When Do “Nudges” Increase Welfare?

Dmitry Taubinsky

University of California, Berkeley

Abstract

“Nudges,” such as simplified information disclosure and warning labels, have become increasingly popular policy instruments. Much of the public discussion and empirical work focuses on whether these instruments produce large average changes to behavior at low implementation cost, instead of more economically-founded metrics of social welfare. We lay out a theoretical framework to understand the effects of “nudges” on social surplus in the presence of imperfect competition, externalities, and consumer bias. A key lesson is the importance of targeting: whether the intervention has the largest effects on the most biased consumers, relative to the variance of treatment effects. Even if the intervention has no implementation cost and moves behavior in the “right” direction on average, the intervention can still generate significant efficiency losses if it is poorly targeted. Interventions that are not well-targeted—including those that strictly increase the quality of consumer decision-making but in highly unequal ways—are imperfect substitutes for traditional corrective policies such as taxes. We combine the theory with two randomized experiments to evaluate fuel economy labels on cars and health warning labels on sugary drinks. In both experiments we find that even though the labels reduce over-consumption in the aggregate, they are poorly-targeted and are imperfect substitutes for standard tax policy tools.