



Behavioural Economics and Complex Decision-Making

Implications for the Australian Tax and Transfer System

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Key Points

Many aspects of observed human decision-making differ from the ‘rational’ behaviour assumed in economic models. For example:

- People are much more concerned about possible losses than possible gains
- People are inclined to stick with the status quo
- People dislike uncertainty
- People value fairness
- People sharply discount the future compared to the present

For all but the simplest of decisions, people generally do not attempt to find the optimal solution, but rather apply simple decision-making strategies:

- They stick with what they know
- They follow others
- They settle for something that is good enough, rather than searching for the best

The more complex the decision, the less well equipped people are to deal with it. As a result, people often make decisions which do not appear to be in their best interests:

- They procrastinate, putting off things such as saving for retirement
- They stick with the default option, even if it is not the best
- If a decision is too complex they may avoid it altogether
- People are readily confused, and prone to misleading advice

These issues tend to be particularly prevalent among the least well-off.

In the case of the Australian tax system:

- Most individual taxpayers use a tax agent, though it is costly to do so
- A large number of people fail to complete a tax return, even if they are entitled to a tax refund
- Welfare payments delivered through the tax system, such as the superannuation co-contribution, are likely to be missed by those who stand to benefit most

There is an opportunity to apply insights from behavioural economics, facilitated by advances in information technology and service delivery, to remove the burden of complexity from most individual taxpayers:

- Send people pre-filled tax forms. This would represent a default tax return, and those who accept it could avoid the expense of a tax agent
- Those with more complex affairs may still add additional information, and/or consult a tax agent

This approach can achieve significant behavioural change at minimal cost, and reduce inequities in access to services and entitlements. This report reviews academic studies from economics, psychology and service delivery which provide the theoretical and empirical basis for these observations.

