Applying Behavioral Economics to the Streamlining and Reduction of Regulation

Outline

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This document is based on a paper currently being written by Feldman and Selivansky on the use of Behavioral methods for improving government work. This project is being conducted under the aegis of the Institute's Center for Governance and the Economy.

Highlights

Behavioral methods are a new tool in the regulatory toolbox. They enable the sovereign to actively promote the public wellbeing, even in instances where there is no justification for rigid regulation. They also allow for the reduction of the regulatory burden by prodding the public into making voluntary choices (private citizens as well as the wider business sector), instead of bringing to bear an element of coercion. As a result, the regulator is provided with new ways to conduct methodical analysis, streamline government regulation and reduce the burden that comes with regulatory compliance.

Behavioral Economics in the Service of Government

Over the past few decades, the field of behavioral economics has become very popular. It lies on the seam between economics and psychology, and uses empirical evidence to help predict human behavior in ways that traditional economics cannot. Behavioral economics methods can have powerful ramifications for policy planning, as it offers a profound understanding of the mechanisms and thought patterns that dictate human behavior.

In recent years, behavioral economics has spawned a variety of methods that exploit behavioral insights for the purpose of enhancing the effectiveness of government. These methods are for the most part based on **soft regulation** intended to point the public toward making choices that promote public wellbeing, but that leaves the final choice in the hands of the public, and steers clear of significant modification of the incentive system. Soft regulation is based on an assortment of tools, such as the setting of default choices, sending of reminders and simplification of complex information. It has made significant contributions in areas such as pension programs, environmental quality, energy efficiency and healthy living.

As part of the civil service's adoption of the behavioral method, research and methodological tools from the behavioral sciences are also being incorporated. Behavioral research tries to avoid being based on axioms of human behavior. Instead, it is based on an empirical examination of that behavior. In accordance with standard behavioral science methodologies being used by governments, most of the work of these behavioral insights teams is guided by empirical study of regulatory interventions, with an emphasis on conducting supervised trials based on randomized controlled trials (RCTs). The behavioral insights teams take an evidence-based policymaking approach, according to which before a policy is set it should be meticulously assessed against alternative policies, along with a study of the policy’s impact on control groups on which it is not being applied.

Governmental Adoption of Behavioral Insights: International Comparison

United Kingdom

In 2010 a team was formed within the Prime Minister's Office (PMO) in the UK that focused on the adoption and application of behavioral insights by the civil service (known as the Behavioral Insights Team-BIT). The team, which operated during a period of economic crisis and budget-cutting, initially functioned on a trial basis. During its first two years of existence, the BIT operated as a pilot program. It was decided that should its contributions to the civil service prove to be negligible, the program would be shut down.

However, after two years, the BIT proved to be extraordinarily successful:

1. Within two years of its advent, BIT was producing a return (ROI) of 22 times the amount of funds invested in its activities, the result of the streamlining of government work, as based on the team's recommendations.
2. Several government ministries incorporated behavioral tools into their daily operations.
3. The number of RCT public sector empirical studies carried out in the first two years of the team's work was greater than all empirical studies conducted throughout the history of the United Kingdom.

United States

The behavioral insights approach was extensively promoted by the Obama administration in the US, which appointed a behavioral sciences expert, Cass Sunstein, to head the unit responsible for examination and evaluation of federal regulations. In addition, Obama issued two presidential orders in which he instructed units of his administration to integrate behavioral insights into their work.[1] In 2014, a dedicated team was created to incorporate behavioral insights into the functioning of various government entities, as based on the British team.

International Organizations

The EU Commission set up a mission-specific behavioral insights team. Moreover, international organizations are working to promote the method[2] and the OECD has held several conferences devoted to promoting added use of the method.[3] The World Bank even devoted its 2015 annual report to behavioral methods and how they can be utilized to reduce poverty and promote welfare in developing countries.[4]

Following the success in the UK, many other countries formed their own teams to adopt behavioral insights into the civil service (Australia, Germany, Holland, Singapore, Finland, France, Qatar, and Canada).

Israel

In Israel, too, initiatives have been promoted to adopt behavioral insights into the civil service. The PMO, in cooperation with the Center for the Study of Rationality at the Hebrew University, has led the way in using behavioral tools. At the same time, such government entities as the Ministry of Finance, Ministry of Environmental Protection, Ministry of Health, Ministry of Justice, National Insurance Institute and the Consumer Protection Authority have cooperated with many academic researchers on this issue, including researchers from the Israel Democracy Institute. As a result, the civil service has first examined and then adopted various behavioral tools.

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1 The White House, Office of the Press Secretary, "Executive Order – Using Behavioral Science Insights to Better Serve the American People," September 15, 2015 (On May 7, 2017 all web sites in this document were retrieved).

2 See: The European Commission's Science and Knowledge Service, Behavioral Insights.

3 For a survey of actions taken in OECD countries, see OECD, "Behavioral Insights and Public Policy Lessons from Around the World," March 1, 2017.

4 The World Bank, "World Development Report 2015: Mind, Society, and Behavior.

Behavioral Insights and Streamlining Regulation

The method of behavioral insights has led to an improvement in the work of government work: a more efficient provision of services is creating greater financial savings and better quality of service for the public. The method is also playing a central role as a tool for enhancing regulation and reducing the regulatory burden. Behavioral insights are thus being applied in several ways: policymakers are using the method to encourage regulators to minimize regulation; facilitation of improved interactions between regulators and the businesses they oversee; enhanced interactions between the business sector and consumers, enabling less rigid regulatory requirements.

How Behavioral Methods Contribute to Better Regulation

(1) **Evidence-based policy for reducing regulation.** This approach is effective in reducing regulation by promoting scrutiny. In practice, numerous directives and bylaws are enacted without adequate assessment of their impacts being conducted, and therefore empirical assessment can be expected to lead to the abolishment of superfluous regulations. Moreover, the demand to conduct empirical research itself places a barrier on the imposition of new regulations, which will thus be enforced only when there are clear indications of market failures and it is determined that intervention is likely to lead to a marked improvement in the functioning of the market.[5]

(2) **Conversion of rigid regulation to soft regulation**. As stated above, the behavioral method extols the virtues of soft regulation in promoting the public wellbeing. In so doing, it puts an emphasis on voluntary tools and the conversion of meticulous compulsory regulatory directives into simple administrative principles. These are meant to guide the manufacturer into adopting the behavior expected of him, while simultaneously increasing the freedom of the players under supervision to act at their own discretion. Such

5 In this context, it should be noted that the US administration gave a high priority in terms of resources to empirically tested regulations and interventions, compared to those that were not systematically examined. See: The White House, Office of Management and Budget, "Commission on Evidence Based Policymaking".

results are based on cooperation between regulator and regulatee, and mutual assessment of the various options for maximizing benefits for all concerned.[6]

(3) **Simplification and clarification of regulatory directives**. A significant contribution that the behavioral insight approach can make to consumers lies in its ability to simplify relevant information and make it more accessible. Consequently, the adoption of behavioral insights by regulators can aid in simplifying and clarifying regulatory directives, making them clear and easy to carry out.[7]

(4) **Adaptation of regulatory requirements to the needs of the public and/or businesses**. Research indicates that regulatory directives are often determined on the basis of an assumption that the public operates like a rational player who reads and understands all the available information. Subsequently, this leads to numerous legal requirements and cumbersome statutory compliance.[8] Conversely, the behavioral approach believes that regulation should be adapted to human behavior, such that it will be straightforward and clear to the public at large, while abolishing requirements that do not contribute to the situation of the reasonable individual.[9] Therefore, by employing the behavioral approach, regulators can reduce burdensome regulatory requirements and exchange them for more lenient and more effective requirements.

(5) **Adaption of regulation to the markets and various players**. The behavioral methodology enables built-in assessments of different markets, and adaptation of the regulation of these markets in accordance with their distinct attributes. Therefore, an empirical and systematic examination of behaviors makes it possible to derive data on the market's conduct and the various players in it and to adjust the regulatory means to fit specific situations. These data enable the

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6 See: Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford: Oxford University Press on Demand, 1992.

7 Cass R. Sunstein, *Simpler: The Future of Government*, New York : Simon and Schuster, 2013

8 Korobkin and Ulen, for example, elaborate on the broad influence of and problems connected with the assumption of rationality on legislation. See: Russell B. Korobkin and Thomas S. Ulen, "Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics," *California Law Review* (2000): 1051-1144.

9 For further information, see Elisabeth Costa, Katy King, Ravi Dutta, and Felicity Algate, "Applying Behavioral Insights to Regulated Markets," Behavioral Insights LTD, May 26, 2016.

establishment of defined and objective criteria to justify the intervention of the regulator in the market, thereby reducing the uncertainty arising from the vesting of too much authority over government regulation to civil servants.[10]

(6) **Preventing corruption and encouraging adherence to regulation.** By creating a situation in which the regulatory directives are clearer and simpler, while the enforcement is more forceful and effective vis-à-vis those who violate the rules, one could differentiate between those factories and business owners who want to follow the law and those who seek to go around it. When regulation is convoluted and cumbersome, both those who follow the law and those who do not are similarly frustrated, with the result being an inability to act. This situation creates fertile ground for corruption, for instance by middlemen who strive for the simplification of regulation on behalf of their employers. Simple and clear regulation, on the one hand, along with prompt enforcement and strong sanctions, on the other, can pave the way for a fast and easy route that enables the majority of factories to operate at an optimal level, while posing a constant threat to those who wish to deviate from the rules of regulation.[11]

(7) **Using behavioral methods to improve the regulator's work**. Behavioral methods furnish tools that enable regulators to influence the players to act in ways that promote social policy goals. In this manner, it is also possible to influence the regulators, to make their behavior more fair-minded, more effective and more sensitive to the crucial importance of balancing the demands of the market with the needs of the public at large.

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10 Costa et al. presented three empirical criteria that ought to be examined in order to justify regulatory intervention in a certain market: 1) differential between the average basket of goods purchased by consumers and the parallel basket they would receive if they had chosen the lowest-cost price quotes; 2) assessing the public's knowledge and familiarity with substantive characteristics of market transactions; and 3) index of consumer satisfaction with the behavior of the market. In their opinion, only if there is a gap between these findings and those that would be obtained under conditions of reasonable market behavior – then there is justification for regulatory intervention that is adapted to a criterion and/or the population group in which the gap was found.

11 For a discussion on the ability of legal rules to distinguish between law abiders and lawbreakers, see Yuval Feldman and Henry Smith, "Behavioral Equity," *Journal of Institutional and Theoretical Economics* 170 (1) (2014): 137-159.

The following are examples of behavioral-insight-based tools that can improve the work of the regulator:

i. Creating a timetable according to which the regulator must offer a response to various types of applications within set periods of time.

ii. Setting a default choice in which, without active intervention or authorization at the higher echelons, regulatory approval will be given automatically.

iii. Fostering the idea that a specific public servant is personally responsible to issue authorizations and work directly with a specific business, instead of authorizations being issued in a decentralized and haphazard manner by an entire department. This approach would serve to increase the accountability of public servants.

iv. Transition to self-regulation, with heavy fines meted out to those who deviate. This would allow more personnel to be diverted to cases where direct regulation is required.

v. Granting bonuses to functionaries for fast and effective action, and, conversely, negative notes being placed in personnel files for instances of lateness or dysfunction.

vi. Transition to computer based systems that allow for as much transparency as possible and that would enable the manager to see how long an application approval took to process and where in this process did were there delays.

(8) **Assessing the mistaken beliefs that are characteristic of regulators**. Behavioral research engages in mistaken beliefs that can lead to chronic and systemic behavioral deviations. Some of these deviations can be linked to non-optimized regulatory work. For example, people tend to place greater importance on short-term results, such as the immediate damage that could result from inadequate regulation. On the other hand, people will place lesser importance on long-term objectives, such as easing of regulation and attracting investors to Israel. People also tend to stick with the default choice and avoid change. Such a tendency is liable to encourage them to leave regulatory directives intact, even when those that have become redundant. Similarly, a World Bank study demonstrated that regulators tend to interpret information in a biased manner, such that it will seem as if their activity is vital and that the

field for which they are responsible requires active intervention.[12] In other contexts, it was found that some countries invest excessive resources in salient but uncommon dangers, due to availability bias.[13]

Based on the above, in-depth assessment of the biases of regulators and the tools used to inhibit them could contribute toward a reduction of the regulatory burden.

Conclusion

In recent years, the use of behavioral methods for fostering better regulation and easing government regulation has become widespread, and has proven effective in the promotion of effective regulation while reducing the government burden. The behavioral approach is likely to contribute toward improving and reducing the regulatory burden by transitioning into an evidence-based endeavor. Similarly, the method provides tools that make it possible to ease the burden that the regulator imposes on the business sector, replacing rigid regulation with gentle regulation, enforcing regulation that focuses primarily on the markets and/or high-risk players, and adapting the regulation to the real needs of the public.

Moreover, the method enables decision-makers to create a framework that encourages the regulator to reduce unnecessary regulation, while implementing tools that encourage the reduction of regulation and assessing the biases that encourage overregulation, and then addressing these biases. **Proper use of behavioral insights, and the cumulative global experience in the use of these insights, is likely to make a dramatic impact on the improving and reduction of regulation in Israel.**

12 Banco Mundial, "World Development Report 2015: Mind, Society, and Behavior," The World Bank, 2015.

13 Kuran, Timur, and Cass R. Sunstein. "Availability Cascades and Risk Regulation" *Stanford Law Review* (1999): 683-768.