Regulators Are People, Too -- And Subject to Bias and Politics, Brookings' Gayer Finds

Justifications for new rules due to consumer "irrationality" fail to take account of regulators' foibles; a caution for using behavioral economics in rulemaking

When promulgating new regulations, government agencies and policymakers increasingly justify them using the argument that consumers behave irrationally and that regulations can correct that deficiency -- but these same regulators fail to recognize that they themselves are subject to behavioral biases and political influences -- according to a paper by Brookings Vice President for Economic Studies Ted Gayer and Vanderbilt University Distinguished Professor of Law, Economics, and Management W. Kip Viscusi published in the *Harvard Journal of Law and Public Policy* today. As a result, these regulations often result in expensive, inefficient polices; instead, government agencies should take a more cautious approach to incorporating the insights of behavioral economics and be less dismissive of the merits of individual choice, Gayer and Viscusi suggest.

In Behavioral Public Choice: The Behavioral Paradox of Government Policy, Gayer and Viscusi analyze several recent regulations, finding that many government actions are in fact also subject to bias. Regulatory agencies have recently relied upon behavioral economics, a relatively new economics field, which identifies cognitive limitations and psychological biases that lead people to make choices that cause self-harm, thus suggesting a justification for government intervention. However, Gayer and Viscusi develop a framework of "behavioral public choice" that recognizes that government officials are also subject to behavioral anomalies and to public choice incentives that can further lead to welfare-reducing or harmful policies. They document several government policies that institutionalize rather than overcome behavioral biases, as well as regulations that justify inefficient mandates "based on weak or nonexistent evidence of consumer irrationality."

For example, the Environmental Protection Agency, the Department of Energy, and the Department of Transportation have recently justified mandating energy-efficiency standards for durable goods (cars, appliances, etc.) based on the assumption that consumers (irrationally) do not take into account future cost savings from buying an energy-efficient product. Yet the agencies offer little or credible evidence that consumers are persistently irrational in their purchasing decisions for energy-consuming products. The authors note that this approach to justify regulations based on weak evidence of consumer irrationality "illustrates a key negative consequence of misusing behavioral findings: the welfare loss associated with ignoring heterogeneous preferences."

In a second area, the authors look at how regulators treat perceived risk. Findings in behavioral economics suggest that people are prone to under-estimating large risks while over-estimating small risks, leading to alarmism about extraordinary cases—like Ebola, plane accidents and beheadings—rather than ordinary occurrences, such as heart attacks and car accidents. Like the citizens they regulate, regulators frequently show the same bias, tending to overestimate small risks. Specifically, the authors point to "EPA's bizarre practice of treating as equal both real and hypothetical exposure risks." The EPA analysis found its way into a court case where Supreme Court Justice Stephen Breyer, then an appellate court judge, criticized the EPA in a Superfund case for "cleaning a site in order to prevent children from eating contaminated dirt, despite the fact that the area was unoccupied swamp land."

Finally, the authors examine how people often focus more on losses than gains, including in rulemaking. This phenomenon has been institutionalized in government policies for products with competing risk effects, such as prescription drugs: the Food and Drug Administration places greater emphasis on losses than on gains, which in turn has resulted in a slower, more burdensome regulatory process to avoid the potential risk of some drugs, despite the fact that there are drugs which may have tremendous benefits for patients -- if they did not have to wait for the drug to be approved by the government regulator.

Gayer and Viscusi recommend that policymakers take a more cautious approach, using one that incorporates the insights of behavioral economics in a way that is less dismissive of the merits of individual choice. In the design of subsequent interventions, government regulators should recognize “the legitimate differences in consumer preferences that may account for the purported behavioral failings.” Regulators should thoroughly reexamine the policy approach to many risk and environmental problems because “fundamental behavioral failures are often embedded in the current policy strategies.”

“An understanding of ‘behavioral public choice’ suggests a more cautious approach to government intervention—one that incorporates the insights of behavioral economics in a way that is less dismissive of the merits of individual choice… Any critical review of private behavioral failures should be accompanied by a comparable assessment of government failures,” they conclude.