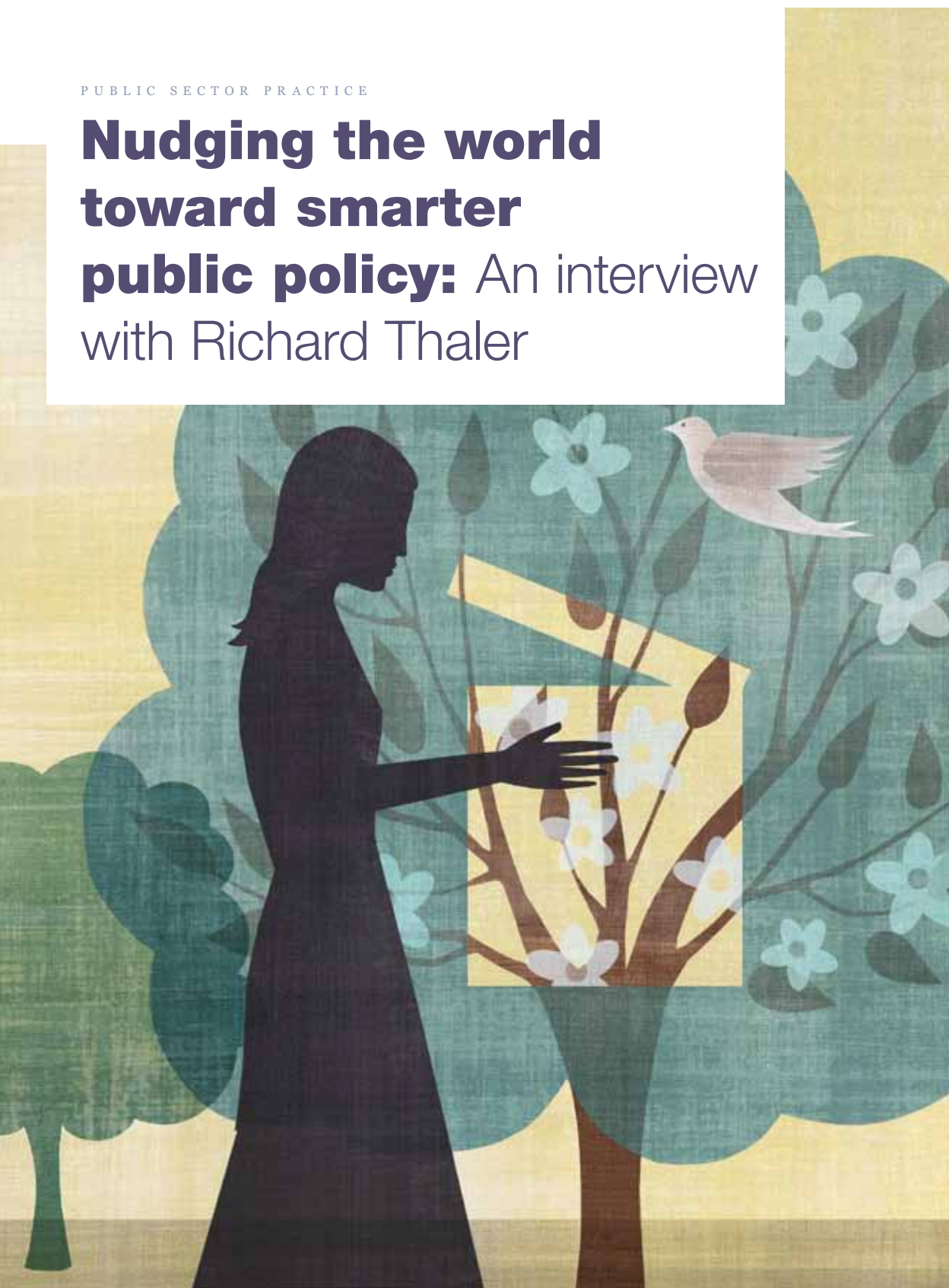


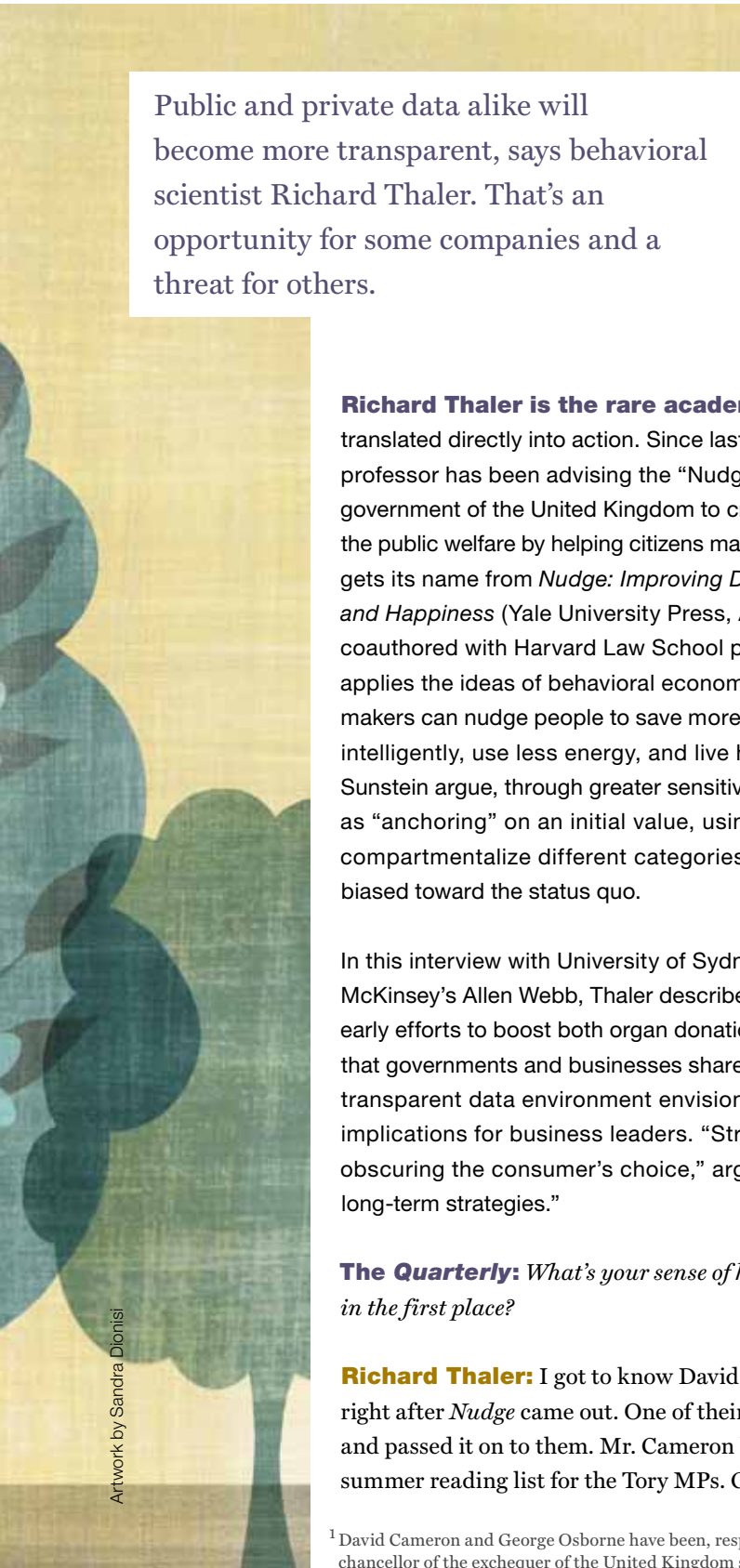
JUNE 2011

McKinsey Quarterly

PUBLIC SECTOR PRACTICE

# **Nudging the world toward smarter public policy:** An interview with Richard Thaler





Public and private data alike will become more transparent, says behavioral scientist Richard Thaler. That's an opportunity for some companies and a threat for others.

**Richard Thaler is the rare academic** whose ideas are being translated directly into action. Since last year, the University of Chicago professor has been advising the “Nudge Unit,” established by the government of the United Kingdom to create policies that will enhance the public welfare by helping citizens make better choices. The group gets its name from *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Yale University Press, April 2008), the book Thaler coauthored with Harvard Law School professor Cass Sunstein, which applies the ideas of behavioral economics to public policy. Policy makers can nudge people to save more, invest better, consume more intelligently, use less energy, and live healthier lives, Thaler and Sunstein argue, through greater sensitivity to human tendencies such as “anchoring” on an initial value, using “mental accounting” to compartmentalize different categories of expenditures, and being biased toward the status quo.

In this interview with University of Sydney professor Dan Lovallo and McKinsey's Allen Webb, Thaler describes some of the Nudge Unit's early efforts to boost both organ donation rates and the volume of data that governments and businesses share with individuals. The more transparent data environment envisioned by Thaler holds profound implications for business leaders. “Strategies that are based on obscuring the consumer's choice,” argues Thaler, will not be “good long-term strategies.”

**The Quarterly:** *What's your sense of how the Nudge Unit came about in the first place?*

**Richard Thaler:** I got to know David Cameron and George Osborne<sup>1</sup> right after *Nudge* came out. One of their young staffers had read it and passed it on to them. Mr. Cameron liked it and put it on a required summer reading list for the Tory MPs. Gratifyingly, this turned out

<sup>1</sup> David Cameron and George Osborne have been, respectively, the prime minister and chancellor of the exchequer of the United Kingdom since May 2010.

not to be just a campaign gimmick. When they got in office they said, “Let’s try to do something.”

People in Downing Street call it the Nudge Unit, but the official term is the Behavioural Insight Team. A bunch of bright civil servants on the team are going around trying to get agencies to think about how they incorporate this tool kit into the things they do. It’s hard to know whether this is early days of a new administration or people being polite to me. But I’ve been very pleasantly surprised with the openness—almost the eagerness—of people to talk to us. I’m sure that there are skeptics. But they are keeping that skepticism to themselves, at least initially.

**The Quarterly:** *What is the core message you try to deliver in those meetings?*



**Richard Thaler** is the Ralph and Dorothy Keller Distinguished Service Professor of Behavioral Science and Economics at the University of Chicago Booth School of Business and is the research associate and codirector of the Behavioral Economics Project at the National Bureau of Economic Research.

**Richard Thaler:** My number-one mantra from *Nudge* is, “Make it easy.” When I say make it easy, what I mean is, if you want to get somebody to do something, make it easy. If you want to get people to eat healthier foods, then put healthier foods in the cafeteria, and make them easier to find, and make them taste better. So in every meeting, I say, “Make it easy.” It’s kind of obvious, but it’s also easy to miss.

**The Quarterly:** *Which of your ideas seem to be gaining the most ground?*

**Richard Thaler:** Two things seem to have traction. One is building on the idea of changing defaults, which is an idea that had already caught on. A big pension reform that Adair Turner<sup>2</sup> took on had automatic enrollment built into it.

The Nudge Unit has an advisory committee, and in the very first meeting with the committee we said, “Let’s try to do something about organ donations.” The idea I’ve been pushing on for that is something I call “prompted choice” that we use in Illinois, where I live. When you get your driver’s license renewed, they ask, “Would you like to be an organ donor?” In Illinois, that doubled the number of people on the organ donation list. So a decision has been made

<sup>2</sup>Adair Turner, an alumnus of McKinsey, served in 2002 as chairman of the UK Pensions Commission. Currently, he is chairman of the Financial Services Authority and the Committee on Climate Change.

to do this in the UK, starting with motor vehicle registration and possibly moving to the National Health Service, which could make more sense in the UK, since everybody's enrolled in that and not everybody has a car.

**The Quarterly:** *So defaults, which have already had an impact on pensions in the UK, are now coming to organ donation. What's the second big priority?*

**Richard Thaler:** The second thing that is getting traction is about data. There's a big report the Nudge Unit has written, and the interesting thing here is they have gotten a big bunch of companies to agree to sit at the table and help design this.

One general principle is that lots of good things can happen if the government just releases data it already has in machine-readable, downloadable format. A good example of this is in San Francisco, where the Bay Area Rapid Transit system has for years had GPS locators in all their buses and trains. There was some big control room someplace where you could see all these things moving around. They took that data that they already had and put it online in real time in a format that app designers could tap into. Now there's an iPhone app that knows where you are and will tell you when the next bus is coming.

So that's one part: government releasing data. The second part is getting firms to release data. One goal there is to get complete price transparency. Another initiative is getting companies that are collecting data on your usage to share that data with you. When it comes time to renew my smartphone calling plan, I'd like to be able to get a file that I could upload to some Web site that would tell the search engine the way I use the phone and, so, what features I should be looking for. It might even be able to tell me, if I'm about to switch to some new model, how much more my data usage is likely to jump based on past experiences.

**The Quarterly:** *What are the business implications of the data policies that the Nudge Unit advocates?*

**Richard Thaler:** I firmly believe there's a kind of regulation that can improve competitive outcomes that some firms should be afraid of but others should welcome. It's clear that some companies' explicit strategy is obfuscation. Rather than "make it easy," their goal is to make it hard: They make the pricing strategy obscure. They make it easy for the consumer to screw up. And then they make a lot of money.

## “There’s an opportunity for firms that want to compete on the basis of fair dealing.”

Right now, it’s very easy to find what the best airfare is from Chicago to San Francisco. It’s not so easy to find all the charges that might come associated with that, especially if you have a big suitcase. And there are plenty of stories of credit card companies that are making all their money on late fees and increases in interest rates, and debit card companies that will stick a big charge that puts you over the limit at the head of the queue, so that the next six times you swipe your card for a coffee, you get charged 25 bucks each time.

Now, in my dream world, through all these data release programs, we make it easier for consumers to be smart shoppers, because the release of the data spawns Web sites that offer shopping tools. It’s not that we want consumers to spend any of their time poring through Excel spreadsheets. We want them, with one click, to be able to go to a Web site and be told, “Your credit card company is charging you hundreds of dollars worth of fees, and if you switch to this other one that sends you text messages when you are about to go over your limit, you could cut your costs in half.”

Many firms view this with fear and trepidation, and some of them should. But others should view this as an opportunity. There’s an opportunity for firms that want to compete on the basis of fair dealing. If we really succeeded with all these initiatives about transparency and making it easier to shop, then we’re going to make it possible to compete on a completely different level. Firms that honestly can say to themselves, “We succeed by having the best products and treating our customers fairly, and we’re getting screwed by the unscrupulous guys”—they should welcome this initiative. The ones who are doing the opposite should fight me tooth and nail.

**The Quarterly:** *You described a more transparent environment as your dream world. Can you point to places where it may become a reality anytime soon?*

**Richard Thaler:** The US Consumer Product Safety Commission has created a national Web site where people can post complaints about products, such as children’s cribs.<sup>3</sup> This is an issue that’s near and dear


<sup>3</sup>See [www.saferproducts.gov](http://www.saferproducts.gov).

to my heart because two of my good friends had an 18-month-old son die in a crib accident at day care—in a crib that had been recalled, but there was no way to find out about that.

Now, there are companies that are fighting this because, they say, some of the information that will be posted will be malicious. While of course it is true that some people may post bad reviews of products—and even the greatest products have some detractors—a good product will manage to overcome some bad-mouthing in the social media. If you're really proud of your product, then you won't mind a complete airing of people's opinions.

What firms have to understand is, this sort of transparency initiative—and, in fact, more generally, the whole Nudge approach to government—is a middle ground. The alternative is having the government administer a two-year test of every product you make. That is much worse from a producer's point of view.

We're all going to make some mistakes, and nobody builds a crib that's intended to strangle toddlers. But sometimes they'll build a crib that human parents will set up wrong. A crib's got to be designed in a way that nobody can possibly set it up wrong. And if somebody figures out how to set it up wrong so that it's dangerous to kids, the manufacturer should want to know.

The strategy of dealing with these things by settling lawsuits with the unlucky consumers, subject to nondisclosure, is not one that's good for the world. Strategies that are based on obscuring the consumer's choice are not good long-term strategies. And I would encourage firms that are making their money that way to think long term and think about how they can survive in a world where everything is transparent and obvious. 

**Dan Lovallo** is a professor at the University of Sydney; a senior research fellow at the Institute for Business Innovation at the University of California, Berkeley; and an adviser to McKinsey.

**Allen Webb** is a member of McKinsey Publishing and is based in McKinsey's Seattle office.