

Improving Financial Behaviors Through Nudges

Abstract

Behavioral economics and its concept of nudges are rapidly influencing the design of community-based financial education programs. This article addresses why nudges can be useful tools for effective financial education, explains the different types of nudges introduced by behavioral economics research, presents evidence of their effectiveness from the field, and suggests ways Extension professionals can use these insights in their work. A particular focus is on nudges that are effective for personal financial behaviors.

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Introduction

The belief that financial education should improve financial decision making assumes a traditional economic model of decision making (Fox, Bartholomae, & Lee, 2005). This model posits that once a person learns the route to better financial wellness, he or she will take the necessary steps to achieve it (Johnson & Shumacher, 2016; O'Neill, 2006). However, as the research on financial education shows—and as many Extension professionals know—this model of decision making is not always accurate (Fernandes, Lynch, & Netemeyer, 2014; Lusardi & Mitchell, 2014). Individuals will not take a course of action to improve their financial well-being, even after they have learned how to do so. Saving is a great example. Even though we know that saving will leave us better off in the future, many of us still find it difficult to save. A myriad of social and psychological factors may stand in our way (Loibl, Jones, & Haisley, 2018).

The field of behavioral economics, which fuses economics with psychology, behavioral science, and neuroscience, is designed to target factors that may hinder the effectiveness of financial education. The behavioral economics toolbox provides valuable insights for Extension professionals working to improve

financial well-being in their communities. In particular, strategies related to a concept known as nudges are tools that may be especially useful to Extension professionals.

The Concept of Nudges

Nudges are initiatives that preserve freedom of consumer choice (Sunstein, 2016). With regard to financial behaviors, nudges are designed to remove everyday barriers to saving, debt repayment, and financial planning. Nudges, ideally, allow for low-cost, replicable, large-scale intervention, and they can be effective with low or no attention required, thus automating behavior.

There are two types of nudges (Kahneman, 2011). The first type, so-called "System 1" nudges, guide behavior without a person noticing it. These nudges are effortless and automatic and appeal to affective and nonconscious systems. Examples include setting up an account to pay a credit card automatically, depositing into a savings account using direct deposit from one's paycheck, or committing to funneling the next raise directly into one's retirement savings account before getting used to spending it (Thaler & Benartzi, 2004).

The second type are the so-called "System 2" nudges (Kahneman, 2011). These nudges require individuals to make deliberate decisions, especially ones that are affected by easy-to-manipulate factors such as the way a decision is framed. Examples include offering information about how much other people save to increase an individual's own savings rate, setting up goal-specific text reminders about making savings deposits (Ly, Ma'ar, Zhao, & Soman, 2013), and having credit card statements that show how long it would take to repay the full balance if only the minimum is paid. The credit card "warning," for example, has increased debt repayment by about 10% (Jones, Loibl, & Tennyson, 2015). Further, framing a savings decision as a loss by calculating the loss in future wealth can increase saving for retirement (Amin et al., 2017).

People typically prefer interventions that are more obvious and that engage their deliberate thinking (i.e., "System 2"), especially in important contexts, with the reason being that people want to feel in control of important decisions and not rely on fast impulsive processes (Marchiori, Adriaanse, & Ridder, 2017). However, once a person understands the differences, and how "System 1" nudges can be more effective than "System 2" nudges in changing their behavior, people may change how they feel about the automatic nudges (Sunstein, 2016).

How Extension Professionals Can Design Nudges

A recommended first step when designing nudges is to aim for simple nudges. Nudges can be combined with other interventions and are most effective when tailored to the target group. It is recommended to test nudges before using them widely to avoid ineffective or unexpected outcomes (for guidance, see, for example, Ly et al., 2013).

An effective financial education program incorporates elements of nudges alongside programming to help clients combine approaches to achieve financially positive behaviors. A common financial education tool used across Extension is the Bean Game. The game consists of participants being gifted 20 beans to represent a month's income. Spending categories are provided along with the number of beans for each action. In behavioral economics terms, this activity serves as a "System 2" nudge to help participants notice

and discuss their decision-making process in a low-pressure environment.

A second behaviorally informed activity is the SMART goal chart. SMART is an acronym that stands for specific, measurable, attainable, realistic, and timely. When SMART goals are being taught, both long-term and short-term plans are discussed as a class along with specific behaviors that need to change in order to realize the goals. The "System 2" nudge in this case comes from the self-reflection necessary to identify barriers to success.

Finally, Extension professionals can encourage clients to take advantage of nudges available at banks, from employers, and through online apps to implement "System 1" nudges. These nudges include automatic deposits into savings accounts or debt repayment, auto-escalation options at some workplaces to funnel raises directly into savings accounts, or apps that automatically transfer money into savings accounts under certain conditions (i.e., rounding up and transferring change into a savings account with every purchase). Extension professionals also can partner with large employers to implement nudges coupled with financial education because many automatic savings programs are tied to paychecks.

Taken together, the nudges approach to common behaviors, such as saving, repaying debt, budgeting, or breaking spending habits, has proven to be effective in improving outcomes. The approaches developed and tested in this area may be especially useful to Extension professionals working to improve financial well-being in the community because they are quick to implement and can be highly effective. Extension professionals can deepen their understanding of nudges by exploring books identified in the "Recommendations for Further Reading" section herein.

Acknowledgment

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Recommendations for Further Reading

Those seeking more information may consult the following selected books written for wide audiences interested in human economic behaviors:

- *The Economic Naturalist: In Search of Explanations for Everyday Enigmas*, by R. H. Frank, 2007, Basic Books, New York, NY.
- *Predictably Irrational: The Hidden Forces That Shape Our Decisions*, by D. Ariely, 2009, Harper, New York, NY.
- *Nudge: Improving Decisions About Health, Wealth, and Happiness*, by R. H. Thaler and C. R. Sunstein, 2008, Yale University Press, New Haven, CT.
- *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, by S. D. Levitt and S. J. Dubner, 2009, Harper Perennial, New York, NY.

- *Thinking, Fast and Slow*, by D. Kahneman, 2011, Farrar, Straus, and Giroux, New York, NY.
- *The Armchair Economist: Economics for Everyday Life*, by S. E. Landsburg, 2012, Free Press, New York, NY.
- *Scarcity: The New Science of Having Less and How It Defines Our Lives*, by S. Mullainathan and E. Shafir, 2014, Picador, New York, NY.
- *Misbehaving: The Making of Behavioral Economics*, by R. H. Thaler, 2015, W. W. Norton & Company, New York, NY.
- *Dollars and Sense: How We Misthink Money and How to Spend Smarter*, by D. Ariely and J. Kreisler, 2017, Harper, New York, NY.

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