If tomorrow there was a heat wave would you prefer to have an ice cream or an ice lolly?

This may seem a trivial question but getting the question right could make the difference between profit or loss for a business. It may be assumed that as ice cream is popular across all groups of consumers that most people will prefer ice cream. Research by the supermarket chain Tesco in the UK shows how people actually behave. It shows that indeed sales of ice cream increase as it gets hot. But if in the south of the UK then at 25 degrees Celsius, the sales of ice creams actually plateau. And above this temperature the demand for frozen ice lollies increases. However in Scotland this change in behaviour happens at 19 degrees Celsius. This information of how people behave assists the sophisticated stocking of products on supermarket shelves and enhances profits. Knowing how people actually behave is critical for businesses, but it is even more critical for governments.

Behavioural approach in regulatory governance

The use of behavioural economics by governments to regulate is a growing trend globally. There is an increase in the application of the inductive scientific method to the study of economic activity that is helping OECD countries to shape regulatory policies based on the actual, and not assumed, behaviour of people. Most notably the United States and United Kingdom have been introducing behaviourally informed policies. The influential work of Thaler and Sunstein, made prominent through their book “Nudge” (2008), demonstrated a form of intervention that applies behavioural economics they termed “libertarian paternalism”. Nudging is one type of intervention using behavioural economics but there are others.

Behavioural economic interventions in regulatory policy

- **Simplification of information and choice**
- **Defaults and convenience**
- **Salience and attention**
- **Debiaising and decision quality**
Types of behavioural informed interventions

Behavioural economics is relevant throughout the cycle of regulating. In the design of regulations, a number of behavioural informed policies have simplified information and choices with clearer presentation of information for better outcomes. The US Consumer and Financial Protection Bureau simplified information disclosure for mortgages, credit cards and student loans so that people can “know before you owe”.

Defaults and convenience are another type of behavioural informed intervention where, for instance, the choice to opt out of a scheme is provided rather than the choice to opt in, thereby changing the default option. One of the most notable examples is in New Zealand where the “Kiwisaver” auto-enrolment in 2007 led to a 50% pension coverage increase by making the default choice of pension to be enrolled and being allowed to opt out, rather than the other way around.

Debiasing policies seek to improve the quality of decisions and counteract individual’s tendencies to make sub-optimal decisions. The regulation by the US Environmental Protection Agency to have gallons per 100 miles and annual fuel cost labels in addition to miles per gallon (MPG) information addressed the misunderstanding of consumers in relation to the actual relevance of the MPG statistic to fuel efficiency. In other words, the MPG figure is not linear and does not reflect the actual running costs of the vehicle for most individuals. (Larrick and Soll, 2008)

The behavioural approach is also relevant in the delivery of regulations as well, such as in the use of salience. The need to get the attention of people for behavioural changes has been long understood such as through the use of warnings on cigarette packets. In the United States, it was found that alcohol purchases were reduced more by a tax made salient on the price tag than by an equivalent tax being levied at the till (Chetty, Looney and Kroft, 2009). The delivery of the policy to levy a tax on alcohol can be more successful if it is made more salient and takes into consideration people’s actual behaviour.

Implementing behavioural economics

There are a number of challenges for implementing behavioural economics in the regulatory cycle, not least the ethical debate which continues of whether governments and regulators should be influencing people’s behaviour in this manner. Nonetheless its application is suggesting a compliment and tendency to a more empirical and evidence based way of designing policies and implementing them effectively. The UK’s Behavioural Insights Team, the European Commission’s Behavioural Economics Taskforce and a host of other countries (including Australia, Denmark, Netherlands, Norway and Sweden), are introducing and institutionalising the discipline in addition to regulatory agencies such as in Columbia and Italy. The current publication Regulatory Policy and Behavioural Economics (Lunn, 2014) cites over 60 behavioural informed policies. Given the current application of behavioural economics in regulatory policy, there will be more in the near future.

Read this report on OECD iLibrary (www.oecd-ilibrary.org/)
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Sources: