Libertarian Welfarism

Russell Korobkin*

According to standard law and economics analysis, the proper motivation for state regulation of private behavior is the desire to increase social welfare.[1] A policy is usually understood to fulfill this criteria if it satisfies the requirement of Kaldor-Hicks efficiency -- the beneficiaries of the regulation gain enough such that they could fully compensate those who are burdened with their gains -- otherwise known as cost-benefit analysis.[2] There are two reasons that unregulated behavior might fail to maximize social welfare, justifying government intervention. The first is that private actors may be unable to act in such as way as to maximize the satisfaction of their own personal welfare, or, more technically, their subjective expected utility (SEU). When this is the case, the state might legitimately coerce behavior in order to make those actors better off. I will refer to this as the "paternalism" justification of regulation. The second is that private actors might act so as to maximize their subjective expected utility but, in so doing, impose signifcant harms, or "externalities," on others. In this circumstance, the state might legitimately coerce behavior to protect the others, or society generally. I will refer to this as the "welfarism" justification.

Because neoclassical economics, built on the edifice of rational choice theory, assumes most actors are able to maximize the satisfaction of their preferences given the constraints they face, coercion on behalf of paternalism usually is considered to be justified by law and economics scholars only in narrow circumstances, such as when minors or the mentally incompetent are involved. (The state might require the disclosure of information to facilitate rational decision making in a broader array of situations,

* Professor of Law, UCLA. Helpful comments from Ian Ayres, Mark Grady, Chris Guthrie, Tim Malloy, and Jeff Rachlinski are gratefully acknowledged.

[1] See, e.g., A. Mitchell Polinsky, An Introduction to Law and Economics 7-8 (3d. ed., 2003) (defining "efficiency"); Steven Shavell, Economic Analysis of Law 1-2 (2004)

[2] See Matthew Adler: Beyond Efficiency and Procedure: A Welfarist Theory of Regulation, 28 Fla. St. L. Rev. 241, 244-46 (noting that this requirement of what he calls the "neoclassical" theory of regulation "is a matter of interpretation -- or at least sometimes it is -- since the neoclassicist's commitment to efficiency …is sometimes implicit or even obscurred rather than laid out in plain view.")

however). Coercion based on the welfarism justification is considered appropriate in a far wider set of circumstances, especially when the harms to non-actors exceed the benefits to actors, such as when a factory owner profits by polluting a common natural resource.

Evidence gathered by psychologists and economists about human decision making over the last three decades has raised a serious challenge to the rational actor assumption of neoclassical economics. It turns out that not only infants and the mentally incompetent fail to make optimal decisions. Most people have trouble making decisions that maximize SEU in a variety of contexts. The world is too complex for our brains to maximize, so instead we rely on mental heuristics and habits, which allow us to function in the work-a-day world without being paralyzed by information overload. The result is that we stumble through life, remaining on our feet most of the time but often enjoying less utility than is theoretically possible. This finding of behavioral economics, imported into normative legal theory as behavioral law and economics, expands the potential space for state intervention on grounds of paternalism.

I say "potential" space because the case for paternalism faces two serious obstacles. First, the state functionaries who would presumably intervene with private decision making – legislators, regulators, judges, administrators, at the like – are no less human than the potential subjects of regulation. If I can't figure out whether I would be better off with a car equipped with expensive airbags (which would carry a higher price tag) or a slightly more dangerous (and cheaper) automobile combined with some other goods and services, why should I be confident that a state functionary can do any better?

Second, in nearly all cases of public policy significance, there will be heterogeneity of subjective preferences. Some people would maximize their SEU by purchasing the cheaper car without airbags and spending the money saved on a family vacation in Hawaii, while others with a greater taste for safety and a lesser yearning to travel would maximize their subjective expected utility by paying for the airbags and foregoing the trip. Assuming that it is impractical for even an omniscient government functionary to impose different rules for each individual – that is, a regulation requiring airbags must apply to all car sales or none -- attempts to operationalize paternalism are bound to harm many, even if they also benefit many.

In response to these objections to using traditional forms of coercive state fiat to address the considerable evidence that individuals are not relentless utility maximizers, a new paradigm of regulation has emerged that calls for the state to help individuals make decisions that the functionaries believe are most likely to make them better off but allow the individuals to decline the assistance if they choose to do so. Colin Camerer, Samuel Issacharoff, George Loewenstein, Ted O'Donoghue, and Matthew Rabin ("Camerer et al.) called this approach "asymmetric paternalism,"[3] in reference to its virtue of creating significant benefits for those who would make suboptimal decisions if left entirely to their own devices while imposing comparatively small costs on those inconvenienced by having to work around the state's "assistance" in order to pursue what they regard to be their own interests. Cass Sunstein and Richard Thaler ("Sunstein & Thaler) proposed a similar approach that they call "libertarian paternalism,"[4] in recognition of its combination of the policy goal of paternalism coupled with the protection of individual freedom of choice.[5] The pair developed the idea in greater depth in a recent book entitled "Nudge: Improving Decisions About Health, Wealth and Happiness."[6]

These scholars have made a significant contribution to legal and policy discourse by showing how the state can promote the underlying goal of paternalism – helping people achieve greater subjective expected utility than they would obtain on their own –

---

[3] Colin F. Camerer et al., Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism," 151 U. Pa. L. Rev. 1211 (2003).

[4] Cass R. Sunstein & Richard H. Thaler, Libertarian Conservatism is Not an Oxymoron, 70 U. Chil. L. Reve. 1159 (2003).

[5] There are subtle differences between the policy visions laid out by Camerer et al. and Sunstein & Thaler. The former do not absolutely rule out coercion, as long as the cost of coercion is substantially outweighed by the welfare benefits enjoyed by individuals who are less than fully rational. The latter support only regulations that do not prevent any individuals from pursuing their desired course of action and impose no more than a small amount of inconvenience on those who wish to avoid the intervention. So, for example, Camerer et al. favor medical licensure as an example of asymmetric paternalism because it offers substantial protections to individuals who could not be counted on to optimally assess the quality of physicians while imposing a relatively lesser cost of physicians who must satisfy the licensure requirements. Camerer et al., supra note __, at 1237. I presume that Sunstein & Thaler would not consider this an example of libertarian paternalism, as it not only imposes heavy costs on physicians who must satisfy the requirements, it coercively prevents patients who wish to contract with an unlicensed physician for medical care from doing so. A nonmandatory certification mechanism, however, that allowed a physician who satisfied state requirements to advertise this, would be consistent with libertarian paternalism.

[6] Richard H. Thaler & Cass R. Sunstein, Nudge: Improving Decisions About Health, Wealth, and Happiness (2008)

without the costs associated with mandated behavior backed up by threats of fines, imprisonment, or other punishment. What they fail to do, however, is describe how the same techniques that can be employed to advance the goal of paternalism can also be used in service of welfarism. To the set of conceptual categories of government intervention into private decision making of coercive paternalism and coercive welfarism, they have added the third category of libertarian paternalism, but they brush by the complimentary fourth category, which I call "libertarian welfarism."[7] Libertarian welfarism uses policy interventions to encourage individuals subject to the law to behave in ways that increases social welfare without mandating the socially desirable behaviors.

		Policy Goal	
		Paternalism	**Welfarism**
Means of Implementation	**Coercion**	Coercive Paternalism	Coercive Welfarism
	Non-coercion	Libertarian Paternalism	*Libertarian Welfarism*

[7] In the article version of their idea, Sunstein and Thaler recognize in passing the possibility that libertarian paternalism could be complemented by an approach that considers vulnerable third parties rather than the targeted actors themselves, but they neither flesh out the contours of this category nor compare its merits to those of libertarian paternalism. Sunstein & Thaler, supra note __, at 1162. The notion of a fourth category is entirely absent in the book version of their idea.

My primary purpose in this essay is to describe the missing category of libertarian welfarism and how it contrasts with libertarian paternalism. Any discussion of legal policy that considers implementing the approach of libertarian paternalism should also at least consider the alternative of libertarian welfarism. I will push further, however, and argue that, for theoretical and practical reasons, the libertarian welfarism approach will often be a more appropriate model for the state than the libertarian paternalism approach.

I. Behavioral Deviations from the Rational Choice Model

Research on human decision making conducted over the last four decades has catalogued of plethora of ways in which individuals violate the implicit assumptions of rational choice theory, which forms the behavioral model of neoclassical law-and-economics analysis. This research, known alternatively as "judgment and decision making," "behavioral decision making," or "behavioral economics," has been sufficiently reported and discussed in legal scholarship over the last decade that it is well-known to many legal scholars, at least in its broad countours, and providing a detailed treatise of its findings here would be redundant. It is important, however, for understanding what is both innovative and potentially problematic about both libertarian paternalism and libertarian welfarism, to recognize that the relevant findings of judgment and decision making research can be loosely divided into two categories: (1) ways in which individuals systematically err in their assessment of factual information, and (2) ways in which preferences, as they are revealed by behavior, are at least partially constructed and dependent on contextual cues rather than fixed and invariant to context.

A. Judgment Biases

In order to maximize subjective expected utility, it is necessary for an actor to have a realistic assessment of the probabilities of the potential outcomes associated with various courses of action. To decide rationally whether to invest in the stock market or in a legal education, one needs to assess the potential financial and non-financial returns from each and evaluate the relative likelihood of the various possibilities. To decide rationally whether to rob a bank, one needs to consider the likelihood of being caught and

convicted, the potential jail time associated with that outcome, and the likely disutility associated with imprisonment.

One thread of research in judgment and decision making details ways in which such factual assessments tend to systematically deviate from objective reality. The general finding is that people tend to overestimate the likelihood of salient or readily "available" events (such as homicides and airplane crashes) while underestimating the likelihood of events that are less mentally prominent (such as suicides and automobile accidents).[8] Memorable events are sometimes more common than events that seem more mundane but, of course, they aren't always.

Events are also judged to be more likely if they seem typical of a class of events. In the most famous experiment to demonstrate this "representativeness" heuristic, subjects were more likely to believe that the protagonist, "Linda," who was described as being active in liberal political causes, was a feminist bank teller than merely a bank teller (a logical impossibility). When deriving numerical estimates, people tend to insufficiently adjust from "anchor" values that are salient but known to be only partially (if at all) diagnostic. Judgments about current facts and probabilities of future events are likely to reveal an ego-centric bias that over weights preexisting belief structures and overestimates one's agency in the world, consistent with the fact that exemplars of our beliefs and our agency tend to be more salient than contradictory events.

Less well-known in the legal literature, but of potential use for legal policy, are several similar findings about the effect of salience on probability judgments known as "support theory."[9] This body of research shows that the assessment of an event's probability will generally be higher if the event is described with greater specifically, or if each of the ways it might come about are enumerated compared to if it is described more vaguely and broadly.

Generally, this body of research demonstrates that, when making probability judgments, individuals are unlikely to behave in an optimal, Bayesian fashion. There is

[8] See Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 Science 1124 (1974).

[9] See Amos Tversky & Derek J. Koehler, *Support theory: A nonextensional representation of subjective probability*, 101 *Psychological Review* 547 (1994); Craig R. Fox & Richard Birke, *Forecasting Trial Outcomes: Lawyers Assign Higher Probability to Possibilities that are Described in Greater Detail*, 26 L. & Hum. Behavior 159 (2002).

too much information available in our world for us to analyze consider all of it, much less process it in accordance with anything like statistically valid methods. People often rely on intuitions rather than careful, reflective analysis, emotions rather than reason, and other heuristics that lead to "boundedly-rational" rather than fully rational decisions.

These types of systematic tendencies can demonstrably lead to incorrect assessments of facts about the world, which in turn can lead individuals to make suboptimal decisions about how to act. It is, therefore, proper to refer to these tendencies as "biases." It is likely that the underlying heuristics have evolved over human history because they are generally useful (or, at least, were in the evolutionary environment) in helping us survive in an information-rich environment. Nonetheless, they clearly can lead to errors of judgment in particular circumstances that cause individuals to deviate from the assumed goal of maximizing subjective expected utility. Some traditional economist might object that it is logically impossible for an individual's actions to be a suboptimal expression of subjective expected utility because the concept of "utility" is traditionally defined solely by reference to choice, but common sense and common experience suggests that misestimation of probabilities or misunderstanding of facts can cause an individual to make a choice that makes him worse off, given his particular preference structure, than he might otherwise have been.

The problem is that, precisely because individuals are boundedly rational and almost always incapable of considering all information that might be relevant, it is difficult for the state to respond to these biases in neutral ways unlikely to introduce new biases. If the state provides information, or, more likely, enacts regulations requiring other actors to provide certain relevant information, this information is likely to become salient. But if this new information becomes salient, it is likely to crowd out other information that also might be relevant for maximizing subjective expected utility.

B. Context-Dependent Preferences

A very different thread of research in the field of judgment and decision making demonstrates that preferences are not fixed and invariant to context, as rational choice

theorists usually assume. Rather, preferences often are constructed at the point of decision making and based, at least in part, on contextual cues.[10]

One extremely important contextual cue, demonstrated by research on prospect theory, can be called, generally, the reference point effect. People typically care less about achieving a "gain" than they do about suffering a "loss." As result, all other things being equal, people tend to shy away from risky choices when they perceive the upside to be a gain but embrace similar risks when they perceive their upside as avoiding a loss. This tendency is called the "framing effect." An even more important implication is that, all other things being equal, most people will favor what they perceive to be the status quo state of the world to an alternative state of the world (the "status quo bias"[11]) and, relatedly, place a higher value on what they own than what they don't own (the "endowment effect"[12]).

The universe of potential or salient alternatives is another contextual feature that can affect preference construction. Given a series of choices that span a spectrum, people are more likely to select an intermediate choice, and people are more likely to select an option if it is contrasted with a similar but inferior option than if it is dissimilar to all the other choices. For example, people are more likely to choose a mid-sized rental car over a compact model if they are also given the choice of a full-sized car than if only the first two options are available, and they are more likely to choose a large ice cream cone over a large cookie if a small ice cream cone is a third option.[13] Given the ability to divide their choice among options, people often diversify equally amongst available choices, even if some are substantially similar.[14]

---

[10] Sarah Lichtenstein & Paul Slovic, The Construction of Preference: An Overview, in The Construction of Preference 1 (Lichtenstein & Slovic, eds., 2006).

[11] William Samuelson & Richard Zeckhauser, The Status Quo Bias in Decision Making, 1 J. Risk & Uncertainty 7 (1988).

[12] This term was coined by Thaler. Richard H. Thaler, Toward a Positive Theory of Consumer Choice, 1 J. Econ. Behav. & Org. 39, 44 (1980); see also Russell Korobkin, The Endowment Effect and Legal Analysis, 97 Nw. Univ. L. Rev. 1227 (2003).

[13] For a clear discussion of these contextual effects, see Dan Ariely, Predictably Irrational 1-21 (2008).

[14] Daniel Reed et al., Mixing Virtue and Vice: Combin ing Immediacy Effect and the Diversification Heuristic, 12 J. Behavioral Decision Making 257 (1999); Shlomo Benartzi & Richard H. Thaler, Naïve Diversification Straeteies in Defined Contribution Savings Plans, 91 Am. Econ. Rev. 79 (2001).

Another example of the context-dependence preferences is the well-documented principle of social proof: people are be more likely to favor a particular choice if they believe most of their peers are making that choice than if they believe most of their peers are making a different one.[15] In different situations, the effect could be due to faith in the wisdom of others or desire for conformity. For example, if I were to learn that 90 percent of law professors drink Pepsi rather than Coke, I might switch my beverage choice from Coke to Pepsi. If the reason for my switch is that I have no inherent preference for the taste of either – or only a slight preference -- but I gain satisfaction from feeling affiliation with a certain social group, my new knowledge can be said to have a preference-shaping effect.

Unlike the findings above that I have called judgment biases, it is difficult to say that, even in theory, the demonstrated effect of contextual cues in preference formation lead to decision making errors or mistakes. Assume that Anthony would not trade the apple in his lunch for Betsy's orange, but if he had the orange and Betsy had the apple, he would still not trade. Informed of the counterfactual, it is not clear that Anthony would feel compelled to alter his behavior. Or assume that Anthony would trade his apple for Betsy's orange if Betsy also had a tangerine but not if she also had a plum. Or assume that Anthony would not trade his apple for an orange if he knew that Carl and Donna like apples better than oranges, but he would if he knew Carl and Donna preferred oranges to apples. In all of these examples, Anthony seems to exhibit inconsistent preferences, but it is not clear that any of them constitute mistakes under the circumstances, because there is no reason that Anthony can't have different preferences in different contexts. That is, once we realize that preferences do not always preexist opportunities to make choices but are often constructed in real time, apparently inconsistent choices might each be utility maximizing given different background conditions.

Another well-documented phenomenon that might be viewed as an example of the context-dependence of preferences is hyperbolic discounting. When faced with the choice between two goods deliverable at different time periods, individuals will often display a much lower discount rate if both time periods are far into the future than if they are closer. [example] Some decision making researchers believe this is a consequence of

[15] Cialdini…

the conjecture that our minds work as dual-system processors, sometimes evaluating an option based on "hot" emotion, or affect, and sometimes based on "cold" analysis. When two options are distant, the analytical mode is used to compare them. When at least one option is immediate, the temptation is more likely to provoke an affective response.

Described this way, it might seem that when you a decision based on hot emotion is inconsistent with a decision that would have been resulted from cold analysis, the emotion-laden decision should be considered a mistake. In some cases, this position seems quite defensible, especially when our visceral drives tempt us to take immediate actions that would have promoted survival in the evolutionary era but are suboptimal in modern society. If you have made a considered option to diet, it would probably increase your overall subjective expected utililty if you were required to choose a week in advance whether or not to order the chocolate cake rather than when it is wheeled before you on the dessert cart and the wafting scent drains your will power. The primal urge humans have for sweet food, while once key to survival, is no longer helpful, and five minutes of pleasure enjoyed will eating the cake probably will be followed by more than a compensating amount of regret.

Research suggests, however, that cold analysis will not always outperform hot emotion in its ability to yield utility maximizing decisions. Considerable research suggests that affective responses to decisions often unconsciously take into account a range of data about past experiences that individuals cannot consciously reference or logically explain.[16] Cold analysis, then, can cause individuals to overweight the aspects of a choice that they can describe and quantify in a rationalist way, such as price and other objective attributes, a regularity that has been called "lay rationalism."[17] In one experiment, researchers found that students who asked to rate how much they liked a series of posters and *provide reasons* before choosing one to take home expressed less satisfaction with their choice one month later than students who were not required to

[16] See Timothy D. Wilson et al., Introspection About Reasons Can Reduce Post-Choice Satisfaction, in The Construction of Preference 471, 472-73 (Lichtenstein & Slovic, eds. 2006).

[17] Christopher K. Hsee et al., Lay Rationalism and Inconsitency Between Predicted Experience and Decision, in The Construction of Preference 532, 533 (Lichtenstein & Slovic eds., 2006).

justify their preferences with reasons.[18] In another, students asked simply to report their preference for five different jams provided ratings that approximated those of expert taste testers, but varied markedly when the students were required to coldly and rationalisticly rate the jams on a variety of attributes.[19] Acting on instinct will not lead to improvements in SEU in every circumstance, but it probably will in some.

II. Libertarian Paternalism

The objective of a paternalist state is to increase the subjective expected utility of the citizens subject to a legal regulation.[20] The objective of the libertarian paternalist state is to accomplish, or at least make progress toward, this goal without resorting to coercion, as understood -- roughly -- as enacting regulations that mandate behavior on threat of some negative material consequence. A policy fits within the libertarian paternalist paradigm if it "nudges" individuals to act in accordance with their best interests but allows them to ignore the nudge at minimal or no cost.[21]

A. Tools

The principal tools of nudging, or of "choice architecture" as Sunstein & Thaler call it,[22] are the provision of various types of information to choosers and the selection of default rules. Altering decision frames and imposing temporary behavioral prohibitions are additional, but less frequently cited, tools.

---

[18] Id. at 474-78. The authors conclude their study with the warning that "unbridled claims about the value of introspection need to be tempered." Id. at 485.

[19] T. D. Wilson & J.W. Schooler, Thinking Too Much: Introspection Can Reduce the Quality of Preferences and Decisions, 60 J. Pers. & Soc. Psychol. 811 (1991).

[20] Thaler & Sunstein put the point this way: "In our understanding, a policy is 'paternalistic' if it tries to influence choices in a way that will make choosers better off, as judged by themselves." Thaler & Sunstein, supra note __, at 5 (emphasis in original). For some common examples of paternalistic policies enacted into law, see CAL. VEH. CODE § 27803 (West 2007) (requiring drivers and passengers of motorcycles to wear a safety helmet); CAL. EDUC. CODE § 48201 (West 2007) (requiring persons age 6 to 18 to enroll in and attend a full-time school); CAL. EDUC. CODE § 48293 (West 2007) (establishing monetary penalties against parents or guardians who do not comply with compulsory education requirements); CAL. BUS. & PROF. CODE § 19921 (West 2007) (preventing individuals under the age of 21 years from entering gambling establishments).

[21] Thaler & Sunstein, supra note __, at 6 ("the intervention must be easy and cheap to avoid").

[22] Thaler & Sunstein, supra note __, at 81.

1. Informational Interventions

The usefulness of providing information is suggested by the broad finding that individuals routinely deviate from Bayesian reasoning when analyzing and evaluating information that is then used in the decision process. What I will call "informational interventions" involve providing information to individual actors about the likely consequences of behaviors. Such interventions can be accomplished by the government directly or through mandatory disclosure or reporting requirements that shifts the information-provision burden to other actors.

One simple example of a direct intervention, offered by Sunstein and Thaler, is the painting of the phrase "look right" in London crosswalks in order to reduce the likelihood that Americans and Europeans, accustomed to looking left for immediately oncoming traffic, will accidentally become road kill.[23] A second example comes from state governments advertising data that shows fewer college students smoke or engage in binge drinking than most college students are likely to predict.[24] As an example of regulation requiring some actors to provide information to others, Sunstein & Thaler suggest requiring credit card companies to provide customers with annual electronic statements of the different type of charges they have been assessed (interest, annual fees, late fees, etc.) along with the algorithm according to which it assesses such charges.[25] This would allow customers, making use of web sites, to more easily determine which of the many credit card products available in the market place would minimize their annual cost of credit, assuming their spending patterns remained constant. According to the theory of libertarian paternalism, the provision of these types of information should help many individuals make decisions -- whether to cross the street, drink excessively, or continue to use a particular credit card -- that are more likely to maximize their subjective expected utility, while leaving individuals who wish to ignore the information free to do so at little cost.

---

[23] Thaler & Sunstein, supra note __,at __.

[24] Thaler & Sunstein, supar note __, at 68.

[25] Thaler & Sunstein, supra note __, at 143. The authors propose similar requirements for mortgage lenders, cell phone service providers, and providers of Medicare prescription drug benefits.

2. Default Rules

As a result of the status quo bias, more people are likely to choose an option if they consider it a constituent part of the status quo than if they view it as inconsistent with the status quo. This insight suggests that the state might be able to alter behavior by changing a default rule of law that apply to individuals who do not make an explicit choice amongst the available options, even if the burdens involved with opting out of the default choice are minimal. One example, used by both Sunstein & Thaler[26] and Camerer et al., is the decision that most employees face about whether to enroll in a company-sponsored 401(k) retirement plan.

Traditionally, the default rule was non-enrollment, meaning that an employee had to make an affirmative election to have a portion of her paycheck withheld and diverted into a retirement amount; no affirmative choice, no participation. Inconsistent with the predictions of rational choice theory, companies that changed the default rule to "enrollment," thus requiring employees to opt out if they did not want to participate, found that substantial majorities of employees began taking advantage of the plans. Since the transaction costs of opting in or out of a 401(k) plan are relatively small -- filling out a single form that is usually readily available from the employee's human resources department, if not on line -- this data suggests that simply changing the default rule can nudge preferences. Of course, changing the 401(k) decision from opt-in to opt-out will slightly inconvenience employees who, because of significant family wealth or high discount rates, wish to spend all of today's income today and thus must go to the effort of opting out. But as long as we take as a given that employees may choose whether to invest in a 401(k) (that is, participation will be neither required nor prohibited), at least one of the two groups, the savers or the spenders, will have to take some step to make their preference known.

3. Frame Alteration

In addition to putting to use the insights of the status quo bias, understanding the related principle of loss aversion can help the state nudge individuals to save more for retirement. Sunstein & Thaler tout the "Save More Tomorrow" program, first suggested

[26] Thaler & Sunstein, supra note __ at 108-09.

by Thaler and colleague Shlomo Benartzi[27] and now implemented by a wide variety of employers. Because people are averse to losses, relatively few sign up to take a current cut in pay in order to shift money into their retirement accounts. On the other hand, it turns out people are much more willing to enroll in a plan that automatically increases the nominal amount of dollars diverted into a retirement account as the employee's paycheck increases over the years.[28] Presumably this option enables employees to increase retirment savings without experiencing what feels like a loss in spendable earnings.[29]

4. Timing of Choice

Another tool of libertarian paternalism is the "cooling off" period, designed with the goal of helping individuals to make choices under "cold," considered conditions, rather than "hot," emotional conditions.[30] Laws that provide a fixed number of days in which consumers can cancel door-to-door sales contracts and waiting periods imposed on gun purchases[31] and divorces are examples of this type of intervention.

B. The Externality Problem

The most immediately obvious weakness of the libertarian paternalist paradigm is that it ignores externalities created by the behavior of the regulated individuals. These indirect effects of regulations are, of course, highly relevant to the goal of maximizing social welfare, which is the implicit normative basis of libertarian paternalism. The proponents of libertarian paternalism offer no theory as to why it would be appropriate for the government to concern itself only with the utililty of the individuals directly affected by regulations, and not those who are indirectly impacted. One likely explanation for this omission is that the proponents of libertarian paternalism view its

[27] Richard H. Thaler & Shlomo Benartzi, Save More Tomorrow: Using Behavioral Economics to Increase Employee Savings, 112 J. Pol. Economy s164 (2004).

[28] Id.

[29] Thaler & Sunstein, supra note __, at 112-18.

[30] Thaler & Sunstein, supra note __, at 250-51; Sunstein & Thaler, supra note __, at 1184-85, 1187-88.

[31] See, e.g., CAL. PENAL CODE § 12071(b)(3)(A) (West 2007) (imposing a 10-day waiting period before a firearm can be released to a buyer or transferee). Federal law no longer requires a cooling off period, having a replaced a 5-day waiting period with a required background check that can be processed immediately. See 18 U.S.C. § 922(t).

tools as useful both to governments and private organizations, and the examples that they offer of how the tools might be employed often switch back and forth between those involving the private sector and government. But the normative justification for private action will necessarily be different than the normative justification for state action. A private company might reasonably choose to nudge its employees to enroll in a 401(k) plan if it believes that participation will increase their SEU, without concern for externalities that might be imposed on non-employees. For the government to demonstrate the same indifference to non-employees, however, demands a justification.

The externalities resulting from many, and perhaps even most, of the choices that individuals make every day are so small relative to the utility consequences experienced by the actors themselves that the former can safely be ingored in an analysis of social welfare. Whether I choose to read a book or watch television after dinner might have a great impact on my utility but very little, if any at all, on that of my neighbors. In such cases, the choice that maximizes my SEU will also maximize social welfare, because no one else's utility will be affected much one way or the other, and the failure of libertarian paternalism to consider the problem of externalities will be inconsequential.

The failure of libertarian paternalism to consider externalities also will be inconsequential if the background legal regime is constructed with Pigouvian taxes that fully internalize the costs of all externalities, because in such cases the utility of non-actors will be unaffected by the choices of actors. For example, if a factory's pollution is taxed at the precise level of harm it causes to the environment, the non-actors (in this example, everyone other than the factory) will be indifferent as to whether the factory owner chooses to produce an extra quantum of pollution and pay the corresponding fine or chooses not to pollute. By nudging the factory owner to make the decision that maximizes his SEU, social welfare will be maximized.

In practice, the areas in which the state considers regulating rarely will fit into either of these categories. My wife might nudge me to read rather than watch television if she thinks I would learn more from a book and thus be more fulfilled, or she might nudge me to watch television is she thinks I have been working too hard and need to relax. Practically speaking, the government is unlikely to take an interest either way. And it is rare that existing regulation perfectly internalizes externalities. For most

activities that create significant externalities, a decision by actors to engage in more or less of the activity will have implications for social welfare. Failing to take this problem seriously substantially weakens the power of the libertarian paternalist paradigm, because its normative basis becomes unclear.

This weakness does not undermine the libertarian paternalism paradigm in all matters of policy making, because the state might choose to limit its concern to the welfare of a limited group of actors for a reason external to the paradigm. For example, if Congress decides to enact legislation aimed solely at the goal of protecting consumers, it might then reasonably search for techniques in the libertarian paternalism toolkit that will nudge consumers to make purchase decisions that will maximize their SEU, without concern for the externalities that this behavior might create. In the absence of such an independent justification external to libertarian paternalism, however, the paradigm lacks a compelling normative basis.

C. The Indeterminacy Problem

The second significant problem with the libertarian paternalism paradigm is that in many if not most cases of significant importance, it will often be difficult or impossible to know whether any particular intervention will actually fulfill the goal of paternalism: making people better off as judged by their own utility functions. This problem exists whether the policy intervention attempts to provide information to undermine judgment biases or attempts to alter the context of a choice to influence preference construction, although the precise nature of the problem is slightly different in these two cases: appropriately labeled a practical problem in the former case and a theoretical problem in the latter.

1. Informational Interventions

Informational interventions satisfy the libertarian condition of libertarian paternalism, in the sense that they do not mandate any behavior on the part of

individuals.[32] Those for whom the additional information is either irrelevant or unnecessary are free to ignore it. And, in theory, providing information can help counteract biased judgments that can cause individuals to make suboptimal choices. The problem, however, is that, in practice, it is often difficult to know whether addressing one informational deficiency will crowd out other information relevant to maximizing subjective expected utility.

In the simplest cases, in which one or two factors almost certainly have the most substantial utility consequence in a decisions, informational interventions will be unobjectionable. Take, for example, the example of painting "look right" in London crosswalks. Policymakers can reasonably assume that the desire to avoid being hit by a car is the single most important factor in making this decision, dwarfing the few other relevant factors, such as the desire to get to the other side of the road quickly. Because foreigners might not know, or might have forgotten, that traffic travels on the left side of the road in the United Kingdom, it is a safe bet that pointing out this fact will enable many pedestrians to make a much more accurate calculation of the probability of being hit should they attempt to cross at any particular moment. It is possible that emphasizing this information might cause individuals to pay relatively less attention to other risks, such as tripping on the curb, or to other factors relevant to utility, such as how much of a hurry they are in to get to the other side. But under the circumstances, the benefits to pedestrians of the warning pretty clearly will swamp the costs of unduly focusing their attention on this particular hazard.

In even slightly more complicated cases, however, it quickly becomes less clear whether well-meaning informational interventions will create a net benefit to subjective expected utility. If credit card companies are required to provide customers with electronic information that makes it easy to compare the annual cost of credit, assuming consistent spending patterns, as Sunstein and Thaler recommend, this would, no doubt improve consumers' ability to compare the products along that metric. At the same time, however, it might encourage consumers to pay relatively less attention to other credit card attributes (service, billing flexibility, perks, etc.) or to the validity of the assumptions

[32] Note, however, that such interventions often mandate behavior on the part of the third party who is required to provide or disclose the information, a feature that might in itself be problematic to true libertarians.

necessarily embedded in the algorithm (i.e., that the consumer's spending patterns will be consistent from year to year). Moreover, because sellers will have an incentive to exploit the bounded rationality of customers in order to increase profits, one might expect that if a regulation requires credit card companies to provide information that makes the annual cost of credit more salient to consumers, those companies are likely to seek profit by reducing the quality of relatively less salient product attributes.[33] At the end of the day, will the information intervention leave customers better off? Quite possibly, but it is difficult to say for sure.

2. Preference-Construction Interventions

When the libertarian paternalism toolkit is extended beyond informational interventions to preference-shaping interventions, it not only becomes difficult to know whether the intervention will increase subjective expected utility in practice, it becomes indeterminate in theory. That is, when preferences are constructed in response to context, it is, at least arguably, not possible to say whether an individual will experience more utility in Context A (having made corresponding Choice A) or in Context B (having made corresponding Choice B).

To make the problem less abstract, consider the following specific example: assume a world with five employees, A, B, C, D, and E, each of whom earn identical salaries at Company X. Under a non-enrollment default rule, A and B will opt in to a 401(k) plan, while C, D, and E remain uninvolved. Under an enrollment default, E will opt out, while A, B, C, and D remain enrolled. (Assume the government can predict these outcomes because it first ran a pilot study in which several employee groups were assigned to each default condition.) Assuming that the transaction cost of avoiding the default outcome is trivial -- for example, checking off a box on an employee intake form -- under either rule each of the five employees will reach the end state that is optimal for them given the context in which the choice is made. So how can we determine which default will maximize the expected subjective utility of each of the five employees?

[33] See generally, Russell Korobkin, Bounded Rationality, Standard Form Contracts, and Unconscionability, 70 U. Chi. L. Rev. 1203, 1234-35 (2003).

One response might be to say that saving is good for everyone, especially under a tax-favored plan, so the enrollment default maximizes employee expected utility. This position, however, would undermine the premise of libertarian paternalism that preferences are heterogeneous and policymakers are not omniscient. If one size fits all and the state always knows what is best for individuals, the advantages of libertarian paternalism over coercive paternalism quickly disappear. The state might as well mandate participation, an approach that (given these assumptions) would benefit E in addition to A, B, C, and D. In reality, the situations in which there is both complete homogeneity of preferences and near-certainty that the state knows which default will maximize expected subjective utility are likely to be few.

A different response is to compare the numbers of employees who opt out of the different possible defaults. Since only one individual (E) will opt out of the enrollment default, whereas two (A & B) will opt out of the nonenrollment default, the enrollment default is preferable. But this logic is flawed. It would be appropriate if the choice of default affected only transaction costs and not preferences, such that, let's say, A, B, and C would opt into enrollment and D, and E would opt out of enrollment. In that circumstance, each employee would end up with the same (personally optimal) end state under either default rule, and the only issue would be which rule would minimize transaction costs. Assuming that the transaction costs of switching in and out of enrollment are the same, and that the switching costs are identical for each employee, the rule that requires fewer employees to opt out would minimize transaction costs and therefore be more efficient.[34] In our example, however, the end state experienced by C & D depends on the default, and even the state that could predict the number of employees that would opt out of either defaults would have no way of determining whether enrollment or nonenrollment would provide more expected subjective utility for the employees who would not opt out of either default.

3. The Response: Compared to What?

[34] If these assumptions fail to hold, the analysis becomes slightly more complicated. See generally Ian Ayres, Making a Difference: The Contractual Contributions of Easterbrook and Fischel, 59 U.Chi. L. Rev. 1391 (1992).

Whether the indeterminacy criticism of libertarian paternalism is problematic for the paradigm depends on the point of comparison. Sunstein & Thaler implicitly assume that the alternative to libertarian paternalism is either coercive paternalism, which would be even less likely to improve subjective expected utility than libertarian paternalism because the unhappy cannot opt out, or doing nothing at all.

Concerning the latter option, Sunstein & Thaler argue that, because information and context are ubiquitous, there is no truly neutral way to present information or options.[35] Decisions are never made in a vacuum. To make any decision, individuals will have to consider some information, and they can never consider and process in an unbiased way every piece of relevant information. They will always have to make the choice in some context. Given this reality, it is better for the state to nudge individuals in the direction policy makers *think* will make most of them better off -- perhaps by imagining what they think most people would choose in a world without context, or hypothesizing which result would likely win the highest ex post satisfaction ratings -- than in some other direction?[36] If we think that the annual cost of credit is likely to be the most important attribute of a credit card to most customers but difficult to understand, isn't it better to provide them with that information in a digestible way rather than providing some other information or none at all? If we think most people will lead overall happier lives if they save more for retirement, even if we can't be absolutely sure, isn't a 401(k) enrollment default preferable to nonenrollment default?

A particularly convincing illustration of this argument offered by Thaler & Sunstein is that research has shown that cafeteria diners are more likely to choose what comes first in the line than what comes last in the line.[37] Since it is physically impossible to place everything at the same place in the line, the cafeteria manager will have to either put fruit in front of cake (favoring fruit) or cake in front of fruit (favoring cake). With

[35] Thaler & Sunstein, supra note __, at 10, 237, 243.

[36] See, e.g., Sunstein & Thaler, supra note __, at 1200 ("We happily grant that planners are human….Nevertheless, … these human planners are sometimes forced to make choices, and it is surely better to have them tryong to improve people's welfare rather than the opposite.")

[37] Thaler & Sunstein, supra note __, at 1.

neutrality not an option, the authors ask rhetorically, doesn't it make more sense for the manager to place fruit first than to put cake first or choose randomly?[38]

Framed in this way, the argument for libertarian paternalism is compelling, but the frame is too narrow. There is third option in addition coercion and inaction that effectively results in randomized nudging. The proponents of libertarian paternalism are clearly right that if the policy goal is to maximize subjective expected utility of targeted individuals it is preferable to nudge individuals in the direction that policy makers think will be better for the individuals than options they think will be worse for the individuals. But what the indeterminacy problem really suggests is that, at least in many circumstances, it might be more sensible to attempt to implement a different policy goal altogether.

III. Libertarian Welfarism

Unlike libertarian paternalism, which has the objective of helping individual actors subject to specific interventions to maximize their subjective expected utility without resorting to coercion, the explicit objective of libertarian welfarism is to maximize social welfare, also without resorting to behavioral mandates. The primary difference between the two orientations is the willingness of the latter to take into account externalities created by individual behaviors when determining legal policy.

When individual behavioral choices threaten to impose significant costs (or benefits) on others the goals of libertarian paternalism and libertarian welfarism diverge. Libertarian paternalists would counsel the state to nudge individual actors toward a behavior that would maximize their expected subjective utility, regardless of social consequences. On the other hand, a liberal welfarist would favor nudging individuals in a direction that would increase social welfare, even if doing so would be expected to decrease the expected utility of the actors who are themselves subject to the nudge, a technique that would be inconsistent with liberal paternalism.

When private and social welfare diverge, the libertarian welfarist paradigm will usually be a more appropriate basis for state action than libertarian paternalism, since the state has a responsibility to all of its citizens. This won't always be true, of course. As

[38] Thaler & Sunstein, supra note __, at 4-5.

noted in Part II.B, the government might consciously decide to place the interests of one group over those of society generally. Even when this is the case, however, it will be useful for policymakers to at least consider the potential differences in outcomes caused by libertarian welfarist and libertarian paternalist interventions.

When behaviors that would increase the utility of the actors would create positive externalities, no externalities, or very small negative externalities relative to the benefits enjoyed by individual actors, the libertarian welfarism and libertarian paternalism paradigms would suggest the same policy interventions. Under either approach, the state would attempt to nudge individuals so as to maximize their private utility (which would also maximize social welfare), while avoiding coercion. But even in this case, libertarian welfarism will often offer a very practical advantage over libertarian paternalism: Whereas the individual choices and behaviors that would maximize individuals' private utilities are often indeterminate (and thus the appropriate libertarian paternalist intervention is unclear), it is often more obvious which behaviors would minimize negative externalities or maximize positive ones (and thus the appropriate libertarian welfarist intervention is clear).

A. The Divergence Between Private and Social Costs

Many important public policy issues concern collective action problems: society as a whole would be better off if everyone did X, but each individual is better off if she does Y, whether or not everyone else chooses to do X or Y. Any issue of pollution, understood broadly, has this structure. A factory owner owner is selfishly better off if he creates more air pollution because he would have to pay the full cost of mitigation but can externalize most of the burdens his neighbors. In many (although not all) circumstances, however, social welfare is maximized if the factory owner invests in mitigation. A true libertarian paternalist would attempt to nudge factory owners to pollute more if doing so would increase their expected utility, even if the costs to neighbors would be so high that the activity would reduce net social welfare,[39] whereas a

[39] The proponents of liberal paternalism might claim that inherent in their specific policy proposals is the limiting condition that the state should not nudge actors to significantly reduce social welfare, but the pure theory of liberal paternalism is indifferent to social welfare.

libertarian welfarist would seek to identify interventions would encourage factory owners to invest in mitigation.

More specifically, a libertarian welfarist might ask the following questions: Given that people will often try to act in their selfish interest, how can the government regulate the provision of information so as to accentuate the private benefits of mitigation? Given that most people are altruistic to at least some degree, how can the government regulate the provision of information so as to accentuate the social costs of pollution (or the social benefits of mitigation) and thus harness altruistic impulses by making these costs more salient to decision makers? Given that many people wish to conform to social norms, how can the context of choice be structured so that activities that are privately beneficial but socially costly be made visible, thus making the socially optimal activity more privately desirable? Given that people usually prefer the status quo over change, is it possible to structure the choice so that the socially optimal decision is viewed as consistent with the status quo by most decision makers?

The following sections provide some examples of how libertarian paternalist and libertarian welfarist interventions would differ in cases where private and social welfare diverge.

1. Informational Interventions

The Environmental Protection Agency (EPA) requires that manufacturers of new cars post on their windshields the estimated gas mileage and the annual cost of gasoline for that car, given the assumptions of a certain price per gallon of gasoline and an average number of miles driven annually.[40] This regulation is an informational intervention that fits comfortably within the libertarian paternalism paradigm. It is likely that the cost of operating a new car is relevant to the subjective expected utility many buyers will obtain from the purchase, and that because of the difficulty to estimate this cost, it might not be salient in the purchasing decision of many buyers. Requiring manufacturers to provide this information is likely to make it more accessible to buyers, and nudge them to buy cars that are cheaper to operate, which, all else being equal, should increase private utility.

[40] 40 C.F.R. § 600.306-08 – 307-08.

Compare the EPA rule with a new California statute that requires manufacturers to add another sticker to the window of new cars sold in that state.[41] These stickers, adorned with a green border, provide a numerical rating of the car's greenhouse gas emissions on a scale of 1-10, with 5 signifying the increase in global warming caused by the car's emissions are average compared to other new cars.[42] This law is an example of libertarian welfarism. It is clearly a *libertarian* approach to regulation, in the sense that it mandates no behavior: consumers are free to ignore the information. It is a libertarian welfarist, rather than a libertarian paternalist intervention, because, to the extent that car's greenhouse gas emissions are uncorrelated with its gas mileage and thus private costs of operation (which are already listed on the car's window), the requirement can only affect consumer behavior by making the social costs of the purchase decision more salient to the customer. The law attempts to nudge the buyer to do what maximizes social welfare even when that bears no relation to his private utility.

2. Policy-Forcing Default Rules

Whereas the libertarian paternalism paradigm is reflected by default rules that create a context that encourages individuals to maximize their subjective expected utility, libertarian welfarism is reflected by default rules that encourage individuals to act in the best interests of society in general by minimizing negative externalities and maximizing positive externalities. Elsewhere I have called these "policy-forcing" default rules.

As an example, consider some of the facts of the well-known case of *Moore v. Regents of the University of California*: John Moore, suffered from hairy-cell leukemia and needed his spleen removed. His physician, also a medical researcher, used Moore's spleen to create the financially valuable Mo cell line but shared none of the profits with Moore, who sued for compensation. Although the court ruled that the physician had violated the rules of informed consent, it held that Moore was not entitled to compensation for the value of his spleen.

---

[41] CAL. HEALTH & SAFETY CODE § 43200.1 (West 2007).

[42] A score of 5 signifies that a car's emissions will have an impact on Global Warming equivalent to that of an average new vehicle. A higher score denotes a car that is 'better for the environment'. *See New Calif. Cars to Sport Greenhouse Gas Labels: Global Warming Score Will Show Buyers Estimated Emissions*, MSNBC, June 20, 2008, http://www.msnbc.msn.com/id/25284062/.

This holding is usually explained as a rule of property or tort law, but it can also be understood as a default rule of contract law. There is little doubt that Moore legally could have negotiated a fee for the use of his organ prior to the surgery -- other individuals with unique physical properties have sold blood, for example, to medical researchers, and federal law prohibits the sale of organs only for "transplant" purposes -- but there was no discussion about compensation between Moore and his physician. The court's ruling established a "no-compensation" default for when physicians and patients do not explicitly discuss compensation for the research use of human tissues. A decade later, in *Greenberg v. Miami Children's Hospital*, a case involving the use of tissue samples from patients with Canavan disease that were used to develop a patentable genetic test for the mutation that causes the disease, a federal district court in Florida expanded the rule to apply also to tissue donors who lack a therapeutic relationship with the medical researcher.

There are many reasons to think that the choice between "pro-compensation" and "no-compensation" default rules will affect the number of uncompensated tissue donations for medical research by affecting the context in which the decision is made. First, there is the pure fact of inertia, which favors the status quo over a deviation from the status quo in any situation. Second, under a non-compensation default, in order to even potentially obtain compensation, donors must raise the issue of payment with medical researchers, which would undoubtedly be uncomfortable for many. Third, the default rule might suggest a social norm of altruism, making a request for compensation appear greedy in this circumstance. In contrast, a pro-compensation default might suggest that payment is deserved and that someone who would waive it is a rube.

The no-compensation default rule cannot be justified on the basis of paternalism, assuming that the intended targets of the rule are tissue donors. Both Moore and the Greenberg plaintiffs would undoubtedly have been objectively better off had they received compensation. Even had they been altruistically inclined, as the *Greenberg* plaintiffs were, they could have used their compensation to fund further medical research of access to diagnostic tests and treatments for people suffering from the illnesses that affected them. A libertarian paternalist would have to favor a pro-compensation default, under which the donor of valuable tissues that led to a medical breakthrough would be

entitled to some amount of compensation absent an affirmative decision to forego it. The no-compensation rule is justified, however, under the libertarian welfarism paradigm. By encouraging more people to donate tissues to medical research altruistically, the rule reduces the cost of medical research -- a result that clearly enhances social welfare.

Another example of a divergence between libertarian paternalist and libertarian welfarist approaches to default rules can be seen in an example discussed in detail by Thaler & Sunstein.[43] In the United States, the default rule concerning the donation of bodily organs for transplantation following death is "no donation." Most states couple this default rule with low cost opt-in provisions, such as enabling individuals to become donors by a simple action such as signing their driver's license in a particular place. Based on research that shows that Americans (and Europeans from countries with the same default rule) are far less likely to become organ donors than European from countries with "presumed consent" default rules and opt-out provisions,[44] Sunstein & Thaler propose changing the default rule in the United States.[45]

While it is almost certain that changing the default rule to presumed consent would increase the number of cadaveric organ donations in the United States, it is implausible that this change would increase the subjective expected utility of individual donors, who are, of course, dead at the time of donation. There are several reasons that American organ donation rates are low under the no-donation default. The first is that some people don't care one way or another about being donors, but they do not wish to think about their mortality, which they must do in order to opt out of the default.[46] A second group of people do not become donors because they would suffer psychic costs while still alive thinking about their bodies being carved into pieces after they die.[47] A

---

[43] Thaler & Sunstein, supra note __, at 175-82.

[44] Eric J. Johnson & Daniel Goldstein, Do Defaults Save Lives, 302 Science 1338 (2003).

[45] Thaler & Sunstein, supra note __, at 177-79.

[46] *See* Carmen M. Radecki and James Jaccard, *Psychological Aspects of Organ Donation: A Critical Review and Synthesis of Individual and Next-of-Kin Donation Decisions*, 16 HEALTH PSYCHOL. 183, 183 (1997) (noting that beliefs about organ donation are influenced by the consequences of choosing to donate, including confronting the issue of mortality).

[47] Margareta Sanner, *Attitudes Toward Organ Donation and Transplantation: A Model for Understanding Reactions to Medical Procedures After Death*, 38 SOC. SCI. & MED. 1141, 1147 (1994) (discussing discomfort with a dead body being cut and the organs removed as a motive for individuals' reticence towards organ donation)

third group fear that if they are potential cadaveric donors an overzealous transplant physician lusting after their organs might prematurely end their life,[48] a small but presumably non-zero risk.[49] The experienced utility of individuals who fall into the first category might be unchanged by a change in default rules, but the experienced utility of those in the second and third group who chose not to opt out of a presumed consent default would, if anything, decrease. It would be exceedingly difficult to argue that a change in default rules that caused some members of each of these groups to become cadaveric donors would be utility enhancing for the donors. For a libertarian paternalist, the policy implication seems clear: leave the no-donation default rule in place.

On the other hand, the positive externalities associated with cadaveric organ donation are large, and the positive consequences for social welfare clear. Each year, thousands of Americans on the waiting lists for donor organs die every year because the demand for donations far exceeds supply.[50] If the U.S. were to achieve organ donation rates as high as the European countries with presumed consent default rules, many if not most of these lives could be saved. If it is possible to make any interpersonal utility comparisons of any kind, it seems safe to predict that the increased welfare enjoyed by the people whose lives would be saved by such a policy would outweigh the decreased welfare suffered by the individuals who are not now organ donors but do not care enough about the issue to opt out of a presumed consent regime. A presumed consent rule thus clearly fits within the libertarian welfarist model.[51]

---

[48] *Id.* at 1148 (discussing individuals' fear that death will be hastened for the sake of someone more highly regarded who is in need of organs).

[49] Cf. Charles Ornstein & Tracy Weber, *Death in San Louis Obispo Organ Donor Case is Ruled Natural*, L.A. TIMES, Mar. 9, 2007, at B5 (discussing allegation that an organ donor's death was hastened by doctors for the benefit of the presumptive donee).

[50] In 2006, 130,527 individuals were on the waiting list for an organ donation. Of those on the waiting list in 2006, 7,191 died. *Reported Deaths and Annual Death Rates Per 1000 Patient-Years at Risk Waiting List, 1997 to 2006*, 2007 Annual Report of the U.S. Organ Procurement and Transplantation Network and the Scientific Registry of Transplant Recipients: Transplant Data 1997-2006, U.S. Dept. of Health & Human Serv., http://www.optn.org/AR2007/chapter_index.htm.

[51] To be fair, Sunstein and Thaler recognize in their article that the organ donation example is inconsistent with many of their other policy examples (in that the benefits of a presumed consent default flow to third parties rather than the choosers) and call the consequence "libertarian benevolence." Sunstein & Thaler, supra note __, at 1192-93. Inexplicably, however, this distinction is not made when they elaborate on organ donation and recommend a presumed consent default in book version of their approach.

B. An Alternative to the Indeterminacy of Libertarian Paternalism

Recall from Part III the two indeterminacy problems that undermine the libertarian paternalism paradigm. First, when informational interventions would alter choice by making some information more salient than it otherwise would be, it is often practically difficult to predict with a high degree of certain which choice would actually maximize the subjective expected utility of most individuals. Second, when the government action changes behavior of individuals by altering the context in which preferences are constructed, it is theoretically impossible to say which choice maximizes subjective expected utility: one choice does in the first context, and the alternative choice does in the second context. A libertarian paternalist might try to avoid this criticism by judging subjective expected utility based on hypothetical choice in a world devoid of context, but this would not avoid the practical problem of determining which choice would maximize SEU under such a set of nonexistent conditions.

Libertarian welfarism has the advantage of avoiding these problems in many circumstances. In some cases, it will be practically difficult to determine which individual behavior would maximize social welfare, but in many more instances the valence of externalities will be strongly in one direction: i.e., the production of greenhouse gasses will almost always have a large negative externalities; cadaveric organ donation will always have positive externalities. In these situations, the libertarian paternalism paradigm can lead to clear policy prescriptions even when libertarian paternalism does not.

New York City recently enacted a law requiring restaurant chains to post the number of calories in their offerings along side the prices.[52] This requirement can be defended as consistent with the libertarian paternalism paradigm, on the grounds that the calorie content of food is relevant to diners' choices but difficult to come by with out assistance from the regulatory state. And, quite obviously, people who aren't calorie sensitive can ignore the information, just as those who are not price sensitive can ignore the prices. This argument has some force, but is it really clear that the information will increase the subjective expected utility of diners? By making calories more salient to the

[52] 24 RCNY HEALTH. CODE § 81.50. King County, Washington, has adopted a similar mandate, and at least 21 other state and local governments are considering following suit. Stephanie Saul, *Conflict on the Menu*, N.Y. TIMES, Feb. 16, 2008, at __.

choice process, the law is likely to alter behavior. But by making calories more salient, other features of potential meals, such as expectations of how the items will taste, will become relatively less important in the decision making processes of diners. As a *New York Times* columnist put the point: "How enticing: a fistful of calories on a bed of cholesterol, to go."[53] Research on judgment and decision making teaches us there is no truly neutral presentation of information, so how do we know that people who respond to the calorie listings by switch to lower calorie entrees that don't taste as good are actually subjectively better off as a result?

The calorie-posting requirement is better justified, I believe, by the libertarian welfarist paradigm. It is well-known that obesity is a growing problem in the United States, with 33% of adults and 17% of children now obese compared with 15% and 6% respectively 30 years ago.[54] The health consequences of obesity are not just limited to individuals. Experts have estimated that treatign obesity-related illnesses costs the nation's health care system $93 billion per year,[55] much of which is paid by Medicare, Medicaid, and other public programs.[56] The financial consequences of obese individuals with private group insurance have less of a direct effect on the taxpayers, but they do affect the health insurance premiums of the other members of their rating groups. In other words, obesity has significant negative externalities, which itself justifies a policy of nudging people toward eating fewer calories, whether or not it is possible to say that the intervention will increase the utility of the individual targets.

A similar analysis applies to selecting the default rule for enrollment in 401(k) retirement programs, discussed by Thaler & Sunstein. We know, not only from theory but also from actual experience with 401(k) plans, that a large number of individuals will enroll in an employer-sponsored plan if participation is the default but will not enroll if

---

[53] Timothy Egan, Nanny Nation, N.Y. Times, Aug. 6, 2008 (available at: http://egan.blogs.nytimes.com/2008/08/06/nanny-nation/?ex=1218772800&en=a557aa731c21677e&ei=5070&emc=eta1/)

[54] Cynthia L. Ogden et al., *The Epidemiology of Obesity*, 132 GASTROENTEROLOGY 2087, 2090-91 (2007).

[55] Ceci Connolly, *Obesity Gets Part of Blame for Care Costs*, WASH. POST, Oct. 20, 2004, at A03,

[56] According to one study, in 1998 the public sector was responsible for financing nearly half of medical spending attributable to excessive weight. Eric A. Finkelstein, *National Medical Spending Attributable to Overweight and Obesity: How much, and Who's Paying?*, HEALTH AFF. J., 223-24 (2003). Another found that nearly 1/4 of Medicare spending in 2002 was attributable to obese patients. Kenneth E. Thorpe & David H. Howard, *The Rise In Spending Among Medicare Beneficiaries: The Role Of Chronic Disease Prevalence And Changes In Treatment Intensity*, HEALTH AFF. J., 384 (2006),

non-participation is the default.[57] But this insight alone doesn't determine which default policymakers should choose. Since accepting the default outcome is a local optimum for the group of individuals in question, and since it is difficult to knowing which default will maximize their individual utilities in a global sense, there is no compelling reason not to choose the default that will have greater positive externalities (or fewer negative externalities) and thus benefit society as a whole. If greater individual retirement savings increases capital available for investment in the short term and minimizes the nursing home expenses of the destitute ultimately shouldered by the taxpayers through the Medicaid program in the long term,[58] the state should make enrollment in a 401(k) plan the default option for new employees.

IV. Libertarian Welfarism vs. Coercive Welfarism?

Because a paternalist seeks to make individuals better off, as judged by their own standards, it is clear why libertarian paternalism is theoretically superior to coercive paternalism. Assuming that the transaction costs associated with avoiding a government nudge are low, nudges strictly dominate mandates. Under a libertarian paternalism approach, a targeted individual who would be better off making a different choice than the one the state thinks is superior – either because the state is mistaken or because preferences are heterogeneous and the individual has a minority preference – can take evasive action.

The welfarist, in contrast, seeks to maximize social welfare, even if this reduces the utility of the individuals targeted by a legal rule. For example, coercive criminal statutes that prohibit murder and mayhem can be justified on welfarist grounds: the harms to the victims and the negative third-party externalities far exceed the benefits to the perpetrators. No one seriously considers merely "nudging" would-be perpetrators to choose not to assault their neighbors, because those who choose to ignore the nudge

[57] See notes __-__, supra.

[58] In 1995, Medicare and Medicaid accounted paid $50 billion, or about 56 percent, of long term care expenditures for the elderly. The Congressional Budget Office has projected this figure will rise to $126 billion in 2020, or about 61 percent of total long term care expenditures for the elderly. *Projections of Expenditures for Long-Term Care Services for the Elderly*, Congressional Budget Office Memorandum, Congressional Budget Office, (1999).

would seriously reduce net social welfare, even if their individual utiltiy were increased.

There are two reasons why welfarists should prefer, at least in some situations, libertarian policy interventions to state coercion that requires individuals to engage in socially desirable behavior or create collective goods. First, freedom of choice is itself a value that is a constituent part of social welfare. Holding all else constant, members of a society in which freedom of action is widespread will enjoy more individual utility than members of a society that relies heavily on coercion, and thus there will be greater social welfare in the former society. Where a nudge can cause most people to act consistently with the maximization of social welfare, the benefits of widespread freedom of action might outweigh the costs attributable to the actions of the few who are not affected by the nudge.

Even in cases in which a nudge will motivate only a small number of people to act in a way that promotes social welfare, a nudge will often be preferable to a mandate if the mandate would place severe restrictions on autonomy. Obesity probably could be reduced if the government required restaurants to serve only low calorie food items, but even most welfarists would find this cure worse than the disease because the positive social externalities would pale in comparison the significant reduction in the utility enjoyed by diners.

Second, nudging can help ensure that desirable externalities are produced by the people able to do so at the lowest possible private cost, which in turn helps to maximize social welfare. Consider, again the issue of cadaveric organ donation. If the government announce a policy of seizing all cadaveric organs, everyone would become a donor, regardless of the depth of his individual opposition. Although social welfare would increase immense if the number of donors were increased sharply, it is not necessary that every American become a donor. By instituting a presumed consent law, and thus shifting the default rule from no donation to donation, two groups of individuals who would not opt-in under the no donation default will be added to the donor pool: people with a mild inherent preference for donating that was swamped by the status quo bias under the no donation default, and people with a mild inherent preference not to donate but who will not opt out under a presumed consent law. The people with the highest disutility for becoming a cadaveric organ donor -- those who have firm religious

convictions, find the prospect particularly disgusting, or are deeply suspicious of the medical community -- will opt out of doing so, overcoming the inertia that accompanies the status quo. Assuming that the number of people who opt out would be relatively low, as it is in European countries with presumed consent defaults, the social need for a large number of organs would be satisfied without unnecessarily imposing large personal costs on the individuals who find the practice most objectionable.

###