

Nobel Prize in Economics ideas help shape Ireland's policy

Richard Thaler's behavioural economics reveal people decide with emotion not logic

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Richard Thaler: Ireland's Department of Public Expenditure and Reform has established a Behavioural Economics Unit to implement some of his ideas.

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Most winners of the Nobel Prize in Economics get the award for work so abstruse that few people understand it and it rarely has any effect on public policy. The theories of the 2017 winner, [Richard Thaler](#), however, are affecting the lives of many people without their being aware of it, as governments are implementing policies based on Thaler's insights.

If you are self-employed and required to submit an income tax return, a job seeker who is required to be interviewed by Intreo (the State jobs agency) or if you are

considering applying for a grant to improve your house's energy efficiency, your decisions are being affected by government policies based on Thaler's insights. Thaler was awarded the prize for his work in behavioural economics which uses insights from psychology to explain how people make economic decisions. He argues that the dominant paradigm in economics which posits that all but the mentally ill are completely rational in their decision-making is absurd. He found overwhelming evidence that many people do not make economic decisions rationally but are affected by emotions or social conventions. He argues that people often make "embarrassing blunders in education, personal finance, healthcare, mortgages, credit cards, happiness and even the planet itself".

Thaler shows that in making decisions, most people are subject to what he calls "cognitive biases". We have limited capacity to process complex information and therefore we take shortcuts. (Price plans from different phone and internet suppliers are hard to compare so we stick with our current provider.) We live in the present and do not consider the future enough. (Young people are unlikely to sign up to pension plans.) We feel losses more keenly than gains. (Paying a tax at source is less painful than paying it out in cash in the present.) We are strongly influenced by social norms. (The smoking ban has made smoking less socially acceptable but Irish people's ambivalent attitude to alcohol abuse may encourage excessive drinking.)

Virtuous option

Thaler found that this bias towards present consumption can be overcome by making the best choice the default option. Thus instead of giving a young worker the option "If you wish to enrol in a pension tick this box", the option should be "if you do not wish to enrol in the pension scheme, tick this box". Most people will balk at rejecting the option of a pension even if they would not have sought one. Thaler's ideas are expounded in the book *Nudge* which Thaler co-wrote with legal scholar Cass Sunstein and which became a bestseller. Thaler's most powerful argument is that governments – instead of trying, and often failing, to coerce people into doing the wise thing – should make the virtuous option more attractive.

Nudge so impressed [Barack Obama](#) and [David Cameron](#) that both set up units in their governments to implement its proposals. Thaler's most significant proposal is that instead of threatening people with sanctions if they make the wrong decision, they should be encouraged ("nudged") towards making the optimal decision.

Power of salience

Ireland's [Department of Public Expenditure and Reform](#) has established a Behavioural Economics Unit to implement Thaler's ideas and has had significant success in some areas. The Revenue Commissioners increased tax filings by the self-

employed by simplifying the language in the reminder letters (avoiding cognitive overload) and by reminding laggards that most taxpayers had paid (social norms). Intreo, the Irish agency which provides all State employment and income supports and which had a high level of “non-shows” for initial interviews, reduced the rate of non-shows significantly by using a client’s first name – we respond to the personal – and telling them that “I have booked you a place in an Intreo jobseekers information session”. (This involves reciprocity; people are more likely to do something when someone has done something for them.) Finally Intreo’s letters printed important information in boxes and in bold letters. (Thaler calls this “salience”, which means that, as people’s attention spans are limited, it is essential that important information is highlighted in some way).

Some social scientists are critical of “nudge” policies, arguing they are manipulative in that they exploit human frailty to achieve the goals of government. They point to the fact that the insights of behavioural economics are being used to manipulate consumers into sometimes making decisions which are not the best value for them. But the evidence suggests that, in most cases, “nudge” type policies result in better outcomes for most people. Had the Government sought the advice of behavioural economists on how best to charge for water, the costly and divisive water charges debacle might have been avoided.

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