Discussion of the Handbook Chapter on Behavioral Public Economics

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- There was no chapter on behavioral public economics
- Bernheim's "Taxation and Saving" addressed topics now central to BPE
- In 1999 he could discuss a bit of theory and some empirics, but not much.

Behavioral Public Economics (c. 1999)

- Theory
  - Bounded rationality. Sensibly criticized as ad hoc or incompletely modeled.
  - Self-control. Thaler and Shefrin (1981,88), Laibson's early work.
  - No other applications
  - Theory of welfare with non-standard models was little developed
- Empirics
  - Good evidence of anomalies in IRA and 401(k) contribution behavior
  - Some evidence of the effects of financial education
  - No direct evaluations of standard vs. non-standard models

12 years later, Behavioral (Public) Economics is Booming

- Several new theories, built on a variety of foundations
- Many applications of those theories to mainstream topics in public economics.
- Deeper understanding of welfare in non-standard models
- More, and more direct, evidence about the relevance of those models
- Active interest, both public and private, in applying behavioral economics to *actual* policy

What I Hope This Chapter Will Do

- Bernheim's task is daunting.
- Literature is now large, but still immature; and it lacks clarity of purpose
- Obvious gaps in knowledge remain.
- This chapter will do a great service if it clarifies central questions and highlights gaps in knowledge.

Question/Gap 1: Behavioral Social Policy Analysis

- An interesting literature in I.O. is concerned with the optimal response of firms facing behavioral consumers.
- Analogous research in the economics social policy seems too thin
  - Sin and externality taxes with $\beta - \delta$
  - Low income insurance with $\beta - \delta$
  - State pensions with optimistic consumers

Question/Gap 1: Recipe for Behavioral Policy Analysis

- Assume an objective of policy
  - ⇓ Obesity
  - ⇑ Takeup of public benefits
  - ⇑ Health insurance coverage
  - ⇑ Investment in girls' human capital
- Study (optimal) policy design if consumer behavior is best described by non-standard models.
- Need for theory and empirics of "nudges" seems especially urgent

Question/Gap 2: Using Policy Experiments to Evaluate Behavioral Models

- Much of PBE research shows insufficient interest in the field empirical evidence for non-standard models.
- Non-standard models that were built to capture intuitions, or an overdetermined class of behaviors, are often just assumed to obtain and then their implications are drawn out.
- With some important exceptions, the opportunity to use naturally-occuring policy experiments to evaluate and refine non-standard models has been missed.
  - Choi et al. and Thaler and Benartzi (2004) on contribution defaults and commitment contracts
  - Chetty and Saez (2009) on the EITC
  - DellaVigna, List, and Malmendier (2011), Landry et al. (2006) on charitable giving.

Question/Gap 3: General Methods for Policy Evaluation

- Existing BPE research is limited by an inability to deal effectively with more than one non-standard element at a time.

- Need models and methods that are robust to non-standard model uncertainty and, yet, can be used to design and evaluate policy.

- This is an important comparative advantage of Public Economics.

- Chetty (2011) on optimization frictions and Caplin and Martin (2011) on imperfect perception, point in promising directions.

Question/Gap 4: Decision-Making Quality

- Early BPE research was hampered by an underdeveloped theory of welfare.
- Berheim and Rangel (2009) took a big step forward.
- They showed how we can still use choice alone to evaluate welfare – even when choices are, in some ways, incoherent.
- An important step in applying their generalized revealed preference criterion is the identification of "characterization failures."
- These failures include instances where choices do not reflect, in Harsanyi's words, what consumer would choose

  "if he had all the relevant information, always reasoned with the greatest possible care, and were in a state of mind most conducive to rational choice."

Question/Gap 4: Decision-Making Quality

- Call decisions made outside Harsanyi's circumstances "lower quality," and people who are more prone to such circumstances, "lower quality decision-makers."

- Is there any hope of identifying lower quality decisions and decision-makers?

- How do we distinguish variation in quality from other, unobserved, sources of heterogeneity in choice?
  - Constraints, preferences, information, beliefs

- If we could identify variation in quality, what would we do with that information?

Question/Gap 4: Decision-Making Quality

- A now large literature is (implicitly) in pursuit of these questions
  - Ameriks et al. (2003)
  - Bernheim and Garrett (2003)
  - Fang et al. (2008)
  - Agarwal et al. (2009)
  - *EJ* special issue (2010)
  - Abaluck and Gruber (2011)

- Allow and sometimes identify Harsanyi's wedge between the choices people make and the choices they *would* make if they had the skills/information/time/state-of-mind to make "better" decisions.

Question/Gap 4: Decision-Making Quality

- Data requirements for identifying variation in DMQ are often extreme, but are increasingly being met.
- Meanwhile *robust* strategies for identifying DMQ remain in their infancy.
- Information on DMQ has only barely been touched for purposes of designing, targeting, and evaluating policy.
- Hope that Bernheim's chapter will highlight the value research and data development along these lines
- Regardless, we can look forward to a chapter that will inspire and improve an important vein of research