

Comment on John Beshears, James J. Choi, David Laibson and Brigitte C. Madrian: Early decisions: A regulatory framework

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There are two main messages to take away from this stimulating and thought-provoking paper by Beshears et al. The first, which is also supported by other research reported at this Conference, is that *regulating unhealthy consumption can be justified as a case of market failure*. One reason why this has not been widely recognized long ago (at least among economists) is that traditionally, most economic models have assumed that consumers have perfect willpower: an unlimited ability—and willingness—to stick to one’s own plans. In the present paper, however, it is assumed that consumers always care more about the present than the future (in addition to the usual discounting). This leads to a conflict of interests between the consumer’s “selves” at different points in time, which bears some resemblance to the conflict between consumers in traditional cases of externalities such as pollution. If this is acknowledged by consumers themselves, a demand for self-regulation arrangements will arise; but, as pointed out by Köszegi (2006, this volume), an unregulated market will not always be able to supply such self-regulation arrangements. Hence, government intervention in markets for unhealthy food, drugs, or other temptation goods such as gambling, is not necessarily paternalistic, since it might satisfy a consumer demand for goods not provided by the market.

The second main message of the paper is that “Early Decisions” regulation—for example, limited opening hours—*is superior to taxation* when consumer preferences are heterogeneous. This is a much more specific and more novel conclusion. It is also somewhat surprising, since economists usually recommend taxes as a more efficient policy tool than direct regulations.

This result does hinge on some important simplifying assumptions. First, the time structure of the model is particularly simple: In period 0, no costs or benefits are realized; in period 1, all benefits occur; and finally, in period 2, all costs occur. Second, this timing is implicitly

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assumed to be identical for everyone. Hence, while the analysis allows consumers' tastes to differ, it does *not* allow their time schedules to differ. I suspect that this is a main reason for the superiority of "Early Decisions" over taxes: When *everybody* gets tempted to smoke in period 1, but not in period 0, and *everybody* is able to purchase cigarettes during period 0 anyway, then closing all cigarette outlets in period 1 seems like a very good idea. But in a society where people must go shopping at different hours, and face temptation at different (and perhaps unpredictable) hours, limited opening hours—although still possibly a good idea—obviously become less efficient than if timing is identical and predictable.

Nevertheless, what the analysis shows is that there *exist*, at least in theory, situations in which accessibility restrictions *do* perform better than taxation. It is an important task for further research to understand better, under more general conditions, when one type of policy instrument is preferable to the other, when they should be combined and, last but not the least, which cautions should be made against the use of these policies.

When the analysis concludes that an Early Decisions mechanism is *optimal*, the basis for this evaluation is *consumer utility viewed from period 0*. However, as mentioned above, in models like this one, there is a conflict of interests between the "selves" at different times. Hence, if we evaluated alternative policies *during period time 1*, then *everybody* would prefer the case of *no* regulation! So, why do preferences in period 0 seem to be regarded as "truer", or carrying a heavier normative weight, than preferences in period 1?

In the present analysis, the consumer is "impartial" in period 0, in the sense that she gives an equal weight to costs and benefits expected to occur in periods 1 and 2, respectively. (Since no benefits or costs are realized in period 0, the bias in favor of the present does not matter in period 0.) This makes period 0 natural to use as an "impartial" perspective: It sounds intuitively reasonable that when evaluating a policy of restricted sales hours for alcohol, we should not primarily ask half-drunk people outside a liquor store (period 1); neither should we mainly ask those in bed with a hangover the next morning. Nevertheless, in the general case when costs and benefits may occur at any time, and differently so for different people, it may be impossible to identify "neutral" situations at all. Hence, what is, in general, the appropriate normative basis for evaluation of policies designed to assist consumers' self-regulation?

Indeed, it would be very interesting to see a general ethical principle outlined on which such evaluation could be based. Without such a principle, however, it is worrisome that policy evaluation may crucially depend on which time perspective is chosen. For example, within an economy like the one described by Beshears et al., an ex post cost benefit analysis would always evaluate the policy more positively than an ex ante evaluation (if we disregard uncertainty): Since the benefits of the policy occur in Period 2 and the present is always emphasized, every consumer will be happier with the policy ex post (in period 2) than they were ex ante (in period 0).

This problem cannot be escaped simply by appealing to consumers' long-term perspective. To see this, it is useful to refer to the idea proposed by Thaler and Shefrin (1981) that in every period, the individual consists of a "planner" (with a long-term perspective) and a "doer" (who cares only about immediate pain and pleasure). Let the planner's welfare judgement made in period t be denoted U_p and let the doer's utility be u_t . Assume that the planner in period t always gives extra emphasis to the utility of the doer in period t , corresponding to the idea of quasi-hyperbolic utility used in Beshears et al. (2006), but that, in contrast to their paper, the planner cares about both future and *past* periods (allowing us to make both ex ante and ex post evaluations of policies). Then, we can write the *planner's* views of his own long-term utility, from the point of view of different periods, as

Period 0: $U_0 = u_0 + \beta(u_1 + u_2)$

Period 1: $U_1 = \beta u_0 + u_1 + \beta u_2$

Period 2: $U_2 = \beta(u_0 + u_1) + u_2$

where $\beta < 1$. An "impartial" planner would evaluate policies using $U = u_0 + u_1 + u_2$; however, this impartial spectator never exists. The philosophical problem of who, or rather when, to ask concerning welfare consequences, thus goes deeper than succeeding in making consumers take a long-term perspective. This, of course, mirrors the fact that in any case where conflicts of interest between individuals arise, and where this cannot be resolved through side payments, it is crucial to choose a specific normative principle—i.e., choosing on whose interests to place most emphasis—if one wants to draw normative

conclusions. The case of conflict of interest between “selves” at different times is no exception to this general rule.

References

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