BEHAVIORAL INSIGHTS IN EU POLICY MAKING – INNOVATION IN GOVERNMENT

Ljubinka Andonovska, M.A., Ph.D. Candidate
"Iustinianus Primus" Faculty of Law, Skopje, Macedonia

Abstract
This paper aims at analyzing the application of behavioral insights to the policy of a supranational regulating body and the way in which the opportunities, challenges and approaches are similar or different in terms of the interpretation in individual governments around the world. Dual process theory is examined in respect to its usefulness in informing policy and an analysis is made regarding policy areas where it might exhibit most effectiveness. Examples are presented of behavioral insights principles and instruments built in specific policy and regulatory documents. Finally, concerns are raised in relation to the libertarian paternalism approach, transparency and ethics of the policy initiatives informed by behavioral insights.

Keywords
behavioral insights, EU policy making

Introduction

By accenting cognitive biases and bounded human rationality in economic behavior, the field of behavioral economics has a high potential to provide direction for policy-making in a post-crisis world. As a result, behavioral economics has made a break-through in policy design at the level of the European Union (EU), especially in the fields of consumer policy, health and food safety.

Key to the popularization of behavioral economics in the context of its application to policy making is the bestseller "Nudge: Improving Decisions About Health, Wealth and Happiness" (2008), authored by the 2018 Nobel

Prize in Economics winner, Richard Thaler, and Cuss Sunstein. Through a broad array of fascinating examples, the book vividly illustrates the application of behavioral economics to directing individuals and societies towards optimal decisions, choices and outcomes. The authors argue that embedding controls for the various cognitive biases that affect decision-making, like loss aversion or the status-quo bias, into policy design, can assist the target groups with making decisions that ultimately advance their personal interest. This idea of "nudging" has introduced a simple, intuitive, economical and non-invasive paradigm in policy making, and policy makers around the world have started to engage experts from behavioral sciences in their teams.

The potential of the behavioral principles has also had an influence on policy making in the European Union. The then Directorate for Health and Consumers (SANCO – now Directorate General for Justice and Consumers) applied these insights and techniques in 2008, in the field of consumer and health policy. Behavioral science has also had an impact on legislation regarding pre-ticked boxes on e-commerce web sites, tobacco products packaging, standards for preparing informational documents for investment products, online gambling, marking energy efficiency levels on electronic goods, as well information banks ought to provide in relation to their banking fees. By adopting the "Better Regulation Agenda" in 2015, many of the behavioral principles became an integral part of the "Tools for Better Regulation", which provided direction for future regulation.

This paper will analyze the following: what are the policy areas where behavioral insights have had a break-through in EU Member States and at the EU level, which insights and techniques have been applied and in what way, as well as which actors and organizations have been the key players in this process, all in order to determine the level of influence of behavioral insights on policy making in the EU.

Theoretical framework for behavioral economics – a new paradigm

The central idea in behavioral economics is that individuals do not always behave as rationally as neoclassical economic models assume. In this view, in order to thoroughly understand economic phenomena, an examination of the psychological bases of the decision-making process is of utmost importance. The literature typically distinguishes between two generations of "behavioralists" – the first generation, represented by Herbert Simon,

which has promoted the ideas of bounded rationality ever since the 1950s, and the new generation, constituted mostly of cognitive psychologists, including Amos Tversky and the 2002 Nobel Prize in Economics winner, Daniel Kahneman. This new generation of scientists has offered a wealth of empirical evidence in support of the claim that decision making in real life deviates from the basic idea of rationality, which is the central assumption in economic science. Behavioral economics underlines that human reasoning suffers from many different cognitive anomalies, which have a prominent and systematic influence. The work of behavioral scientists abounds with experimental research about the mechanisms of how various cognitive anomalies hinder rational decision making.

One of the key assumptions of the behavioral sciences is that people simplify problems in a situation of reasoning and decision making. According to the insights gathered from behavioral sciences in the past 30 years, there is a wide consensus in the academic community that people use two different ways of thinking. In some cases they think deliberatively, employ effort and take into account many different aspects of the problem. This kind of thinking is slow, difficult, cognitively tasking and exhausting, and people's capacity for it is limited. Most of the time, people employ a different mode of thinking, whereby the human brain is in automatic mode. This type of thinking is fast, does not require effort, and is, mostly, outside of people's conscious and voluntary control. In the literature, this latter type of thinking is labeled as System 1, and deliberative reasoning is labeled as System 2.

Table 1. Two systems of reasoning

System 1	**System 2**
Takes into account what comes to mind automatically (narrow frame)	Takes into account a broad set of relevant factors (broad frame)
Effortless	Effortful
Associative	Based on deliberation and reasoning
Intuitive	Reflective

The psychologists Kahneman and Tversky have determined that in the process of decision making people tend to rely on the automatic system of thinking. People quickly evaluate alternatives, and rarely, if ever, take into account all possible alternatives. Although often perfectly capable of more careful analyses, people have a strong tendency to use a very small set of

information in the process of making decisions and drawing conclusions. System 2 is even more difficult to activate in situations of cognitive fatigue, which may be caused, among else, by poverty and other lack of resources, as well as by time pressure.

Having all this in mind, behavioral economists propose an entirely new paradigm for policy making, formulating it as "libertarian paternalism". This entails manipulating the choice architecture in a decision making setting in order to guide economic agents towards optimal decisions and choices which would advance their interests, all the while having in mind the anomalies that affect human reasoning. This paradigm differs from liberal interventions, the goal of which in general is to correct some type of market anomaly through regulation. Also, it differs from neoliberal interventions, which generally use markets as universal instruments in policy making. Instead, this paradigm aims at altering the circumstances in which people make decisions, not through additional regulation, in order for them to be able to make decisions that advance their self-interest.

Institutionalization of the application of behavioral principles to policy making in EU Member States

The interest in the potential of the application of behavioral insights to policy making has already resulted in significant organizational activities in some EU Member States. The United Kingdom, the Netherlands, Germany and France have already established competent teams, and Denmark, Finland and Austria are in the process of analyzing best practices for institutionalizing behavioral insights activities. A key role in the transmission and popularization of academic insights within the behavioral paradigm in the field of EU public policy has been played by the interest that international organizations working on economic policy, especially the OECD and the World Bank, have exhibited in the area. The OECD and World Bank reports on the application of behavioral insights to public policy remain one of the most influential documents in the field.

When it comes to the application of behavioral insights to policy making, and in light of the U.S. example, the institutional structure in which this happens is not irrelevant. Namely, back in 2009, the then US president, Barack Obama, appointed Cuss Sunstein, one of the academic frontrunners in the field of behavioral economics, as Director of the Office of Information and Regulatory Affairs in the White House, which is charged with oversight and assessment of federal regulation, in terms of assuring that the costs

of new regulation does not outweigh its projected benefits. However, three years later, when Sunstein withdrew from this powerful position, which is also sometime dubbed as "regulatory czar", his contribution to improving the regulatory system was quite modest. In 2015 President Obama issued an executive order calling on all US federal bodies to implement behavioral insights in public policy design. One of the key lessons of the US experience is that to affect change in large and complex institutions, one person does not suffice, regardless of his/her expertise and good will. Additionally, it was made evident that behavioral insights can be more easily applied in the earlier stages of the policy making cycle, compared to the stage when proposals reach regulatory impact assessment.

Around the same period, the newly elected government of David Cameron in the United Kingdom established a formal so-called Behavioral Insights Team (UK BIT). The BIT enjoyed full political support and had a clear mandate, sufficient initial resources, broad competence over many areas of the public sphere, access to world-renown experts, all the while being fully integrated in the system of public administration. In the period 2010-2015, BIT confirmed and solidified its political influence, by exceeding even the most optimistic expectations. In 2014 the unit was partly privatized (one third belongs to the UK government, one third to its employees and one third to a non-governmental organization), and it now has over 50 employees of broad expertise, who also work on projects outside the UK.

An analysis of the UK team and of corresponding units in other countries gives insight about several key characteristics of structures with a mandate to apply behavioral insights to policy making, including: political support (inclusion of high level political representatives, political closeness to their cabinets, an official and straightforward mandate), adequate resources (sufficient human resources and financial resources for hiring experts and for executing appropriate research trials), expertise (multidisciplinary teams and access to advisory services from the academic community), coverage (a broad horizontal array of public policy areas), integration (close relationship with adequate governmental bodies) and structure (centralized teams strongly related to policy champions).

The Netherlands was the second European country to establish a team dedicated to the application of behavioral insights to policy making within the government. However, unlike the UK experience, the Netherlands does not feature a centralized team. The team within the Ministry of Economic Affairs operates as a joint secretariat, which connects and facilitates all teams or experts in the separate ministries. In 2014 a Network for Behavio-

ral Insights was promoted, consisting of 11 ministries and regulatory bodies, in order to encourage cooperation and knowledge sharing. Benefiting from broad political support in the country, the application of behavioral principles to policy making extends to a wide array of public policy areas, with the Agency for financial market and the Agency for consumers and market leading the way. In response to a series of advisory reports related to the application of behavioral insights to public policy, in December 2014, the Dutch Minister for economic affairs underlined the importance of conducting timely regulatory impact assessment, as well as the potential of behavioral sciences in the area of increasing policy effectiveness and efficiency.

The third European country to set up a unit charged with informing policy making with insights from behavioral sciences is Germany. In 2015, within the Federal Chancellery, the Unit for Policy Planning was established, the aim of which is to improve the effectiveness of policy through citizen orientation, process and project design determined by the users, as well as through good access to useful and clear information. An equally important aim of this unit is testing proposed policy solutions and regulatory impact assessment at very early stages of policy development. A small multidisciplinary team functions as a service for the federal ministries, and integrates insights and methods from behavioral and social sciences in the development and empirical testing of processes and alternative policies.

France was one of the first countries that began incorporating behavioral insights in official documents, back in 2010, in the areas of public health and the environment. The application of behavioral insights is now concentrated within the Secretariat General for Government Modernization, which operates directly under the Prime Minister. This inter-ministerial agency focuses on application of behavioral science tools, including amending legislation, tax policy and information provision, in the context of significant budget constraints. The first experiment this unit conducted in 2014, in relation to identifying adequate policies to increase online tax filings, resulted in a 10-percent increase of electronic filing. Successive projects generally focused on issues related to public safety and public health, especially on reducing using mobile phones while driving.

Noteworthy cases of implementation of behavioral insights to policy making, albeit in a less structured manner, are seen in Denmark, Finland and Austria, where there are ongoing analyses on ways to formalize and institutionalize this practice. In these countries there is noticeable engagement by specialized non-governmental organizations and by the academic community in the field.

In addition to these specific steps that are taken in various European countries, there is an increased interest to apply behavioral insights at the level of regional administrations and local self-government units, as well. In fact, the behavioral approach to policy making promotes the idea that policy decisions ought to be made as close to the citizens as possible, since this requires a better and more thorough understanding of people's every day behavior.

Behavioral principles in policy making at the EU level

The interest in behavioral economics insights among EU-level policy makers has culminated in the past 10 years. The first formal study which analyzed alternative policies from a behavioral perspective conducted by the European Commission focused on decision making by consumers in the retail investment services market. It was coordinated by the Directorate for Consumers within the Directorate General for Health and Consumers (currently in the Directorate General for Justice and Consumers) in 2010. According to the European Report from 2016, 19 other studies have been conducted since, in 9 general fields of public policy. There are four instances that are considered landmark cases whereby behavioral insights have inspired EU legislation, in the form of directives and official recommendations.

The first intervention relates to the amendment of the Consumer Rights Directive (2011/83/EC, Art. 92) in 2011, adding a provision to ban preticked boxes on electronic commerce web sites. The proposal had been prepared as early as in 2008 and is considered to be among the first visible applications of behavioral principles on EU-level policy making. This policy has been informed by the overwhelming research confirming people's strong, irrational tendency to go with the default option, and this minor intervention in the environment where the transaction is taking place would help them advance their self-interest.

The second landmark intervention is the European Commission Decision in the field of competition in 2009, whereby it banned Microsoft to offer Internet Explorer as the standard browser within Windows installation. It, therefore, forced Microsoft to include a pop-up screen, offering users the option to select a browser for themselves, choosing from 12 different programs, ordered randomly. However, according to Art. 12 of the Decision, this obligation for Microsoft to show the pop-up screen for browser selection expired in 2014. Although initially there were signs that this measure in fact contributed to increased traffic at competing browsers by increasing their user base, long-term trends indicate that the effects have been minimal. For example, the

market share of Opera, Firefox and Internet Explorer in Europe has decreased in the past five years, regardless of their prominent placement on the selection screen, while the market share of Chrome has significantly increased.

The third case of application of behavioral principles to policy making relates to the new provisions for generic packaging and bans for visual display of logos and other types of branding within the Revised Tobacco Products Directive (2014/40/EU, Art. 9). The regulation stipulates that all packaging ought to be of the same size and color, and the only images allowed are ones with large graphic warnings about the consequences of smoking on human health, and the brand name in a small-type standardized font. This Directive is considered to be indicative of a conceptual shift in regulating cigarette consumption – instead of regulating with financial stimuli or with provision of factual information about health risks, for example, this measure steers consumers towards more beneficial decisions through altering the choice environment. This Directive seems to be the first document that was explicitly prepared on the basis of behavioral research, i.e. a report on which types of warnings would be effective in influencing the behavior of smokers.

The fourth case which has most explicitly opened the way for applying behavioral principles to policy making in the EU is the preparation of regulation 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs). In 2010 the Directorate General for Health and Consumers hired a consultancy specialized in behavioral approaches to decision making in a consumer context, in order to study the decision making process of consumers in the market of retail investment products, in order to design policies which would assist them in making more beneficial decisions. The study entailed several online experiments and one laboratory experiment to test how consumers react to varying interventions that address typical cognitive anomalies which appear in this context. The findings of all these studies pointed to the direction of simplifying and standardizing information for investment products, and, among else, using a standardized key information document. Even the precise format and content of the aforementioned standardized document were subject to behavioral research.

Several other behavioral interventions in policy are underway in the EU. For example, in 2014 the Commission published Recommendation 2014/478/EU on online gambling services, which was based in a report commissioned by the Consumer, Health and Food Executive Agency within its framework agreement for the provision of behavioral studies. The research, conducted by London Economics, assessed the reactions of participants in

online gambling to existing and new protection measures in experimental conditions. The Recommendation incorporates the main findings of the report, but it remains to a subsequent intervention to take into account the finding that the registration forms the participants are required to fill in before engaging in online gambling (as mandated by the EC recommendation) are, in fact, counterproductive and steer players towards illegal gambling sites.

Also in the legislative phase is the Proposal to regulate the energy efficiency labeling (COM/2015/0341 final). The new regulation proposes a revision of the labeling system towards re-introducing a simple A-G scale, thus eliminating the complicated +/- additions (e.g. A+++). The findings reported in the review of the relevant directive indicate that although the new scale is understandable for the consumers, it has reduced their willingness to pay more for more energy efficient products, having in mind that they are less motivated by a difference between A+ and A+++, compared to a difference between C and A. These insights are based in the study prepared by London Economics and Ipsos, on behalf of the Directorate-General for Energy, which conducted a large multinational online behavioral experiment, as well several small and simple experiments in energy-related products stores in several member states.

Additionally, there are other initiatives to apply behavioral principles in various phases of the policy making process in several policy areas, including:

• Consumer policy – consumer behavior in a digital environment, banking fees, testing standardized informational notes for consumers in relation to the Common European Sales Law;

• Environment – testing options for CO_2 labeling for vehicles, nudging and influencing consumer behavior towards increased energy savings;

• Health policy – the influence of information on patient choice in the context of exercising patient rights in cross-border healthcare, studying the influence of the information on the calorie value of food in decision making, studying the choice of food and the food consuming habits;

• Taxation – behavioral economics and taxation.

In 2015, the European Commission established the EU Policy Lab within the Joint Research Centre, with a mission to support policy making informed by evidence from the behavioral sciences. This unit employs a multidisciplinary and participatory approach, focused on individuals, in order to identify the behavioral elements of a given policy, communicating and applying the available evidence, as well as incorporating behavioral solutions in policy design. The Joint Research Centre has the necessary expertise to

support EC bodies with behavioral advice and to conduct, internally or with the assistance of contractors, appropriate research.

The Juncker Commission has expressed strong dedication to the principles of advancing regulation, in the sense of committing to base regulatory documents on the best available evidence related to their potential effectiveness and to make regulatory decisions in a transparent manner. The focus is put on basing policy in the best possible solutions that pose the lowest level of burden, thus achieving the desired goals at minimal general cost. The directions for improving regulation contain a clear commitment to take into account both regulatory and well-designed non-regulatory interventions, as well as improving the implementation of existing regulation, when assessing the alternatives. The key takeout is that the behavioral approach has been embedded as complementary to the traditional policy making processes, as an additional tool to identify customized and efficient solutions in all phases of the process, and especially in the policy evaluation phase.

Within the Better Regulation Agenda, the EC has compiled and published a list of tools to support the policy making process, which explicitly mentions cognitive anomalies and behavioral economics on several occasions, in the context of tools for regulatory impact assessment. This so-called toolbox explicitly embraces the assumptions that policy design is more effective when it takes into account the cognitive anomalies that influence human decision making in the real environment, as well as that behavioral research can produce useful insights to compare various solutions before the implementation phase. Additionally, cognitive anomalies are referred to as one of the four categories of problematic elements in policy implementation. This explicit acknowledgment of bounded human rationality and the implications it has on policy making sends a strong signal for the relevancy of behavioral sciences to EU policy design.

The 2016 EU Report formulates four general conclusions related to incorporating behavioral insights in the policy making process, as follows:

• There is a strong dynamics and a growing interest in the application of behavioral insights in policy making;

• There is room to improve the exchange and sharing of knowledge among the policy makers and the academic community, bearing in mind that there is vast potential to analyze large databases which need to be made available to researchers;

• Behavioral insights ought to be applied in all phases of the policy making process, in order to generate useful evidence as effectively as possible;

• There is room to further promote the usefulness of behavioral insights among citizens, in order to reach broad a consensus about their application.

Ethical issues

According to Cass Sunstein, who has written extensively on nudges, most objections to applying behavioral insights revolve around the question whether nudges promote or instead undermine welfare, autonomy and dignity. The key to overcoming the concerns of government paternalism, intrusion on autonomy, manipulation and policy maker bias is transparency. The entire array of government interventions, including nudges, ought to be subject to an adequate burden of justification – the government must explain and defend itself. The fact that with behavioral interventions people retain freedom of choice and are not ultimately coerced to anything does not give public officials freedom to do what they want.

Conclusion

Although the application of behavioral principles in EU policy making is marginal, the insights and techniques from behavioral economics have been embraced as a legitimate input in the policy making process and have exerted a real influence on legislation. Most of the interventions relate to consumer policy, the environment, health and food safety, as well as, to a lesser extent, to taxation. There is a noticeable shift from regulating markets to regulating citizen behavior, as well as an almost exclusive focus on consumers, rather than other actors. It is evident that the areas where the application of behavioral principles is extensive are not policy areas where the EU has exclusive authority, but, rather, areas where authority is shared among the EU and the Member States. This means that the EU's power to adopt mandatory regulation in these areas is limited. In this sense, behavioral interventions, as a softer form of regulation, are more adequate in political circumstances whereby more rigorous legislation is politically unattainable, i.e. invasive policies would run into political limitations. Additionally, one of the biggest benefits from the application of the behavioral paradigm to policy making is that policies are being tested on the market before they are implemented, which largely contributes to evidence-based policy making, within the better regulation context.