




POLICY BRIEF

Does Conventional Economics Provide All the Answers? Contribution of Behavioural Economics to Regulatory and Policy Impact Analysis

Conventional regulatory, program and policy development approaches, which normally depend upon traditional economic theory, lead departments and agencies to anticipate certain outcomes. However, the outcomes may not materialize as originally intended. Why? One possibility is that the assumptions used did not take into account how individuals would actually respond to the new government action. Instead, they were based on more traditional or established perspectives. The government action may have proven more successful, yielded better results, or used fewer resources had it been created using an approach that considered more realistic behavioural responses and a broad range of incentives from people/actors in society.

Behavioural economics, which links economics with psychology, relaxes some of the traditional assumptions about how individuals act and the values they hold. The behavioural approach recognizes that people do not always act in ways that maximize self-interest, and that they do not always have perfect information on which to base decisions. Also, how an issue is framed affects individual response. For example, if we must make a decision between two actions, we are strongly influenced by how the two possible outcomes are presented to us. If one is characterized as a loss and the other as neutral or as a gain, we will often act to avoid the apparent loss—even when the two outcomes are mathematically and theoretically identical. Another example is “asymmetric paternalism – the concept of creating regulations that are relatively harmless to those who regularly make decisions in their best interest, while at the same time helping those who do not independently seek better choices.

Behavioural economic approaches have increasingly been the focus of mainstream publications. Most notable is *Nudge*, which was co-authored by Cass Sunstein, currently Administrator of the White House Office of Information and Regulatory Affairs. Many countries may be including these approaches in their toolkits. A report for the Dutch government argues that behavioural economics can help policy-makers to better design policies, at lower cost, without distorting markets or limiting individual choice.



Behavioural economic approaches may not be applicable to all regulatory, program and policy initiatives. But where application is possible, the government action may be completed more efficiently and the outcomes may be more representative of society, as a result of better information made more accessible to decision-makers. Key questions for the Deputy Ministers community are¹:

- How integrated are these approaches in current regulatory, program and policy development processes within departments and agencies?
- Is there evidence of improved decision making as a result of these complementary approaches?
- Does further work to identify and illustrate its potential and possible uptake be undertaken?

Notes:

¹ A Policy Brief prepared by Policy Horizons Canada begins to explore how this emerging field of economics may contribute insights during the development of regulations, programs and policies. Policy Horizons Canada would like to thank Vic Adamowicz and Jason Shogren for their helpful comments.

Link to full report:

<http://www.prp-pri.gc.ca/page.asp?pagenm=2011-0053&langcd=E>