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BOOK REVIEW

Nudge: The Final Edition

BY RICHARD H. THALER AND CASS R. SUNSTEIN

Reviewed by Teresa Ghilarducci, PhD

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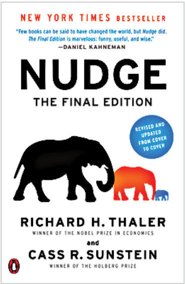

The "nudge" is a charming concept; pension plan auto-enrolling and auto-escalating have shaped U.K. and U.S. pension policy. Australia and Canada have taken more of the "shove" approach and have mandated pension contributions rather than auto-enrolling and allowing withdrawals. The best-rated pension systems in the world—those in the Netherlands, Denmark, and Israel (ranked by Mercer, CFA Institute Global Pension Index)—do not use nudge-based designs. These countries compel employers and employees to save for their retirements. Nor is opting out part of the design features of Social Security and defined benefit pension plans.

But the nudge and the burgeoning field of behavioral economics, which form the basis of nudge-like government policies, began to have wide appeal, especially in pension policy, after Richard H. Thaler and Cass R. Sunstein published their 2008 surprise hit book *Nudge*. Thaler won the Nobel Memorial Prize in Economic Sciences in 2017, and Sunstein became one of President Barack Obama's top advisors. Sunstein and Thaler used their new-found pandemic time—I don't think either of them got a new puppy—to update *Nudge* into a new book called *Nudge: The Final Edition*. In the introduction to the 2021 book, they wrote that they'd recently noticed references to the now-extinct iPod and a defense of same-sex marriage in the original *Nudge*—all outdated examples. So, they decided it was time for an update.

I wish I could imitate the inimitable writing style of Cass and Sunstein. The ideas are heavy, rooted in theory, but the communication is light—like lemon mousse packed with pea protein. It's easy to get down and leaves you with reflections and ah-ha-moment *bon mots* to tell friends at parties.

The new *Nudge* is well written and in five parts. The first part reviews the wide world of behavioral economics in a primer on human biases, temptations, and impulses that standard economics often ignores. The second part defines "choice architecture"—a device to use in your personal life as well as in social policy. The third part contains good consumer advice about mortgages, credit cards, and insurance deductibles. The fourth part applies the theories to organ donation and climate change mitigation policies. The fifth and final part defends nudging against its critics.

PENSION POLICY, CHOICE ARCHITECTURE, AND LIBERTARIAN PATERNALISM

Choice architecture and nudging have been extremely influential in economic policy-making. The policy recommendations are based on behavioral economic theories about nudges and powerful inertia impulses, which lead to the assumption that an automatic program—of, for example, saving money for retirement—will be effective. Indeed, Thaler shook up economics in 1980 with a paper titled "Toward a Positive Theory of Consumer Choice"; a *New Statesman* reporter wrote, "Thaler had mentally titled it 'Stupid Shit That People Do'" (O'Brien 2019).

Sunstein and Thaler advance a principle of political economy called "libertarian paternalism" and argue it is the appropriate framework for policy. The approach is refreshingly normative. It doesn't pretend to be free of values, and the values are up front. Libertarian paternalism is a belief structure that upholds individual choice as paramount. Because it is the authors' value system, it is not surprising that a critical analysis of the costly trade-offs of achieving the goal of free choice in pension policy is missing.

At the heart of this pension policy is the auto-enrollment of workers in retirement savings and pension plans rather than depending on workers signing the forms to start the payroll deductions.

Indeed, auto-enrollment has been shown repeatedly to be very effective in getting lower-paid workers to start saving for retirement (Beshears et al. 2016). Policy makers were convinced that auto-enrollment design coupled with the human foibles of inertia and "following the herd" would keep enrollment high without mandates. Libertarian paternalism stops short of mandating saving for retirement. If Social Security were being debated today, Thaler and Sunstein surely would be on the side of making Social Security voluntary.

The New Statesman reported that Sunstein claimed auto-enrollment as one of nudge theory's defining achievements (O'Brien 2019). However, inertia is at the heart of auto-enrollment, and continual wage growth and stable jobs are assumptions at the heart of the companion policy of auto-escalation, which calls for the contribution to automatically increase as worker pay increases.

Ghilarducci et al. (2018) shows that fear sparked by income shocks and life shocks overwhelms voluntary retirement savings. It especially raises doubts among newly enrolled retirement plan members.

Inertia is the magic force to keep people saving by keeping them from opting out of their auto-enrolled pensions. This is what Secure Choice 2.0 proposed, and it's what all the auto-individual retirement account (IRA) state plans and 401(k) plans do. But cleverly nudging and automating fails if emotions such as fear overwhelm inertia, and the reality is that most people don't get steady wage increases over their lifetimes.

Ghilarducci et al. (2018) shows that fear sparked by income shocks and life shocks overwhelms voluntary retirement savings. It especially raises doubts among newly enrolled retirement plan members. Guvenen et al. (2021) shows that career-long wage increases in the United States are enjoyed primarily only by men in top income brackets.

The U.K. Behavioural Insights Team (BIT, https://www.bi.team/)—a Sunstein and Thaler achievement—notes that long-term changes in public behavior caused by official nudged interventions are unknown and little studied (Sanders et al. 2018). Sanders et al. (2018) points out that the U.K. BIT does not encourage transparent program evaluation. Too bad. Evidence suggests opt-outs invite failure and, therefore, might not stand up to a serious evaluation.

Growing evidence shows that people who opt out of auto-enrollment are precisely the people whom public policy most wants to help. Since 2012, the U.K. universal pension plan NEST has automatically enrolled workers into plans—with an opt-out feature—but the government does not gather evidence about whether that policy is effective. Other researchers have found that, after 10 years, just more than one in six employees were still contributing (Smith 2006), indicating a loss of about 30 percent of members five years after initial enrollment and many more after 10 years; these losses are concentrated in the middle and bottom of the earnings distribution. Oregon and California's auto-IRA state plans are too young to be evaluated for long-term success, but the evidence suggests they won't be successful. Nevertheless, I am on record encouraging these plans to be implemented, figuring something was better than nothing, which represents more resignation to a third-best policy than enthusiastic support.

Real life affects most people's voluntary retirement savings and effective accumulation. If employees change jobs, they likely leave plans behind so that after 40 years of work they may have lost track of some of them and don't track the overall portfolio allocations or fees.

Though plan design changes are often proposed so that the "pot follows the worker," no movement has been made to do so. Gig workers, the self-employed, non-paid care workers, and workers with variable hours and earnings below the minimum required to automatically enroll also miss out and opt out. Negative income shocks and well-founded pessimism that wages will persistently increase encourage people to stop saving for retirement. There may be substantial disenrollment and therefore substantial failure of auto-enrollment.

NEW INSIGHTS ABOUT ORGAN DONATION AND OTHER FUN FACTS

I really liked the chapter about organ donation policies. The rare policy called routine removal, where the state is presumed to own the organs, would save many lives. So would implied consent, where every person is presumed to be a willing organ donor unless the person opts out. But in the few nations that require opt-out, doctors almost never harvest organs unless the family consents, and because families usually don't know the deceased's wishes, they often say no. So an opt-out policy for implied consent turns out to be grounded in family consent, which turns out to be more restrictive than policies that actively encourage people to be willing donors by making it easy to be informed and easy to sign up, for instance through promotional material included with driver's license renewals or vehicle registrations.

But strong encouragement to consent to being an organ donor—a decision that does not detract from a material standard of living like saving 5 percent for retirement or using complex financial management tools—does not translate to pension policy.

The authors also provide a few other fun facts to tell friends. For example, don't ever take the consumer insurance packages for appliances. Also, always opt for high deductibles. Insurance companies exploit peoples' short-term thinking and lack of probabilistic acumen.

CONCLUSION

Nudge: The Final Edition falls short as a guiding principle for U.S. pension reform. Blurbs for the book called it "great fun to read," "an entertaining book that highly informs," "engaging and thoroughly delightful." *Nudge: The Final Edition* is all those things. But for the pension or policy-making professional there is nothing new. Nudging has been criticized from the right as paternalistic and from the left as manipulative and anti-democratic, which is evidence, Sunstein and Thaler argue, of its success.

I fear that libertarian paternalism, especially conveyed in such a charming way, can cause us wrongly to think that large social problems, such as retirement wealth inequality and retirement wealth inadequacy, can be solved by spending nothing. The appeal of *Nudge* is that it promises to do big things cheap.

"Choice architecture" gets people to do the right thing, without spending any money. Auto-enroll workers into a retirement-savings plan and let inertia do its thing to keep them in. Want men to eat more fruits and vegetables? The result of one experiment suggests putting apples near the beer succeeds in doing just that. Want to save on cleanup costs? Embed an image of a fly in a urinal and men aim better. Little cost, great benefits.

The United States and the United Kingdom have always depended upon private savings and employers' voluntary provision of retirement accounts to help supplement Social Security. U.S. Social Security was never meant to provide adequate retirement income. So far public policy is filled with efforts to promote commercial solutions to the widespread problem that workers don't have enough wealth to generate income for adequate retirements. The stunning result? The United States—a very rich country—has one of the highest elder poverty rates among the rich countries, and the United Kingdom is not far behind.

Solving the problem of inadequate retirement income and the vast gaps in retirement wealth, healthy retirement time, and retirement dignity will take a lot more than auto-enrollment and auto-escalation. I am on record favoring mandatory pension plans as supplements to Social Security. Plenty of surveys suggest people like Social Security and defined benefit plans and would support universal pension accounts that will help secure their financial futures.

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