



BEHAVIORAL ECONOMICS,
LIBERTARIAN PATERNALISM AND
NUDGES

A Moderate Austrian Analysis

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Introduction

To Austrians, the “market” and its dynamic self-correcting nature provide the most organic and efficient solutions to abnormal human behavior. Differing economic frameworks tend to argue for interventionist solutions such as taxes, incentives, and regulation to combat problems caused at the market-level. As of recent, a revolutionary framework continues to gain popularity that approaches market interaction and implications from a behavioral perspective. Behavioral economics, the brainchild of Herbert Simon, Daniel Kahneman, and Richard Thaler, attempt to combine discoveries in human psychology and understandings of modern economics to modify economists understanding of human behavior.

Behavioral economics’ most fruitful contribution to the literature is found in its application of behavioral economics to policy making. Socioeconomic analysis has been incorporated in both public and private policy making arenas but the research within this paper will focus solely on the private sector. At first glance, it seems that the Austrian view of the market process isn’t very compatible with the behavioral economics view. Applications of behavioral economics attempt to conservatively influence human behavior towards welfare promoting outcomes, where Austrians strongly argue against intervention of any kind. This paper will explore the development of behavioral economics, its private policy making applications, and the implications that arise from their employment. All of this will develop an essay providing a moderate approach to the ostensible incompatibility of Austrian and behavioral economics.

After research and analysis, I conclude that beyond the obvious methodological differences, behavioral economic applications fruitfully augment Austrian appreciation for individualistic freedom, especially in the retirement savings industry. Similarly, I argue that behavioral policy applications such as nudges prove to be a valid alternative to other paternalistic strategies. Additionally, I propose other unexploited outlets that behavioral economics could further develop Austrian “applied” economic modeling and understanding.

A Brief History of Behavioral Economics

The historical roots behavioral economics trace back to Adam Smith. While Adam Smith, never refers to himself as a “behavioralist” per se, his work titled, *Theory of Moral Sentiments*, inspired a new cognitive approach to human decision making. Smith’s contributions were introductory and rather undeveloped lacking any real psychological evidence but provided a behavioral perspective that was ways ahead of his time. Acceptance of Smiths cognitive approach was rather unpopular due to its modernity, lack of textual consistency, and hesitation to associate psychology with economics (University of Chicago 2018).

In economics, the market is understood to steer behavior toward a competitive equilibrium in which all economic actors behave optimally and in which welfare of society is maximized. In 1980, psychologists Daniel Kahneman and Amos Tversky proposed a new angle of human behavior and market correcting dynamics that contributed market imperfections to “fallible human behavior” (Huekelom 2014, 1). The

existence of errancy in human action is not a new one but it was the unique method of behavioral economics that revealed its potential influence. Where behavioral economics revolutionized the scope of economic understanding is in the addition of principles derived in psychology. Since its origination, behavioral economics has transformed from a proposition arguing a nuanced illustration of human behavior to a field dedicated to analyzing the possibility of fruitfully exploiting cognitive shortcomings. The future of behavioral economics literature continues to be developed by the names of Richard Thaler, Cass Sunstein, and George Loewenstein. The reach of behavioral economics continues to diversify, but the most promising development is contained within their works that outline a new approach to policy making known as Libertarian Paternalism.

Behavioral Economics Driving Force: Libertarian Paternalism

At first glance the term *Libertarian Paternalism* incites an immense amount of irony, and it rightfully should! Up to this point in political economics the words “libertarian” and “paternalism” are almost never used in unison. *Libertarian Paternalism* is Thaler and Sunstein’s attempt to not only critique economists view of “irrational” behavior but provide a means of influencing individuals toward welfare promoting alternatives while maintaining a freedom of choice. According to Thaler, “anti-paternalistic fervor expressed by many economists is based on a combination of a false assumption and at least two misconceptions”. Unlike other fields of study, economics foundation is built on a set of assumptions that undergird application and analysis. According to Thaler, one of these assumptions tends to be incorrect, therefore misinforming any further analysis. This assumption states that “usually individuals make

choices that are in their best interest”. According to Thaler and Sunstein, this claim must either be tautological which would warrant inherent disinterest or be testable (Thaler and Sunstein 2003). Behavioral economics interests itself in testing and ultimately disproving the following assumption. At its core the argument for *Libertarian Paternalism* is founded on the belief that people don’t always objectively do a good job making choices, warranting the possibility of a third-party organizer.

Thaler and scholars typically begin explaining their counterapproach to human rationality by pointing to research that concludes that, “people do not exhibit rational expectations, fail to make forecasts, use heuristics that lead them to make systematic blunders”. Thaler argues that the improper assumption of “homo economicus” has led to misconceptions in choice theory. The first misconception that there are “viable alternatives to paternalism” (Thaler and Sunstein 2003, 175-176). In other words, some form of paternalism is inevitable. In many situations, an individual must make a choice that will affect the choices of other individuals. The inevitability of paternalism seems to be one of their most verifiable arguments due to the fact that it doesn’t need to be proved by empirical studies but can be proven by reflection of organizational reality. Organizational reality points to the fact that generally institutions fail to remain organized without leadership structure and decision makers. In its simplest form, influence of the environment individuals act within is impossible to avoid. Once economists acknowledge that administrative decisions cannot be avoided, it becomes much clearer that *Libertarian Paternalism* is superior to other forms of paternalism which fail to recognize cognitive shortcomings of the human actor.

Austrian Approach to Irrationality and Human Behavior

Much of the inconsistencies between Austrian economics and behavioral economics is rooted in the variance of foundational definitions. These definitional differences are imperative in understanding the scope that each framework attempts to cover. Initial incompatibility and intellectual stubbornness have created a polarization of the literature. Before the paper continues, I believe it's imperative to eradicate the dissidence of rationality argument.

For Mises, one of the most notable Austrians, "human action is necessarily always rational". Mises continues to explain that when "applied to the ultimate ends of action, the terms rational and irrational are inappropriate and meaningless." Mises famously develops a deeply philosophical and axiomatic understanding of human rationality. Mises concludes with saying that "the ultimate end of action is always the satisfaction of some desires of the acting man". Mises also comments on attempts to claim erroneous judgements due to poorly judged means are not irrational actions. Mises states, "When applied to the means chosen for the attainment of ends, the terms rational and irrational imply a judgment about the expediency and adequacy of the procedure employed". Mises admits that means often fall short in attaining the expectation but reaffirms that although the outcome is "contrary to purpose" it still is rational. Which is represented in his logical deduction of the action itself. Mises's conclusion states, "the outcome of a reasonable although faulty deliberation and an attempt although an ineffectual attempt to attain a definite goal" is still perfectly rational (Von Mises 2012,

21-104). If the Austrian definition of “rationality” is all action that is purposeful than it becomes clearer what Mises would categorize as irrational action. According to Mises, irrational action is behavior induced by response to stimuli, typically behavior that lies beyond the control of a person's will or volition (Heiber 2017). It becomes clear that there is little to no consistency of what rationality means to Austrians and behavioral economists. But it’s important to notice that the inconsistency is not due to disagreement but a deviation of scope and method which are arguably less important in applied settings.

The behavioral approach is most similar to the argument of instinct, emotion, and impulse. As previously mentioned, Mises rejects this argument by reaffirming the fact that praxeology is not concerned with “the ultimate sources end”, meaning praxeology strategically neglects the intermediate and unseen factors of human action (Von Mises 2012, 23). This strategic approach allows for a mitigation of confusion created by the convergence of psychology and economics, further eliminating any demand for intervention. The Austrian approach to rationality provides a praxeological method that eliminates the need to study the unseen. Despite the sense of antiquation, the Austrian method prides itself in providing methodological specificity while also providing a vast understanding of the human condition.

At this point it surely seems that there is no compatibility between anything covered in behavioral approaches to rationality, except one small point. In *Human Action*, Mises states that “It is a fact that human reason is not infallible, and that man very often errs in selecting and applying means” (Von Mises 2012,12). Mises’ claim that humans

are capable of errors and faulty foresight sounds quite familiar to the arguments proposed by Thaler. If we chose to view “irrationality” in the sense that actions are occasionally objectively unoptimized. Austrian, and behavioral understandings seem much more compatible. Austrians praxeologically recognize human error and behavioral economics supplements this conclusion with cognitive reasoning. While the scopes of each framework are methodological different, there seems to be a connection in the existence of fallible human actors.

Unfortunately, a new intellectual divide is created when frameworks look to correct these human errors. Austrians’ solution point to the power of the market and the human condition, while behavioral economics provides a more cognitive solution that can be employed by policy makers. This solution, derived from the toolbox of *Libertarian Paternalism*, aims to exploit cognitive deficiencies, that generally lead humans to error. These are known as “nudges”, the following sections will aim to what nudges are, provide a practical example, and employ Austrian comparative analysis to determine its potential utility in the private sector.

Nudges: Biases and Blunders

The point of this section of the paper is to reinforce the fallible nature of humans. Behavioral economics differentiates itself in its unique application of psychology. Psychology allows economists to make human behavior more predictable, given the fact that constraints in situations are consistent. As technology and method improves, the

findings of psychologists continue to imply the existence of cognitive deficiencies that impair our ability to make fully informed decisions. Cognitive deficiencies manifest themselves in different forms but generally are categorized as what behavioral economists call biases. The existence of these biases directs the strategies behavioral economists propose to correct the biases in a welfare promoting directions.

In 1974, Daniel Kahneman and Amos Tversky proposed three “rules of thumb” that inherently produce cognitive biases. These rules of thumb are anchoring, availability, and representativeness. The following section will look to explain and understand the proposed foundational cognitive principles and deductively produce the biases that form from each. Lastly, I will articulate the proposed employment of nudges in the private sector.

Anchoring

The anchoring effect is one of the most robust cognitive heuristics. According to Tversky and Kahneman, the anchoring effect is the “disproportionate influence on decision makers to make judgements that are biased toward an initially presented value” (Tversky, Slovic, and Kahneman 1974, 208). In other words when people are trying to decide, they often have an anchor or focal point as a reference or starting point. Thaler provides a practical example of the anchoring principle in practice. Thaler illustrates an individual being asked to guess the population of Milwaukee. Thaler continues by stating that the individual lives in Chicago, which is about 2 hours south of Milwaukee. The demonstration of the thought process of the individual is as follows: If the population of

Chicago is around 3 million, and Milwaukee is considered a major city but not quite as big, maybe a third of the size which would put the population at around one million. This process is what psychologists call anchoring and adjustment. Individuals typically start with some anchor and adjust your perception and conclusion in a subjective manor. The anchoring principle has been applied not only to knowledge but to other domains such as probability and utility. Ricard Thaler concludes that bias occurs “because the adjustments are typically insufficient and misinformed” (Thaler and Sunstein 2008, 22-25). In the case of the Milwaukee and Green Bay situation, the people that guessed in higher population regions such as Chicago held a “higher anchor” and generally speculated higher populations.

So how can nudges be employed to exploit this mental phenomenon? In this case, the nudge is the “anchor”. Thaler argues that “we can influence the figure you will chose in a particular situation by ever-so-subtly suggesting a starting point for your thought process” (Thaler and Sunstein 2008, 24). The existence of this heuristic begins to open the door for applications in the private sector to beneficially lead individuals’ decisions.

Availability

The next heuristic is what Tversky and Kahneman entitle, the availability heuristic. This heuristic outlines the mental process when accessing the likelihood of risks. Evidence tends to point towards the risk assessment is generally made with consideration of previous examples of such situation. In more simpler terms, if people have previous relevant examples, they are more likely to be concerned than if no

comparable situation comes to mind. A great example that is pointed to in Thaler's book is the belief that because homicides are more informationally available than suicides, people generally believe that more people from homicides. As you can probably guess this is an incorrect assumption. The availability heuristic helps to explain much of risk related behavior, and how individuals respond to it. Thaler concludes his explanation by explaining that when the availability bias is present, private decisions can be improved by nudging individuals toward the directions of "true probabilities" (Thaler and Sunstein 2008, 27). Therefore, if you want to remind individuals of fear of a bad outcome, it is helpful to remind them of an instance where outcomes were poor and vice versa.

Representativeness

The final heuristic is known as representativeness, or more simply known as the similarity heuristic. Representativeness refers to the idea that when individuals are asked to judge how likely is that a certain object (A) to belong to another category (B), people's conclusions align with a judgement of how similar is (A) to the stereotype of (B). The typical illustration of such heuristic is seen in many domains but most clearly in stereotyping. So, imagine you are shown pictures of two individuals one is wearing a nicely ironed shirt, a nice watch, and polished shoes. The other is wearing ripped jeans, a tie dye shirt, is not well manicured. Individuals, naturally, when asked who they think the Wall Street banker is, would almost unanimously answer with the first option. The representativeness heuristic becomes harmful when "events that are determined by chance... are interpreted as random distribution" (Thaler and Tversky 1990, 209). But in fact, most of the perceived random fluctuations are causal patterns. Because

categorization is a foundational prerequisite to our perception of the world, it is very difficult to completely avoid the representativeness heuristic. However, being aware of it is a good start, and nudges can be created to increase awareness. Research has shown that when people become aware that they are using a heuristic, they often correct their judgment.

Austrian View of Heuristics

Modern heuristics tend to explore the interaction between what psychologists refer to the automatic and reflective systems (Thaler and Sunstein 2008). Mental shortcuts are exposed in certain situations when one mental system outperforms the other, usually caused by a lack of information. Like I have previously explained, this is what psychologists call biases. With the exception of the representative heuristic, the availability and anchoring heuristic blend seamlessly with the Austrians approach to linguistics and praxeology. Behind all the institutional lexicon, it is language and its composition that can manipulate cognitive biases. Language often is neglected in interaction but notably has been categorized as action by speech theorists and Austrian economists. Ludwig Von Mises famously wrote that language, “is a not simply a collection of phonetic signs. It is an instrument of thinking and acting” (Heiber 2017). Language is to not be neglected but studied the same as someone paying for Italy’s finest bottle of red wine.

Let’s take a look at the anchoring heuristic for example. For a reminder the anchoring heuristic explores the fact that individuals typically start with some anchor and

adjust your perception and conclusion in a subjective manner. This means that biases can be manipulated to produce a more predictable outcome based on the anchor individual are provided. In most situations, the anchor is a word or a series of words. The decisions of choice architects, which is a term we will explore later, boil down to the importance of linguistics. Austrians and behavioral economists view of language is nothing short of harmonious. Again, while the methods are far from similar, in principle both frameworks stress the importance language as an action not a means.

Nudges

Typically, nudges are explained before the explanation of heuristics, but I believe that understanding the shortcomings is important to demonstrate before the solution is proposed. We concluded previously that human decision making is inherently erroneous. In order for people to make perfect “unbiased” forecasts, people would have to be omniscient which is outside the bounds of reality. After an acknowledgement of these “biases”, it becomes clear that in certain situations human error becomes predictable. The “nudge” that is proposed by Thaler and other economists is the attempt to harness the power of these mistakes. Nudges are any “factors that significantly alters the behavior of Humans”. Nudges look to target the cognitive biases that are subconsciously utilized in certain decisions, such as the representativeness heuristic, and design policies that mitigate their influence. According to Thaler this mitigation of influence allows individuals to act within a relatively higher amount of information and awareness that was not present prior to the nudge. Hesitation of such strategies form due to the fear of

paternalistic governance, but Thaler reminds that nudges must be designed “insisting on everyone’s freedom to choose” (Thaler and Sunstein 2008, 8).

Choice Architecture

Choice architecture is the planner’s responsibility to “make major improvements to the lives of others by designing user-friendly environments” (Thaler and Sunstein 2008, 10). Choice architects are also responsible for designing the nudges that are applied to counteract the heuristics and biases in each situation. Behavioral economics stresses the importance of choice architects’ ability to maintain the individual’s freedom to choose in situations. A notable misconception of nudges is that they are just incentives. The difference between “incentives” and “nudges” is that nudges don’t look to distort the choice structure of humans like incentives do. Nudges rather change the environment in which the choices are made. Discovering the environment, and allocating solutions is the job of a choice architect.

The next question becomes how do choice architects design policies without over intervening. The next portion of the essay will examine the proposed process of institution, and the challenges that choice architects face. Thaler outlines this process by categorizing it as the Libertarian Toolbox. How should sensible planners choose among possible systems, given that choice is inevitable. Thaler proposes two solutions to this problem, the first is a “comparative rules analysis” the second is design that “creates indirect proxies for wealth” (Thaler and Sunstein 2003, 178). The first solution mimics what economists would call a cost-benefit analysis; the goal is to list the complete set of

implications that would be created by the design choice. The second solution is a response to one of the inherent ramifications of policymaking in both the public and private sector, how do choice architects approach subjective welfare inquiries. In many cases the planner is unable to make a direct judgment of welfare. In layman's terms it's very difficult to determine what makes other people happier, both happiness and welfare are subjective. Where anti- paternalists, such as Austrian economists, would argue that simply be able to choose in wherever they feel fit. Behavioral economics argues that the "subjective choice" is not a very helpful one. The solution to this problem involves developing "indirect proxies" for welfare which take out the guesswork and replace it with real analysis (Thaler and Sunstein 2003, 178). Behavioral economists recognize the irony of allowing fallible humans to correct fallible action but argue that there is no real alternative unless robots were created.

401 (k) Retirement Savings Accounts and the Default Nudge

Rather than explaining the myriad applications of nudges in the private sector I found it more efficient to focus on one rather than all of them. The focus on one allows analysis to be more cohesive and specific. In the case of this paper, I will be focusing on the utilization of nudges in the retirement savings industry. In order to provide the best description of behavioral applications into the employee investment accounts, I will provide a brief history of retirement accounts in the United States, target the existing heuristics, discuss behavioral solutions, and provide the outcomes and ramifications.

History

2005 was the first year since the Great Depression that the savings rate was negative. This meant that American households spent more than they earned and borrowed more than they had in savings. Historically, this was not made any better with increasing growth in home equity loans and credit card debt. For almost all Americans, saving rates were dangerously low, which contributed to the already existing troubled Social Security system. To make things worse, economists have also argued for the eventual disappearance of the Social Security system and the movement of retirement investing solely into the hands of independent retirement consultants and advisors. The irony in all of this is that the United State government knows about the problem, which is exposed in their pursuit of laws designed to encourage personal savings. The manifestation of these laws is typically in the form of tax protections. 401(k) and other employee savings programs are generally well intended, but many Americans who are eligible for plans don't even enroll. While there are many probable justifications for low enrollment, behavioral economics has uncovered new solutions to work with cognitive biases (Investment Company 2006).

The history of retirement accounts is a relatively new one as people never demanded a retirement fund. This can be contributed to the idea of retirement has only become relevant in the past 100 years. One hundred years ago, the demand for retirement accounts was much less due to the relatively shorter lifespans of humans. As time progressed, life expectancies increased, and civilization become more dispersed paving the way for new social security programs. Originally instituted by Bismarck, the first social security program was created in Germany in 1889 (Beland 2005, 19). Bismarck's

approach to retirement was slightly antiquated but paved the way for modern approaches none the less.

Retirement plans began as defined-benefit plans. Defined-benefit plans entitle participants to a benefit that is calculated using a specific formula, typically based on the participants salary and number of years the participant was a member of the plan. The most common example of a defined- benefit plan is the American Social Security program. Your Social Security check is determined by the amount you have paid in taxes and the number of years you have worked. The most powerful feature of the Social Security system comes in its design. From a choice architecture perspective, it is made very easy for participants. Thaler states, “they are designed with the most mindless of Humans in mind” (Thaler and Sunstein 2008, 109). The only real decision and action that must take place is when to start taking benefits. Defined- benefit plans are easy and forgiving in the private sector but become much more difficult when an employee moves jobs.

Defined contribution plans such as 401(k) plans offer a solution to the lack of flexibility and high administrative costs of defined benefit plans. 401(k) plans offer employer flexibility and offer more individualistic investment choice such as the ability to increase contributions and investment allocation. However, defined contribution plans are not as “well designed” from choice architecture perspective. Employees have to enroll, calculate how much to save, and manage the portfolio. The design of defined contribution plans neglects the cognitive biases that accompany human action, this is where behavioral economics look to design plans with more awareness of these biases.

The economic theory of retirement saving on the other hand is simple and is often complicated by the individuals looking to begin. People calculate how much they will need when they retire, and then save up enough to enjoy retirement savings as well as maintenance of present expenditures. In practice, saving for retirement is not an easy task. Successful retirement requires individuals to practice enough foresight, maintain self-control, and display investment knowledge. Mastering one of these things is hard enough so managing all of them becomes almost impossible. A combination of poor design choices and neglect for cognitive deficiencies make the 401(k) process very confusing and often under participated in. The following discussion will address the specific biases and the proposed nudges to minimize their influence.

When analyzing the employee's choice to enroll in either a defined benefit plan or a defined contribution plans it becomes clear that the defined contribution plan is superior. In most plans contributions are tax deductible, balances are tax deferred, and often employers will match individual contributions up to a certain threshold. With this being said, employees continually fall short in enrolling. Thaler proposes a statistic that states that "roughly 30 percent of employees that are eligible to join a 401(k) plan fail to enroll" (Thaler and Sunstein, 2008, 109). The question becomes now why employees are continually making this blunder and how can choice architects design better systems to correct it.

Sholomo Benartzi points to the three most relevant psychological factors that affect 401(k) decision making. Loss Aversion, Inertia, and Myopia are the powerful factors that affect individuals' participation. Inertia refers to the idea that humans don't

like change, especially if it involves physical and mental effort. According to Benartzi, inertia is the most influential in the creation of the mistakes surrounding 401(k) participation (Benartzi and Lewin 2012, 11). Ultimately, the resistance to change by individuals is mindboggling, especially since 401(k) saving offers an immense number of benefits. The most notable being free money from your employer in the form of matches. Benartzi points to an interesting study that proves that the stubbornness of humans is very real. A study was conducted that showed that after an employee education program was completed, its participants universally said that they would now get involved in the employee 401(k). A study was then conducted of the same individuals 14 months later, only 14 percent of the team enrolled (Choi et al., 2004).

The next psychological factor is myopia, this refers to humans' strong tendency to focus on the immediate present and find it difficult to properly map the distant future. Temporal myopia leads to detrimental consequences in retirement and is so difficult to avoid due to the challenge of sacrificing present money, for future financial security. This is not an issue that is unique to retirement either, temporal myopia or time preference is deeply rooted into the actions of all human beings. Overcoming this phenomenon is much harder than you think but is curtailed with the proper employment of nudges and technological progresses that make it easier to map financial growth.

The last mental roadblock to optimized decision making is found in loss aversion. Loss aversion refers to the implication that "losses loom in our heads much worse than the equitable gain" (Benartzi 2012, 9). Loss aversion makes it difficult for potential participants to invest money when the possibility of loss is in the picture. With this being

said, with proper asset allocation and investment choice, these fears become irrational as most retirement plans are extremely conservative. Especially as movements in investment management have moved to indexing, most portfolios return around 4 to 8%.

In order to overcome the stubborn default of human choice which seems to be doing nothing, choice architects must employ a new default. The alternative approach to selective enrollment is to move towards automatic enrollment. When an employee becomes eligible, a form is sent to them denoting that they will be enrolled in their current plan. Therefore, a designated contribution will be made by the employee in the next pay period. The allocation of the money and the chosen investments is designated by the plan sponsor. If the individual chooses that they don't want to be enrolled, an opt out form is made available. Automatic enrollment in principle is a very mundane solution to a complex issue, but it has been proven to work. Thaler points to a study done by Brigitte Madrian and Dennis Shea, that states that participation rates under the opt-in approach were barely 20 percent after 3 months of employment. Once automatic enrollment was adopted, enrollment of new employees jumped to 90 percent and reached a peak at 98 percent within 36 months (Madrian and Shea, 2001). The automatic enrollment "nudge" has managed to help participants join sooner and with the help of auto-take off, they contribute more over time.

The solution to psychological factors is admittedly still underdeveloped but as technology advances and more resources are poured into analysis its organization can be perfected. Defaulting with the ability to opt out provides a unique solution to what you could call cognitive "speed bumps". While critics would point to private governance such

as this as too paternalistic, the ability of opting out seems to quite those concerns. Choice architecture solutions grounded in behavioral assumptions has proven to make it easier for individuals to enroll and contribute to their financial security. The last portion of this essay will be analyzing the 401(k) nudge from an Austrian perspective in order to present gains from trade from each framework.

Austrian Perspective of 401(k) Choice Architecture

From an Austrian perspective the 401(k) nudge and choice architecture decisions conflict with the Austrians belief in individualistic choice and preference. Mises states in Human Action, “No man is qualified to declare what would make another man happier or less discontented” (Von Mises, 2012, 19). It becomes abundantly clear that the automatic enrollment strategy is incompatible with Mises’s sentiment of human interaction.

Automatic enrollment strategies look to make the decision for employees but where it becomes more than compatible is with the introduction of opt-out abilities. As a reminder, opt- out clauses allow participants leave if they don’t want to be further enrolled. The existence of opt out possibilities further exposes the existence of cognitive biases as even after individuals are defaulted into the plan a good majority stay enrolled. This would loosely defend the ability to be fruitfully paternalistic while also maintaining actors’ freedom to choose. Demonstrating preferences is at the core of the understanding of human action. Automatic enrollment and default strategies allow choice architects to design environments that promote preference demonstration while also nudging individuals in areas that would be avoided due to cognitive distractions.

Another notable Austrian counterargument would defend the alternative to private employer sponsored 401(k)'s would be engaging in private investment. The United States allows individuals to purchase stock, bonds, mutual funds, and other investment vehicles to build and maintain wealth. Austrians would argue if employers were not enrolling initially, it means they preferred undertaking the investment process into their own hands. While this might be true, just like the previous argument, it is made irrelevant when opt-out opportunities are offered. Additionally, undertaking investment on your own presents its own and some similar cognitive "speed bumps". This means that the Austrian argument that states preferences are being satisfied naturally would become less verified, people are not saving and investing either way. If individuals really didn't like being enrolled, they would leave but the fact that participation remains stable proves its fidelity. Choice architecture can be simply understood in the Austrian sense. The choice architect is the entrepreneur that responding to preference. The only difference is that in the 401(k) situation preferences aren't being openly revealed. The entrepreneurial argument is the most robust understanding of what choice architects are doing. The choice architect is tasked with undertaking the risk of fulfilling preferences of an individual that is not outwardly expressing or some cases even know what they prefer.

Other Unexploited Potential Gains from Trade

As I have presented behavioral solutions to private choice architecture provide gains from trade to Austrian approaches to policy making. In my research I have discovered also potential areas of unexploited areas where gains from trade could be made. The most promising is the potential influence that behavioral economics could

play in understanding the Austrian Business Cycle. It is understood that the business cycle is moved from a boom to a bust through a series of malinvestment. Austrians contribute this malinvestment as a product of monetary implications most notably, inflation. Inflation exposes the investments of capital in the higher stages of the production structure. Behavioral economics has also made many contributions to understanding investment behavior, more specifically overconfidence and malinvestment. Similarly, to 401(k) enrollment, corporate investment presents its own cognitive issues. I would presume that the modern Austrian would not allocate all malinvestment to monetary inflation, behavioral approaches can potentially provide more understanding to the cognitive biases that lead to mal investment.

Admittedly, this seems rather ironic. I can assume that this proposition will be met with a handsome level of hesitation as the “behavioral” approach to business cycle theory starts to look very familiar to John Maynard Keynes “animal spirits” argument. While this is true if my research in the 401(k)-enrollment process has proven that human behavior is extremely complex, and the root of these complexities is the human brain. Dedication to the studying of cognitive biases that affect decision making at first glance seems like another interesting potential and currently underdeveloped collaboration with Austrians and behavioral economists.

Conclusion

The point of this essay is to provide a practical analysis of behavioral economics and its potential compatibility to the Austrian framework. It might seem like a daunting

and relatively pointless exploration due to the seemingly incompatible areas of method but after close examination consistency seems valid in the area of applied economics. Behavioral economics, Libertarian Paternalism, and nudges provide a cognitive focus to the decisions we make. The cognitive focus provides Austrian frameworks a new strategy of governance that preserves freedom of choice while also mitigating the influence of cognitive errancies to nudge humans in a welfare promoting direction. Libertarian paternalism and behavioral economics are relatively new studies that still have areas that need developed but continue to prove the potential influence of its findings. The current application of behavioral economics in the retirement savings industry further proves that when designed correctly, Libertarian Paternalism and nudges provide Austrian policy makers practical solutions to combat innate cognitive biases that continue to push humans away from welfare promoting and optimized outcomes.

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