



FINAL COMMENTS I



**KEY PUBLIC POLICY
IMPLICATIONS**

POLICY RECOMMENDATIONS OF BF

- One school of thought in behavioral economics/finance argues that people are essentially irrational, and it requires experts to nudge or even force people to behave smartly.
- The other school of thought maintains that people often make good choices except when they face poorly designed institutions, misleading information and decision-making defaults, inadequate education or experience, or an inability to make their preferred choices.

CONSUMER RIGHTS, PROTECTION AND THE FRAMING OF INFORMATION

- Conventional economics:
 - Assumes that sellers worry too much about their reputation to willingly mislead consumers.
- Behavioral approach:
 - We wouldn't need to worry about protecting consumer rights if consumers could easily collect and process all the necessary information required to make informed decisions.
 - But people are affected by how and where information is presented.
 - People are not mentally constructed to see that all-important needle in the haystack. This needle is so much more difficult to find because firms do their best to hide the needle. The devil is in the details. This is why consumer rights are critical.

PRODUCT LABELING & CONSUMER CHOICE

- Without proper labels, consumers' purchases are based on inadequate or imperfect information.
- Government can play an important role:
 - foster the development of independent agencies that certify the integrity of labels.
 - can force suppliers to properly label their products.
- Consumers are still free to choose.
- The fair-trade label
 - Without appropriate universal and independently certified standards, what you see may not be what you get.
- Other labels???? Children protection

FINANCIAL MARKET & INFORMATION DECEIT

- Financial markets have always had information problems.
 - Investors may end up with financial assets that behave in a way that they don't expect
 - They may lose lots of money in the process when you thought you were making conservative investment decisions.
- One possible solution is the introduction of proper labeling for financial products, similar to what's required for food.
- Suppliers of financial products should be forced to clearly disclose the historical rates of return and risk
 - consumers can make more intelligent decisions, which could force suppliers to provide safer financial products (if consumers demand)
- This kind of labeling requires an independent and trusted agency to validate the integrity of financial product labels.

SAVING FOR THE FUTURE

- Conventional economics
 - People will and can calculate how much money they'll require over their lifetime and save appropriately.
 - People have the willpower to save adequately and can resist buying something they want today in order to save for the future.
 - Saving behavior should be independent of defaults
- In many parts of the world private savings are not sufficient.
- Some behavioral economists argue that part of the solution is to change the default in favor of saving.

SAVING FOR THE FUTURE

- Saving behavior is heavily influenced by how saving is framed.
 - When saving is not the default (money isn't automatically pulled out of your paycheck and put into a savings account), a large percentage of people won't save enough.
- Changing the default in favor of saving increases saving.
- If government forces a change in default, it's nudging you to save more.
- If the default is not saving, government is, in a sense, nudging you *not* to save.

ORGAN DONATIONS

- In the US, organ donation at death isn't as common as it is in parts of Europe. Is this because Americans are more selfish than their European counterparts?
- In the conventional view, defaults shouldn't affect a person's decision making, but the evidence says otherwise.
- Defaults appear to be more important than altruism.
 - Organ donation rates tend to be high where the default is that, at death, a person's organs are donated to those in need.
 - Of course, Americans can donate their organs if they make the right inquiries and fill out the right forms, but this appears to represent too high of a hurdle for most people.
 - Changing the default from not donating to donating one's organs will have a large effect.

ORGAN DONATIONS

- The important point is that defaults matter here, and important moral concerns surface no matter which default is chosen.
 - If organ donation is the preferred option for most, and this preference is not the default, many people will end up not making the choices that they prefer.
 - If donation is the default, some people will end up donating their organs at death even though this isn't their preferred option.
- By making organ donation the default, but providing avenues to opt out of the default option, government could improve the organ donation rate.
 - Those who strongly oppose organ donation would opt out; those who favor organ donation or don't feel strongly one way or the other would donate; and the end result would benefit people whose lives depend on organ donations.

WEAKNESS OF WILL AND SELF-CONTROL

- Contrary to what conventional economics says, people are often plagued by a weakness of will and a lack of self-control.
 - You may *want* to eat less, but can't.
 - You may *want* to stop smoking, but can't.
 - An alcoholic may *want* to stop drinking booze, but can't.
 - You may *want* to change your job, but can't.
- Banning certain activities raises the important moral issue of what to ban and who decides what to ban.
 - When one person prefers to do something and another person prefers not to (but has little self-control), a ban improves the welfare of the person with a weakness of will and reduces the welfare of the person who wants to engage in the behavior.

WEAKNESS OF WILL AND SELF-CONTROL

- Public policy may facilitate individuals who want to overcome their weakness of will.
 - In a Ulysses contract, you bind yourself (sometimes legally) to certain future commitments in order to overcome your anticipated future weakness of will.
 - Ancient Greek myth in which Ulysses had himself bound to the mast of his ship in anticipation of hearing the Siren's song, which he knew would drive him insane and to his death.
 - Ulysses anticipated his weakness of will and overcame it by having himself bound to the mast
- The gambling addict may not *want* to gamble, but he knows that he won't be able to resist the temptation. Government can help gambling addicts restrict their gambling by providing them with a means to be voluntarily added to a list banning them from gambling facilities.

LABOR MARKET REGULATION AND ECONOMIC EFFICIENCY

- Conventional economics
 - People are already working as hard and as smart as possible.
 - Increasing wages ends up increasing production costs and generates unemployment.
- Behavioral economics
 - Government regulation can motivate increased economic efficiency
 - Motivating members of the firm to work smarter and harder
 - To maintain and improve minimum wages, working conditions, union rights, and environmental protection all can contribute to increasing economic efficiency.
 - Undermining labor rights and ignoring environmental concerns contributes to relatively low levels of efficiency and economic well-being.

GOVERNMENT & BEHAVIORAL ECONOMICS: DOES GOVERNMENT KNOW BEST?

- Conventional economics:
 - Each person is able to make best choices.
 - People have appropriate information, there is no weakness of will, and people have time to think through the information before them.
- Behavioral approach
 - people don't know what's in their own best interest or
 - lack the willpower to make decisions that are in their best interest.
 - Note: These are not accepted by all behavioral economists
- Thaler and Sustein introduced the term **choice architect**.
 - A type of expert who knows what's in people's best interest.
 - This can have the power to nudge people into making choices.
 - These choices may be the ones that the majority would choose under ideal circumstances. But even so, the minority would be short-changed and end up with choices that reduce their well-being.

GOVERNMENT & BEHAVIORAL ECONOMICS: DOES GOVERNMENT KNOW BEST?

- One example of choice architecture is regulating how food is displayed in school cafeterias.
 - If fatty and unhealthy foods are prominently displayed, then ... ???
 - If you present salads first and desserts later in the line, then ... ???
 - If kids are exposed to healthy foods more often
 - They may develop a taste for healthy food and have a greater preference for it.

- A big public policy question: Should expert be *advising* on how things should be done or should expert be *legislating* choice?
 - If the expert legislates, many people argue that the expert will limit individual rights. Plus, the expert may end up being wrong.

CRIME, PUNISHMENT, AND IDENTITY

- The conventional argument
 - Crime is best deterred by increasing the costs of crime.
 - If the penalty is increased, we would expect crime to decrease.
 - If white-collar crime (ex. deceiving clients) carries light penalties, the criminally minded to move in this direction.
 - Changing the relative cost of criminal behavior has strong affects.
 - Also, providing people with non-criminal sources of income reduces criminal behavior.

CRIME, PUNISHMENT, AND IDENTITY

- Most behavioral economists would not deny these assertions. Instead, they would add that other factors.
 - Non-monetary factors such as identity, addiction, and emotion also play important roles.
 - People gain satisfaction from being part of a group.
 - If your identity is tied to a group that celebrates criminal behavior, you have non-economic incentives to engage in criminal behavior.
 - Many people in prison do not (and often cannot) calculate even the approximate cost and benefits of criminal behavior

CRIME, PUNISHMENT, AND IDENTITY

- Problems:
 - In the US, over 10% of African Americans are in prison.
 - Over 3% of the U.S. adult population was behind bars.
 - Prisons are breeding grounds for future criminal behavior.
 - A prisoner's source of identity stems from groups within the prison population.

- Government can reduce crime by supporting community groups that provide alternative sources of identity and self-esteem.
 - A football, hockey, or debating team instead of a gang, for example.
 - This solution can dramatically reduce the non-economic incentive for crime, without the add-on cost of the conventional solution (which is to incarcerate a larger percentage of the population).

CRIME, PUNISHMENT, AND IDENTITY

- Addiction that results in criminal behavior is also difficult to address with conventional economic tools.
 - Drug addicts can't be easily deterred from engaging in criminal behavior by increasing its relative cost.
 - A drug addict's demand for criminal behavior is not very sensitive to price, just as a diabetic's demand for insulin.
- Government can reduce addiction-related criminal behavior by decriminalizing certain categories of drugs
 - recommended by *The Economist*.
- Government can facilitate efforts to reduce drug addiction.
 - Fewer addicts results in fewer people engaged in addiction-related criminal behavior.

POPULATION GROWTH AND THE EMPOWERMENT OF WOMEN

- Conventional economics suggests that
 - population falls as the cost of raising children increases, so market forces should take care of things.
- The world's population has increased from about 1.6 billion in 1900 to about 8 billion — a pretty big jump.
 - Much of this is growth is due to dramatic drops in death rates.
 - Problems for growth, development, environmental changes....
 - Market forces don't appear to work at a fast enough pace.
- Nobel Laureate in Economics Amartya Sen argues that
 - by providing girls and women with more information, power, and rights, population growth rates will fall. Women who are equal to men will be able to realize their desire for fewer children. And men may very well change their preferences for more children, too.

TAX COMPLIANCE: THE CARROT IS AS IMPORTANT AS THE STICK

- The conventional approach to tax compliance:
 - People largely pay taxes (or try to evade taxes) based on the penalties and chances of getting caught. Increase the penalty and the chances of getting caught, and tax compliance increases.
- Behavioral economics doesn't deny the importance of them.
- But non-economic factors such as fairness, sense of belonging to a community imposing taxes, and a belief that taxes are used to do good for society also contribute to tax compliance
- Government can increase tax compliance without any change in economic incentives by
 - making the tax system fairer
 - making the tax system and its use of tax revenue transparent
 - improves taxpayers' sense of belonging
 - demonstrating that taxes are being used productively

TRUST AND ECONOMIC EFFICIENCY IN AN IMPERFECT WORLD

- People develop *heuristics* to save time and energy.
 - Searching for all relevant information and processing this information in great detail takes too long.
- One heuristic that people have used for centuries is the trust heuristic.
 - Most people start off trusting another party in a transaction unless they suspect that something is fishy.
 - People want to trust that product labels are truthful, that financial advisors are honest, that their business partners are upfront, and that their children's teachers and coaches will take care of them.
 - To the extent that you can make decisions quickly based on trust, you're making decisions in a relatively effective and efficient fashion.

TRUST AND ECONOMIC EFFICIENCY IN AN IMPERFECT WORLD

- If people can't employ the trust heuristic, the cost of decision making increases dramatically.
- Government can facilitate the use of the trust heuristic by
 - providing instruments to validate the trustworthiness of information
 - providing relatively low-cost methods of punishing those who violate the trust that others place in them.
- In addition, encouraging and developing norms of trust and *reciprocity* (treating others well, if that's how they treat you) helps weave the social fabric of society.
- This increases the non-monetary incentives not to breach behavioral rules and social norms that make for more effective and efficient decision making.

TRUST AND ECONOMIC EFFICIENCY IN AN IMPERFECT WORLD

- The evidence shows that per-capita income is fairly closely tied to the level of trust in society.
- Countries where trust is more abundant tend to be the more prosperous.
 - Scandinavian countries are characterized by higher levels of trust than the United Kingdom, and the United Kingdom is characterized by a higher level of trust than African and Arabic countries.
 - Russia and the Ukraine, with very low levels of per-capita income, are characterized by very low levels of trust.
 - The United States falls below Scandinavia's trust level but well above that of most other countries in the world.