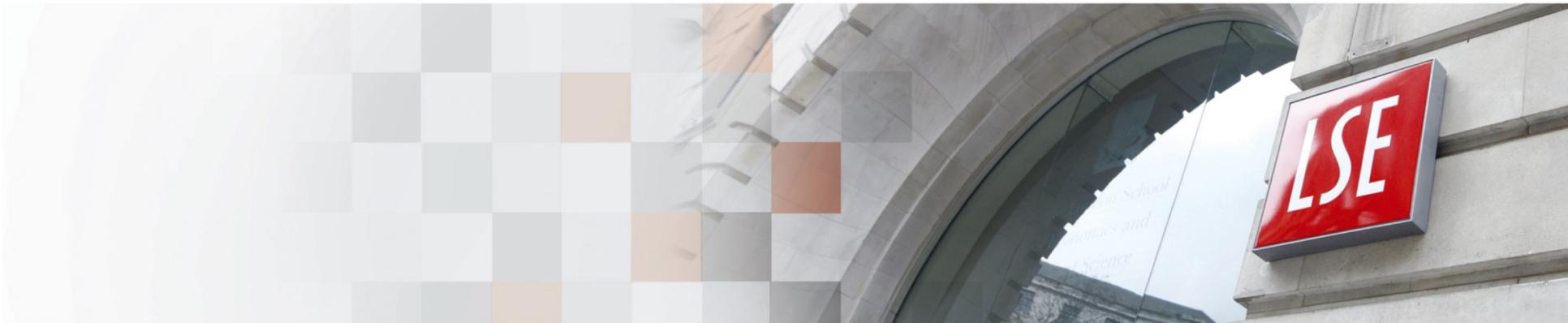


# Behavioral economics and Public Policy: The UK experience

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# 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



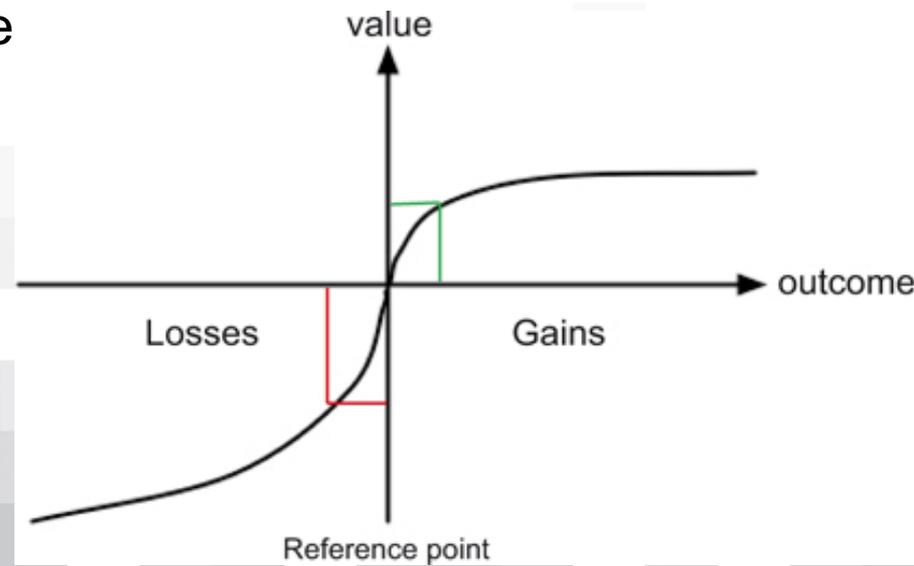
Behavior is increasingly understood to be shaped by:

## **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

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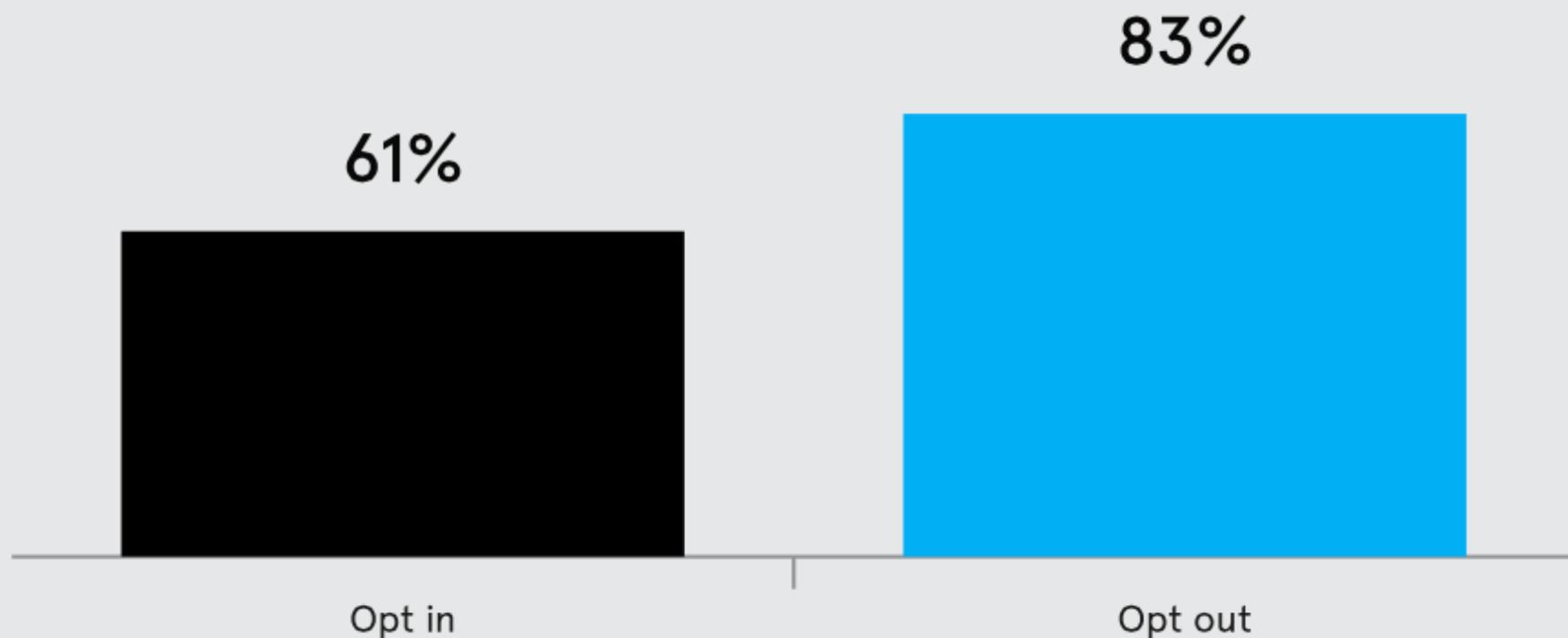
SAVE

## 1. Pension plans

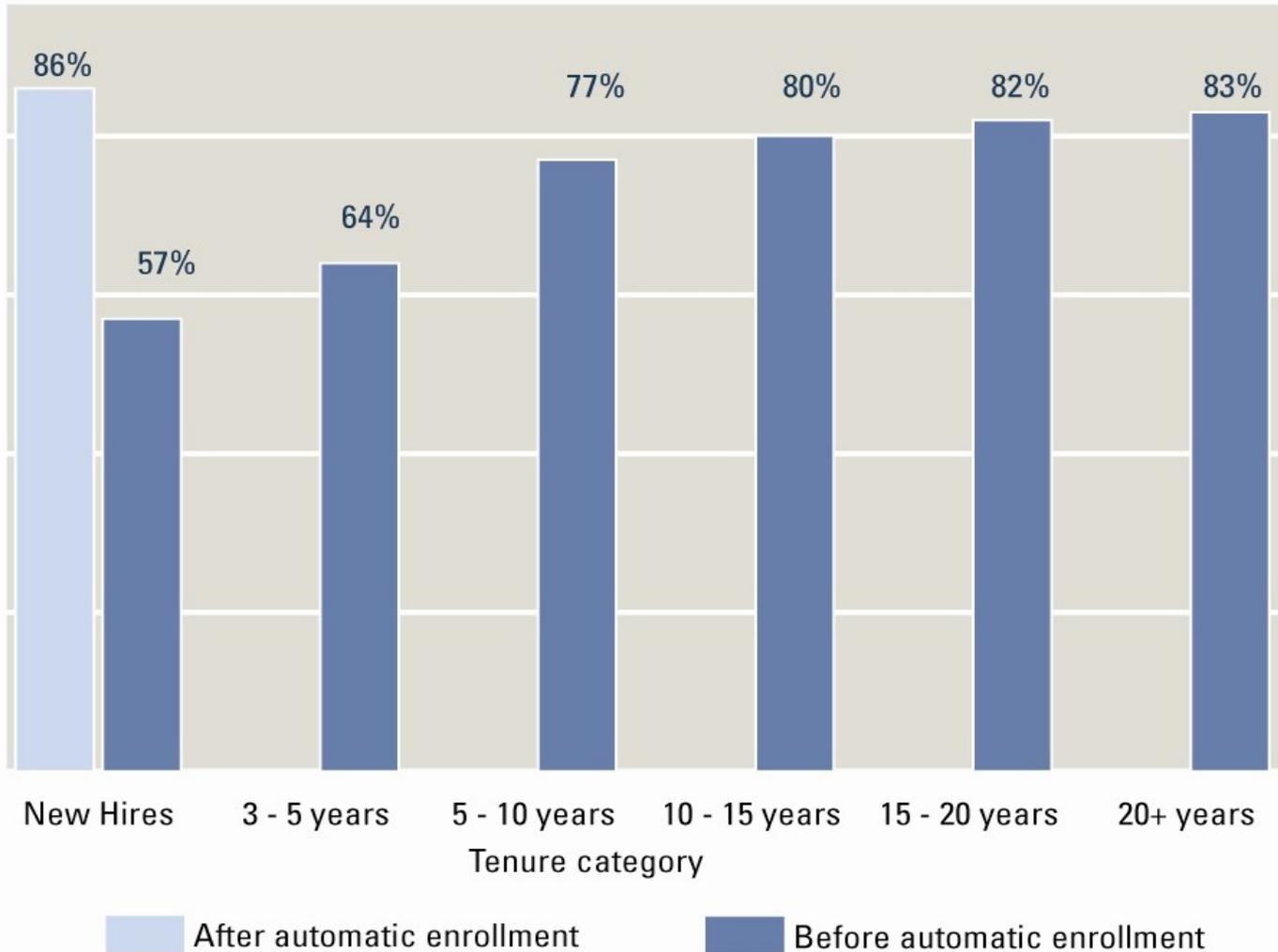
Government switched pension plans from **opt-in** to **opt-out** at large companies

*[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.<sup>5</sup>



# 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.

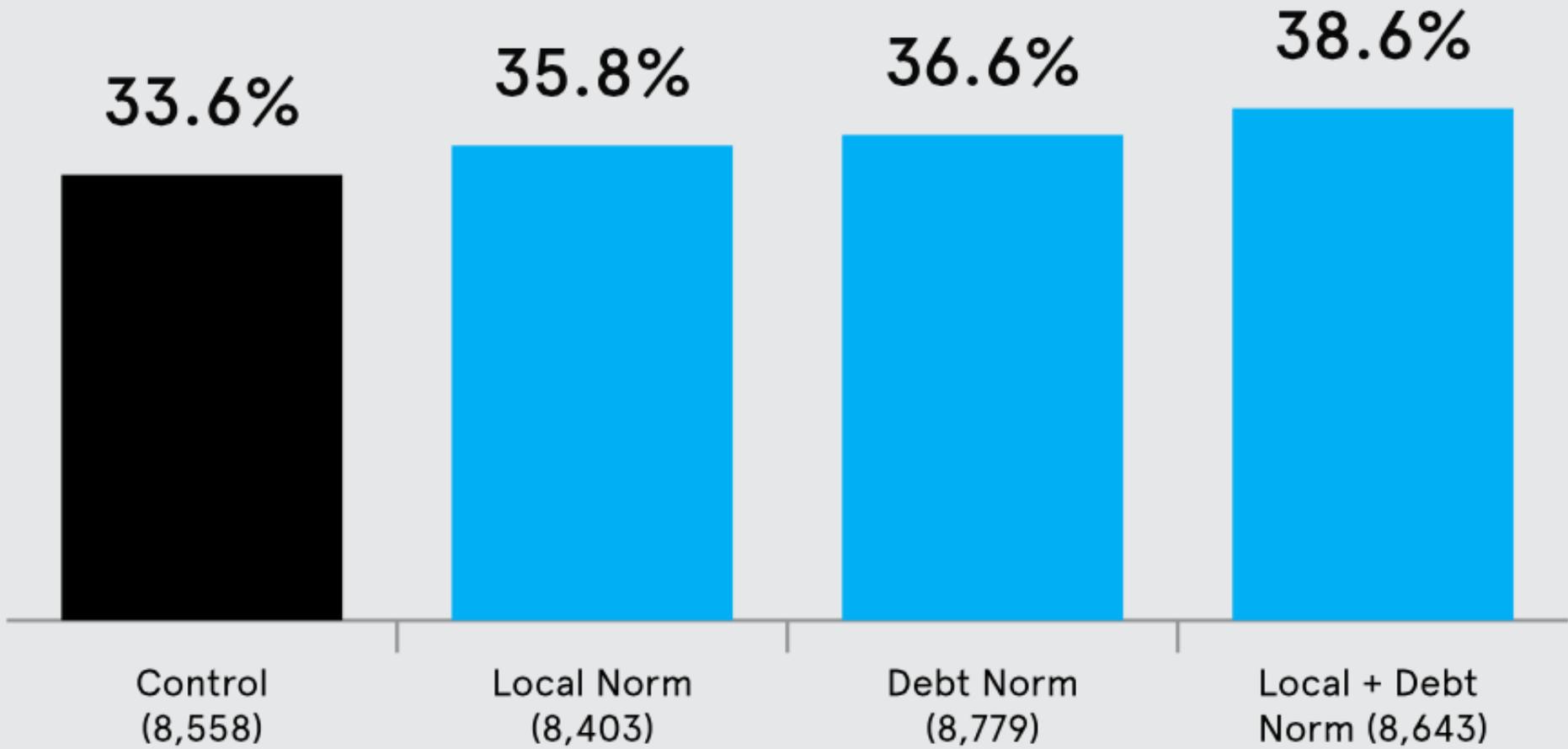
## 4. Tax compliance (reminder letters overdue taxes)

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.

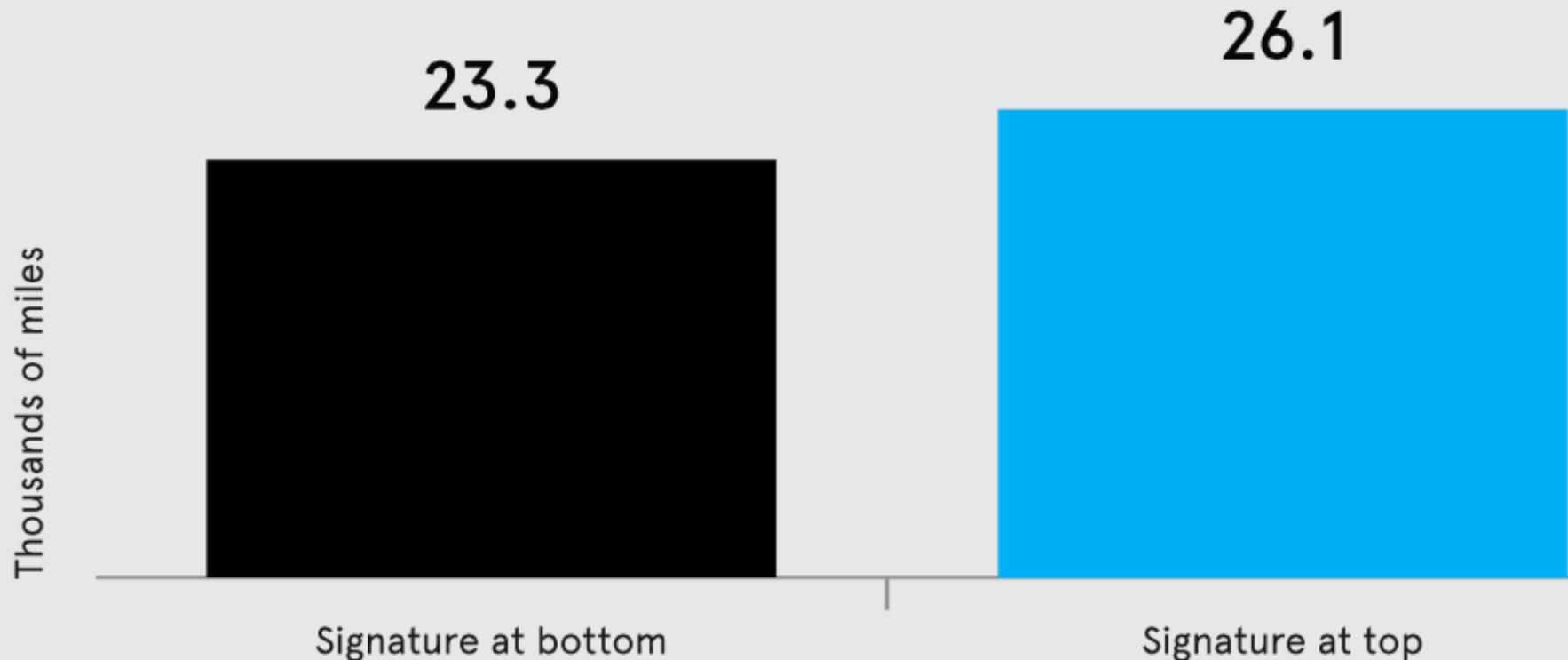
# Applications and preliminary results



## 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?

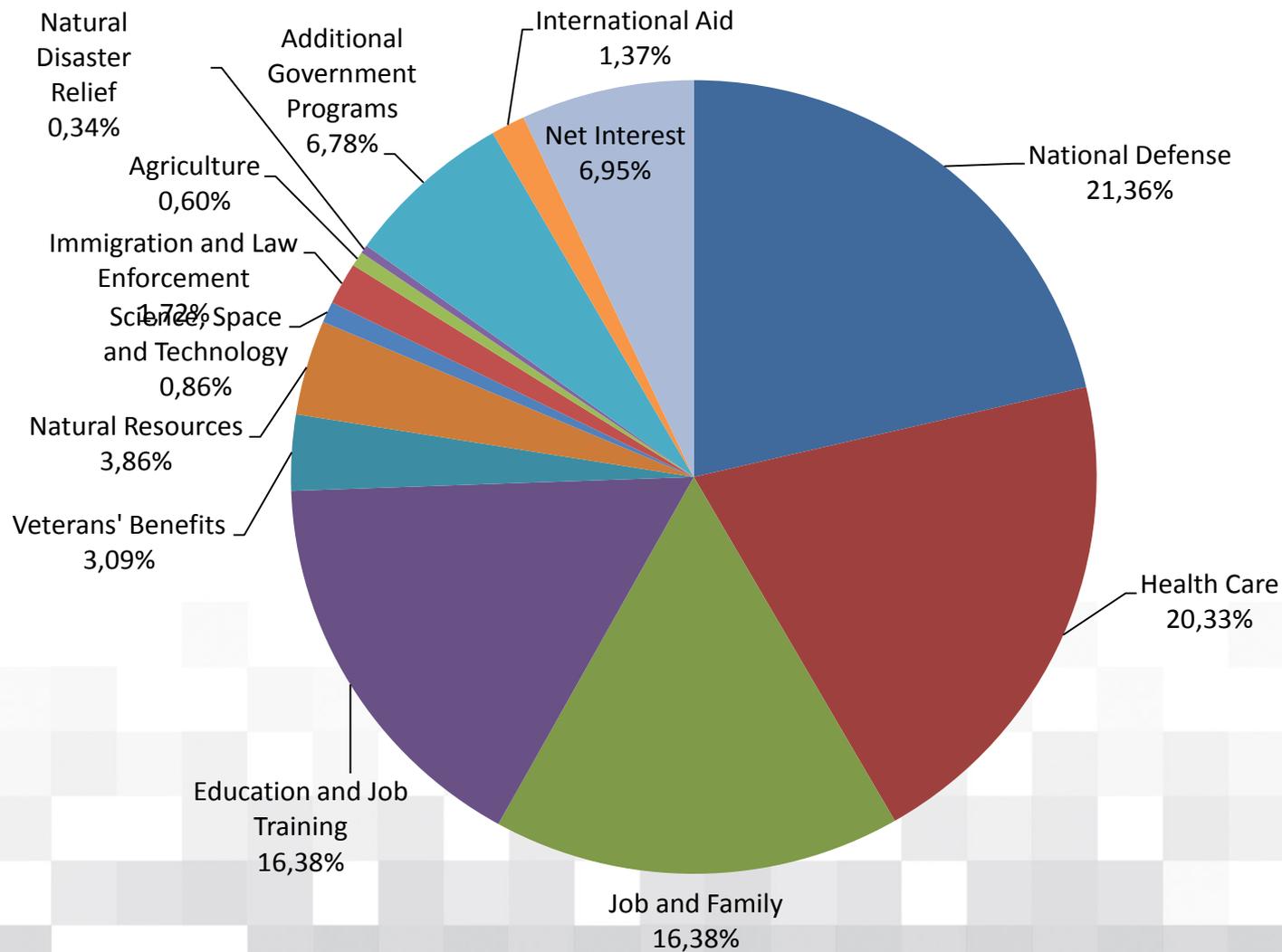
1. Psychological distance between paying taxes and public goods in return

**[information]**

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

**[agency]**

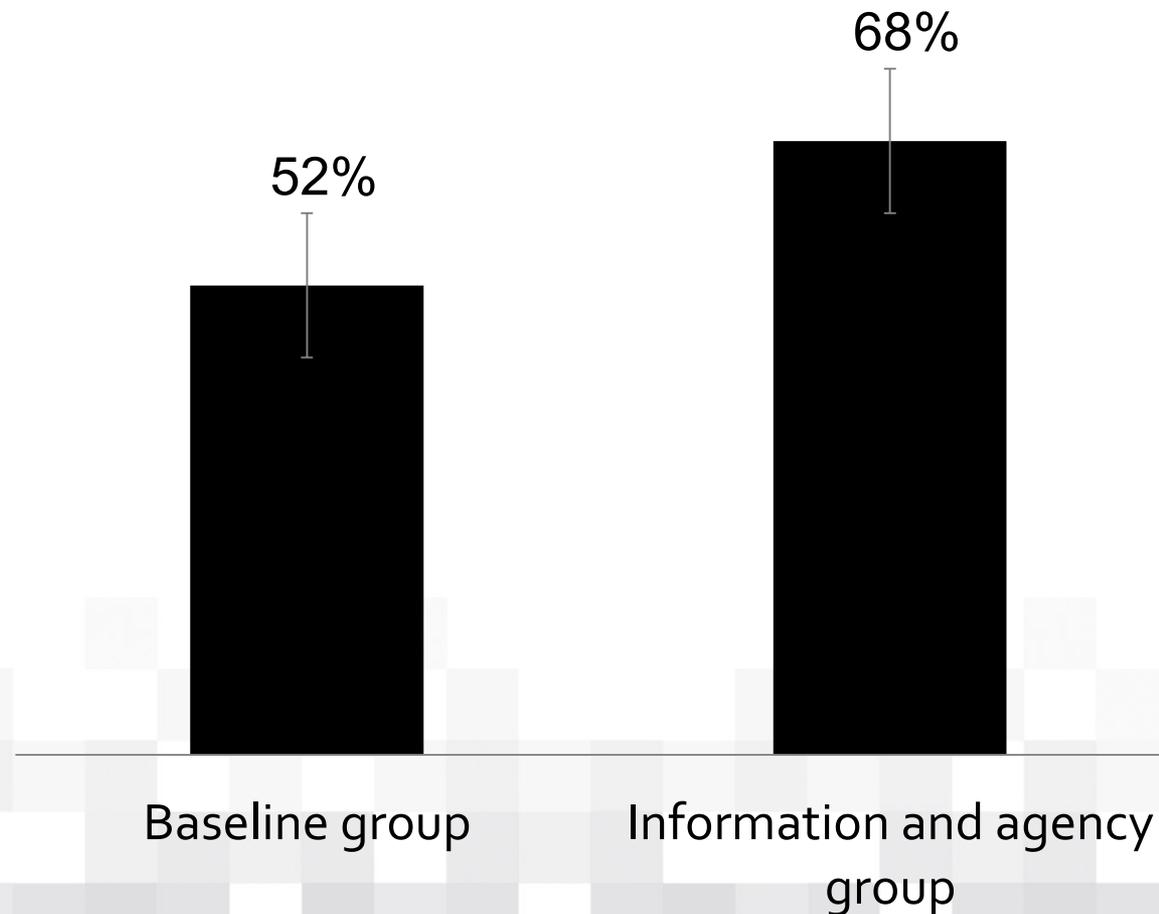
# Lab experiments



# 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>