

From Behavioral Economics to Public Policy

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Orientation: Some Background Findings

- Automatic enrollment in green energy **has large effects**
- Old German study
- New German study – **tenfold increase!**
- Green Party predictive? Yes – and then no
- A general finding, a **significant fact**: Automatic enrollment more effective than active choosing, which is more effective than opt in
- Both Americans and Germans LIKE automatic enrollment in green energy!
- Compare: Voter registration: Oregon, California, HRC

Orientation: US Policy, 2008-present

- Credit Card law
- Tobacco law
- Affordable Care Act
- Financial reform
- Greenhouse gases
- Fuel economy; energy efficiency
- Obesity

Orientation: Default Rules

- Savings (more coming)
- NY taxis
- Thermometer settings
- Why?
- Power of inertia
- Power of suggestion
- Loss aversion (golfers; teachers; DC bag experience)

Orientation: A Success Story?

Information Disclosure

- The tale of calorie labels (USG initiative)
- The sophisticated view, and the aggregate data
- Men
- Women
- What makes sense
- A puzzle

Orientation: Five Problems

- Poverty (uptake challenge; EITC)
- Highway safety (tens of thousands of deaths)
- Smoking (hundreds of thousands of deaths)
- Mental illness
- Energy and the environment (climate change)
- What might help?
- Dozens of behaviorally informed policies from the US in recent years; possibly hundreds

Real Developments

- Behavioral Insights Team in UK
- US: White House Social and Behavioral Sciences Team
- New Team in Germany
- Activity in Australia, Canada, Mexico, Colombia, Italy, and many other nations
- Breaking news from Europe
- **Behavioral Applications Without Dedicated Offices**

Executive Order 13563: “Mini-Constitution” (2011) **(Note: This is The Big One)**

Flexible approaches: “each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public. These approaches include warnings, appropriate default rules, and disclosure requirements as well as provision of information to the public in a form that is clear and intelligible.

Executive Order, Sept. 2015, from President Obama (Important too)

- “A growing body of evidence demonstrates that behavioral science insights -- research findings from fields such as behavioral economics and psychology about how people make decisions and act on them -- can be used to design government policies to better serve the American people.”
- “The Federal Government should design its policies and programs to reflect our best understanding of how people engage with, participate in, use, and respond to those policies and programs.”

A Question

- What happened?
- A glimpse:

Standard Views and Prescriptions, 1960-2000

- Human beings are rational
- They calculate probabilities and maximize “expected value”
- They respond to incentives
- Policy prescription: Improve incentives!
(Becker)

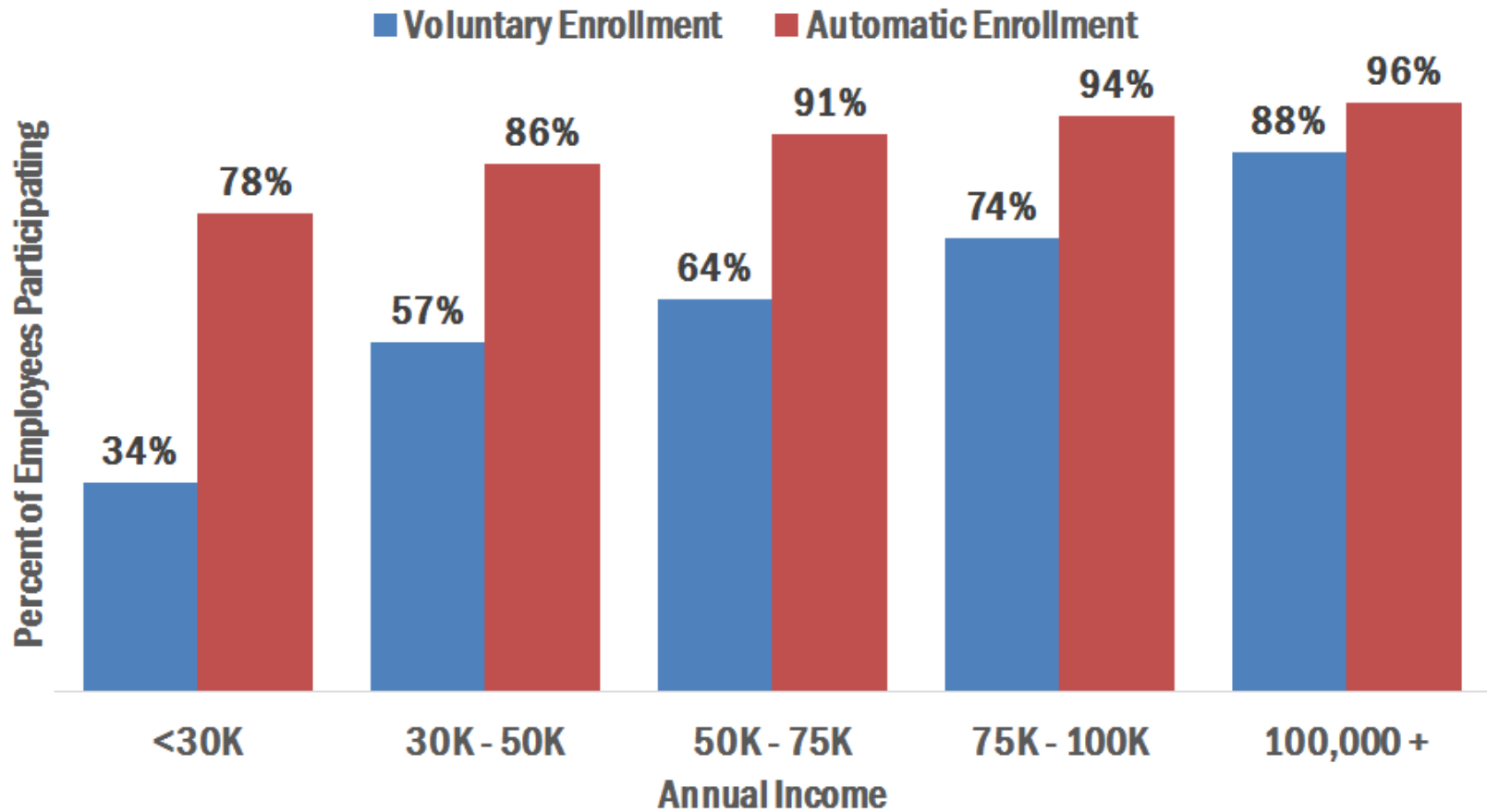
Behavioral Objections (starting in 1970s)

- People have limited attention (“shrouded attributes”)
- People show “present bias” (inertia, procrastination)
- People do not always deal well with probability
- People can be unrealistically optimistic
- People are “loss averse”
- Note relevance to finance and health

Six Behavioral Policy Claims (emphasized in 2000s)

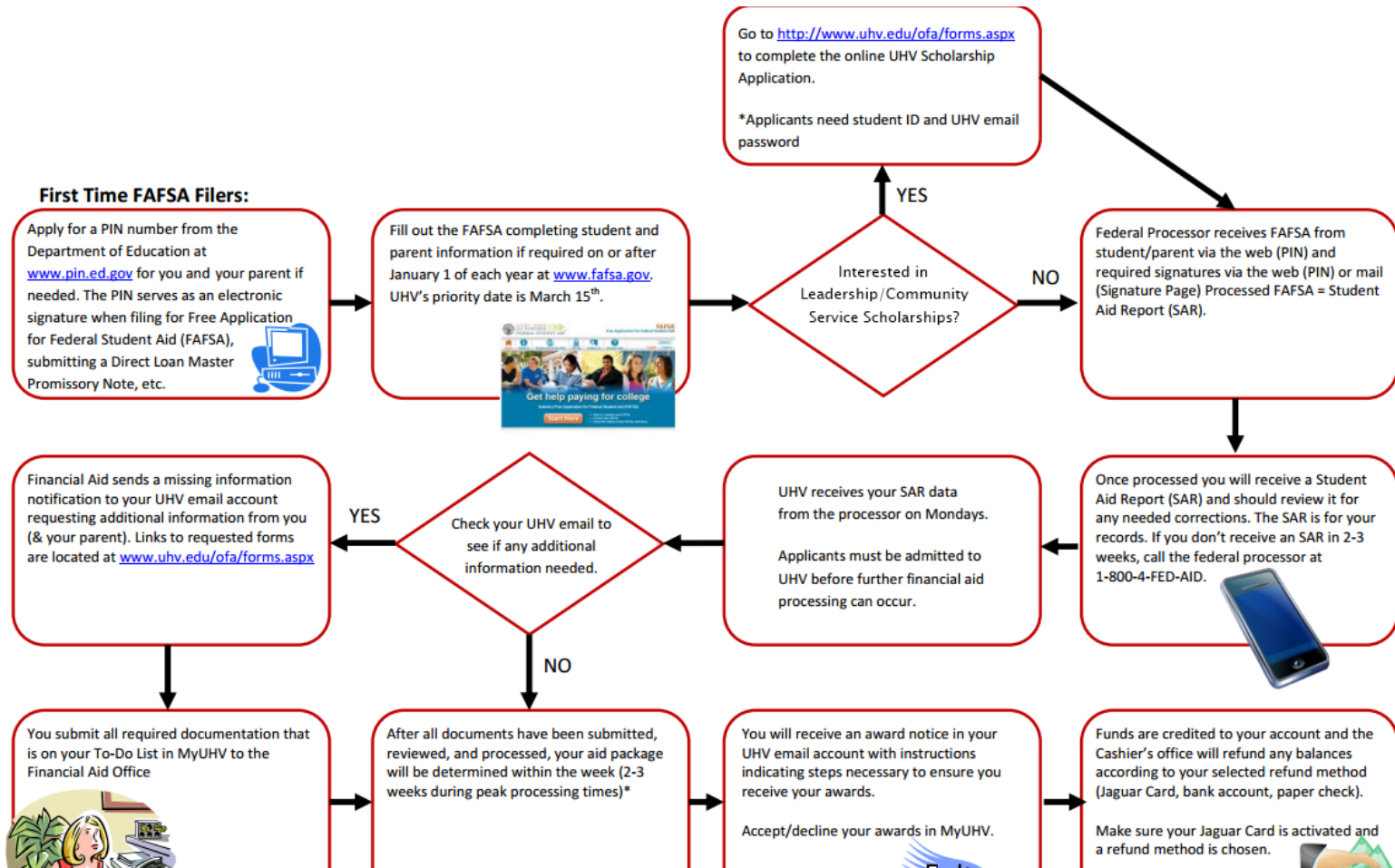
- 1) Default rules matter (energy, savings, voting)
- 2) Incentives may not always matter (much)
- 3) Choice architecture is exceedingly important
- 4) Choice architecture is not avoidable
- 5) People can use a nudge
- 6) Simplicity is VERY important (“Simpler” as a mantra)

Some Data: Automatic Enrollment and Savings



Government Failure, in a Nutshell?

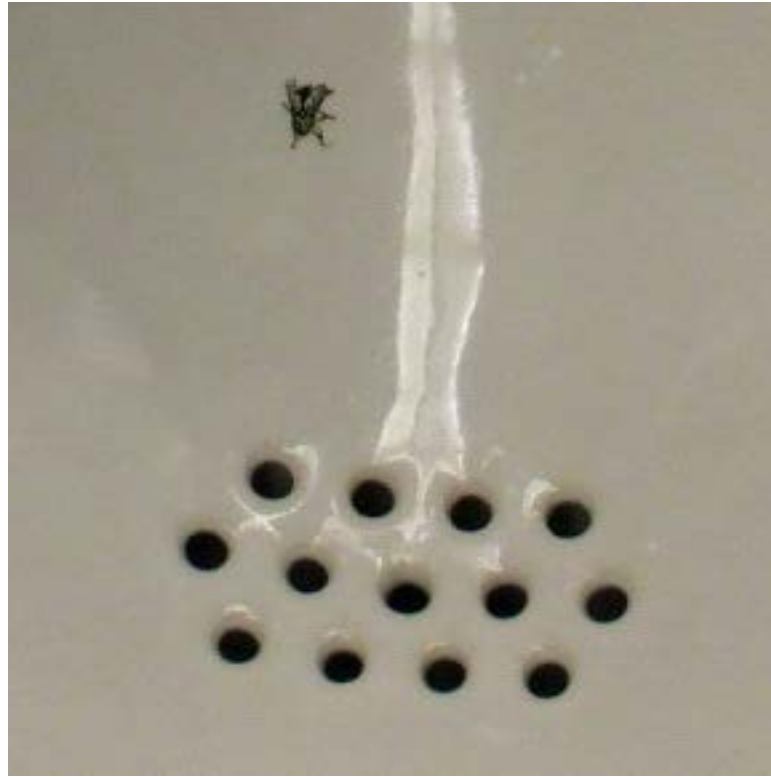
FAFSA (this is a flowchart, not the form)



What Is A Nudge?



What is a Nudge?



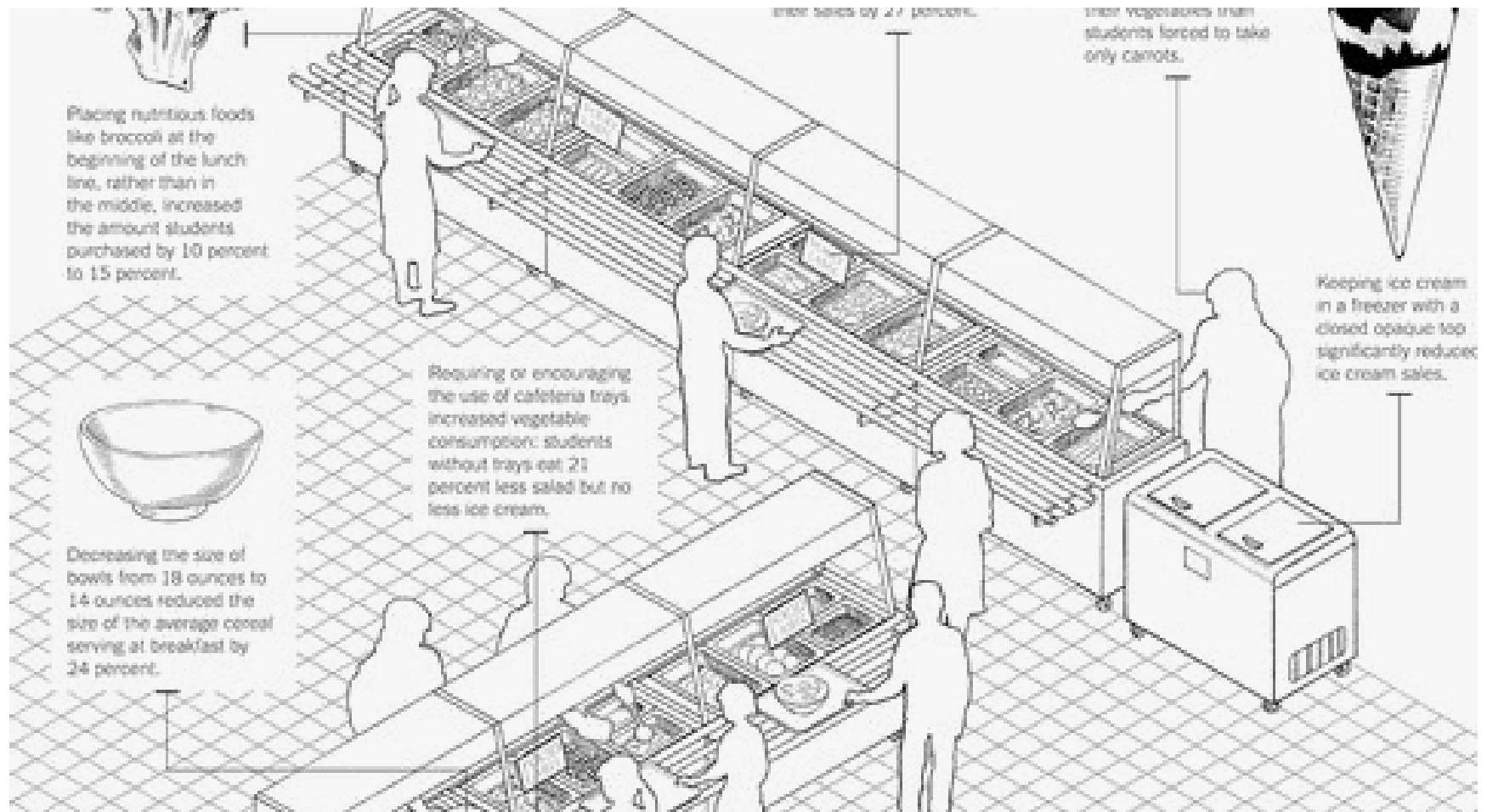
A Nudge That Went Wrong



What Is A Nudge?



What Is A Nudge?



What is a Nudge? (Without graphics)

- A feature of the social environment that affects people's choices without imposing coercion or any kind of material incentive.
- Can be a psychic cost, though; definition might be slippery.
- We might want to speak of a continuum of costs rather than a categorical distinction. Is a graphic health warning materially different from a 2 cent tax? (Maybe!)

A Word on Calorie Labels

- “The final rule may also assist consumers by making the long-term health consequences of consumer food choices more salient and by providing contextual cues of food consumption. The behavioral economics literature suggests that distortions internal to consumers (or externalities) due to time-inconsistent preferences, myopia or present-biased preferences, visceral factors (e.g., hunger), or lack of self-control, can also create the potential for policy intervention to improve consumer welfare.”
- Large impact? Recall: new data!

Energy Efficiency and Fuel Economy: Behaviorally Informed, but Well Beyond Nudges

- Department of Energy and EPA
- Lots of regulations (lots); very major effects; not mere nudges
- Benefits way higher than costs
- But a secret!
- The behavioral speculation
- The internalities puzzle

Orientation: Ten Nudges

- 1) Default rules
(retirement, health, poverty, environment)
- 2) Simplification
(forms easier to complete/understand)
- 3) Information/disclosure
- 4) Warnings (cigarettes; distracted driving)
- 5) Reminders (education and parents)

Ten Nudges, Continued

- 6) Increases in ease and convenience
- 7) Uses of social norms
(tax payments; energy use)
- 8) Nonmonetary rewards
(recognition of some kind)
- 9) Active choosing/prompted choice
- 10) Precommitment strategies
(people voluntarily agree, in advance, to a certain course of conduct, eg smokers)

Acknowledgments

- Active choosing can indeed be best, and it is a form of choice architecture (my recent environmental finding)
- Choice architecture must be transparent and subject to public scrutiny (meaning what, exactly?)
- Choice architecture must not be undertaken for illicit ends (important!)

What is NOT a Nudge?

- A jail sentence
- A criminal sentence or a civil penalty
- A subsidy
- A tax incentive
- Note: Hard paternalism vs. soft paternalism
- Note: Means paternalism vs. ends paternalism
- Note: Study of more free reports to universities
- Note: Effect of small tax (loss aversion)

American Model

- A few of **many** American nudges:
 - CARD act (disclosure and default rules; cf. Federal Reserve and overdraft protection) (a note on data!)
 - Financial reform (“know before you owe”);
 - Health care (disclosure [calorie labels etc.] and the interesting tale of auto-enrollment);
 - Fuel economy & energy efficiency labels (and rules);
 - Education (financial aid form, for-profit education, and more);
 - Childhood obesity (norms and choice architecture)
 - Much more

Children and School Meals

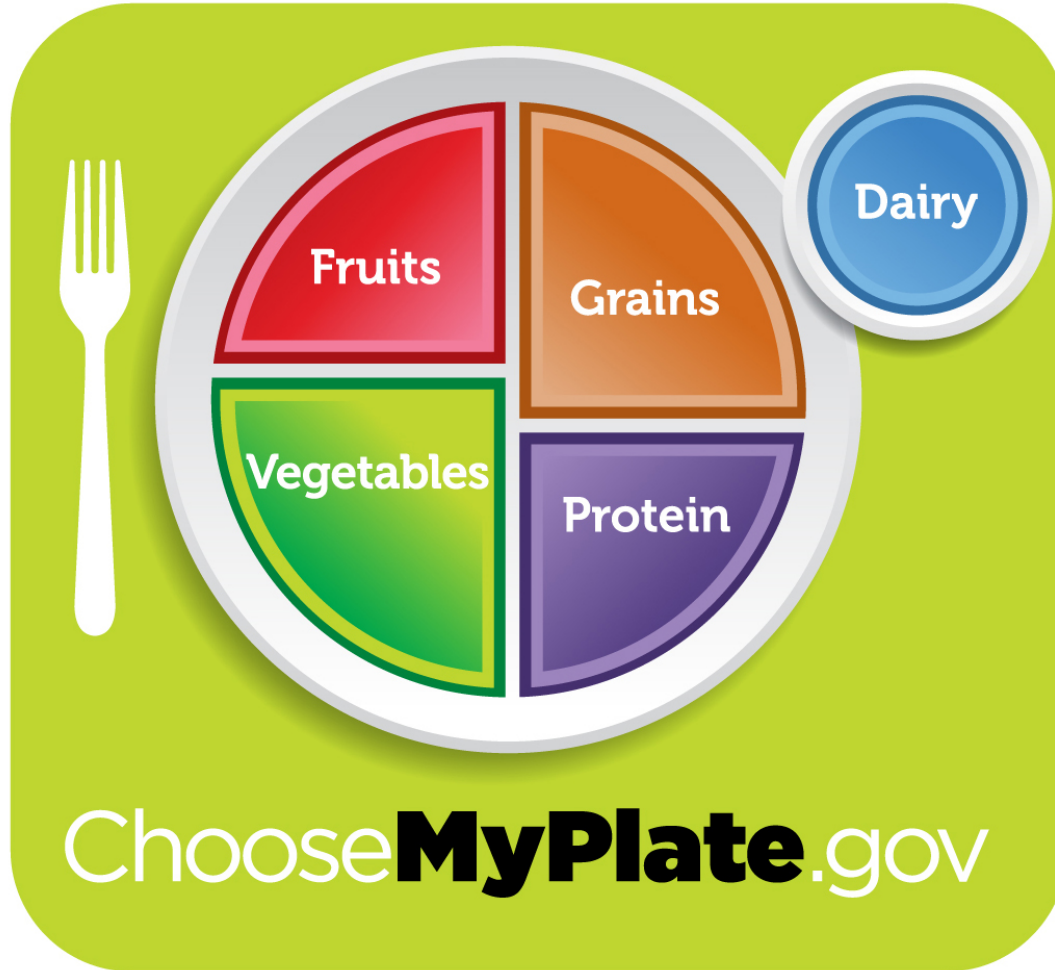
- “Direct certification”
- States and Local Educational Agencies directly certified 12.3 million children at the start of School Year 2012-2013, an increase of 740,000, or 6 percent, from the previous school year.
- Very Recent initiative

PLATE, NOT PYRAMID

Old USDA Food Pyramid



New USDA Food Plate



Do Nudges Work? Three Revealing Examples

- Chetty et al.: Automatic enrollment has a **much** bigger effect than significant tax incentives (Denmark) (US Gov has responded)
- Opower: Home energy report has a bigger effect on energy use than significant price increases
- FAFSA simplification – effect equivalent to a several thousand dollar education subsidy (US Ed Dept has responded; cf. new ACA application)

Social and Behavioral Sciences Team

- A behaviorally informed email campaign to increase savings by service members nearly **doubled** enrollment in federal savings plans.
- Simple text messages to lower-income students, reminding them to complete required pre-matriculation tasks, increased college enrollment among those students by 5.7 percentage points.

SBST, continued

- An outreach letter to farmers, designed to promote awareness of a loan program, produced a 22 percent increase in the proportion of farmers who ultimately obtained loans.
- A new signature box on an online form, requiring vendors to confirm the accuracy of self-reported sales, produced an additional \$1.59 million in fees collected by the government in just one quarter, apparently because the box increased honest reporting.

Is Nudging Tyrannical? (“Libertarian” objection)

- **1) Nudging is inevitable** (what JS Mill did not quite see); choice architecture is unavoidable; active choosing is **itself a form of libertarian paternalism**)
- **2) Human errors (what Mill also missed), eg:**
 - a) neglect of the long term;
 - b) unrealistic optimism;
 - c) problems in dealing with probability;
 - d) attention (we don't notice)

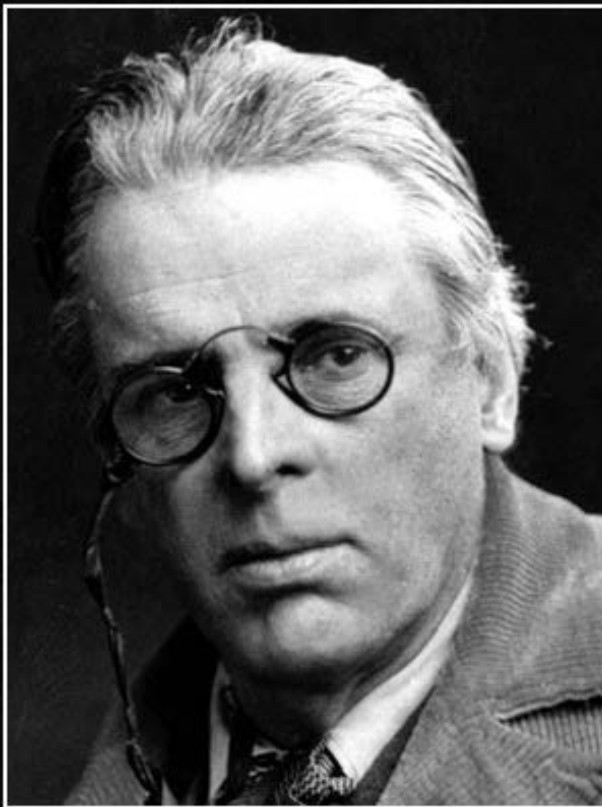
Are Stronger Tools Better?

- True, coercion or economic incentives might be justified (when costs and benefits justify them)
- But one size may not fit all
- Government or business may not know best
- Choice architects may have their own agenda
- Freedom of choice is an important safeguard
- An ingredient in welfare and human dignity

Behaviorally Informed, but Not Nudging?

- CARD Act, Agarwal et al. 2013: “We estimate that regulatory limits on credit card fees reduced overall borrowing costs by an annualized 1.6% of average daily balances, with a decline of more than 5.3% for consumers with FICO scores below 660. We find no evidence of an offsetting increase in interest charges or a reduction in the volume of credit. Taken together, we estimate that the CARD Act saved consumers \$11.9 billion per year.”
- Household finance? (poor choices, eg investment)
- Health care choices? (poor choices)
- Social security reform? (more savings?)
- Third-party effects (nudges as complements?)

Wise Words



Do not wait to strike till the iron is
hot; but make it hot by striking.

— *William Butler Yeats* —

AZ QUOTES