

Behavioral economics and Public Policy: The UK experience

Jan-Emmanuel De Neve

Prof in Political Economy and Behavioural Science



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

Overview



1. Intro
2. The UK Behavioural Insights Team
3. Some policy applications and preliminary results:
 - Pension plans (automatic enrollment)
 - Energy consumption (insulation)
 - Jobs
 - Tax compliance (social norms + signature box)
4. Proposal: Make Tax-on-Web more interactive

- Nudge = Cost effective, light-touch intervention to induce behavior change
 - builds on a better understanding of human behavior (that is often ‘predictably irrational’)
- ‘Hard’ v. ‘soft’ regulation
- Liberal paternalism (keuzevrijheid!)
- Choice architecture
- Evidence-based policy making (RCTs)

Behavioral economic insights



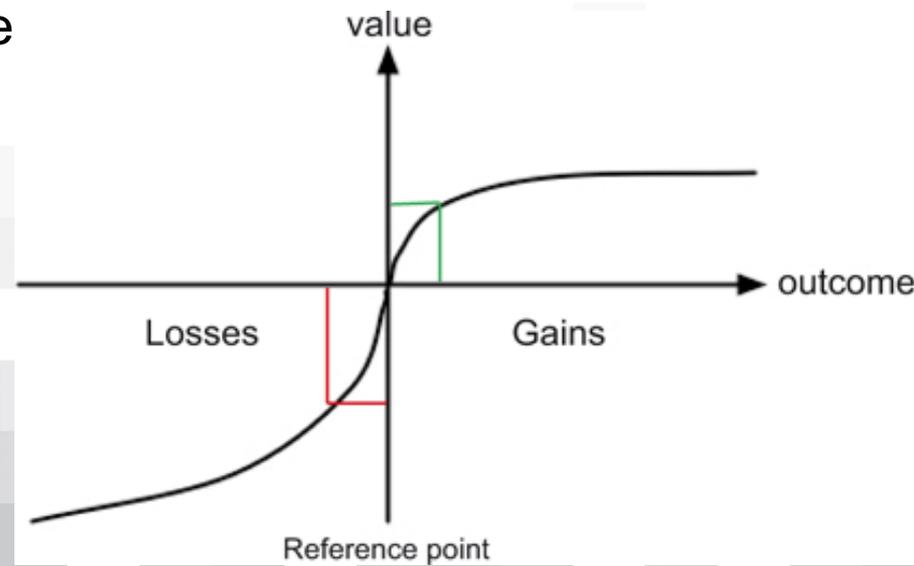
Behavior is increasingly understood to be shaped by:

Bounded rationality in decision-making

Rationality of individuals is limited by the information they have, the cognitive limitations of their minds, and the finite amount of time they have to make a decision. Individuals are “satisficers” rather than “optimisers”; only apply rationality after having reduced the options through simplification. (Herbert Simon)

Prospect theory and decision-making under risk (*loss aversion*)

Contrary to “expected utility theory,” probabilities of gains and losses are not valued symmetrically. (Kahneman and Tversky)



Behavioral economic insights



- **Reference-dependent utility**

Utility tends to be measured against a reference point, not in absolute terms. (Koszegi and Rabin)

Example: satisfaction among Olympic medalists

- **Time preferences and hyperbolic discounting**

Individual discount rates are not constant (time inconsistent). **Present-biased preferences** lead us to discount values rapidly for small delays, but we discount values less fast for longer delays. (Laibson)

Example: Would you prefer \$100 today over \$110 next year? and Would you prefer \$100 in 5 years over \$110 in 6 years?

- **Anchoring**

Decisions are often made by anchoring around an easily available number or piece of information and adjusting from there. Bias creeps in by adjusting insufficiently. (Kahneman and Tversky)

Example: suggested donations, priming survey questions

Behavioral economic insights



- **Status quo bias**
The current baseline (or status quo) is taken as a reference point, and a change from that baseline is perceived as a loss. Status quo bias has been attributed to a combination of loss aversion, endowment effect, and transaction costs (Kahneman, Knetsch, and Thaler)
- **Herd behaviour (and social norms)**
Herding behaviors occur frequently in everyday decisions based on learning from the information of others. Can be 'benign' or not (e.g. irrational exuberance and financial bubbles).
- **Optimism and overconfidence**
A well-established bias in which a person's subjective confidence in his or her judgments is reliably greater than the objective accuracy of those judgments (Sharot)

Behavioural Insights Team



- “Nudge Unit” founded in 2010 (Cabinet Office)
- Small team with academic ‘secondments’ on advisory board
- Political clout to trial a handful of behavioral insights in collaboration with Departments
- Recent spin off (Cabinet Office kept 1/3 stake) and localized behavior change units
- Evidence-based policy-making (RCTs)

**THE
BEHAVIOURAL
INSIGHTS TEAM** ♦

IN PARTNERSHIP WITH



Cabinet Office



Britain's Ministry of Nudges



Andrew Testa for The New York Times

The nudge team, led by David Halpern, (shown with the psychologist Alex Gyani) is using behavioral science to reach a variety of goals — like having more people insulate their attics, stop smoking during pregnancy or give to charity.

By **KATRIN BENNHOLD**

Published: December 7, 2013

Alex Gyani had an idea, but even he considered it a little far-fetched.

Related

[A Few Findings of Britain's Nudge Unit \(December 8, 2013\)](#)

A 24-year-old psychologist working for the British government, Mr. Gyani was supposed to come up with new

FACEBOOK

TWITTER

GOOGLE+

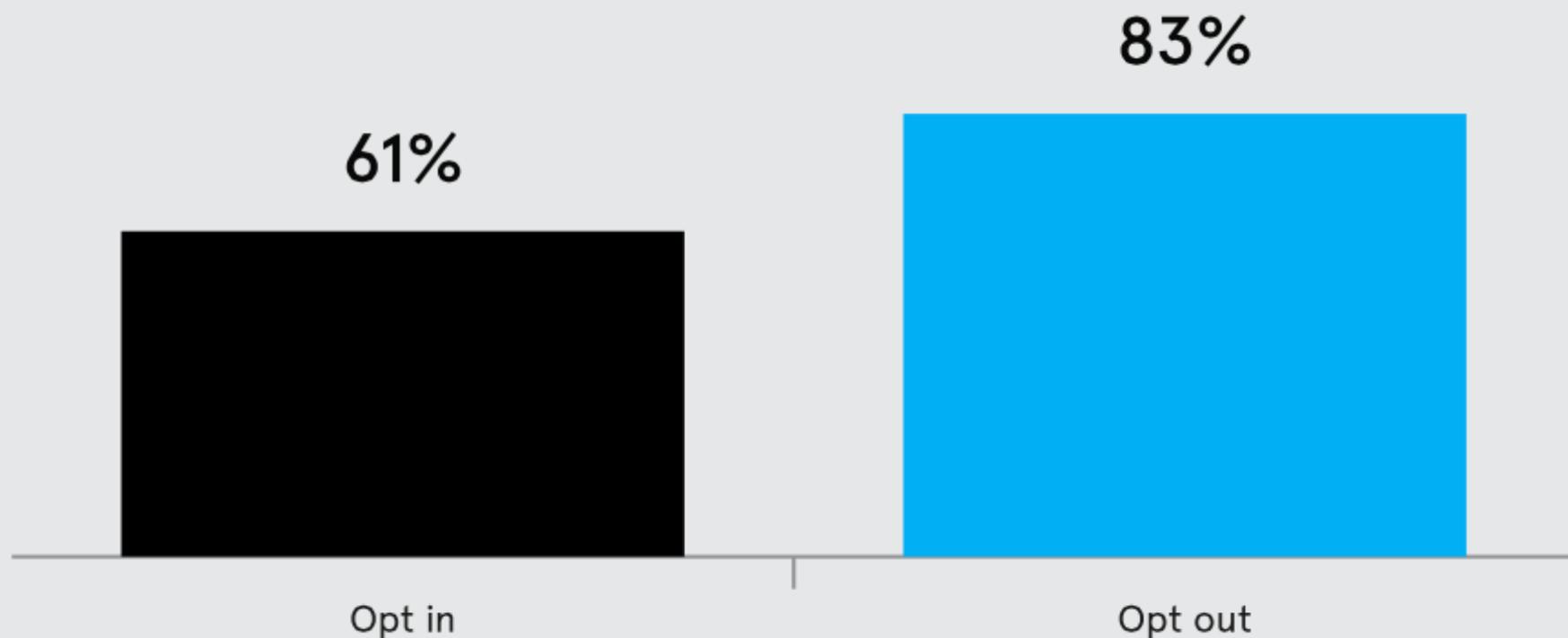
SAVE

1. Pension plans

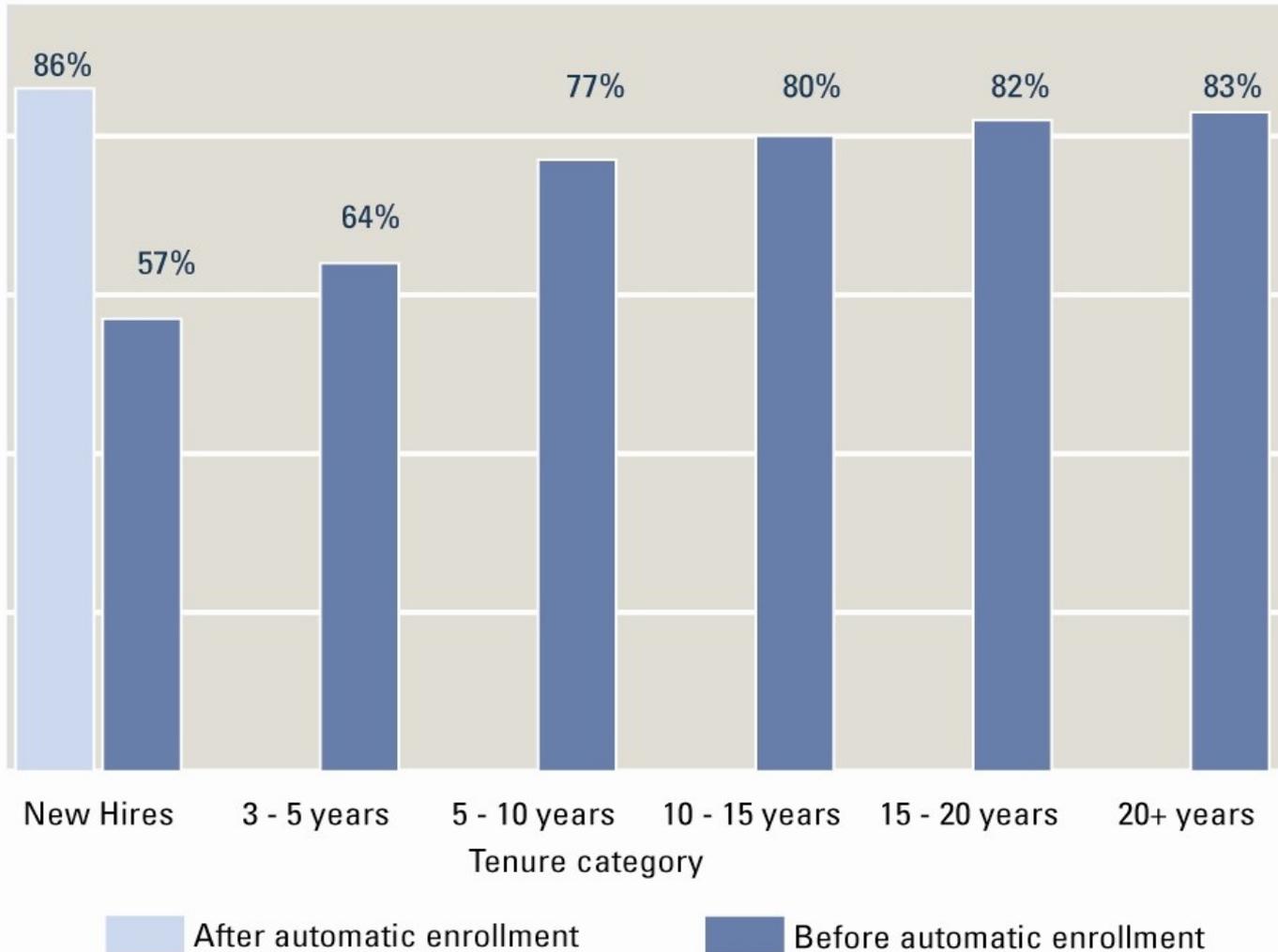
Government switched pension plans from **opt-in** to **opt-out** at large companies

[automatic enrollment]

In October 2012 UK employers started automatically enrolling their workers into a pension. The scheme started with the largest UK employers (250 or more workers) and by 2018 will cover all employers. Initial results show that the overall participation rate rose from 61% to 83% and 400,000 more people now have a pension.⁵



Power of defaults: Pension plans (401(k)) before and after automatic enrollment



Source: Matrian, Bridgette C. and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," Quarterly Journal of Economics 116:4 (November 2001).

2. Energy savings (roof insulation)

Problem: few people insulating their roofs...

1. *Trial 1*: Norms and social networks (Groupon-style):

Test the impact of offering energy efficiency products and services at varying levels of **discount depending on how many people opt in to the offer**. Creates a financial incentive to encourage others and a signal that people are taking up the offer.

Result: Insignificant...

Applications and preliminary results



2. *Trial 2*: Transaction costs:

A subsidised loft-clearing service in conjunction with loft insulation (and the opportunity for residents to donate their unwanted loft contents to a local good cause).

Result: Fivefold increase in up-take of insulation offer

3. Jobs

Improving success of Jobcentres at getting jobseekers back into labor force

4 approaches:

- **Easy** (cutting down the process)
- **Attractive** (personalising job advice/advisor)
- **Social** ('commitment device' with personal advisor)
- **Timely** (making sure a work-focused interview happens on day one)

Preliminary results from the trial show a significant increase in those off benefits at 13 weeks.

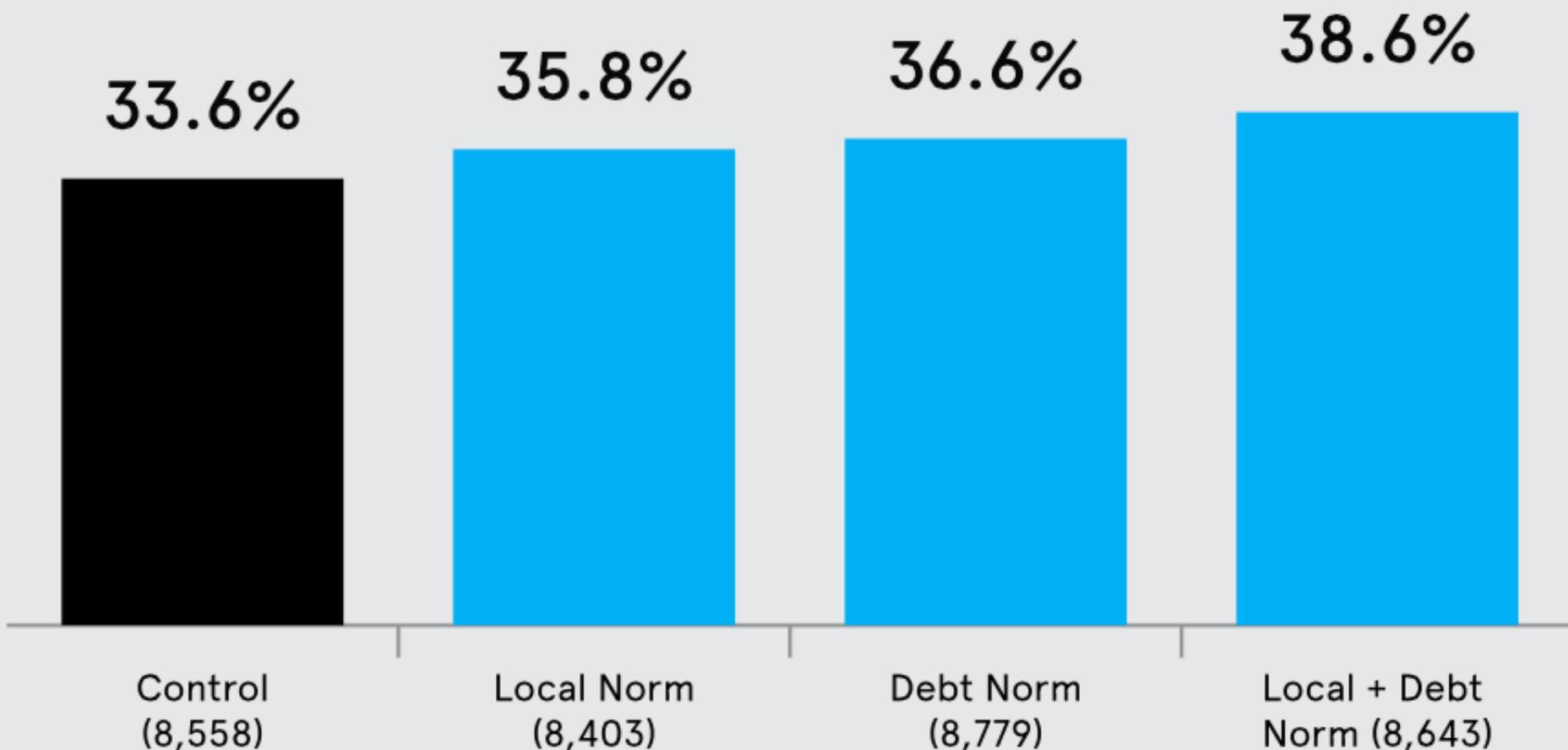
4. Tax compliance (reminder letters overdue taxes)

Tested various *social norm* messages to increase tax payments (N=100,000).

‘local norm’ letters noted that the great majority of people in the recipient’s local area had paid on time

‘debt norm’ pointed out that most people with a debt like theirs had already paid.

% paying after 23 days



Combined local and debt norm increased payment rates by five percentage points (15% in relative terms) and led to £1.2m more being paid in the first month than the control. The use of these and similar messages brought forward £210m of tax revenue in the 2012/13 financial year.

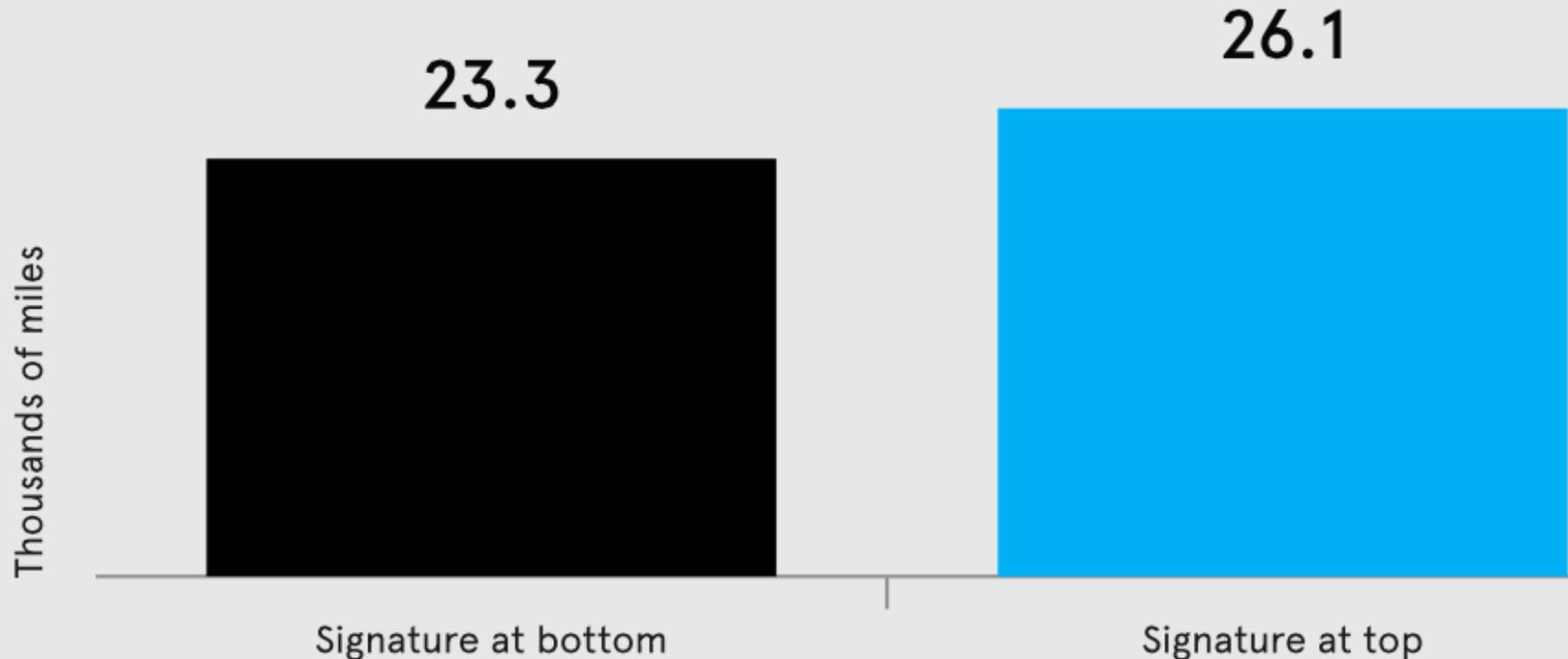
Applications and preliminary results



New compliance trial:

Prompting honesty by putting signature box up front

Number of miles declared



Source: Ariely et al. 2012. PNAS

New trial: Eliciting taxpayer preferences raises tax compliance



Problem = “Tax aversion”

Why?

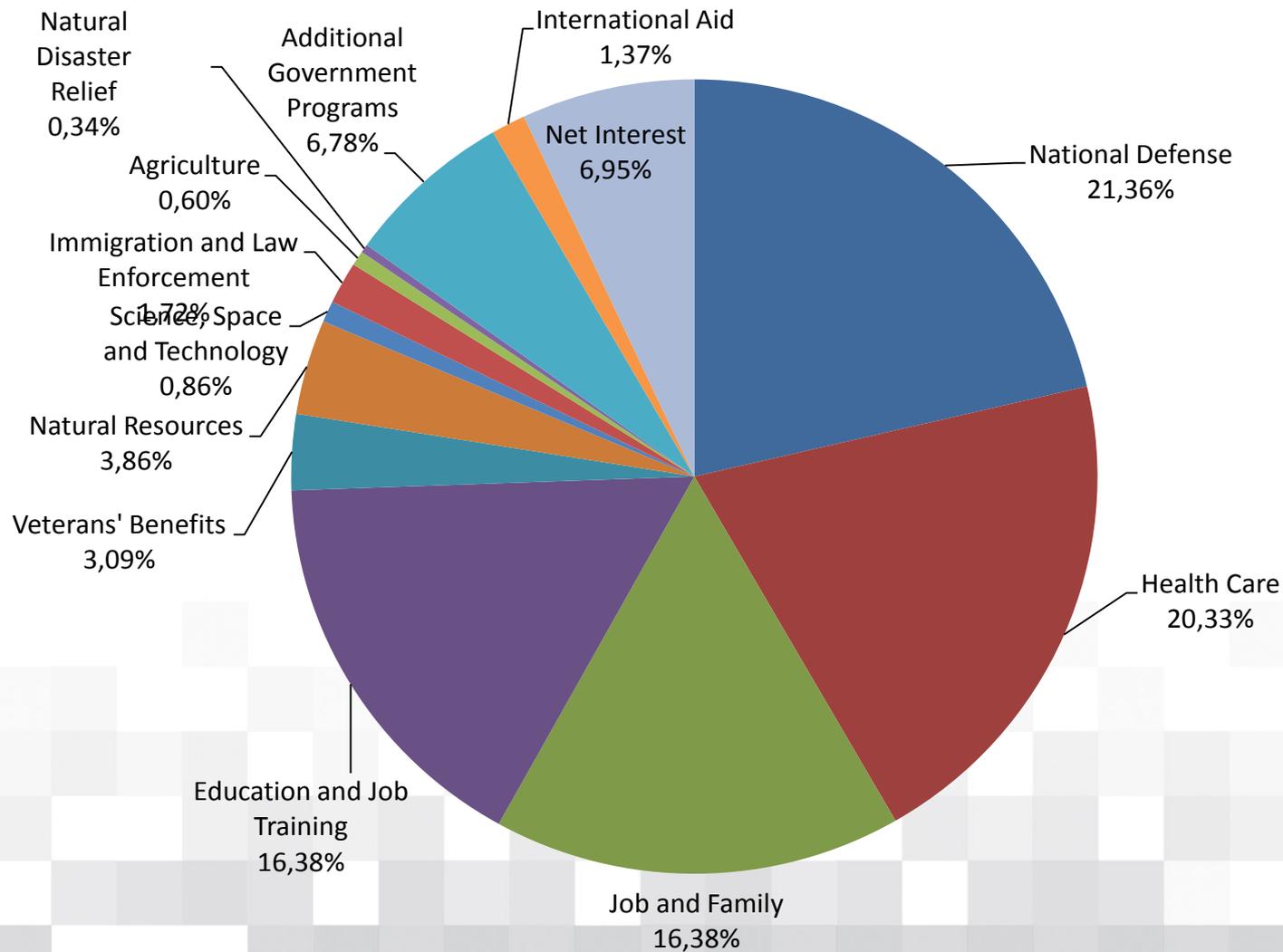
1. Psychological distance between paying taxes and public goods in return

[information]

2. Little sense of having something to say in the allocation process

[agency]

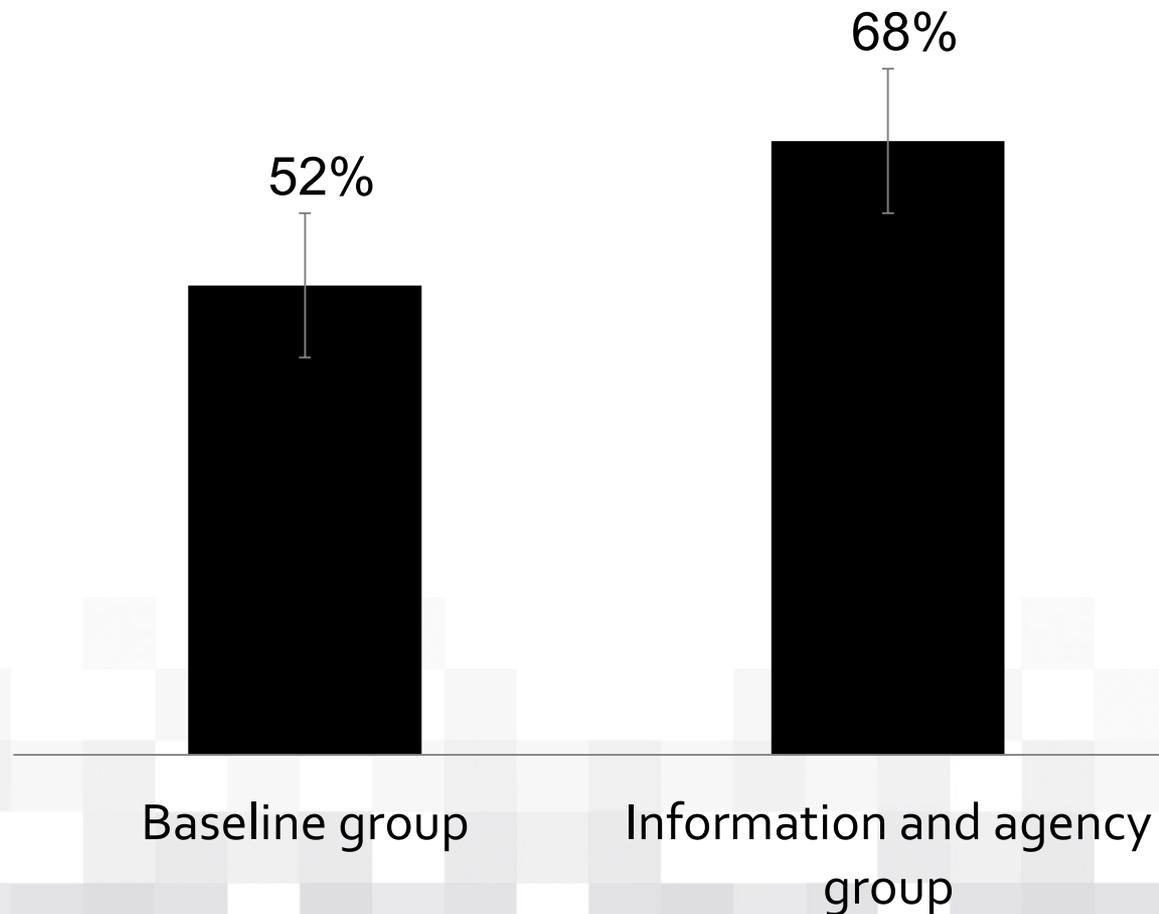
Lab experiments



Eliciting taxpayer preferences raises tax compliance



Tax compliance



Opportunity to express *non*-binding preferences over tax allocation raises compliance with 16% (lab) and 15% (survey)

Recommended reading



- Thaler and Sunstein. 2008. *Nudge*
- Behavioural Insights Team reports and blog
- World Development Report 2015: *Mind, Society, and Behavior*
- Peter John. 2012. *Nudge Nudge, Think Think*
- Institute for Government. 2010. *Mindspace: Influencing behaviour through public policy*
- De Neve et al. 2014. *Eliciting taxpayer preferences*
- Shafir. 2012. *The behavioural foundations of public policy*
- US think thank: <http://www.ideas42.org>