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**AN ANALYSIS OF THE DESIGN AND IMPLEMENTATION  
OF BEHAVIOURALLY INFORMED LAWS, REGULATION,  
AND DECISIONS TO ‘NUDGE’ IN NEW ZEALAND**

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## Abstract

*The advent of behavioural economics and nudge theory provides new challenges for policy designers and regulators. These theories assume a different model of human behaviour than that commonly used by regulators, and also introduce a new type of governance – that of ‘libertarian paternalism’. This paper seeks to answer the question of how New Zealand’s regulatory design and law reform processes should adapt in light of these two developments.*

*This paper considers the regulatory impact statement process should incorporate a complementary behavioural economic model, whereas the case for a change to disclosure statements is less clear cut. It proposes that explicit and open consideration of behaviourally informed options regulatory impact statements increases the transparency and accountability of government, without decreasing their efficacy. As behavioural economics and nudging become more prevalent, the suggested changes aim to ensure that New Zealand’s law reform processes remain thorough and robust. This should allow complex policy issues to be translated into effective instruments.*

Key words: New Zealand regulatory design, nudge, behavioural economics, cognitive errors, libertarian paternalism.

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## *I Introduction*

Governments spend large amounts of time and resources formulating policy which they believe will benefit the society they serve. Creating a healthier population, increasing the housing supply, and providing social welfare (among others) are all legitimate policy goals which often require behavioural change in some shape or form. The various tools that governments worldwide attempt to use in order to achieve behavioural change and thus policy goals, have become more innovative and varied over the past 50 years. Governments increasingly feel pressure to find low cost solutions to high-level and complex problems. Mere mandates and prohibitions in statute as to what people must or must not do have evolved as the world and human behaviour has become more complex and dynamic. Regulators have found that even carefully designed rules can have unintended consequences, creating a dissatisfaction with more traditional forms of regulation. Consequently, there has been an increased interest in public policy innovation. Some of these innovative approaches fall under the broad heading of ‘new governance’.

New governance is part of a novel wave of ideas that seek to inform more effective, efficient regulatory schemes. Public policy makers and other agencies are gradually taking to designing regulations and other instruments with reference to the actual behaviour of human beings, and not the economic neoclassical assumptions that have dominated the school of thought for the past century. In short, laws are being made accepting that people are imperfect, and so is their decision making. By harnessing the results of a vast array of behavioural research completed over the past two decades, new governance scholars hope that policy makers will be better placed to design cheap, choice-preserving and successful instruments to deal with various social problems.<sup>1</sup> Though discussion of the best method through which to incorporate behavioural science and research into law can be traced back to the 1960s,<sup>2</sup> this paper will attempt to undertake a more contemporary analysis. The two new governance tools it will consider in depth are the use of behavioural economics, and nudge theory.

The rise of behavioural economics and nudge poses interesting and important questions for law reformers and policy makers. First, given that they are now legitimate policy tools, does the

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<sup>1</sup> Alberto Alemanno and Alessandro Spina “Nudging Legally: On the Checks and Balances of Behavioural Regulation” (2014) 12(2) *I Con* 429 at 431.

<sup>2</sup> See W Berns “Law and Behavioral Science” (1963) 28 *Law and Contemporary Problems* 185.

regulatory design process allow or prompt policy makers to make appropriate use of behavioural economics and nudge? Second, do current reform processes sufficiently mitigate the fears that some have with new governance tools? That is, that they allow governments to incite behavioural change in a manipulative and covert manner? Behaviourally informed laws and nudges have already been implemented in New Zealand. However, this paper aims to illustrate that as it stands New Zealand's law reform and regulatory design processes are inadequately structured to deal with these new developments. It proposes that there are a number of relatively minor changes which could be made to the regulatory impact analysis and disclosure statement processes which would help to ensure that behavioural economics and nudge can be used by governments transparently yet effectively. The suggested establishment of a 'nudge register' would assist policy makers to openly consider any potential effects of nudging, regardless of whether the nudge is an administrative decision or the product of regulation. The misguided nature or inefficacy of some of the behaviourally informed tools produced by the current system are testament to the need for change.

## *II Behavioural Economics in New Zealand Law*

Behavioural economics combines economics with cognitive science to reason that an individual's decision making is not always rational.<sup>3</sup> People are imperfect and so are their decision making processes. People make errors. The idea of harnessing the results of psychological and behavioural analysis was considered by early economists, but it is only relatively recently that behavioural economics has gained recognition and its resulting academic legitimacy. It is generally believed that the school of thought began with Herbert Simon's explanation of "bounded rationality" (that is, human beings are not perfectly rational) in 1957.<sup>4</sup>

The assumption in behavioural economics that economic agents make decisions on grounds other than in pursuit of wealth maximisation and self-interest challenges neoclassical economic theory. In neoclassical theory, economic agents respond to incentives by undertaking traditional cost-benefit analyses, and by considering all available information (even if

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<sup>3</sup> Joshua Wright and Douglas Ginsburg "Behavioural Law and Economics: Its Origins, Fatal Flaws and Implications for Liberty" 106(3) *Northwestern University Law Review* 12 at 17.

<sup>4</sup> Herbert Simon *Models of Man: Social and Rational* (Wiley, New York, 1957).

complex).<sup>5</sup> Within this model, economic agents always act in their best interests and do not make errors of any kind. This conceptualisation of human nature has been referred to '*homo economicus*.'<sup>6</sup> The neoclassical model is a fine theory with many applications, but it is just that: a theory. In the real world where laws and regulations are actually implemented, humans are often irrational and make cognitive errors. Neoclassical economics should thus be seen as comparator with reality, which is more in line with the tenets of behavioural economics.

The theories developed by behavioural economists are not necessarily ground breaking. As put by Camerer and Loewenstein:<sup>7</sup>

Most of the ideas in behavioural economics are not new; indeed, they return to the roots of neoclassical economics after a century-long detour. When economics first became identified as a distinct field of study, psychology did not exist as a discipline. Many economists moonlighted as the psychologists of their times.

Despite the foundations of behavioural economics having been recognised for some time, recent psychological research has driven behavioural economic studies forward through the introduction of cognitive errors into the neoclassical model. People often act irrationally because they are liable to make mistakes, take mental shortcuts and be subject to other biases. A greater understanding of the situations in which cognitive errors manifest consistently and predictably allows policy makers to exploit them in designing regulation and other instruments. Designing rules with reference only to the '*homo economicus*' view of the human condition will often lead to unintended consequences. Incorporating the behavioural economic model into the overall analysis can assist in understanding why people might act as they do, and thus in predicting the consequences of any given rule. The cognitive errors which have been identified and incorporated into various models by behavioural economists are the main aspect of behavioural science discussed in this paper, and are explained below. Examples of New Zealand legislation attempting to remedy these errors has also been included where relevant.

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<sup>5</sup> C Camerer, G Loewenstein and M Rabin *Advances in Behavioural Economics* (Princeton University Press, New York, 2004) at 4.

<sup>6</sup> Cass Sunstein and Richard Thaler *Nudge: Improving Decisions about Health, Wealth and Happiness* (Revised ed, Yale University Press, Connecticut, 2008) at 6.

<sup>7</sup> Camerer, Loewenstein and Rabin, above n 5, at 7.

## **A Cognitive Errors Generally**

Cognitive errors are mental shortcuts or mistakes that people make in a variety of circumstances.<sup>8</sup> They can be identified through a simple ‘recipe’ established by early papers in behavioural economics.<sup>9</sup> First, behavioural economists should pinpoint normative frameworks such as utility maximisation. Second, they should isolate repeated violations of the assumptions made in the framework inexplicable on the basis of ‘alternative explanations’. The third and final step is to use the identified anomalies as a muse for inventing a theory that “generalises existing models”.<sup>10</sup> The general theory is that if the occurrence of such errors is predictable and readily identifiable, then regulation or other rules can be implemented to remedy them.

There are hundreds of cognitive errors that people make on a day to day basis, and this paper does not intend to outline all of them. In saying that, cognitive errors in the decision making process can usually be categorised into five broad (and sometimes fluid) groups: poor use of information, overconfidence, susceptibility to framing, time inconsistent preferences and availability heuristics. Relevant literature also refers to these concepts as ‘cognitive biases’ or ‘heuristics’.<sup>11</sup> It is important to recognise that this section is limited to cognitive errors arising in the decision making process. They also occur in other contexts (such as memory and social biases), and will be explained and discussed as they arise throughout this paper.

Despite the lack of a dedicated review of New Zealand’s law reform and regulatory design processes to ensure behavioural economics and nudge can be used transparently, appropriately and accurately, New Zealand governments have legislated to bypass or remedy cognitive errors. As these laws have been developed through the existing framework, they provide an interesting example of how the current system accommodates behavioural economics.

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<sup>8</sup> On Amir and Orly Lobel “Stumble, Predict, Nudge: How Behavioural Economics Informs Law and Policy” (January 2009) University of San Diego Law School Research Paper No 09-006 at 2.

<sup>9</sup> Camerer, Loewenstein and Rabin, above n 5, at 10.

<sup>10</sup> At 10.

<sup>11</sup> At 5.

## **B      *Bounded Rationality***

### *1      Theory*

In a market with perfectly rational players, each player seeks out and then considers all relevant information before making a choice. In considering the information, the rational player engages in a cost-benefit analysis and chooses the course of action that maximises their utility. Bounded rationality recognises that in reality, people are imperfectly rational.<sup>12</sup> People are not always able to process information correctly (or even at all). This commonly occurs either when the information is complex, copious or otherwise difficult to simplify. To compound this problem, people have a tendency to consider irrelevant information when making a decision. An interesting experiment found that people's decisions and choices are affected by 'anchoring'.<sup>13</sup> In the experiment, people were asked to guess the price of a bottle of wine after completing a random number generator, which gave them a number between 1 and 100. The experiment found that people were very reluctant to depart too far from the number generated when guessing the price, even though this number clearly had no relevance to the price of the wine. Furthermore, people are prone to 'sticking with the status quo' even if doing so is not in their best interests, a phenomena psychologists call 'inertia' or 'status quo bias'.<sup>14</sup> Opt-out default rules often seek to exploit inertia, as will be expanded on later in this paper.

### *2      Credit Contracts and Consumer Finance Act 2003*

Provisions in the Credit Contracts and Consumer Finance Act 2003 aim to cure the bounded rationality of consumers. One purpose of the Act is to remedy information asymmetries between lenders and borrowers in consumer credit contracts.<sup>15</sup> The Ministry for Consumer Affairs found that consumers were being misled as to the applicable interest rates and other fees associated with the contracts, and were defaulting on their loans at record rates.<sup>16</sup> The primary mechanism through which this end was sought was disclosure of key information by lenders to borrowers. Under a neoclassical theory, simple disclosure remedies information

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<sup>12</sup> Daniel Hausman and Brynn Welch "Debate: To Nudge or Not to Nudge" (2010) 18(1) *The Journal of Political Philosophy* 123 at 130.

<sup>13</sup> Dan Ariely, George Loewenstein and Drazen Prelec "'Coherent arbitrariness': Stable demand curves without stable preferences" (2003) 118(1) *Q J Econ* 73 at 75.

<sup>14</sup> See the discussion in Cass Sunstein *Why Nudge? The Politics of Libertarian Paternalism* (Yale University Press, Connecticut, 2015) at 157.

<sup>15</sup> Credit Contracts and Consumer Finance Act 2003, s 3(3)(b).

<sup>16</sup> Cabinet Paper "Responsible Lending Requirements for Consumer Credit Providers" (October 2011) at [10].



asymmetry and borrowers then have full information entering into the contract. However, the disclosed information is useless to people who do not understand what it means, or who cannot sift through it to ascertain the relevant parts. The responsible lending concept was introduced in recognition of this. The concept imposes positive obligations on lenders to ensure that borrowers understand the consequences of the contracts that they enter into.<sup>17</sup> This aims to remedy the poor use of information or bounded rationality errors described above. These obligations, whilst they may impose extra costs upon lenders, arguably result in socially efficient outcomes as people only enter into contracts that they reasonably believe they can fulfil. The Act employs behavioural economic theory to good effect therefore, despite being developed through the current reform process.

### ***C Optimism Bias***

People are subject to an optimism bias. They are overconfident or overly optimistic as to what will occur in the future. Whilst the optimism bias is desirable in that it helps motivate people to act, it increases their risk of failure. Many studies have proven manifestations of this bias, the most well-known being that the average person considers themselves to be a better-than-average driver.<sup>18</sup> People often grossly underestimate the amount of time it will take for them to finish a particular project, overestimating their time management skills and other abilities. The optimism bias often reveals itself in tandem with ‘hyperbolic discounting’, in which people underestimate future risks.

The Credit Contract and Consumer Finance legislation which seeks to remedy bounded rationality also applies to removing the optimism bias. Even if people do understand the fees and interest rates, they may overestimate their ability to be able to pay them. People believe that they will be able to save more than they actually do, or believe that they will be able to pay back a loan at a higher interest rate in the future, discounting the possibility of unforeseen financial strife. The responsible lending obligations ensure that lenders enquire into and assess the borrower’s ability to repay.

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<sup>17</sup> Credit Contracts and Consumer Finance Act, s 9C.

<sup>18</sup> Ola Svenson “Are we all less risky and more skilful than our fellow drivers?” (1981) 47 Acta Psychologica 143 at 147.

## ***D Framing***

Though the substance of a particular choice may be the same, a person may change their choice depending on how the choice is presented or framed. Choices often are designed to take advantage of people's inherent loss aversion. Studies have found that people's negative reaction to losses is often twice as large as their positive response to gains of the same amount.<sup>19</sup> As such, people are far happier to not lose an amount, than gain the same amount. For example, one experiment found that test subjects were more likely to agree to an operation if told that the 'survival' rate is 90 per cent, rather than when the same information was put negatively (that the mortality rate is 10 per cent). Further, businesses often frame facts about their products to entice people into buying them. Presenting a soft serve ice cream as '95% fat free' is far more appealing to consumers than advertising it as 'only 5% fat'.

A non-governmental example of 'framing' can be found in the billing methods of utilities companies. Utilities companies may offer a 'prompt payment' discount if a customer pays their bill by a certain date. The discount does not apply if payment is made after said date. What difference therefore, is there between a 'prompt payment discount' and a 'late payment fee' if a bill is not paid on time? Nothing, apart from the way in which the choice is framed, and the context in which the decision is made. The utility company wants to maximise profits, and so frames the decision to appeal to people's innate loss aversion characteristics. In other words, people are far more concerned about being charged an extra fee, than they are about not receiving a discount, despite the net financial result being identical. People would rather lose the prompt payment discount than pay the late payment fee, and so the utility company increases its revenue through framing the choice as such. Framing is often used in nudging techniques, as will be seen below.

## ***E Time Inconsistency***

### ***1 Theory***

People often display time inconsistent preferences.<sup>20</sup> This means that their preferences change over time. At one point, a person will display preference set X, but at a later point in time, they

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<sup>19</sup> Amos Tversky and Daniel Kahneman "The framing of decisions and the psychology of choice" (1981) 211 Science 453 at 457.

<sup>20</sup> Peter Huang "Empowering People to Choose Wisely by Democratizing Mindfulness and Thinking Tools" (11 January 2015) Social Sciences Research Network <[www.ssrn.com](http://www.ssrn.com)> at 16.

will display preference set Y. Another way of expressing this is through the lens of ‘hot’ and ‘cold’ states. In a cold state, a person may be analogous to the wealth-maximising, notional, rational consumer. But in a hot state, a person may be less rational and unable to undergo the same cost-benefit analysis. The classic example is the use of tobacco products. In a cold state, a person may resist the urge to smoke, as they recognise that it is bad for their health. In a hot state, a person may smoke anyway as they now prefer the instant gratification of a cigarette despite the health effects.

## 2 *Fair Trading Act 1986*

Since June 2014, a cooling off period applies to ‘uninvited direct sales’ under s 36M of the Fair Trading Act 1989. Uninvited direct sales are those where a seller makes an unsolicited approach to a person either at home, work or over the phone for the purpose of offering goods or services.<sup>21</sup> People are more likely to make irrational purchases in the context of an uninvited direct sale (i.e. they are in a hot state due to the external pressure of the salesperson). During this hot state, the purchaser may not undergo a correct cost-benefit analysis. After the purchase, and in the aptly named ‘cooling off’ period, it is assumed that away from the pressure of the uninvited salesperson the purchaser may realise that they in fact no longer wish they had entered into the contract. As such, they are entitled to cancel the contract within five working days after they receive a copy of the sales agreement.<sup>22</sup>

## 3 *Gambling Act 2003*

Another example is the availability of self-exclusion orders to problem gamblers. In a cold state, a person may recognise that they have a gambling problem and understand the need to stop gambling and seek help. In a hot state they may disregard their earlier preference for not gambling, and want to gamble. However, the self-exclusion orders allow a person to prohibit themselves from entry to casinos and the gambling areas of particular venues.<sup>23</sup> The underlying idea is that problem gamblers can voluntarily put themselves on exclusion lists whilst they are in their cold state, to prevent them from gambling when they are in their hot state and lack self-control.

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<sup>21</sup> Fair Trading Act 1986, s 36K.

<sup>22</sup> Section 36M(1)(a).

<sup>23</sup> Gambling Act 2003, s 310.

### ***F Availability Heuristics***

If information is more present in people's minds, they will give it more weight in their decision making process. For example, people rate recent events which feature prominently in the media as more probable than those which happened far in the past, even though the statistical probability of the past event occurring again may be far greater. This heuristic has been observed by think-tank Motu in the housing market post the 2010 and 2011 Christchurch earthquakes.<sup>24</sup> These earthquakes brought the risk of liquefaction subsequent to an earthquake into the public domain. This was due to widespread media coverage. For example, Motu discovered that the word 'liquefaction' was used 353 times in *The New Zealand Herald* in the year after the 2010 earthquake, when it had only appeared once in the year beforehand.<sup>25</sup>

Hutt City is an area 15 kilometres north of Wellington which lies on a fault line, and is at risk of significant liquefaction as a result of an earthquake. As the risk of liquefaction and earthquake damage was present in the minds of Hutt citizens and prospective purchasers, the average house price decreased in the area by about four percent in 2011. This appeared to reflect the market taking account of the risk. However, as the hazard became less present in the media and thus also in people's minds, they gradually stopped factoring it in to their decision making process. As a result, the current prices of houses in liquefaction prone areas in Hutt City appear to be consistent with those of houses not at risk of liquefaction.<sup>26</sup> People have forgotten what should be a very pertinent risk, and so do not take it into account when making their decision to purchase property.

### ***III Thaler and Sunstein's Nudge***

The 'Nudge Agenda' has captured the imagination of policy makers and government officials worldwide. The pioneers of the self-described 'movement' are economist Richard Thaler and legal scholar Cass Sunstein from the University of Chicago. Their book *Nudge: Improving*

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<sup>24</sup> See Arthur Grimes, Levente Timar and Richard Fabling "That Sinking Feeling: The Changing Price of Disaster Risk Following an Earthquake" (November 2014) Motu Working Paper 14-13.

<sup>25</sup> At 18-20.

<sup>26</sup> At 18-20.

*Decisions About Health, Wealth and Happiness* is one of the seminal works in this particular space.<sup>27</sup> In *Nudge*, Thaler and Sunstein describe a ‘nudge’ as:<sup>28</sup>

[A]ny aspect of the choice architecture that alters people’s behaviour in a predictable way without forbidding any options or significantly changing their economic incentives. To count as a nudge, the intervention must be easy and cheap to avoid.

In other words, a nudge is anything other than an incentive which pushes people towards acting in a privately optimal manner, without expressly limiting their choice set. A successful nudge should lead to a situation in which the nudgee (the target of the nudge) is better off, *as judged by themselves*.<sup>29</sup> A classic example of a nudge is displaying fruit next to supermarket checkouts, which nudges shoppers towards healthy eating. Another is placing stairs right next to the main entrance of a building, with elevators off to the side, to nudge people towards taking the stairs. Nudges often seek to either evade or manipulate the cognitive errors identified by behavioural economists. Therefore, there is a large overlap in the underlying science between the two disciplines.

Humans are conditioned by society to be open to ‘social’ nudging, and as such are liable to be affected by other forms of nudges, for example those issued by the public and private sector.<sup>30</sup> As such, Thaler and Sunstein actively suggest that their ideas should be employed by government policy makers in order to effect behavioural change.<sup>31</sup> They propose that nudging is particularly attractive to any administration given that it should impose very little cost on those who are already acting optimally.<sup>32</sup> Given that the above definition of nudge is rather abstract, this section aims to explain nudge as a policy tool and introduce New Zealand specific examples. Once one understands how different nudges operate in practice, they should have a greater appreciation of the concerns some have with them, and thus the need for a review of New Zealand’s law reform and regulatory design processes.

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<sup>27</sup> Thaler and Sunstein, above n 6, at 6.

<sup>28</sup> At 6.

<sup>29</sup> At 5.

<sup>30</sup> At 10.

<sup>31</sup> At 13.

<sup>32</sup> At 15.

### **A *Three Degrees of Nudge***

Not all nudges are created equal. One nudge may be more intrusive in a person's life than another. It is commonly accepted that three 'degrees' of nudge can be delineated.<sup>33</sup> Each successive degree represents a further potential encroachment upon the liberty and autonomy of the nudgee. Whilst first degree nudges are prevalent in our everyday lives, third degree nudges are more controversial and have been the subject of much academic comment in recent years.<sup>34</sup> The ability to place nudges into three distinct categories would be a useful organisational tool to employ in the regulatory impact statement process, as will be discussed below.<sup>35</sup>

A first degree nudge "enhances reflective decision-making".<sup>36</sup> It provides information in the form of a notice or cue, in the hopes that the nudgee will then be better situated to make a wealth-maximising decision: 'You have 14 days left to apply for your tax refund.' Indeed, it is difficult to see how a first degree nudge is different than disclosure as a tool to remedy information asymmetry is under the neoclassical theory. As a result some commentators have voiced their doubts over whether a first degree nudge is in fact a nudge at all, given that it does not truly attempt to 'push' the nudgee into acting in a particular manner or engaging in any particular behaviour.<sup>37</sup> For the purposes of this paper, a first degree nudge will be accepted as a legitimate nudge.

A second degree nudge attempts to bias a decision in a particular direction. The impact on individual autonomy escalates, since "the target's 'automatic' responses will in practice lead him or her to accept the nudge with limited awareness".<sup>38</sup> The nudgee should in hindsight be able to recognise that they have been nudged, and then assess whether or not they are better off or not.<sup>39</sup> The benefit of hindsight and self-realisation reduces the intrusion on individual autonomy compared with third degree nudges.

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<sup>33</sup> Robert Baldwin "From Regulation to Behaviour Change: Giving Nudge the Third Degree" (2014) 77(6) MLR 831 at 832.

<sup>34</sup> At 835.

<sup>35</sup> See below at p 42.

<sup>36</sup> Robert Baldwin "Nudge: Three Degrees of Concern" (2015) LSE Law Policy Briefing Series 7 at 2.

<sup>37</sup> At 2.

<sup>38</sup> At 3.

<sup>39</sup> Robert Baldwin, above n 33, at 835.

A third degree nudge contains messages with an underlying emotional power that hinders the consideration of all options in a particular choice set, so the nudgee may be unable to act in accordance with their true preferences. That is, the nudgee cannot act as they would were they a completely rational human being with clearly defined preferences. Third degree nudging has been described by one commentator as behavioural manipulation.<sup>40</sup> In contrast to a second degree nudge, the nudgee may not be able to recognise that they have been nudged in hindsight. A classic example of a third degree nudge is regulation requiring graphic images to be displayed on cigarette packets in an attempt to stop people from smoking.

### ***B Nudge in New Zealand***

Knowingly or not, New Zealand government policy specialists have enlisted nudge techniques in an attempt to effect behavioural change. These have come in the form of statutory provisions, such as the KiwiSaver Act 2006, or decisions made by Crown entities, such as the Electricity Authority's 'What's My Number?' campaign. It appears that to date, New Zealand policy designers have not jumped to the (almost certainly erroneous) conclusion that nudging is the panacea to all regulatory failings. Further, the New Zealand government has not yet openly labelled any behaviourally informed decisions or laws as nudges, despite certain statutes and regulations resembling such instruments. These have been implemented through the current law reform and regulatory design processes. Their problems and limitations provide support for the proposition that the current reform system needs to be reviewed and altered to incorporate specific consideration of nudging.

#### *1 Default Rules*

Default rules are an aspect of choice architecture which influences the way people act. The implementation of a default rule is therefore a nudge.<sup>41</sup> Default rules aim to exploit inertia. Inertia is the phenomena that people are reluctant to move from one course of action, or one plan to another even if another course of action or plan is more beneficial to them. The argument therefore is that for better or worse, default rules are important to people's overall welfare. Policy designers and regulators should choose a default rule that (in general) maximises people's welfare so that the harms of inertia are mitigated and societal wealth

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<sup>40</sup> At 837.

<sup>41</sup> Thaler and Sunstein, above n 6, at 177-183.

increased. This does not limit individual autonomy, as those who the default rule is suboptimal for (or even those who do not want to be on that course of action for whatever reason) are in theory able to change their plan or course of action at little or no cost. The default rule nudge is therefore legitimised “on a presumption of consent”, and a presumption that the opt-out costs are low.<sup>42</sup>

Perhaps the most prevalent example of a default rule nudge in New Zealand can be found in the KiwiSaver Act 2006. The Act details the state-run superannuation scheme. Prior to the Act, the Government identified that people were not saving enough for retirement, and struggling to live on their New Zealand Superannuation pension.<sup>43</sup> Viewed through a behavioural economics lens, this is a classic manifestation of the optimism bias. The Act aims to “encourage... long-term savings habit[s] and accumulation of assets by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement.”<sup>44</sup> KiwiSaver is effectively run as a workplace-contributions scheme, where participants decide whether to allocate 3%, 4% or 8% of their income to their KiwiSaver account. Employers match all contributions made by employees. Further, the Government contributes 50 cents for every dollar an employee contributes up to \$521.43 per year. Until 21 May 2015, new KiwiSaver participants were also given a ‘kick start’ by the Government of \$1000, tax-free.<sup>45</sup>

The nudge in the KiwiSaver Act is simple but effective. In general, people are automatically enrolled in KiwiSaver when they begin to work for a new employer.<sup>46</sup> To opt out, they must provide a notice to their employer within a certain time period from the commencement of their employment.<sup>47</sup> In a market with fully rational actors, the result under this rule would be no different to a default rule in which people were not automatically enrolled. People would switch if it was optimal to do so. However due to inertia, under the default rule more people stay enrolled in KiwiSaver than would enrol if they had to actively choose to opt in to the scheme. This goes some way to helping people save for retirement, which puts less of a strain on the

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<sup>42</sup> Fabiana Di Porto and Nicoletta Rangone “Cognitive-Based Regulation: New Challenges for Regulators?” (2013) 20 *federalismi.it* at 19.

<sup>43</sup> Cabinet Paper “KiwiSaver – Various Issues” (31 January 2006) at 10.

<sup>44</sup> KiwiSaver Act 2006, s 3(1).

<sup>45</sup> See s 226 [repealed].

<sup>46</sup> Section 10.

<sup>47</sup> Section 16.



individual and ultimately the State. As it attempts to bias a decision in a particular direction without appealing to any underlying emotional messaging, it is likely to be a second degree nudge. There are issues with this nudge stemming from its design and implementation through a process not fully equipped to deal with nudges and behavioural economics. As such, whether or not it has been successful as a policy tool is discussed below.<sup>48</sup>

## 2 *Smart Information Nudge*

A smart information nudge provides tailored information to the consumer which should then place them in the best possible position to make a wealth-maximising decision.<sup>49</sup> These are generally first-degree nudges, but can be second degree depending on how the information is framed. An example of a smart information nudge is the Electricity Authority's 'What's My Number?' and 'Powerswitch' tools. The Electricity Authority of New Zealand is an independent Crown entity established under the Electricity Authority Act 2010.<sup>50</sup> Its statutory purpose is "to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers".<sup>51</sup> Though its main function is to act as the chief regulator of New Zealand's electricity market, it is also involved in empowering consumers to actively search for the best power deal available, thus driving competition.

The principal way in which the Electricity Authority drives retail competition is through the 'What's My Number?' campaign. The campaign was first introduced in 2011, and has appeared through a series of web and TV advertisements. Consumers are encouraged to use the 'What's My Number?' web tool which will show them the best deal they can get for their power.<sup>52</sup> Using the web tool, consumers enter information about their power consumption. This includes the region they live in, the number of people in their household and whether these people are mostly home during the day or not. The tool then gives the amount of money that the consumer could have saved on their power bill had they been with the best plan for them. The tool then becomes 'Powerswitch', and allows the consumer to view the best possible plan for their circumstances. Logically, when presented with an option that is cheaper (on average by

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<sup>48</sup> See page 22.

<sup>49</sup> Daniel Zizzo, Jiwei Zheng and Stefania Sitzia "Complexity and Smart Nudges with Inattentive Consumers" (November 2012) Social Sciences Research Network <[www.ssrn.com](http://www.ssrn.com)> at 3.

<sup>50</sup> Electricity Industry Act 2010, s 12(1).

<sup>51</sup> Section 15.

<sup>52</sup> See the tool at <[www.whatsmynumber.org.nz](http://www.whatsmynumber.org.nz)>.

\$174.86 in 2015<sup>53</sup>), even the least sophisticated consumer will realise that changing to that plan is in their best interests. This does presume a certain level of rationality such that consumers recognise that they should switch if their potential savings are greater than the cost of changing retailers.

This nudge aims to remedy both bounded rationality and inertia. It makes complex information regarding power bills simple, and Powerswitch reduces inertia (384,841 switches were completed in 2015, about 21.6% of all households<sup>54</sup>). However, whether or not the nudge has been a complete policy success is debatable. This is principally because despite the nudge, New Zealand households have forgone \$1.5 billion in power savings since 2011.<sup>55</sup> It could benefit from a complementary approach to policy to pursuing policy objectives, as discussed below.<sup>56</sup> It is interesting that the ‘What’s My Number?’ campaign is a nudge instituted through an administrative decision as opposed to regulation, differentiating it from the others described in this section.

### 3 *Exploiting or nullifying the emotional response*

Certain nudges attempt to “exploit or nullify” the emotional response of their intended audience to guide them towards certain behaviours. A relevant example is the regulation of the sale of tobacco in New Zealand. Whilst traditional command and control rules exist in this space (for example, tobacco cannot be sold to minors<sup>57</sup>), these are complemented by nudges. Since February 2007, 30% of the front and 90% of the back of cigarette packs in New Zealand have been covered in health warnings accompanied by graphic images.<sup>58</sup> First, these are aimed to educate people of the risks involved, and to make this information *salient*. Smokers more often than not understand the risks of smoking, but those risks may be more effective at point of sale. Secondly, the graphic images of various smoke-damaged organs invoke strong emotions of disgust, causing people to want to smoke less. If the Smoke-free Environments (Tobacco Plain Packaging) Amendment Bill currently before the House passes (awaiting its third reading at the time of writing), then cigarettes and other tobacco products will have to be sold in plain or

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<sup>53</sup> “How the Residential Electricity Market Performed in 2015” (2016) Electricity Authority <[www.ea.govt.nz](http://www.ea.govt.nz)>.

<sup>54</sup> At 1.

<sup>55</sup> Electricity Authority “Electricity Market Information (EMI)” <[www.emi.ea.govt.nz](http://www.emi.ea.govt.nz)>.

<sup>56</sup> See page 43.

<sup>57</sup> Smoke-free Environments Act 1990, s 30(1).

<sup>58</sup> Smoke-free Environments Regulations 2007, sch 1-4.

unbranded packaging. This aims to nullify any emotional response to advertising which may encourage people to smoke. These nudges work in tandem towards the same policy goal. The percentage of New Zealanders who smoke has fallen from 20% to 17% since the graphic health warnings were introduced.<sup>59</sup> It is unclear how much of the decrease is a direct result of the nudge.

Plain packaging and graphic health warnings are likely to be third degree nudges, as they contain an underlying emotional message effectively attempting to limit the choice set of the individual. However, they are not hidden nudges that have been enacted in the dark shadows of some public servant's office. The provisions concerning the plain packaging and graphic health warnings have been well-publicised by the media, and have been the subject of much public scrutiny.<sup>60</sup> Though people are actively aware of the provisions, are they in fact aware of the science behind the nudge? This raises the interesting question of whether 'transparent' nudges are less effective (discussed below).

#### *IV Governmental Use of Behavioural Economics / Nudge*

Governments are judged on their successes and failures in implementing changes that benefit the society that voted them in to power. The extent to which the State should intervene in people's lives is of course a controversial topic. Different people will have legitimate differences in opinion as to the role that the State should play. Libertarian paternalism is the jurisprudential term given to tools such as nudge. The nudge agenda, and perhaps many of the related new governance tools rooted in behavioural economics, claim to sit somewhere in the middle (or perhaps outside) of the political spectrum. Nudges purportedly do not limit the choice set of the nudgee (so are libertarian), yet they are pushed towards making a decision which is the State believes is best for them (and so are paternalistic). Hence the moniker 'libertarian paternalism' aims to appeal to both the political left and right, which is useful for its proponents in pitching it to government officials.

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<sup>59</sup> SmokeFree New Zealand "Facts and Figures" (5 September 2016) <[www.smokefree.org.nz](http://www.smokefree.org.nz)>.

<sup>60</sup> See for example: Rob Stock "NZ cigarette plain packaging law would see Imperial Tobacco sue for compensation" *stuff.co.nz* (online ed, Wellington, 26 June 2016), Stacey Kirk "Tobacco plain packaging likely to be law by end of year – John Key" *stuff.co.nz* (online ed, Wellington, 15 February 2016), Nicholas Jones "Plain packaging for tobacco confirmed" *New Zealand Herald* (online ed, Auckland, 08 September 2016).

Libertarian paternalism is of course *prima facie* attractive to governments. It is potentially less costly to the state than command and control rules. Compared with command and control rules, there are very few (if any) enforcement costs as economic agents are not in fact required to act in a particular manner. Furthermore, nudges should not impose costs on those who do not require them (hence libertarian paternalism is sometimes termed ‘asymmetric’ paternalism). As such, in theory nudges should not incite much political backlash. Those who are affected by the nudge are made better off than they would have been had the nudge not been in place, and those who do not want to take the course of action proposed by the nudge can opt out. Moreover, governments often do not have to navigate the legislative process and get Parliamentary approval to implement a nudge, making it an expeditious mode of inciting behavioural change. This section seeks to canvas issues around the New Zealand government engaging in libertarian paternalism, and also consider whether nudging is a defensible mode of governance. Whether or not these issues can be solved or mitigated through changing aspects of the law reform and regulatory design process will be examined in Section V below.

#### ***A Concerns of Governmental Nudging***

While many have embraced nudging and genuinely regard it an exciting new method of governance, others have not. Whilst many different ethical, jurisprudential and accountability issues have been raised, the concerns are succinctly stated by the authors of “Nudging Legally”:<sup>61</sup>

By intervening in the human decision-making process, behaviourally informed regulation could interfere substantially, and be perceived as incompatible, with fundamental rights of citizens of freedom of expression, privacy, and self-determination

This section aims to outline common fears that academics have with nudging. Once the problems have been outlined, this paper will later suggest how any risk can be minimised through the law reform or regulatory design process.

#### ***1 Nudge Design and Choice Architects***

‘Choice Architect’ is the term given to a person who designs a nudge.<sup>62</sup> In a law reform or regulatory design context, the choice architect is ultimately the regulator or the relevant policy

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<sup>61</sup> Alemanno and Spina, above n 1, at 432.

<sup>62</sup> Thaler and Sunstein, above n 6, at 7.

adviser. There are two chief concerns: first, how is the choice architect to determine the direction in which it is legitimate to nudge people, and second how can we ensure that choice architects are less subject to bounded rationality than those that they are trying to influence?

(a) The correct direction to nudge

Before designing the choice itself, any choice architect must first decide the direction in which to nudge. It is often assumed that the nudge's goal is an 'objective' good. The issue is that there will probably always be debate about what the 'correct' direction to nudge is. A particular nudge, for example, plain packaging on cigarettes may be designed to further 'better health' on the premise that this is an accepted objective good but, as Gregory Mitchell opined:<sup>63</sup>

Many may agree in the abstract that better health is preferable to worse health, but when the choice is framed as enjoying life-shortening but intensely pleasurable vices during one's college days versus abstaining during college to gain a couple of extra boring years at an advanced age, then better health may not look quite as good.

Despite this compelling sentiment, the concern that there can never be one objectively good direction in which people can be nudged may be overstated. Policy is policy, regardless of the nudge. The nudge is just one mechanism through which the policy can be pursued. The same concerns could equally be applied to paternalistic rules which mandate or prohibit certain behaviours. As such, the real debate with nudge should surround the way in which it pursues the chosen policy.

(b) Misguided nudges

Further, if a nudge is misguided then more people may be 'manipulated' or influenced into a course of action that may not be in their best interests. This concern can be illustrated to an extent by the KiwiSaver nudge described above. The nudge has indeed been successful in enrolling people into KiwiSaver, but the KiwiSaver scheme has not prompted an increase in national saving.<sup>64</sup> According to a 2011 Treasury report, only 29% of KiwiSaver contributions

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<sup>63</sup> Gregory Mitchell "Libertarian Paternalism is an Oxymoron" (2005) 99 N Western U Law Review 1245 at 1268.

<sup>64</sup> *KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving* (New Zealand Treasury Working Paper 11/04, December 2011) at 25-27.

represent new savings (i.e. those that have only occurred as a result of the KiwiSaver scheme).<sup>65</sup> As the government borrows one dollar for each dollar it contributes to the scheme, the report found that KiwiSaver would be unlikely to increase national saving in a significant way. This may be because the nudge was designed through a process which does not prompt or allow full consideration of behavioural economics and nudges.

Within each KiwiSaver scheme there are different fund allocations ranging from low risk funds which hold cash and income assets, to those which hold higher risk growth assets. The automatic enrolment provisions enrol people in the ‘default’ fund allocation (termed the ‘conservative’ fund in some schemes). The default fund makes less risky investments than other funds available to KiwiSaver members, and so its returns are lower. The 2015 Treasury report on KiwiSaver found that the average 5-year return on default funds was 6.48% compared with 10.73% in growth funds.<sup>66</sup> The underlying idea is that the default fund is a short term fund designed as a platform from which the scheme member can then elect the fund which best reflects their risk profile. However, this fails to account for the inertia of many scheme members who will remain in the default fund regardless of whether or not it is in their best interests. New Zealanders who are just starting in the workforce or who otherwise do not want to withdraw their KiwiSaver for many years are in general far better off joining a growth or aggressive fund. The automatic enrolment nudge fails to recognise this, and so New Zealanders are missing out on the higher returns that would result from automatic enrolment in a growth fund. This is almost a direct result of the nudge being designed through an inappropriate framework.

Commentators have identified this problem before, and the current government is likely to be aware of it.<sup>67</sup> That the government has not yet taken any action to remedy the nudge may be the result of political conservatism. That is, there is the potential for aggressive or growth funds to tank in the event of a major financial crisis. Politicians may not want to nudge people into

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<sup>65</sup> At 3.

<sup>66</sup> *Review of the KiwiSaver Fund Manager Market Dynamics and Allocation of Assets* (New Zealand Treasury, September 2015) at 5.1.

<sup>67</sup> See Craig Simpson “Our Comprehensive Review of KiwiSaver Default Fund Performance to March 2016, identifying who had the best long-term returns” (April 13, 2016) Interest <[www.interest.co.nz](http://www.interest.co.nz)> and “KiwiSaver problem with default option” First Financial Limited <<http://www.firstfinancial.co.nz>>.

taking reasonable risk. There would be a large political backlash if people were nudged into growth funds, and then lost everything in an unpredictable financial downturn.

Reviewing the materials available to the government when designing the KiwiSaver scheme reveals an incomplete or rudimentary understanding of the impact of a default rule. The literature review completed by the US Tax Policy Centre for the New Zealand Inland Revenue Department recognised that there is a significant increase in participation in superannuation schemes when participation is opt-out rather than opt-in.<sup>68</sup> It did not however mention any of the behavioural science behind this phenomenon such as inertia or status quo bias, and indeed neither did the relevant RIS. The Officials' Report on the KiwiSaver bill specifically discusses inertia and references overseas studies outlining the benefits of an opt-out scheme.<sup>69</sup> The fleeting consideration of the underlying science leads this author to believe that it is unlikely that the New Zealand government understood that the automatic enrolment provision was nudging (especially since *Nudge* was not published until two years later). If inertia had been outlined and understood as the underlying science, policy makers may have applied it to the fund allocation part of the scheme. This likely would have led to better overall results. In other words, the design of the KiwiSaver scheme would have benefitted from a regulatory impact analysis which incorporated a behavioural science and economics model.

(c) Choice architects are human

Secondly, there are significant concerns around the role that lawmakers, policy makers and regulators have in the decision to employ a nudge to achieve a policy goal.<sup>70</sup> How are lawmakers less subject to bounded rationality or otherwise erratic behaviour than those that they are trying to regulate? Policy makers and those completing regulatory impact analyses should themselves be neutral in their risk assessment and comparisons between different regulatory options. Given its recent academic popularity, policy makers may unreasonably favour nudging over more traditional (but in the circumstances, objectively more effective) methods of pursuing policy goals. Furthermore, fervent proponents of nudging may be sluggish

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<sup>68</sup> *Final Report to Inland Revenue 'KiwiSaver Evaluation Literature Review'* (US Tax Policy Centre, December 2006) at 10.

<sup>69</sup> *Inland Revenue Officials' Report on the KiwiSaver Bill* (26 June 2006) at 5-6.

<sup>70</sup> See the prolonged discussion in Cass Sunstein "Nudging and Choice Architecture: Ethical Considerations" *Yale Journal on Regulation* (Forthcoming) at 25.

in accepting ideas of welfare or conceptualising preferences which are not immediately obvious to them, or which they do not believe in. This problem is likely unavoidable, is not unique to nudge design and will be present in any policy design team. Timothy Irwin from Sapere Research Group motions that a list of ‘de-biasing’ questions should be answered at some stage during the design process.<sup>71</sup> This would arguably be best placed near the conclusion of the regulatory impact analysis.

## 2 *Opt Out Costs*

By definition, it must be cheap and easy for the nudgee to avoid the nudge. It is unclear what this means in practice for a number of reasons. First, the definition assumes a level of “competence, rationality and volitional control” on the part of the nudgee.<sup>72</sup> That is, the nudgee must have some sense of their true preferences and be able to navigate the system sufficiently in order to opt out of the nudge (if that is their preference). The assumption of rationality is antithetical to the behavioural economic model which is the foundation of the Nudging theory. Opting out of a superannuation scheme via a checkbox on a webpage may seem simple enough, but it is difficult for those who do not have internet access, or cannot otherwise work a computer.<sup>73</sup> Similarly, if the information regarding opt-out is unclear or complex then there will be a certain percentage of people who cannot opt out. The KiwiSaver opt-out may fit this description. A person cannot opt-out of KiwiSaver in the first two weeks following their automatic enrolment.<sup>74</sup> After this initial two weeks, one then has a six-week period to complete a form to opt out.<sup>75</sup> If one wishes to opt-out after their six week period has lapsed, then they can apply for a late-opt out in certain circumstances.<sup>76</sup> This process, particularly the two week delay before one can opt out arguably renders the nudge difficult to avoid.

Essentially, if for whatever reason a person cannot opt-out or avoid the nudge, they are essentially subject to the whims of the relevant choice architect. Therefore, the requirement that a nudge be ‘cheap and easy to avoid’ is potentially too subjective a standard, and it does

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<sup>71</sup> Timothy Irwin “Implications of behavioural economics for regulatory reform in New Zealand” (December 2010) Sapere Research Group Limited at 64.

<sup>72</sup> Robert Baldwin, above n 33, at 847.

<sup>73</sup> See similar examples at 848.

<sup>74</sup> KiwiSaver Act, s 16.

<sup>75</sup> Section 16.

<sup>76</sup> Section 18.



not sufficiently take into account the differing levels of rationality and resources that people possess to take advantage of the opt-out. A reform process which accommodates nudging should bring the level of opt out costs to the policy maker's attention.

Second, Robert Baldwin discusses the concept of an 'aggregation of nudges'.<sup>77</sup> Though each individual nudge may be small or insignificant, the aggregate weight of many nudges may be large. The separate opt-out costs may therefore be small, but the total costs of opting out may be large. This large cost of avoiding the aggregate nudges is antithetical to the concept of libertarian paternalism itself. A situation in which citizens are unable to navigate through their lives as they wish due to an inundation of nudges is problematic. Such a system is not libertarian paternalism – it is more akin to plain paternalism. This begs the question of how a government that uses nudge as a governance tool can ensure that the cumulative effect of nudges on any one citizen is not too great. Is there some critical mass of nudges in any one context which could be deemed unreasonable to impose? This issue could be dealt with during the law reform and regulatory design process, as will be discussed below.

### 3 *Threat to Autonomy?*

Implicit in the discussion above is that nudges pose a threat to autonomy. Nudges work on the automatic responses of individuals, that is, people may be influenced to act in a particular way without being aware of it. This is a pertinent issue when the nudge causes someone to pursue a course of action inconsistent with their true preferences. Regardless of whether or not the nudgee believes that they are better off after the nudge, they could rightly complain that the State should not be attempting to subtly prey on the automatic responses of its citizens without their knowledge or consent.

In response, Cass Sunstein has pointed out that choice architecture is unavoidable (i.e. there are always nudges from various aspects of society). Therefore it is pointless to oppose the government engaging in choice architecture as well.<sup>78</sup> If the government does not implement nudges, then the private sector will. The difference is that nudges from the private sector will not attempt to make the individual better off, rather its aim is likely to be to maximise profit, potentially to the detriment of the nudgee. If choice architecture is truly unavoidable, then the

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<sup>77</sup> Robert Baldwin, above n 33, at 847.

<sup>78</sup> Sunstein (2015), above n 14, at 118.

best society can do is ensure that the processes through which nudges are instituted are robust, considered and potentially transparent. This provides strength for the proposition that New Zealand's law reform and regulatory design processes must be reviewed in light of cognitive insights.

**B Dishonest Governance?**

As put by Ryan Calo from the University of Washington Law, “[a] frequent observation made about behaviourally informed regulation is that it does not amount to ‘law’”.<sup>79</sup> He explains further:<sup>80</sup>

The messages and techniques designed to drive behavioural change (for example, a pair of black lungs on a cigarette packet) are ‘devoid’ of traditional legal significance as to their intended purpose, i.e. they do not apparently involve the exercise of authoritative power.

In an ideal world, governments would pass laws and regulations which are transparent and consistent with the rule of law. Such a law may be a prohibition of behaviour X, and so citizens understand that the government is attempting to stop people from engaging in behaviour X, as it is not socially desirable. Alternatively, the law or rule might be an incentive scheme to encourage behaviour Y. Again, citizens understand that the government believes that behaviour Y is socially valuable and worth engaging in. If a government passes a law banning the sale of good Z, then that is in the public domain, it is a topic for debate, and citizens can ask the government to defend why it has instituted such a rule. The same cannot be said of most nudges. The very nature of a nudge is that it is covert and operates on people's subconscious or automatic reactions. This means that it is not easy for people to ascertain what behaviours the government is attempting to encourage or prohibit. Many people will be uneasy with the notion that a government is trying to invoke behavioural change without openly stating what change they desire and what the underlying policy is. This will likely be the case regardless of whether or not the nudge has benevolent ends. Thaler and Sunstein recognise this in *Nudge*, motioning that the main objections with nudges arise because they can be “invisible and thus impossible to monitor”.<sup>81</sup> As such, the concern here is not primarily with nudges established by statute and regulation. Instead, the principal issue lies in nudges that are the product of an administrative

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<sup>79</sup> Ryan Calo “Code, Nudge or Notice?” (2014) 99 Iowa L Rev 773 at 805.

<sup>80</sup> At 805.

<sup>81</sup> Thaler and Sunstein, above n 6, at 246.

decision and consequently are far less visible to someone attempting to discern government policy and influence over society.

However, even nudges introduced by regulation may be seen as dishonest or otherwise not transparent. To reprise the KiwiSaver example, suppose that government policy is to increase long-term national saving. A statutory provision describing the default enrolment and opt-out process is less transparent than a statutory provision mandating compulsory saving. People can readily ascertain the purpose of the mandate, to increase national saving. However, ascertaining the purpose of a default rule is almost impossible without having the underlying science explained as well. As such the policy or behaviour that the government wants to encourage is far less clear with a provision concerning a default rule than a simple mandate.

If the general public is aware that the government is using cognitive insights to effect behavioural change, then that would arguably allay some fears that nudge opponents have. Since 2010, the Behavioural Insights Team (or 'Nudge Unit') in the United Kingdom have been using behavioural insights in an attempt to make public services simpler and more cost-effective. The Social and Behavioural Sciences Team in the United States undertakes a similar role. These are government agencies dedicated to helping people make better decisions for themselves (though the Nudge Unit in the UK has been partly privatised in order to commercialise its services). New Zealand does not yet have a similar dedicated department or agency. If a comparable agency existed, this could raise nationwide awareness of the use of nudge in general. Knowledge that the government is actively using nudging would make this type of governance more honest, especially if nudges are simply the result of administrative decisions not put before the House. Such an agency or department could publish reports and the results of their work, which would at least in retrospect allow citizens to try hold the government to account. If public knowledge of the use of nudging makes it a less dishonest practice, presumably there would be no issue with the use of behaviourally informed tools if a government had openly campaigned on their use, and was subsequently voted in on that premise.

The government already uses advertising campaigns to try and manipulate public behaviour. There have been campaigns against domestic violence and drink-driving in recent years, all of

which aim to shock the public and appeal to their automatic reactions and emotions.<sup>82</sup> There is an interesting question concerning how this kind of advertising differs from a nudge. Perhaps the difference is that people do not consider such advertising to be behavioural manipulation. Or perhaps it is the universal agreement that domestic violence and drink-driving are undesirable, and so behavioural manipulation is therefore justified to prevent them. Possibly it is because these are seen as ‘cultural problems’ which can only be solved through behavioural manipulation. The authors of “Nudging Legally” suggest that it is the presumption of altruism on the part of the government which renders such emotive campaigns acceptable and not dishonest in the eyes of the public.<sup>83</sup> This is probably too idealistic a view of the trust that New Zealanders have in the government.

People are subject to nudges (or similar devices) in the private sector. Private sector nudges are not necessarily transparent or honest, but people ultimately presume the fundamental objective of the nudge is not to make the nudgee better off as judged by themselves, but to increase sales and maximise profit for the corporate. This suggests that people may be uncomfortable with a governmental nudge or choice architecture when they are unsure of its ultimate aim. Put differently, people are happy to assume the worst of corporate nudges (i.e. that they are profit maximising), but are probably reluctant to assume the best of government nudges (i.e. that they are benevolent).

### ***C Do Nudges “typically work better in the dark”?***

Nudges are inherently opaque. If they are the product of a pure administrative decision, they will not go through the same rigorous regulatory impact assessment process or public consultation as those instituted by law or regulation. Instead, they can be implemented on a day-to-day basis, and only scrutinised if subject to an Official Information Act request. This may work to the nudge’s advantage however. As put by Luc Bovens, nudges “typically work better in the dark”.<sup>84</sup> He considers two of the prominent nudges suggested by Thaler and Sunstein:<sup>85</sup>

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<sup>82</sup> See the New Zealand Transport Agency’s campaign at <[www.nzta.govt.nz/safety/driving-safely/alcohol-and-drugs/drink-driving-advertising](http://www.nzta.govt.nz/safety/driving-safely/alcohol-and-drugs/drink-driving-advertising)>.

<sup>83</sup> Alemanno and Spina, above n 1, at 447.

<sup>84</sup> Luc Bovens “The Ethics of Nudge” as Chapter 10 in *Preference Change: Approaches from philosophy, economics and psychology* (Springer, Heidelberg, 2009) at 10.3.

<sup>85</sup> At 10.3.

If we tell students that the order of the food in the Cafeteria is rearranged for dietary purposes, then the intervention may be less successful. If we explain the endowment effect to employees, they may be less inclined to Save More Tomorrow. And even if we try to affect our own behaviour by means of these mechanisms, then our efforts will be most effective when our knowledge of having done so is latent (or when we are simply able to forget).

Nudges act on the subconscious. Therefore, being conscious of nudges may counteract any effect they may have. A transparent nudge is a nudge with its underlying purpose, as well as the methods through which behavioural change is attempted is disclosed or otherwise readily ascertainable by the nudgee. If we assume that transparent nudges are less effective than opaque nudges, what implications does that have how they are considered in law reform and regulatory design? Is it preferable to have transparent Nudges which are less effective, or opaque nudges which work well?

Fortunately, this question may not have to be answered and no balance between the two struck. Academics from the University of Hamburg recently conducted an experiment to consider whether transparent nudges are still effective.<sup>86</sup> The experiment concerned contributions to carbon emission reduction. The researchers introduced a default amount to contribute (attempting to exploit status quo bias and inertia). They tested how different levels of transparency influenced the efficacy of the nudge. There were five groups tested. There was one control group who did not have the nudge. The second group was given just the nudge. A third was given the nudge and information about the potential influence of the default. A fourth was given the nudge and the purpose of the default. A fifth was given everything.<sup>87</sup> The results found that the default rule did increase contributions, as would be expected. Importantly, the experiment also found that the provision of the information or purpose (or both) had no significant effects. They concluded that “providing the ‘most transparent form of the nudge’ neither has advantages nor disadvantages with respect to the other types of transparency (including no transparency at all).”<sup>88</sup> In short, the nudge’s efficacy was unaffected by how

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<sup>86</sup> Hendrik Bruns, Elena Kantorowicz-Reznichenko, Katarina Klement et al “Can Nudges be Transparent Yet Effective?” (2016) WiSo-HH Working paper series, paper no 33.

<sup>87</sup> At 9.

<sup>88</sup> At 13.

transparent it was. Though this is only one laboratory experiment, it could be a useful building block on which further assumptions can be made about nudges. Further experiments would be required, despite that people act slightly differently in laboratory experiments than in real life.

If transparent nudges are still effective, there is no reason to conceal any consideration of nudges in the regulatory design process or other governmental publications. Therefore departments should always make any discussion of a nudge as a potential option explicit and open, as is discussed below. Even if nudges did ‘work better in the dark’, it is difficult to mount a strong argument that the increased efficacy of a nudge should trump the transparency and accountability of government. The gains from transparent governance far outweigh any marginal gains to be had from nudging in the dark. A New Zealand example of a transparent nudge is the plain packaging of tobacco products (nudge described above). People understand the purpose of the provision. It is to reduce smoking rates in New Zealand. Given that the number of New Zealanders who smoke has only decreased 3% since the introduction of the nudge may suggest that this has not worked. Whether or not this is a direct result of the nudge being transparent is almost impossible to tell.

#### *V Accommodating Behavioural Economics and Nudge within New Zealand’s Law Reform and Regulatory Design Processes*

New Zealand’s law reform and regulatory design processes should be altered to firstly, incorporate behavioural economic models, and secondly mitigate any fears that people have with governmental use of nudges. As has been illustrated above, an increasing number of government departments and other policy makers are prepared to incorporate the results of behavioural research in regulatory and policy design. Translating this into actual workable instruments has proven to be a far more difficult task. As put by Alemanno and Spina:<sup>89</sup>

Policy makers...lack a clear framework enabling them to incorporate those insights. Once an administrative agency embraces a behavioural approach towards regulation, the question arises about how to turn the plentiful empirical findings about human behaviour into operational regulatory tools.

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<sup>89</sup> Alemanno and Spina, above n 1, at 440.

The various examples discussed throughout this paper have their limitations and failings, and could have been more effective had the process they were developed under accommodated behavioural economics and nudges. A complete and comprehensive reform proposal is outside the scope of this section. Instead, it intends to make the case for change in various parts of the law reform and regulatory design process.

***A Incorporating Behavioural Economics into Law Reform and Regulatory Design***

If the neoclassical model paints an incomplete portrait of society and the human condition, then it is prudent to reflect this in New Zealand’s law reform and regulatory design processes. This is not to say that the neoclassical model is unhelpful or redundant, but rather that a complementary behavioural economic model might help policy makers design better rules for the nation. New Zealand has a relatively rigorous regulatory design process in place which can be altered to broadly accommodate new evidence of the human condition. To this end, the authors of ‘Nudging Legally’ propose that any law reform should:<sup>90</sup>

[C]onsider formalized behavioural mechanisms, such as default rules, disclosure requirements and simplification, at the pre-legislative and/or pre-rulemaking stage... could serve to accommodate in a more principled and consistent way these insights into policy-making while at the same time protecting them from possible abuses. In particular, it seems that the privileged framework for incorporating behavioural considerations into the regulatory process could be offered by regulatory impact assessment, as inclusive of RCTs [Randomised Control Tests]. Within this process of regulatory analysis, behavioural considerations may allow policy makers to not only consider a broader set of regulatory options and test their effectiveness through RCTs but also to empower citizens to have a say thus increasing the accountability of the regulatory outcome.

As with any sound regulatory proposal, substantial research should be engaged in ex ante implementation, and monitored ex post.

***1 The New Zealand Regulatory Impact Analysis Process***

In New Zealand, certain regulatory proposals must be accompanied by a Regulatory Impact Statement (*RIS*). Cabinet requires that the relevant agency produce a *RIS* for any proposal that contemplates options involving introducing, amending or repealing legislation, or is otherwise

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<sup>90</sup> At 453.

expected to result in a Cabinet paper. The RIS is a government policy document, as opposed to a Ministerial or Cabinet paper. In the Treasury's words:<sup>91</sup>

A RIS provides a high-level summary of the problem being addressed, the options and their associated costs and benefits, the consultation undertaken and the proposed arrangements for implementation and review.

These are prepared by the relevant department or the Treasury, and are published when the corresponding Bill is introduced to the House, or at the time of Ministerial Release.

The purposes of a RIS are broadly fourfold.<sup>92</sup> First, they provide a foundation for consultation with key stakeholders and other interested parties. Second, they assist the relevant department engage with Ministers, and therefore help to inform any subsequent policy decisions. Third, RISs inform Cabinet about the feasible options moving forward with the proposal, and the associated costs and risks of the preferred option. Fourth, they greatly enhance transparency and accountability in the policy decision making process. The public can scrutinise the information which helped form the basis of Ministerial decisions, and determine whether such a decision was reasonable, or indeed in the public interest.

In order to prepare a RIS, the relevant department undertakes a Regulatory Impact Analysis (*RIA*). The Regulatory Impact Analysis Handbook outlines the key components of a good RIA. A good RIA process is as follows:<sup>93</sup>

1. Describe the status quo (the anticipated situation in the absence of any additional government action);
2. Define the problem and assess its size;
3. Define the objectives of any Government action;
4. Identify viable policy options;
5. Analyse said options, taking into account their relative costs, benefits and risks;
6. Consult with interested parties and key stakeholders;

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<sup>91</sup> "Regulatory Impact Statements Information Release" (19 September 2016) New Zealand Treasury <[www.treasury.govt.nz](http://www.treasury.govt.nz)>.

<sup>92</sup> See "Regulatory Impact Statements" (21 September 2015) New Zealand Treasury <[www.treasury.govt.nz](http://www.treasury.govt.nz)>.

<sup>93</sup> *Regulatory Impact Analysis Handbook* (New Zealand Treasury, July 2013) at Part 2.



7. Conclude on what decisions are required, and what choices are available, outlining a preferred option;
8. Consider how the preferred option would be implemented; and
9. Establish a plan for monitoring, evaluating and reviewing the regulatory changes over time.

The result and reasoning of the RIA is effectively summarised in the RIS published alongside Cabinet proposals. In light of newfound knowledge about cognitive biases and human decision making, the regulatory design process should evolve in two ways. It should first evolve in terms of problem definition and information gathering, and second in the evaluation and implementation of regulation. A regulatory design process without such considerations may insufficiently inform Ministers and other regulators as to the ‘full-picture’ or other consequences of any decision they make. They would potentially not consider the actual behaviour and reaction of the people subject to the proposed policy.

## 2 *Adapting RIA problem definition*

Problem definition in any RIA should identify the gap between the status quo and the outcome that the agency is aiming for.<sup>94</sup> For behaviourally informed matters, the problem definition aspect of the RIA should accurately capture and outline the nature and extent of any predictable cognitive errors relevant to the regulatory proposal. As it stands, the RIA Handbook cites externalities, imperfect competition, market failures and a lack of clear property rights as examples of problems to be defined.<sup>95</sup> These are essentially all failures that occur within the neoclassical economic model. Though agencies may in practice already take into account behavioural economic considerations, the Handbook should explicitly include internalities (such as cognitive errors) as genuine problems which can be defined. This would legitimise them as issues requiring a policy response, in line with the acceptance of behavioural economics as a distinct discipline. It may also prompt regulators to consider them even when not immediately obvious to the issue at hand.

The research process or recipe used to pinpoint cognitive errors as developed by early papers in behavioural economics could be translated into the law reform or regulatory design process.<sup>96</sup> Surveys and other consultation should be undertaken by the relevant law reform

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<sup>94</sup> At Part 2, 3.

<sup>95</sup> At Part 2, 3.2.

<sup>96</sup> See above at page 7.

agency to isolate relevant information about cognitive biases and heuristics. The relevant agency should employ cognitive science experts, perhaps behavioural economists or psychologists to assist with this process (assuming that behavioural scientists are not already part of the policy team). Furthermore pursuant to the Handbook, the reasons why cognitive errors will not be addressed within existing frameworks or by private arrangements should be explained, with assistance from experts.<sup>97</sup> This should not be difficult given that cognitive errors are internalities, and so cannot be fixed through the market.

This paper submits that cognitive based options such as nudging, or those which otherwise have behavioural economics underlying them (commonly called ‘cognitive based options’) should clearly be stated as a viable option within the RIA Handbook. The RIA Handbook requires the relevant agency to “identify the full range of policy options that may fully or partially achieve the stated objectives and thereby address the identified problem”.<sup>98</sup> The full range of policy options “should include both regulatory and non-regulatory options”.<sup>99</sup> The Handbook provides that options of varying levels of regulatory intervention are to be considered, perhaps a nod towards new governance methods.<sup>100</sup> Cognitive based options provide a stark alternative to typical command and control rules or incentive-based regulation. As non-regulatory options are already suggested in the Handbook, it would not be too much of a step to expressly name some of these options. Given the unprecedented rise of nudging techniques in the UK and US, it is prudent to clearly provide this as an option to New Zealand regulators in appropriate circumstances. Given its cost-efficiency, a nudge should almost always be one of the options on the table for policy makers. The cost of a nudge is the time and resources put into its design and subsequent monitoring, but there are few enforcement costs when compared with traditional mechanisms. Whether or not the nudge is in fact employed is ultimately up to the decision maker, but expressly providing it as an option is consistent with the overarching goal of transparent governance.

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<sup>97</sup> New Zealand Treasury, above n 93, at Part 2, 3.2.

<sup>98</sup> At Part 2, 5.

<sup>99</sup> At Part 2, 5.

<sup>100</sup> At Part 2, 5.

### 3 *Adapting evaluation and implementation in the RIA process*

In the RIA process, the relevant agency must examine the costs, benefits and risks of each option that they outline. Conventional cost-benefit analysis presumes that regulations “are good to the extent that they generate outcomes that people would choose”.<sup>101</sup> The problem with this presumption is that cognitive errors obscure regulators from uncovering people’s true preferences. Perhaps a good policy or standard for judging behaviourally informed regulation or non-regulatory options such as a nudge, is considering whether or not the option creates benefits to the less rational which exceed the costs imposed on more sophisticated, rational players. This is effectively an articulation of Kaldor-Hicks Pareto efficiency, a utilitarian theory.<sup>102</sup> In other words, if those who gain from the nudge could theoretically fully compensate those who are harmed (i.e. those who opt-out costs are imposed on) and remain better off, then the nudge is a beneficial option to pursue. One issue with this model is the difficulty of quantifying the costs and benefits of a tool like nudge. With a mandate or prohibition, one assumes the benefits come from almost 100% compliance. However, given that the nudge does not strictly *require* a course of action or prescribed behaviour, it will be difficult to estimate the potential net benefits. Furthermore, other than in the abstract, how are policy makers to quantify the ‘costs’ of imposing the opt-out on rational actors? Costs and benefits are likely to be framed in terms of ‘utility’. Given the inherent uncertainty of the efficacy of a nudge, policy makers may err on the side of caution. They would be anxious to avoid the inevitable political backlash that would result if a nudge failed, and it emerged that the net benefits were overestimated. Such a risk averse approach may inhibit the progression of nudges as a tool in regulation. Traditional forms of regulation are far easier to evaluate, and may be mistakenly preferred for this reason. However, it is possible that the lower administrative costs of a nudge may outweigh their uncertainty. This is ultimately an issue to be left for decision makers.

Incentive analysis plays an important role in the evaluation process. The Handbook states:<sup>103</sup>

The specific costs, benefits and risks may be difficult to identify, and could be more accurately described as positive or negative ‘impacts’. Where this is the case, the relative

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<sup>101</sup> Timothy Irwin, above n 71, at 54.

<sup>102</sup> Allan M Feldman “Kaldor-Hicks Compensation” in Peter Newman (ed) *The New Dictionary of Economics and the Law* (2<sup>nd</sup> ed, MacMillan, London, 2002) at 417-421.

<sup>103</sup> New Zealand Treasury, above n 93, at Part 2, 6.4.

effectiveness of alternative options may need to be assessed in terms of how parties' behaviour might change. Incentive analysis is one method of comparing each option with the status quo.

The above method implicitly assumes that relevant parties are rational, self-interested wealth maximisers who respond to incentives in accordance with the neoclassical economic model. The RIA risk assessment and analysis would be greatly enhanced by factoring in how various parties' behaviour might change given the predictable and documented cognitive biases and heuristics they may be subject to. It does not appear that departments currently consider the behavioural economic model alongside the neoclassical. For example, the plain packaging RIS displays some discussion of behaviour change, but with no reference to a behavioural economic model which would provide consistent framework.<sup>104</sup> Incorporating such a model would provide a framework for policymakers to consider behaviour change consistently among RISs. This broader lens through which human behaviour could be analysed

Policy designers are human, and so naturally may be subject to cognitive errors and biases during the option evaluation process. Including the de-biasing questions from Timothy Irwin's paper as part of the RIA process would help remedy the relevant errors.<sup>105</sup> These questions could be included near the end of RIA process, to be reflected upon once the analysis is complete. The question "are we likely to be giving too much weight to a problem because of its vividness or recent prominence in the media?" attempts to remedy availability heuristics. Asking "does the preferred option still look the best if we frame the choice differently?" attempts to mitigate the effects of contextualisation. Considering "are we overconfident in our judgments about the problem and the possible solutions?" aims to correct the optimism bias. All of these questions could potentially de-bias a policy designer who is overly enthusiastic about nudging given its recent popularity, and ensure that policy designers are neutral between their proffered options.

The inclusion of a complementary behavioural economic model would greatly assist regulators in designing behaviourally informed laws in an open and transparent manner. For example, if

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<sup>104</sup> Ministry of Health *Regulatory Impact Statement: Plain Packaging of Tobacco Products* (28 March 2012) at [22].

<sup>105</sup> Timothy Irwin, above n 71, at 64.

a policy involves a default course of action or plan, then regulators should be required to consider inertia and the risk that people will not move from that default even if it is in their best interests to do so. The Handbook could outline a list of known cognitive biases (including, but not necessarily limited to those discussed in this paper) which the policy designer would explicitly have to consider. This is expanded upon below.

#### 4 *Cognitive errors augmenting traditional regulatory strategies*

There is a case to be made for assisting regulators to employ the findings of behavioural science and economics to assist with traditional policy options. The RIA process and suggestions described above would adequately deal with crafting behaviourally-informed regulations and administrative decisions. However, not every piece of regulation is going to be primarily concerned with cognitive based regulation. The advent of new governance does not mean that all of the traditional regulatory tools such as mandates, prohibitions and economic incentive schemes are to be repealed and replaced. Instead, this paper submits that an understanding of cognitive errors can be used to augment traditional regulatory strategies to achieve optimal results. The inclusion of behavioural economics and science in the RIA Handbook as proposed above may prompt policy makers to consider new ways to solve complex problems. Two possible ways this could occur are outlined below.

##### (a) Reconsidering ‘command and control’

‘Command and control’ regulations proscribe certain actions and behaviours of citizens. These commonly take the form of mandates, prohibitions or bans. Opponents of command and control often complain that such an approach systematically leads to overregulation.<sup>106</sup> For example, a prohibition on certain drugs is detrimental to the person who can use them without becoming addicted.<sup>107</sup> If behavioural economics or some other cognitive approach is able to pinpoint a particular bias only affecting a certain portion of the market, that would point towards a blanket ban being unnecessary.<sup>108</sup> This would be relevant at the ‘problem definition’ stage of the regulatory design process.

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<sup>106</sup> Sabine Frerichs “False Promises? A Sociological Critique of the Behavioural Turn in Law and Economics” (2011) 34 J Consum Policy 289 at 301.

<sup>107</sup> Jan Schellenbach “A Constitutional Economics Perspective on Soft Paternalism” (23 October 2015) Social Sciences Research Network <[www.ssrn.com](http://www.ssrn.com)> at 12.

<sup>108</sup> See the discussion along similar lines in Di Porto and Rangone, above n 42, at 7.

## (b) Disclosure

Information asymmetry creates inefficiency. In some circumstances, one party may have far more information about the nature of a transaction or situation than the other, and will use that to their advantage. Many regulatory regimes attempt to remedy such information asymmetries by requiring disclosure on the part of one agent to another. The costs of disclosure can be small, but the benefits large. With full information, it is assumed that the economic agents will be able to make the best decision they can based on that information. The primary weakness of disclosure models is that they in fact make this assumption.

In other words, regulatory regimes centred around disclosure often fail to consider that the disclosure of information does not necessarily mean that the information is used.<sup>109</sup> Complex or opaque screeds of information may dissuade people from participating, or it may confuse them (c.f. the consumer credit example above). The disclosure of too much information increases transaction costs and creates inefficiencies, even if search costs are now much lower. Disclosure should be clear, simple and salient to its target audience. New Zealand policy designers need to design disclosure regimes bearing this in mind. Regulation of this kind has already been introduced in New Zealand. For example, in a financial markets context, issuers are required to provide Product Disclosure Statements (outlining details of an offer of financial products) before or at the time the offer is made.<sup>110</sup> This ensures that the information is salient. There are also regulations prescribing the form and nature of the enclosed information to enhance accessibility.<sup>111</sup>

The CCCFA reform (discussed above) could have benefitted from such an approach. When the Act was initially passed in 2003, it effectively accepted that disclosure of the relevant information implied use. It was not until a decade later that responsible lending obligations were introduced to ensure that the information was in fact used. Prompting consideration of the behavioural economic approach to disclosure would help regulators avoid a similar failing in the future.

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<sup>109</sup> At 8.

<sup>110</sup> Financial Markets Conduct Act 2013, s 50(2).

<sup>111</sup> Section 61.

## 5 *Adapting Disclosure Statements*

Disclosure statements should be reviewed to ensure that they sufficiently accommodate the advent of cognitive errors as a key driver behind certain legislative changes. Disclosure statements are departmental documents that provide information about the specific features and developmental processes of a piece of proposed legislation.<sup>112</sup> In order to ensure that governmental policies are implemented in legislation that is “robust, principled and effective” In June 2013, Cabinet agreed to trial disclosure statements, while legislation making them compulsory is introduced.<sup>113</sup> They are expected to become a part of the overall law reform process under the Legislation Amendment Bill (currently before the House). The purpose of disclosure statements is to:<sup>114</sup>

- Bring attention to specific features of a piece of proposed legislation and/or the key processes through which it was developed and tested;
- Make this information publicly available in an accessible and cost-effective way; and
- Thereby facilitate greater and more effective scrutiny of that legislation by Parliament and the general public.

A disclosure statement outlines questions that must be answered about the content and development of the proposed legislation. These are generally framed in a yes/no format. If the answer to a question is ‘yes’, then further information relating to that question must be disclosed. A disclosure statement comprises four components, a general policy statement, background information and policy information, testing of legislative content and significant legislative features.<sup>115</sup>

Information about the use of cognitive science should be disclosed in the interests of transparency, especially since such provisions are inherently opaque. It is not immediately clear what the best manner to include this in disclosure statements would be in practice. One option may be to insert an explicit question along the lines of “Does the bill seek to remedy, bypass

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<sup>112</sup> *Disclosure Statements for Government Legislation: Technical Guide for Departments* (New Zealand Treasury, June 2013) at 3.

<sup>113</sup> Cabinet Office Circular “Disclosure Requirements for Government Legislation” (4 July 2013) CO (13) 3 at 3.

<sup>114</sup> New Zealand Treasury *Disclosure Statements for Government Legislation: Technical Guide for Departments*, above n 112, at 3.

<sup>115</sup> At 5.

or exploit predictable cognitive errors recognised by behavioural science?” This question would capture all types of behaviourally-informed provisions. This would best be placed in Part 3 of the statement, which is labelled ‘testing of legislative content’. It would not be appropriate to place it in Part 2 given the content and nature of Part 2 questions, which are inherently legal. For example, some Part 2 questions ask whether the legislation allows the compulsory acquisition of private property, is retroactive, or provides civil or criminal immunity.<sup>116</sup>

However, the introduction of a distinct behavioural science/cognitive error question may be unnecessary. Any relevant discussion could be discussed in Question 3.7. Question 3.7 asks “Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill’s provisions are workable and complete?” The emphasis on testing is to reduce the risks of unintended consequences arising. Given that the underlying assumptions on whether or not the hypothetical Bill will achieve its policy objectives lie in cognitive science, this may be an appropriate question within which to outline if any cognitive errors have been tested, what the outcomes were, and how these are reflected in legislation. If the concern is that government is using behavioural science covertly, then an explicit question is preferable to ensure that an agency must discuss their use of cognitive errors and cannot avoid such a discussion. Like with RISs, the inclusion of this information may be ineffective at informing the public of governmental use of cognitive science if everyday citizens do not actively engage with disclosure statements.

### ***B Mitigating Fears of Nudging***

Many decisions to nudge are administrative decisions and are thus opaque and lack accountability to an extent. The goal of the nudge, the behavioural change desired, is often not made explicit (or at least as explicit as a mandate or prohibition). These fears among others can be alleviated by altering the law reform and regulatory design process to ensure nudges are openly discussed and designed carefully. In theory, RISs increase the transparency of the law making process, and encourage the participation of citizens and other interested parties in said process. Open consideration of nudging is beneficial for the transparency and accountability of government, and as discussed above, is unlikely to reduce the efficacy of the nudges.

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<sup>116</sup> At 50-74.



### *1 Establishing a nudge register*

A publically accessible nudge register could be established. If any public sector agency or department employed a nudge, the agency would be required to register it. They would enter details of the nudge's purpose and a brief summary of the behavioural science behind it. The principal purpose of the register would be to increase the transparency of government action and influence. This is especially useful since not all nudges are implemented through regulations or statutes, as some nudges are simply the product of an administrative decision. These nudges would not have the benefit of the open and robust consideration provided by the RIS and disclosure statement processes, and the nudge register seeks to mitigate any harm of this. The State Services Commission could potentially be the entity charged with maintaining the register and ensuring compliance. The State Services Commission (or a future New Zealand Behavioural Insights Team) could also publish a 'Nudge: Best Practice' set of guidelines. These would include similar information and considerations regarding nudge design as that proposed above for the RIA process. The guidelines' purpose would be to assist regulators who implement nudges through an administrative decision, and to ensure that non-regulatory nudges are of a similar quality to regulatory nudges.

One issue with the register would be definition. If nudging or choice architecture occurs all the time, what happens if a decision maker does not realise they are nudging? To mitigate this fear, only second and third degree nudges should be required to be registered. These nudges attempt to actively influence or bias behaviour in a certain direction, and so the risk of any accidental nudging is reduced. This is also appropriate given that most of the concerns with nudging manifest in second and third degree nudges. Despite this issue, the establishment of a publically accessible nudge register would increase transparency of nudging and reduce 'dishonest governance'. It is not a complete fix to the above fears, but it is preferable to lodging an Official Information Act request as would be the status quo.

### *2 Categorisation in the RIS*

If a RIS does consider a nudge to be a viable option, the RIS should state whether it is a first, second or third degree nudge. If the suggested intervention is a second or third degree nudge, it should be less desirable (or riskier) to implement than a first degree nudge, which are relatively inoffensive to one's autonomy. Logically, the level of risk should share a positive linear relationship with the degree of nudge. The numerical categorisation of nudges should also appeal to government officials. Categorisation simplifies and standardises the nudge's

intrusion on individual autonomy for decision makers. It provides a clear signal to the decision maker and interested parties as to the consequences for liberty and autonomy. It further provides decision makers with a system of comparability between the effects of one nudge with another. Categorisation should introduce some structure and make justifying the nudge as an option simpler for those creating the RIS. This approach could introduce some definitional issues however. There are commonly accepted definitions of the differing degrees of nudge, but no bright line tests. As categorisation is proposed as a tool to help organise the regulator's thinking, this is not a significant issue.

### *3 Identification of overlapping nudges and opt-out costs*

The RIA Handbook should be updated to instruct policy makers that where a RIS suggests a nudge as a possible or preferred option, it should identify other nudges which are likely to be operating in the same context. This is to prevent the overbearing 'aggregation of nudges' discussed above. Identifying overlapping nudges will allow policy makers to decide whether the cumulative opt-out costs are still cheap, and whether the total nudging is still 'easy to avoid'. Identification of the governmental nudges that operate in any one context would be assisted by the establishment and maintenance of a nudge register. It would otherwise be a relatively impossible task to collate all the relevant information. Deciding whether or not two nudges overlap is likely to be more of an art than an exact science. Ultimately, whether or not the aggregate opt-out costs are too large to justify implementing the nudge is for the relevant decision maker to resolve. However it is still in the interests of open and transparent government for an agency consider the overlap as part of their risk evaluation.

Even if there are no overlapping nudges, the evaluation should also prompt specific discussion of the opt out costs of a proposed nudge. Given that the 'cheap and easy to avoid' standard is potentially too subjective, the policy maker should carefully outline in the RIA and RIS how the nudge can be avoided, and whether or not there is a certain class of people who may find this difficult or impossible for whatever reason. The risk that people may not be able to opt out of the nudge should be factored into the desirability

### *4 Limitations*

Mere publication or disclosure of the use of nudges does not imply that the average New Zealander would be aware of them. Even if an examination of nudging options was published as part of RISs and other governmental publications, it is unlikely that the everyday New

Zealander would be aware of the government using such a technique. The average New Zealand does not peruse through every RIS. People would only know that nudges were pervasive in their lives if mainstream or social media outlets picked up the story. Furthermore, it may be that those who the nudge is attempting to help (the less rational, less ‘sophisticated’ members of society) would be unaware of the nudge register, or unable to comprehend what a nudge is. If a person is unable to comprehend their mortgage contracts, it is conceivable that they will be unable to fully comprehend nudge. Further, if they are cogent and interested enough to seek out the nudge register / relevant RIS in the first place, then it they may be more rational actors, and the nudge may not be particularly targeted at them in any case.

### ***C      Emphasis on a Complementary Approach***

This paper has consistently proposed that decision makers would be better placed to decide whether or not regulation is required to correct cognitive errors if the policy options put to them included carefully considered cognitively-informed options. It is conceivable that an RIA following this formula could in fact lead to less regulation overall. If the RIA and subsequent RIS recommends that no regulation is really needed, but instead cognitive strategies such as nudge are likely to be more effective (and cost-efficient) then regulation may be unnecessary. This has led commentator Dr Adam Oliver to coin nudging as ‘antiregulatory’.<sup>117</sup> Whether or not this is true likely depends on the manner in which the nudge is implemented: either as a product of regulation or through a pure administrative decision. This author considers that the better approach is to consider that nudges and other cognitive tools are useful complements to more traditional forms of regulation.

In a discussion of the various tools available to regulators and policy makers, each instrument is often analysed in a vacuum for ease of description and comparability. From a public policy perspective, such a conceptualisation of the contemporary regulatory toolbox is unhelpful. In certain circumstances, regulators can and should choose a mix of different tools when designing regulation and other instruments to achieve policy goals and effect behavioural change. In fact, they already do. Default rules, such as the automatic enrolment into KiwiSaver, are accompanied by another nudge in the information regarding opt-out. Further, the nudges in the tobacco industry (plain packaging and graphic health warnings) are complements to traditional command and control mechanisms where sales to minors are prohibited.

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<sup>117</sup> Adam Oliver “Should Behavioural Economic Policy Be Antiregulatory?” (2013) 22 Health Econ 373 at 375.

The ‘What’s My Number?’/Powerswitch example described above could potentially benefit from such an approach. The nudge could be complemented by a mandate. This mandate could prescribe that before any retail electricity supply contract was entered into online, consumers have to be given the option to use the ‘What’s My Number’/Powerswitch tool. As it stands, consumers have to actively seek out the tool (though they are encouraged by advertising). This would make the pricing information salient to consumers when they are in fact making an active decision to enter into a retail electricity supply contract

The authors of *Cognitive-Based Regulation, New Challenges for Regulators* posit that on occasion, different types of tools should be used “incrementally” to gradually increase the success of regulatory intervention.<sup>118</sup> A mixture of regulatory and non-regulatory options may in fact be the best way forward to achieve a policy goal. Given that some nudges will be administrative decisions only, it is vital that communication channels between Cabinet, and the department are open. If the communication channel remains open, then an administrative and low cost nudge could be implemented before the regulations or statutes complete the legislative process. This would be consistent with the ‘incremental’ approach above. A specific additional framework is probably unnecessary, but perhaps an inclusion in regulatory impact statements giving nudges as a potential complement to any regulatory or legislative action would perhaps push Cabinet to at least start the conversation.

## VI Conclusion

The advent of behavioural economics and nudge theory is certainly an exciting time for policy designers and regulators. The ability to implement policy instruments which are cost-efficient and compatible with the realities of human behaviour is something which should be embraced with open arms. To date, behaviourally informed regulation, statutes, and nudges have been introduced in New Zealand with varying levels of success. Nudging in particular has been the subject of much concern, with potential implications for the honesty, transparency and accountability of government. It is prudent to therefore review New Zealand’s law reform and regulatory design processes to ensure that first, they accommodate behavioural economic models and acceptance of cognitive errors, and second, minimise the transparency concerns that some have with ‘libertarian paternalism’ style government.

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<sup>118</sup> Di Porto and Rangone, above n 42, at 74.

This paper has not proposed any radical changes to the law reform and regulatory design process. Regulatory impact analyses should outline relevant cognitive errors as part of its problem definition, and should expressly include cognitive-based options when presented to decision makers. This is unlikely to affect their efficacy. Further, the way in which various policy options are evaluated should differ depending on the type of option it is. Cost-benefit analyses should be attempted through a different lens, with reference to Kaldor-Hicks efficiency. Disclosure statements could include a specific question about the use of cognitive science. Moreover, the establishment of a nudge register and categorisation of nudges would assist policy makers to organise their thinking, and simplify choices for decision makers.

The changes in the types of policy instruments favoured by regulators illustrates that policy design is a dynamic process. The process by which that policy is turned into workable legislative instruments should also be dynamic. It should be periodically reviewed to ensure that they accommodate all of the new tools provided by new governance, and provide all the available options to decision makers through a robust, thorough, and informed process. Behaviourally informed laws and nudges do have flaws, but as has been illustrated, these can be mitigated through the processes proposed by this paper.

**Word Count:** The text of this paper (excluding footnotes, bibliography and abstract) comprises approximately 14,826 words.

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