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Utilizing Behavioral Insights (Without Romance)

An Inquiry into the Choice Architecture of Public Decision-Making

Adam C. Smith*

ABSTRACT

Behavioral economics has been employed in a number of policy applications over the last decade. From energy requirements to tax compliance to consumer finance, policymakers are increasingly operating under the assumption that people consistently fail to make rational choices. While the benefit of this policy trend remains an open debate, behavioral economists have long neglected a complementary examination of public decision-makers themselves. Comparison of two public agencies influenced by behavioral economics, the U.S. Consumer Financial Protection Bureau and U.K. Behavioural Insights Team, demonstrates how different institutions create divergent policy outcomes across the two agencies in a way that cannot be accounted for without incorporating public choice theory. I argue that improvement of private choice architecture must be accompanied by careful understanding of the public choice architecture in which policies are rendered if behavioral economics is to be a successful foundation for welfare-improving policies.

I. INTRODUCTION

It should be no surprise to learn that humans behave in ways that are far from optimal. Be it from poor planning or untoward circumstance, we rarely, if ever, experience the idyllic fantasy of optimality in our various day-to-day activities. Or as David Byrne of the Talking Heads once sang:

Heaven, Heaven is a place
A place where nothing
Nothing ever happens.¹

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Economists have spent decades investigating just how day-to-day choices can be improved. The older welfare economics research program, for example, sought to improve competition in the marketplace by correcting perceived market failures, with the intended result of reducing prices and improving product quality.² The Chicago school of economics, on the other hand, tended to emphasize the role of fiscal policy and regulation in creating bad incentives and misallocating market resources.³ Smaller and smarter regulation could therefore unleash dormant market potential. Despite their different orientations, both of these approaches rely on the canons of neoclassical price theory and highlight institutional factors as the source of observed shortcomings. Individuals choose optimally within the constraints produced by prevailing institutions, and thus undesirable outcomes could easily be avoided by “getting the rules right.”

In a different vein, starting with Nobel laureate Daniel Kahneman and his co-author Amos Tversky, behavioral economics has exposed dozens of behavioral “anomalies” through extensive laboratory investigation of behavior.⁴ These anomalies constitute observed behavioral deviations from the predictions of neoclassical economic theory, and behavioral economists have sought to explain the sources of such anomalous choices by identifying and cataloging a variety of cognitive limitations and psychological biases. Building on these findings, behavioral economists have even begun to export their psychological findings into policy prescriptions.⁵ This research program – led by such luminaries as Richard Thaler and Cass Sunstein and known as behavioral law and economics – seeks to apply the insights gleaned from studies of human behavior to improve existing institutions by designing rules to compensate for (or take advantage of) people’s various biases.⁶ Given that observed choices are inconsistent with neoclassical theory, behavioral economists argue that “get-

1. *Heaven*, GENIUS, <https://genius.com/Talking-heads-heaven-lyrics> (last visited Aug. 24, 2017). In other words, real world observations of strictly rational behavior in the neoclassical sense are in the null set.

2. *Welfare Economics*, INVESTOPEDIA, http://www.investopedia.com/terms/w/welfare_economics.asp (last visited Aug. 24, 2017).

3. *Chicago School*, INVESTOPEDIA, http://www.investopedia.com/terms/c/chicago_school.asp (last visited Aug. 24, 2017).

4. See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 *ECONOMETRICA* 263, 265–77 (1979).

5. Not all experimentalists are enthusiastic about this application to policy. Vernon Smith notes that the “connective interface between rationality at the individual level and the market level and how institutions modulate the interface is yet to be fully explored and understood.” VERNON L. SMITH, *RATIONALITY IN ECONOMICS: CONSTRUCTIVIST AND ECOLOGICAL FORMS* 155 (2008). See also Vernon L. Smith, *The Two Faces of Adam Smith*, 65 *S. ECON. J.* 1 (1998), for a similar argument with respect to the difference between personal exchange at the individual level and impersonal exchange at the market level.

6. See Richard H. Thaler, Cass R. Sunstein & John P. Balz, *Choice Architecture*, in *THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY* 428 (Eldar Shafir ed., 2013).

ting the rules right” with respect to neoclassical decision-makers will be insufficient to generate desirable outcomes. If people are not rational to begin with, in the neoclassical sense of the word, then solutions designed for rational agents will not necessarily lead to desired outcomes.

Thaler et al. provide a cogent outline of how we, as observers, might conceive of this dilemma.⁷ Their phrase “choice architecture” encapsulates the notion that choice itself is affected by the context in which it is made. Providing one set of incentives elicits certain responses, even when the actor is unaware of how they are being affected. Developing better choice architecture, defined as that which allows for optimal decision-making, could potentially improve choice outcomes. While this choice architecture can be manipulated through a variety of means, it is often policy prescription through the public sector that is proposed by behavioral economists.

This has led to the creation of several public agencies, such as the Behavioural Insights Team⁸ in the United Kingdom and the Consumer Financial Protection Bureau⁹ in the United States. Furthermore, an executive order in September 2015 signed by President Obama created a new Social and Behavioral Science Team mandated with the task of combing regulatory and other public activities for opportunities to improve choice architecture.¹⁰ Clearly, public policy guided by the insights of behavioral economics is on the rise.¹¹

But as Boettke et al. indicate, this framework puts the cart before the horse in prescribing policy purely due to anomalous behavior.¹² They show how behavioral approaches resemble previous efforts to curtail market activity based upon deviations from theoretically optimal conditions; they further argue that finding deviations from a theoretical optimum does not in and of itself justify market intervention. A variety of obstacles lie in the way between theory and practice. Coordination failures, third-party influence (or intervention), poor institutions, corruption, and simple unknowns all represent realistic considerations that any policymaker must anticipate.¹³ Without understanding the nested context in which their insights will be embedded, theorists risk encouraging activity that little resembles what they are after.

7. *See id.*

8. BEHAVIORAL INSIGHTS TEAM, <http://www.behaviouralinsights.co.uk/> (last visited Aug. 24, 2017).

9. CONSUMER FIN. PROTECTION BUREAU, <https://www.consumerfinance.gov/> (last visited Aug. 24, 2017).

10. Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 15, 2015).

11. Wright makes much the same observation in response to the development of the Consumer Financial Protection Bureau, offering that its creation represented a “meteoric emergence in the legislative and regulatory spheres” of behavioral influence. *See* Joshua D. Wright, *The Antitrust/Consumer Protection Paradox: Two Policies at War with Each Other*, 121 YALE L.J. 2216, 2231 (2012).

12. Peter Boettke, W. Zachary Caceres & Adam Martin, *Error is Obvious, Coordination is the Puzzle*, in HAYEK AND BEHAVIORAL ECONOMICS 90, 91 (Roger Frantz & Robert Leeson eds., 2013).

13. *See id.* at 92.

These considerations revolve around the idea that public actors themselves act within a certain choice architecture, which can very well interfere with improving market outcomes. Thus, there is a “public choice architecture” to be considered alongside the “private choice architecture” that is the focus of behavioral law and economics.¹⁴ Put another way, behavioral economists cannot assume away the burdens of the political process. Desiring a simple, clean application of behavioral insights and attaining this through the political process are two very different things. Or as Mullane and Sheffrin put it, “It is typically easier to draw conclusions as to what behavioral tendencies caused policies to have certain outcomes than to demonstrate that these behavioral tendencies can be effectively used to *create* desired outcomes through their implementation in policy design.”¹⁵

This Article addresses this tension by organizing how we might conceive of improving choices through behavioral-minded policy while incorporating standard public choice considerations. Public choice economists have argued for decades that political actors are susceptible to incentives just like the rest of us, and as the public choice program has emphasized, in some cases, these incentives cause political decision-makers to act against the public interest.¹⁶ What seems implicit in many behavioral policy proposals is that either (1) the regulators are not themselves subject to the limitations and biases they aim to combat or (2) that knowledge of the biases will be sufficient to mute their effects.¹⁷ The first assumption is surely unjustified, and as for the second, informing regulators about their own behavioral biases will do little if not aligned with the proper institutional incentives. After all, if people are prone to bias in their own lives, it is safe to assume that people will be equally, if not more, prone to bias when dealing in other people’s lives.

Let us be clear. To the extent that behavioral economics identifies consistent and predictable patterns in the way individuals make their decisions, it offers the theoretical potential to improve decision-making and policy outcomes by tailoring policies and institutions to human psychology. In addition, President Obama’s executive order now makes behavioral considerations the law of the land in guiding regulatory policy in the United States.¹⁸ Nevertheless, successful implementation of any policy prescription requires a detailed knowledge of the existing political and market institutions and the resulting

14. See Adam C. Smith, *(Mis)Application of Behavioral Economics to Regulation: The Importance of Public Choice Architecture*, 13 ENGAGE 11 (2012) for an earlier presentation of “public choice architecture.”

15. Maggie Mullane & Steven Sheffrin, *Regulatory Nudges in Practice* 1–2 (Tulane U. Dep’t of Econ. and Murphy Inst., White Paper, 2012), http://murphy.tulane.edu/files/events/Regulatory_Nudges_mullane_sheffrin.pdf

16. See ADAM SMITH & BRUCE YANDLE, *BOOTLEGGERS AND BAPTISTS: HOW ECONOMIC FORCES AND MORAL PERSUASION INTERACT TO SHAPE REGULATORY POLITICS* (2014).

17. Niclas Berggren, *Time for Behavioral Political Economy? An Analysis of Articles in Behavioral Economics*, 25 REV. AUSTRIAN ECON. 199, 200 (2012).

18. Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 15, 2015).

incentive structure through which any behavioral remedy would ultimately have to pass. Hence, careful consideration of the accompanying public choice architecture is surely warranted.

This Article is organized as follows. I first present the behavioral approach as a means to overcome so-called “behavioral market failures.” I then justify the need for public choice underpinnings to behavioral policies if these failures are to be addressed in practice. I show how consideration of political institutions, a crucial component to any policy prescription, has largely been left to others, as behavioral economists focus on correcting biases in an institution-less vacuum. Using the contributions of James Buchanan and Elinor Ostrom, I then argue that public choice insights can add to behavioral policy initiatives and further show that without these public choice guidelines, behavioral policies are unlikely to attain the desired ends of behavioral theorists. I demonstrate this latter concern by comparing the U.S. Consumer Financial Protection Bureau to the U.K. Behavioural Insights Team, both largely motivated by behavioral economics yet very different in practice and outcome. I conclude by explaining the need for behavioral economists to incorporate an accompanying public choice architecture to the improvement of its private choice counterpart.

II. THE NEED TO NUDGE

Before delving into the role of public choice architecture in improving private choices, it is prudent to examine why private choices need correcting in the first place. Behavioral economists have discovered a wide variety of biases that people are prone to display in the laboratory. The original experiments by Tversky and Kahneman and Kahneman and Tversky found a number of behavioral patterns that were difficult to reconcile with neoclassical theory.¹⁹ For example, one prominent finding was that losses loomed larger for their subjects than corresponding gains, a pattern of behavior that came to be known as loss aversion and closely tied to the notion of an endowment effect.²⁰ Thaler popularized these findings by couching them in consumer theory,²¹ later importing them into mainstream economic conversations through a regular feature in the *Journal of Economics Perspectives*.²²

In a replication of the classic Tversky and Kahneman experiments, this time with actual monetary payments, Laury and Holt reported that subjects were still averse to losses, even when addressed through multiple treatment

19. Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 *SCIENCE* 1124 (1974); Kahneman & Tversky, *supra* note 4.

20. Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 *Q.J. ECON.* 1039, 1045 (1991).

21. Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 *J. ECON. BEHAV. & ORG.* 39 (1980).

22. See Tversky & Kahneman, *supra* note 20, for a highly influential presentation of various behavioral anomalies reported in this series including the endowment effect, status quo bias, and loss aversion.

effects, such as higher payouts and using other demographics than students as their laboratory subjects.²³ The authors concurred that these framing effects led subjects to make decisions that were inconsistent with those predicted by a strict neoclassical framework. A behavioral framework that incorporated notable decision patterns observed in the laboratory would perhaps improve upon the traditional use of the neoclassical model in understanding and predicting human behavior.

As Chetty notes, however, “A common criticism of behavioral economics is that it does not offer a single unified framework as an alternative to the neoclassical model.”²⁴ While it is certainly true that this relatively newer discipline has not yet achieved the maturity of the neoclassical approach, several have attempted to group its most prominent findings into a more coherent framework. Congdon et al. consolidate these various findings into categorical areas where people are most likely to display bias in their decision-making.²⁵ These categories are *imperfect optimization*, *bounded self-control*, and *non-standard preferences*.²⁶ For example, returning to the seminal work of Herbert Simon, we find in laboratory environments that people are prone to “satisfice,” that is to fail to achieve optimal performance in favor of whatever works to consistently achieve positive, though suboptimal, levels of success.²⁷ Imperfect optimization is at the root of the widely applied “Save More Tomorrow” retirement savings plan developed by Thaler and Benartzi to supplement a perceived hyperbolic discounting rate in the allocation of savings over time.²⁸ In addition, people have difficulty aligning their short-term preferences with their long-term goals. Indeed, this lack of willpower – or bounded self-control – is one of the chief justifications used to empower policymakers to act in the consumer’s interest by, for example, reducing access to certain credit options (e.g., payday loans, overdraft protection). Finally, the well-known behavioral trait

23. Susan K. Laury & Charles A. Holt, *Further Reflections on Prospect Theory* (Andrew Young Sch. of Policy Studies Research Paper Series, Working Paper No. 06-11, 2005), <https://pdfs.semanticscholar.org/2e31/21bb33d6f137d67f8b633a5b2ce295-961fe6.pdf>.

24. Raj Chetty, *Behavioral Economics and Public Policy: A Pragmatic Perspective*, 105 AM. ECON. REV. 1, 25 (2015).

25. WILLIAM J. CONGDON, JEFFREY R. KLING & SENDHIL MULLAINATHAN, POLICY AND CHOICE: PUBLIC FINANCE THROUGH THE LENS OF BEHAVIORAL ECONOMICS 17–39 (2011).

26. *Id.* See W. Kip Viscusi & Ted Gayer, *Behavioral Public Choice: The Behavioral Paradox of Government Policy*, 38 HARV. J.L. & PUB. POL’Y 973 (2015), for a more detailed analysis of this framework.

27. Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99, 108 (1955).

28. Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164, S166–S170 (2004).

of loss aversion mentioned above shows that we are not always prone to a consistent set of preferences.²⁹ The Allais paradox, which demonstrated a larger aversion to perceived losses than a corresponding benefit to expected gains, was a pioneering attempt to show that we make inconsistent choices when exposed to different framing contexts.³⁰

This is a mere glimpse of the many biases subjects display when placed in a laboratory environment. To move from a description of human biases to a prescription for how these biases should be addressed in a public forum required a framework to demonstrate that correcting bias has the potential to improve consumer welfare. The field of behavioral law and economics seeks to do just this and in doing so transforms these normative ideals into actual policy outcomes. An earlier article by Sunstein provided a framework for producing policy guided by behavioral insights.³¹ Jolls et al. expanded on this and introduced the initial concept of “nudge” by way of its earlier, more cumbersome label “anti-antipaternalism.”³² The basic principle is the same, which is that behavioral insights reveal that people’s decisions can be improved and in a way they themselves would value.

Thaler et al. show how the concept of “nudge” is predicated on the assumption that some will inevitably serve as “choice architects,”³³ that is, those who structure the choice environment in which people make decisions. This emphasis on “choice architecture” leads to a variety of considerations including what incentives are created by the choice environment, how feedback operates, what defaults are in place, and how these choices can be structured in a manner that leads to welfare-improving outcomes. Or in other words, private choice architecture can be structured in a manner that is consistent with behavioral insights. The “nudge” concept has since gone on to capture a wide audience in the policymaking realm so much so that Kahneman has described the insights of Thaler and Sunstein as “the basic manual for applying behavioral economics to policy.”³⁴

Allcott and Sunstein present a consideration that allows policymakers to transform these behavioral insights more generally into the realm of rulemaking.³⁵ They employ the concept of “internalities”; these are “costs we impose on ourselves by taking actions that are not in our own best interest.”³⁶ Just as asymmetric information, externalities, and public goods concerns give way to

29. See Tversky & Kahneman, *supra* note 20.

30. M. Allais, *L'Extension des Theories de l'Equilibre Economique General et du Rendement Social au Cas du Risque [The Extension of the Theories of General Economic Balance and Social Performance to Risk]*, 21 *ECONOMETRICA* 269 (1953).

31. Cass R. Sunstein, *Behavioral Analysis of Law*, 64 *U. CHI. L. REV.* 1175 (1997).

32. Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 *STAN. L. REV.* 1471, 1541 (1998).

33. Thaler, Sunstein & Balz, *supra* note 6, at 428.

34. DANIEL KAHNEMAN, *THINKING, FAST AND SLOW* 372 (2011).

35. Hunt Allcott & Cass R. Sunstein, *Regulating Internalities*, 34 *J. POL'Y ANALYSIS & MGMT.* 698 (2015).

36. *Id.* at 698.

charges of so-called “market failure,” failing to exercise self-control or displaying inconsistent preferences allows for the possibility of “behavioral market failure.”³⁷ It follows then that policymakers can improve people’s lives in ways never attempted previously.

As Chetty explains, “Expanding the policy set broadens the set of feasible allocations that can be achieved, which could ultimately increase welfare.”³⁸ This pragmatic approach to behavioral economics would lend it the same access to policymaking that the older welfare economics program enjoyed. Bar-Gill and Sunstein directly placed behavioral economics on the same footing as the old welfare approach, arguing, “Standard treatments of ‘market failures’ do not devote much discussion to the kinds of ‘behavioral market failures’ that, in our view, provide the strongest justification for prominent regulatory regimes.”³⁹ Even the term “behavioral welfare economics” has emerged from this discussion, describing a normative approach guided by the work of behavioral economics to expand the set of outcomes that could conceivably improve consumer choices.⁴⁰

Because of these efforts, behavioral insights are being utilized more to address so-called behavioral market failures and are employed in a wide range of regulatory policy fields including energy, health, and consumer finance among others. The growing use of this novel framework for thinking about how people make decisions would be welcome but for the fact that so little effort has been put into examining the bounded rationality of public decision-makers and accompanying public choice architecture within which these behavioral insights will ultimately be utilized.

III. IN SEARCH OF BEHAVIORAL PUBLIC CHOICE

Though written over a decade ago, Lambert comments in a most telling way on the emergence of these behavioral policies. In reference to a study advocating the utilization of behavioral insights, he states:

Professor Slovic advocates a governmental fix *without first asking* whether the government is institutionally capable of correcting individuals’ affect-induced tendency to overestimate the risk of terrorism. This is a crucial oversight since the answer to the question is probably no. As an initial matter, there is no reason to believe that bureaucrats are any less susceptible to cognitive quirks than the citizens they seek to protect. More fundamentally, a democratically accountable agency

37. *See id.*

38. Chetty, *supra* note 24, at 5.

39. Oren Bar-Gill & Cass R. Sunstein, *Regulation as Delegation*, 7 J. LEGAL ANALYSIS 1, 4 (2015).

40. B. Douglas Bernheim, *Behavioral Welfare Economics*, 7 J. EUR. ECON. ASS’N 267 (2009).

faces *institutional* constraints that would render it incapable of correcting affect-induced overestimation of terrorism risks.⁴¹

Unfortunately, little has changed since Lambert's prescient analysis. In a revealing study of the top ten journals in economics from 2000 to 2009, Berggren analyzes how behavioral economists treat political institutions when offering policy prescriptions.⁴² He specifically asks whether (a) the authors offer explicit policy prescriptions and (b) if they incorporate political institutions into their model/experimental design.⁴³ The criteria for this latter element is fairly wide, as he only looks to see if they apply their findings to the political actor herself, that is, whether the politician is cognitively limited in the same manner as everyone else.

Berggren finds that 20.7% of behavioral economists offer policy prescriptions in the leading journals, with 95.5% of these articles not applying their analysis to the politician herself.⁴⁴ Berggren concludes that while behavioral studies are worthwhile in understanding human cognition, they serve as poor indicators of actual policy performance with so little attention paid to the political institution itself.⁴⁵ These figures are discouraging as without such an analysis, any policy prescription is premature – that is not to imply that any behavioral intervention will be applied perversely. In fact, the greater worry is that because these authors have not incorporated political institutions into how their insights should be applied, they enable a wide range of policy outcomes – both positive and negative – with the accompanying volatility in realized welfare benefits.⁴⁶

While the search for a behavioral public choice remains open, behavioral economists have commented (albeit sparingly) on the application of their work to political actors. For example, Sunstein touches upon the problem of public officials exercising authority under the same biases as their private counterparts. He states:

None of these points makes a firm case for legal paternalism, particularly since bureaucrats may be subject to the same cognitive and moti-

41. Thomas A. Lambert, *Two Mistakes Behavioralists Make: A Response to Professors Feigenson et al. and Professor Slovic*, 69 MO. L. REV. 1053, 1059 (2004) (emphasis added) (footnotes omitted). See PAUL SLOVIC, *THE PERCEPTION OF RISK* (2000), for a complete and authoritative account of overestimation of risks.

42. Berggren, *supra* note 17, at 200.

43. *Id.*

44. *Id.*

45. *Id.* at 215–16.

46. It is worth noting that these academics display a certain “policy bias” in that they offer policy applications without fully treating the ramifications of such application within the analysis itself. Put another way, it may be that too many policy applications are offered, given the supporting argumentation, though this is surely a broader issue beyond those publishing on the topic of behavioral economics.

vational distortions as everyone else. But they do suggest that objections to paternalism should be empirical and pragmatic, having to do with the possibility of education and likely failures of government response, rather than a priori in nature.⁴⁷

Sunstein further expands upon and supplements the list by breaking challenges to behavioral policies down into five broad areas of concern: *information, competition, heterogeneity, learning, and public choice concerns*.⁴⁸ This last category in particular acknowledges that public officials are both subject to influence by special interest groups and susceptible to the same biases as the consumers they govern.⁴⁹

These are welcome – though limited – additions to the discussion of public choice architecture, which represent more than obstacles for successful policy prescription.⁵⁰ They are the contextual features in which public decision-making unfolds. To take public choice architecture seriously is to incorporate this aspect into the policy framework directly. Otherwise, these policy advocates risk failure in changing private choice architecture in a way that improves consumer welfare. As Alemanno and Spina observe, “It is likely that without a rational, fully transparent mechanism to integrate behavioral research into policy-making, the wealth of knowledge of this science will continue to have only a haphazard, anecdotal and minimal or, as recently illustrated, even counterproductive effect on the activities of public administrations.”⁵¹

The broader consideration of public choice architecture is not often appreciated, even by those directly involved in applying behavioral insights to public policy. Barr et al., for example, propose a framework that would apply

47. Sunstein, *supra* note 31, at 1178 (footnote omitted).

48. Cass R. Sunstein, *The Storrs Lectures: Behavioral Economics and Paternalism*, 122 *Yale L.J.* 1826 (2013).

49. See Viscusi & Gayer, *supra* note 26, at 990–91, and Gary M. Lucas, Jr. & Slavisa Tasic, *Behavioral Public Choice and the Law*, 118 *W. VA. L. REV.* 199, 213–14 (2015), for surveys of this new area of “behavioral public choice.” See Dima Yazji Shamoun & Bruce Yandle, *Asserting Presidential Preferences in a Regulatory Review Bureaucracy*, 166 *PUB. CHOICE* 87 (2016), for a discussion of the public choice architecture and accompanying incentives generated by special interest groups for presidential policy. Sunstein himself led the Office of Information and Regulatory Affairs (“OIRA”) from 2009 to 2012. John M. Broder, *Powerful Shaper of U.S. Rules Quits, with Critics in Wake*, *N.Y. TIMES* (Aug. 3, 2012), <http://www.nytimes.com/2012/08/04/science/earth/cass-sunstein-to-leave-top-regulatory-post.html>.

50. Bar-Gill & Sunstein, *supra* note 39, at 7, exemplify this argument, noting that “political economy constraints limit the viability of such opt-out in many cases” in the context of optimal regulation of markets. Their argument is telling in that it positions political considerations as a form of transaction cost that prevents optimality, as opposed to an underlying institutional concern that would challenge the use of behavioral insights more generally. *See id.*

51. Alberto Alemanno & Alessandro Spina, *Nudging Legally: On the Checks and Balances of Behavioral Regulation*, 12 *INT’L J. CON. L.* 429, 440 (2014) (footnote omitted).

behavioral insights to a wide number of policy environments, noting that their framework incorporates both the relationship between the firm and consumer along with the firm and regulator.⁵² This second aspect could conceivably capture certain public choice architecture in the analysis, but the authors instead focus solely on the incentives regulators put into place for regulated firms, as opposed to the incentives placed before the regulators themselves.⁵³ Put another way, the relationship is only examined in one direction and so does little to add to previous efforts that ignore public choice architecture altogether. Nevertheless, they claim that “[b]ehaviorally informed regulation is cognizant of the importance of framing and defaults, of the gap between information and understanding and between intention and action, and of the role of decisional conflict and other psychological factors that affect how people behave.”⁵⁴ It is remarkable that such an impressive list of insights is applied strictly to consumers and firms reacting to government policymaking and not the policymakers themselves.⁵⁵

Glaeser provides one notable exception to this trend. He models choice architecture across two corresponding contexts, one public and one private, starting from a position of behavioral symmetry across the two contexts and then introducing certain institutional parameters to estimate the capacity for bias.⁵⁶ He outlines three cases where the capacity for bias is endogenous to the private or public context – that is, generated by unique institutional features – and finds in each case that the public context is likely to generate more errors, not fewer, than the private context.⁵⁷ As he maintains, “[T]he flaws in human cognition should make us more, not less, wary about trusting government decisionmaking. The debate over paternalism must weigh private and public errors.”⁵⁸

Glaeser’s work is just a start, and as Allcott and Sunstein have noted, models with different assumptions than Glaeser’s could potentially show reduced error in certain public contexts.⁵⁹ Nevertheless, the point is not to show

52. Michael S. Barr, Sendhil Mullainathan & Eldar Shafir, *Behaviorally Informed Regulation*, in THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 440 (Eldar Shafir, ed. 2013).

53. *See id.* at 444–57.

54. *Id.* at 457.

55. This is especially pertinent to this discussion of public choice architecture and the CFPB, as one of the co-authors (Mullainathan) is currently Assistant Director of research at the agency. *See CFPB Organization Chart*, CONSUMER FIN. PROTECTION BUREAU, http://files.consumerfinance.gov/f/201303_cfpb_org_chart.png (last visited Aug. 24, 2017).

56. Edward L. Glaeser, *Paternalism and Psychology*, 73 U. CHI. L. REV. 133 (2006).

57. *Id.* at 142–49. These results were primarily due to private actors having a greater incentive to discover and correct errors than public actors. *Id.* The curious reader should refer to Glaeser’s original paper. *Id.* at 133–56.

58. *Id.* at 133–34.

59. *See* Allcott & Sunstein, *supra* note 35, at 698–705.

that public actors are always more error-prone; it is that, without incorporating political institutions into the actual positive analysis being performed, we are limited in our understanding of what policy outcomes will emerge once these behavioral insights are utilized. Despite – or better yet, because of – the great potential for improving choices through behavioral intervention, it is essential to consider the public choice architecture in which use of the behavioral insights would have to navigate in order to improve consumer welfare.

To illustrate this point, Viscusi and Gayer look at biases caused by poor risk assessment on the part of public actors. They claim that environmental relief fiscal sinkholes like Superfund are more likely due to the greater risk aversion of public actors who face little in the way of upside in efficiently regulating the environment but much downside should a certain environmental waste issue become salient to the public.⁶⁰ This in turn “leads to an overestimation of very small risks and comparative inattention to larger risks.”⁶¹

To be fair, Thaler and Sunstein emphasize the need for empirical verification that behavioral interventions are found wanting.⁶² While acknowledging the considerable challenges behavioral policies face, they argue that this in itself does not overwhelm the potential benefit that comes with improving choice architecture for the consumer.⁶³ Nevertheless, the heavy lifting in this body of work resides with the analysis of private choice architecture, not the accompanying public choice architecture in which all policy recommendations must inevitably pass.⁶⁴

60. Viscusi & Gayer, *supra* note 26, at 991–93.

61. *Id.* at 993.

62. RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 247–48 (2008).

63. *Id.*

64. A related example demonstrates the shortcomings of previous behavioral policy specifically. Behavioral scientists are particularly keen on the notion of “shrouded fees,” which refer to costs that are especially likely to confuse consumers. See Ryan Bubba & Richard H. Pildes, *How Behavioral Economics Trims Its Sails and Why*, 127 *HARV. L. REV.* 1593, 1643–44 (2014). A perennial target of this term is in how banks charge their customers for overdrawing an account. See *id.* at 1653–58. In 2010, the Federal Reserve – in which the CFPB is housed – required banks to give their customers the choice to opt in to overdraft protection. *Id.* at 1654–55. The idea was that consumers are prone to inertia and so may be paying fees that they actually would choose not to, if given conscious effort. See *id.* at 1655. To the surprise of many, customers overwhelmingly rejoined the protection plans. See *id.* at 1656. This caused some behavioral economists to argue that stronger restrictions on consumer choice were needed. See *id.* at 1596–1600; see also Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 *U. CHI. L. REV.* 1155, 1186–87, 1211–26 (2013). Others instead insist that the reaction of heavy users of overdraft protection to re-enroll in the service is a rational response to the necessity to meet their everyday financial obligations. See Willis, *supra*, at 1196. The alternative for such customers is not an equity line or other line of credit but instead a payday loan or even less reputable source of short-term credit. *Id.* at 1176–77. Adjudicating between these two perspectives would surely be easier with a more coherent behavioral framework for measuring success.

By ignoring public choice architecture, behavioral economists are at a minimum risk of seeing their ideas used in ways vastly different than originally intended. Furthermore, the ability to determine improvements in consumer welfare is muted by failing to incorporate a crucial component of what ultimately becomes “choice architecture” to the consumer they ostensibly wish to assist.

IV. IMPROVING PUBLIC CHOICES

This lack of public choice analysis represents more than a pedantic oversight. It is an all too common occurrence as new ideas blind us to the institutional limitations in which we as purposeful human beings actually operate. Commenting upon the advancement of science, Hayek similarly claimed that

a belief, seemingly shared by many scientists, [is] that the range of our ignorance is steadily diminishing and that we can therefore aim at more comprehensive and deliberate control of all human activities. It is for this reason that those intoxicated by the advance of knowledge so often become the enemies of freedom.⁶⁵

This is, of course, just the sort of statement that Thaler and Sunstein seek to dismiss on empirical grounds. But Hayek’s claim is a positive one. The assertion is that scientific advances so often lead to premature policy prescription, which, given Berggren’s analysis, is a reasonable assessment.

Behavioral economists are clearly right in that choice does not occur in a vacuum. This insight must be applied, however, consistently across public and private spheres. Using the language introduced earlier, there should be a public choice architecture to accompany the private choice architecture we are attempting to improve, at least if these theories are to be applied at the policy level. This not only applies to how we model the decision-maker but also how we model the choice architecture in which the decision is made.

This does not mean that we should assume that the same choice architecture exists across both contexts. Instead, as Schnellenbach and Schubert state, “Explanations of individual behavior in politics should rely on the same motivational assumptions that guide the economic analysis of market behavior.”⁶⁶ Put another way, we must examine behavioral “politics without romance.”⁶⁷

Integrating public choice architecture into the analysis requires us to think of the relevant institutions that will ultimately determine the trajectory of subsequent policy outcomes. Elinor Ostrom, Nobel Prize Winner and intellectual

65. FRIEDRICH A. HAYEK, *THE CONSTITUTION OF LIBERTY* 26 (1960).

66. Jan Schnellenbach & Christian Schubert, *Behavioral Political Economy: A Survey*, 40 *EUR. J. POL. ECON.* 395, 395 (2015).

67. James M. Buchanan, *Politics without Romance: A Sketch of Positive Public Choice and Its Normative Implications*, in *THE THEORY OF PUBLIC CHOICE – II*, 11, 11 (James M. Buchanan & Robert D. Tollison eds., 1984).

leader of the Bloomington School, devised an agenda for the study of institutions in practice.⁶⁸ Her short list of institutions helps identify what elements are core aspects of public choice architecture.⁶⁹ These are:

(1) *Position rules* that specify a set of positions and how many participants hold each position.

(2) *Boundary rules* that specify how participants are chosen to hold these positions and how participants leave these positions.

(3) *Scope rules* that specify the set of outcomes that may be affected and the external inducements and/or costs assigned to each of these outcomes.

(4) *Authority rules* that specify the set of actions assigned to a position at a particular node.

(5) *Aggregation rules* that specify the decision function to be used at a particular node to map actions into intermediate or final outcomes.

(6) *Information rules* that authorize channels of communication among participants in positions and specify the language and form in which communication will take place.

(7) *Payoff rules* that prescribe how benefits and costs are to be distributed to participants in positions.⁷⁰

While not meant to be exhaustive, this list provides a useful template of what is needed to understand how choice operates in public contexts.⁷¹

Translating this framework, known as Institutional Analysis and Development (“IAD”), into a useful guide for behavioral policies is no trivial task. Nevertheless, it is one of many useful models that behavioral economists would be at great advantage to adopt as a means of gauging the effectiveness of their policy proposals. Again, understanding the public choice architecture (or institutions) by which decisions are rendered is crucial in determining the likelihood that policies will succeed in promoting consumer welfare.

There are a number of questions these components of public choice architecture bring to our attention that can aid in ensuring behavioral policies lead to welfare-improving outcomes. For example, who are the policymakers

68. Ostrom was herself no stranger to behavioral theories, even remarking in her Presidential Address to the American Political Science Association:

We have not yet developed a *behavioral theory of collective action* based on models of the individual consistent with empirical evidence about how individuals make decisions in social-dilemma situations. A behavioral commitment to theory grounded in empirical inquiry is essential if we are to understand such basic questions as why face-to-face communication so consistently enhances cooperation in social dilemmas or how structural variables facilitate or impede effective collective action.

Elinor Ostrom, Presidential Address, *A Behavioral Approach to the Rational Choice Theory of Collective Action*, 92 AM. POL. SCI. REV. 1, 1 (1998).

69. Elinor Ostrom, *An Agenda for the Study of Institutions*, 48 PUB. CHOICE 3, 3–5 (1986).

70. *Id.* at 17.

71. *Id.* at 16.

responsible for implementing the behavioral intervention? What is the scope of their (e.g., underlying agency) authority? What are the institutional incentives facing these policymakers? How do policymakers accumulate information used to formulate these policies? And from what sources? Is there any measurement by which we can estimate the effectiveness of the behavioral intervention? Does the choice environment encourage compliance with the proposals made by behavioral economists? Or are policymakers encouraged to break from these policy origin points?

To illustrate this approach in practice, consider the argument for the necessity of a default position.⁷² Behavioral economists are right, of course, that in many cases a default must be chosen. Coase famously made this point⁷³ in reference to the establishment of property rights when transaction costs prohibit private adjudication. In cases like this, the choice of default is crucial, and perhaps enhanced if informed by insights from behavioral economics. It should equally be informed, though, by the insights of public choice. What does it matter if the proper behavioral considerations are considered at the formative level if the actual administrator simply chooses to ignore them, or worse, uses them to pursue an undesirable end?

Take the popular behavioral example of a school administrator considering where to place healthy food in a school cafeteria described at the beginning of *Nudge*.⁷⁴ In this particular case, the scope of authority is largely defined upfront.⁷⁵ The administrator has to choose something, as the food will not just sort itself. In addition, the administrator has a preference for kids to eat healthy food instead of junk food and so could place healthier choices in the front of the cafeteria line. This would make kids more likely to choose them, thereby providing a better outcome through behavioral correction, albeit of the softer variety.⁷⁶

Harford offers a challenge to even this simple choice environment. While noting that “most of the best examples Thaler and Sunstein suggest are innovations in the private or voluntary sectors,” he exposes the different outcomes that emerge when behavioral interventions are imposed publicly rather than privately.⁷⁷ When we take into account how the transformation of outcomes takes place in practice, policies aimed at correcting individual choices often

72. See Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1171–90 (2003).

73. See R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

74. See THALER & SUNSTEIN, *supra* note 62, at 1.

75. But see Robert Sugden, *Why Incoherent Preferences Do Not Justify Paternalism*, 19 CONST. POL. ECON. 226, 238 (2008), for an Austrian challenge as to the entrepreneurial feasibility of even this simple choice environment.

76. Sunstein & Thaler, *supra* note 72, at 1164–66.

77. TIM HARTFORD, ADAPT: WHY SUCCESS ALWAYS STARTS WITH FAILURE 193 (2011).

involve hardline coercion by way of regulation on firms.⁷⁸ For example, in reference to the cafeteria example, he ponders what would really happen if a law required restaurants to display healthier food choices more prominently.⁷⁹ Perhaps this would elicit greater advertisement of healthy choices, or perhaps it would motivate restaurants to abandon healthier choices altogether to avoid the cumbersome legislation in its entirety.⁸⁰ Just as “protecting” endangered species often leads to the unwanted consequence of “shooting, shoveling, and shutting up,” “protecting” healthy choices could serve to further marginalize their already tenuous existence.⁸¹

Another troubling aspect of the cafeteria example is that it simplifies the information retrieval process to a degree far more trivial than what policymakers would find confronting consumers in actual nested choice contexts. As Schnellenbach states, “If information on individual preferences and beliefs cannot be centralized by a government planner, then neither soft nor hard paternalist policies can reliably move the economy closer to its utility possibility frontier, but they always redistribute welfare between heterogeneous individuals.”⁸² To reiterate the author’s point, even soft paternalism in the form of a nudge can only be demonstrated to be utility maximizing if it is known *ex ante* how consumers will react to a given policy. The reason for this is that nudges, like their harder paternalistic counterparts, redress biased behavior by making it more expensive, if not in terms of pecuniary cost then in some other form that would diminish its utility (e.g., requiring additional steps to opt out of a certain service that policymakers feel is beneficial). This is only utility maximizing if we know that consumers are indeed worse off as a result of their biased choices, a possible though strong assumption to make.⁸³

In short, these institutional considerations can help inform us as to the veracity of behavioral policy in action to which we now turn.

V. EXAMINING THE PUBLIC CHOICE ARCHITECTURE OF BEHAVIORAL POLICIES

To better appreciate the role of public choice architecture, let us compare two government agencies motivated by behavioral economics. This provides us with the means to address Thaler and Sunstein’s challenge to provide empirical verification by demonstrating the added value of incorporating public

78. Mullane & Sheffrin, *supra* note 15, at 2; see Adam C. Smith & Todd Zywicki, *Behavior, Paternalism, and Policy: Evaluating Consumer Financial Protection*, 9 N.Y.U. J.L. & LIBERTY 201, 242–44 (2015).

79. HARTFORD, *supra* note 77, at 193.

80. *Id.*

81. *See id.*

82. Jan Schnellenbach, *Nudges and Norms: On the Political Economy of Soft Paternalism*, 28 EUR. J. POL. ECON. 266, 269 (2012).

83. As Chetty explains in the choice context of retirement savings, “[R]esponses that appear to be consistent with optimization in the aggregate may mask significant deviations from optimization at the individual level.” Chetty, *supra* note 24, at 8.

choice architecture. Or as Hyman and Kovacic explain, “Simply stated, what an agency is assigned to do and where it is located matters.”⁸⁴

As it so happens, our two examples have emerged from like-minded policymakers on separate sides of the Atlantic. In the United States, the Consumer Financial Protection Bureau applies behavioral economics to regulating the financial industry. In the United Kingdom, previously located within the government itself, the Behavioural Insights Team or so-called “Nudge Unit” is tasked with improving a variety of government services.

Note that this discussion is not intended to be an exhaustive treatment of the activities of the two agencies. It is instead intended to showcase how public choice architecture can transform similar policy ideas into very different policy outcomes. Therefore, I do not attempt to provide an exhaustive analysis of the effectiveness of their respective policies. The curious reader should consult the articles cited to judge the efficacy of these policies in practice. Instead, I wish to illuminate the impact of public choice architecture on the application of policies generated by behavioral ideas. As I will show, generating policy proposals with no mention of the underlying public choice architecture leads to undesirable variability in the actual policy outcome in a way that obscures the ultimate effects on consumer welfare.

A. *The Consumer Financial Protection Bureau*

The Consumer Financial Protection Bureau (“CFPB”) emerged as one of the key reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), itself a response to the global financial crisis of 2008 to 2010. The CFPB’s chief architect was Harvard Law Professor Elizabeth Warren, now Senator of Massachusetts. Warren forcefully argued the need to protect consumers from the perceived harm rendered by their creditors, a harm of which consumers are not typically aware.⁸⁵ In a highly influential follow-up article, Bar-Gill and Warren demonstrated various shortcomings in consumer rationality with respect to credit transactions including framing effects, the influence of inertia, and optimism bias.⁸⁶ They ended their analysis with a call for a new agency that would assist consumers in making more rational decisions.⁸⁷ They further argued that an agency with the proper motivation and authority needed to be created, as existing agencies lacked one or both of these two features.⁸⁸

84. David A. Hyman & William E. Kovacic, *Why Who Does What Matters: Governmental Design and Agency Performance*, 82 GEO. WASH. L. REV. 1446, 1451 (2014).

85. Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY (2007), <http://democracyjournal.org/magazine/5/unsafe-at-any-rate/>.

86. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008).

87. *Id.* at 98–100.

88. *Id.*

Thus, the CFPB was born.⁸⁹ Its self-stated mission is as follows: “The CFPB is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives.”⁹⁰ Currently led by the former state attorney general of Ohio, Richard Cordray, the agency is guided by a team of behavioral economists, including Richard Thaler.⁹¹ This group represents more than a backroom set of advisers. As Pridgen explains, the creation of this agency represents a “shift from the use of pure disclosures as consumer protection under the rational choice theory of economics, to a system of regulation-based on the more realistic view of consumer decision-making as revealed by behavioral economics.”⁹² Accordingly, a secure advisory role has been laid for behavioral insights. Indeed, Wright maintains that this paradigm shift in the regulation of consumer finance has fully superseded the older welfare-based framework in guiding policy.⁹³

Bar-Gill and Sunstein go so far as to claim that the CFPB is “structured . . . in a way that aligns its interests with those of individual consumers.”⁹⁴ This is a rather strong claim given that the agency is constituted in a peculiar way of particular relevance for this paper. As I will explain below, greater insularity discourages the kinds of experimentation and collaboration with the relevant parties necessary to make best use of behavioral insights. Because of the arguments put forth by Bar-Gill and Warren, along with the stringent efforts of Warren herself when she was Assistant to the President,⁹⁵ the agency was set up to be extraordinarily insulated from legislative interference, a fact that has

89. See Hyman & Kovacic, *supra* note 84, at 1485–88, for a more extensive discussion of its inception.

90. CONSUMER FIN. PROT. BUREAU, CONSUMER FINANCIAL PROTECTION BUREAU STRATEGIC PLAN: FY 2013 – FY 2017 at 5 (2013), <https://s3.amazonaws.com/files.consumerfinance.gov/f/strategic-plan.pdf>.

91. *CFPB Announces Consumer Advisory Board Members*, CONSUMER FIN. PROTECTION BUREAU (Sept. 12, 2012), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-announces-consumer-advisory-board-members/>. In addition, Hyman and Kovacic point out that, “The CFPB hired a prominent behavioral economist [Sendhil Mullainathan] as its first Assistant Director of Research,” noting that “[m]any behavioral economists believe insights from research in consumer psychology justify expansive regulatory intervention into financial services markets.” Hyman & Kovacic, *supra* note 84, at 1492; *see also* Glaeser, *supra* note 56, at 133–56.

92. Dee Pridgen, *Sea Changes in Consumer Financial Protection: Stronger Agency and Stronger Laws*, 13 WYO. L. REV. 405, 405 (2013).

93. *See* Wright, *supra* note 11, at 2252.

94. Bar-Gill & Sunstein, *supra* note 39, at 21.

95. Press Release, WHITE HOUSE OFFICE OF PRESS SEC’Y, President Obama Names Elizabeth Warren Assistant to the President and Special Advisor to the Sec’y of the Treasury on the Consumer Financial Protection Bureau (Sept. 15, 2016), <https://obamawhitehouse.archives.gov/the-press-office/2010/09/17/president-obama-names-elizabeth-warren-assistant-president-and-special-a>.

caused some to question the constitutionality of the agency.⁹⁶ While it is housed within the Federal Reserve, its budget cannot be changed by the Fed. Furthermore, its Director is given a five-year appointment and cannot be removed once appointed except for “cause.” Indeed, on October 11, 2016, the D.C. Circuit Court of Appeals struck down this last feature, citing that it gave the Director more power than any officeholder besides the President of the United States.⁹⁷ The court has since vacated this ruling after agreeing to hear an appeal en banc and is currently deliberating whether to send the appeal to the Supreme Court.⁹⁸

Finally, the CFPB is not accountable to Congress in terms of appropriations or oversight, an especially strong constraint given that other similar agencies that regulate consumer products, such as the Federal Trade Commission, are subject to review by bipartisan commissions.⁹⁹ While the Financial Stability Oversight Council – housed within the Treasury Department – was set up as a veto authority should the CFPB’s rulings threaten overarching financial stability,¹⁰⁰ this group has yet to consider a motion or otherwise credibly constrain CFPB activity.

According to the CFPB’s strategic plan, this peculiar form¹⁰¹ of public choice architecture was necessary to push back against corporate interests and consistent with other financial regulatory bodies like the Federal Reserve, claiming:

The Congress, in implementing the Dodd-Frank Act, followed a long-established precedent in providing the CFPB with funding outside of the congressional appropriations process to ensure full independence as the Bureau supervises and regulates providers of consumer financial products and services and protects consumers. Congress has consistently provided for independent funding for bank supervisors to allow for long-term planning and the execution of complex initiatives and to

96. Susan E. Dudley, *Is the Consumer Financial Protection Bureau Unconstitutional?*, FORBES (Apr. 15, 2016, 11:00 AM), <https://www.forbes.com/sites/susandudley/2016/04/15/is-the-consumer-financial-protection-bureau-unconstitutional/#3555262764e7>.

97. See Brent Kendall & Yuka Hayashi, *Appeals Court Deals Setback to Consumer-Watchdog Agency*, WALL STREET J. (Oct. 11, 2016, 7:51 PM), <https://www.wsj.com/articles/federal-appeals-court-finds-structure-of-cfpb-unconstitutional-1476197389>; PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1 (D.C. Cir. 2016), *reh’g en banc granted, order vacated* (Feb. 16, 2017).

98. PHH Corp., 839 F.3d at 1.

99. Todd Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 857–59 (2013).

100. See *id.* at 874.

101. CONSUMER FIN. PROT. BUREAU, *supra* note 90, at 9–13; see generally Richard E. Wagner, *The Peculiar Business of Politics*, 36 CATO J. 335 (2016) (describing states as networks of peculiar enterprises that are obligated to raise sufficient revenue to return profits to investors).

ensure that banks are examined regularly and thoroughly for compliance with the law.¹⁰²

Nevertheless, Hyman and Kovacic summarize this agency's institutional structure by claiming that, "the combination of protections afforded by Dodd-Frank makes the CFPB unique. The bundle of autonomy mechanisms, along with the independent-agency-within-an-independent-agency structure, gives the CFPB unmatched insulation from the accountability devices that apply to all other federal regulators."¹⁰³ This was certainly the opinion of the D.C. Circuit Court of Appeals, which labeled them a "gross departure" from the traditional agency model.¹⁰⁴ Furthermore, its institutional structure is likely to encourage standard bureaucratic pitfalls, as "[t]hese risks are particularly pronounced for the CFPB, given the breadth of its substantive mandate, its powerful implementation tools, and the absence or relaxation of institutional controls that constrain other regulatory bodies."¹⁰⁵ Even if these pitfalls were somehow avoided, the agency has an enormous mandate to devise and enforce the duties imposed by the Dodd-Frank Act.¹⁰⁶

Zywicki shows how the CFPB's relatively loose constitutional structure would likely elicit just this kind of bureaucratic overreach, noting with respect to these tendencies that "[s]everal are particularly relevant in understanding the flaws in the CFPB's institutional design: a tunnel vision selection bias and commitment to regulatory mission, systematic risk-averse bias in agency decisionmaking, a tendency toward agency overreach and expansionism, and a heightened risk of regulatory capture by industry participants."¹⁰⁷ As Zywicki's analysis demonstrates, institutions map into predictable outcomes, even when these outcomes depart from the underlying set of motivating ideas.

While still early in its development as a Washington bureau, the CFPB has displayed a muscular effort in a number of areas, most notably with credit card fees, mortgage loans, auto lending, student loans, and general consumer banking practices. In each case, the CFPB has exercised formidable powers in regulating consumer markets. For example, in the case of consumer banking practices, the CFPB has been attentive to the kinds of fees banks charge their customers. These fees often offset, however, the costs of maintaining accounts with low-income customers. The pressure on banks to reduce or eliminate these fees has resulted in a reduction of free checking accounts by half since the enactment of the Dodd-Frank Act.¹⁰⁸

102. CONSUMER FIN. PROT. BUREAU, *supra* note 90, at 36–37.

103. Hyman & Kovacic, *supra* note 84, at 1488.

104. PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1, 8 (D.C. Cir. 2016), *reh'g en banc granted, order vacated* (Feb. 16, 2017).

105. Hyman & Kovacic, *supra* note 84, at 1492.

106. *See id.* at 1475.

107. Zywicki, *supra* note 99, at 875–76.

108. TODD ZYWICKI, THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE STABLE? 3 (2015), <https://financialservices.house.gov/uploadedfiles/hhrg-114-ba00-wstate-tzywicki-20150709.pdf>.

One of the initial efforts by the new agency was to define so-called “qualified mortgages” based upon the customers’ ability to pay. In other words, mortgages offered to consumers with a proven FICO score are labeled “qualified.” Though the measure was meant to increase customers’ awareness of their ability to pay, the added consequence of the policy is to discourage loans to low-income households. Federal Reserve Chair Janet Yellen stated, “Banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores. They mention in meetings with us consistently their concerns about putback risk, and I think they are – it is difficult for any homeowner who doesn’t have pristine credit these days to get a mortgage.”¹⁰⁹

Another policy area the CFPB has made efforts to address is auto lending. The agency has accused auto lenders of prejudice in how they determine lending rates. According to the Equal Credit Opportunity Act, lenders cannot discriminate in offering borrowing terms on the basis of race, color, religion, national origin, sex, marital status, or age.¹¹⁰ The overtones of racism in lending practices are a leading argument on behalf of the CFPB, with Director Cordray exclaiming, “Consumers should not have to pay more for a car loan simply based on their race.”¹¹¹ The solution for such discriminatory practices, Cordray claims, is to offer a uniform markup rate across consumers.¹¹²

As a consequence, the CFPB expanded the scope of its mandate to not only include large lending institutions, but also non-bank lending organizations located in the automotive industry. This constitutes a significant and somewhat surprising shift in responsibilities, as the Dodd-Frank Act, which established the CFPB, specifically barred the agency from going after motor vehicle dealers.¹¹³ Regardless, the CFPB has moved forward claiming that these firms create a market that is being under-represented and misinformed. The basis for its intervention is whether the auto dealers are breaking existing law. Since the agency is not technically creating new rules (at least for now), this ostensibly keeps them in the confines of the mandate provided by the Dodd-Frank Act.¹¹⁴

The major complaint again is that terms and conditions are not well-specified, leading under-informed consumers into financial obligations they cannot afford.¹¹⁵ The automotive industry does provide a significant number of in-

109. TRANSCRIPT OF CHAIR YELLEN’S PRESS CONFERENCE (2014), <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20140618.pdf>.

110. 15 U.S.C. § 1691(a)(1) (2012).

111. Nadia Taha, *Consumer Agency Warns Lenders on Bias in Auto Loans*, N.Y. TIMES: BUCKS: MAKING THE MOST OF YOUR MONEY (Mar. 21, 2013, 2:49 PM), https://bucks.blogs.nytimes.com/2013/03/21/consumer-agency-warns-lenders-on-bias-in-auto-loans/?ref=autoloans&_r=0.

112. *Id.*

113. *See* Pridgen, *supra* note 92, at 413.

114. Robin Sidel & Alan Zibel, *Regulators Scrutinize Auto Lenders Over Add-Ons*, WALL ST. J. (May 2, 2013, 7:41 PM), <https://www.wsj.com/articles/SB10001424127887324582004578459170902840306>.

115. *Id.*

house loans, usually geared towards those with lower credit and/or fewer outside lending options. These loans tend to have a longer term period and can have increasing rates, should the consumer get behind on payments, as these loans are structured to assist high-risk debtors.

As a result of this pressure to charge flat rates across different consumers, several companies, such as Honda Motors' financing arm, have raised their wholesale rate while reducing the amount of loan markup discretion of their dealers, with the total cost of the loan increasing in many cases.¹¹⁶ The long-term result will more than likely be a massive downturn in auto lending, particularly for low-income households. This prompted a number of minority-sponsored interests to challenge the CFPB's assessment. Damon Lester, president of the National Association of Minority Automobile Dealers, stated, "The CFPB is refusing to share how they came to the conclusion that dealerships have unintentionally discriminated or why."¹¹⁷ He also commented on the impact these interventions have on the underlying market, claiming, "The CFPB is fundamentally changing the multibillion-dollar automobile marketplace and yet the bureau is not clear on how their actions will impact auto lending, consumers or the economy."¹¹⁸ In addition, a letter to the CFPB included signatures from Democratic Representatives Joyce Beatty of Ohio, William Lacy Clay of Missouri, Gregory Meeks of New York, and David Scott of Georgia, all members of the black caucus.¹¹⁹

Student loans are a third policy area of interest for the CFPB. Here, the CFPB has primarily targeted the private sector, which only encompasses around fifteen percent of the overall market. The reason for this focus is that the Department of Education regulates the public provision of student loans. That said, the CFPB has been particularly aggressive in its suggestion that this legal boundary may be crossed at some point in the not-too-distant future. In a March 2013 rule proposal, the agency sought to oversee nonbank student lending institutions, especially those with more than a million accounts. This would include the government's largest student loan vendor, Sallie Mae, which is currently overseen by the Department of Education. It also involved itself in the investigation of private, for-profit schools at the behest of the Obama administration.¹²⁰

116. AnnaMaria Andriotis & Gautham Nagesh, *Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*, WALL ST. J. (Aug. 31, 2015, 8:08 PM), <https://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864>.

117. *House Democrats Seek Details on Consumer Bureau Auto Loan Rules*, AUTOMOTIVE NEWS (May 30, 2013, 8:54 AM), <http://www.autonews.com/article/20130530/OEM11/130539998/house-democrats-seek-details-on-consumer-bureau-auto-loan-rules>.

118. *Id.*

119. *Id.*

120. Opinion, *Obama's For-profit Execution: How to Kill a Company Without Proving a Single Allegation*, WALL ST. J. (Aug. 29, 2016, 7:05 PM), <http://www.wsj.com/articles/obamas-for-profit-execution-1472511905>.

The agency's primary goal has been to reduce the amount of student loan debt, a goal not necessarily consistent with behavioral foundations.¹²¹ That is to say, there would need to be behavioral evidence for students taking on debt in a manner not consistent with rational choice. Rather than confront this evidentiary burden, the agency has instead called for loan companies to consider certain debt consolidation schemes not currently offered in the marketplace.¹²² What is telling about these efforts is how the CFPB specifies the ideal outcome without detailing the market process by which companies should achieve it.

B. The Nudge Unit

The Behavioural Insights Team, or "Nudge Unit," was founded in 2010 at the behest of Prime Minister David Cameron's coalition government.¹²³ It was originally situated within the U.K. government's Cabinet Office but is now a mutual venture between the U.K. government and private interests, which I will address further below. Led by psychologist David Halpern, the team was originally designed to help create efficiencies within the U.K. government but has since broadened its goals to impact a number of areas, not all confined to the United Kingdom. The agency now describes itself as follows: "The Behavioural Insights Team (BIT) is a social purpose company. We are jointly owned by the UK Government; Nesta (the innovation charity); and our employees."¹²⁴

The Nudge Unit operates in a different manner than the CFPB. It has a flatter hierarchy with a far smaller staff. It also is largely able to manage its own agenda and so avoids much of the bureaucratic pitfalls that most agencies face, such as the short-run bias noted by Sobel and Leeson.¹²⁵ The group has also had little turnover, a markedly different result than the CFPB, which has contributed to more consistency and solidarity in pushing forward the group's agenda.¹²⁶

121. See Andrew Soergel, *CFPB Takes Aim at Student Loan Forgiveness*, U.S. NEWS & WORLD REP. (June 22, 2017, 12:35 PM), <https://www.usnews.com/news/articles/2017-06-22/consumer-financial-protection-bureau-takes-aim-at-student-loan-forgiveness>.

122. See AnnaMaria Andriotis, *Wells Fargo Investigated by CFPB over Student Loan Servicing*, WALL ST. J. (Oct. 8, 2015, 3:46 PM), <https://www.wsj.com/articles/cfpb-investigating-wells-fargo-on-student-loan-servicing-1444333614>.

123. See Bubb & Pildes, *supra* note 64, at 1596.

124. *Who We Are*, BEHAVIOURAL INSIGHTS TEAM, <http://www.behaviouralinsights.co.uk/about-us/> (last visited Aug. 24, 2017). It is worth noting that *Nudge* co-author Richard Thaler is a formal advisor of this group as well. See Peter John, *Policy Entrepreneurship in UK Central Government: The Behavioural Insights Team and the Use of Randomized Controlled Trials*, 29 PUB. POL'Y. & ADMIN. 257, 259 (2014).

125. Russell S. Sobel & Peter T. Leeson, *Government's Response to Hurricane Katrina: A Public Choice Analysis*, 127 PUB. CHOICE 55, 68–69 (2006).

126. John, *supra* note 124, at 262–63.

Like the CFPB, the Nudge Unit is a relatively new organization and so has not generated many observations to study. Nevertheless, there are several policy areas in which the team has had a noticeable impact, first and foremost, in the area of tax collections. Hallsworth et al. describe a series of experiments in which tax delinquency notices were accompanied by different messages.¹²⁷ Some of these messages appealed to social norms (e.g., “Nine out of ten people in the U.K. pay their tax on time. You are currently in the very small minority of people who have not paid us yet.”), while others invoked the government services that taxes provide.¹²⁸ In each case, tax compliance went up with the most effective messages increasing tax collection by five percent.¹²⁹

Because of this success, the Nudge Unit ran a second series of experiments that attempted to ascertain just what motivated the highest levels of tax compliance. Specifically, the experiment compared the effects of descriptive (i.e., what others do) and injunctive (i.e., what others think should be done) norms.¹³⁰ Results indicated that a simple description of the norms of tax compliance were most effective in increasing payments.¹³¹ As they point out, targeting tax delinquency with different messages is virtually cost-free to the government and, as a result, has been widely adopted by various government bureaus in the United Kingdom.¹³²

Haynes et al. present a closely related set of experiments that are targeted at those owing court fines.¹³³ The experimental team sent different text messages indicating either the person’s name, the amount owed, or a combination of the two.¹³⁴ They found these text messages to be an effective way of reaching an otherwise reticent target population. Simply sending a text message with the person’s name nearly tripled the amount of fines collected compared to when no text was sent.¹³⁵

The Nudge Unit has found success in a number of other areas with similar experimental approaches including pension plan sign-ups, university applications, charitable giving, electoral registration, and organ donations.¹³⁶ In each

127. Michael Hallsworth et al., *The Behaviorist as Tax Collector: Using Natural Field Experiments to Enhance Tax Compliance*, 148 J. PUB. ECON. 14, 16–17 (2017).

128. *Id.*

129. *Id.* at 18–19.

130. *Id.* at 15.

131. *Id.*

132. *Id.*

133. Laura C. Haynes et al., *Collection of Delinquent Fines: An Adaptive Randomized Trial to Assess the Effectiveness of Alternative Text Messages*, 32 J. POL’Y ANALYSIS & MGMT. 718, 720–21 (2013).

134. *Id.*

135. *Id.* at 728.

136. For a more detailed description of these experiments see BEHAVIOURAL INSIGHTS TEAM, *EAST: FOUR SIMPLE WAYS TO APPLY BEHAVIORAL INSIGHTS* (2014), <http://38r8om2xjhhl25mw24492dir.wpengine.netdna-cdn.com/wp-content/up->

case, the Nudge Unit conducts experiments to test the most effective method of achieving the outcome intended by the team. They also point out where nudges fail and certain pitfalls to avoid when applying behavioral insights. Above all, the team emphasizes that context matters, so each environment will need certain adaptations or nudges to be successful.

Due to its success, the Nudge Unit has since spun off the U.K. Cabinet and is now a mutual joint venture between the cabinet, Nesta (the United Kingdom's innovation foundation), and the BIT staff.¹³⁷ This has enabled the team to work with other vendors besides the U.K. government and broadened the potential areas where the nudges it designs can be used. It also enables the team to profit from its activities.¹³⁸

VI. INSTITUTIONS MATTER

While the two agencies, the Consumer Financial Protection Bureau and Behavioural Insights Team, both apply behavioral insights and even share the guidance of one of the *Nudge* co-authors, Richard Thaler, the strategies employed and consequent outcomes of their policies could not be more different. While the Nudge Unit utilizes experimental design and adaptive learning, the CFPB is more heavy-handed and subject to tunnel-vision in its use of policy tools.

As noted above, to apply the IAD framework in its entirety to the two organizations would take us beyond the scope of this paper. I will confine my analysis to a circumscribed list of considerations that will capture many of the questions asked above without belaboring the thesis of this paper that public choice architecture matters with respect to policy outcomes.

The respective political mandates for the CFPB and BIT obviously differ. While the BIT must elicit cooperation from various departments within the U.K. government – along with the private companies it now works with – in order to pursue its behavioral agenda, the CFPB is more or less responsible for its own domain of consumer activity, a domain that it has strived to expand.

Limiting the scope of authority increases focus and concomitantly reduces the variability of policy. By setting the CFPB up to operate aggressively and independently of other government organizations, the result has been a deviation from the agency's original goals into areas of consumer choice and policy interventions that exceed the guidelines set out by behavioral economics. As Hyman and Kovacic explain, “[A]n agency with a sweeping, adaptable mandate has incentives to extend the boundaries of its authority, in order to

loads/2015/07/BIT-Publication-EAST_FA_WEB.pdf. See also a list of the BIT's publications at *Academic Publications*, BEHAVIOURAL INSIGHTS TEAM, <http://www.behaviouralinsights.co.uk/academic-publications/> (last visited Aug. 24, 2017).

137. John, *supra* note 124, at 261.

138. Patrick Wintour, *Government's Behaviour Insight Team to Become a Mutual and Sell Services*, GUARDIAN (Feb. 4, 2014, 19:01 EST), <https://www.theguardian.com/politics/2014/feb/05/government-behaviour-insight-nudge-mutual-nesta-funding>.

show it is fulfilling the goals Congress set for it. Open-ended assertions of authority invite carelessness in implementation.”¹³⁹ This led to the D.C. Circuit Court of Appeals decision described above, where the CFPB was found enforcing a certain administrative provision erroneously.¹⁴⁰

Kuran and Sunstein argue that agencies should have certain institutional checks such as mandatory cost-benefit analysis, peer review by other agencies, and/or congressional oversight in order to avoid overly aggressive intervention into consumer practices.¹⁴¹ This makes sense as public acrimony is hardly a reliable gauge by which policy should be adjudicated, as Thaler and Sunstein propose.¹⁴² After all, consumers who are believed to be incapable of making their own choices are surely incapable of evaluating the actions of regulators. Because the CFPB faces so little in the way of institutional constraints, it has become prone to much of the excesses feared by Kuran and Sunstein.

The BIT, on the other hand, is considered a successful endeavor by a wide swath of interested parties despite (or perhaps because of) the fact it has “very little money and no power to do its job.”¹⁴³ In having so little authority *ex ante*, the group must ensure that the relevant parties truly benefit from the proposed policies, in contrast to the more aggressive practices of the CFPB. By showing how these policies work through experimental practice, the agency is better able to convince others of the efficacy of its practices.

The underlying lesson here is that overwhelming government authority and improving social welfare are hardly mutually enforcing. Public organizations that are forced to be cooperative by way of their institutional constraints (e.g., having a budget set by congressional oversight) are more likely to deliver policies consistent with a broader set of interests than organizations with no

139. Hyman & Kovacic, *supra* note 84, at 1502 (footnote omitted). The Wall Street Journal’s Peter Wallison describes the agency as follows:

The consumer bureau, on the other hand, roams the financial landscape enforcing 18 statutes and bringing actions that can cost hundreds of millions of dollars. It writes rules governing a wide swath of American business, has the power to define what is “unfair” or “abusive” in financial services, investigates companies and imposes penalties.

Peter Wallison, *Consumer Financial Protection Racket*, WALL ST. J. (April 24, 2016, 4:45 PM), <https://www.wsj.com/articles/consumer-financial-protection-racket-1461530729>. Playful language aside, the comment is telling in how it describes the broad authoritative responsibilities of the CFPB, which include investigation, enforcement, and adjudication of an incredible range of market interactions, all with little oversight by outside authority.

140. See Kendall & Hayashi, *supra* note 97; PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1 (D.C. Cir. 2016), *reh’g en banc granted, order vacated* (Feb. 16, 2017).

141. Timur Kuran & Cass R. Sunstein, *Availability Cascades and Risk Regulation*, 51 STAN. L. REV. 683, 751–54 (1999).

142. See *id.* at 736–45.

143. John, *supra* note 124, at 258.

such incentives. Substituting “[o]pen-ended assertions of authority” for institutional constraints instead invites conflict both with other government organizations and the underlying market.¹⁴⁴

As an example of this latter effect, consider the costs of complying with this new set of regulations. Compliance complaints are more than simple bickering by affected firms; their impact can create a substantial reorientation of the underlying market.¹⁴⁵ For example, a study by the Mercatus Center found:

71 percent of small banks stated that the CFPB has affected their business activities. Sixty-four percent of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely. Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a “significant negative impact” on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.¹⁴⁶

These compliance costs associated with policymaking are particularly onerous to small banks as they reduce the competitive pressure these firms can put on larger banks.¹⁴⁷ The CFPB has also been noted as failing to properly notify firms of the results of its examination process along with generating confusion with respect to the terms of ending its investigation.¹⁴⁸ An additional criticism is that the CFPB publishes enormous policy documents, a far cry from the simplicity emphasized in *Nudge*.¹⁴⁹

The criticism perhaps most pertinent to the validity of welfare-improving outcomes of the CFPB involves cutting off credit: that is, when policy rules eliminate certain aspects of the marketplace altogether, despite the market alternatives that will inevitably arise as a result. The issue here is not about

144. Hyman & Kovacic, *supra* note 84, at 1503; see Eric Boehm, *Nevertheless It Persists: The Consumer Financial Protection Bureau Fights Trump, Congress, and Federal Courts in Effort to Remain Unaccountable to Anyone*, REASON.COM (Jun. 2, 2017, 9:15 AM), <http://reason.com/blog/2017/06/02/nevertheless-it-persists-the-consumer-fi>.

145. See Peter T. Calgagno & Russell S. Sobel, *Regulatory Costs on Entrepreneurship and Establishment Employment Size*, 42 SMALL BUS. ECON. 541 (2014).

146. ZYWICKI, *supra* note 108, at 6.

147. Bill Poovey, *Banks Look for Regulatory Relief on Nov. 8*, GSA BUS. REP. (Aug. 25, 2016), <http://gsabusiness.com/news/banking-finance/70341/>.

148. BIPARTISAN POLICY CTR., THE CONSUMER FINANCIAL PROTECTION BUREAU: MEASURING THE PROGRESS OF A NEW AGENCY 32 (2013), <https://bipartisanpolicy.org/wp-content/uploads/sites/default/files/BPC%20Consumer%20Financial%20Protection%20Bureau%20Report.pdf>.

149. See *Caveat Vendor*, ECONOMIST (Feb 7, 2014), <http://www.economist.com/news/finance-and-economics/21595488-new-regulator-takes-expansive-view-its-remit-caveat-vendor>.

whether a policy is successful or not but the deeper reality that markets will create new, less desirable platforms for trading (e.g., black markets) in response to market bans. It also captures what Congdon describes when he maintains that “[t]oo narrow a focus might result in policy recommendations that are locally effective but globally counterproductive.”¹⁵⁰ By eliminating a perceived localized behavioral market failure, the agency risks disrupting the underlying market in a manner that reduces consumer welfare.

The BIT, on the other hand, transforms ideas into policy through experimental design. As Smith outlines, experiments provide a space in which to test existing theories, establish empirical regularities to create new theories, evaluate policy proposals, and prototype novel institutional designs.¹⁵¹ The BIT approaches policy solutions through a series of experiments generated to test appropriate means of eliciting desired outcomes. Once success is found, the agency then builds upon these findings to identify why the strategy is successful. It then provides recommendations on how to implement it.

Again, it is most likely due to the lack of authority and financial support that forces the agency to make policy agreeable to a large group of interested parties. John notes, “The team operates collaboratively which largely reflects its small size and the need for willing partners to carry out its interventions.”¹⁵² Policies that benefit all (or at least most) of the parties involved are crucial in justifying interventions based upon behavioral insights. As Lunn notes, “BE [Behavioral Economics] has had its most concrete effects on policy where findings point to policies that are in the interests of all parties affected by the decision being influenced.”¹⁵³

The BIT retrieves information mostly through its experimental testing. It describes its information retrieval tactics as follows: “We are also highly empirical; we test and trial these ideas before they are scaled up. This enables us to understand what works and (importantly) what does not work.”¹⁵⁴ This last aspect refers to its use of randomized control trials as a means of not only collecting, but also refining the data it analyzes.

The CFPB, by comparison, employs a wide number of information-gathering tactics.¹⁵⁵ According to its strategic plan, “The CFPB is a data-driven agency. We take in data, manage it, store it, share it appropriately, and protect it from unauthorized access. Our aim is to use data purposefully, to analyze and distill data to enable informed decision-making in all internal and external

150. William J. Congdon, *Psychology and Economic Policy*, in THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 465, 469 (Eldar Shafir ed., 2013).

151. Vernon L. Smith, *Economics in the Laboratory*, 8 J. ECON. PERSP. 113, 113–16 (1994).

152. John, *supra* note 124, at 260.

153. Peter D. Lunn, *Behavioural Economics and Policymaking: Learning from the Early Adopters*, 43 ECON. & SOC. REV. 423, 433 (2012).

154. *Who We Are*, *supra* note 124.

155. For research and partial data collected by the CFPB, see CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/data-research/> (last visited Sept. 1, 2017).

functions.”¹⁵⁶ The agency collects information through several avenues, most importantly through its own requests to firms. These requests have been called excessively burdensome and often outside the scope of the agency’s jurisdiction.¹⁵⁷ Furthermore, often the purpose of the information request is not disclosed to the targeted firm, leaving in question the ultimate outcome of the agency’s investigation.¹⁵⁸

For example, one of the criticisms levied against the CFPB is its use of enforcement staff at its examination meetings with banks, a practice which departs from other similar agencies.¹⁵⁹ By using these sorts of aggressive tactics, the agency appears to desire compliance at the expense of nuance in finding the appropriate solution. This is a predictable outcome given Hyman and Kovacic’s observation that “[e]nforcement involves selective, ex post intervention and the identification of wrongdoers.”¹⁶⁰ The result is a “chilling effect” on targets of inquiry that inevitably leads to a reduction in crucial information that would identify appropriate policies. Surely such an outcome does not serve all consumers, and it is easy to argue that it constitutes a far departure from the framework developed by Thaler and Sunstein.¹⁶¹ But as Hyman and Kovacic describe, “Repeated exposure to business misconduct, coupled with a mandate to attack apparent episodes of illegal behavior aggressively, could easily lead CFPB personnel to develop a ‘shoot first, ask questions later’ approach to enforcing Dodd-Frank.”¹⁶²

The CFPB also collects information from consumers directly by allowing credit customers to post comments about banks to its website. Hence, this information is not collected through random survey but through self-identified credit consumers, which of course leads to a number of selection biases. Critics have argued that this information should be better categorized by the agency to avoid presumptions of guilt.¹⁶³

156. CONSUMER FIN. PROT. BUREAU, *supra* note 90, at 6.

157. *See Caveat Vendor*, *supra* note 149.

158. BIPARTISAN POLICY CTR., *supra* note 148, at 26–27.

159. *Id.* at 26.

160. Hyman & Kovacic, *supra* note 84, at 1489.

161. THALER & SUNSTEIN, *supra* note 62.

162. Hyman & Kovacic, *supra* note 84, at 1491.

163. *See* Alan Zibel, *CFPB Proposes Publishing Detailed Complaints Against Banks*, WALL ST. J. (July 16, 2014, 4:05 PM), <https://www.wsj.com/articles/cfpb-to-propose-publishing-detailed-complaints-against-banks-1405526806>. In the example of auto lending described above, the CFPB determined bias based upon a controversial method that assigned the most likely ethnic background of the customer according to his or her last name. *See* Yuka Hayashi & AnnaMaria Andriotis, *CFPB Head Defends Regulator’s Work Before Lawmakers*, WALL ST. J. (Sept. 29, 2015, 6:41 PM), <https://www.wsj.com/articles/cfpb-head-defends-regulators-work-before-lawmakers-1443566473>. So, for example, names like Johnson, Williams, or Robinson indicated that the customer was African-American, at least according to the employed methodology. *Id.*

VII. CONCLUSION

Boettke et al. explain that the behavioral movement resembles previous episodes in the history of economic thought that sought to change market outcomes based upon a perceived deviation from a theoretical optimum.¹⁶⁴ As they explain, though, deviation does not condone intervention, at least not until greater understanding of market coordination and the political institutions by which such policy would be rendered is given. And as Berggren notes, the acknowledgment of crucial political institutions in behavioral economics is sorely lacking. Until this lacuna is filled, policy prescription is ultimately unconvincing and premature.¹⁶⁵

While this Article does not fully address this shortcoming, it does provide a framework for those who wish to utilize behavioral insights in a way that accounts for the public choice architecture by which these ideas will ultimately be turned into policy outcomes. Those seeking to use behavioral insights to achieve specific policy outcomes should incorporate not only behavioral economics but also public choice, new institutional economics, and even market design theory. The chief contribution of this last aspect is to learn from error in order to better anticipate how policies may fail to achieve the desired results. A more experimental approach, as is employed by the BIT, is surely warranted while this research program is in its formative stage, as market design can enhance and complement the use of behavioral insights. Far from invalidating the approach, careful institutional analysis can provide behavioral economics with a platform to move forward as a progressive research program.

Nevertheless, there is much to do before behavioral insights can become widely adopted to attain favorable policy. The *Nudge* movement is a telling example of this claim. While the ideas propounded by Thaler and Sunstein are compelling, their adoption by different agencies has shown remarkably divergent results. While the BIT has worked alongside government agencies and market actors to produce efficient outcomes, the CFPB has shown a far less nuanced – and potentially unconstitutional – approach that relies more on intimidating firms into choices that regulators unilaterally deem appropriate, with less regard to an ultimate set of choices left before the consumer. As Mannix and Dudley maintain, the improvement of “‘choice architecture’ cannot produce benefits by destroying choice.”¹⁶⁶

The more general lesson is that without the proper public choice architecture in place, there is little hope for improving private choices in practice. These insights are especially important as the United States adopts its own version of the Behavioural Insights Team. Led by Maya Shankar, an Oxford alumna with behavioral credentials, this initiative looks to duplicate much of

164. Boettke, Caceres & Martin, *supra* note 12, at 90–110.

165. Berggren, *supra* note 17, at 216.

166. Brian F. Mannix & Susan E. Dudley, *The Limits of Irrationality as a Rationale for Regulation*, 34 J. POL’Y ANALYSIS & MGMT. 705, 711 (2015).

the work of the BIT.¹⁶⁷ Further, the executive order in September 2015 puts behavioral insights on the same footing as cost-benefit analysis in guiding regulatory policy. The order stipulates that government “should design its policies and programs to reflect our best understanding of how people engage with, participate in, use, and respond to those policies and programs.”¹⁶⁸

In its inaugural year, this nascent group found itself in much the same institutional setting as the Behavioral Insights Team, with no real authority or power over other agencies. In order to succeed in its mission, the team “focused on projects in two areas where behavioral science had a strong role to play and impacts could be demonstrated relatively rapidly: (1) streamlining access to programs and (2) improving government efficiency.”¹⁶⁹ Notably, the team also relied heavily on random control trials to best ascertain the effectiveness of its proposals.¹⁷⁰ The group has reported success in areas such as increasing retirement savings and encouraging college enrollment, mostly by disseminating information more effectively.

While this group finds its feet, the most important work will be to better appreciate the public choice architecture in which behavioral policies will be rendered. As I have shown by comparing the CFPB and BIT, institutions matter. Indeed, getting the institutions right may be more important to the ultimate consumer than the ideas the policies are based upon. Without proper understanding of context and the institutional constraints regulators will inevitably face, it is unlikely that behavioral ideas will lead to better private choice architecture. While these efforts are encouraging for attempting to improve the choices people face, this paper exposes the importance of getting the institutions right. Those who truly wish to improve private choice architecture should take greater care in understanding the public choice architecture in which their theories are applied.

167. Evan Nesterak, *Head of White House “Nudge Unit” Maya Shankar Speaks About Newly Formed Social and Behavioral Sciences Team*, PSYCH REP. (July 13, 2014), <http://thepsychreport.com/current-events/head-of-white-house-nudge-unit-maya-shankar-speaks-about-newly-formed-us-social-and-behavioral-sciences-team/>.

168. Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 15, 2015).

169. SOC. & BEHAVIORAL SCI. TEAM, 2015 ANNUAL REPORT: EXECUTIVE SUMMARY 2 (2015), <https://sbst.gov/download/2015-exec-summary.pdf>.

170. Alemanno and Spina explain that “[t]he rationale behind the extension of RCT from the pharmaceutical sector to that of public policymaking lies in the promises of low-cost, highly effective results inherent in the appeal of behaviorally informed regulation.” Alemanno & Spina, *supra* note 51, at 442.

