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Nudging Consumers into more Sustainable Lifestyles: Lessons from Behavioural Economics

Conference on the Occasion of the
20th Anniversary of the EC-US Task Force
on Biotechnology Research
Barcelona, 2nd June 2010

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Richard H. Thaler
Cass R. Sunstein

Nudge



Improving Decisions
About Health, Wealth,
and Happiness



Questions

1. Why is Behavioural Economics the better conceptual approach?
2. Why is the rational consumer (not more than) a useful idealtyp?e?
3. What does empirical research know about consumer behaviour?
4. Is libertarian paternalism (really) a charter for the „nanny state“?



Neoclassical Economics

- Perfect markets
- Prices include all relevant information
- Sovereign consumers
- Stable individual preference orders
- Rational actors (*homo oeconomicus*)

*"No social regulation
needed"*



Economics of Information

- market failures under *imperfect information*
- „bounded rationality“ of actors
 - „provide useful information“
 - Regulated information („disclosure“)
 - Signaling
 - Definition of standards
 - Ban on misleading information
 - Self-regulation of industry



New Institutional Economics

„Create / support institutions that reduce transaction costs on markets“

Formal

- quality standards
 - products
 - production
- laws
 - liability law
 - contract law
- bans & „editing out“

Informal

- mental models
- norms
- values
- reputation
- trust
- ...



But what about...

- ✎ the framing and context of information
- ✎ restricted channel capacity
(„the magical number 7 ± 2 “)
- ✎ limited willingness to make informed decisions („the brain is lazy“)
- ✎ involvement, emotion and motivation
(„the brain runs on fun“)
- ✎ behavioural „anomalies“: heuristics and biases
- ✎ the power of context and situational cues



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„ECONs“ vs. „HUMANS“

Rational?
Competent?
Knowledgeable?
Far sighted?
Confident?
Responsible?
Sovereign?
Stable preferences?
Information search?
Disciplined?
Self-controlled?



Behavioural Economics

- systematic violation of „rational“ self-interested behaviour in decision-making („**anomalies**“)
- cognitive mechanisms applied („**heuristics & biases**“) in information processing and risk analysis
- the power of **context** / environment
- **empirical** view of consumer behaviour (experiments, surveys)

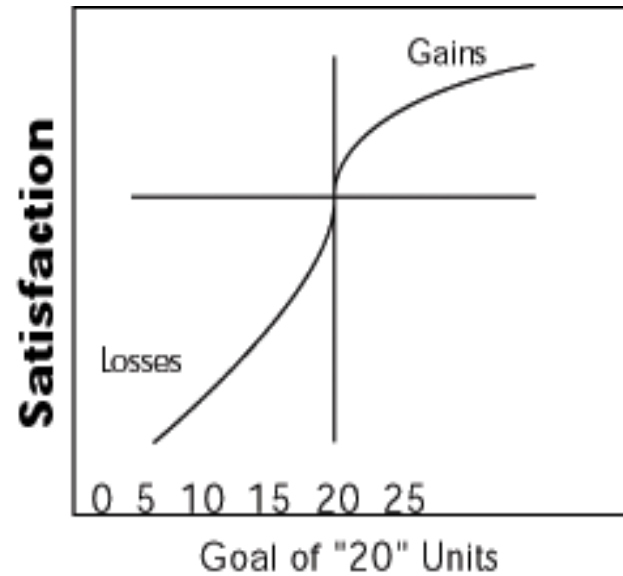


Behavioural biases – Heuristics and decision rules

1. Overconfidence bias
2. Conformity bias
3. Endowment effect and status quo bias
4. Irrational risk aversion and probability blindness
5. Preference for the immediate
6. Altruisms and sense of fairness



Endowment effect & status quo bias



S-Curve of Prospect Theory applied to goal setting.
(re-drawn from Heath, Larrick & Wu, 1999)



Situation and context

1. Overchoice & information overload
2. Framing effects, reference points & cognitive anchors
3. Constructive preferences
4. Intertemporal effects



BE informed policy

- Make use of the **power of defaults**

The power of defaults
(Johnson & Goldstein, 2003)

D: „opt in“ – 14%

A: „opt out“ – 98%



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BE informed policy

- Make use of the **power of defaults**
- Exploit **biases** and **heuristics**



BE informed policy

- Make use of the **power of defaults**
- Exploit **biases** and **heuristics**
- **Simplify** and use **smart disclosure**



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Smart disclosure

Consumer Research
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Financial Services Authority
*Financial Capability:
A Behavioural
Economics Perspective*

Prepared for the
Financial Services Authority
by David de Meza, Bernd Irlenbusch, Diane Reyniers
London School of Economics

July 2008

FSA

**WARNING:
TOO MUCH
INFORMATION CAN HARM**

(AND CAN FAIL TO HELP CONSUMERS
TO MAKE CHOICES AND CAN IMPOSE
COSTS ON BUSINESS, DESPITE THE FACT
THAT IT IS OFFERED AS A FUNDAMENTAL TOOL AND MEANS
FOR PROMOTING ECONOMIC AND FINANCIAL STABILITY)

A final report by the
Better Regulation Executive
and National Consumer Council
on maximising the positive impact
of regulated information for
consumers and markets
November 2007

2009 Report to Congress
on the Benefits and Costs of
Federal Regulations
and Unfunded Mandates on
State, Local, and Tribal Entities

2009

Office of Management and Budget
Office of Information and Regulatory Affairs

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 8.10.2008
COM(2008) 614 final
2008/0196 (COD)

Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on consumer rights

{SEC(2008) 2544}
{SEC(2008) 2545}
{SEC(2008) 2547}



BE informed policy

- Make use of the **power of defaults**
- Exploit **biases** and **heuristics**
- **Simplify** and use **smart disclosure**
- Focus on **strategies** and **habits**

Design a choice architecture where the more sustainable choice is the easy and attractive choice



Libertarian paternalism or: Welcome to the nanny state?



Social regulation can help you make the choices *you would make* for yourself ...



You can always opt-out ...



The question is not *whether* or not to nudge ...



Consumer choices do not exhaust the idea of freedom ...