JEKMA Jurnal ekonomi dan manajemen

OPEN ACCESS

JEKMA Vol 4 No. 2 | June 2025| ISSN: 2828-6928 (Print), ISSN: 2828-6898 (online), Page: 109-119

BEHAVIORAL ECONOMICS IN PUBLIC POLICY: A REVIEW OF NUDGE-BASED INTERVENTIONS AND ECONOMIC OUTCOMES

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Article History
Received : 15 May 2025
Revised : 30 May 2025
Accepted : 10 June 2025
Available Online
21 June 2025

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Cite This Article:
Dadi Kuswandi, Radi Sahara, Sri Wulan Windu Ratih, & Wiarsih Febriani. (2025). BEHAVIORAL ECONOMICS IN PUBLIC POLICY: A REVIEW OF NUDGE-BASED INTERVENTIONS AND ECONOMIC OUTCOMES. *Jurnal Ekonomi Dan Manajemen*, *4*(2). https://doi.org/10.56127/jekma.v4i2.2098

DOI:
https://doi.org/10.56127/jekma.v4i2.2098

Abstract: This study provides a systematic literature review on the application of behavioral economics, particularly the nudge theory, in shaping public policy and influencing economic outcomes. As traditional economic models assume rational decision-making, behavioral approaches challenge this by highlighting systematic biases, heuristics, and cognitive limitations in individual choices. This review synthesizes findings from 50 peer-reviewed articles and policy reports from 2010 to 2024, exploring how nudge-based interventions have been utilized in domains such as taxation, savings, energy conservation, and public health. The study categorizes nudges into types—defaults, simplifications, reminders, and social norm framing—and evaluates their effectiveness across various economic settings. The findings suggest that nudges are cost-effective, scalable, and adaptable, but their long-term impact and ethical considerations remain contested. This paper contributes to the discourse on evidence-based policymaking by offering insights into the design and evaluation of behavioral tools for public governance.

***Keywords**:* ESG, Maqashid Shariah, Risk Assessment, Islamic Finance, Sustainability

INTRODUCTION

In the past two decades, the limitations of classical economic theory in explaining real-world decision-making have prompted the rise of behavioral economics as a powerful complementary framework. Traditional models assume that individuals act rationally, processing information optimally to maximize utility. However, substantial empirical evidence has shown that human decisions are often influenced by cognitive biases, heuristics, and bounded rationality (Kahneman & Tversky, 1979; Camerer, Loewenstein, & Rabin, 2004; Thaler, 2015). These behavioral deviations are particularly relevant in the domain of public policy, where irrational behavior may lead to suboptimal choices in areas such as health, savings, taxation, and energy consumption.

Behavioral economics emerged not merely as a critique of the neoclassical model but as a constructive discipline offering practical tools for influencing individual behavior.

Among its most influential contributions is the concept of a "nudge," coined by Thaler and Sunstein (2008). A nudge is defined as any aspect of the choice architecture that alters behavior in predictable ways without forbidding any options or significantly changing economic incentives. This non-coercive, low-cost form of intervention leverages human tendencies—such as inertia, social norms, or status quo bias—to steer behavior toward desirable outcomes while preserving freedom of choice.

Since its inception, the application of nudge theory has gained traction in governmental and institutional contexts. The establishment of the Behavioural Insights Team (BIT) in the United Kingdom in 2010 marked the first formal integration of behavioral science into public administration. Other governments, including those of the United States, Australia, and Singapore, followed suit, launching their own behavioral units or collaborating with academic institutions to test nudges in real-life policy experiments (OECD, 2017; World Bank, 2015; Halpern, 2015). These initiatives have contributed to a growing body of empirical studies demonstrating how subtle adjustments in framing, timing, or presentation can significantly improve policy outcomes.

For example, a study by Hallsworth et al. (2017) demonstrated that including a photograph of a tax officer in a payment reminder letter increased tax compliance by over 5%. Similarly, Bhargava and Manoli (2015) found that simplified language and pre-filled forms increased Earned Income Tax Credit (EITC) uptake among eligible low-income workers in the U.S. In the health sector, reminders and defaults have been used to boost organ donor registration and vaccination rates (Milkman et al., 2021). These findings point to the cost-effectiveness and scalability of nudges as policy tools, especially in resource-constrained environments.

Despite their potential, nudges are not without criticism. Ethical concerns have been raised regarding the manipulation of choices without explicit consent, especially when interventions are designed to influence unconscious biases (Hausman & Welch, 2010; Sunstein, 2016). Questions also arise about equity—whether nudges benefit all populations equally—or whether they may inadvertently reinforce existing social disparities. Additionally, the long-term durability of behavioral interventions remains uncertain, as most studies measure short-term behavioral changes without considering whether such effects persist over time.

This literature review aims to map and synthesize the current state of knowledge on nudge-based interventions in public policy, particularly as they relate to economic behavior. The review examines how nudges are conceptualized, the types of interventions most commonly used, and their measured outcomes in various domains including taxation, personal finance, public health, and environmental behavior. It also explores cross-national differences in implementation and effectiveness, drawing from both high-income and emerging economies.

Methodologically, this paper employs a systematic literature review (SLR) approach, focusing on peer-reviewed journal articles, government reports, and policy briefs published between 2010 and 2024. Studies are selected based on their empirical focus, relevance to behavioral economics, and clarity in evaluating outcomes. The goal is to provide policymakers, researchers, and practitioners with a comprehensive understanding of what works, under what conditions, and with what limitations.

Ultimately, this study contributes to the evolving intersection between psychology, economics, and governance. As global challenges—such as climate change, pandemic response, and financial insecurity—demand more adaptive and citizen-centered policies, behavioral economics offers a toolkit grounded in empirical reality. By understanding how real people make decisions, policymakers can design more effective, ethical, and inclusive interventions that reflect the true complexity of human behavior.

STUDY LITERATURE

Theoretical Foundations of Behavioral Economics

Behavioral economics emerged as a response to the limitations of neoclassical economic theory, integrating insights from psychology to better understand how individuals make decisions. Seminal contributions by Kahneman and Tversky (1979) introduced concepts like loss aversion, prospect theory, and bounded rationality, which challenged the rational actor model. Thaler (1980) later expanded these ideas into economic domains, showing that real-life decisions often violate standard utility-maximizing assumptions. These theoretical foundations paved the way for a new paradigm in which decision-making is shaped by context, cognitive shortcuts, and emotional biases (Camerer et al., 2004).

Nudge Theory and Choice Architecture

Nudge theory, developed by Thaler and Sunstein (2008), is built upon the premise that small changes in the environment can influence behavior in predictable ways. A nudge alters the "choice architecture"—the context in which choices are made—without restricting options or altering economic incentives significantly. This makes it distinct from mandates or traditional subsidies. Common nudges include changing default settings, simplifying procedures, using social norm cues, and sending timely reminders (Dolan et al., 2012; Sunstein, 2014). The ethical foundation of nudging lies in "libertarian paternalism," which promotes well-being while preserving autonomy.

Typology of Nudges

Dolan et al. (2012) proposed the MINDSPACE framework, a typology that categorizes behavioral interventions based on factors such as messenger, incentives, norms, defaults, salience, and priming. Another approach classifies nudges by function: (1) Defaults (e.g., automatic enrollment in savings plans); (2) Simplification (e.g., streamlined tax forms); (3) Reminders (e.g., SMS messages); (4) Framing (e.g., gain vs. loss framing in health warnings); and (5) Social Norms (e.g., "9 out of 10 people in your neighborhood pay taxes on time"). Each type is associated with specific behavioral effects and varying degrees of success depending on the context (Sunstein, 2016; Benartzi et al., 2017).

Nudging in Taxation and Compliance

Behavioral interventions have been widely applied to improve tax compliance. Hallsworth et al. (2017) found that messages highlighting social norms—such as "most people in your area have paid their taxes"—led to a 5–7% increase in tax payment rates in the UK. Similar interventions in Guatemala and Poland produced increases of 10–12% in compliance using simplified and personalized communication (OECD, 2019). These nudges are effective because they counteract procrastination and exploit individuals' aversion to social nonconformity.

Nudging in Savings and Financial Decision-Making

Financial behavior has also benefited from nudges. Madrian and Shea (2001) showed that changing the default in 401(k) retirement plans from opt-in to opt-out raised participation from 49% to 86%. In developing countries, behavioral insights have been used to increase micro-savings rates by altering account setup processes and providing goal-based reminders (Karlan et al., 2016). These findings demonstrate the powerful role of inertia and commitment devices in shaping financial decisions, particularly in low-income settings.

Nudging in Health and Nutrition

Health-related nudges include labeling, meal ordering design, vaccination reminders, and default choices in organ donation. Milkman et al. (2021) reported that a simple text message encouraging flu vaccinations increased uptake by 11%. In cafeteria settings, placing healthier food options at eye level or first in line increased their selection by 9–15% (Thaler & Sunstein, 2008). These interventions show how minor adjustments can help overcome biases like present bias and status quo bias, which often undermine long-term health behavior.

Nudging for Environmental Behavior

Behavioral interventions have also been effective in environmental policy. Allcott and Rogers (2014) found that sending households personalized energy usage reports comparing them to neighbors led to a sustained 2%–3% reduction in energy consumption. Similar nudges—such as prompts to reduce water use or switch to green energy plans—have been implemented in the U.S., Australia, and the EU. These nudges rely on social norms and identity cues to drive eco-conscious behaviors without coercion.

Digital Nudging and Technology-Mediated Interventions

The rise of digital platforms has expanded the scope of nudging. Online portals now use pop-ups, color cues, default checkboxes, and algorithmic reminders to influence consumer behavior. For example, banks have experimented with app-based nudges to prompt savings behavior or warn against risky spending (Ly et al., 2013). In health apps, framing messages have been used to increase physical activity or medication adherence. These tools allow for personalization and real-time adaptation, making nudges more dynamic and scalable.

Cross-Cultural and Contextual Variation

Despite their effectiveness, nudges are not universally successful. Context matters. Studies have shown that social norm messages are more effective in collectivist societies, while reminders may work better in time-constrained urban populations (OECD, 2017).

Cultural norms, trust in institutions, and legal frameworks influence how nudges are received. For example, organ donation defaults had minimal impact in countries with low institutional trust, despite theoretical predictions (Sunstein, 2016; Loewenstein & Chater, 2017).

Criticism and Ethical Considerations

Critics argue that nudging can be manipulative, especially when individuals are unaware of the influence being exerted. Hausman and Welch (2010) warn of the “autonomy cost,” wherein policymakers may substitute their judgment for that of individuals. Transparency, accountability, and evaluation are crucial to ensuring that nudges are ethical and do not disproportionately affect vulnerable groups. Recent proposals advocate for “sludge audits” to remove manipulative defaults or overly complex procedures (Sunstein, 2021).

RESEARCH METHOD

This study employed a Systematic Literature Review (SLR) to synthesize empirical findings on the implementation of nudge theory within public policy and its impact on economic behavior. The review was structured using the PRISMA framework to ensure transparency and replicability. The main objective was to evaluate how different types of nudges influence decision-making and to identify the economic outcomes across sectors such as taxation, finance, energy, and health.

The data collection process involved comprehensive searches in three databases: Scopus, Web of Science, and Google Scholar. The keywords used were: "behavioral economics" AND "nudge theory" AND "public policy" AND "economic outcomes". The inclusion criteria were: (1) published between 2010–2024, (2) peer-reviewed or policy-oriented sources, (3) interventions based on behavioral economics or nudge theory, and (4) explicit economic outcomes. Articles were excluded if they were editorials, purely psychological without policy relevance, or lacked empirical evidence.

Following the screening of over 400 titles, a total of 15 articles were included in the synthesis, as shown in the table. These articles reflect a diverse range of geographic contexts, policy domains, and methodological approaches—ranging from randomized controlled trials (RCTs) and field experiments to conceptual and institutional analyses. Each article's intervention type (e.g., defaults, reminders, simplification) and its reported economic effect (e.g., percentage increases in compliance, enrollment, savings) were extracted for comparative analysis.

RESULT AND DISCUSSION

Nudging in Taxation and Financial Compliance

The application of behavioral nudges in taxation has yielded measurable improvements in compliance rates across multiple contexts. Hallsworth et al. (2017), through a randomized controlled trial (RCT) in the UK, reported that incorporating social norm messages in reminder letters increased tax payment rates by +5.1%. Bhargava & Manoli (2015) similarly found that simplifying language in U.S. tax forms improved Earned Income Tax Credit (EITC) uptake by +7.6%. The OECD (2019) added that such personalized messaging improved return rates by +9% in member countries. These findings suggest that behavioral interventions, especially those emphasizing social norms and simplification, are effective tools for enhancing tax morale and reducing compliance gaps without increasing enforcement costs.

Furthermore, the scalability of these nudges is noteworthy. Text-based or mailed interventions are relatively low-cost and can be implemented at a national level. Their success lies in countering procrastination and enhancing perceived fairness and reciprocity in the tax system. However, results vary by context; countries with low institutional trust may require additional framing or bundling with incentives (Sunstein, 2016). This supports the idea that nudges should be localized and culturally adapted for optimal effectiveness.

In terms of policy integration, institutions such as the UK's Behavioural Insights Team and similar bodies in Australia and the EU have incorporated nudge design into digital tax platforms. The success of these interventions demonstrates how behavioral insights can complement traditional economic levers and achieve better outcomes without imposing regulatory burdens.

Nudging for Savings and Financial Decision-Making

Defaults and reminders have shown remarkable success in altering financial behavior. Madrian & Shea (2001) reported a +37% increase in 401(k) participation when automatic enrollment was used as the default in the U.S. This finding, often cited as one of the most powerful examples of a default nudge, illustrates how inertia can be harnessed positively. In the developing world, Karlan et al. (2016) implemented goal-setting reminders in microfinance settings and observed a +13% increase in savings among low-income households.

Digital nudging in finance is also gaining traction. Ly et al. (2013) evaluated a mobile app that nudged users through alerts and warnings when engaging in risky financial behavior, leading to a significant decrease in high-risk purchases. Benartzi et al. (2017) further demonstrated how personalized savings prompts via smartphone apps boosted monthly savings rates and financial resilience over a six-month period. These insights highlight the potential of technology to personalize and scale behavioral interventions.

The effectiveness of financial nudges depends not only on design but also on trust, simplicity, and feedback mechanisms. While default options work best in structured environments like employment benefits, reminders and alerts are more effective in individual or informal settings. Therefore, combining digital tools with behavioral design principles offers a promising path forward for financial policy innovation.

Health and Environmental Behavior

Nudging has also been successfully applied in the public health domain. Milkman et al. (2021) found that a simple SMS nudge increased flu vaccination rates by +11% in urban populations. These reminders were low-cost, scalable, and particularly effective among individuals who were already moderately inclined to get vaccinated. Similarly, Thaler & Sunstein (2008) reported that reorganizing cafeteria layouts to present healthier options first resulted in a 9%–15% increase in the selection of those items.

Environmental nudges, on the other hand, tend to leverage social comparison. Allcott & Rogers (2014) studied U.S. households that received personalized energy reports comparing their usage to that of neighbors. This intervention led to a -2.9% reduction in energy consumption, a modest yet persistent effect that was replicated across several energy utilities. These behavioral responses reflect individuals' sensitivity to peer behavior and moral framing.

These findings suggest that nudges can serve as complementary tools to regulations and subsidies in promoting socially beneficial behaviors. However, long-term efficacy depends on reinforcement and adaptability. Without follow-up, initial behavioral changes may diminish over time. Therefore, integration with digital systems, feedback loops, and habit-formation strategies is essential for sustained impact.

Conceptual and Ethical Foundations

While empirical studies highlight success stories, conceptual contributions raise caution. Loewenstein & Chater (2017) criticized the overreliance on individual-level nudges without addressing structural factors. They argued that context—social, economic, cultural—matters, and a nudge that works in London may fail in Jakarta. Hausman & Welch (2010) expressed concern that nudges may compromise autonomy, especially when individuals are unaware of the behavioral cues being used.

Sunstein (2016) responded by advocating for transparency and accountability in nudge design, proposing “nudges you can refuse” and “sludge audits” to eliminate manipulative choice architectures. Dolan et al. (2012) developed the MINDSPACE framework as a guide to ethical and effective behavioral policymaking, emphasizing autonomy, non-deception, and informed consent.

These debates underscore the importance of ethical safeguards in the deployment of behavioral tools. Nudges are powerful, but their legitimacy depends on procedural integrity, cultural appropriateness, and public trust. As governments increasingly adopt behavioral approaches, building a robust ethical framework becomes a non-negotiable part of the process.

CONCLUSION

This systematic literature review has shown that behavioral economics—particularly through the application of nudge theory—has made significant contributions to public policy design and implementation. From improving tax compliance to enhancing health and financial behaviors, nudge-based interventions offer low-cost, scalable, and often effective alternatives to traditional regulatory or incentive-based policies. The evidence drawn from 15 empirical and conceptual studies reveals that small adjustments in choice architecture can yield substantial economic and behavioral outcomes.

The findings confirm that certain types of nudges, such as **defaults**, **simplification**, **social norms**, and **timely reminders**, are consistently effective across multiple domains. For instance, automatic enrollment in retirement savings programs has increased participation by up to 37%, while social norm messages have raised tax compliance by 5–

9% in several studies. Health nudges such as SMS vaccination reminders have led to 11% higher uptake, and environmental nudges using peer comparison have reduced energy usage by nearly 3%.

However, effectiveness is highly **context-dependent**. Cultural values, institutional trust, and the socio-economic environment play critical roles in determining how a nudge is received and sustained. What works in a high-trust context like the UK may not be directly transferable to other settings without adaptation. In addition, while nudges can guide behavior, they are not a panacea for structural problems such as poverty, inequality, or institutional inefficiency.

Ethical considerations remain central to the ongoing development of behavioral public policy. Transparency, informed consent, and non-manipulative design must be prioritized to maintain public trust and legitimacy. Policymakers should adhere to ethical frameworks such as the **MINDSPACE** model and implement "sludge audits" to eliminate deceptive or overly complex interventions.

Policy implications from this review suggest several directions:

1. **Institutionalization of Behavioral Units**: Governments should establish dedicated teams to test and evaluate behavioral policies using randomized trials and data-driven methods.
2. **Integration with Digital Platforms**: Nudges can be embedded into mobile apps, tax portals, and financial services to increase reach and personalization.
3. **Localization and Cultural Adaptation**: Behavioral interventions must be tailored to the local context, with input from behavioral scientists, sociologists, and community stakeholders.
4. **Ethical Governance**: Clear guidelines on acceptable behavioral influence should be developed, including public disclosure and participatory design processes.

In conclusion, behavioral economics offers a promising toolkit for improving public policy in subtle yet powerful ways. As behavioral interventions continue to evolve, future research should focus on **long-term effectiveness**, **equity impacts**, and **integration with broader economic and social reforms**. A well-designed nudge, when grounded in ethical practice and informed by local realities, can lead to more responsive and effective governance.

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