

# Libertarian Welfarism

Russell Korobkin<sup>†</sup>

## INTRODUCTION

Neoclassical law and economics analysis, preoccupied with the normative goal of maximizing efficiency, assiduously avoids paternalism as a justification for regulatory policy. Built on the edifice of rational choice theory, law and economics scholars usually assume that economic actors are able to maximize the satisfaction of their preferences given the constraints they face.<sup>1</sup>

Evidence gathered by psychologists and behavioral 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 most people routinely fail to make optimal decisions—understood as those that maximize the actor’s subjective expected utility (“SEU”)—in a variety of contexts. The world is too complex for our brains to accurately and reliably calculate expected utility in strategic environments. Instead, humans rely on mental heuristics and habits, which allow us to function in the workaday world without being paralyzed by information overload. The result is that we stumble crudely through life, remaining on our feet most of the time but often enjoying less utility than is theoretically possible. These findings, imported into normative legal theory as behavioral law and economics, expand the potential space for paternalistic state intervention.<sup>2</sup>

I say *potential* space because the case for paternalism is subject to two challenges. First, the state functionaries who would presumably intervene in

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<sup>†</sup> Professor, UCLA School of Law. Ian Ayres, Chris Guthrie, Mark Grady, Doug Lichtman, Tim Malloy, Jacob Nussim, Margo Schlanger, Kirk Stark, Jeff Rachlinski, Tom Ulen, and workshop participants at UCLA and the University of Illinois provided excellent advice and comments on drafts. George Chapman, Paul McReynolds, Gina Nicholls, and Joe Woodring provided critical research assistance.

1. See Russell Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1060–66 (2000).

2. Christine Jolls, Cass Sunstein, and Richard Thaler described this evidence as supporting “anti-antipaternalism—a skepticism about antipaternalism, but not an affirmative defense of paternalism.” Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1541 (1998).

private decision making—legislators, regulators, judges, administrators, and the like—are no less human than the potential subjects of regulation. If I can't figure out whether I would be better off owning a car equipped with expensive airbags or a slightly more dangerous (and cheaper) automobile and the concomitant ability to purchase some other goods and services, why should I be confident that a state functionary can do any better?<sup>3</sup>

Second, heterogeneity of subjective preferences exists in most if not all cases of public policy significance. Some people would maximize their subjective expected utilities 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 SEU by paying for the airbags and forgoing the trip. Assuming that it is impractical even for an omniscient government functionary to impose different rules for each individual, a regulation requiring airbags must apply to all car sales or none. Accordingly, attempts to operationalize paternalism must necessarily harm many, even if they also benefit many.

In response to these two objections, legal and economic theorists have proposed a new regulatory paradigm that calls for the state to help individuals make decisions most likely to make individuals better off, but allow those 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.") call this model "asymmetric paternalism."<sup>4</sup> The paternalism is "asymmetric" because it creates significant benefits for those who would otherwise make suboptimal decisions and imposes comparatively small costs on those inconvenienced by the state's "assistance."<sup>5</sup> George Loewenstein and Emily Haisley use the phrase "light paternalism" to describe a comparable framework.<sup>6</sup> Cass Sunstein and Richard Thaler label their similar approach "libertarian paternalism,"<sup>7</sup> in recognition of its balance between pursuing the goal of paternalism and protecting individual freedom of choice.<sup>8</sup>

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3. See, e.g., Edward L. Glaeser, *Paternalism & Psychology*, 73 U. CHI. L. REV. 133, 134 (2006) (claiming that government decision making "is likely to be particularly erroneous" because lawmakers are subject to the same biases as the individual but lack the incentive that individuals have to make optimal decisions); cf. Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165, 1168 (2003) ("The psychological case for paternalism . . . must rest on a relative assessment of the cognitive costs of improved decision against the costs of supplanting individual choice.").

4. Colin F. Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism"*, 151 U. PA. L. REV. 1211 (2003).

5. *Id.* at 1219.

6. George Loewenstein & Emily Haisley, *The Economist as Therapist: Methodological Ramifications of "Light" Paternalism*, in THE FOUNDATIONS OF POSITIVE AND NORMATIVE ECONOMICS: A HANDBOOK 210 (Andrew Caplin & Andrew Schotter eds., 2008).

7. Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003) [hereinafter Sunstein & Thaler, *Libertarian Paternalism*].

8. 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

Thaler and Sunstein developed this idea in greater depth in their recent book, *Nudge: Improving Decisions About Health, Wealth and Happiness*,<sup>9</sup> which has garnered significant attention in the popular media as well as in academic circles.<sup>10</sup>

All of 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 SEU than they would obtain on their own—with lower costs than those associated with regulatory mandates backed up by threats of fines, imprisonment, or other punishment. Their paradigm can be expanded, however, to make the tools they promote even more useful. Non-coercive approaches to changing behavior can be used not only to help individuals maximize their SEU, but also to encourage them to produce public goods and otherwise improve overall social welfare, even when doing so is inconsistent with maximizing their own utility. I call the use of “nudges” for this goal “libertarian welfarism.”<sup>11</sup>

In this article, I first situate the missing category of libertarian welfarism within the existing literature. Second, I explain how recognizing and defining libertarian welfarism has two virtues for public policy: it can help policymakers identify a class of useful nudges that might otherwise be overlooked, and it can provide a normative justification for nudges that is missing from accounts of libertarian paternalism. Libertarian welfarism can help us to both understand and justify a broad range of state actions—ranging from publicizing greenhouse gas emissions of new cars, to providing recycling bins to homeowners, to

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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.

9. RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (Penguin Books 2009).

10. See, e.g., Benjamin M. Friedman, *Guiding Forces*, N.Y. TIMES, Aug. 24, 2008, at BR13 (book review); Elizabeth Kolbert, *What Was I Thinking?*, NEW YORKER, Feb. 25, 2008, at 77 (book review); Barbara Kiviat, *Lured Toward the Right Choice*, TIME, Apr. 14, 2008, at 76 (book review); Conor Clarke, Special Ideas Report: Get Rid of Polls, ATLANTIC, Jul. 8, 2009, [http://ideas.theatlantic.com/2009/07/get\\_rid\\_of\\_polls.php](http://ideas.theatlantic.com/2009/07/get_rid_of_polls.php); Paul B. Farrell, *Goldman Should Pay Paulson a Fat Bonus*, FOX BUSINESS, July 20, 2009, <http://www.foxbusiness.com/story/markets/industries/finance/goldman-pay-paulson-fat-bonus/>; Stephen Gandel, *A Political Plan to Help Save You More*, CNN MONEY MAGAZINE, July 24, 2008, <http://money.cnn.com/2008/07/24/magazines/moneymag/105711588.moneymag/index.htm>; Dahlia Lithwick, *Taming Your Inner Homer Simpson*, SLATE, May 12, 2008, <http://www.slate.com/id/2191156>.

11. In the article version of *Libertarian Paternalism* (although, oddly, not in *Nudge*), Sunstein and Thaler briefly note the possibility that libertarian paternalism could be complemented by or distinguished from an approach that considers vulnerable third parties rather than the utility of the targeted actors themselves. Sunstein & Thaler, *Libertarian Paternalism*, *supra* note 7, at 1162, 1185, 1193. As such, I do not wish to suggest that I have discovered something that these authors, or the other leading proponents of libertarian paternalism, failed to notice. However, Sunstein and Thaler neither flesh out the contours of a distinct complementary category nor compare its merits to those of libertarian paternalism. This article attempts to accomplish these two goals.

automatically enrolling individuals in 401(k) and cadaveric organ donation programs unless they opt out, to requiring restaurants to post the calorie content of their meals—far better than can libertarian paternalism.

## I

### LIBERTARIAN PATERNALISM

The objective of a paternalist state is to increase the SEU of its citizens through legal regulation.<sup>12</sup> The objective of the libertarian paternalist state is to accomplish this goal without resorting to coercion, roughly understood as enacting regulations that mandate behavior on threat of some negative consequence.<sup>13</sup> 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.<sup>14</sup>

#### *A. The Empirical Basis*

Research on human decision making conducted over the last four decades has catalogued a plethora of ways in which observed individual decision making is inconsistent with key assumptions of rational choice theory.<sup>15</sup> Known alternatively as “judgment and decision making,” “behavioral decision making,” or “behavioral economics,” this field of research has been sufficiently reported and discussed in legal scholarship over the last decade that it is well-known to many legal scholars.<sup>16</sup> To understand what is both innovative and potentially problematic about libertarian paternalism, however, one must recognize that the 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

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12. Thaler and 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 9, at 5. For some common examples of paternalistic policies enacted into law, see CAL. VEH. CODE § 27803 (West 2000) (requiring drivers and passengers of motorcycles to wear a safety helmet); CAL. EDUC. CODE § 48201 (West 2006) (requiring persons age 6 to 18 to enroll in and attend a full-time school); CAL. EDUC. CODE § 48293 (West 2006) (establishing monetary penalties against parents or guardians who do not comply with compulsory education requirements); CAL. BUS. & PROF. CODE § 19921 (West 2008) (preventing individuals under the age of 21 years from entering gambling establishments).

13. THALER & SUNSTEIN, *supra* note 9, at 5–6.

14. *Id.* at 6 (“[T]he intervention must be easy and cheap to avoid.”). Some critics have criticized the concept of libertarian paternalism on the grounds that it is inconsistent with a particular understanding of libertarian philosophy. This criticism misses the point of Thaler and Sunstein, whose argument is that the non-coercive nature of their paradigm should appeal to people who consider themselves libertarians.

15. For a discussion of the various conceptions of rational choice theory, as used in legal scholarship, see Korobkin & Ulen, *supra* note 1, at 1060–66.

16. See, e.g., Korobkin & Ulen, *supra* note 1; Jolls et al., *supra* note 2; Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998).

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.

### *1. Judgment Biases*

In order to reliably maximize SEU, an actor must have a realistic assessment of the probabilities of 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 evaluate the relative likelihood of various potential financial and non-financial returns from each course of action. 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 deviate systematically 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).<sup>17</sup> Memorable events are sometimes more common than events that seem more mundane, but this is not always the case.

People also judge events to be more likely if they seem typical of a class of events. In the most famous experiment to demonstrate this “representativeness” heuristic, researchers introduced subjects to “Linda,” who they described as being active in liberal political causes. Subjects were more likely to believe that “Linda” was a feminist bank teller than merely a bank teller (a logical impossibility).<sup>18</sup>

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.<sup>19</sup> Judgments about current facts and probabilities of future events are likely to reveal an egocentric bias<sup>20</sup> that results from paying

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17. See Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1128 (1974).

18. The likelihood of any two events occurring cannot be greater than the likelihood of one of the events occurring on its own. THALER & SUNSTEIN, *supra* note 9, at 26–27.

19. Tversky & Kahneman, *supra* note 17, at 1128–30. For example, studies have shown that laypeople’s estimate of the number of African countries in the United Nations is affected by whether a large or small number comes up on the spin of a wheel, *id.* at 1128, and that real estate agents’ estimates of the value of a house is biased by the (only partially relevant) anchor of the house’s asking price. MAX H. BAZERMAN & MARGARET A. NEALE, NEGOTIATING RATIONALLY 26–28 (1992).

20. David A. Armour & Shelley E. Taylor, *When Predictions Fail: The Dilemma of Unrealistic Optimism*, in HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 334 (Thomas Gilovich et al. eds., 2002).

disproportionate attention to facts consistent with preexisting belief structures<sup>21</sup> and overestimating one's agency in the world.<sup>22</sup> Both of these effects are 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 potentially useful for legal policy, are several similar findings about the effect of salience on probability judgments known as "support theory."<sup>23</sup> This body of research shows that the assessment of an event's probability will generally be higher if the event is described with greater specificity, or if all the ways the event might come about are enumerated (as opposed to a situation where the event's realization is described vaguely and broadly).<sup>24</sup>

Generally, this body of research demonstrates that individuals are unlikely to behave in an optimal, Bayesian fashion when they make probability judgments.<sup>25</sup> There is too much information available in our world for us to analyze or even consider all of it, much less to process it in accordance with anything like statistically sound methods. People often rely on intuitions driven by attention to highly salient information rather than careful, reflective analysis, emotions rather than reason, and other heuristics that lead to "boundedly rational"<sup>26</sup> rather than fully rational decisions.

These systematic tendencies can demonstrably lead to incorrect factual assessments, which can, in turn, lead individuals to make suboptimal decisions about how to act. It is, therefore, proper to refer to these tendencies as "biases." The heuristics underlying these biases have likely evolved over human history because they generally help us survive in an information-rich environment (or, at least, did so in the evolutionary environment).<sup>27</sup> Nonetheless, they clearly can lead to errors of judgment in particular circumstances that cause individuals

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21. See, e.g., Charles G. Lord et al., *Biased Assimilation and Attitude Polarization: The Effects of Prior Theories on Subsequently Considered Evidence*, 37 J. PERSONALITY & SOC. PSYCHOL. 2098 (1979).

22. See, e.g., David Dunning et al., *Ambiguity and Self-Evaluation: The Role of Idiosyncratic Trait Definitions in Self-Serving Assessments of Ability*, in *HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT*, *supra* note 20, at 324.

23. See Amos Tversky & Derek J. Koehler, *Support Theory: A Nonextensional Representation of Subjective Probability*, 101 PSYCHOL. REV. 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. BEHAV. 159 (2002).

24. See Tversky & Koehler, *supra* note 23; Fox & Birke, *supra* note 23.

25. On the mathematics of rationally updating probability assessments when new information becomes available in accordance with "Bayes's Law," see, e.g., ROBERT V. HOGG & ALLEN T. CRAIG, *INTRODUCTION TO MATHEMATICAL STATISTICS* 208–09 (3d ed. 1995).

26. The term "bounded rationality" is usually attributed to Herbert Simon. See Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q. J. ECON. 99 (1955); HERBERT A. SIMON, *Rational Choice and the Structure of the Environment*, in *MODELS OF MAN: SOCIAL AND RATIONAL* 261 (1957).

27. See, e.g., Colin Camerer et al., *Neuroeconomics: How Neuroscience Can Inform Economics*, 43 J. ECON. LITERATURE 9, 11, 26 (2005); Michael Waldman, *Systematic Errors and the Theory of Natural Selection*, 84 AM. ECON. REV. 482, 483 (1994).

to deviate from the assumed goal of maximizing SEU.

Some traditionalists might object that it is logically impossible for individuals' actions to be suboptimal expressions of SEU because the concept of "utility" has been defined historically by reference to observed actions.<sup>28</sup> Common sense and common experience suggest, however, that incorrect estimations of probabilities or misunderstandings of facts can cause individuals to make choices that leave them worse off, given their particular preference structure, than they otherwise might have been.<sup>29</sup> Daniel Kahneman has described this as the difference between "decision utility," which is the amount of weight individuals assign to a particular course of action at the point in time that a choice is made, and "experienced utility," which is a measure of the hedonic experience associated with that course of action.<sup>30</sup> For policymakers, the net hedonic value of a choice, discounted by its likelihood of coming to pass at the time the choice is made, represents the appropriate understanding of SEU.<sup>31</sup>

The problem legal theorists face is that it is difficult for the state to respond to these biases in ways unlikely to introduce new biases or impose new costs, precisely because individuals are boundedly rational and almost always incapable of considering all information that might be relevant. If the state provides information or enacts regulations that require other actors to provide certain information, then this information is likely to become salient. But if this new information becomes salient, then it can crowd out other information that might also be relevant to SEU calculations. The result would be that one biased decision or choice simply replaces another.<sup>32</sup>

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28. See, e.g., Faruk Gul & Wolfgang Pesendorfer, *The Case for Mindless Economics*, in THE FOUNDATIONS OF POSITIVE AND NORMATIVE ECONOMICS, *supra* note 6, at 3, 8 ("As its welfare criterion, standard economics uses the individual's choice behavior, that is, revealed preferences. . . . Hence, welfare is defined to be synonymous with choice behavior.").

29. Cf. Colin F. Camerer, *Wanting, Liking, and Learning: Neuroscience and Paternalism*, 73 U. CHI. L. REV. 87, 90–92 (2006) (criticizing the familiar "revealed-preferences view [that] basically equates welfare (experienced utility) with choice (decision utility), as a matter of the definition of welfare").

30. Daniel Kahneman, *New Challenges to the Rationality Assumption*, 150 J. INSTITUTIONAL & THEORETICAL ECON. 18 (1994).

31. Cf. John Bronsteen et al., *Well-Being Analysis 2* (Ill. Pub. Law Research Paper No. 08-31, 2009), available at <http://ssrn.com/abstract=1397843> (arguing that "well-being" is better understood as "happiness or positive affect" than as preference satisfaction); Matthew Adler & Eric Posner, *Happiness Research and Cost-Benefit Analysis 5* (Univ. of Pa. Inst. for Law & Econ. Research Paper No. 07-15, 2007), available at <http://ssrn.com/abstract=999928> (arguing that individual wellbeing "consists in those things that individuals, with full information and deliberating rationally . . . converge in self-interestedly preferring," rather than a consequence of preference satisfaction).

32. See generally Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 230–31 (2006) (discussing the problem of "overshooting").

## 2. 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, people often construct preferences at the point of decision making based, at least in part, on contextual cues.<sup>33</sup>

One extremely important contextual cue is the reference point from which a decision maker evaluates changes to the status quo as “gains” or “losses.”<sup>34</sup> People typically care less about achieving a “gain” than they do about suffering a “loss.” As a 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 avoiding a loss as an upside. This tendency is called the “framing effect.”<sup>35</sup> Similarly, all other things being equal, most people will favor what they perceive to be the status quo over an alternative state of the world (the “status quo bias”),<sup>36</sup> and thus will place a higher value on what they own than what they don’t own (the “endowment effect”).<sup>37</sup>

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 than an outlier (the “compromise effect”).<sup>38</sup> For example, people are more likely to prefer a mid-sized rental car over a compact model if they are also given the third option of a full-sized car. People are also 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 (the “contrast effect”).<sup>39</sup> For instance, 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. Given the ability to divide their choice among options, people often diversify equally amongst available choices, even if some are substantially similar.<sup>40</sup> For example, if a retirement plan offers three funds, many people

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33. Sarah Lichtenstein & Paul Slovic, *The Construction of Preference: An Overview*, in *THE CONSTRUCTION OF PREFERENCE* 1 (Sarah Lichtenstein & Paul Slovic eds., 2006).

34. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263, 274 (1979).

35. See Daniel Kahneman, *Reference Points, Anchors, Norms, and Mixed Feelings*, 51 *ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES* 296, 298 (1992).

36. See William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 *J. RISK & UNCERTAINTY* 7 (1988).

37. 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. U. L. REV.* 1227 (2003).

38. See Itamar Simonson, *Choice Based on Reasons: The Case of Attraction and Compromise Effects*, 16 *J. CONSUMER RES.* 158, 171–72 (1989).

39. See Mark Kelman et al., *Context-Dependence in Legal Decision Making*, 25 *J. LEGAL STUD.* 287, 288–89 (1996).

40. Daniel Read et al., *Mixing Virtue and Vice: Combining the Immediacy Effect and the Diversification Heuristic*, 12 *J. BEHAV. DECISION MAKING* 257 (1999); Shlomo Benartzi & Richard H. Thaler, *Naïve Diversification Strategies in Defined Contribution Savings Plans*, 91

will divide their money equally between the three whether two are stock funds and one is a bond fund or two are bond funds and one is a stock fund.<sup>41</sup>

The power of social pressure also illustrates how preferences can be highly context-dependent. According to the well-documented principle of “social proof,” people are 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.<sup>42</sup> Depending on the situation, this effect could be due to faith in the wisdom of others or a desire to conform. 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, then my new knowledge can be said to have a preference-shaping effect. A related regularity is that preferences are often shaped by a desire to conform to social norms. Separate from what my colleagues actually drink, my preference for Coke or Pepsi might be affected by which beverage choice I believe will generate more esteem in the eyes of my colleagues.<sup>43</sup>

Unlike the findings above that I have called judgment biases, it is difficult to say that the demonstrated effect of contextual cues in preference formation leads to decision making outcomes that can properly be called 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, because he is likely to think conservatism toward exchange is quite reasonable, even if it results in different outcomes in different contexts. 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

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AM. ECON. REV. 79 (2001).

41. For a clear discussion of these contextual effects, see DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 1–21 (2008). On Amir and Orly Lobel provide an interesting discussion of how the compromise and contrast effects might result from very different mental processes. On Amir & Orly Lobel, *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy*, 108 COLUM. L. REV. 2098, 2110–12 (2008).

42. ROBERT B. CIALDINI, INFLUENCE: SCIENCE AND PRACTICE 100 (4th ed. 2001).

43. Different theories of the power of social norms suggest slightly different motivational bases. Robert Cooter theorizes the power of norms comes from their internalization. See Robert Cooter, *Normative Failure Theory of Law*, 82 CORNELL L. REV. 947, 954–55 (1997). Richard McAdams argues that people comply with norms to earn the esteem of others. See Richard H. McAdams, *The Origin, Development and Regulation of Norms*, 96 MICH. L. REV. 338 (1997). Eric Posner believes that norms have power because conformance with them generally signals that one is responsible and cooperative, which is valued by others. See ERIC POSNER, LAW AND SOCIAL NORMS (2000).

preferred oranges to apples. Anthony seems to exhibit inconsistent preferences in all of these examples. It is far from clear that any of Anthony's judgments constitute mistakes under the circumstances, however, because there is no compelling reason that a fully rational person cannot have different preferences in different contexts.<sup>44</sup> 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 maximize SEU given different background conditions.

Another well-documented phenomenon that might be viewed as an example of the context-dependence of preferences is referred to as "hyperbolic discounting."<sup>45</sup> When faced with the choice between two goods deliverable at different times, individuals will often display a much lower discount rate if both time periods are distant than if one is distant and the other is immediate. For example, many people would choose \$100 today over \$110 tomorrow while also choosing to receive \$110 in 31 days rather than \$100 in 30 days.<sup>46</sup> Some decision making researchers believe this is a consequence of 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. An immediate option provides a level of temptation that is more likely to provoke an affective response.

Described this way, it might seem that an emotion-laden decision should be considered a mistake when it differs from a decision that would have resulted from cold analysis not influenced by temptation.<sup>47</sup> And this position seems quite defensible in some cases, especially when our visceral drives (such as hunger, thirst, sleep, sexual desire, or other cravings) provide a physiological urge to take an immediate action that would have promoted survival in the evolutionary era but is suboptimal in modern society.<sup>48</sup> If you made a considered decision to diet, your SEU would probably be increased if you were required to choose whether or not to order chocolate cake a week in advance rather than when it is wheeled before you on the dessert cart and the wafting

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44. See Claire A. Hill, *The Rationality of Preference Construction (and the Irrationality of Rational Choice)*, 9 MINN. J. L. SCI. & TECH. 689, 707 (2008) ("[P]eople form their preferences [in many situations] based on how they come to understand the choice they are making . . . . The choice made at a particular time is context-specific. In a different context, the choice may be different . . . . [I]t is not clear why as a normative matter such preferences should be undesirable.").

45. See Shane Frederick et al., *Time Discounting and Time Preference: A Critical Review*, 40 J. ECON. LITERATURE 351, 360–63 (2002).

46. *Id.* at 361.

47. This is essentially the position of Loewenstein and Haisley. See Loewenstein & Haisley, *supra* note 6, at 201–05.

48. See, e.g., George Loewenstein, *Out of Control: Visceral Influences on Behavior*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 272, 272–73 (1996) (intense visceral factors drive a wedge between decisions and self-interest).

scent drains your will power. The primal urge humans have for sweet food, while once key to survival,<sup>49</sup> is no longer helpful. The five minutes of pleasure that evolution has ensured we will enjoy while eating the cake probably will be followed by more than a compensating amount of regret, as anyone who has ever tried to diet knows.

Research suggests, however, that cold analysis will not always outperform hot emotion in its ability to yield utility maximizing decisions. A considerable amount of 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.<sup>50</sup> Cold analysis, then, can cause individuals to overvalue the aspects of a choice that they can describe and quantify in a rationalistic manner, such as price and other objective attributes, a regularity that is called “lay rationalism.”<sup>51</sup> In one experiment, researchers found that students who were asked to rate how much they liked a series of posters and to explain their decisions before choosing one to take home expressed less satisfaction with their choice one month later than students who were not required to justify their preferences with reasons,<sup>52</sup> notwithstanding the well-known urge to rationalize actions to reduce cognitive dissonance.<sup>53</sup> In another study students asked to report their preference for five different jams provided ratings that approximated those of expert taste testers. This group’s reports varied markedly, however, from the ratings of other students who were required to coldly and rationalistically rate the jams on a variety of attributes.<sup>54</sup>

The conclusion is that cold calculation will lead to improvements in SEU in many circumstances, but certainly not in all.<sup>55</sup>

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49. See RICHARD DAWKINS, *THE SELFISH GENE* 57 (2d ed. 1999).

50. See Timothy D. Wilson et al., *Introspection About Reasons Can Reduce Post-Choice Satisfaction*, in *THE CONSTRUCTION OF PREFERENCE*, *supra* note 33, at 471, 472–73.

51. Christopher K. Hsee et al., *Lay Rationalism and Inconsistency Between Predicted Experience and Decision*, in *THE CONSTRUCTION OF PREFERENCE*, *supra* note 33, at 532, 533.

52. *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.

53. See generally LEON FESTINGER, *A THEORY OF COGNITIVE DISSONANCE* (1957).

54. See T. D. Wilson & J.W. Schooler, *Thinking Too Much: Introspection Can Reduce the Quality of Preferences and Decisions*, 60 *J. PERSONALITY & SOC. PSYCHOL.* 181, 181 (1991).

55. Cf. Ellen Peters, *The Functions of Affect in the Construction of Preferences*, in *THE CONSTRUCTION OF PREFERENCE*, *supra* note 33, at 454, 463 (“[Affect] sometimes may help and other times hurt decision processes . . . . [T]he presence of affect does not guarantee good or bad decisions, only different information processing.”); Timothy D. Wilson et al., *Introspecting About Reasons Can Reduce Post-Choice Satisfaction*, 19 *J. PERSONALITY & SOC. PSYCHOL.* 331, 339 (1993) (“[M]ore work is needed to specify the conditions under which introspecting about reasons will have deleterious consequences.”).

### B. Tools

The principal tools of nudging, or of “choice architecture” as Thaler and Sunstein call it,<sup>56</sup> are (1) the provision of various types of information to choosers (“informational interventions”) and (2) the selection of default rules. Other, less frequently cited tools include (3) the alteration of decision frames and (4) imposition of temporary behavioral prohibitions.

#### 1. Informational Interventions

The broad finding that individuals routinely deviate from Bayesian reasoning when analyzing and evaluating information before making a decision suggests the usefulness of providing information. What I will call “informational interventions” involve providing information to individual actors about the likely consequences of their choices. The government may intervene directly or indirectly through mandatory disclosure or reporting requirements that shift the information-provision burden to other actors.

One simple example of a direct intervention, offered by Thaler and Sunstein, 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.<sup>57</sup> A second example is state government advertisements, showing data indicating that fewer college students smoke or engage in binge drinking than most college students are likely to predict, in order to combat the perception that “everyone is doing it.”<sup>58</sup>

As an example of regulation requiring some actors to provide information to others, Thaler and Sunstein suggest requiring credit card companies to provide customers with annual electronic statements of the different types of charges they have been assessed (interest, annual fees, late fees, etc.) along with the algorithm the company uses to assess such charges.<sup>59</sup> This would allow customers, making use of websites that would analyze this data, to more easily determine which of the many credit card products available in the marketplace would minimize their annual cost of credit, assuming their spending patterns remained constant. Camerer et al. suggest laws requiring that “rent-to-own” establishments provide customers with the implicit interest rate that they will pay for the goods in the event that they rent for a long enough period of time to obtain title.<sup>60</sup>

Consistent with the values of libertarian paternalism, dissemination of these types of information should help many individuals make decisions—

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56. THALER & SUNSTEIN, *supra* note 9, at 85.

57. *Id.* at 92.

58. *Id.* at 68–69.

59. *Id.* at 145. The authors propose similar requirements for mortgage lenders, cell phone service providers, and providers of Medicare prescription drug benefits.

60. *See* Camerer et al., *supra* note 4, at 1231.

whether to cross the street, drink excessively, continue to use a particular credit card, or purchase consumer goods on an installment plan—that are more likely to maximize their SEU, while leaving individuals who wish to ignore the information free to do so at little cost.

## 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 applies 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 Thaler and Sunstein<sup>61</sup> and Camerer et al.,<sup>62</sup> is the decision that most employees face about whether to enroll in a company-sponsored 401(k) retirement plan.

Traditionally, the default rule for employer-sponsored but individually-funded retirement savings plans was “non-enrollment.” In other words, an employee had to take affirmative steps to have a portion of her paycheck diverted into a retirement amount; no affirmative choice, no participation. Contrary to the predictions derived from rational choice theory, companies that changed the default rule to “enrollment” (by requiring employees to opt out if they did not want to participate) reported a significant increase in the number of employees taking advantage of the plans.<sup>63</sup> Since the transaction costs of opting in or out of a 401(k) plan are relatively small—in most cases, filling out a single form that is usually readily available—this data suggests that simply changing the default rule can affect behavior.

Of course, changing the 401(k) default from the traditional opt-in to opt-out will slightly inconvenience employees who, because of significant family wealth, high discount rates, or particularly good prospects for increasing their earnings in future years wish to spend all of today’s income today and save none. 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 action 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

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61. THALER & SUNSTEIN, *supra* note 9, at 112–13.

62. Camerer et al., *supra* note 4, at 1227.

63. See, e.g., Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. ECON. 1149, 1184 (2001).

individuals to save more for retirement. As an example, Thaler and Sunstein tout the “Save More Tomorrow” program, first suggested by Thaler and Shlomo Benartzi.<sup>64</sup> Because people are averse to losses, relatively few sign up to take a current pay cut in order to shift money into their retirement accounts. On the other hand, it turns out that 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.<sup>65</sup> Presumably this option enables employees to increase retirement savings without experiencing what feels to them like a loss in spendable earnings.<sup>66</sup>

Similarly, Loewenstein and Haisley champion incentive systems that make use of the loss aversion phenomenon by providing individuals with benefits (or inviting them to place their own dollars at risk) and then penalizing them if they engage in harmful behaviors, such as gaining weight.<sup>67</sup> The idea here is that people will be more motivated to avoid losses than to seek affirmative incentives that might be obtained from fighting temptation.

#### 4. *Timing of Choice*

Another tool of libertarian paternalism is the “cooling off” period, which is designed to help individuals make choices under “cold,” considered conditions, rather than “hot,” emotional conditions.<sup>68</sup> Laws that provide a fixed number of days in which consumers can cancel door-to-door sales contracts<sup>69</sup> and waiting periods imposed on gun purchases<sup>70</sup> and divorces<sup>71</sup> are all examples of this type of intervention.

## II

### WEAKNESSES OF LIBERTARIAN PATERNALISM

The paradigm of libertarian paternalism suffers from two principal weaknesses. Both substantially limit the breadth of situations where the tools of libertarian paternalism can be applied fruitfully in the real world. First, many actions that increase an individual’s utility will decrease overall social welfare,

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64. Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. s164, s166 (2004).

65. *Id.*

66. THALER & SUNSTEIN, *supra* note 9, at 116–21.

67. Loewenstein & Haisley, *supra* note 6, at 227–28.

68. See THALER & SUNSTEIN, *supra* note 9, at 253–54; Sunstein & Thaler, *Libertarian Paternalism*, *supra* note 7, at 1184–85, 1187–88; Camerer et al., *supra* note 4, 1238–47.

69. 16 C.F.R. § 429.1 (2009) (requiring door-to-door sales contracts to provide a three business-day cancellation period).

70. 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 replaced a 5-day waiting period with a required background check that can be processed immediately. See 18 U.S.C. § 922(t).

71. See, e.g., CONN. GEN. STAT. ANN. § 46.b-67(a) (West 2009) (requiring a 90-day pre-divorce waiting period).

raising the question of whether and how policymakers should nudge individuals when private and social welfare diverge (the “externality problem”). Second, when the net utility consequences to individuals of a particular choice are uncertain or indeterminate, libertarian paternalism can be defended only as a second-best solution to the resulting policymaking dilemmas (the “indeterminacy problem”). This Part describes these two shortcomings; the following Part explains how libertarian welfarism largely avoids them.

#### A. *The Externality Problem*

The first weakness of the libertarian paternalist paradigm, as currently articulated, is that it ignores negative externalities created by the behavior of the regulated individuals. The normative goal of most law and economics scholarship is to maximize social welfare, which includes the utility of actors subject to regulation *and* the utility of third parties. But libertarian paternalism offers neither a theory as to why it would be appropriate for the government to concern itself solely with the utility of the individuals directly affected by regulations nor, alternatively, how libertarian paternalists ought to go about taking into account the welfare effects on third parties.

One possible explanation for this omission is that the proponents of libertarian paternalism view its tools as useful both to governments and private organizations. In *Nudge*, for example, Thaler and Sunstein explicitly set out to provide examples of how both public and private actors could use the techniques described.<sup>72</sup> But the normative justification for private action will necessarily be different from 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.

A second possible explanation is that the externalities associated with 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 lawmakers can safely ignore them. 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. The failure of libertarian paternalism to consider the problem of externalities will be inconsequential in this example. 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,<sup>73</sup> because in such cases the utility of non-actors will be unaffected by the choices of actors.

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72. THALER & SUNSTEIN, *supra* note 9, at 105.

73. See generally ARTHUR C. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932).

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.

The areas in which the state considers regulating, however, rarely 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 experience greater satisfaction, or she might nudge me to watch television if 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. In short, 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. The state might, and often does, choose to limit its concern to the welfare of a limited group of actors for a reason external to the paradigm. In such cases, maximizing the welfare of target individuals and ignoring the welfare of everyone else might well be justified. 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 purchasing decisions that will maximize their SEU, with little or no 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.

### *B. The Indeterminacy Problem*

The second significant problem with the libertarian paternalism paradigm is that in many, and perhaps most, significant cases, it will 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 epistemological problem exists whether the policy intervention attempts to provide information to undermine judgment biases ("informational interventions") or attempts to alter the context of a choice to influence preference construction ("preference-construction interventions"). The precise nature of the problem is slightly different in these two cases, as the former case presents a practical problem while the latter case is a theoretical issue.

### 1. *Informational Interventions*

Informational interventions satisfy the libertarian condition of libertarian paternalism since they do not mandate any behavior on the part of individuals.<sup>74</sup> Those for whom the additional information is either irrelevant or unnecessary are free to ignore it. And providing information can also help counteract biased judgments that can cause individuals to make suboptimal choices. The practical problem, however, is that it is often difficult to know whether addressing one informational deficiency will crowd out other information relevant to maximizing SEU.

Informational interventions will be unobjectionable in the simplest cases: those in which one or two factors almost certainly have the most substantial utility consequence in a decision. Take, for instance, the example of painting “look right” in London crosswalks.<sup>75</sup> Policymakers can reasonably assume that the desire to avoid being hit by a car is the single most important factor to pedestrians deciding whether or not to cross the street, dwarfing all 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, pointing out this fact will enable many pedestrians to make a much more accurate calculation of the probability of being hit while crossing the road. It is possible that emphasizing this information might cause individuals to pay 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 will swamp the costs of focusing their attention on this particular hazard.

In more complicated cases, however, it is less clear whether well-meaning informational interventions will create a net benefit to SEU. If credit card companies were required to provide customers with electronic information that makes it easy to compare the annual cost of credit, as Thaler and Sunstein recommend,<sup>76</sup> the regulation would undoubtedly improve consumers’ ability to compare the products along that metric. However, it might also encourage consumers to pay less attention to other credit card attributes (service, billing flexibility, perks, etc.) or to the accuracy of the assumptions necessarily embedded in the algorithm (i.e., that the consumer’s spending patterns will be consistent from year to year).<sup>77</sup> Moreover, because sellers will have an incentive to exploit the bounded rationality of customers in order to increase

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74. Note, however, that such interventions often mandate behavior by the third party who is required to provide or disclose the information, a feature that might in itself be problematic to true libertarians.

75. THALER & SUNSTEIN, *supra* note 9, at 92.

76. *Id.* at 93–94.

77. *Cf.* Amir & Lobel, *supra* note 41, at 2114–15 (observing that requiring merchants to provide clearer information might cause consumers to overemphasize those attributes).

profits,<sup>78</sup> companies may respond to such regulation by reducing the quality of product attributes rendered less salient by the regulation in an effort to maximize profits.<sup>79</sup> Will the information intervention ultimately leave customers better off as judged by their own utility functions? Possibly, but it is difficult to know for sure.

## 2. Preference-Construction Interventions

Libertarian paternalism's attempt to increase SEU by shaping preferences not only faces practical problems but is also indeterminate in theory: when preferences are constructed in response to context, there is arguably no way 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. 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 SEU of each of the five employees?

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. The Thaler and Sunstein brand of libertarian paternalism implicitly makes this type of assumption.<sup>80</sup> This move, however, is logically inconsistent with the foundational premises of libertarian paternalism: that preferences are heterogeneous and policymakers are not omniscient. If one size fits all and the government always knew what was best for individuals, there would be no reason to favor libertarian paternalism over coercive paternalism. In such a world, 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

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78. See generally Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630 (1999).

79. See generally, Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1234–35 (2003).

80. See Amir & Lobel, *supra* note 41, at 2120 (“Thaler and Sunstein’s assumption that, absent irrationalities, every individual would agree that future savings and improved long-term health are better than immediate satisfaction and gratification seems problematic.”); Gregory Mitchell, Review Essay, *Libertarian Paternalism Is an Oxymoron*, 99 NW. U. L. REV. 1245, 1268–69 (2005) (criticizing Thaler and Sunstein for assuming that central planners can identify objective welfare measures that will satisfy everyone).

reality, there are few situations in which there is both complete homogeneity of preferences and near-certainty that the state can know which default will maximize SEU.

A different response would be to compare the numbers of employees who would 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 non-enrollment default, the enrollment default is preferable.

Unfortunately this logic is flawed. It would be appropriate if the choice of default affected only transaction costs and not preferences, such that A, B, and C would opt into enrollment and D and E would opt out. 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 determining 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.<sup>81</sup> In our example, however, C and D's outcomes depend on the default. Thus, even a state that could predict the number of employees who would opt out of either default would have no way of determining whether enrollment or non-enrollment would provide more SEU for those employees who would choose not to opt out in either case.

A better approach would be to compare the reported happiness over time of people who make different choices. There is a clear practical problem with this approach, however: few policies would ever be implemented if the government first had to study the utility consequences of decisions (e.g., 401(k) participation) on those who were eligible over a period of forty to fifty years. And even such an impractical data-gathering exercise would not offer an adequate response to the indeterminacy critique in close cases. Imagine that half of the members of a study sample were assigned to an opt-in default condition of 401(k) enrollment and the other half were assigned to an opt-out condition. If subjects in both groups who participated in the savings plan were much happier on average over a long period of time than subjects who did not participate, we might feel confident that participation was the utility-maximizing choice for the majority.<sup>82</sup> But the indeterminacy problem would remain if the subjects in both conditions who accepted their default status

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81. 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) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991)).

82. Even in this case, one might object that the policy maker would need to make some adjustments for risk. If investment returns over a certain period are abnormally high or the average lifespan suddenly increases, savers might report greater happiness with their decision that they would have under the alternative possible circumstances (i.e., disappointing investment returns and shorter lifespans).

reported greater happiness than those who did not regardless of whether they were assigned to the opt-in or opt-out group.

In response to the difficulties inherent in determining which option would maximize individual utility, at least some of the leading proponents of libertarian paternalism believe that libertarian paternalist policies should be implemented only when the disjunction between observed choices and actual utility is uncontroversial.<sup>83</sup> This approach strikes me as unobjectionable in theory, but if accepted, it would severely limit the practical usefulness of the paradigm.

### 3. *The Response: Libertarian Paternalism Compared to What?*

The significance of the indeterminacy criticism depends on the point of comparison. Thaler and Sunstein attempt to finesse the indeterminacy problem by implicitly assuming that the alternative to libertarian paternalism is either coercive paternalism, which would be even less likely to improve SEU because the unhappy cannot opt out, or conscious inaction.

Concerning conscious inaction, Thaler and Sunstein argue that, because information and context are ubiquitous, there is no truly neutral way to present information or options.<sup>84</sup> 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 every piece of relevant information in an unbiased way. Choices must always be made in some context. Given this reality, isn't it better for the state to nudge individuals in the direction policymakers *think* will make most of them better off—perhaps based on which option policymakers believe most people would choose in an acontextual world or based on which outcome policymakers believe would receive the highest ex post satisfaction ratings—than in some other direction?<sup>85</sup>

For example, suppose we think that the annual cost of credit is likely to be the most important attribute of a credit card to most customers, but that calculating that cost is difficult. Isn't it better to provide customers 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 non-enrollment default? If we think that people will be happier with their consumer purchases if we encourage cold, cognitive reasoning and discourage hot, emotional intuition by instituting cooling off periods, isn't it better to have cooling off periods than not?

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83. Loewenstein & Haisley, *supra* note 6, at 221 (“[E]ven light paternalistic policies should only be put into play when welfare judgments tend to be relatively straightforward.”).

84. THALER & SUNSTEIN, *supra* note 9, at 10, 240, 246.

85. See, e.g., Sunstein & Thaler, *Libertarian Paternalism*, *supra* note 7, 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 trying to improve people’s welfare rather than the opposite.”).

A particularly convincing illustration of this argument offered by Thaler and 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.<sup>86</sup> 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). Since neutrality is not an option, doesn't it make more sense, Thaler and Sunstein argue, for the manager to place fruit first than to put cake first or to choose the placement order randomly?<sup>87</sup>

Framed in this way, the argument for libertarian paternalism is compelling, but the frame is too narrow. Given a choice between laissez-faire inaction, coercion, and “self-conscious efforts . . . to steer people’s choices in directions that will improve their lives,”<sup>88</sup> the last of these choices often will be the most normatively desirable. But there is another option. The indeterminacy problem suggests that, in many circumstances, it might be more sensible to attempt to implement a different policy goal altogether.<sup>89</sup> The conceptual category of libertarian welfarism provides the alternative goal.<sup>90</sup>

### III

#### LIBERTARIAN WELFARISM

##### *A. A Missing Category*

As mentioned above, most law and economics analysis assumes that the proper normative goal of state regulation of private behavior is to increase social welfare.<sup>91</sup> A policy is usually understood to fulfill this criterion if it satisfies the requirement of Kaldor-Hicks efficiency,<sup>92</sup> otherwise known as cost-benefit analysis. That is, the beneficiaries of the regulation should gain

86. THALER & SUNSTEIN, *supra* note 9, at 1.

87. *Id.* at 4–5.

88. *Id.* at 5.

89. *Cf.* Hill, *supra* note 44, at 733 (“That preferences are constructed suggests that there is no clear way for law to respect what people really want—and that trying to respect what people really want ought not to trump other legitimate societal aims.”).

90. In what he calls a “libertarian approach to choice-framing paternalism,” Gregory Mitchell suggests a goal that is different than both libertarian paternalism and libertarian welfarism. Mitchell argues that the state should “frame choices in ways that push irrational persons in directions that maximize their liberty or help them retain the greatest degree of future freedom to contract;” for example, by favoring default rules like at-will employment. Mitchell, *supra* note 80, at 1262. Because true freedom includes the freedom to commit oneself to future actions, I do not think that maximizing *future* freedom to contract is a normatively defensible objective, even if we assume the primacy of personal liberty on the value hierarchy.

91. *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).

92. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 13 (7th ed., Aspen Publ. 2007).

enough so that they could fully compensate those who are burdened.<sup>93</sup> Even if actors are perfectly capable of maximizing their SEU without assistance from the state, they often impose significant costs, or “negative externalities,” on others while doing so. The welfarist norm implies that, when private benefits to focal actors are small relative to the negative externalities they impose on others, the state legitimately can coerce behavior to protect third parties or to protect society generally. I refer to this as the “welfarism” justification for regulation.

Coercive regulation based on the welfarism justification is generally considered by law and economics scholars to be appropriate in a far wider set of circumstances than coercion based on the paternalism justification.<sup>94</sup> This is because there are ubiquitous collective action problems: actions that benefit individual actors harm the collective good, and actions that benefit the collective good require sacrifice by individual actors. A clear example of this “tragedy of the commons”<sup>95</sup> is global warming. Climate change is approaching crisis proportions because billions of individual decisions to pollute are made by individuals and companies that make those decisions in their private interests, while most of the costs are externalized onto the rest of society. Similarly, soaring medical costs threaten the very viability of the healthcare insurance system because individuals with insurance have a private incentive to overuse healthcare resources while externalizing the costs to the insurance pool. The list could go on.

Just as legal policies that apply nudging techniques can increase the likelihood that individuals will maximize their own SEUs, the same tools can be employed to encourage actors to act in ways that increase social welfare, even when doing so will have either negative or uncertain effects on their individual utilities. That is, just as the use of nudging tools can differentiate between coercive paternalism and libertarian paternalism, the same tools can differentiate between coercive welfarism and libertarian welfarism.

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93. See Matthew D. 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 obscured rather than laid plain to view.”)

94. See, e.g., POSNER, *supra* note 92, at 390; ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 510 (5th ed. 2008).

95. See Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

**Figure 1: Situating Libertarian Welfarism**

		POLICY GOAL	
		Paternalism	Welfarism
MEANS OF IMPLEMENTATION	Coercive	Coercive Paternalism	Coercive Welfarism
	Non-coercive	Libertarian Paternalism	<i>Libertarian Welfarism</i>

### *B. The Divergence Between Private and Social Costs*

When behaviors that would increase the utility of the actors subject to regulation would create positive externalities, no externalities, or very small negative externalities relative to the benefits enjoyed by individual actors, libertarian welfarism would suggest the same policy interventions as libertarian paternalism. Under either approach, the state would attempt to nudge individuals to maximize their private utility, which would also maximize social welfare.

But adding the category of libertarian welfarism to the policy maker's mental model of regulation offers two distinct benefits. First, libertarian welfarism offers a different and more normatively defensible<sup>96</sup> set of policy prescriptions than does libertarian paternalism when private and social welfare diverge, as they often do. Second, libertarian welfarism provides a needed justification for using nudges where the effect of such nudges on private utility is unclear or indeterminate, but the valence of the externalities that will be created by private behaviors is clear.

Many important public policy issues involve 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 any or all others choose to do X or Y. To take one ubiquitous example, almost any policy issue concerning pollution, understood broadly, has this structure. A factory owner is selfishly better off if he foregoes installing expensive, cleaner machines because he would have to shoulder this cost himself whereas he can externalize most of the costs

96. See Jonathan Klick & Francesco Parisi, *Wealth, Utility, and the Human Dimension*, 1 N.Y.U. J. L. & LIBERTY 590, 602 (2005) ("Normative economics holds that a law should be judged by its effects in promoting social welfare . . .").

associated with less expensive, dirtier equipment on his neighbors. In many circumstances, however, social welfare would be maximized if the factory owner were to invest in mitigation. A *pure* libertarian paternalist would attempt to nudge factory owners to pollute more if doing so would increase his expected utility, even if the costs to neighbors would be so high that the activity would reduce net social welfare.<sup>97</sup> A libertarian welfarist, in contrast, would support interventions that would encourage factory owners to invest in mitigation.

More specifically, a libertarian welfarist might ask the following questions: Given that people will often 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 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 most decision makers perceive the socially optimal decision to be consistent with the status quo?

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.<sup>98</sup> 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 many buyers' SEU, and 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. All else being equal, this nudge should increase private utility.

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

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97. 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. The pure theory of liberal paternalism, however, is indifferent to social welfare.

98. 40 C.F.R. § 600.306-08 to .307-08 (2008).

state.<sup>99</sup> These stickers, adorned with a green border, provide a numerical rating of the car's greenhouse gas emissions on a scale of 1 to 10, with 5 signifying the increase in global warming caused by the car's emissions are average compared to other new cars.<sup>100</sup> 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 *welfarist* because, to the extent that a car's greenhouse gas emissions are uncorrelated with its gas mileage (already posted on the window), the law attempts to nudge the buyer to do what maximizes social welfare—in this case, the statute increases the salience of the social cost of the purchase decision, even when this bears virtually no relationship to the buyer's private utility.

## 2. Social Proof

Whereas libertarian paternalists propose that lawmakers provide information about social practices to encourage individuals to take steps in their own interest, the libertarian welfarist will try to use state power to create or reinforce social norms meant to encourage those individuals to act consistently with the collective interest, even when it is inconsistent with their self-interest.

Because the way in which individuals construct preferences can incorporate a general desire to conform to social norms, a libertarian welfarist would favor providing individuals with hard-to-locate information about the content of norms when greater conformity would create positive externalities. Charitable giving usually has positive externalities, so a libertarian welfarist would favor having the Internal Revenue Service inform taxpayers of the average amount of charitable gifts made by others with similar income.<sup>101</sup> This tactic would create some risk that taxpayers who are more charitable than average would reduce their gifts, but the more likely effect is that it would motivate the miserly to increase their donations in order to at least reach the average donation level. Conservation of natural resources also has positive externalities. So, a libertarian welfarist would support requiring utility companies to report to customers how their level of energy consumption compares to that of their neighbors, an innovation that has been voluntarily implemented by some utility companies.<sup>102</sup> At least one company has reported that this approach has successfully promoted conservation among above-average energy users by motivating them to conform to the conservation efforts

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99. CAL. HEALTH & SAFETY CODE § 43200.1 (West 2007).

100. 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*, MSNBC, June 20, 2008, <http://www.msnbc.msn.com/id/25284062/>.

101. See Ian Ayres & Barry Nalebuff, *Charity Begins at Schedule A*, N.Y. TIMES, Apr. 15, 2003, at A17.

102. Leslie Kaufman, *Utilities Turn Their Customers Green With Envy*, N.Y. TIMES, Jan. 30, 2009, at A1.

of their peers.<sup>103</sup> Neither of these interventions should appeal to a true libertarian paternalist. That is, there is no reason to assume that a person who chooses not to donate or conserve when ignorant of others' actions but would choose to donate or conserve given knowledge of social norms would enjoy more SEU in the latter case than in the former.

Recycling of household refuse presents a classic example of a collective action problem that a libertarian welfarist might seek to address, but that a libertarian paternalist would not. Recycling produces significant social benefits that are mostly externalized, such as reduced use of landfills, fewer emissions from incinerators, less litter, and energy conservation. For any individual, sorting household trash is costly and the benefits virtually nonexistent. Thus, lawmakers strictly applying the lessons of libertarian paternalism would have no interest in attempting to nudge people to recycle, while libertarian welfarists would want to do precisely that.

Government-sponsored curbside pickup programs for recyclable materials, which are now widely available in American cities,<sup>104</sup> demonstrate how a libertarian welfarist might go one step beyond merely providing information about indiscernible norms and actually encouraging the development of norms that will create positive externalities. Curbside pickup programs have been tremendously effective at encouraging recycling.<sup>105</sup> Research suggests that an important explanation is that curbside pickup substantially reduces the private cost of recycling. Reducing cost is viewed as the primary driver of behavioral change because recycling rates are higher in municipalities that permit residents to commingle all their recyclable materials (i.e., those that make it as easy as possible) than in municipalities that require residents to separate different types of recyclable material.<sup>106</sup> But reductions in private cost cannot fully explain household recycling because dividing refuse into even two categories—garbage destined for the landfill and recyclable material—is inconvenient compared to throwing everything into a single garbage bin.

Curbside recycling programs not only make recycling more convenient, they also provide information to individuals about whether their neighbors recycle.<sup>107</sup> The evidence suggests that this matters quite a bit: people who

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103. *Id.*

104. *See, e.g.*, Ann E. Carlson, *Recycling Norms*, 89 CALIF. L. REV. 1231, 1265 (2001).

105. The portion of solid waste recycled in the United States increased from 10 percent in 1990 to nearly 30 percent in 2000, and this is due, at least in part, to the advent of curbside recycling programs. *See* Thomas C. Kinnamon, *Policy Watch: Examining the Justification for Residential Recycling*, 20 J. ECON. PERSPECTIVES 219, 219 (2006) (citing BioCycle's annual *The State of Garbage in America* study for 2004); *see also* Ljupka Arsova et al., *The State Of Garbage In America*, BIOCYCLE, Dec. 2008, at 22–23, available at [http://www.jgpress.com/archives/\\_free/001782.html](http://www.jgpress.com/archives/_free/001782.html).

106. Carlson, *supra* note 104, at 1275–78.

107. *Id.* at 1266.

recycle report that a much higher percentage of their friends and neighbors recycle than do nonrecyclers.<sup>108</sup> When some people engage in a behavior that increases social welfare and that behavior is visible, a norm can emerge that then increases the likelihood that others will prefer to act in accordance with the norm.

### 3. Policy-Forcing Default Rules

Whereas a libertarian paternalist would select default rules in an effort to encourage individuals to maximize their SEU, a libertarian welfarist will choose 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.<sup>109</sup>

As an example, consider some of the facts of the well-known case of *Moore v. Regents of the University of California*.<sup>110</sup> 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.<sup>111</sup>

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. Moore undoubtedly could have legally 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<sup>112</sup>—but there was no discussion about compensation between Moore and his physician. The court’s ruling established a “no-compensation” default for situations in which physicians and patients do not explicitly discuss compensation for the research use of human tissues.<sup>113</sup> A decade later, *Greenberg v. Miami Children’s Hospital*<sup>114</sup> involved the use of tissue samples provided by patients with Canavan disease to develop a patentable genetic test for the mutation that causes the disease. A federal district court in Florida extended the *Moore* rule to apply also to tissue donors who lack a therapeutic relationship with the medical researcher.

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108. *Id.* at 1290.

109. Russell Korobkin, “No Compensation” or “Pro Compensation”: *Moore v. Regents and Default Rules for Human Tissue Donations*, 40 J. HEALTH L. 1, 18 (2007).

110. 793 P.2d 479 (Cal. 1990).

111. *Id.* at 480–85.

112. National Organ Transplant Act, 42 U.S.C. § 274e(a) (2006).

113. Korobkin, *No Compensation*, *supra* note 109, at 9–10.

114. 264 F.Supp.2d 1064 (S.D. Fla. 2003).

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 always favors the status quo.<sup>115</sup> Second, under a no-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 fool.<sup>116</sup>

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 John 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,<sup>117</sup> they could have used their compensation to fund further medical research or access to diagnostic tests and treatments for people suffering from the same illness. Libertarian paternalism lends support to a pro-compensation default, under which the donor of valuable tissues that led to a medical breakthrough would be entitled to some payment absent an affirmative decision to forego compensation.

The no-compensation rule is justified, however, under the libertarian welfarism paradigm. By encouraging more people to donate tissues to medical research altruistically, the no-compensation 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 *Nudge*.<sup>118</sup> In the United States, the default rule is “no donation” of bodily organs for transplantation following death. Most states couple this default rule with low cost opt-in provisions, such as signing a donor card to indicate their willingness to be a donor at the time they obtain or renew their driver’s license.<sup>119</sup> 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 Europeans from countries with “presumed consent” default rules and opt-out provisions,<sup>120</sup> Thaler and Sunstein propose changing

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115. See Korobkin, *Endowment Effect*, *supra* note 37, at 1228–29.

116. Korobkin, *No Compensation*, *supra* note 109, at 20.

117. The plaintiffs’ goal was to ensure affordable access to diagnostic tests. *Greenberg*, 264 F. Supp. 2d at 1066–67.

118. THALER & SUNSTEIN, *supra* note 9, at 177–84.

119. See, e.g., Michelle Oberman, *When the Truth is Not Enough: Tissue Donation, Altruism, and the Market*, 55 DEPAUL L. REV. 903, 938 (2006).

120. See Eric J. Johnson & Daniel Goldstein, *Do Defaults Save Lives?*, 302 SCIENCE 1338 (2003).

the default rule in the United States.<sup>121</sup>

More than 100,000 Americans are on waiting lists for transplant organs,<sup>122</sup> and approximately 5,000 die every year as a result of the organ donor shortage in this country.<sup>123</sup> 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 SEU 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 would prefer not to think about their mortality, which they must do in order to opt out of the default.<sup>124</sup> A second group of people do not become donors because they are troubled by the thought of their bodies being carved into pieces after they die.<sup>125</sup> A third group fear that if they are potential cadaveric donors, an overzealous transplant physician lusting after their organs might prematurely end their life,<sup>126</sup> a small but presumably non-zero risk.<sup>127</sup>

Assuming that a shift to a presumed-consent default would increase the number of donors, how would the experienced utility of marginal donors be affected? The utility of individuals in the first category would be unchanged; by passively accepting either default, they avoid the costs of considering their mortality. The experienced utility of those in the second and third groups who would fail to opt out of a presumed-consent default would, if anything, decrease, as they would suffer increased psychic costs. Consequently, 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.

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121. THALER & SUNSTEIN, *supra* note 9, at 179–81.

122. As of September 7, 2009, the exact number was 103,247. See United Network for Organ Sharing (UNOS), National Data Reports, <http://optn.transplant.hrsa.gov/latestData/step2.asp> (last visited Sept. 7, 2009).

123. Craig R. M. McKenzie et al., *Recommendations Implicit in Policy Defaults*, 17 PSYCHOL. SCI. 414, 414 (2006).

124. See Carmen M. Radecki & 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).

125. Margareta Sanner, *Attitudes Toward Organ Donation and Transplantation: A Model for Understanding Reactions to Medical Procedures After Death*, 38 SOC. SCI. & MED. 1141, 1146 (1994) (discussing discomfort with a dead body being cut and the organs removed as a motive for individuals' reticence towards organ donation).

126. *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).

127. Cf. Tracy Weber & Charles Ornstein, *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).

On the other hand, the positive externalities associated with cadaveric organ donation are both clear and large. Each year, thousands of Americans on the waiting lists for donor organs die because the demand for donations far exceeds supply.<sup>128</sup> If the United States 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 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 do not care enough about the issue to exert the minimal amount of effort needed to opt out of a presumed-consent regime. A presumed-consent rule thus clearly fits within the libertarian welfarist model.<sup>129</sup>

### *C. An Alternative to the Indeterminacy of Libertarian Paternalism*

Recall from Part III the two indeterminacy problems that reduce the usefulness of 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 certainty which choice would actually maximize the SEU of most individuals. Second, when the government action changes the behavior of individuals by altering the context in which preferences are constructed, it is theoretically impossible to say which choice maximizes SEU: 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 SEU 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.

New York City,<sup>130</sup> King County in Washington (Seattle),<sup>131</sup> and California<sup>132</sup> have all recently enacted statutes requiring restaurant chains to post the number of calories in their offerings alongside the prices. A number of

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128. In 2006, 130,266 individuals were on the waiting list for an organ donation. Of those on the waiting list in 2006, 7,245 died. U.S. DEP'T OF HEALTH & HUMAN SERVS., ANNUAL REPORT OF THE U.S. ORGAN PROCUREMENT AND TRANSPLANTATION NETWORK AND THE SCIENTIFIC REGISTRY OF TRANSPLANT RECIPIENTS: TRANSPLANT DATA 1997–2007, at tbl. 1.6 (2008), [http://www.ustransplant.org/annual\\_reports/current/106\\_dh.htm](http://www.ustransplant.org/annual_reports/current/106_dh.htm).

129. To be fair, Thaler and Sunstein recognize in the article-version of their argument 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 of organ donation “libertarian benevolence.” Sunstein & Thaler, *Libertarian Paternalism*, *supra* note 7, at 1192–93. Puzzlingly, this distinction is not made when they elaborate on organ donation and recommend a presumed consent default in *Nudge*.

130. N.Y. CITY HEALTH CODE § 81.50 (2008).

131. KING COUNTY, WA, BOARD OF HEALTH CODE, ch. 5.10 (2008).

132. CAL. HEALTH & SAFETY CODE § 114094 (West 2009). The calorie-posting requirement in California doesn't take effect until in 2011.

other jurisdictions are considering doing so as well.<sup>133</sup> A calorie-posting requirement could possibly be defended as consistent with the libertarian paternalism paradigm, on the ground that the calorie content of food is relevant to diners' choices but difficult to come by without 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 SEU of diners?

By making calories more salient to the choice process, such laws might alter behavior, but 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 sarcastically put the point: "How enticing: a fistful of calories on a bed of cholesterol, to go."<sup>134</sup> 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 switching to less-tasty, lower-calorie entrees are actually subjectively better off as a result? Moreover, the guilt suffered by the diner who chooses to order the French fries even after seeing the calorie information is an added cost of the intervention, reducing the utility of those individuals without providing any offsetting benefit.<sup>135</sup>

The calorie-posting requirement is far better justified by the libertarian welfarist paradigm. It is well-known that obesity is a growing problem in the United States, with 33 percent of adults and 17 percent of children now obese compared with 15 percent and 6 percent, respectively, thirty years ago.<sup>136</sup> The health consequences of obesity are not just limited to individuals. Experts have estimated that treating obesity-related illnesses costs the nation's healthcare system \$93 billion per year,<sup>137</sup> much of which is paid by Medicare, Medicaid, and other public programs.<sup>138</sup> The financial consequences of obese individuals

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133. Editorial, *Chewing the Fat*, WASH. POST, July 25, 2009, at A16; Stephanie Saul, *Conflict on the Menu*, N.Y. TIMES, Feb. 16, 2008, at C1.

134. Timothy Egan, *Nanny Nation*, N.Y. TIMES OUTPOSTS, Aug. 6, 2008, <http://egan.blogs.nytimes.com/2008/08/06/nanny-nation/>.

135. See George Loewenstein & Ted O'Donoghue, "We Can Do This the Easy Way or the Hard Way": *Negative Emotions, Self-Regulation, and the Law*, 73 U. CHI. L. REV. 183, 186, 190 (2006).

136. Cynthia L. Ogden et al., *The Epidemiology of Obesity*, 132 GASTROENTEROLOGY 2087, 2090–91 (2007).

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

138. 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 et al., *National Medical Spending Attributable to Overweight and Obesity: How Much, and Who's Paying?*, HEALTH AFF., May 14, 2003, at 223–24. Another found that nearly one-fourth 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., Aug. 22, 2006, at 384 (2006).

with private group insurance do not directly affect taxpayers, but they do increase the cost of health insurance premiums for 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 and 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 non-participation is the default. 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 know 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 in the short term increases capital available for investment or minimizes long-term nursing home expenses of the destitute that are ultimately shouldered by taxpayers,<sup>139</sup> enrollment in a 401(k) plan might be justified as the default option for new employees under the libertarian welfarism paradigm.

Libertarian welfarism will not always be immune to the indeterminacy critique. In some cases, the social welfare impact of individual choices will be just as, or even more, uncertain than the individual utility consequences for the actors potentially subject to nudges. But in other instances, the valence of externalities will be strongly in one direction. The individual utility consequences of the decision to become a cadaveric organ donor depend on how the subjective weight given to the positive feelings created by committing an altruistic act (sometimes called "warm glow") are compared to the negative feelings provoked by the fear that one's death might be hastened for organ-salvage purposes or the discomfort that arises when thinking about one's cadaver being mutilated. In comparison, it seems implausible that a serious argument could be made that the externalities generated by cadaveric organ donations are anything but positive. In this type of situation, the libertarian welfarism framework can generate determinate policy proposals when libertarian paternalism cannot.

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139. In 1995, Medicare and Medicaid 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. CONGRESSIONAL BUDGET OFFICE, CBO MEMORANDUM: PROJECTIONS OF EXPENDITURES FOR LONG-TERM CARE SERVICES FOR THE ELDERLY 2 (1999), *available at* <http://www.cbo.gov/ftpdocs/11xx/doc1123/lcicare.pdf>.

Even when an individual's behavior will have both positive and negative externalities, the externalities will often be more susceptible to measurement than the utility consequences of the action to the individual. Individual utility consequences almost always depend on the subjective weighting of competing values, whereas externalities are often (although, admittedly, not always) more susceptible to objective measurements.

For example, the individual utility consequences of the decision to save for retirement depend on the subjective value of trade-offs between short-term consumption and long-term security. The calculus is likely to be further complicated by the utility consequences of second order preferences:<sup>140</sup> Do I want to be the type of person who provides every possible advantage for my children today or the type who builds a nest egg? The externalities associated with an individual's choice of whether to contribute to a 401(k) plan might also run in both directions. For example, the benefits to the taxpayers of 401(k) enrollments in the form of fewer elderly making claims on public resources might be counterbalanced to some degree by the cost of additional children claiming public resources (or suffering without them) if crucial income of poor parents is siphoned into retirement accounts. But because both types of externalities are objectively measurable, policymakers will be better situated to estimate their net effect than the net effect of competing subjective preferences of individuals.

#### IV

##### LIBERTARIAN WELFARISM VS. COERCIVE WELFARISM

Because a paternalist seeks to make individuals better off, as judged by their own standards, policymakers ought to prefer libertarian paternalism to coercive paternalism, at least where it is possible to nudge errant individuals in the right direction. Assuming that the transaction costs associated with avoiding a government nudge are low, nudges strictly dominate mandates. A libertarian paternalist intervention allows 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 some individuals will have minority preferences—to take evasive action.

The welfarist lawmaker, 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 (at least usually) the benefits to the perpetrators. No one seriously considers merely “nudging” potential perpetrators to choose not to assault their neighbors, because those who choose to ignore or avoid the nudge would seriously reduce net social welfare, even if their individual

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140. See Hill, *supra* note 44, at 708.

utilities were increased. So why would policymakers principally concerned with social welfare ever prefer libertarian welfarism to coercive welfarism? Why nudge, when you can mandate?

The remainder of this Part provides three 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.

#### *A. Freedom-of-Choice Enhances Welfare*

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 could probably 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 to the significant reduction in the utility enjoyed by diners.

#### *B. Costs of Coercion*

Second, in many circumstances, using coercive regulation to promote social welfare will either be (a) politically infeasible or (b) so expensive that the costs of enforcement will substantially (or even entirely) offset the expected benefits. In the former case, the only available policy tools might be libertarian welfarist approaches; in the latter case, such approaches could provide the greatest net expected increase in welfare. A recycling mandate would increase recycling, but the government would have to pay garbage police to pick through the trash to ensure compliance. Ubiquitous deposit requirements might eliminate the need for refuse inspection, but there are significant administrative costs associated with operating such programs, and the size of the deposits might need to be very large to change behavior. Either of these proposals might produce substantial political opposition.<sup>141</sup> Distributing recycling bins to each household is almost certainly a much cheaper alternative and could potentially

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141. See Carlson, *supra* note 104, at 1294 (noting that so-called “bottle bills remain politically contentious” and that none have been enacted by a state since the mid-1980s).

produce enough voluntary compliance to maximize social welfare.

### *C. Encouraging Low-Cost Producers*

Third, nudging can help ensure that desirable externalities are produced by the people able to do so most efficiently, which in turn helps to maximize social welfare. Consider, again the issue of cadaveric organ donation. If the government were to 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 immensely if the number of donors were to increase sharply, it is not necessary that every American become a donor. By 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 only a mild aversion to donation 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 most deeply suspicious of the medical community—will opt out of donating, overcoming the inertia that accompanies the status quo. Assuming that the number of people who opt out is 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.

## CONCLUSION

Legal policymakers can use findings of empirical research from the field of behavioral decision making to fashion tools that shape individual behavior without mandating it or providing direct economic incentives. This insight underlies the *libertarian* portion of “libertarian paternalism.” But the tools implied by the growing body of empirical research are useful not only for paternalistic ends. The category of libertarian paternalism implies the complementary category of libertarian welfarism. And, in fact, libertarian welfarism will likely prove to be the more useful of the two categories for public policy for two reasons: welfarism provides a sounder normative basis for government action (because it takes externalities into account), and the net externality created by an individual’s behavior will often be easier for policymakers to estimate than the net utility consequence experienced by particular individual actors.

