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Using Behavioural Economics For Rather than Against Consumers – A Practitioner's Perspective

The science of behavioural economics has gained major traction with policy-makers over the last decade, culminating in the award of a Nobel Prize in Economics to one of its most prominent academics, Richard Thaler. Behavioural economics can be a powerful tool in achieving consumer policy goals, by nudging people to make healthy, sustainable and cost-conscious choices. It can also, however, be used against consumers' interests by misleading and deceiving them by exploiting their biases.

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Behavioural economics and EU consumer policy: Beyond the talk, has anything happened?

Behavioural economics is a promising tool for addressing the failures of an economy that is based on consumer choice and the assumption that consumers are well informed about competing offers and able to choose freely among them. At the EU level, the European Commission's departments in charge of consumer policy began embracing behavioural economics in the 2000s. This contributed tremendously to a better understanding of consumer biases and policy responses to these biases.

Is there willingness to act beyond the consumer information model?

Unfortunately, this better understanding of how consumers act in "real life" has rarely led to ambitious policy measures aimed at correcting these behavioural biases so as to promote the interests of the consumer. Most consumer policy initiatives still follow the mainstream economic approach of the rational *homo economicus* (as well as its female equivalent, the *mulier economica*). According to this approach, consumers are perfectly equipped to take decisions in their best interest as long as they receive all of the information needed to do so. This leads to the paradoxical situation that consumer information becomes more and more abundant and complex, and ultimately risks becoming a tool of consumer disempowerment. To make matters worse, policy-makers are able to claim that they did their best and that any poor choice is the responsibility of the consumer.

Because of this information paradigm, policy-makers – supported by a European Court of Justice decision – use as a benchmark an unrealistic "average" consumer who is always informed and circumspect.[1]

There is no doubt that products and markets are becoming more complex. However, the growing complexity of products is disconnected from consumer needs. Take for example the financial services sector. The majority of consumers have rather basic needs in relation to retail financial services: a simple bank account and savings product, basic payment tools, a mortgage loan, and automotive and home insurance. The abundance of complex products does not match their needs as consumers.

Behavioural economics in EU consumer policy: Some positive examples

While there are a great number of missed opportunities, a positive example of an EU consumer policy initiative that integrates lessons from behavioural economics is that of the 2011 Consumer Rights Directive. This directive prescribes the express consent of the consumer to pay for additional services (beyond the trader's main contractual obligations) by addressing the "default bias", i.e. the fact that consumers tend to opt for the default choice in order to avoid making more complex decisions.[2] The default bias has been abundantly exploited by companies. Airlines, for example, use pre-ticked boxes that push consumers to buy travel insurance and other additional services that are not an essential part of the main product.

In the area of financial services, the 2014 Payment Accounts Directive introduced a standardised product: a basic bank account.[3] This product offers all of the essential features required for such an account: a bank card, the capacity for direct debits and credit transfers, and online banking functionalities. It thus satisfies the needs of consumers who want to both receive payments (such as salaries and social benefits) and make payments (for example, online shopping and utility bills) from their accounts. Importantly, financial providers are not allowed to link other products (such as credit card insurance) to this basic account.

The untapped potential of behavioural economics

Behavioural economics could contribute greatly to achieving the EU's consumer policy goals, which are organised around the right to information, safety, fair practices and contracts, as well as access to redress. Here are a few examples:

- *Food and nutrition information*: Various studies have demonstrated that simple, colour-coded labelling containing the product's nutritional composition and placed on the package front helps consumers to make healthier food choices.[4] Such guidance tools have been developed (e.g. the red-yellow-green "traffic lights" labelling scheme in the UK, and the more recent

1 The European Commission's European Consumer Consultative Group has criticised these concepts; see European Consumer Consultative Group: Opinion on consumers and vulnerability, adopted on 7 February 2013, available at http://ec.europa.eu/consumers/archive/empowerment/docs/eccg_opinion_consumers_vulnerability_022013_en.pdf.

2 Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, L 304/64, in: Official Journal of the European Union, Vol. 54, 22 November 2011.

3 Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features, L 257/214, in: Official Journal of the European Union, Vol. 57, 28 August 2014.

4 See K.L. Hawley, C.A. Roberto, M.A. Bragg, P.J. Liu, M.B. Schwartz, K.D. Brownell: The science on front-of-package food labels, in: Public Health Nutrition, Vol. 16, No. 3, 2013, pp. 430-439; and E.V. Kleef, H. Dagevos: The growing role of front-of-pack nutrition profile labeling: a consumer perspective on key issues and controversies, in: Critical Reviews in Food Science and Nutrition, Vol. 55, No. 3, 2015, pp. 291-303.

Nutri-Score front-of-pack nutritional labelling scheme in France), but a compulsory display was intensely (and successfully) opposed by food industry lobbyists during the adoption of the 2011 Food Information to Consumers Regulation. Currently, consumers in most countries must grapple with a back-of-pack numerical nutrition declaration in the form of a table, possibly complemented by complex percentages of the amounts of certain nutrients on the front of the package. These percentages do not even allow for proper product comparison, as companies use different portion sizes in the calculations.

- *Display of information requirements*: Many EU laws include the obligation to inform consumers about the products and services that are on offer. For instance, the Consumer Rights Directive provides for a long list of information that must be given to the consumer before the conclusion of a contract: the main characteristics of the product, the duration of the contract, the right (or not) of withdrawal, the existence (or not) of after-sales services and the existence of out-of-court dispute settlement.[5] The Consumer Credit Directive also provides a list of disclosures that must be communicated to the consumer ahead of the conclusion of a contract: the duration of the credit agreement; the total credit amount; the borrowing rate and terms applicable to this rate; the annual percentage rate and the total amount owed by the consumer; the amount, number, and frequency of payments; the fees related to or resulting from the agreement; and the consequences of late payment and non-performance.[6] The Mortgage Credit Directive has similar provisions.[7]

However, while the quantity of mandatory information has increased due to these requirements, the result is that it is even more challenging for consumers to find their way among difficult-to-compare offers. Indeed, companies are too often given the freedom to determine the layout and prioritisation of information. While standardised information requirements have been pushed through in the credit sector[8] – despite heavy industry lobbying – consumer advocates are still struggling to convince policymakers to introduce such tools into increasingly complex energy supply contracts.[9] But information disclosure has its limits. Policy-makers should thus place the proper emphasis in order to address the main drivers of consumer detriment. In some cases, product intervention (the standardisation of products, default options and the banning of overly complex products) must be considered.

Companies have known it all along

While behavioural economics has emerged rather recently as a new and heavily underexploited policy tool to promote consumer interests and restore market failures, its underlying principles have been well understood – and heavily exploited – by companies for decades. The behavioural economics concept might seem somewhat overhyped at the moment, but the biases it lays open – default, inertia, short-termism, neglecting probability, in-group bias and many more – are consistently used by marketers to attract consumers to their products and services. A few examples:

- Eye-level promotion in the organisation of supermarket shelves
- The display of sugary snacks at checkout counters
- The pricing of products at 9.99 rather than at 10
- The advertising of cars with scantily clad female models
- The creation of a sense of urgency through short-term offers and promotions
- The exploitation of the fact that it is difficult for consumers to calculate percentages quickly

Abuse of consumer information and contract terms

Some companies excel in stuffing their contracts full of lengthy and complex terms and conditions. While this is a paradise for lawyers, it leaves many consumers struggling to read – let alone understand – important legal information. A brief look at standard insurance contracts or the terms and conditions of Facebook and the like demonstrates the challenge involved. In 2016 the European

5 Directive 2011/83/EU, op. cit.

6 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers, L 133/66, in: Official Journal of the European Union, Vol. 51, 22 May 2008.

7 Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property, L 60/34, in: Official Journal of the European Union, Vol. 57, 28 February 2017, in particular article 11.

8 See the above-mentioned directives.

9 At the time of writing, EU legislators were discussing the introduction of consumer-friendly information requirements within the Clean Energy Package, both in terms of comparison sites as well as billing. It is, however, not sure how these information requirements will effectively enable consumers to make well-informed choices at the end of the process. See European Commission: Commission proposes new rules for consumer centred clean energy transition, 30 November 2016, available at https://ec.europa.eu/energy/en/news/commission-proposes-new-rules-consumer-centred-clean-energy-transition.

Consumer Organisation's Norwegian member association organised a marathon session to read the terms and conditions of all of the apps included in an average smartphone. It took them a total of 27 hours![10]

Consumer complaint fatigue

Another way in which companies exploit consumer biases is by assuming that consumers will not pursue the claims to which they are entitled. This might be a rational choice for the individual consumer; taking a company to court would likely not be cost-effective if a small amount is at stake. Moreover, consumers are often not aware of the existing tools available for bringing even small claims against companies (such as the European Union's small claims procedure, Alternative Dispute Resolution schemes and so forth). Taken together, these small, separate unresolved claims lead not only to individual frustrations – and over time to a sense of disempowerment – but also to the collective denial of justice. At the end of the day, the wrongdoers are rewarded and those who abide by the law are penalised. There are numerous examples, but let us cite a few:

- In 2012, European consumer organisations brought a case against Apple for pushing consumers to buy a three-year commercial manufacturer warranty with its products without indicating that a free two-year legal guarantee was already available to them based on EU legislation. Rather than respecting EU law and adapting their contract terms *ex ante*, Apple opted to wait for consumers to launch court cases. The company eventually changed its marketing practices, but only after significant pressure from public authorities and courts.

- When Dieselgate broke, Volkswagen immediately settled the case and compensated US consumers. This fast action was due to the country's strong collective enforcement mechanism via class action lawsuits. However, many EU consumers do not have access to such a system and were thus forced to go to court individually. Only in the few countries with effective collective redress mechanisms was it possible for consumer organisations to bring Volkswagen to court. The cases are pending, and consumer organisations are braced for a long litigation process.[11]

The following more detailed case studies are particularly relevant in the current EU policy context.

10 Norwegian Consumer Council broadcasts live, marathon reading of app Terms of Service, boingboing, 25 May 2016, available at https://boingboing.net/2016/05/25/norwegian-consumer-council-bro.html.

11 For more information, see BEUC: Volkswagen Emission Affair, available at http://www.beuc.eu/volkswagen-emission-affairs.

Case study I: Dynamic currency conversion and the need for a counterintuitive approach

What is the problem?

In recent years, the practice of dynamic currency conversion (DCC) has become more and more common in the payment sector. Basically, when paying or withdrawing money abroad with a credit or debit card, consumers are invited to pay in their home currency. This invitation is often presented as the default option, and takes place at the checkout counter or ATM. The checkout counter is not the ideal place for consumers to ask questions about the applicable exchange rates, and cash dispensers and payment devices also have limited capacity to provide more detailed information. Intuitively, consumers are tempted to opt for this choice, not only because it is the default one but because they have an (ill-based) assumption that they know how much they are going to pay when they are familiar with the currency. Numerous studies have demonstrated that the business model behind this practice leads to consumers paying five to ten per cent more than if they had not opted to pay in their home currency.[12]

We randomly (and anecdotally) tested this practice with senior EU policy-makers. Amazingly, they also found it misleading: they all would have opted for dynamic conversion, following their vague intuition that knowing how much you will pay is the most cost-effective solution.

How can DCC be tackled?

There is a window of opportunity at the EU level to boldly tackle this practice. The Commission plans to publish a proposal to review the EU's Regulation on cross-border payments in the near future.

As the current form of dynamic currency conversion systematically works to the detriment of consumers, we urge the Commission to introduce a ban on this practice. However, fairer models of DCC could be introduced whereby consumers could make informed currency choices with no major detriment. For example, a reasonable fee could be charged for the convenience of knowing what you pay in your own currency. In order to allow the emergence of such models, an alternative option would therefore be to ban only the most extreme forms of DCC. Other tools for protecting consumer interests – such as the

12 For more information and analysis, see BEUC: The great currency conversion scam, Factsheet, November 2017, available at http://www.beuc.eu/publications/beuc-x-2017-131_currency_conversion_scam_factsheet.pdf.

standard presentation of comparative information on exchange rates and applicable commissions – could then be stimulated. Consumer testing is imperative in avoiding a reshaped policy instrument that is yet again poorly designed; a behavioural economics test should check the real behavioural responses of consumers.

Case study II: Nutrition labelling and the small portion trick

What is the problem?

In the presence of a soaring global obesity crisis,[13] helping consumers to eat healthily will be one of this century's major challenges. Nutrition labelling, one of the tools employed to help with this task, makes it possible for consumers to make informed food choices for healthier diets. EU legislation to regulate the content and format of nutrition labelling already exists, and a compulsory nutrition declaration has been in place since December 2016.[14] Although these are good steps towards providing consumers with better information, they still fall short of providing straightforward tools that allow buyers to make smart decisions at the point of sale (where time pressure is a major factor in consumer behaviour).

Encouragingly, several EU member states have seized the opportunity provided in the Food Information to Consumers Regulation to develop their own simplified nutrition labelling schemes. These schemes include an interpretative element (colour coding) and provide consumers with quick information on either the overall nutritional composition of the food (French Nutri-Score) or the content of nutrients such as fat, saturated fat, salt and sugar (UK traffic lights).

As previously mentioned, compulsory front-of-pack nutrition labelling with colour coding was discussed in the context of the adoption of the Food Information to Consumers Regulation, but was eventually dropped due to heavy industry lobbying. Despite consumer praise for the clarity and usefulness of colour-coded schemes, industry has long fiercely opposed having a red mark on their products (due to the behavioural connotations connected with red as a symbol for danger).

Six multinational companies have recently recognised the value of colour coding, and are now promoting their own voluntary scheme in order to demonstrate that they can effectively regulate themselves.[15] There is, however, a catch: instead of attributing colours to levels of fat, saturates, salt and sugar based on a 100g/100ml reference, the system proposed by industry adapts the UK traffic lights to attribute colours based on portions. In practice, this means that a company can escape the red mark by simply reducing the portion size. This is misleading to consumers; they might consider a given food less unhealthy if not labelled red and ultimately eat more portions. Using portions as a basis for attributing colours will also make it virtually impossible for consumers to compare between products with different portion sizes, leading again to the counterproductive effect of consumer disinformation.

How to design nutrition labelling that truly helps consumers make healthier food choices

Behavioural insights can play a role in this respect. Consumers, certainly when under pressure, such as when shopping for food, understand colours more comfortably and intuitively than figures. The introduction of a well-conceived colour-coded front-of-pack scheme is widely recognised as an important component of a comprehensive strategy for reducing the health and economic burden of diet-related diseases.

Given the missed opportunity to introduce EU-wide rules during the Food Information to Consumers Regulation negotiations, consumer advocates welcome member states' initiatives to recommend schemes, following scientific consumer research, that can help consumers better understand the nutritional content of the food they purchase. In advance of an eventual EU-wide proposal, the European Commission should then consider the evidence gathered and evaluate which schemes are most effective in aiding consumer understanding and consequently consumer behaviour.

Integrating behavioural economics into EU consumer policy

Behavioural economics as a tool for better regulation

Over the years, EU institutions have introduced many processes – from impact assessments to public consultations to regulatory scrutiny – with the goal of rolling out a Better Regulation Agenda. While this agenda is mainly focused on "lightening the burden" for companies, it is also open to the introduction of other measures to improve the

13 NCD Risk Factor Collaboration: Trends in adult body-mass index in 200 countries from 1975 to 2014: a pooled analysis of 1698 population-based measurement studies with 19.2 million participants, in: The Lancet, Vol. 387, No. 10026, 2016, pp. 1377-1396.

14 Regulation (EU) No 1169/2011 of the European Parliament and of the Council of 25 October 2011 on the provision of food information to consumers, L 304/18, in: Official Journal of the European Union, Vol. 54, 22 November 2011.

15 Evolved Nutrition Label Initiative: Promoting Healthier Diets through an Evolved Colour-Coded Nutrition Labelling Scheme, Public Statement, 8 March 2017, available at https://evolvednutritionlabel.eu/public-statement/.

legislative process. In spite of good intentions and interesting content, many of the consumer regulations adopted by the EU in the past have lacked impact, as their implementation did not deliver benefits for consumers. One example is the obligation under the data protection legislation to obtain consumer consent before the processing of their data. While in principle this reflects the right of consumers to control their data, in practice the manner in which this consent is obtained ultimately takes away their control: pre-ticked boxes, the unavailability of services in the case of non-consent and complex contract terms (on apps) that are complicated to read and understand.

Behavioural economics could contribute to creating more concrete benefits for consumers by shaping laws that can be practically used by their beneficiaries. Otherwise, such laws risk burdening industry while not delivering tangible results to their intended beneficiaries.

Behavioural economics as a tool for bringing the EU closer to its citizens

When it comes to consumer legislation, making use of insights from behavioural economics during the impact assessment stage would be a major improvement. This would be a necessary test to ascertain whether the envisaged regulatory provisions are shaped to deliver the best outcomes for consumers or whether adaptation or additional measures are needed.

The EU Better Regulation Agenda is a work in progress. EU policy-makers would be well advised to check their proposals against behavioural economics when they announce *urbi et orbi* that the EU is preparing a New Deal for Consumers.[16] This will help to bring about tangible wins for consumers in an EU that needs to get closer to its citizens. Beyond this exercise, and to act sustainably, EU consumer policy might consider systematically embedding a behavioural insight check into its law-making processes, but further reflection on this suggestion is a subject for a future paper.

16 European Commission, DG Justice and Consumers: Coming up in 2018: We will propose a #NewDealForConsumers, Twitter post, 4 January 2018, available at https://twitter.com/EU_Justice/status/948889498439446528.