare economics. Very recently, Thaler spoke about Milton Friedman and his theory of "As If…" It is known that some people are smarter and some are slightly less smart than the others. Bounded rationality as an assumption to most of the theories in the field of Economics is an error. Human behaviour cannot be made predictable.

To begin with Thaler's Nudge Theory, it is is invaluable in understanding behavioural economics. Economics, as a discipline, relates to the activities of macroeconomic variables in a particular society, country and corporations along with microeconomic variables of individuals and firms who become the rational agents aiming at maximizing utility, welfare and profit margins. Behavioural economics as a branch of economics is defined as the psychological branch of study focussing on the insights of human beings which undertakes policy decisions. Professor Thaler's Nudge theory is based on the behaviour of the individuals (econs as he addresses them), studies how decision making is subjected to irrationality and deviates from rational behaviour in the real world, and incorporates the same in economic modelling. In His analysis he linked human psychology and economics, this forms the essence/core of behavioural economics.

Thaler's theory has stressed on three factors for varied and unconfirmed human traits resulting in disparity between individual decision making and market decision making.

- Bounded/ Limited Rationality due to cognitive limitations- Explains how financial decisions are simplified at the human intellectual level. These results in minute accounts made at a psychological level while focussing only on the narrow gains made at the micro level than focussing on the overall impact.

- “Econs”/Agents with social preferences – social preferences may relate to consumer-producer fairness deals. For the benefit of the consumer, big firms may restrict from raising their price levels in the periods of high demand. Eg: A shopkeeper selling umbrellas may be reluctant to raise the price of his commodity during the rainy season just to be fair and satisfy his conscience.
- Lack of self-control: Econ’s psychiatric trait- capitulating short term temptations regarded as an important factor, he explains why the present standard of living is restricted to enable a plan for a secured old age.

The study suggests solutions to certain hurdles which come in the way. Firstly, it is identified that there could be a stigma present in the traditional theory. Human beings find it difficult to change their pattern of thoughts. Behavioural economics can combine fundamental principles with this new branch of science to bring about a change in the perspective of the individuals. Secondly, behavioural requires a robust, real world tested framework for crisp decision making. While dealing with human beings, unrealistic assumptions like controlled or known variables for the analysis cannot be considered. The real world is subjected to multiple biases. Most market decisions are based on the rational aspects of decision making. Behavioural patterns can incorporate real life contexts for their analysis based on non-rationality or limited rationality quotient. Thirdly, a common criticism is that it needs help from other sciences in managing and planning procedures. As an answer to this, de-biasing strategies are adopted should be considered in this particular field of economics. E.g. - the existence of an invisible hand wave can execute better results in understanding the working of the economy. Many corporate agencies have adopted “Devil’s advocate” as their strategy where an employee is deployed in the role of counter narrative to the decisions made by the others. This enhances the performance and enriches it further.

2. BEHAVIOUR ANALYSIS AND THE ESSENTIAL ‘NUDGE’

Nudge theory as the quintessential part of behavioural study undertaken by the Nobel Laureate Richard. H. Thaler makes a simple and smart disclosure.

Question: Can a slight change/nudge cause people to make better decisions?

Thaler answers this question in three dimensions-

- ✓ People (the agents in the economy who are referred to as econs) tend to buy more than they always need. It is difficult to curb the temptation of not buying a commodity when the board outside a shop reads- “Sale” or “Buy one and get one free”
- ✓ Default setting operations are simple nudges in the economy. An automatic sign up for any program instead of options given can benefit the individuals.
- ✓ Nudge can also be a bet on goals. This factor may restrict a nudge, as once the goal is achieved, the agents might want to quit the game.

3. CONCLUSION

The Nudge theory could make an analysis at a psychological level. People who are the economic agents do not act rationally; in fact they are seen to be acting irrationally but in predictable ways. As earlier researches suggest, this predictability can be identified and rectified to avoid further mistakes and encouraging the agents to make better choices in the future. Daniel Koheman has also been instrumental in forming this theory along with Professor Thaler. They have envisaged the concept of Behavioural Nudge which focuses on how to get an individual do something with restrained freedom or a slight change in the financial incentives. There could be nudges that makes the agent do something like saving money with new schemes or getting into a healthier life pattern with monitored diet and regular exercising. On the other hand, it could even stop or encourage the individual to refrain from doing something like wasting money, drinking and driving or even basic mannerisms like not littering. In such cases, nudges could be activated by boosting self-control, being mindful towards the directive desired behaviour. Like, for saving money for the future mandatory deductions could be made along with simplified decision payment process. On the contrary, ban on junk food or raising the price level of such commodities or even placing them on a higher rack at the supermarkets could reduce the intake. Smart lunch rooms

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make over in Cornell University (2013), where junk food was replaced by healthier options, resulted in 13% rise in healthy food habits of the students. In case of lithering, paying fines, paying people for using dustbins or placing green foot print on the ground pointing the way to the nearest garbage bin could bring down the percentage of garbage spilling.

Thaler's contribution to behavioural theory definitely adds a nudge of the common people or to be precise the choice architects. And, with the support of the government policies there can be a ray of hope that it could extend itself to the common man rather than being constrained to the educational campuses alone.

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