

# What role for behavioural economics? A legal perspective

Prof. Dr. S.A.C.M. Lavrijssen

Amsterdam Centre for Energy Issues/Amsterdam  
Centre for European Law and Governance

# 1. Background

- Behaviour of consumer crucial for realizing EU climate and environmental goals
  - Who is the consumer?
  - Focus on households
  - The energy consumer and behavioural economics
  - Implementation in practice
  - Pros and cons of a behavioural approach

## 2. Who is the consumer? (I)

- “The average consumer” in consumer law (ECJ, C-210/96, Gut Springenheide)
- Reasonably well informed, reasonably observant and circumspect consumer
- Rational behaviour is the (high) standard of the consumer protection directives
- Who is the energy consumer?

## 2. Who is the consumer? (II)

- Two possible approaches for additional protection in energy directives
- The average energy consumer is “bounded rational”
  - Correction for information asymmetries
  - Transparency obligations for energy suppliers
- The average consumer is not rational (behavioural approach)
  - Makes mistakes when it makes economic decisions
  - Needs extra help, user-friendly information, tools and nudges

## 3. Consumer in practice (I)

- In practice consumer does not fulfill its role of driver of competition
  - Low switching rates
  - Large market shares for the incumbents
  - Consumers do not benefit from potential cost savings
  - Sticky consumers

## 3. Consumer in practice (II)

- Insights from behavioural economics
  - Time-varying discounts
  - Simplified choice strategies
    - Complexity of contracts, complex pricing-models and complex information
  - Prospect theory
    - Power of defaults (Kaenzig et al 2013), status quo-bias, loss-aversion
  - Prosocial behaviour
    - Gaps between preferences for renewable energy products and the strategies of electric utilities (Kaenzig et al 2013)

# 3. Consumer in practice (III)

- The consumer from an economic perspective (Micklitz et al 2010)
  - Confident consumer
  - Vulnerable consumer
  - Responsible consumer

## 4. Implementation in practice (I)

- Purpose of a behavioural economics approach
  - Benchmark for the assessment of the effectiveness of regulatory remedies
  - Remedies are designed to promote/achieve certain behavioural changes with consumers



## 4. Implementation in practice (II)

- Promote behavioural change
  - Policy makers should have a well-founded, realistic and nuanced image of the behavior of consumers
  - Why do consumers do not make optimal choices?
  - Differentiation between different groups (responsible, confident, vulnerable)
  - Search costs, lack of information, cognitive limitations or other factors?
  - Link between consumer preferences, biases and remedies

## 4. Implementation in practice (III)

- Mix of legal, economic and psychological instruments (nudges)
  - Instruments to promote the right of free choice of supplier
    - E.g. information, transparency of tariffs, conditions, energy-use and costs, price-comparison tools, contract templates, setting maximum number of tariffs
  - Instruments to promote energy efficiency
    - E.g. promote demand reponse programmes, education, regulating appliances
  - Instruments to promote use of renewable energy
    - E.g. ecolabel, default contracts, framing of information
  - Instruments to protect vulnerable customers
    - E.g. standard contracts, subsidies, personalized advice, default contracts

## 4. Implementation in practice (IV)

- How to choose the right instrument?
- Relation to current legal mandates of NRAs
- Crucial importance of proportionality principle (ECJ, C-331/88 and ECJ, C-265/08)
- Libertarian paternalism
- Informational strategies should be considered first, more intrusive remedies only when information does not suffice (Gayer and Viscusi 2013)

# 5. Pros/cons (I)

## Advantages

- Example of green defaults
  - May have major impact (Sunstein & Reisch 2013, Pichert & Katsikopoulos 2008)
  - Less economic and political obstacles than traditional tools such as subsidies or regulation (Sunstein & Reich 2013)
  - Maintain freedom of choice
  - May reduce transaction costs and search costs for consumers
  - May reduce “mistakes” by consumers
  - Beneficial effects for social welfare (CO2-reductions)

# 5. Pros/cons (II)

## Disadvantages

- Heterogeneity of preferences is not always considered (or difficult to consider) in empirical research (Gayer and Viscusi 2013)
- Costly and time-consuming to do high quality empirical research into consumer preferences
- Irrational behaviour is assumed by regulators
- Regulatory failure (Gayer and Viscusi 2013)
- Danger of manipulation/ethical risks

# 6. Challenges

- Behavioural economics approach useful for benchmarking remedies and for promoting behavioural change
- Policy-makers should recognize limitations of behavioural economics approach
- Defaults have more beneficial effects, if there is adequate information about preferred choices of consumers
- If there is too little information about preferred consumer behavior (Sunstein & Reich 2013), restraint use of defaults
  - Unless there are large external effects, but then regulation may be a better alternative