

Behavioural Economics

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Overview

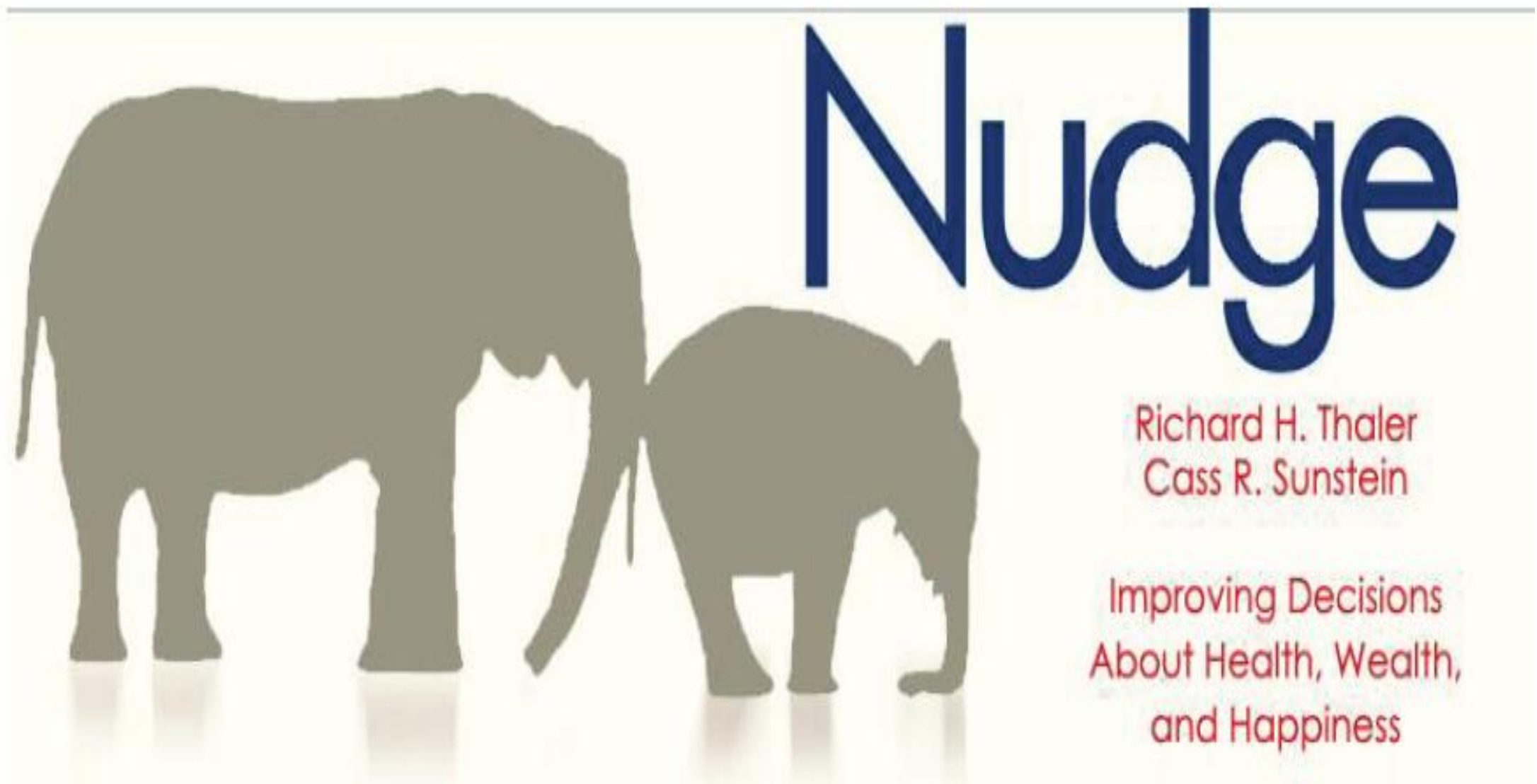
- Definition of Behavioural Economics
- Consumer Behaviour
- Inertia and Financial Decisions
- Consumer Search, data and privacy

Behavioural Economics

- Psychology applied to economic decisions
- Behavioural finance, neuroeconomics, economic psychology
- Limited rationality and self-control
- Increasing influence in UK, EU and US policy

Key Concepts

- Loss aversion and endowment effect
- Reference dependency
- Mental accounting
- Heuristics and Biases
- Time discounting
- Affective forecasting
- Betrayal aversion



Nudge

Richard H. Thaler
Cass R. Sunstein

Improving Decisions
About Health, Wealth,
and Happiness

Case Studies

- Irish pension Autoenrolment
- DG Sanco Consumer Empowerment work
- UK Cabinet Office "MyData" project

I – Determinants of Retirement Saving contd.

- Habit Formation and Inertia
 - Irish example: Finn and Harmon find very strong “initial conditions” effects on health insurance
 - Status-quo bias (Choi et al 2001)
 - Default as investment advice (Madrian and Shea 2000)
- Social Interaction
 - Esther Duflo (MIT)
 - Parental, Sibling, School, Town and Neighborhood Effects
 - Media and Social Amplification of Risk and Quality
 - Reorganisation of financial affairs - cognitive bulk buying

II- Behavioural Economics Interventions

- Mandatory Pension Contributions Frequently mentioned as a possibility
- Less Discussion of Behavioural Economic Approaches
- However, growing international literature on the use of behavioural interventions

Example 1

Save More Tomorrow (SMarT) – Thaler and Benartzi

- Key Features
 - Employees opted in to a programme
 - Savings Retained from Future Pay Increases
- Key Results
 - a high proportion (78 percent) of those offered the plan joined,
 - the vast majority of those enrolled in the SMarT plan (80 percent) remained in it through the fourth pay raise, and
 - the average saving rates for SMarT program participants increased from 3.5 percent to 13.6 percent over the course of 40 months.
- The results suggest that behavioral economics can be used to design effective prescriptive programs for important economic decisions.

Example 2

Automatic Enrolment - Madrian and Shea (2001)

- Key Features
 - Opt in rather than opt-out
 - Either with or without employee contributions
- Key Results
 - Find that participation is substantially higher under automatic enrolment
 - A substantial proportion of people retain the default amount even though this default amount varied among participants in the scheme.
 - boosted 401(k) participation rates among some plans as follows:
 - Women from 35% to 86%
 - Hispanics from 19% to 75%, and
 - Low income groups from 13% to 80%

Example 3

- **Quick Enrolment - Choi, Laibson and Madrian (2006)**
- **Key Features**
 - Low-cost manipulation
 - Designed to simplify the 401(k) enrollment process. Employees are given the option to make an election to enroll in their 401(k) plan at a pre-selected contribution rate and asset allocation mechanism
 - Simplifies the savings plan decision process.
- **Key Results**
 - Quick Enrollment™ tripled 401(k) participation rates among new employees three months after hire.
 - When Quick Enrollment™ was offered to previously hired non-participating employees at two firms, participation increased by 10 to 20 percentage points among those employees affected.

1. Pension Autoenrolment

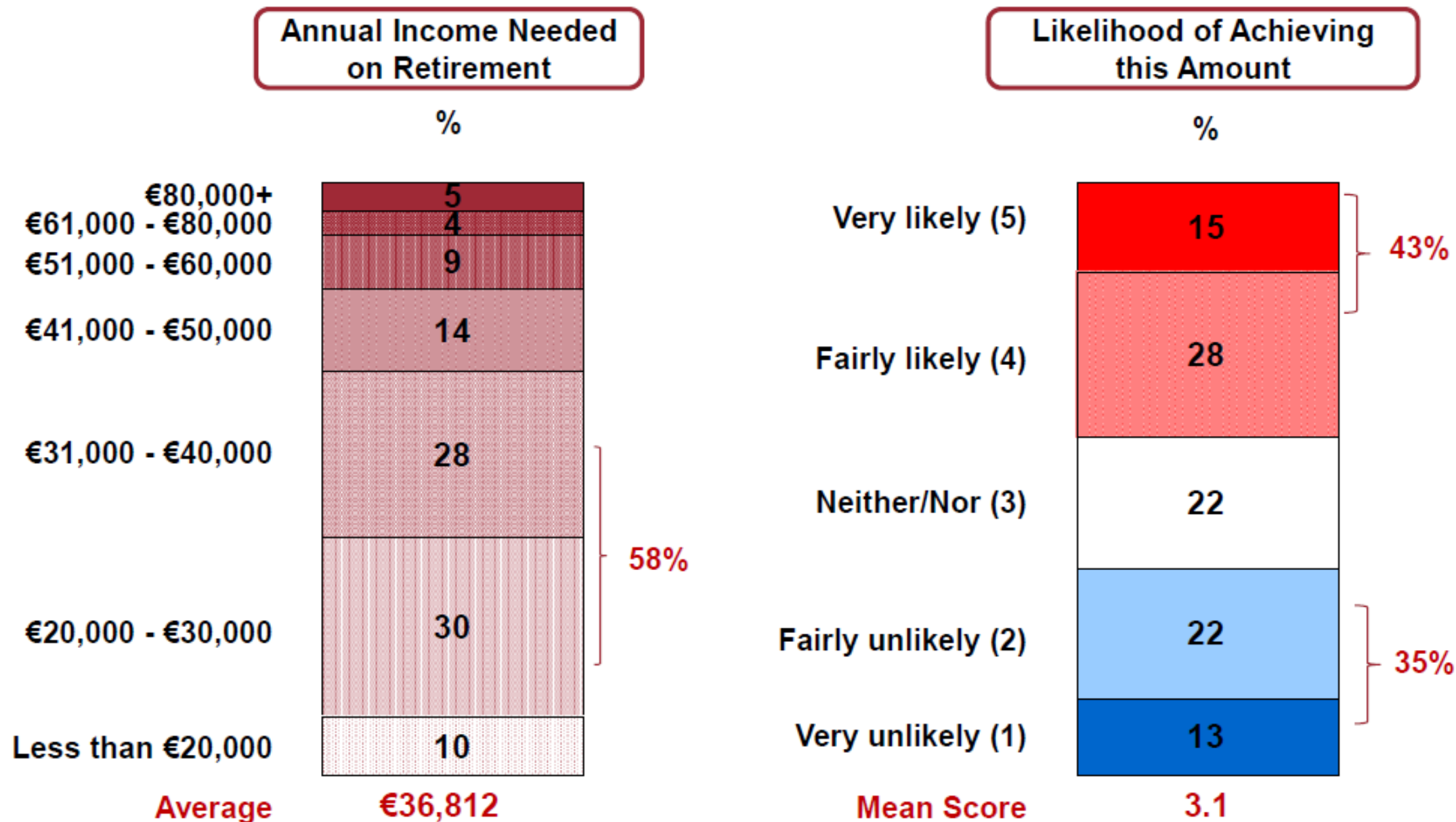
- Soft-mandatory for employee
- UK and Ireland
- Based on theories of inertia
- Mandatory for employer
- Autoenrolment
- 4 per cent, 2 per cent and 2 per cent in Ireland
- 4, 3 and 1 per cent in UK

Survey Results

- Substantial degree of under saving
- Respondents not focused on the future
- Aware that they are saving too little
- Strong feelings of inertia

Retirement Provision I

(Base: All Adults 18+ 301)



Over half (58%) state they will need an annual income of €20,000-€40,000 on retirement while 3 in 10 (32%) state they will need more than this amount. 2 in 5 (43%) state they are likely to achieve the amount they will need however worryingly a large number (35%) state they are unlikely to have what they will need.

Benefits of Policy

- Adds new entrants to schemes
- Ensures retirement provision
- Allows some element of free choice
- May have knock on effects on other behaviours

Potential problems

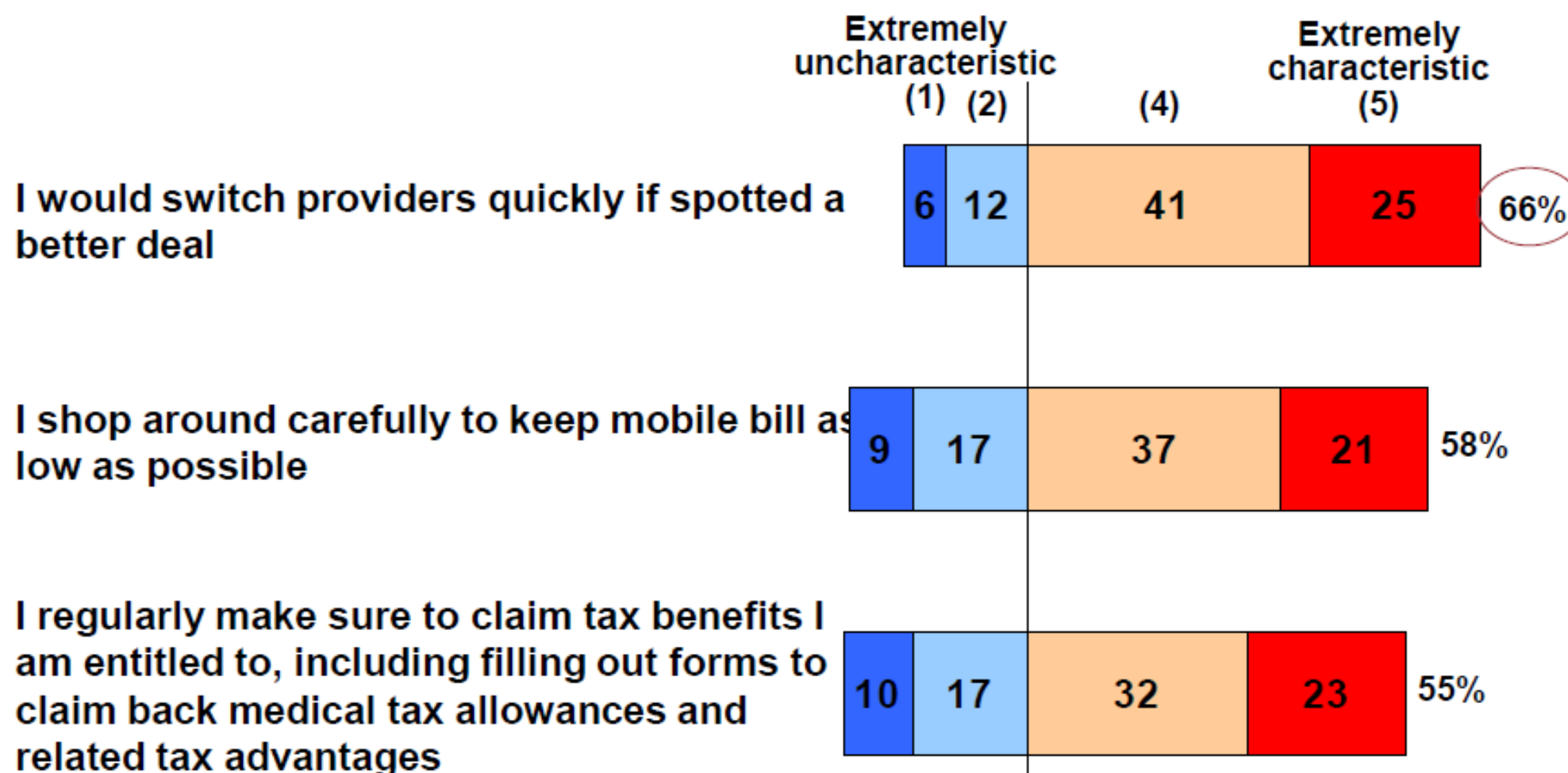
- Shove rather than nudge
- Mandatory for employer
- Increase in wage effectively
- Substitution away from other savings
- Less discerning financial consumers
- Slippery Slope?

2. DGSanco

- Has led interest in Behavioural Economics in Europe
- A number of high-level conferences
- Recent work on retail investment products
- Recent work on consumer empowerment

Attitudes and Behaviour - I

(Base: All Adults 18+ - 301)



Uncertain	Mean Score
16	3.7
16	3.4
18	3.4

Actions indicate prudence is evident. 2 in 3 (66%) would switch providers if they spotted a better deal. 3 in 5 (58%) would shop around to keep mobile bills as low as possible. Nearly 3 in 5 (58%) make sure they claim tax benefits that they are entitled to.

Retail Investment

- Major study commissioned by Sanco
- 6,000 respondents in 6 countries
- Very high degree of suboptimal strategies pursued by consumers
- Very low degree of option-seeking
- Crucial role of financial advisor

3. UK Cabinet Office

- Behavioural Insights team
- Health psychology, social marketing, behavioural economics
- Heavily influenced by work of Richard Thaler
- MINDSPACE

Examples

- Food labelling
- Safety certificates
- Energy labels
- Complaints data
- Making online information available instore

MyData

- Reduce Asymmetry if information between consumers and firms
- Firms upload data held on consumers to government run website
- Consumers can then use as a recommender site

Consumer Information Working Group

- Aims of Information Framework
 - Tailor to individual's goals
 - Delivery Should facilitate engagement
 - Information should be free of bias

Consumer Information Working Group

- Multitude of factors influence financial decision making
- Including:
 - Age
 - Life Events
 - Levels of Engagement
 - Sources of Information/Methods of Sourcing

Consumer Information Working Group

- Help in delivering information to consumers
- Beyond 'Plain English' approach
- Delivery **and** content are important
- How do social, cognitive and emotional factors influence financial decision making?

Consumer Information Working Group

- Information Overload
 - People are turned off if there is too much information/ it is too complicated
- Inertia
 - Awareness that default option is highly influential for individuals
- Ambiguity Aversion
 - Will try to avoid uncertainties in financial outcomes

Consumer Information Working Group

- Availability Heuristic
 - Easier to imagine benefits of present consumption than future retirement needs.
- Regret & Loss Aversion
 - Make imprudent decisions to avoid losses,
- Consumption vs. Savings Decisions
 - Less willing to reduce current consumption to satisfy distant gains

Resources

- Brookings Institute Book on BE and Policy

<http://www.brookings.edu/press/Books/2011/policyandchoice.aspx>

- Consumer Empowerment DG Sanco

http://ec.europa.eu/consumers/consumer_empowerment/index_en.htm

- Behavioural Insights Team Cabinet Office

<http://liamdelaneyecon.blogspot.com/2011/06/cabinet-office-consumer-empowerment.html>