Paternalism and Feedback Effects

- Jonathan Klick and Greg Mitchell (2006), “Government Regulation of Irrationality: Moral and Cognitive Hazards,” *Minnesota Law Review*
- Paternalism reduces incentive to invest in decision making process
- Paternalism limits opportunities for learning (lowers stock of human capital)
  - Domain Specific
  - Domain General

Evidence for Learning

- Agarwal, Driscoll, Gabaix, Laibson (credit card fees, financial decisions, etc.)
- John List's work on trading in various environments
- Vernon Smith's work on repeated experiments
- Developmental psychology

  e.g., James Byrnes's self-regulation model of decision-making, stressing the value of feedback from successes and failures for improving decision-making in both children and adults

Moral and Cognitive Hazards

- Ex ante paternalism (restrict choices; incentivize the “right” choice, etc.)
  - Restricts opportunities to develop successful decision making capabilities
  - Mutes the positive/negative feedback from good/bad choices
- Ex post paternalism (bail outs, etc.)
  - Reduces motivation to invest in decision making inputs
  - Mutes the negative feedback from bad choices

Domains of Learning

- Specific context: Paternalism at time 1 (because of the moral and cognitive hazards) increases the “need” for paternalism when the same kind of decision is made at time 2
- General context: Decision strategies might be transportable across domains, so paternalism in domain A might lead to worse outcome in domain B (or else will require that paternalism spans domains)
- External effects: Seeing others “protected” may induce even “good” decision makers to cut back on their decision-making inputs

As usual, it comes down to elasticities . . .

- How sensitive are people to feedback
  - Both in the specific domain and the general domain
- How much do individuals cut back on their own decision making inputs when their outcomes are less dependent on their actual decisions
- How effective might education be
- Note just as there is heterogeneity in the “biases” themselves, there is likely to be heterogeneity in these elasticities

Regulatory Inputs/Considerations

1) Efficiency loss from current underinvestment in individual decision inputs
2) Capitalized cost of future efficiency losses related to current underinvestment
3) Costs of private inputs and education as well as public education subsidies
4) *Efficiency gains from limiting decision making mistakes
5) *Efficiency losses owing to regulatory mistakes (i.e., choosing incorrectly for some individuals)
6) Welfare gains from discouraging non-productive exploitation of biases
7) Welfare losses from rent-seeking in the regulatory process
8) Administrative costs