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# **BEHAVIORAL LAW AND ECONOMICS: ITS ORIGINS, FATAL FLAWS, AND IMPLICATIONS FOR LIBERTY**

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## BEHAVIORAL LAW AND ECONOMICS: ITS ORIGINS, FATAL FLAWS, AND IMPLICATIONS FOR LIBERTY

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**ABSTRACT**—Behavioral economics combines economics and psychology to produce a body of evidence that individual choice behavior departs from that predicted by neoclassical economics in a number of decisionmaking situations. Emerging close on the heels of behavioral economics over the past thirty years has been the “behavioral *law and economics*” movement and its philosophical foundation—so-called “libertarian paternalism.” Even the least paternalistic version of behavioral law and economics makes two central claims about government regulation of seemingly irrational behavior: (1) the behavioral regulatory approach, by manipulating the way in which choices are framed for consumers, will increase welfare as measured by each individual’s own preferences and (2) a central planner can and will implement the behavioral law and economics policy program in a manner that respects liberty and does not limit the choices available to individuals. This Article draws attention to the second and less scrutinized of the behaviorists’ claims, viz., that behavioral law and economics poses no significant threat to liberty and individual autonomy. The behaviorists’ libertarian claims fail on their own terms. So long as behavioral law and economics continues to ignore the value to economic welfare and individual liberty of leaving individuals the freedom to choose and hence to err in making important decisions, “libertarian paternalism” will not only fail to fulfill its promise of increasing welfare while doing no harm to liberty, it will pose a significant risk of reducing both.

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### INTRODUCTION

Behavioral economics is one of the most significant developments in economics over the past thirty-six years. The field combines economics and psychology to produce a body of evidence that individual choice behavior departs from that predicted by neoclassical economics in a number of decisionmaking situations. These departures from rational choice behavior are said to be the result of the individual's "cognitive biases," that is, systematic failures to act in one's own interest because of defects in one's decisionmaking process. The documentation of these cognitive biases in laboratory experiments has been behavioral economics' primary contribution to microeconomics. These biases, behavioral economists assert, demonstrate systematically irrational choice behavior by individuals and firms. This irrational behavior, in turn, breaks the link between revealed preference and individual welfare upon which neoclassical economic theory depends.

Emerging close on the heels of behavioral economics over the past thirty years has been the "behavioral *law and economics*" movement, which explores the legal and policy implications of cognitive biases. The legal academy has widely disseminated the body of experimental evidence

documenting irrational behavior and is largely responsible for the behaviorists' foothold in regulatory policy circles,<sup>1</sup> in and out of the Obama Administration, and, more recently, the government of the United Kingdom as well. Behaviorist proposals include mandates requiring the supply of more or better information in an attempt to "debias" individual decisionmakers, altering legal default rules, and imposing "sin" taxes upon or even banning disfavored products.

Despite its remarkably broad scope, covering nearly every area of law and human behavior, the behavioral law and economics regulatory agenda reflects a common philosophical source—so-called libertarian paternalism. That seemingly oxymoronic phrase, coined by proponents Richard Thaler and Cass Sunstein, is intended to describe legal interventions that both (1) increase the individual's economic welfare by freeing him from the limitations of his cognitive biases and (2) change the individual's behavior without limiting his choices.<sup>2</sup> In other words, the promise of behavioral law and economics is to regulate so as to improve economic welfare by more closely aligning each individual's actual choices with his "true" or unbiased preferences without reducing his liberty, at least as it is represented by the choices available to him.

We agree with Thaler and Sunstein's implicit premise that the behavioral law and economics enterprise is properly evaluated by how successfully it solves this constrained optimization problem of maximizing welfare while respecting liberty. The behaviorists' economic welfare claims have been questioned by economists and some law professors on a variety of disparate theoretical, empirical, and institutional grounds, but the behaviorists' claim that their proposed policy interventions do not entail a significant reduction in liberty and individual autonomy has been less scrutinized.

The full implications of the behaviorist regulatory agenda for liberty are the focus of our analysis. Those implications have not been fully appreciated at least in part either because legal scholars have excluded libertarian considerations from their regulatory calculus altogether or because they have accepted the behaviorists' conception of liberty as the

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<sup>1</sup> We refer to adherents of behavioral law and economics as "behaviorists," but their work is not to be confused with the "radical behaviorism" of John Watson and B.F. Skinner. See generally B.F. SKINNER, *SCIENCE AND HUMAN BEHAVIOR* (1953) (advocating a science of psychology focused upon external human behavior to the exclusion of consciousness and other internal phenomena); John B. Watson, *Psychology as the Behaviorist Views It*, 20 *PSYCHOL. REV.* 158 (1913) (defending the scientific study of human behavior).

<sup>2</sup> See Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 *U. CHI. L. REV.* 1159, 1161–62 (2003).

mere preservation of choices.<sup>3</sup> Alas, the behaviorists' libertarian claims fail on even these narrow terms. Nonetheless, as we show in Part IV, the behaviorists' narrow conception excludes the broader liberty interest in what Mill, Hayek, Sen, and others taught about the "process aspect of freedom."<sup>4</sup> We argue that so long as libertarian paternalism ignores the economic welfare and liberty value of allowing individuals the freedom to err, it will fail to achieve its goal of increasing welfare without reducing liberty and will pose a significant risk of reducing both.

In Part I we provide a brief history of the economics of irrational behavior and describe the research program of modern behavioral economics. In Part II we describe the major categories of cognitive biases documented in the behavioral economics literature. We also evaluate the robustness of those findings and their appropriateness for policy implementation in light of a variety of theoretical, experimental, and empirical critiques. In Part III we discuss the incorporation of behavioral economics into the legal academy and subsequently into policy discourse; document the remarkable intellectual distance between the regulatory interventions proposed by behaviorists in the legal academy and the policy interventions, if any, justified by existing theory and empirical evidence; and examine existing welfare-based critiques of behavioral law and economics. In Part IV we argue behavioral law and economics poses a significant and underappreciated threat to liberty. In Part V we analyze the present appeal and future prospects of behavioral law and economics in the legal academy.

## I. FROM BOUNDED RATIONALITY TO PREDICTABLY IRRATIONAL: A BRIEF HISTORY OF THE ECONOMICS OF IRRATIONAL BEHAVIOR

### A. *Irrationality and Economic Theory*

The neoclassical economic edifice is built upon the foundational assumption that economic agents—individuals as well as firms—are

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<sup>3</sup> Our analysis focuses upon Thaler and Sunstein's libertarian paternalism because their apparent commitment to "choice preservation" evinces a greater concern about liberty than do other behaviorists. For example, the "asymmetric paternalism" of Camerer prefers paternalism that "helps those whose rationality is bounded from making a costly mistake and harms more rational folks very little." Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211, 1254 (2003). This asymmetric paternalism makes no commitment to avoiding infringements upon individual autonomy. See *id.* at 1219 (focusing upon paternalism justified because the benefits of error prevention to irrational decisionmakers would exceed the harm imposed upon rational individuals). As discussed *infra* Part III.B, a number of behaviorist regulatory proposals would prohibit or tax certain products, reduce consumer choice, or otherwise reduce liberty. Thus, Thaler and Sunstein's libertarian paternalism represents a lower bound on the threat to liberty presented by the behaviorist regulatory agenda.

<sup>4</sup> See *infra* Part IV.A, in which we contrast the "process aspect of freedom," which is focused upon means, with the "opportunity aspect of freedom," which is focused upon ends.

rational maximizers. Indeed, within the model of “perfect competition,” economic agents do not make mistakes or commit errors of any kind. Sellers are homogenous. Transaction and information costs, including the costs of processing information required to make economic decisions, are zero. It follows that resources instantaneously flow to their highest valued use.<sup>5</sup>

That these assumptions are counterfactual is not a critique of price theory. After all, the model of perfect competition was not designed for the purpose of describing the competitive activities of economic agents. Indeed, as Harold Demsetz has pointed out, the neoclassical model has little to say about competitive activities at all and is better described as a model of “perfect decentralization.”<sup>6</sup> The purpose of the model was to demonstrate the relative efficiency of decentralized allocation of resources.

With the academic battle over the relative virtue of market versus governmental allocation of resources largely settled by the 1950s, economists devoted their efforts to extending the neoclassical framework to explain real-world phenomena observed in markets. Beginning with George Stigler’s *The Economics of Information*, economists began to consider the costs of obtaining and processing the information required for economic decisionmaking.<sup>7</sup> The cost of information and the roles of error and of irrational behavior in consumer decisionmaking also attracted the attention of Armen Alchian, Gary Becker, and Milton Friedman, who demonstrated that the tools of price theory were both consistent with and valuable for analyzing observed irrational behavior.<sup>8</sup>

While the price-theoretic framework was expanding to address irrationality from one direction, Herbert Simon offered insights from another, planting the seed of what would become the modern behavioral economics literature. Simon’s work began with the observation that humans do not possess the cognitive capacity to execute all the functions necessary to maximize their welfare; instead, human decisionmaking is better

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<sup>5</sup> See ARMEN A. ALCHIAN & WILLIAM R. ALLEN, *UNIVERSITY ECONOMICS* 114 (3d ed. 1972) (explaining that in the model of perfectly competitive markets, “no unexploited opportunity of trade remains to enable any person to reach still more preferred situations by revision of the allocation of goods”); FRANK H. KNIGHT, *RISK, UNCERTAINTY AND PROFIT* 76–87 (Cosimo, Inc. 2006) (1921). For the history and implications of the model of perfect competition, see George J. Stigler, *Perfect Competition, Historically Contemplated*, 65 *J. POL. ECON.* 1 (1957).

<sup>6</sup> Harold Demsetz, *The Theory of the Firm Revisited*, 4 *J.L. ECON. & ORG.* 141, 142 (1988).

<sup>7</sup> George J. Stigler, *The Economics of Information*, 69 *J. POL. ECON.* 213 (1961).

<sup>8</sup> See MILTON FRIEDMAN, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3, 3–16 (1953); Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 *J. POL. ECON.* 211, 220–21 (1950); Gary S. Becker, *Irrational Behavior and Economic Theory*, 70 *J. POL. ECON.* 1, 12–13 (1962).

explained by “satisficing” behavior.<sup>9</sup> He explained the role of mental shortcuts or “heuristics” in economizing upon limited cognitive capacity. This form of bounded rationality, as Simon described it, generated predictions for economic behavior by both individuals and firms that often differed from those offered by price theory.<sup>10</sup>

In the 1970s, psychologists Daniel Kahneman and Amos Tversky built upon Simon’s insights to generate an alternative to the rational choice model, which they called “prospect theory.”<sup>11</sup> Their work provided the intellectual foundation for the modern literature on behavioral economics. Based upon a series of laboratory experiments, Kahneman and his various co-authors identified departures from rationality and categorized these departures by attributing them to one of three sources of bias: “representativeness,” “availability,” and “adjustment or anchoring.”<sup>12</sup>

The modern research program of behavioral economics, which continues to use the approach introduced by Kahneman and Tversky, has proceeded largely along two lines. The first line has expanded the set of documented cognitive biases, cataloging the systematic departures from rational choice observed in experimental and field settings.<sup>13</sup> The second line of research has tested whether these biases, initially documented in experiments within a controlled laboratory setting, are generalizable to markets.<sup>14</sup>

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<sup>9</sup> Herbert A. Simon, *Rational Decision Making in Business Organizations*, 69 AM. ECON. REV. 493, 495 (1979); see also Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99, 99–100 (1955) (suggesting, based upon modern psychological insights, revisions to the traditional assumption of rationality in economic theory).

<sup>10</sup> See, e.g., RICHARD M. CYERT & JAMES G. MARCH, *A BEHAVIORAL THEORY OF THE FIRM* 10 (2d ed. 1992).

<sup>11</sup> Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 274–84 (1979).

<sup>12</sup> See, e.g., Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1329–36 (1990); Daniel Kahneman & Shane Frederick, *Representativeness Revisited: Attribute Substitution in Intuitive Judgment*, in HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 49 (Thomas Gilovich et al. eds., 2002); Kahneman & Tversky, *supra* note 11, at 265–73; Amos Tversky & Daniel Kahneman, *Availability: A Heuristic for Judging Frequency and Probability*, 5 COGNITIVE PSYCHOL. 207, 208–09 (1973); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY 3 (Daniel Kahneman et al. eds., 1982).

<sup>13</sup> For a recent review of the literature, see Christine Jolls, *Behavioral Law and Economics, in BEHAVIORAL ECONOMICS AND ITS APPLICATIONS* 115 (Peter Diamond & Hannu Vartiainen eds., 2007).

<sup>14</sup> Articles exploring the quantitative and other relevant differences between laboratory and market conditions with respect both to study results and to cognitive biases include, e.g., Michael S. Haigh & John A. List, *Do Professional Traders Exhibit Myopic Loss Aversion? An Experimental Analysis*, 60 J. FIN. 523 (2005) (discussing the sensitivity of laboratory results to market environments where competition, expertise, and learning might be expected to ameliorate any biases); Steven D. Levitt et al., *What Happens in the Field Stays in the Field: Exploring Whether Professionals Play Minimax in Laboratory Experiments*, 78 ECONOMETRICA 1413 (2010) (same); John A. List, *Does Market Experience Eliminate Market Anomalies?*, 118 Q.J. ECON. 41 (2003) [hereinafter List, *Market*

In a series of academic articles, Sunstein and Thaler,<sup>15</sup> individually and together, made significant contributions to what is now a vast literature documenting cognitive biases in a variety of laboratory settings and in some field experiments.<sup>16</sup> Sunstein and Thaler are best known for introducing the concept of “libertarian paternalism,” which they define as “an approach that preserves freedom of choice but that authorizes both private and public institutions to steer people in directions that will promote their welfare.”<sup>17</sup> Sunstein and Thaler distinguish libertarian paternalism from classic paternalist philosophies on the grounds that the former seeks to develop legal rules that encourage individuals to maximize their welfare as those individuals subjectively define it.<sup>18</sup> As discussed below, the concept of libertarian paternalism has served as a catalyst, facilitating the creation of a behavioral law and economics movement in the legal academy and beyond.<sup>19</sup> Sunstein and Thaler thus attempt to provide an intellectual link between the behavioral economics literature—mapping the conditions under which economic decisionmakers err—and a theory of when and how the government should regulate their errors.<sup>20</sup>

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*Experience*] (same); John A. List, *Neoclassical Theory Versus Prospect Theory: Evidence from the Marketplace*, 72 *ECONOMETRICA* 615 (2004) [hereinafter List, *Neoclassical Theory*] (same); and Uri Gneezy & John A. List, *Putting Behavioral Economics to Work: Testing for Gift Exchange in Labor Markets Using Field Experiments* (Nat'l Bureau of Econ. Research, Working Paper No. 12063, 2006) (same).

<sup>15</sup> Sunstein was formerly a law professor at the University of Chicago Law School and Harvard Law School and is currently Administrator of the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, which oversees the regulatory activity of the Executive Branch of the government. Thaler is an economist at the University of Chicago Booth Graduate School of Business.

<sup>16</sup> See, e.g., Timur Kuran & Cass R. Sunstein, *Availability Cascades and Risk Regulation*, 51 *STAN. L. REV.* 683 (1999); Cass R. Sunstein, *Moral Heuristics and Moral Framing*, 88 *MINN. L. REV.* 1556 (2004); Sunstein & Thaler, *supra* note 2; Richard H. Thaler, *Doing Economics Without Homo Economicus*, in *FOUNDATIONS OF RESEARCH IN ECONOMICS: HOW DO ECONOMISTS DO ECONOMICS?* 227 (Steven G. Medema & Warren J. Samuels eds., 1996); Richard Thaler, *Mental Accounting and Consumer Choice*, 4 *MARKETING SCI.* 199 (1985) [hereinafter Thaler, *Mental Accounting*]; Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 *J. ECON. BEHAV. & ORG.* 39 (1980) [hereinafter Thaler, *Positive Theory*]; Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving*, 112 *J. POL. ECON.* S164 (2004); Richard H. Thaler & Robyn M. Dawes, *Cooperation*, in *THE WINNER'S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* 6 (1992).

<sup>17</sup> Richard H. Thaler & Cass R. Sunstein, *Libertarian Paternalism*, 93 *AM. ECON. REV.* 175, 179 (2003); accord RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 4–6 (2008).

<sup>18</sup> See Thaler & Sunstein, *supra* note 17, at 175.

<sup>19</sup> See *infra* Part III.

<sup>20</sup> Thaler & Sunstein, *supra* note 17, at 179 (“Our goal here has been to defend libertarian paternalism, an approach that preserves freedom of choice but that authorizes both private and public institutions to steer people in directions that will promote their welfare.”).



*B. Behavioral Economics as a Theory of Errors*

As has long been observed, the assumption of rationality in price theory is not meant to characterize the actual decisionmaking process of economic agents.<sup>21</sup> Rather, rationality is a simplifying assumption made to render modeling of economic interactions among firms and consumers tractable and to harness the powerful mathematical tools of optimization. Therefore, if behavioral economics is to outperform price theory, its superiority must be proven by its greater predictive power, not merely by the assertion that its underlying assumptions are more “realistic.”

The behaviorists appear to embrace this challenge. The fundamental link holding together the various strands of behavioral economics—or behavioral decision theory, as it is sometimes called—is the identification of errors in decisionmaking, each of which is independently costly. Thus, behavioral economics research is overtly empirical. Behaviorists believe a market theory that incorporates “more realistic” psychological accounts of economic actors is a means of generating predictive power greater than that of economic accounts grounded in the assumption of individual rationality.

The first stage of the behavioral economics research program is best described as developing a comprehensive theory of errors. The theory-building exercise thus far has focused largely upon the effort to catalog circumstances in which economic decisionmakers appear systematically to depart from rational choice behavior.<sup>22</sup> The second step required to make the theory of errors relevant to policy is to map the conditions under which specific errors are more or less likely to affect decisions and then to generate estimates of the social costs imposed by those errors. This step is particularly important when the incidence of a particular decisionmaking error is context specific, unevenly distributed throughout the population, and likely to interact systematically with other errors. The third step is to compare the costs of any proposed corrective intervention against the social benefits produced by reducing the rate of error. At present, however, research in behavioral economics does not appear to have moved much beyond the first step.<sup>23</sup>

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<sup>21</sup> See FRIEDMAN, *supra* note 8, at 14 (“Truly important and significant hypotheses will be found to have ‘assumptions’ that are wildly inaccurate descriptive representations of reality, and, in general, the more significant the theory, the more unrealistic the assumptions . . .”).

<sup>22</sup> See Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards*, 90 MINN. L. REV. 1620, 1627–28 n.20 (2006) (“The dominant research program within behavioral decision theory, the heuristics and biases program, consists of a collection of robust empirical findings bound together by high-level concepts rather than an integrative theory that can predict how particular features of the mind and environment are likely to interact in particular cases . . .”).

<sup>23</sup> Some notable early efforts to craft a general theory of errors include Botond Köszegi & Matthew Rabin, *A Model of Reference-Dependent Preferences*, 121 Q.J. ECON. 1133 (2006), and Botond Köszegi & Matthew Rabin, *Reference-Dependent Risk Attitudes*, 97 AM. ECON. REV. 1047 (2007).

The lack of an integrative theory of errors has not discouraged ambitious attempts to leverage the biases documented in the first stage of the research program into specific regulatory applications.<sup>24</sup> Indeed, the mere identification of systematic decision errors leads behaviorists seemingly without hesitation to ask: How can government “correct” those errors with “choice architecture” or other forms of “libertarian paternalism?”

The minimum required to correct recurring and systematic errors is an accounting of their social costs and benefits. The behavioral law and economics literature exhibits a strong tendency to ignore the social benefits of error. At the same time, it tends to overestimate the social costs of errors or at least implicitly to assume the social benefits from reducing identified errors will be greater than the social costs of interventions aimed at correcting those errors.<sup>25</sup> This tendency explains the current condition under which “virtually every scholar who has written on the application of psychological research on judgment and choice to law has concluded that cognitive psychology supports institutional constraint on individual choice.”<sup>26</sup>

## II. IDENTIFYING COGNITIVE ERRORS AND KNOWING WHEN THEY ARISE

Although the literature documenting cognitive biases continues to develop, much of the behavioral law and economics agenda is based upon two well-documented and long-recognized categories of cognitive bias: contextualization effects and self-control errors. After describing these biases, we explain why the research underlying them is not as sound as behavioral economists claim.

### A. The Biases

1. *Contextualization Errors: Framing, Prospect Theory, and Endowment Effects.*—Contextualization errors are those departures from rational choice that arise from the context in which the individual makes his decision.<sup>27</sup> Biases of this type are frequently described as

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<sup>24</sup> See *infra* Part III.B.

<sup>25</sup> See *infra* Part II.B.

<sup>26</sup> Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165, 1166 (2003); see also Gregory Mitchell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence*, 91 GEO. L.J. 67, 73–74 (2002) (characterizing the policy prescriptions of behaviorists as relying upon the empirically false assumption that people uniformly suffer from certain cognitive biases).

<sup>27</sup> Gregory Mitchell, *Libertarian Paternalism Is an Oxymoron*, 99 NW. U. L. REV. 1245, 1255 (2005).

“framing effects.”<sup>28</sup> These effects are seen when an individual faced with an identical set of choices in different contexts makes different choices, thereby implying an underlying inconsistency in his preferences, denominated “preference reversals.”<sup>29</sup>

Kahneman and Tversky’s prospect theory is most commonly associated with framing effects. Prospect theory posits that decisionmakers evaluate and maximize expected outcomes not in isolation but rather relative to an initial reference point.<sup>30</sup> While this effect is uncontroversial, prospect theory adds the empirical observation that decisionmakers weigh losses from the reference point more heavily than gains, a phenomenon described as “loss aversion.” The key experimental finding of prospect theory is that individuals are, in many cases, reluctant to sell a good endowed to them when offered a sum greater than they are willing to pay to acquire the good.<sup>31</sup>

This “endowment effect” is the most celebrated, and certainly the most discussed, of the cognitive biases in the behavioral law and economics literature, in part because behavioral economists and legal scholars claim it as the most robust of the biases,<sup>32</sup> and in part because of its significant policy implications. The principal implication of the endowment effect is that the Coase Theorem does not apply,<sup>33</sup> and thus market transactions may not lead to an efficient allocation of resources, which in turn has implications for virtually every area of substantive law.<sup>34</sup> Legal scholars

<sup>28</sup> See Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1536–37 (1998).

<sup>29</sup> See, e.g., Richard H. Thaler & Amos Tversky, *Preference Reversals*, in THE WINNER’S CURSE, *supra* note 16, at 79, 79–81.

<sup>30</sup> Kahneman & Tversky, *supra* note 11, at 277–79. In this narrow sense, prospect theory implicates rational choice behavior. As discussed, however, the reference-dependent preferences against which economic agents maximize generally arise from a form of cognitive bias such as “loss aversion.”

<sup>31</sup> Thaler, *Positive Theory*, *supra* note 16, at 43–44; Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q.J. ECON. 1039, 1041–42 (1991).

<sup>32</sup> See, e.g., Samuel Issacharoff, *Can There Be a Behavioral Law and Economics?*, 51 VAND. L. REV. 1729, 1735 (1998) (“[T]he endowment effect is the most significant empirical observation from behavioral economics.”); Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, in CHOICES, VALUES, AND FRAMES 159, 170 (Daniel Kahneman & Amos Tversky eds., 2000) (describing the robustness of the endowment effect as “part of our endowment, and we are naturally keener to retain it than others might be to acquire it”); Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227, 1229 (2003) (“The endowment effect is undoubtedly the most significant single finding from behavioral economics for legal analysis to date.”).

<sup>33</sup> Cf. Elizabeth Hoffman & Matthew L. Spitzer, *Willingness to Pay vs. Willingness to Accept: Legal and Economic Implications*, 71 WASH. U. L.Q. 59, 99 (1993) (illustrating how a difference between a person’s willingness to pay to purchase a good and the price the same person is willing to accept to sell the same good could prevent Coasean bargaining); Jolls et al., *supra* note 28, at 1497 (“[A]n important aspect of law and economics is the Coase theorem, which says that the assignment of a legal entitlement will not influence the ultimate allocation of that entitlement . . .”).

<sup>34</sup> See Christopher Buccafusco & Christopher Sprigman, *Valuing Intellectual Property: An Experiment*, 96 CORNELL L. REV. 1, 13 (2010) (“Recognition of the systematic discrepancy between

have certainly not missed many opportunities to elaborate on these implications.<sup>35</sup> For example, they have relied upon failures of Coasean bargaining caused by the endowment effect to reexamine areas of property law,<sup>36</sup> tort law,<sup>37</sup> contract law,<sup>38</sup> and intellectual property.<sup>39</sup>

## 2. *Self-Control Problems: Hyperbolic Discounting and Optimism*

*Bias.*—The behavioral economics literature focuses upon two types of biases affecting self-control. The first involves systematic errors in decisions allocating resources over time. In other words, individuals place so much weight upon immediate gratification that they regularly make decisions they will later come to regret. Stable, time-consistent preferences require a constant exponential discount factor; hyperbolic discounting generates time-inconsistent preferences, sometimes described as present bias.<sup>40</sup> Rather than discounting the future exponentially, as is done when calculating present value, hyperbolic discounting entails placing an extremely high weight upon the present, after which future values decline exponentially.<sup>41</sup> Behavioral economists have relied upon hyperbolic discounting to explain a wide array of self-control problems, ranging from

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owner and purchaser valuations has caused legal scholars to reevaluate many areas of the law where Coasean bargaining has been influential.”); Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 112 (2002) (“The Coase Theorem fails to account for the fact that the initial allocation seems to create an endowment effect. When the endowment effect is at work, those who initially receive a legal right value it more than they would if the initial allocation had given the right to someone else.” (footnote omitted)).

<sup>35</sup> As of June 19, 2012, a search of the Westlaw Journals & Law Reviews (JLR) database reveals 1094 articles in legal periodicals referencing “endowment effect.” The same search on Google Scholar shows 1030 references in legal periodicals and court opinions. According to one legal scholar, a broader search for “endowment effect” or “status quo bias” revealed that the terms were referenced in only two legal periodicals in 1990 but in 373 by 2003. Korobkin, *supra* note 32, at 1229.

<sup>36</sup> See, e.g., William A. Fischel, *The Offer/Ask Disparity and Just Compensation for Takings: A Constitutional Choice Perspective*, 15 INT’L REV. L. & ECON. 187, 187 (1995); Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541, 1542–46 (1998).

<sup>37</sup> See, e.g., Jack L. Knetsch, *Biased Valuations, Damage Assessments, and Policy Choices: The Choice of Measure Matters*, 63 ECOLOGICAL ECON. 684, 684–85 (2007); Edward J. McCaffery et al., *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards*, 81 VA. L. REV. 1341, 1351–54 (1995).

<sup>38</sup> See, e.g., Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 630–33 (1998).

<sup>39</sup> See, e.g., Christopher Buccafusco & Christopher Jon Sprigman, *The Creativity Effect*, 78 U. CHI. L. REV. 31, 51–52 (2011) (arguing evidence of an endowment effect in experiments simulating intellectual property markets “undermine[s] the normative justification for an IP law structured around strong property rules”); Buccafusco & Sprigman, *supra* note 34, at 2–4.

<sup>40</sup> See Shane Frederick et al., *Time Discounting and Time Preference: A Critical Review*, in TIME AND DECISION: ECONOMIC AND PSYCHOLOGICAL PERSPECTIVES ON INTERTEMPORAL CHOICE 13, 24–26 (George Loewenstein et al. eds., 2003).

<sup>41</sup> See *id.*

overeating, to incurring excessive debt, to gambling and other forms of addiction.<sup>42</sup>

The second type of self-control error is optimism bias.<sup>43</sup> Behavioral economists have identified circumstances in which individuals appear to underestimate the likelihood of their experiencing a loss. Jolls, Sunstein, and Thaler describe optimism bias as “[a] common feature of human behavior” characterized by people tending to “think that bad events are far less likely to happen to them than to others.”<sup>44</sup> The tendency to underestimate the likelihood of a bad outcome leads decisionmakers to take on too much risk.<sup>45</sup> Accordingly, this bias is often blamed for an individual’s impulsive or high-risk choices that might indicate a lack of self-control.<sup>46</sup>

### *B. Empirical Shortcomings: Robustness and Data Interpretation*

While the experimental findings of cognitive biases are interesting, it does not necessarily follow that they are useful for policy purposes. One need not (and we do not) reject the existence of behavioral biases in order to raise doubts about the policy relevance of purely experimental results. A significant concern for the behavioral law and economics policy agenda is that biases documented in experimental settings may not prove robust when exposed to market institutions.<sup>47</sup> Indeed, as others have pointed out, many (but not all) of the behaviorists’ findings are fragile and disappear when exposed to market discipline and the profit motive, which create incentives

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<sup>42</sup> See, e.g., Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1375 (2004) (relying upon hyperbolic discounting to explain why people incur extensive credit card debt); Jonathan Gruber & Botond Köszegi, *Tax Incidence When Individuals Are Time-Inconsistent: The Case of Cigarette Excise Taxes*, 88 J. PUB. ECON. 1959, 1960 (2004) (using hyperbolic discounting to explain cigarette smoking); Deborah M. Weiss, *Paternalistic Pension Policy: Psychological Evidence and Economic Theory*, 58 U. CHI. L. REV. 1275, 1275 (1991) (discussing how imperfect self-control results in insufficient saving for retirement).

<sup>43</sup> Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806, 806–07 (1980).

<sup>44</sup> Jolls et al., *supra* note 28, at 1524.

<sup>45</sup> Optimism bias can be characterized as contextual; individuals reach inordinately optimistic conclusions due to their failure to process information that would give them an accurate risk perception. Nevertheless, most behaviorist commentators group optimism bias with irrational failures of self-control.

<sup>46</sup> See Bar-Gill, *supra* note 42, at 1376 (explaining how optimism bias could cause consumers to underestimate the occurrence of a future event that might necessitate borrowing). On the other hand, pessimism bias occurs when an individual overestimates the occurrence of adverse events. Cass R. Sunstein, *Hazardous Heuristics*, 70 U. CHI. L. REV. 751, 773 (2003) (book review) (“With respect to some low-probability events, including life-threatening risks such as AIDS, people actually tend to overestimate their own susceptibility, and in that sense seem to show pessimistic bias.”).

<sup>47</sup> See generally Steven D. Levitt & John A. List, *Viewpoint: On the Generalizability of Lab Behaviour to the Field*, 40 CANADIAN J. ECON. 347 (2007) (analyzing properties of human behavior that limit the power of inferences drawn from laboratory results in markets).

for participants to specialize and to learn to reduce their errors.<sup>48</sup> These incentives are not present in the laboratory.<sup>49</sup> To support a policy intervention, however, experimental research must (1) yield data that are robust and (2) be interpreted carefully to distinguish irrational behavior from efficient mistakes. The current research agenda fails to meet either requirement.<sup>50</sup>

1. *Experimental Evidence and Data Accrual.*—Behaviorists propose to alter the regulatory regime in broad and fundamental ways. It is a bedrock principle of both law and science that such advocates of change bear the burden of demonstrating the superiority of their theories. The existing data marshaled in support of behaviorist proposals generally, however, fail to meet this standard for several reasons. First, much if not most of the data suggesting cognitive biases affect individual decisionmaking are drawn from experimental settings and the bias has not been shown to persist in the presence of market institutions.<sup>51</sup> This limitation is especially significant because some biases found in the laboratory have been shown not to survive exposure to real-world settings.<sup>52</sup> Second, even within the confines of the laboratory, results may be sensitive to relatively small changes in experimental procedures. Finally, and perhaps most importantly, the evidence supporting the behaviorist regulatory regime has not been subjected to comparative institutional analysis; there is little to no evidence that any particular behavioral regulation would reduce errors more efficiently than would market institutions. Nonetheless, a regulator faced with behaviorist advocacy, even if unsupported by empirical data sufficient to reject alternative theories, may readily embrace the behaviorist model because it produces outcomes closest to his own preconceptions.

Behavioral economists are, of course, aware of the need for experiments that isolate and identify biases that persist in market

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<sup>48</sup> See Edward L. Glaeser, *Paternalism and Psychology*, 73 U. CHI. L. REV. 133, 140 (2006) (“In experiments, individuals have few tools with which to improve their reasoning, and their only real method of responding to incentives is to think harder.”).

<sup>49</sup> See Jennifer Arlen et al., *Endowment Effects Within Corporate Agency Relationships*, 31 J. LEGAL STUD. 1, 4 (2002); Joshua D. Wright, *Behavioral Law and Economics, Paternalism, and Consumer Contracts: An Empirical Perspective*, 2 N.Y.U. J.L. & LIBERTY 470, 471–72 (2007); see also sources cited *supra* note 14.

<sup>50</sup> The most obvious failure is to attribute all errors to irrational behavior when rational economic agents would not reduce their error rate to zero because the gains to error reduction are small relative to its cost. For example, consumer errors in selecting the best credit card from among several choices are often attributed to irrational behavior despite the low cost of making an error that can readily be corrected with experience, the relatively high cost of analyzing competing offers, and evidence that the error rate declines as the cost of errors increases. See *infra* Part II.B.2.

<sup>51</sup> See, e.g., Buccafusco & Sprigman, *supra* note 39, at 51 (advocating various intellectual property reforms on the basis of experimental evidence).

<sup>52</sup> See Vernon L. Smith, *Economics in the Laboratory*, 8 J. ECON. PERSP. 113, 118 (1994); sources cited *supra* note 14.

environments as a precondition to regulation designed to mitigate those biases; nevertheless, the available data frequently fall short of that standard because they fail to account for the possibility of multiple and simultaneous biases,<sup>53</sup> do not adequately control for experimental procedures that might bias studies in favor of finding bias,<sup>54</sup> or cannot rule out rational behavior as an explanation for the observed conduct.

This is true even of the bias most cited in support of the behaviorist agenda—the endowment effect.<sup>55</sup> As mentioned above, prospect theory is based upon the purported gap between willingness to accept (WTA) and willingness to pay (WTP)—the idea that individuals will report a lower WTP for a particular good than their WTA after they have been given the same good.<sup>56</sup> As economist David Levine explains, however, it is not at all clear that evidence of a WTA–WTP gap implies a preference reversal:

On the surface [the appearance of a gap] is not much of a paradox: we all know to buy low and sell high. However: the elicitation of values is done using a method called the Becker Marschak DeGroot [1964] elicitation procedure. A willingness to pay or accept payment is stated, then a random draw is made. If the random draw is lower than the stated value (in the willingness to pay case) then the item is sold at the randomly drawn price. If the draw is higher than the stated value then no transaction takes place.

Is it obvious to you that when this procedure is used that the unambiguously best course of action is to bid your true value and not buy low and sell high? It is true, and subjects are often informed of this fact. So: is there a paradox here, as some behavioral economists and psychologists would argue, or, . . . is it simply the case that people have trouble understanding a complex and unfamiliar procedure?<sup>57</sup>

A critical precondition to acting upon the purported WTA–WTP gap is to know, rather than to assume, the reason it arises. Charles Plott and Kathryn Zeiler demonstrate that observed gaps can be explained by misconceptions about experimental protocols and the experimental task;

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<sup>53</sup> See Thomas A. Lambert, *Two Mistakes Behavioralists Make: A Response to Professors Feigenson et al. and Professor Slovic*, 69 MO. L. REV. 1053, 1054–55 (2004).

<sup>54</sup> Charles R. Plott & Kathryn Zeiler, *Exchange Asymmetries Incorrectly Interpreted as Evidence of Endowment Effect Theory and Prospect Theory?*, 97 AM. ECON. REV. 1449, 1454–56 (2007) [hereinafter Plott & Zeiler, *Exchange*]; Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay–Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530, 532–35 (2005) [hereinafter Plott & Zeiler, *Willingness*].

<sup>55</sup> See, e.g., Plott & Zeiler, *Exchange*, *supra* note 54, at 1454; Plott & Zeiler, *Willingness*, *supra* note 54, at 532.

<sup>56</sup> See, e.g., Plott & Zeiler, *Willingness*, *supra* note 54, at 530–31.

<sup>57</sup> DAVID K. LEVINE, IS BEHAVIORAL ECONOMICS DOOMED?: THE ORDINARY VERSUS THE EXTRAORDINARY (forthcoming 2012) (manuscript at 6–7), available at <http://www.dklevine.com/general/behavioral/ch6.pdf>.

when those misconceptions are dispelled and a full set of experimental controls is employed to eliminate them, contrary to prospect theory, such gaps disappear.<sup>58</sup>

Plott and Zeiler's results do not eliminate the possibility that prospect theory is the best explanation of the WTA–WTP gap observed in some improved experimental settings.<sup>59</sup> That finding would encourage further inquiry and elicit a serious scholarly discussion of the origins of WTA–WTP gaps, skeptically approached, as would any theory contradicted by robust evidence. Indeed, experimental economists continue to study the conditions under which WTA–WTP gaps might appear independent of the subjects' misconceptions and whether any such gaps are explained by the reference-dependent preferences contemplated by prospect theory.<sup>60</sup> Although the debate rages on in economics, the legal academy has leapt to the conclusion that individuals act irrationally in actual market transactions. Over 1000 articles in legal periodicals reference the “endowment effect.”<sup>61</sup> Of the 396 articles published after Zeiler's and Plott's first two articles appeared, only 34 cite either one of them.<sup>62</sup>

The scientific method obliges behaviorist scholars to disclose and to discuss alternative theories for explaining observed facts. The methodological commitment—in Jolls, Sunstein and Thaler's words, to produce a “higher  $R^2$ ”<sup>63</sup>—reflects acceptance of both scientific rigor and the pursuit of objectively verifiable knowledge. That only 10% of the legal articles citing the endowment effect even refer to the leading contrary

<sup>58</sup> Plott & Zeiler, *Exchange*, *supra* note 54, at 1462; Plott & Zeiler, *Willingness*, *supra* note 54, at 531–32.

<sup>59</sup> Plott & Zeiler, *Exchange*, *supra* note 54, at 1462 (“While we do challenge the general accuracy of endowment effect theory, we do not challenge prospect theory . . .”). Others have also found prospect theory to have limited power in explaining WTA–WTP gaps. See Stephanie Kovalchik et al., *Aging and Decision Making: A Comparison Between Neurologically Healthy Elderly and Young Individuals*, 58 J. ECON. BEHAV. & ORG. 79, 85–87 (2005) (finding results consistent with Plott & Zeiler on the endowment effect).

<sup>60</sup> See, e.g., Jack L. Knetsch & Wei-Kang Wong, *The Endowment Effect and the Reference State: Evidence and Manipulations*, 71 J. ECON. BEHAV. & ORG. 407, 408 (2009); Keith M. Marzilli Ericson & Andreas Fuster, *Expectations as Endowments: Evidence on Reference-Dependent Preferences from Exchange and Valuation Experiments*, 126 Q.J. ECON. 1879, 1879–83 (2011). One recent study replies to Plott and Zeiler's findings and has elicited a response from them. See Andrea Isoni et al., *The Willingness to Pay—Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations: Comment*, 101 AM. ECON. REV. 991 (2011); Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay—Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations: Reply*, 101 AM. ECON. REV. 1012 (2011).

<sup>61</sup> A search on May 31, 2012, of the Westlaw Journals & Law Reviews (JLR) database for the term “endowment effect” resulted in 1087 articles that include the term.

<sup>62</sup> These results are based upon the search referenced *supra* note 61, with the results restricted to articles written after September 1, 2007.

<sup>63</sup> Jolls et al., *supra* note 28, at 1487 (“Behavioral law and economics, in short, offers the potential to be law and economics with a higher ‘ $R^2$ ’—that is, greater power to explain the observed data.”).



literature suggests that in the legal academy, pursuit of the behaviorist policy agenda is only minimally constrained by the norms of scientific inquiry.

Similar problems plague the literature on framing effects. As Gregory Mitchell has observed, though the existence of framing effects is not disputed—indeed, such effects have long been noticed in public opinion polling<sup>64</sup>—the effects are not robust to even small changes in experimental settings.<sup>65</sup> For example, small manipulations in the decisionmaking context, such as asking subjects to think about the possible success or failure of their options, to give reasons for their choices, or to deliberate more analytically, can reduce or eliminate the influence of framing effects.<sup>66</sup> Mitchell also highlights evidence that stable preferences prevail in settings where choices are made frequently and involve less emotion, more deliberation or reflection, or a smaller number of options, or where the subject is well informed.<sup>67</sup> These findings suggest framing effects can be reduced or eliminated at low cost without the extensive interventions proposed by libertarian paternalists.<sup>68</sup> As we will discuss in Part II.B.2, a fundamental problem with the behaviorists' regulatory agenda is that its proposals are not calibrated to the costs of “debiasing” behavioral biases as evidenced by experiments; to the contrary, behaviorist proposals frequently assume that the social costs of cognitive error are large and presumptively greater than the cost of the regulatory solution designed to reduce them.

2. *Data Interpretation and Rational Error.*—Even if there were robust evidence of irrationality in markets, such evidence would have to be interpreted with care; the challenge would be to distinguish truly irrational behavior from rationally made and therefore efficient mistakes. Efficient mistakes occur because rational economic actors economize on both information and transaction costs. In short, not all errors imply irrationality because perfect decisionmaking would be costly. To miss subtle distinctions between rational and irrational decisionmaking will almost

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<sup>64</sup> See generally STANLEY L. PAYNE, *THE ART OF ASKING QUESTIONS* (1951) (discussing how varying the wording of a question can affect survey outcomes); Donald Rugg & Hadley Cantril, *The Wording of Questions*, 37 J. ABNORMAL & SOC. PSYCHOL. 469, reprinted in GAUGING PUBLIC OPINION 23 (1944) (same).

<sup>65</sup> See Mitchell, *supra* note 27, at 1256 n.40.

<sup>66</sup> *Id.* at 1255–56.

<sup>67</sup> *Id.* at 1253.

<sup>68</sup> *Id.* at 1255–60. Libertarian paternalists have relied upon framing effects, and particularly the endowment effect, to justify significant policy interventions, including switching the legal default rule from “at will” to “for cause” termination, redistributing various property rights, and preferring liability rules over property rules. See, e.g., Korobkin, *supra* note 32, at 1259–69, 1283–87 (respectively discussing proposals to redistribute property rights relying upon the endowment effect and favoring liability rules over property rules); Sunstein & Thaler, *supra* note 2, at 1187 (advocating the Model Employment Termination Act).

certainly lead to erroneous conclusions about legal policy. The data required to distinguish rational mistakes from irrational mistakes, much less to estimate the magnitude of any welfare loss caused by the latter, are significant and may be unavailable.

The behavioral law and economics literature nonetheless fails to distinguish between rational and irrational errors, assuming instead that error reduction is always efficient. Where there are information and transaction costs, however, the efficient level of error is not zero.<sup>69</sup> For example, if a consumer could switch from Credit Card A to Credit Card B at a transaction cost of \$10, but Credit Card B is only \$5 superior to Credit Card A, then the consumer's failure to switch is not evidence of his irrationality. Consider the problems encountered if a behavioral economist tries to interpret the following stylized facts from an empirical study of consumers' selection of credit cards following a natural experiment in which a card company offers them two cards: (1) one card has a higher interest rate but no annual fee and (2) the other has a lower interest rate and an annual fee. What do the behavioral theories of consumer credit predict?

Oren Bar-Gill, who, along with Elizabeth Warren, championed creation of the new Consumer Financial Protection Bureau (CFPB), argues that consumers consistently underestimate their future borrowing due to a potpourri of behavioral biases such as imperfect self-control, hyperbolic discounting, and systematic underestimation of the probability of negative consequences.<sup>70</sup> Rather than viewing "teaser rates," zero annual fees, and rewards programs as signs of intense and healthy competition among credit card issuers, they and others have argued that card issuers design such products and contracts to exploit the behavioral biases of consumers.<sup>71</sup> Bar-Gill argues that competition on these margins leaves consumers worse off because their expressed credit choices do not reflect their true preferences.<sup>72</sup>

This "predatory lender" interpretation of the credit market gives rise to several testable hypotheses about the underlying behavioral theories. First,

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<sup>69</sup> This point is doubly salient when one considers that behaviorists often assert the inapplicability of the Coase Theorem due to the mere presence of transaction costs. See *supra* Part II.A.1.

<sup>70</sup> Bar-Gill, *supra* note 42, at 1395–1411.

<sup>71</sup> E.g., MICHAEL S. BARR ET AL., BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 12 (2008), available at [www.newamerica.net/files/naf\\_behavioral\\_v5.pdf](http://www.newamerica.net/files/naf_behavioral_v5.pdf) ("Credit card companies have fine-tuned product offerings and disclosures in a manner that appears to be systematically designed to prey on common psychological biases—biases that limit consumer ability to make rational choices regarding credit card borrowing."); Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 46–52 (2008) (providing examples of numerous product design features that can be used to exploit consumer biases); Elizabeth Warren, *Redesigning Regulation: A Case Study from the Consumer Credit Market*, in GOVERNMENT AND MARKETS: TOWARD A NEW THEORY OF REGULATION 391, 391 (Edward J. Balleisen & David A. Moss eds., 2010) ("Businesses have learned to exploit customers' systematic cognitive errors, selling complex credit products that are loaded with tricks and traps.")

<sup>72</sup> See Bar-Gill, *supra* note 42, at 1411–12.

we should expect to see a significant majority of consumers selecting the wrong card—that is, the card that does not maximize interest-cost savings net of any annual fee paid. Second, we should expect the consumers' error rate, if it is the product of irrationality, to remain invariant to the cost of the error. Third, we should expect consumers who carry monthly balances instead of paying them off to hold cards with high rewards and no annual fee. This third hypothesis is the heart of the Bar-Gill “seduction by plastic” argument that consumers who revolve debt are irrationally optimistic about their financial prospects, leading them to select the card better suited for nonrevolvers.<sup>73</sup>

The data bear out none of these expectations. Agarwal et al. found that approximately 60% of consumers selected the “optimal” card.<sup>74</sup> Of the 40% who did not, many corrected their errors with some experience and only “a small minority of consumers persist[ed] in holding substantially sub-optimal contracts without switching.”<sup>75</sup> The authors found these errors were bounded in magnitude by the level of the annual fee (typically around \$25).<sup>76</sup> Further, and consistent with neoclassical economic theory, the probability of selecting the optimal credit card increased both with the cost of the error and with repeat decisions, which suggests that learning mitigates the effects of the relevant biases.<sup>77</sup> All of these findings are consistent with rational (but, of course, not perfect) decisionmaking and, more specifically, with price theory. Further, contrary to the behaviorist model, “more nonrevolvers than revolvers” carried “cards with average minimum APRs greater than 10 percent . . .”<sup>78</sup> “This result does not support the hypothesis that hyperbolic discounting results in consumers bearing credit card debt at high interest rates.”<sup>79</sup>

The available data strongly suggest consumers make rational choices in the credit card market. The upper bound of the initial error rate suggests switching costs would outweigh any potential gains consumers might realize from changing cards—the error rate is efficient. How would a behaviorist interpret these same data? Warren explains her approach as follows:

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<sup>73</sup> *Id.* at 1400.

<sup>74</sup> Sumit Agarwal et al., Do Consumers Choose the Right Credit Contracts? 4 (November 2006) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=843826](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=843826).

<sup>75</sup> *Id.* at 5.

<sup>76</sup> *Id.* at 4–5, 7. That potential consumer irrationality is bounded by the level of the relevant cost is potent indirect evidence for the proposition that even relatively minor market pressures will dissipate behavioral errors made in a laboratory.

<sup>77</sup> *Id.* at 15.

<sup>78</sup> Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHI. L. REV. 63, 80 (2006).

<sup>79</sup> *Id.*

What's the point of offering two different products, except to hope that the number of consumer [sic] who get it wrong will exceed in dollar volume the number who get it right. Or, from an informed consumers' [sic] perspective, perhaps the optimal system is one in which they make good decisions and hope for cross-subsidization from less-clever consumers who help keep credit cards highly profitable and easy to use in a variety of settings (e.g., grocery stores, cabs, pizza deliveries, etc.).

I realize it is heresy in many circles to ask if consumers should have fewer choices. But at some point the empirical studies about high error rates bring into question the assumptions that underlie the claim that more choice is always good.<sup>80</sup>

Professor Warren's answer is simple: A high error rate implies irrationality, and irrationality implies the need for choice-reducing regulation. It is also simplistic.

Warren's interpretation—the behaviorist interpretation—of the data reveals her methodology, which results in three significant errors. First, the initial error rate of 40% is evaluated without reference to the costs of switching; therefore, no attention is paid to the fundamental challenge of identifying the efficient rate of error. Second, no weight is assigned to the finding that the error rate decreases both with the cost of error and with repeat decisionmaking, facts that are consistent with rational choice but difficult to reconcile with the models of consumer behavior in credit markets put forth by Bar-Gill and others. Third, Warren describes the errors as “staggering,”<sup>81</sup> but does not address the finding that the magnitude of these costs is bounded by the size of the typically small annual fee. While the initial error rate is indeed high, her evaluation of the rationality and welfare properties of the choice occurs in a vacuum where the costs of error or of investment to correct the error are ignored and thus effectively assumed to be zero. Warren's leap from identifying the error rate to questioning whether “more choice is always good” illustrates what Harold Demsetz famously called the Nirvana Fallacy—the failure to ask: compared to what?<sup>82</sup>

Our point is not merely that we disagree with Warren's interpretation of this single study. The more general point is that Warren's analysis ignores fundamental economic concepts and threatens to subject consumers

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<sup>80</sup> Elizabeth Warren, *Economic Model Almost Working or Broken?*, CREDIT SLIPS (Dec. 26, 2006, 04:12 PM), [http://www.creditslips.org/creditslips/2006/12/economic\\_model\\_.html](http://www.creditslips.org/creditslips/2006/12/economic_model_.html).

<sup>81</sup> *Id.*

<sup>82</sup> See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1–3 (1969) (“The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing ‘imperfect’ institutional arrangement. This *nirvana* approach differs considerably from a *comparative institution* approach in which the relevant choice is between alternative real institutional arrangements.”).

to a serious policy error by conflating rational choice with irrational behavior—that is, by ignoring switching and other costs incurred everywhere except in Nirvana—and by avoiding comparative institutional analysis.

*C. Compounding the Shortcomings of the Research with Policy Error*

As previously discussed, behavioral economics research has largely consisted of identifying, documenting, and classifying apparent errors in decisionmaking. What has thus far eluded the researchers is a theoretical mapping of the real-world conditions under which individual decisions will be fettered by these cognitive biases and when they will not.<sup>83</sup> This gap in the behavioral theory of errors is critical because it makes it inevitable that, in attempting to correct for cognitive biases, behavioral interventions will lead to policy errors.

The inevitability of policy errors derives from the insurmountable theoretical and empirical obstacles to identifying any one person's, let alone the distribution of all persons', "true preferences." One type of policy error will occur when a behavioral intervention is aimed at seemingly irrational behavior that is in fact rational for the decisionmaker in question. In other words, the social costs of this type of policy error flow from encouraging behavior the paternalist inaccurately believes will make individuals better off and concomitantly discouraging acts that satisfy their actual preferences. A second type of policy error will occur when an intervention designed to improve the decisionmaking of truly irrational economic agents imposes costs, as it inevitably will, upon all those who are not irrational and for whom the same decision is not an error. In this case, it is erroneous beliefs about the distribution of true preferences that lead to the policy error. For example, even if a particular default rule meant to offset a cognitive bias will reduce some individual errors in decisionmaking, failure to calibrate the default rule to the distribution of true preferences may impose social costs upon rational decisionmakers that are greater than any benefits in error reduction.

The risk of policy error is significant, however, even if consumers' error rate is 100%. For example, behaviorists repackage the "sin tax" as a means to reduce hyperbolic discounting by consumers of certain goods, such as cigarettes, that often have deleterious health effects in the long run. But even if all consumers in the market exhibit present bias in consumption and the intervention is successful in reducing the rate of consumption, the question remains whether the social costs saved are greater than the social

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<sup>83</sup> See Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards*, 90 MINN. L. REV. 1620 (2006); Mitchell, *supra* note 27.

costs of intervention. In the case of a sin tax, the likelihood of this type of policy error is exacerbated because regulators do not, and surely cannot, have accurate knowledge of every consumer's, or even the average consumer's, "true" preferences or the discount rate necessary to calculate the optimal tax. The expanding behavioral law and economics agenda largely disregards these risks.

### III. FROM BEHAVIORAL ECONOMICS TO BEHAVIORAL LAW AND ECONOMICS

The quest to translate the insights of behavioral economics, such as they are, into public policies intended to improve decisionmaking and welfare has achieved a remarkable degree of momentum. In addition to Thaler and Sunstein's recent book, *Nudge: Improving Decisions About Health, Wealth, and Happiness*, a popular summary of the behavioral approach to law, and Dan Ariely's similarly oriented *Predictably Irrational*, there is abundant evidence that behavioral law and economics is affecting public policy. Indeed, a recent account in the popular press describes behavioral economics as "the governing theory" of the Obama Administration's regulatory agenda, in part because Cass Sunstein now heads the Office of Information and Regulatory Affairs in the Executive Office of the President, which reviews proposed regulations before they can be issued.<sup>84</sup> To give concrete examples, behavioral economics provided the intellectual blueprint for the CFPB, which the Congress created at the urging of the Obama Administration,<sup>85</sup> and a member of the Federal Trade Commission has discussed taking a more behavioral approach to enforcing the antitrust laws.<sup>86</sup> Regulatory proposals informed by behavioral law and economics span the law school curriculum, ranging from antitrust and

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<sup>84</sup> Andrew Ferguson, *Nudge Nudge, Wink Wink: Behavioral Economics—The Governing Theory of Obama's Nanny State*, WKLY. STANDARD, Apr. 19, 2010, at 18, 18. *Time Magazine* described the Obama Administration's advisers as a "behavioral dream team" that would rely upon behavioral economics to "transform the country." Michael Grunwald, *How Obama Is Using the Science of Change*, TIME, Apr. 13, 2009, at 28, 29.

<sup>85</sup> Warren, a prominent behaviorist in her own right, was charged with setting up the CFPB. For examples of her writing on behavioral economics and consumer choice, see Bar-Gill & Warren, *supra* note 71, at 39, and Elizabeth Warren, *Unsafe at Any Rate*, 5 DEMOCRACY 8 (2007). Sendhil Mullainathan, a leading behavioral economist, was recently appointed CFPB Assistant Director for Research. For a criticism of the behavioral approach to regulating consumer credit, see David S. Evans & Joshua D. Wright, *The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit*, 22 LOY. CONSUMER L. REV. 277 (2010). The CFPB and its roots in behavioral law and economics are discussed *infra* Part III.B.2.

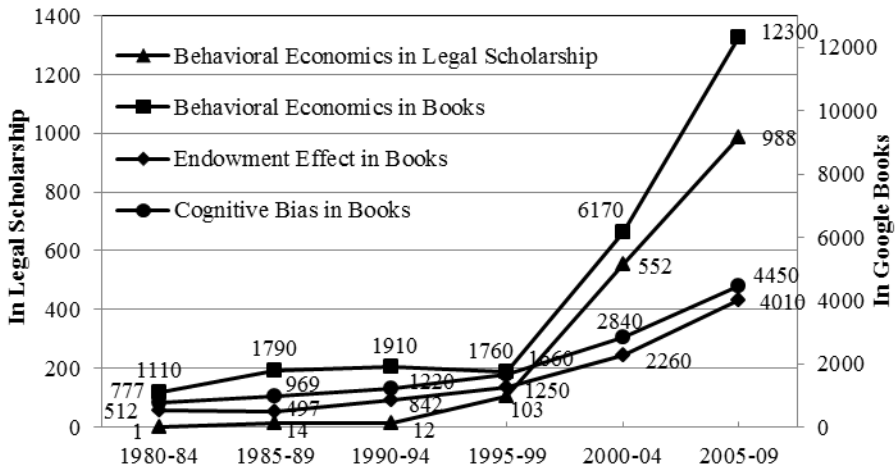
<sup>86</sup> J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Behavioral Economics: Observations Regarding Issues That Lie Ahead, Remarks Before the Vienna Competition Conference 12–15 (June 9, 2010), available at <http://ftc.gov/speeches/rosch/100609viennaremarks.pdf>. For a skeptical account of the implications of behavioral economics for antitrust, see Joshua D. Wright & Judd E. Stone, *Misbehavioral Economics: The Case Against Behavioral Antitrust*, 33 CARDOZO L. REV. 1517 (2012).

consumer protection to discrimination and employment law. The depth and breadth of the behaviorist agenda is in no small part due to its success in the legal academy.

A. *The Rise of Behavioral Law and Economics in the Legal Academy*

The legal academy is the driving force behind the rise of behavioral law and economics and its growing influence in policy debates. Legal academics have discovered in the behavioral economics literature a rich supply of empirical findings they can marshal in support of paternalistic regulatory interventions. Indeed, law professors have produced hundreds of such articles in a relatively short time.<sup>87</sup> From 1980 through 1984, across all legal publications, only a single article mentioned the term “behavioral economics.” From 2005 through 2009, however, 988 articles mentioned the term.<sup>88</sup> This dramatic increase has been duplicated in books. As Figure 1 shows, the terms “behavioral economics,” “endowment effect,” and “cognitive bias” have experienced an equally dramatic increase in usage over the same time period.

FIGURE 1: REFERENCES TO “BEHAVIORAL ECONOMICS”



<sup>87</sup> As of May 31, 2012, a search of the Westlaw JLR database finds 2281 articles in legal periodicals referencing “behavioral economics.” A search on Google Scholar turns up 2190 legal opinions and articles referencing the same term.

<sup>88</sup> Based on data that first appeared in Douglas H. Ginsburg & Derek W. Moore, *The Future of Behavioral Economics in Antitrust Jurisprudence*, 6 COMPETITION POL’Y INT’L 89, 93–96 (2010), which Figure 1 updates. The number of references in the Google Book search was compiled by the authors at books.google.com on December 22, 2010. The Y-axis on the left hand side of Figure 1 measures the number of times the term “behavioral economics” appears in the Westlaw JLR database in the relevant time period. The Y-axis on the right hand side of Figure 1 measures the number of times each of the three terms appears in Google Books.

The increasing footprint of behavioral law and economics in the legal academy extends beyond legal scholarship, via law school faculties, into the law school curriculum. For example, ten of the top twenty law schools in the United States have offered at least one course in behavioral law and economics in the past five years.<sup>89</sup>

There has also been a concerted effort to transplant the research agenda of behavioral economics overseas, particularly to Europe. In April 2004, the European Network for the Advancement of Behavioural Economics (ENABLE), a joint venture between European universities with nascent behavioral institutes and established programs at Harvard and Princeton, undertook a mission to “advance this emerging field of behavioural economics in Europe” by facilitating the “development of a critical mass of the brightest young researchers by concentrating the currently highly fragmented expertise in Europe.”<sup>90</sup>

### B. Some Behavioral Law and Economics Regulatory Proposals

Behaviorist regulatory proposals run the gamut from gentle attempts to encourage retirement savings to outright bans of certain products.<sup>91</sup> Common to each of these proposals is the claim that the intervention will improve individuals’ decisionmaking by reducing errors attributable to cognitive biases and bounded rationality, thus making each individual better off as measured by his own preferences.<sup>92</sup> Some proposals would modify legal default rules; others invoke “choice architecture” to manipulate framing effects. Some behaviorist proposals do not directly restrict the set

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<sup>89</sup> Data compiled by authors (on file with Northwestern University Law Review). The law schools are those of Yale University, Harvard University, the University of Chicago, New York University, Columbia University, Vanderbilt University, the University of California at Los Angeles, the University of Virginia, the University of Pennsylvania, and Georgetown University.

<sup>90</sup> *First European Summer Symposium in Behavioural Economics*, CENTRE FOR ECON. POL’Y RES., <http://www.cepr.org/meets/meetings/meetdesc.asp?meetno=5525> (last visited Aug. 13, 2012). The ENABLE network, funded in part by the European Commission, completed its work in March 2008. EUROPEAN NETWORK FOR THE ADVANCEMENT OF BEHAV. ECON., <http://www.cepr.org/research/networks/enable/> (last visited Aug. 13, 2012). The research training network enlisted several prominent figures in behavioral economics, including Daniel Kahneman of Princeton University and David Laibson of Harvard University. *People*, EUROPEAN NETWORK FOR THE ADVANCEMENT OF BEHAV. ECON., [http://www.cepr.org/research/networks/enable/people\\_new.htm](http://www.cepr.org/research/networks/enable/people_new.htm) (last visited Aug. 13, 2012).

<sup>91</sup> Descriptions of the behaviorist approach similarly vary, from Sunstein & Thaler’s preferred “libertarian paternalism” to the more restrictive “asymmetric paternalism” and the more constraining “new paternalism.” See Camerer et al., *supra* note 3, at 1212 (“A regulation is asymmetrically paternalistic if it creates large benefits for those who make errors, while imposing little or no harm on those who are fully rational.”); Mario J. Rizzo & Douglas Glen Whitman, *The Knowledge Problem of New Paternalism*, 2009 BYU L. REV. 905, 908 (“The new paternalism, by contrast, takes the individual’s own subjective preferences as the basis for policy recommendations. New paternalist policies allegedly help the individual to better achieve his own subjective well-being, which cognitive impediments prevent him from attaining on his own.”).

<sup>92</sup> See, e.g., Jolls et al., *supra* note 28, at 1536–37; Thaler & Sunstein, *supra* note 17, at 178–79.



of choices available to consumers but impose a cooling-off period or some other burden placed upon producers that, in turn, results in higher prices, reduced variety, or both.<sup>93</sup>

*I. Choice Architecture and Retirement Savings.*—The most frequently discussed example of a behavioral intervention invoking choice architecture is default enrollment in employer-sponsored savings plans. Sunstein and Thaler have argued that a law “requir[ing] employers to provide automatic enrollment and allow[ing] employees to opt out” would be consistent with libertarian paternalism.<sup>94</sup> Others less concerned with preserving the opportunity to opt out have suggested that firms be required by law to make enrollment automatic.<sup>95</sup>

The most common behavioral argument in support of automatic enrollment is that, freed of the “status quo bias” and the “sticky” nature of defaults, many more employees would enroll in a savings plan than actually enroll at present.<sup>96</sup> Sunstein and Thaler contend that if employees only thought more carefully about the enrollment decision, they would act upon, and hence reveal, their true preference, causing enrollment rates to rise.<sup>97</sup> The “Save More Tomorrow” plan—a defined contribution retirement savings plan in which the contribution rate of those who do not opt out increases automatically when an enrollee receives a pay raise—was designed to “help those employees who would like to save more but lack the willpower to act on this desire.”<sup>98</sup> Sunstein and Thaler describe Save More Tomorrow as “successful libertarian paternalism in action” because it has resulted in increased enrollment and savings rates at the handful of firms that have implemented it.<sup>99</sup> Paradoxically, this claim of a successful behavioral intervention is based upon the failure of employees to opt out of the new default.<sup>100</sup> That is, in order to evaluate the success of the behavioral intervention in terms of employees’ welfare, the behaviorists point to the preferences revealed by subjects’ actual behavior—in this case, their failure

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<sup>93</sup> See discussion *infra* Part III.C.2.a.

<sup>94</sup> Sunstein & Thaler, *supra* note 2, at 1176.

<sup>95</sup> See Camerer et al., *supra* note 3, at 1227–30.

<sup>96</sup> Behaviorists also rely on present bias and hyperbolic discounting in support of nudges that would increase savings. See, e.g., David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q.J. ECON. 443 (1997).

<sup>97</sup> Sunstein & Thaler, *supra* note 2, at 1172–73 (“[E]mployers think (correctly, we believe) that most employees would prefer to join the 401(k) plan if they took the time to think about it and did not lose the enrollment form . . .”).

<sup>98</sup> Thaler & Benartzi, *supra* note 16, at S170.

<sup>99</sup> Sunstein & Thaler, *supra* note 2, at 1185; accord Thaler & Benartzi, *supra* note 16, at S186.

<sup>100</sup> Sunstein & Thaler, *supra* note 2, at 1191 (“The fact that very few participants choose to opt out supports (though it does not prove) the claim that they are helped by a system that makes joining easy . . .”).

to opt out of the default—while simultaneously justifying the intervention on the ground that status quo and other biases render defaults “sticky” and revealed preferences therefore untrustworthy evidence of true preferences.<sup>101</sup> The only meaningful difference is the preference of the would-be regulators for one outcome over the other.<sup>102</sup>

2. *Regulation of Consumer Credit.*—Behavioral law and economics has provided the intellectual foundation for the new CFPB and a new approach to the regulation of consumer credit. The proponents argue the Bureau can promulgate rules and regulations that improve consumers’ decisionmaking by altering the design of consumer credit products, mandating various disclosures, restricting consumers’ choices, and instituting default rules in favor of standardized products approved by the Bureau.<sup>103</sup>

The Bureau’s approach to regulating consumer credit is a direct outgrowth of the behavioral law and economics movement—indeed, the Bureau itself is the outgrowth of a 2008 article written by law professors Elizabeth Warren and Oren Bar-Gill.<sup>104</sup> Another law professor, Michael Barr, who was an Assistant Secretary of the Treasury in the Obama Administration, contributed to a second article laying out a series of proposals to regulate consumer credit, including the requirement that a lender offer every customer a basic or “plain vanilla” product before trying to sell him a product with additional features.<sup>105</sup> The behavioral premise of these proposals is that “[m]any consumers are uninformed and irrational”<sup>106</sup> and therefore make “systematic mistakes in their choice of credit products”<sup>107</sup> and require behaviorally informed policy interventions in order to reduce those mistakes and hence increase consumers’ welfare. Other

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<sup>101</sup> For a discussion of this point, see Mitchell, *supra* note 27, at 1252 n.24, 1254–55 n.36.

<sup>102</sup> Recent evidence also supports skepticism concerning the claim that manipulating the choice architecture for retirement savings will “nudge” the decisions of those whose welfare will be increased while allowing nearly costless opt out by those whose welfare would not. See Anne Tergesen, *401(k) Law Suppresses Saving for Retirement*, WALL ST. J., July 7, 2011, at A1 (discussing findings that while total 401(k) savings increased moderately due to greater participation at specified default rates, participants’ average savings rates fell after adoption of auto-enrollment because individuals who would have opted for higher savings rates in the absence of auto-enrollment accept the lower auto-enrollment default rate).

<sup>103</sup> See Evans & Wright, *supra* note 85, at 319–20; see also BARR ET AL., *supra* note 71, at 12–15 (discussing the potential structure of such rules and regulations).

<sup>104</sup> See Bar-Gill & Warren, *supra* note 71.

<sup>105</sup> See BARR ET AL., *supra* note 71, at 7–9. This is consistent with the behaviorists’ preference for legal requirements to call attention to particular risks in order to offset consumers’ optimism bias, which causes them to underestimate the likelihood that they will personally suffer bad outcomes. See Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 212–13 (2006).

<sup>106</sup> Bar-Gill & Warren, *supra* note 71, at 21.

<sup>107</sup> *Id.* at 26.

behaviorist proposals concerning consumer credit include banning credit cards altogether<sup>108</sup> and requiring credit card companies to unbundle transaction and financing services so that consumers could not use the same card to make a purchase and to finance it.<sup>109</sup> The Bureau has broad powers, perhaps sufficient to implement these or similar behavioral interventions in the consumer credit market.<sup>110</sup>

3. *Sin Taxes*.—Behaviorists also propose using taxes to improve individual decisionmaking and to offset the effects of behavioral biases. For example, Botond Köszegi and Jonathan Gruber contend consumers would be made better off with higher taxes on goods as to which they exhibit time-inconsistent preferences.<sup>111</sup> While Köszegi and Gruber have focused upon the theoretical and empirical case for higher taxes on tobacco products, other behaviorists have proposed sin taxes aimed at reducing errors committed by consumers who discount hyperbolically, especially with respect to the consumption of potentially unhealthful products, such as fatty foods, alcoholic beverages, and sugary sodas.<sup>112</sup>

As discussed above, hyperbolic discounting invokes the concept that people value immediate gratification so much that they make decisions they will come to regret.<sup>113</sup> The behaviorists often bundle this concept with the

<sup>108</sup> George Loewenstein & Ted O'Donoghue, "We Can Do This the Easy Way or the Hard Way": *Negative Emotions, Self-Regulation, and the Law*, 73 U. CHI. L. REV. 183, 196–98 (2006).

<sup>109</sup> Bar-Gill, *supra* note 42, at 1421–22.

<sup>110</sup> The CFPB has the broad authority to "ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service . . ." 12 U.S.C. § 5532(a) (2006). This provision may authorize, for example, a plain vanilla requirement, at least if the CFPB interprets the statute to mean all or nearly all consumers must understand disclosures before it authorizes a product. *See, e.g., Who's Watching the Watchmen? Oversight of the Consumer Financial Protection Bureau: Hearing Before the Subcomm. on TARP, Fin. Servs. & Bailouts of Pub. & Private Programs of the H. Comm. on Oversight & Gov't Reform*, 112th Cong. 50 (2011) [hereinafter *Who's Watching the Watchmen?*] (statement of David S. Evans, Chairman, Global Economics Group) (explaining that, even without explicit authority to do so, "the [CFPB] can also steer financial services companies toward offering plain vanilla products designed by the CFPB by either banning products that don't conform to the CFPB view or by making it legally risky and expensive to deviate too far from the products that the CFPB wants"); Joshua D. Wright & Todd J. Zywicki, *Three Problematic Truths About the Consumer Financial Protection Agency Act of 2009*, LOMBARD ST., September 14, 2009, at 29, 41–44 (discussing the vague mandates of the CFPA Act).

<sup>111</sup> *See* Jonathan Gruber & Botond Köszegi, *Is Addiction "Rational"? Theory and Evidence*, 116 Q.J. ECON. 1261, 1293–94 (2001); Gruber & Köszegi, *supra* note 42, at 1980–81; Jonathan H. Gruber & Sendhil Mullainathan, *Do Cigarette Taxes Make Smokers Happier*, 5 ADVANCES ECON. ANALYSIS & POL'Y 1, 2 (2005).

<sup>112</sup> *See* Ted O'Donoghue & Matthew Rabin, *Studying Optimal Paternalism, Illustrated by a Model of Sin Taxes*, 93 AM. ECON. REV. 186, 190–91 (2003).

<sup>113</sup> *See supra* Part II.A.2. The original analysis of such time-inconsistent preferences in economics is R. H. Strotz, *Myopia and Inconsistency in Dynamic Utility Maximization*, 23 REV. ECON. STUD. 165 (1955).

idea of “multiple selves” to argue that time-inconsistent preferences result in lower lifetime well-being for consumers because they regularly make decisions today that their future “self” will regret. Paralleling the economic concept of externalities,<sup>114</sup> the behaviorists describe these costs as “internalities.” The case for sin taxes based upon the logic of internalities requires both an aggregate loss of total welfare when one sums up the utilities of all one’s selves across time, and some assumption about which of one’s multiple selves represents one’s true preferences. As we show below, however, there is neither a theoretical nor an empirical basis for the behaviorists’ implicit privileging of a future self who may or may not ever come into existence, depending upon the individuals’ age at death.<sup>115</sup>

### C. Behavioral Law and Economics and Economic Welfare

Sunstein and Thaler are clear in stating the goals of the behavioral approach: to make individuals better off. But what is meant by “better off” in a world where individuals’ revealed preferences cannot be relied upon for inferences about their own welfare? Again, Sunstein and Thaler provide a clear answer: The appropriate measure of welfare is economic well-being as it would be expressed by the preferences of each individual if he were free of behavioral biases.<sup>116</sup> Thus, the promise of behavioral law and economics lies in its potential to increase economic welfare according to each individual’s “true” preferences. As we have seen, the behavioral literature often appears to assume a reduction in errors is conclusive evidence of a move toward true preferences and hence of an increase in welfare. Much of this literature, in our view, overestimates the expected welfare benefits of behavioral interventions while underestimating some costs and altogether failing to take account of others.

An economic analysis of the effects of a behavioral intervention requires not only an agreed-upon metric of welfare but also information sufficient to measure its effects. At its core, the promise of behavioral law and economics’ theory of errors is to design interventions that will make each individual better off by more closely aligning his choices with his “true preferences.” Once one assumes an individual’s decisions do not align

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<sup>114</sup> See THOMAS C. SCHELLING, CHOICE AND CONSEQUENCE 84 (1984) (“[P]eople act as if there were two selves alternately in command. . . . [T]he ways that people cope, or try to cope, with loss of command within or over themselves are much like the ways that one exercises command over a second individual.” (emphasis omitted)).

<sup>115</sup> See *infra* Part III.C.1.

<sup>116</sup> See Thaler & Sunstein, *supra* note 17, at 176.

with his own preferences, however, evaluating the behaviorists' welfare claims becomes difficult, if not impossible.<sup>117</sup>

To date, critiques of behavioral law and economics and its promise of increasing welfare have raised three types of concerns: The behaviorists (1) as we discussed in the previous section, have no way to identify irrational decisions, (2) cannot reliably discern an individual's "true preferences," and (3) fail consistently to account adequately for the social costs of a proposed intervention. Each of these concerns raises significant doubt both about the presumption that error reduction alone increases welfare and about the potential for behavioral interventions to improve welfare. Having considered the first problem above, we now direct our attention to the other two concerns.

*1. The Search for True Preferences.*—Behavioral law and economics' claim to welfare-increasing intervention requires one to disregard the neoclassical assumption that actual behavior reveals evidence of welfare. How then do behavioral economists identify true preferences?

In rejecting the standard understanding among economists that, by choosing  $x$ , an actor reveals he expects to be better off with  $x$ ,<sup>118</sup> the behaviorist conflates welfare and happiness. This critical difference concerning conceptions of economic welfare leads to a methodological divide: When the neoclassical economist finds an economic agent's actual behavior departs from the prediction of his economic model, he suspects the model is to blame; when a behavioral economist observes a gap between actual and predicted behavior, he concludes the agent is acting against his own best interests.

The neoclassical critique of the behaviorists' view of the relationship between preferences and welfare is illuminated by examining the behaviorists' model of the individual as multiple and distinct sequential selves with conflicting interests owing to different time perspectives. But the multiple-self model fails both in theory and in practice.<sup>119</sup> The theoretical failure is simple: Economics does not provide a basis for identifying which of the multiple selves' decisions expresses the individual's "true" preferences for the purposes of welfare analysis. The convention in the behavioral literature, in order to make utility tradeoffs

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<sup>117</sup> In Part IV of this Article, where we focus upon the underappreciated threat behavioral law and economics poses to individual liberty, we will assume for the sake of the argument that any given behavioral intervention offers a Pareto-superior alternative to the status quo.

<sup>118</sup> See HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 121 (8th ed. 2010) (describing the core economic concept of revealed preference, whereby "[i]f a bundle  $X$  is chosen over a bundle  $Y$ , then  $X$  must be preferred to  $Y$ ").

<sup>119</sup> We discussed *supra* Part II.B the empirical obstacles facing behaviorists relying on hyperbolic discounting models.

among the various selves possible, has been to adopt the long-run ex ante preference.<sup>120</sup> Nothing, however, either in standard economic theory or in behavioral economics justifies this approach to identifying “true” preferences.<sup>121</sup>

The manipulation of the standard welfare criterion in favor of long-run ex ante preferences, and thereby the behaviorists’ preferred alternative, is not a defensible basis upon which to claim departures from those preferences represent defects justifying a legal intervention. Untethered from the standard economic approach to welfare, the behaviorist’s approach becomes “both an opportunity and a rationale for activism,” and implicitly assigns to the economist the task of convincing individuals to improve their own decisionmaking and the welfare of their future selves or, alternatively, persuading a third party to intervene on behalf of the future selves.<sup>122</sup>

As Rizzo and Whitman observe, a similar problem arises more generally with claims of welfare-reducing choices biased by context dependence, such as those affected by the status quo bias or the endowment effect.<sup>123</sup> Once again, the behaviorist theory claims empirical proof of internal inconsistency of choices but cannot offer an empirical basis for identifying which choice represents one’s “true” preferences. With respect to framing, the question is not how to resolve conflicts between multiple selves but rather how to determine which context-dependent choice expresses the preference that maximizes welfare. After ruling out revealed preferences as expressions of true preferences, the behaviorist lacks a coherent principle to identify welfare-maximizing choices. Indeed, without revealed preferences, economic science simply cannot do so. The behaviorists can only declare by fiat what they expect a rational individual would or should do—thereby justifying the imposition of correct choices by a third party, contrary to the behaviorist promise to maximize economic

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<sup>120</sup> See, e.g., Gruber & Köszegi, *supra* note 111, at 1287; O’Donoghue & Rabin, *supra* note 112, at 190.

<sup>121</sup> See Mario J. Rizzo & Douglas Glen Whitman, *Little Brother Is Watching You: New Paternalism on the Slippery Slopes*, 51 ARIZ. L. REV 685, 701 (2009) (“[T]he normative standard inherent in any attempt to ‘help’ agents with hyperbolic preferences is *inherently vague*. We do not know where ‘reasonable’ impatience ends and ‘excessive’ patience begins.”); see also Faruk Gul & Wolfgang Pesendorfer, *The Case for Mindless Economics* 38–39 (Nov. 2005) (unpublished manuscript), available at <http://economics.uchicago.edu/pdf/Pesendorfer040306.pdf> (“Economists often note the arbitrariness of using  $U_0$  as a welfare criterion in the multiselves model. It is not clear what hedonic utility calculations have led neuroeconomists to decide that  $U_0$  represents the right trade-off among the hedonic utilities of the various selves.”).

<sup>122</sup> Gul & Pesendorfer, *supra* note 121, at 39. Gul and Pesendorfer describe this stance as “therapeutic” and “paternalistic,” and “similar to the position of medical professionals who attempt to cure a patient’s addiction.” *Id.*; accord Gary S. Becker & Kevin M. Murphy, *A Theory of Rational Addiction*, 96 J. POL. ECON. 675, 681 (1988) (defining addiction as current behavior positively influencing future behavior).

<sup>123</sup> See Rizzo & Whitman, *supra* note 121, at 703.

welfare by the individuals' own lights and undermining the behaviorist claim to the prefix "libertarian."

2. *Errors of Omission in Behavioral Cost-Benefit Analysis.*—Another concern regarding behavioral law and economics is that it proceeds from premises that ignore the often significant costs of intervention. We identify three types of omitted costs.

a. *The default rule.*—Sunstein and Thaler claim choice architecture, or selection of a default rule,<sup>124</sup> is "inevitable."<sup>125</sup> This may be so, but it neither requires nor implies that the state—or anyone else—must always select the default rule.<sup>126</sup> It is even less apparent that the state will select a default rule more closely aligned with an individual's true preferences (as defined by the central planner) than what the individual himself would choose to do. As Mitchell points out, the inevitability claim regarding "manipulation of choices by central planners" holds only "so long as individuals remain subject to these irrational influences."<sup>127</sup> Mitchell demonstrates the claim of inevitability is not justified by the psychological literature, which identifies conditions under which individuals are not likely to be affected by framing.<sup>128</sup> We can reject Sunstein & Thaler's inevitability hypothesis on the ground that a less intrusive measure is often sufficient to eliminate the framing effect without exposing individuals to the risks of policy errors.

Relatedly, behaviorist analyses of policy interventions often underestimate or ignore the cost of opting out of the default rule. The claimed "libertarian" aspect of behavioral interventions is that the manipulation of choice frames still respects freedom of choice; the individual can always reject the regulator's preferred choice in favor of expressing his own preference, even if irrational. Many of the proposed behavioral interventions, however, simply do not live up to the claim of "choice-neutrality," for they ultimately reduce or constrain available choices. For example, sin taxes raise the cost of opting out, while product bans go further, eliminating entirely the ability to opt out; the number of

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<sup>124</sup> In contract law, a default rule is a right that acts as the standard unless waived by the party it benefits. See Sunstein, *supra* note 34, at 107.

<sup>125</sup> Sunstein & Thaler, *supra* note 2, at 1174.

<sup>126</sup> One alternative to the selection of a default rule may be to require that the individual make a choice, for example, about whether to participate in a payroll savings plan.

<sup>127</sup> Mitchell, *supra* note 27, at 1250–51 (emphasis omitted); see also Jeffrey J. Rachlinski, *Cognitive Errors, Individual Differences, and Paternalism*, 73 U. CHI. L. REV. 207, 224–26 (2006) (discussing how "[t]he presence of significant individual variation in [cognitive] vulnerability" weakens the common cognitive psychology arguments supporting paternalistic interventions).

<sup>128</sup> See Mitchell, *supra* note 27, at 1251–52. For a fuller explanation of the circumstances under which framing effects are likely to dissipate, see *supra* Part II.B.1.

choices practically available is reduced, respectively for some or for all individuals.

Other proposed interventions, such as the plain vanilla requirement or the cooling-off period, impose significant costs upon those who would like to opt out. The behaviorally inspired Model Employment Termination Act, which Sunstein and Thaler support on the ground that it respects freedom of choice, would switch the legal default rule from employment “at will” to termination “for cause” only, but would require the employer to pay a substantial price to opt into the “at will” regime.<sup>129</sup> Thus, the choice set of mutually agreeable employment contracts initially available to employers and employees is restricted, and opting out entails significant costs. These costs would be borne in part by employers and in part by employees, who are the intended beneficiaries of the scheme, because employers’ willingness to pay for labor will decline to reflect the additional risk they assume by hiring new employees subject to the penalties of the Act. Behaviorist policy analysis simply assumes these costs of opting out are at or near zero, thereby skewing regulators in favor of an intervention that reduces welfare.

*b. The cost of government intervention.*—In addition to underestimating or ignoring the social cost associated with manipulating choice frames through legal default rules, behaviorists tend to underestimate the costs of implementing proposed policies—an error we term the “government intervention bias.” If one believes individuals are predictably irrational and will commit decisionmaking errors, then the relevant policy question is whether society is better off if error correction is supplied by individuals in markets or by individuals in the government.<sup>130</sup> It is unclear that either bounded rationality or outright irrationality supports a larger role for government as opposed to greater private investment in error correction, but more government is inevitably the policy prescription favored by the behaviorist agenda.<sup>131</sup> Answering this question requires comparative institutional analysis in order to identify the lower cost source of “error reduction.” The pro-government position suffers from two underlying problems.

First, we question the behavioral economist’s implicit assumption that regulators are rational. As Judge Posner pertinently inquired: “Behavioral

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<sup>129</sup> MODEL EMPLOYMENT TERMINATION ACT §§ 3, 4(C), 7A U.L.A. 71, 312–13 (2002); Sunstein & Thaler, *supra* note 2, at 1187.

<sup>130</sup> See Glaeser, *supra* note 48, at 134 (“[I]f psychological errors are understood to be endogenous, then there are good reasons why we might think that public decisionmaking is likely to be more flawed than private decisionmaking.”).

<sup>131</sup> Rachlinski, *supra* note 127, at 224 (“The most common use of cognitive psychology in legal scholarship is to support paternalistic legal interventions.”).



economists are right to point to the limitations of human cognition[, b]ut if they have the same cognitive limitations as consumers, should they be designing systems of consumer protection?"<sup>132</sup> In response to Judge Posner's question, Thaler posits that regulators' bounded rationality has indeterminate conclusions for behavioral regulation. He explains:

The premise of behavioral economics is that humans are not perfect decision-making machines. . . . Even Judge Posner is human, and given the number of books he has written, he must have made a few mistakes in print. But our legal system needs judges, and one of the reasons we have a layered judicial system is so that mistakes by one judge can be corrected by others. Should we abolish our legal system because judges are known to make mistakes?

No government agency (or judge) will be error-free. The goal of the Nudge agenda sketched out in my co-authored book of that title was to create decision-making environments in which it is easier for error-prone human decision makers to choose well. The [CFPB] proposed by the administration is a good example of this kind of thinking. Even imperfect experts can help us achieve better outcomes, just as imperfect judges can help us enforce the law fairly. Until we invent the perfect human (or computer decision-making device), we have no good alternatives.<sup>133</sup>

Thaler's response proceeds from the Nirvana fallacy and hence misses the critical point: Neither governments nor individuals can make error-free choices. Perhaps, as Thaler says, "[e]ven imperfect experts can help us achieve better outcomes," but the pertinent question is their comparative performance. How costly will government policy errors be if government actors suffer from, say, hyperbolic discounting or status quo bias, or are subject to framing effects? What will be the frequency and magnitude of those errors relative to relying upon private decisionmakers to correct their own errors to the extent they can do so? Can we trust behavioral regulators suffering from confirmation bias reliably to identify the true preferences of individuals, as they would have to do in order to implement successful behavioral polices?<sup>134</sup> By casting the issue as whether people err—which no one could dispute—Thaler ignores the more subtle and fundamental points about the consequences of the choice to rely upon the government rather than private decisionmakers to correct errors.<sup>135</sup> The counterintuitive

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<sup>132</sup> Richard A. Posner, Op-Ed., *Treating Financial Consumers as Consenting Adults*, WALL ST. J., July 23, 2009, at A15.

<sup>133</sup> *Thaler Responds to Posner on Consumer Protection*, PBS NEWSHOUR (July 28, 2009), <http://www.pbs.org/newshour/businessdesk/2009/07/thaler-responds-to-posner-on-c.html>.

<sup>134</sup> For a discussion of the confirmation bias in the context of behavioral law and economics and its proponents, see Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907 (2002).

<sup>135</sup> Nor do Sunstein, Thaler, or other behaviorists appear to be concerned with a research program or policy agenda intended to "nudge" regulators and judges to more rational evaluation of data or improved decisionmaking free from behavioral biases. For example, the behavioral literature does not appear to

presumption that irrationality among regulators is irrelevant consistently biases cost–benefit analysis in favor of government intervention.

Second, the behaviorists’ government intervention bias depends upon their systematic underestimation of information costs. Behaviorist prescriptions for intervention assume regulators are able to recognize, gather, and process the data required to identify each individual’s “true preferences.”<sup>136</sup> Their implicit assumption is that regulators enjoy a comparative advantage over private economic actors in acquiring information. Professors Mario Rizzo and Douglas Whitman describe this obstacle to welfare-increasing behavioral interventions as the “knowledge problem” of behavioral law and economics, derived from F.A. Hayek’s well-known critique of central planning.<sup>137</sup> Rizzo and Whitman describe the dilemma facing behaviorists:

*If well-meaning policymakers possess all the relevant information about individuals’ true preferences, their cognitive biases, and the choice contexts in which they manifest themselves, then policymakers could potentially implement paternalist policies that improve the welfare of individuals by their own standards. But lacking such information, we cannot conclude that actual paternalism will make their decisions better; under a wide range of circumstances, it will even make them worse. New paternalists have not taken the knowledge problems that are evident from the underlying behavioral and economic research seriously enough.*<sup>138</sup>

The assumptions required to overcome the knowledge problem are both heroic and impossible. Behaviorists must assume regulators will be able simultaneously to (1) identify the distribution of individuals’ true preferences, (2) access reliable empirical data sufficient to identify departures from rational choice, (3) interpret those data accurately, and (4) design and implement policies so the reduction in errors works a net increase in welfare. The failure of any one of these assumptions is fatal to the behavioral enterprise; disregard of the knowledge problem biases the perceived costs of behavioral interventions.

The knowledge problem necessarily invites regulators to misuse behavioral economics. The behavioral literature does not offer clear predictions of individual behavior when multiple cognitive biases infect

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include cooling off periods for regulatory decisions made in haste, or a plain vanilla requirement for novel applications of behavioral interventions that would require the government decisionmaker to be informed of the risks of policy error and the potential costs of unintended consequences. *But see* Josh Wright, *A “Plain Vanilla” Proposal for Behavioral Law and Economics*, TRUTH ON THE MARKET (July 16, 2010, 8:53 AM), <http://truthonthemarket.com/2010/07/16/a-plain-vanilla-proposal-for-behavioral-law-and-economics/>.

<sup>136</sup> Rizzo & Whitman, *supra* note 91, at 910.

<sup>137</sup> *Id.*; F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

<sup>138</sup> Rizzo & Whitman, *supra* note 91, at 910.

decisionmaking. The interaction of biases is poorly understood even in controlled settings, much less in markets. Because behavioral economics generates indeterminate predictions in many settings, central planners have myriad opportunities to substitute their preferences (or the preferences of special interest groups) for those of the public. Furthermore, because behavioral economics produces a range of possibilities open to a regulator considering a proposed intervention, behavioral economics entails a much greater risk of policy error than would reliance upon the relatively narrow predictions of price theory.<sup>139</sup> Any rigorous evaluation of the costs and benefits of behavioral intervention must account for the potential abuse or simply mistaken use of behavioral economics by regulators.

Consider, for example, the recent policy decision to implement the Making Work Pay income tax credit as a slow and recurring decrease in withholding rather than a one-time lump-sum reduction. Behavioral economists, including Sunstein and Thaler,<sup>140</sup> predicted that one-time tax cuts, such as the 2008 tax rebate, would be less effective in stimulating economic activity than would recurring payments because individuals would be more likely to treat the latter as disposable income.<sup>141</sup> The limited available evidence, however, suggests their prediction was incorrect.<sup>142</sup> Claudia Sahn, Matthew Shapiro, and Joel Slemrod found, contrary to the behaviorist prediction, 25% of households reported that the one-time economic stimulus payment in 2008 would lead them to mostly increase their spending while only 13% reported that the extra pay from the lower withholding in 2009 would lead them to mostly increase their spending.<sup>143</sup>

Either of these classes of objections—the default rule fallacy or the government intervention bias—is sufficient to undermine dramatically or to reject altogether the welfare-based case for behavioral law and economics. Even if, however, we assume the behavioral economics research and policy programs can avoid all such problems and would be justified on pure

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<sup>139</sup> See Ginsburg & Moore, *supra* note 88, at 96–97 (“[Behavioral economics] is almost the opposite of price theory, which narrows significantly the range of outcomes a court may reach;” instead it “increases the degrees of freedom with which a court may pursue personal, idiosyncratic goals.”).

<sup>140</sup> See James Surowiecki, *A Smarter Stimulus*, NEW YORKER, Jan. 26, 2009, at 25 (attribution to Thaler); Claudia R. Sahn et al., *Check in the Mail or More in the Paycheck: Does the Effectiveness of Fiscal Stimulus Depend On How It Is Delivered?*, (Nat’l Bureau of Econ. Research, Working Paper No. 16246, 2010), available at <http://www.nber.org/papers/w16246.pdf> (citing Cass Sunstein & Richard Thaler, *How Behavioral Economics Could Show Up in the New Stimulus Package*, NUDGE BLOG (Jan. 20, 2009), <http://nudges.org/2009/01/20/how-behavioral-economics-could-show-up-in-the-new-stimulus-package/> (no longer available online)).

<sup>141</sup> See Barry Schwartz, *On the Economic Stimulus Package: The “Packaging” Counts*, PSYCHOL. TODAY (Feb. 1, 2009), <http://www.psychologytoday.com/blog/the-choices-worth-having/200902/the-economic-stimulus-package-the-packaging-counts>.

<sup>142</sup> See Sahn et al., *supra* note 140, at 1–3.

<sup>143</sup> *Id.* at 29. Sahn, Shapiro, and Slemrod use survey data based upon telephone interviews to assess the impact of the tax rebates. *Id.* at 6 & n.9.

economic welfare grounds, the behaviorist calculation of the net increase in societal welfare ignores the significant but underappreciated threat to individual liberty posed by government interventions predicated upon behavioral law and economics.

#### IV. BEYOND WELFARE: BEHAVIORAL ECONOMICS AND LIBERTY

In the brave new world contemplated by the advocates of government policies informed by behavioral law and economics, many more aspects of each individual's life would be regulated, or more stringently regulated, than at present. This would be true even if the behaviorists' agenda were limited to matters of health and finance, the two major subdivisions of Thaler and Sunstein's book,<sup>144</sup> each of which they define capaciously; the former, for example, includes smoking, nutrition, and medical insurance,<sup>145</sup> while the latter includes credit cards, investing, and saving for retirement.<sup>146</sup>

Assuming, again, the behavioral law and economics regulatory agenda could be implemented in a manner that avoids the problems discussed in Part III, and in a manner that increases or at least does not reduce economic welfare, that agenda would still present a substantial threat to the liberty of the individual. The current literature, however, assigns no weight to liberty beyond the narrow focus upon choice preservation; it is nearly devoid of thinking about the implications of behavioral law and economics for individual autonomy and about the social significance of autonomy's further diminution.<sup>147</sup> How should one evaluate a regulatory intervention that would increase welfare but also diminish liberty? What are the mechanics of trading off welfare and liberty when the two are in tension? To be sure, a minor reduction in liberty should not be sufficient to reject an intervention with significant welfare benefits just as an intervention generating only modest welfare benefits is not justified regardless of its negative effect upon liberty.

In close cases it will be necessary to consider such trade-offs in order fully to assess the desirability of a proposed policy intervention.<sup>148</sup> Assigning a precise value to liberty in the regulatory calculus is an impossible task given that individuals value their liberties to different degrees and policy makers have no way of knowing those valuations or their distribution. Even without assigning a precise weight to a loss of

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<sup>144</sup> See THALER & SUNSTEIN, *supra* note 17.

<sup>145</sup> *Id.* at 157–96.

<sup>146</sup> *Id.* at 101–56.

<sup>147</sup> Mitchell, *supra* note 27, at 1260–64.

<sup>148</sup> Regulatory proposals that reduce welfare for the reasons described in Part III will necessarily reduce liberty. The theoretically plausible set of “close calls” involves interventions that would increase welfare while posing a significant threat to liberty.

liberty, however, it is inevitable that such losses, if taken into account, will sometimes—perhaps often—defeat the case for intervention.<sup>149</sup> We believe the best approach to evaluating these potential tradeoffs is to establish a presumption against behaviorist regulation that reduces liberty, rebuttable only by demonstrating that the regulation is likely to generate significant gains in economic welfare. It is to those liberty concerns that we now turn.

### A. *Autonomy*

John Stuart Mill followed Immanuel Kant<sup>150</sup> in noting explicitly the value of autonomy in its own right, that is, apart from what one does with one's autonomy or the consequences of its exercise.<sup>151</sup> Mill's point was that a fully realized human being is one who makes the important decisions in his own life:

If a person possesses any tolerable amount of common sense and experience, his own mode of laying out his existence is the best, not because it is the best in itself, but because it is his own mode. Human beings are not like sheep; and even sheep are not undistinguishably alike. . . . If it were only that people have diversities of taste that is reason enough for not attempting to shape them all after one model. But different persons also require different conditions for their spiritual development . . . .<sup>152</sup>

On the related topic of unthinking conformity to a tradition or custom, which he acknowledges may embody the teachings of experience, Mill's observation is a cautionary note with equal application for those who would relieve the citizen of the need to decide things for himself:

[T]o conform to custom, merely as custom, does not educate or develop in him any of the qualities which are the distinctive endowment of a human being. The human faculties of perception, judgment, discriminative feeling, mental activity, and even moral preference, are exercised only in making a choice.<sup>153</sup>

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<sup>149</sup> For example, these liberty concerns are likely to dominate behaviorist regulatory proposals with positive, but trivial, expected welfare benefits.

<sup>150</sup> See IMMANUEL KANT, *GROUNDWORK FOR THE METAPHYSICS OF MORALS* 97–98 (Lara Denis ed., Thomas K. Abbott trans., Broadview Press 2005) (1785).

<sup>151</sup> *Cf.*, e.g., JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* 306 (Peter Laslett ed., student ed. 1988) (1690) (“[T]he end of Law is not to abolish or restrain, but to preserve and enlarge Freedom . . . . Freedom is . . . a Liberty to dispose, and order, as he lists, his Person, Actions, Possessions, and his whole Property, within the Allowance of those Laws under which he is; and therein not to be subject to the arbitrary Will of another, but freely follow his own.”).

<sup>152</sup> JOHN STUART MILL, *On Liberty*, in *ON LIBERTY AND OTHER ESSAYS* 5, 75 (John Gray ed., 1991) (1859); accord JAMES GRIFFIN, *WELL-BEING: ITS MEANING, MEASUREMENT, AND MORAL IMPORTANCE* 67 (1986) (“One component of agency is deciding for oneself. Even if I constantly made a mess of my life, even if you could do better if you took charge, I would not let you do it. Autonomy has a value of its own.”).

<sup>153</sup> MILL, *supra* note 152, at 65.

And finally, in words that fortuitously seem to anticipate Thaler and Sunstein's ideas on manipulating the default rule for enrolling employees in payroll savings plans,<sup>154</sup> Mill exhorts:

He who chooses his plan for himself, employs all his faculties. He must use observation to see, reasoning and judgement to foresee, activity to gather materials for decision, discrimination to decide, and when he has decided, firmness and self-control to hold to his deliberate decision.<sup>155</sup>

More than a century later, Friedrich Hayek, in *The Constitution of Liberty*, made a slightly different point about the value of having more rather than fewer choices:

[T]he importance of our being free to do a particular thing has nothing to do with the question of whether we or the majority are ever likely to make use of that particular possibility. . . . [T]he less likely the opportunity, the more serious will it be to miss it when it arises, for the experience it offers will be nearly unique.<sup>156</sup>

As Amartya Sen would later point out, this consideration relates to “the process aspect of freedom,” which “includes considerations that may not figure in the accounting of the opportunity aspect [of freedom].”<sup>157</sup> In particular, Sen identifies

(i) decisional autonomy of the choices to be made, and (ii) immunity from interference by others. The former is concerned with the operative role that a person has in the process of choice, and the crucial issue here is self-decision, e.g., whether the choices are being made by the person herself—not (on her behalf) by other individuals or institutions.<sup>158</sup>

Behaviorists in general do not place any value upon the “the process aspect of freedom” or “decisional autonomy.”<sup>159</sup> Sunstein and Thaler in particular claim to preserve the choices now open to people by, for example, merely altering default rules without preventing the determined

<sup>154</sup> See THALER & SUNSTEIN, *supra* note 17, at 103–17.

<sup>155</sup> MILL, *supra* note 152, at 65.

<sup>156</sup> F.A. HAYEK, *THE CONSTITUTION OF LIBERTY: THE DEFINITIVE EDITION* 83 (Ronald Hamowy ed., 1960).

<sup>157</sup> Amartya Sen, *Markets and Freedoms: Achievements and Limitations of the Market Mechanism in Promoting Individual Freedoms*, 45 OXFORD ECON. PAPERS 519, 523–24 (1993).

<sup>158</sup> *Id.* at 524; cf. MILTON FRIEDMAN & ROSE FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT* 27 (1980) (noting that “[s]elf-interest is not myopic selfishness. It is whatever it is that interests the participants, whatever they value, whatever goals they pursue,” including their altruistic goals).

<sup>159</sup> Sunstein and Thaler would assign zero weight to decisional autonomy unless it is linked with a welfare-based preference for decisionmaking. Sunstein & Thaler, *supra* note 2, at 1198–99 (“Freedom of choice is itself an ingredient in welfare. In some situations people derive welfare from the very act of choosing. . . . But much of the time, especially in technical areas, people do not particularly enjoy the process of choice . . .”). In practice, they ignore it altogether.

individual from opting out; as we have seen, however, that is not always the case, and it is never without cost to the person whose preference is different from theirs. Indeed, the proposals they advance are libertarian only in the limited sense that they “do not block choice” altogether.<sup>160</sup> As Mozaffar Qizilbash observes, Sunstein and Thaler do not address the deeper antipaternalist objection that their proposals deny the inherent value individuals place upon autonomy.<sup>161</sup> Autonomy—“deciding for oneself”—has value that “run[s] contrary to even the weak form of paternalism” favored by Sunstein and Thaler, rendering “the idea of ‘libertarian paternalism’ as they define it . . . potentially incoherent.”<sup>162</sup>

Sometimes Sunstein and Thaler obscure their coercive instinct from view, as in the example with which they begin *Nudge*. There they instance the “director of food services for a large city school system” who has “formal training in nutrition.”<sup>163</sup> She can have food presented in the schools’ cafeterias in any sequence, including the sequence that is best for the children and the one that will maximize profits.<sup>164</sup> Sunstein and Thaler mean to point out the inevitability of some choice being made and of that choice influencing the children’s preferences. Their choice of setting, however, defeats this implication. In their hypothetical illustration, the nutritionist ultimately influences children, who have less autonomy than do adults—which is why most of them are in school. The “choice architect” works for a public school system, not a for-profit enterprise, the mission of which school system is to educate children, perhaps even on the subject of nutrition. What the nutritionist’s choice, inevitable or not, has to do with the case for the government manipulating adults, who are sovereign in the marketplace, remains obscure.<sup>165</sup>

Limiting the range of decisions to be made by individuals or burdening those who would make an officially disfavored choice—not saving enough, eating unhealthful foods, etc.—tends to infantilize the public. Effective decisionmaking is acquired through trial and error, that is, by making a

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<sup>160</sup> Mozaffar Qizilbash, *Well-Being, Preference Formation and the Danger of Paternalism* 23 (Max Planck Inst. of Econ. Papers on Econ. & Evolution, Working Paper No. 0918, 2009), available at [ftp://papers.econ.mpg.de/evo/discussionpapers/2009-18.pdf](http://papers.econ.mpg.de/evo/discussionpapers/2009-18.pdf).

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> THALER & SUNSTEIN, *supra* note 17, at 1.

<sup>164</sup> *Id.* at 1–3.

<sup>165</sup> Sunstein clarified the connection in an earlier work, instancing “the cafeteria at some organization” and rather lamely suggesting that if the cafeteria’s goal is profit maximization, then even “those cafeterias that face competition will find that some of the time, market success will come not from tracking people’s preferences, but from providing goods and services that turn out, in practice, to promote their welfare, all things considered. Consumers might be surprised by what they end up liking . . .” CASS R. SUNSTEIN, *LAWS OF FEAR* 178–79 (2005). Clearly Sunstein and Thaler have little to offer when they move from a coercive to a market environment, where consumers are sovereign.

decision and either getting verbal feedback about or directly observing the success or failure of one's decision as a means of reaching one's goal.<sup>166</sup> Moreover, "when people are motivated to be accurate, they expend more cognitive effort on issue-related reasoning, attend to relevant information more carefully, and process it more deeply, often using more complex rules."<sup>167</sup>

The lesson, which is, ironically, ignored in the prescriptive behavioral law and economics literature, is clear: The more palpable the consequences of one's decisions, the more indelible the imprint of experience.<sup>168</sup> Indeed, there is reason to think experimental results such as these tend to understate significantly the value of experience gained outside the confines of the experiment, i.e., in the marketplace. As Glaeser has pointed out, the subjects enrolled in an experiment face limited incentives, which are

much stronger in the real world than in the laboratory. In experiments, individuals have few tools with which to improve their reasoning, and their only real method of responding to incentives is to think harder. Outside of the lab, people have access to advisers, books, the Internet, and more time. Their

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<sup>166</sup> James P. Byrnes et al., *Learning to Make Good Decisions: A Self-Regulation Perspective*, 70 CHILD DEV. 1121, 1122 (1999); see also JAMES P. BYRNES, THE NATURE AND DEVELOPMENT OF DECISION MAKING: A SELF-REGULATION MODEL 27–28 (1998) (relying upon the approach used in the field of artificial intelligence in formulating the self-regulation model for rational task analysis and observing "[n]o one would disagree with . . . my claim that decision making requires the[se] four processes"). The experimental literature shows that subsequent decisions are more likely to be improved by experiencing success or failure than by being told one's decision was a success or a failure and why. Byrnes et al., *supra* at 1137. Experimental studies suggest "adults could progressively learn to make better decisions if they received relatively clear feedback from outcomes." *Id.* at 1125, 1137 (citing two studies in support of the general proposition adults will make better decisions as a result of clear feedback and two studies that conclude older children are more likely to exhibit improved decisionmaking as a result of feedback than are young children). Klick and Mitchell have expanded somewhat upon Byrnes's findings, concluding that, because feedback is obtained "[t]hrough education, experimentation, experience, and observation," increased activity or opportunity in these areas will likewise lead individuals to "select the option that will lead to the most favorable outcomes." Klick & Mitchell, *supra* note 83, at 1629. A related body of studies in experimental psychology shows that individuals better remember and more closely analyze unfavorable feedback than they do favorable feedback. See, e.g., Peter H. Ditto et al., *Motivated Sensitivity to Preference-Inconsistent Information*, 75 J. PERSONALITY & SOC. PSYCHOL. 53, 65 (1998).

<sup>167</sup> Ziva Kunda, *The Case for Motivated Reasoning*, 108 PSYCHOL. BULL. 480, 481 (1990).

<sup>168</sup> Consistent with this inference, Vernon Smith and James Walker's review of the experimental literature on the effect of incentives on decisionmaking finds that "[s]ome studies report observations that fail to support the predictions of rational models, but as reward level is increased the data shift toward these predictions." Vernon L. Smith & James M. Walker, *Monetary Rewards and Decision Cost in Experimental Economics*, 31 ECON. INQUIRY 245, 259–60 (1993). Consequences need not be serious, however, for the effect of a choice to provide valuable feedback; studies show the repetition of feedback that accompanies making similar decisions may be useful to the decisionmaking process. See List, *Market Experience*, *supra* note 14, at 70 ("I find strong evidence that individual behavior converges to the neoclassical prediction as trading experience intensifies."); Smith, *supra* note 52, at 118 (noting that rational behavior tends to emerge "in the context of a repetitive market institution").



willingness to spend time and money to use these resources will surely depend on the stakes involved in the decision.<sup>169</sup>

It is precisely because individuals invest more effort when making more important decisions that paternalistic policies relieving them of responsibility for those decisions will have the most corrosive effect upon their decisionmaking ability.<sup>170</sup> Klick and Mitchell describe this cost of libertarian paternalism as a type of moral hazard, which in the long run would raise error rates because people would invest less in error correction.<sup>171</sup> Nor is it reasonable to think the adverse effect will be felt with respect only to a narrow class of similar decisions; a muscle that has atrophied is rendered incapable of any strenuous activity, regardless of the particular purpose of that activity.

If individuals are to realize their full potential as participants in the political and economic life of society, then they must be free to err in large ways as well as small. The fatal flaw of libertarian paternalism is to ignore the value of the freedom to err. Interestingly, Hayek said as much in making the inherently antipaternalistic case for *The Constitution of Liberty*: “Man learns by the disappointment of expectations.”<sup>172</sup> “Liberty not only means that the individual has both the opportunity and the burden of choice; it also means that he must bear the consequences of his actions and will receive praise or blame for them. Liberty and responsibility are inseparable.”<sup>173</sup> In a passage that, if heeded, would have saved the behaviorists a great deal of effort, he wrote:

The justification for assigning responsibility is thus the presumed effect of this practice on future action; it aims at teaching people what they ought to consider in comparable future situations. . . . This does not mean that a man will always be assumed to be the best judge of his interests; it means merely that we can never be sure who knows them better than he . . . .<sup>174</sup>

James Buchanan also emphasizes the relationship between liberty and responsibility,<sup>175</sup> and in particular, individuals’ demand for institutions that insulate them from responsibility: “Relatively few persons are sufficiently strong, as individuals, to take on the full range of liberties and their accompanying responsibilities without seeking some substitute or

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<sup>169</sup> Glaeser, *supra* note 48, at 140.

<sup>170</sup> See Klick & Mitchell, *supra* note 83, at 1635–36.

<sup>171</sup> *Id.* at 1626.

<sup>172</sup> HAYEK, *supra* note 156, at 82.

<sup>173</sup> *Id.* at 133.

<sup>174</sup> *Id.* at 139.

<sup>175</sup> James M. Buchanan, *Afraid to Be Free: Dependency as Desideratum*, 124 PUB. CHOICE 19, 23 (2005) (observing that the academy has “failed to emphasize sufficiently, and to examine the implications of, the fact that liberty carries with it *responsibility*”).

replacement of the parental shelter.”<sup>176</sup> The role of economists is to remedy the “widespread failure to understand that the independence offered by the entry and exit options of the market offsets the *dependence* on others when markets are closed or displaced.”<sup>177</sup> Hayek and Buchanan illustrate that the political and economic value of the freedom to err derives from the exercise of individuals’ liberty but requires sufficient independence from the state that individuals bear the costs of their choices.

Thinking about the implications of paternalism—soft or hard, libertarian or totalitarian—both for individuals and for the society they compose, yields some testable hypotheses. For one, we would expect people who were raised in a paternalistic state, and hence relieved of the need to make many important decisions for themselves, to have less well-developed decisionmaking skills and to be more risk averse. As it happens, there is a body of literature in cognitive psychology that tends to support this hypothesis; it proceeds from an understanding of the characteristics associated with entrepreneurship.

In general, “entrepreneurs . . . exhibit a particular mode of information processing, or cognitive style.”<sup>178</sup> They are more alert to opportunities that require linking previously unrelated information.<sup>179</sup> Indeed, the experimental literature strongly tends to validate Israel Kirzner’s description of the Austrian tradition, which “postulates a tendency for profit opportunities to be *discovered* and *grasped* by routine-resisting entrepreneurial market participants.”<sup>180</sup>

In a socialist state, however, resistance is futile. Uncritical acceptance of the party line is essential to survival, much less advancement. Of course, there are choices to be made: Shall I read Pravda or Izvestia? Yet the choice set has been limited by the state in a way that serves the state’s ends, not those of the individual.<sup>181</sup> As Milan Simecka so graphically recounted from his personal experience after the Prague Spring of 1968, the Communist Party of Czechoslovakia controlled the citizenry by depriving individuals of their decisional autonomy in only three respects: The state determined their

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<sup>176</sup> *Id.* at 24.

<sup>177</sup> *Id.* at 27.

<sup>178</sup> Amir N. Licht, *The Entrepreneurial Spirit and What the Law Can Do About It*, 28 COMP. LAB. L. & POL’Y J. 817, 819 (2007).

<sup>179</sup> *Id.* at 824–25; see also Connie Marie Gaglio & Jerome A. Katz, *The Psychological Basis of Opportunity Identification: Entrepreneurial Alertness*, 16 SMALL BUS. ECON. 95, 96–98 (2001).

<sup>180</sup> Israel M. Kirzner, *Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach*, 35 J. ECON. LITERATURE 60, 71 (1997).

<sup>181</sup> See KATHERINE VERDERY, WHAT WAS SOCIALISM, AND WHAT COMES NEXT? 26 (1996) (explaining that the purpose of socialism was “to accumulate means of production” in order “to redirect resources to a goal greater than satisfying the population’s needs”).

housing, their occupation, and their children's education.<sup>182</sup> That is why this professor of mathematics in mid-career became an operator of construction equipment. Perhaps it is not a coincidence that his book was published in 1984.<sup>183</sup>

The end of the Soviet era in Russia and the Eastern European states it dominated, and the very substantial movement in China toward a market economy, provide useful comparisons. The Soviet experience uniquely spanned the lives of three generations over a period of seventy-four years.<sup>184</sup> The experience of Eastern Europe with communism lasted about forty-five years and in most places did not entail as comprehensive a form of state control over the economy;<sup>185</sup> unlike in Russia, therefore, at the end of the communist era there were many small business owners as well as people with pre-communist business experience who could rekindle the entrepreneurial spirit. China began to shift to a more privatized economy even in the late 1970s, after only thirty years of economic totalitarianism, again during the lifetime of pre-communist-era business people.<sup>186</sup>

Transnational comparisons using data from the Global Entrepreneurship Monitor<sup>187</sup> produce strong evidence that, even after controlling for relevant variables, all countries with a communist past have a lower rate of entrepreneurship activity than do other countries.<sup>188</sup> A recent study concludes that even now those unfortunate countries have “low levels of entrepreneurial human capital that have been engendered by decades of

<sup>182</sup> See MILAN SIMECKA, *RESTORATION OF ORDER: THE NORMALIZATION OF CZECHOSLOVAKIA 1969–1976* (A.G. Brain trans., 1984).

<sup>183</sup> See *id.* at 18; see also KEVIN DEVLIN, *HOW NORMAL IS NORMALIZATION?* 4 (1982), available at <http://www.osaarchivum.org/files/holdings/300/8/3/pdf/139-4-7.pdf>.

<sup>184</sup> See Ruta Aidis et al., *Institutions and Entrepreneurship Development in Russia: A Comparative Perspective*, 23 *J. BUS. VENTURING* 656, 658 (2008).

<sup>185</sup> See, e.g., TONY JUDT, *POSTWAR: A HISTORY OF EUROPE SINCE 1945*, at 428 (2005) (noting that Hungary under János Kádár implemented economic reforms in 1968 to promote a “mixed economy” with some local autonomy and private ownership); David Lipton & Jeffrey Sachs, *Creating a Market Economy in Eastern Europe: The Case of Poland*, *BROOKINGS PAPERS ECON. ACTIVITY*, no. 1, 1990, at 75, 80–82 (noting that farmers in Poland “retained their private land after World War II,” and a larger though still restricted “private sector ha[d] been allowed to operate under the reforms in Hungary and Poland” during communism).

<sup>186</sup> Louis Putterman, *The Role of Ownership and Property Rights in China's Economic Transition*, in *CHINA'S TRANSITIONAL ECONOMY* 85, 86 (Andrew G. Walder ed., 1996) (“The period from 1978 to the early 1990s was marked by a massive shift . . . with significant new participation by foreign and domestic private firms.”); see also Jonas Alsén, *An Introduction to Chinese Property Law*, 20 *MD. J. INT'L L. & TRADE* 1, 20–21 (1996) (detailing shift to more private ownership in China beginning in 1978); Richard D. Cudahy, *From Socialism to Capitalism: A Winding Road*, 11 *CHI. J. INT'L L.* 39, 53–56 (2010) (noting “[t]he flexibility of the Chinese in economic matters seemed to far exceed the Soviets” and discussing China's cautious shift toward privatization).

<sup>187</sup> GLOBAL ENTREPRENEURSHIP MONITOR, <http://www.gemconsortium.org> (last visited Aug. 13, 2012).

<sup>188</sup> See Aidis et al., *supra* note 184, at 658–59, 662.

existence under a central planning system that tended to blunt individual incentives.<sup>189</sup> As one would expect, however, the level of entrepreneurship is “significantly lower in Russia.”<sup>190</sup> A study conducted jointly by Russian and U.S. scholars concludes that “[t]he absence of freedom of decision-making in the most important resource—the workforce—and the ‘no-choice’ employment situation were two fundamental obstacles to the development of entrepreneurship” during the communist era.<sup>191</sup> After the fall of communism, moreover, Russian entrepreneurs tended to be younger than was typical elsewhere;<sup>192</sup> only the young were unscathed by their nation’s paternalistic history.

### B. A Slippery Slope

Of course, no proponent of regulation based upon the findings of behavioral economics espouses a regime remotely as encompassing and restrictive as even the least oppressive of the late, unlamented communist regimes. There is reason to believe, however, they would put us on a slippery slope—or push us that much further down the slope than we have already slid.<sup>193</sup>

Paternalistic policies are, by nature, likely to be slippery.<sup>194</sup> Such policies are expressed in regulations specifically adopted, at least initially, for the benefit of those regulated and, if those individuals do not want to be regulated for their own good—which is hardly unusual—the regulators will likely deem ever more stringent measures necessary. The federal laws protecting the occupants of automobiles provide a familiar historical example.<sup>195</sup> Initially, the regulators merely required manufacturers to install seatbelts in all automobiles. As the Supreme Court has recounted: “It became apparent, however, that most occupants simply would not buckle

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<sup>189</sup> Martin Robson, *Explaining Cross-National Variations in Entrepreneurship: The Role of Social Protection and Political Culture*, 28 COMP. LAB. L. & POL’Y J. 863, 890 (2007).

<sup>190</sup> Aidis et al., *supra* note 184, at 657, 670 (attributing difference in part to weak institutions to support entrepreneurial development).

<sup>191</sup> Alexander I. Ageev et al., *Entrepreneurship in the Soviet Union and Post-Socialist Russia*, 7 SMALL BUS. ECON. 365, 369 (1995).

<sup>192</sup> *See id.* at 371, 374 (finding entrepreneurs in Russia are younger than their counterparts in Poland and Hungary).

<sup>193</sup> *See* Douglas Glen Whitman & Mario J. Rizzo, *Paternalistic Slopes*, 2 N.Y.U. J.L. & LIBERTY 411, 412 (2007) (“A slippery slope argument is one suggesting that a proposed policy or course of action that might appear desirable now, when taken in isolation, is in fact undesirable (or less desirable) because it increases the likelihood of undesirable policies being adopted in the future.”).

<sup>194</sup> *See* Rizzo & Whitman, *supra* note 121, at 691–705 (stating “slippery slopes flourish in the presence of a gradient or continuum,” and “[t]he new paternalist paradigm . . . relies on discarding sharp distinctions in favor of gradients”).

<sup>195</sup> For a brief history of federal seat belt laws, see Barry L. Huntington, *Welcome to the Mount Rushmore State! Keep Your Arms and Legs Inside the Vehicle at All Times and Buckle Up . . . Not for Safety, But to Protect Your Constitutional Rights*, 47 S.D. L. REV. 99, 101–04 (2002).

up their belts,” so the regulators turned to requiring various passive restraints, including airbags, automatic seat belts, and briefly even an “ignition interlock” device that prevented a car from starting if an occupant had not fastened his seatbelt.<sup>196</sup> “But the interlock and buzzer devices were most unpopular with the public.”<sup>197</sup> Then the regulators threatened the states with sanctions if they did not adopt laws requiring that seat belts be used.<sup>198</sup>

Each of these mandates imposed a cost upon the manufacturers and the purchasers of automobiles, but not upon the government officials who formulated them. On the contrary, each successive measure tended to insulate the regulators from legislative and bureaucratic reprisals. Risk regulators—whether they supervise financial institutions, protect the environment, or certify foods and drugs as fit for use—face asymmetrical incentives that inevitably put them on a slippery slope: They stand to be criticized if their initial measures are insufficient to prevent all harms of the sort they are tasked (or have tasked themselves) with preventing; they will not be fully rewarded until they have fully accomplished their mission.

Also, regulatory missions tend to expand;<sup>199</sup> “mission creep”<sup>200</sup> assures that the government agency will require more money and more staff over time, forestalling any danger of the agency accomplishing its mission and becoming redundant.<sup>201</sup> Just as the development of a vaccine for polio threatened to put the March of Dimes charity out of business<sup>202</sup> (and caused it to adopt a mission that could never be fully achieved, namely,

<sup>196</sup> See *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 875–77 (2000) (discussing history of federal regulations requiring passive restraints).

<sup>197</sup> *Id.* at 876.

<sup>198</sup> Huntington, *supra* note 195, at 101–02. States without mandatory seatbelt laws also receive reduced federal funding for highway maintenance. *Id.* at 102.

<sup>199</sup> See MILTON FRIEDMAN, *WHY GOVERNMENT IS THE PROBLEM* 9 (1993) (“The general rule is that government undertakes an activity that seems desirable at the time. Once the activity begins, whether it proves desirable or not, people in both the government and the private sector acquire a vested interest in it. If the initial reason for undertaking the activity disappears, they have a strong incentive to find another justification for its continued existence.”); see also Rizzo & Whitman, *supra* note 121, at 717–23 (arguing that the adoption of a moderate paternalist policy makes the adoption of further policies more likely because the proponent can argue the now-accepted justification for the first policy also provides a foundation for the new policy).

<sup>200</sup> Gary W. Jenkins, *Who’s Afraid of Philanthrocapitalism?*, 61 CASE W. RES. L. REV. 753, 805 n.212 (2011) (“Mission creep refers to an organizational phenomenon in which entities inadvertently, over time, stray from their fundamental mission by engaging in activities or behaviors less closely related to the core . . . purpose.”).

<sup>201</sup> See, e.g., Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1, 3 (2002); Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101, 117 (1987).

<sup>202</sup> See HOWARD P. GREENWALD, *ORGANIZATIONS: MANAGEMENT WITHOUT CONTROL* 369 (2008); DAVID L. SILLS, *THE VOLUNTEERS: MEANS AND ENDS IN A NATIONAL ORGANIZATION* 253–54 (1957).

“improv[ing] the health of babies” worldwide<sup>203</sup>), government agencies are always on the lookout for conduct that needs to be regulated. Mission creep is a concern regardless whether an agency’s purpose is paternalistic, but with a mandate to regulate conduct for the benefit of the regulated individuals, there is no end to the good an agency may attempt to do at the expense of those individuals’ freedoms.<sup>204</sup>

Once a regulation is in place it may well come to be accepted as the new norm. Extension of the regulation then seems like a modest and indeed logical next step.<sup>205</sup> Smoking bans are a case in point.<sup>206</sup> The federal government first determined that cigarette smoking is bad for the smoker’s health and so advised the public. When the public’s behavior did not conform to the regulators’ expectations for what rational people would do, i.e., give up smoking, they ratcheted up the regulatory intervention: warnings were required on cigarette packages, tobacco advertisements were prohibited from television, and sin taxes were imposed upon the purchase of cigarettes.<sup>207</sup> The regulators’ preferences notwithstanding, millions of people continued to smoke cigarettes.<sup>208</sup> The federal government then publicized the hazard smoking posed to nonsmokers, which provided a new, externality-based rationale for banning smoking.<sup>209</sup> This rationale was flawed, of course, because there was no gap in the relevant property rights: Patrons of restaurants and bars who did not want to be exposed to secondhand smoke could take their custom elsewhere. The expressed concern for employees of those establishments was similarly flawed in that, unlike the unfortunate subjects of the Soviet system, they were free to change their place of employment. Eventually, the ban on smoking in bars

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<sup>203</sup> *Global Programs*, MARCH OF DIMES, <http://www.marchofdimes.com/mission/globalprograms.html> (last visited Aug. 13, 2012).

<sup>204</sup> See *Olmstead v. United States*, 277 U.S. 438, 479 (1928) (Brandeis, J., dissenting) (“Experience should teach us to be most on our guard to protect liberty when the Government’s purposes are beneficent. Men born to freedom are naturally alert to repel invasion of their liberty by evil-minded rulers. The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding.”).

<sup>205</sup> See Whitman & Rizzo, *supra* note 193, at 441; cf. Lawrence Lessig, *The New Chicago School*, 27 J. LEGAL STUD. 661, 666–72 (1998) (describing work by scholars concluding law can regulate social norms); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 964 (1996) (“Many laws have an expressive function. They ‘make a statement’ about how much, and how, a good or bad should be valued. They are an effort to constitute and to affect social meanings, social norms, and social roles. Most simply, they are designed to change existing norms and to influence behavior in that fashion.”).

<sup>206</sup> See Rizzo & Whitman, *supra* note 121, at 720–23.

<sup>207</sup> *Id.* at 720.

<sup>208</sup> See *Trends in Current Cigarette Smoking Among High School Students and Adults, United States, 1965–2010*, CENTERS FOR DISEASE CONTROL & PREVENTION, [http://www.cdc.gov/tobacco/data\\_statistics/tables/trends/cig\\_smoking/index.htm](http://www.cdc.gov/tobacco/data_statistics/tables/trends/cig_smoking/index.htm) (last visited Aug. 13, 2012).

<sup>209</sup> See Rizzo & Whitman, *supra* note 121, at 720.

and restaurants was generalized by many local governments to all indoor spaces and recently has spawned proposals to ban smoking out-of-doors in some localities,<sup>210</sup> notwithstanding the lack of any reason to be concerned with the welfare of third parties there.

As the assault on smoking proceeded down the slope, the justification for each new step zigged and zagged between the paternalistic and fallacious externality-based rationales. In fact, once smoking was deemed unhealthful to smokers and bystanders alike, the actual rationale for each next step became unimportant.<sup>211</sup> The previous step had established the new normal, and the next step was but a small effort to perfect implementation of the norm.

It is upon similarly flawed grounds that the historical concept of “public health” evolved from a concern with contagious disease<sup>212</sup> into a paternalistic, all-encompassing concern with the health of the public.<sup>213</sup> If smoking is unhealthful, that is now enough to deem it a matter of public health. So, too, with obesity<sup>214</sup> and other self-determined and noncontagious harms—if harms they are in the eyes of the individual who smokes or overeats.

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<sup>210</sup> See, e.g., Sewell Chan, ‘No Smoking’ Could Be Rule Outdoors, Too, N.Y. TIMES, Sept. 15, 2009, at A1 (discussing the New York City Health Commissioner’s proposal to ban smoking at city parks and beaches).

<sup>211</sup> See Rizzo & Whitman, *supra* note 121, at 722 (“[F]urther restriction of public smoking became acceptable with little or no evidence of significant harm to bystanders.”).

<sup>212</sup> BERNARD J. TURNOCK, ESSENTIALS OF PUBLIC HEALTH 4 (2d ed. 2012) (noting the “clear intent” of creating state public health agencies in the late nineteenth century was that their “powers be used to battle epidemics of infectious diseases”).

<sup>213</sup> For example, the Office of the Assistant Secretary for Health—formerly the Office of Public Health and Science, 75 Fed. Reg. 53,304 (Aug. 31, 2010)—currently comprises eleven public health offices with missions ranging from “improv[ing] the quality of healthcare across the United States” to “[c]oordinat[ing] adolescent health promotion and disease prevention . . .” *Public Health Offices*, U.S. DEP’T OF HEALTH & HUMAN SERVS., [http://www.hhs.gov/ash/public\\_health/indexph.html](http://www.hhs.gov/ash/public_health/indexph.html) (last visited Aug. 13, 2012). The World Health Organization, the objective of which is “the attainment by all peoples of the highest possible level of health,” defines “health” as “a state of complete physical, mental and social well-being and not merely the absence of disease or infirmity.” *Constitution of the World Health Organization*, WORLD HEALTH ORG. pmbl., art. 1 (Oct. 2006), [http://www.who.int/governance/eb/who\\_constitution\\_en.pdf](http://www.who.int/governance/eb/who_constitution_en.pdf). Similarly, the mission of the U.S. National Institutes of Health is “to enhance health, lengthen life, and reduce the burdens of illness and disability.” *Mission*, NAT’L INSTS. OF HEALTH, <http://www.nih.gov/about/mission.htm> (last visited Aug. 13, 2012).

<sup>214</sup> The legal effort to promote more healthful eating started in 1990 with the enactment of the Nutrition Labeling and Education Act, which authorized the Food and Drug Administration to issue rules requiring that food bear nutrition labels. See Pub. L. No. 101-535, 104 Stat. 2353 (1990); see also 21 C.F.R. pt. 101 (implementing regulations). This effort has evolved into outright bans on the use of trans fats in restaurants. N.Y.C. ADMIN. CODE § 81.08 (West 2006). The Centers for Disease Control refers to obesity as an “epidemic.” CENTERS FOR DISEASE CONTROL & PREVENTION, OBESITY: HALTING THE EPIDEMIC BY MAKING HEALTH EASIER 2 (2009), available at <http://www.cdc.gov/chronicdisease/resources/publications/AAG/pdf/obesity.pdf> (“American society has become ‘obesogenic,’ characterized by environments that promote increased food intake, nonhealthful foods, and physical inactivity. Public health approaches that affect large numbers of different populations in multiple settings—communities, schools, work sites, and health care facilities—are needed.”).

The theoretical and empirical problems that make the case for behaviorally inspired regulation so weak also increase the probability that, once adopted, such a regulation will have an even more pronounced tendency to expand. If the regulation is justified on the ground that there is a divergence between the expressed preference and the “true preference” of the regulated persons, and assuming that, based upon experimental data worthy of reliance, the degree of that divergence can be estimated for each individual, the regulator will initially have to make his best guess as to the degree of debiasing pressure to exert. Suppose, for example, my true preference is to save more tomorrow for retirement—specifically, \$100 more per month—or to eat a less fattening diet—specifically, enough less to lose one pound per month for 25 months. How much must the regulator burden my poor choices to spend rather than save and to indulge rather than abstain in order to goad me into making choices aligned with my true preferences? The answer, alas, is blowing in the wind and hence out of reach.

If the burden the regulator imposes initially does not produce the expected result, then it will seem self-evidently insufficient; the obvious, self-serving, and hence nearly inevitable response will be to ratchet up the pressure as many times and as much as needed, not to re-examine whether there is really a gap between the expressed and the true preference, whether it is of the magnitude estimated, and whether there are other explanations for the initial or successive burdens’ failure to work as expected. Perhaps my true preference for saving, as detected in the laboratory, changed when a member of my family developed a health problem that made a more immediate demand upon my income. Perhaps I shifted my consumption of fattening foods, when they were taxed highly enough, to consumption of unhealthful quantities of foods that would not be fattening in the recommended serving size. As long as the regulator can tax only the inputs, and not the output in the form of a tax based upon my weight, it can only continue to cumulate the burdens in the hope of getting lucky. As the king might have said upon learning all his men and all his horses could not put



Humpty Dumpty together again, this “simply proves to me that I must have more horses and more men.”<sup>215</sup>

On the other hand, suppose the burden initially established by the regulator over-corrects the bias at which it is aimed. I start saving too much for retirement—that is, more than my true preference—because I would rather forgo present gratification than have my money go to the government in taxes; and I consume insufficient calories because I do not substitute healthful foods for the sweets I consumed before the sin tax took the pleasure out of eating. For all that appears to the regulator, the taxes it imposed upon unsaved income and fattening foods will have been a success. It will have no incentive to learn whether the regulation overshot the mark and induced an unexpected adaptation; doing so could only cause it to confess its error and ratchet down the tax. To admit to overregulating is more embarrassing than to confess to having underregulated, for the public is somewhat grudging about being regulated at all.<sup>216</sup>

#### V. WHY THIS, WHY NOW?

Behavioral law and economics is produced primarily by law professors. As we have seen, the number of articles on behavioral law and economics appearing in law reviews has grown exponentially over the last

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<sup>215</sup> Dana Fradon, *NEW YORKER*, July 24, 1978, at 29.



*“Gentlemen, the fact that all my horses and all my men couldn’t put Humpty together again simply proves to me that I must have more horses and more men.”*

<sup>216</sup> In addition, as pointed out by Rizzo & Whitman, *supra* note 121, at 717, “rent-seeking activities impart a particular direction to slippery slopes . . . . As a result, we are unlikely to observe ‘backward’ slippage toward more laissez-faire policies.” (emphasis omitted).

ten years.<sup>217</sup> What, we now ask, accounts for the great and increasing attraction of the subject to legal academics?

For at least the last forty years, legal scholarship has been swept along by waves of fashion in academia, and the amplitude of those waves has been increasing. Starting around 1970, the Realist school that had dominated the legal academy for decades gave way increasingly to the newer field of economic analysis of law; particularly after Richard Posner published his treatise on that subject in 1973,<sup>218</sup> scores of articles analyzing the economics of a particular legal doctrine appeared in law journals every year.<sup>219</sup> They contributed greatly to our understanding of the law as an instrument of social control and as a force for the promotion or diminution of economic growth. Articles and books in this genre continue to be published,<sup>220</sup> but they no longer have as large a share of the market.

In something of a reaction to the growing interest in economic analysis, a small but prolific cadre of law professors created the Critical Legal Studies (CLS) movement,<sup>221</sup> which in turn inspired cognate subschools such as Critical Race Theory,<sup>222</sup> Critical Feminism,<sup>223</sup> and Queer

<sup>217</sup> See *supra* Fig. 1; see also Ginsburg & Moore, *supra* note 88, at 94 (cataloging the number of law review articles discussing behavioral economics).

<sup>218</sup> RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (1973).

<sup>219</sup> See, e.g., William Breit & Kenneth G. Elzinga, *Antitrust Penalties and Attitudes Toward Risk: An Economic Analysis*, 86 HARV. L. REV. 693 (1973); Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977); Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978); Richard A. Posner, *Gratuitous Promises in Economics and Law*, 6 J. LEGAL STUD. 411 (1977); George L. Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the Uniform Commercial Code: An Economic Approach*, 91 HARV. L. REV. 960 (1978); Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979).

<sup>220</sup> See, e.g., ANN-SOPHIE VANDENBERGHE, *AN ECONOMIC ANALYSIS OF EMPLOYMENT LAW* (2004); Judy A. Temple et al., *Cost-Effective Crime Prevention: Economic Analysis of the Chicago Child-Parent Centers Early Education Program*, 15 PUB. INT. L. REP. 181 (2010).

<sup>221</sup> See MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES 1* (1987) (“[T]he first annual Conference on Critical Legal Studies in 1977 gave little hint as to what the organizers thought ‘critical legal studies’ (CLS) was or might become. . . . [T]he organizers were simply seeking to locate those people working either at law schools or in closely related academic settings [who were] . . . something akin to New Leftists . . .”).

<sup>222</sup> See *CRITICAL RACE THEORY: THE CUTTING EDGE* xvi (Richard Delgado & Jean Stefancic eds., 2d ed. 2000) (noting that Critical Race Theory “has predecessors—Critical Legal Studies, to which it owes a great debt”).

<sup>223</sup> See generally Deborah L. Rhode, *Feminist Critical Theories*, 42 STAN. L. REV. 617, 617–19 (1990) (charting the relationship between CLS and feminist theories, identifying “crosscutting objectives, methodologies, and concerns” between the two fields and observing a “growing body of feminist and critical race scholarship . . . developed along lines that paralleled, intersected, and challenged critical legal theory”).

Theory.<sup>224</sup> CLS, which had a significant following, particularly among faculty at elite law schools, advanced the idea that all law, including court-made law, is indistinguishable from politics, particularly class politics.<sup>225</sup> As recounted by Harvard Law School Professor Duncan Kennedy, a leading figure in the CLS movement, one of its early projects was to “produce[] a critique of mainstream economic analysis of law.”<sup>226</sup>

Overtly a leftist movement,<sup>227</sup> CLS turned out to be little more than a warmed-over species of Marxism, as it had evolved in the hothouse of radical European social theorists such as Herbert Marcuse, Jürgen Habermas, and others of the Frankfurt School of neo-Marxist critical theorists, Antonio Gramsci, a leader of the Communist Party in Italy, and Michel Foucault, Jacques Derrida, and other “poststructuralist” philosophers.<sup>228</sup> The self-declared purpose of the CLS movement was “to provide a critique of liberal legal and political philosophy” that would show the “liberal embrace of the rule of law is actually incompatible with other essential principles of liberal political thinking.”<sup>229</sup>

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<sup>224</sup> See Francisco Valdes, *Queers, Sissies, Dykes, and Tomboys: Deconstructing the Conflation of “Sex,” “Gender,” and “Sexual Orientation” in Euro-American Law and Society*, 83 CALIF. L. REV. 1, 29 (1995) (“[T]his project endeavors to enlist critical legal theories and theorists in an effort to create a space and a framework for holistic and contextual critiques of sex, gender, and sexual orientation as legal (and social) concepts.”); see also Minna J. Kotkin, *Creating True Believers: Putting Macro Theory into Practice*, 5 CLINICAL L. REV. 95, 101–02 (1998) (“Critical jurisprudence also finds expression in feminist legal theory, critical race theory, and queer theory. These movements are alternatively viewed as off-shoots of CLS or independent schools of legal thought that changed the focus of CLS. In either case, by the late 1980s, critical scholarship had shifted to some degree from exclusively economic analysis to the exploration of how issues of race, gender, and sexuality determine legal outcomes.”).

<sup>225</sup> See, e.g., MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW: 1780–1860* (1977); KELMAN, *supra* note 221; ROBERTO MANGABEIRA UNGER, *KNOWLEDGE AND POLITICS* (1975); Mark Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. CAL. L. REV. 669, 676–77 (1979); Mark G. Kelman, *Misunderstanding Social Life: A Critique of the Core Premises of “Law and Economics,”* 33 J. LEGAL EDUC. 274, 277–78 (1983); Duncan Kennedy, *How the Law School Fails: A Polemic*, 1 YALE REV. L. & SOC. ACTION 71 (1970); Duncan Kennedy, *Legal Education and the Reproduction of Hierarchy*, 32 J. LEGAL EDUC. 591, 591–92 (1982) [hereinafter Kennedy, *Legal Education*]; Duncan Kennedy, *Psycho-Social CLS: A Comment on the Cardozo Symposium*, 6 CARDOZO L. REV. 1013 (1985) [hereinafter Kennedy, *Psycho-Social CLS*]; Duncan Kennedy, *The Critique of Rights in Critical Legal Studies*, in LEFT LEGALISM/LEFT CRITIQUE 178 (Wendy Brown & Janet Halley eds., 2002); Duncan Kennedy, *Toward a Critical Phenomenology of Judging*, in THE RULE OF LAW: IDEAL OR IDEOLOGY 141 (Allan C. Hutchinson & Patrick Monahan eds., 1987). For a more complete bibliography of the CLS movement, see Duncan Kennedy & Karl E. Klare, *A Bibliography of Critical Legal Studies*, 94 YALE L.J. 461 (1984).

<sup>226</sup> Duncan Kennedy, *Law-and-Economics from the Perspective of Critical Legal Studies*, in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 465, 465 (Peter Newman ed., 1998).

<sup>227</sup> KELMAN, *supra* note 221, at 1; Kennedy, *Psycho-Social CLS*, *supra* note 225, at 1014, 1017.

<sup>228</sup> See David S. Caudill, *Disclosing Tilt: A Partial Defense of Critical Legal Studies and a Comparative Introduction to the Philosophy of the Law-Idea*, 72 IOWA L. REV. 287, 299–304 (1987); Robert W. Gordon, *Critical Legal Histories*, 36 STAN. L. REV. 57, 102 n.102 (1984).

<sup>229</sup> ANDREW ALTMAN, *CRITICAL LEGAL STUDIES: A LIBERAL CRITIQUE* 3 (1990); accord KELMAN, *supra* note 221, at 1–8.

Key to the CLS analysis was the notion of “false consciousness,”<sup>230</sup> meaning the “holding of false or inaccurate beliefs that are contrary to one’s own social interest and which thereby contribute to the maintenance of the disadvantaged position of the self or the group.”<sup>231</sup> Like the presumed gap between revealed preferences and “true preferences,” assuming a wedge between reality and the perceptions of others provides a space to be filled by some combination of reeducation and outright coercion.<sup>232</sup> Duncan Kennedy encapsulates these Maoist<sup>233</sup> tendencies in his proposal that professors and janitors at the Harvard Law School be required to trade places for one month each year.<sup>234</sup> Kennedy described the ultimate goal of CLS as “building a left bourgeois intelligentsia that might one day join together with a mass movement for the radical transformation of American society.”<sup>235</sup>

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<sup>230</sup> This phrase is often attributed directly to Marx. *But see* Joseph McCartney, *Ideology and False Consciousness*, MARX MYTHS AND LEGENDS (Apr. 2005), <http://marxmyths.org/joseph-mccarney/article.htm> (questioning whether Marx ever actually described ideology as “false consciousness”). The phrase, if not the concept, seems actually to derive from an early translation of a letter Friedrich Engels wrote to Franz Mehring. *See* MICHÈLE BARRETT, *THE POLITICS OF TRUTH: FROM MARX TO FOUCAULT* 5–6 (1991).

<sup>231</sup> John T. Jost, *Negative Illusions: Conceptual Clarification and Psychological Evidence Concerning False Consciousness*, 16 POL. PSYCHOL. 397, 400 (1995) (emphasis omitted); *accord* Richard Delgado, *Rodrigo’s Sixth Chronicle: Intersections, Essences, and the Dilemma of Social Reform*, 68 N.Y.U. L. REV. 639, 653 n.57 (1993) (defining “false consciousness” as the “phenomenon in which the oppressed come to identify with their oppressors, internalize their views, and thus appear to consent to their own subordination”).

<sup>232</sup> As one student of Kennedy’s put it, the phrase “implies that all those who disagree with you are stupid.” RICHARD D. KAHLENBERG, *BROKEN CONTRACT: A MEMOIR OF HARVARD LAW SCHOOL* 166 (1999).

<sup>233</sup> *See* A. Michael Froomkin, *Habermas@Discourse.net: Toward a Critical Theory of Cyberspace*, 116 HARV. L. REV. 749, 768 (2003) (noting that under Habermas’s theory of self-deception, “[e]xplanation, education, discussion, and even therapy may serve to allow everyone except those suffering from the worst forms of self-delusion to understand (or, at least, better understand) their true interests”); Robin J. Munro, *Political Psychiatry in Post-Mao China and Its Origins in the Cultural Revolution*, 30 J. AM. ACAD. PSYCHIATRY & L. 97, 103 (2002) (“[I]f we use class education and political-line education to profoundly re-educate the mentally ill in the proletarian worldview . . . and raise their awareness of the class struggle, the struggle over political line and the need to continue the revolution under the dictatorship of the proletariat . . . and dig out the roots of mental illness by overthrowing the concept of private ownership and implanting the principle of public ownership . . . then the overwhelming majority (90%) of mentally ill people can be completely cured.” (quoting Jia Rubao, a psychiatrist from Shaanxi Province, April 1977)).

<sup>234</sup> *See* Kennedy, *Legal Education*, *supra* note 225, at 615 (proposing legal education be reformed by “equaliz[ing] all salaries in the school (including secretaries and janitors), regardless of educational qualifications, ‘difficulty’ of job, or ‘social contribution’” and encouraging every university employee or faculty member to “spend one month per year performing a job in a different part of the hierarchy from his normal job, [so that] over a period of years everyone [is] trained to do some jobs at each hierarchical level”); *see also* Randy Beck, *The Faith of the “Crits”: Critical Legal Studies and Human Nature*, 11 HARV. J.L. & PUB. POL’Y 433, 447 (1988) (“Among [Kennedy’s] more familiar proposals is his suggestion that law schools allocate positions in the starting class by lottery to all students possessing minimum qualifications and that janitors and law professors periodically switch jobs.”).

<sup>235</sup> Kennedy, *Legal Education*, *supra* note 225, at 610.

The end of the communist era in Russia and Eastern Europe dealt a blow to CLS, as it did to all leftist movements. The worldwide triumph of socialism, which had long seemed inevitable to so many, now seemed more improbable than ever. That is not to say that CLS surrendered or even went underground; the leading authors are still publishing,<sup>236</sup> but new recruits are scarce.<sup>237</sup>

With interest in CLS and other “critical” movements waning, young legal scholars were in danger by the mid-1990s of being remitted to further work in economic analysis of law or even more traditional doctrinal exegesis. The widespread excitement and productive fervor of law and economics scholarship in the 1970s and 1980s, however, could not be recovered. Whereas the pioneering work had been done by academic lawyers who were autodidacts in economics, such as Richard Posner, Robert Bork, Henry Manne, Gordon Tullock, and Guido Calabresi,<sup>238</sup> and by collaborations between those same academics and their economist colleagues,<sup>239</sup> by the mid-1990s all the leading law schools had appointed to their faculties one or more Ph.D. economists, many of whom also had a law degree. In other words, the field had grown up; the creative and talented amateurs gave way to highly trained professionals using the formal tools of economics and statistics. An assistant professor without significant formal

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<sup>236</sup> See Duncan Kennedy, *Teaching from the Left in My Anecdote*, 31 N.Y.U. REV. L. & SOC. CHANGE 449 (2007); Steven Lukes, *In Defense of “False Consciousness,”* 2011 U. CHI. LEGAL F. 19.

<sup>237</sup> See Cass R. Sunstein, *Foreword: On Academic Fads and Fashions*, 99 MICH. L. REV. 1251, 1255 (2001) (discussing the disappearance of critical legal studies from law schools). In 2007, Brian Leiter compiled a list of the most cited faculty members by specialty, including Critical Theories, which includes Critical Legal Studies, Critical Race Theory, and Feminist Legal Theory. The ages of the top twenty members ranged from mid 40s to 60s, showing a lack of young entrants in the field. Brian Leiter, *Most Cited Law Professors by Specialty, 2000–2007*, BRIAN LEITER’S LAW SCHOOL RANKINGS, (Dec. 18, 2007), [http://www.leiterrankings.com/faculty/2007faculty\\_impact\\_areas.shtml#CriticalTheory](http://www.leiterrankings.com/faculty/2007faculty_impact_areas.shtml#CriticalTheory). More recently, the 2010–2011 edition of the Association of American Law Schools Directory of Law Teachers listed only ninety-nine professors with one to five years of experience currently teaching Critical Theories, which also includes Critical Legal Studies, Critical Race Theory, and Feminist Legal Theory. ASSOCIATION OF AMERICAN LAW SCHOOLS: 2010–2011 DIRECTORY OF LAW TEACHERS 1627–28, 1669–70 (2011).

<sup>238</sup> See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978); GUIDO CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970); POSNER, *supra* note 218; Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967).

<sup>239</sup> See, e.g., Guido Calabresi & Alvin K. Klevorick, *Four Tests for Liability in Torts*, 14 J. LEGAL STUD. 585 (1985); William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249 (1976). Pioneering examples include JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF A CONSTITUTIONAL DEMOCRACY* (1962); Robert H. Bork & Ward S. Bowman, Jr., *The Crisis in Antitrust*, 65 COLUM. L. REV. 363 (1965); and Aaron Director & Edward H. Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281 (1956).

training in economics could not hope to distinguish himself in law and economics, let alone write something to warrant his promotion to a tenured position.<sup>240</sup> What to do?

The answer came: Behavioral law and economics, for which a more than sophomoric understanding of economics was not required. Just as the first wave of law and economics scholarship had provided hundreds of opportunities to revisit plowed ground and turn up new insights, behavioral law and economics offered a reason to return to the same ground with confidence that the new approach would yield new results—results that could be published in one of the more than 750 non-peer-reviewed, student-edited law reviews.<sup>241</sup> Much of the early law and economics work had explored the hypothesis that a particular common law rule was efficient<sup>242</sup> or, in the public choice variation, that a particular statutory provision served some special interest and was inefficient.<sup>243</sup> In the new behavioral scholarship, the author would inevitably conclude the prevailing rule should be reformed to take account of the cognitive biases of the individuals

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<sup>240</sup> See generally Henry G. Manne & Joshua D. Wright, *The Future of Law and Economics: A Discussion* 10–11 (George Mason Univ. Law & Econ., Research Paper No. 08-35, 2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1145421](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1145421) (discussing the shift toward the modern, formal, mathematical approach to economics and its implication for law and economics and legal education).

<sup>241</sup> The Berkeley Electronic Press law review submission service, ExpressO, includes more than 750 student-edited law reviews and journals. See *List*, EXPRESSO, <http://law.bepress.com/expresso/list.html> (last visited Aug. 13, 2012).

<sup>242</sup> See, e.g., CALABRESI, *supra* note 238, at 311–18; William M. Landes & Richard A. Posner, *Joint and Multiple Tortfeasors: An Economic Analysis*, 9 J. LEGAL STUD. 517, 517 (1980); A. Mitchell Polinsky, *Resolving Nuisance Disputes: The Simple Economics of Injunctive and Damage Remedies*, 32 STAN. L. REV. 1075, 1079–80 (1980); cf. John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 77–96 (1980) (arguing conventional investment practices of trusts are inadequate with the portfolio theory and therefore yield inadequate returns).

<sup>243</sup> See, e.g., Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371, 394–96 (1983); Frank H. Easterbrook, *Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 15–16 (1984) (“People demand laws just as they demand automobiles, and some people demand more effectively than others. Laws that benefit the people in common are hard to enact because no one can obtain very much of the benefit of lobbying for or preserving such laws. Smaller, more cohesive groups are more effective lobbyists. These groups can obtain a greater share of the benefits of laws targeted to assist people who have common characteristics, and so they will raise more money and campaign for legislation more effectively. . . . It also turns out that small, cohesive groups can get more for themselves by restricting competition and appropriating rents than by seeking rules that enhance the welfare of all. Thus we should expect regulatory programs and other statutes to benefit the regulated group—they need not ‘capture’ the programs, because they owned them all along. The burgeoning evidence showing that regulatory programs increase prices for consumers and profits for producers supports this understanding.”); McChesney, *supra* note 201, at 101–03; Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211, 240 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 3–4 (1971).

subject to the rule<sup>244</sup> or to regulate some as yet unregulated conduct in order to protect individuals from their tendency to err as they pursue their self-interest.<sup>245</sup>

Because behavioral law and economics scholarship yields proposals for law reform less radical than what CLS had produced, it appeals to a larger segment of the legal professoriate than CLS ever did. At the same time, behavioral law and economics shares with CLS the paternalistic premise that the poor wretches to be benefitted by the insights of their governors suffer from a form of “false consciousness.” Behavioral law and economics scholars never use that term—the connotation would not be helpful—but they have built their entire enterprise upon its foundation. Indeed, we doubt legal academics would have seen the appeal of appropriating the fruits of cognitive research had they not first been exposed by CLS to the idea that individuals routinely fail to act in their own best interest as they themselves express it.

False consciousness is a hearty perennial, much like the notion that there is a “third way” of social organization that suffers from neither the arbitrary nature of government nor the unforgiving ways of the market. The staying power of the idea reflects the romantic notion that government can help individuals overcome their own frailties and conform their behavior to their stated goals.

The full effect the behaviorists’ new formulation of this old idea will have upon policy is yet to be determined. Academic lawyers and economists who studied regulation and the economic analysis of law had a profound impact upon the government of the United States starting in the Carter Administration. In those four years, the Congress passed significant deregulatory legislation affecting energy,<sup>246</sup> transportation,<sup>247</sup> and other

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<sup>244</sup> See, e.g., Michael S. Barr et al., *Behaviorally Informed Home Mortgage Credit Regulation*, in *BORROWING TO LIVE: CONSUMER AND MORTGAGE CREDIT REVISITED* 170, 197–98 (Nicolas P. Retsinas & Eric S. Belsky eds., 2008) (arguing for a default option of plain vanilla mortgages).

<sup>245</sup> Nutrition labeling on menus exemplifies well the creeping nature of paternalism. Initially required by only a few cities and states—most notably, New York City, Philadelphia, and the state of California—the House of Representatives proposed to bring nutrition labels to restaurant menus nationwide in its first three drafts of the Affordable Health Care for America Act. See Shirley S. Wang, *Menu Labeling to Go National, Thanks to Health Bill’s Passage*, WALL ST. J. HEALTH BLOG (Mar. 22, 2010, 2:16 PM), <http://blogs.wsj.com/health/2010/03/22/menu-labeling-to-go-national-thanks-to-health-bills-passage/>; see also Affordable Health Care for America Act, H.R. 3962, 111th Cong. § 2572 (2009) (as introduced to the Senate on November 16, 2009). The labeling provision did not survive the Senate, Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, Pub. L. No. 111-192, 124 Stat. 1280, but it is unlikely we have seen the last of the nutrition-labeling proposal.

<sup>246</sup> See, e.g., Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (codified as amended in scattered sections of 5, 12, 15, 16, and 42 U.S.C.) (phasing out price regulations); Emergency Natural Gas Act of 1977, Pub. L. No. 95-2, 91 Stat. 4 (codified at 15 U.S.C. § 717).

<sup>247</sup> See, e.g., Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (codified as amended in scattered sections of 5 and 49 U.S.C.); Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (codified in scattered sections of 49 U.S.C.); Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92

sectors of the economy.<sup>248</sup> The Congress was less obliging during the Reagan Administration, but the President's appointees did much administratively to deregulate telecommunications,<sup>249</sup> finance,<sup>250</sup> energy,<sup>251</sup> and other sectors.<sup>252</sup> Reagan also appointed to the federal courts a number of law professors prominent in the economic analysis of law, including such luminaries as Richard Posner and Frank Easterbrook of the University of Chicago, Robert Bork and Ralph Winter of Yale, and Stephen F. Williams of the University of Colorado.

The Obama Administration has now made behavioral law and economics the foundation for its re-regulatory program.<sup>253</sup> The President has appointed the leading proponent and popularizer of the behavioral approach, Cass Sunstein, to oversee the regulatory output of the Executive Branch.<sup>254</sup> Whether this Administration will be able to work a substantial change in the government's approach to regulation will depend vitally upon

Stat. 1705 (codified in scattered sections of 49 U.S.C.); Air Cargo Deregulation Act of 1977, Pub. L. No. 95-163, 91 Stat. 1278 (codified as amended in scattered sections of 26 and 49 U.S.C.).

<sup>248</sup> See, e.g., Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered sections of 12, 15, 22, 38, and 42 U.S.C.) (preempting various state restrictions on mortgages).

<sup>249</sup> See, e.g., Revision of Programming & Commercialization, Policies, Ascertainment Requirements, & Program Log Requirements for Commercial Television Stations, 6 FCC Rcd. 5093 (1991) (eliminating ascertainment requirements and programming guidelines for commercial television); Syracuse Peace Council, 2 FCC Rcd. 5043, 5052 (1987) (invalidating "fairness doctrine" as unconstitutional and contrary to public interest), *aff'd*, Syracuse Peace Council v. FCC, 867 F.2d 654 (D.C. Cir. 1989); Amendment of Part 73 of the Comm'n's Rules & Regulations in Regard to Section 73.642(a)(3) & Other Aspects of the Subscription Television Serv., 90 F.C.C.2d 341 (1982) (abolishing various programming and other restrictions for subscription television); *In re* Deregulation of Radio, 84 F.C.C.2d 968 (1981).

<sup>250</sup> See, e.g., Shelf Registration, Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889 (Nov. 23, 1983) (codified as amended at 17 C.F.R. § 230.415) (reducing registration requirements for mortgage-related securities); Davis W. Turner, Note, *Nonbank Banks: Congressional Options*, 39 VAND. L. REV. 1735, 1736, 1744 (1986) (describing willingness of the Comptroller of the Currency in the Reagan Administration to charter "nonbank banks," thereby allowing companies to escape restrictions of various banking laws and regulations).

<sup>251</sup> See, e.g., Exec. Order No. 12,287, 46 Fed. Reg. 9909 (Jan. 30, 1981) (eliminating oil price controls immediately rather than phasing out over time).

<sup>252</sup> See Improvement of TOFC/COFC Regulation, 46 Fed. Reg. 14,348, 14,352 (1981) (exempting "piggyback" services from certain railway and trucking rules); Mary A. Wallace, *Interstate Commerce Commission*, 56 GEO. WASH. L. REV. 937, 938-41 (1988) (describing the Commission's largely successful efforts at deregulating the transportation industry in the 1980s).

<sup>253</sup> See Ferguson, *supra* note 84, at 18; Grunwald, *supra* note 84, at 29; Mike Dorning, *A Beachhead for the Behavioralists* [sic], BUS. WK., June 28, 2010, at 19 ("[T]he behavioralists could be influencing regulations long after [Peter] Orszag leaves [OMB]. Their ideas have been seeded in numerous initiatives, just as the regulatory state is poised for a dramatic comeback following decades of retrenchment. Other promoters include Michael S. Barr, the Assistant Treasury Secretary for Financial Institutions, who helped draft Obama's Wall Street reforms.") The first chairman of President Obama's Council of Economic Advisers was Austan Goolsbee, who is sympathetic to (but not himself a practitioner of) behavioral economics. See Lori Montgomery, *New Economic Face, Still Familiar*, WASH. POST, Sept. 11, 2010, at A12.

<sup>254</sup> Ferguson, *supra* note 84, at 18.



whether the President is re-elected. Enduring changes of this magnitude cannot be made in a mere four years, in large part because a change in political leadership does not effect a change in the composition of the bureaucracy;<sup>255</sup> the Administration's challenge is to educate the permanent staff in how to initiate regulatory proposals based upon the new behaviorism.

#### CONCLUSION

Even the least paternalistic version of behavioral law and economics makes two central claims about government regulation of seemingly irrational behavior: that (1) the behavioral regulatory approach, by manipulating the way in which choices are framed for consumers, will increase welfare as measured by individuals' own preferences and (2) a central planner can and will implement the behavioral law and economics policy program in a manner that respects liberty and does not limit the choices available to individuals. Some economists and law professors have focused, in their disparate ways, upon these two claims, offering critiques grounded in microeconomic theory, empiricism, and public choice. The crux of their critiques, with which we agree, is that the behaviorists' welfare claims are in some cases misspecified and, in the others, unsupported by robust data; such data as exist are misinterpreted in support of a paternalist objective; and the behaviorists' cost-benefit analysis is woefully incomplete. While behavioral economics broadly, and behavioral law and economics in particular, are too new to support bold predictions about what future laboratory and field evidence might show, the theoretical and empirical infirmities plaguing the behavioral welfare claims suggest these faults will prove to be enduring limitations. Further, the chasm between the aggressive policy interventions proposed in the behavioral *law and economics* literature and the interventions (if any) warranted by existing behavioral economic theory and empirical evidence is a warning sign of a discipline far overextended.

Our primary goal in this Article has been to draw attention to the second and less scrutinized of the behaviorists' claims, viz., that behavioral law and economics poses no significant threat to liberty and individual autonomy. One need not await further evidence to conclude that this claim fails. The behaviorists' regulatory toolkit includes not only overt coercion, but also subtler forms of control, including interventions that would directly or indirectly either reduce the choices available to individuals or penalize individuals for pursuing their own preferences rather than following those

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<sup>255</sup> Indeed, the CFPB is perhaps the only major behavioral law and economics initiative that will be realized within the President's first term.

of a regulator. Despite having adopted a narrow conception of liberty as consisting only of “choice preservation,” the behaviorists’ libertarian claims fail on their own terms. What Mill, Hayek, Friedman, and others taught about the “process aspect of freedom”—the liberty interest of a public that is not infantilized, has entrepreneurial spirit, and can learn effective decisionmaking through experience—has no place in the behaviorists’ regulatory calculus. So long as behavioral law and economics continues to ignore the value to economic welfare and individual liberty of leaving individuals the freedom to choose and hence to err in making important decisions, libertarian paternalism will not only fail to fulfill its promise of increasing welfare while doing no harm to liberty; it will pose a significant risk of reducing both our welfare and our liberty.

