

The Case for Paternalism Revisited: Updating the Friedman Critique

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"What is government itself but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary."— James Madison

In *Capitalism and Freedom* (1962) Milton Friedman states: "There is no avoiding the need for some measure of paternalism. There is no formula telling us where to stop. . . . We must put our faith, here as elsewhere, in a consensus reached by biased and imperfect men through free discussion and trial and error." In general, Friedman's brief arguments for pragmatic state paternalism are limited to particular individuals or categories of individuals—to madmen and children—whom we believe incapable of acting rationally and responsibly. Friedman's limits on the breadth of applications are consistent with his arguments for freedom: Without most people having the capacity to act independently to further their interests, the case for economic and political freedom is weakened.

This paper reexamines the Friedman perspective on paternalism, taking into consideration behavioral research over the intervening decades since the book was published. This research suggests that the typical person—not just madman or child—faces many situation—and context-specific reasoning breakdowns. These problems can be categorized as (a) cognitive biases and computation failures and (b) "pre-rational" preferences, tied to an adapted (evolved) mind that is not necessarily well-suited to its 21st century environment. For the purposes of this paper, paternalism is not about policies applied to the deficient

few, as Friedman saw it, but rather applications to the average man or woman who confronts circumstances from time to time that cause reasoning difficulties. Thus, the essential difference is this: Friedman discussed specific categories of individuals whose reasoning can generally be called into question; the new behavioral approach instead focuses on the specific situations that cause reasoning breakdowns within the general population.

This emerging knowledge might tempt activists to draw justification for applying more paternalistic government interventions. But the leap to government remedy is not an obvious one. In many cases, individuals are well aware of their short-comings in decision-making and, in a variety of ways, can voluntarily alter their decision environment (self regulate) in order to overcome deficiencies. Further, a coercive paternalism introduces two major concerns: first, that (very rational) policy-makers and bureaucrats will abuse policy for personal (rent-seeking) gains, and, second, that public policy-making can suffer from the same problems that afflict private decision-making. Frequently, government reinforces problematic preferences and biases rather than corrects them. Unlike the private citizen, who pays a price for failing to reason well on his own account and therefore has incentives to discover ways to avoid such failure, the government agent is largely insulated from such personal costs. If this is so, then who acts as parent to the governmental parent?

In a sense, the emerging research on the foundations of reasoning provides yet another common-sense argument for citizens in a democracy to vigorously assume this “parenting” role. The role of “parent” in any relationship depends on the relative knowledge and reasoning capacities of each party. In many instances, that knowledge and wisdom lies with the governed. As Madison argued, we are not angels. While his concerns were predominately with individuals rapaciously pursuing self interest in situations of unbalanced power, reasoning deficiencies that are not “balanced” by other sources of understanding can do great harm too. Government as the “greatest”

reflection of that difficult human nature clearly provides as many, if not more, circumstances in which citizens must assume the paternal role.

To lend context to the abstract, the paper examines two specific cases where state paternalistic restrictions are sought or have been imposed: (a) citizen-investor decisions with “privatized” social security retirement accounts; and (b) parents’ choices of who will educate their children. These applications of paternalism serve to highlight inconsistencies in arguments made for government paternalism.

Defining Paternalism

Broadly defined, paternalism is the execution of any policy or practice that treats people in such a way as to advance their well-being by limiting their personal responsibility in some sphere of decision-making. This presumes that the “parent” understands the interest of the individuals being protected better than the protected. As Friedman points out, there are clear practical circumstances where we apply this test—most obviously with children living by their parents’ rules.

For the purposes of this paper, I narrow the focus on paternalism in two ways. First, only policies whose impact is solely upon the individual are considered. Thus, questions about “spillover” effects from private decisions are not taken up in this paper. Second, I assume paternalism to mean policies or practices that are established by government. Most instances of paternalism practiced in private society lack the obvious legal enforcement provisions that a government can deploy. For example, a business may establish specific policies that restrict or guide the choices for employees selecting among retirement funding options. As Sunstein and Thaler (2004) describe, establishing the default option to be full participation in a savings plan, thus requiring an additional choice in order to “opt out,” will generate far more saving than providing a menu and asking for “opt-in” to one among many items. They indicate that we have no choice but to practice paternalism from time to time because a structure for a decision

process must be determined, and how we frame the decision affects subsequent choice (Kahneman and Tversky, 2000).

Sunstein and Thaler make no distinction between government and private paternalism, but these are not of the same character (Klein, 2004). Most private citizens face private paternalism from time to time and generally can avoid it by selecting others with whom we will deal. On the other hand, we sometimes actively seek such paternalism to assist us where we recognize our own reasoning deficiencies. Such choice is not available to the citizen facing government paternalism. For example, private retirement funds that attempt to constrain participants' uses of funds can suffer losses if consumers choose a substitute fund. Thus, each fund cannot impose its private beliefs about proper client investment behavior without bearing a cost.¹ By contrast, in the current debate over "allowing" private citizens to invest their social security payments in private investment accounts (see Section IV), paternalists presume that law can prevent citizens from freely using whatever funds are at their disposal.² The clear differentiator between private and public paternalism is the monopoly on force to comply with policy that lies with the latter. Thus, for the purposes of this paper, I consider only government paternalistic policies. These have far greater effect on personal freedom.

¹For example, TIAA-CREF once restricted a participant from borrowing against his retirement holdings. The growth in the 1980s of alternative competitive funds from which participants could choose—and these other providers did offer borrowing options—led TIAA-CREF to liberalize its policies with respect to fund borrowing.

²The libertarian case for complete privatization of the social security system rests on the pervasive rationality of individuals in tending to their own long-term retirement needs.

Two Views of Behavioral Problems: Biases or 'Pre-Rational' Preferences?

If individuals sometimes err significantly in pursuing their best interests, then knowing the specific underlying causes for such non-rational behavior can help in determining how we might go about remedying the decision-making failures. Two ways in which individual reasoning can be troubled or troublesome are discussed below. The first set of issues suggests "correctible error," while the second suggests much more stubborn and complex issues of behavior wedded to the nature of the mind.

A. Biases and Computation Limitations

Rationality may not be achieved due to a problem's complexity or emotion-stirring content. Earlier work on limited human information processing capabilities suggested "bounds" on rationality (Simon, 1982); more recently, cognitive psychologists have extended the critique to address how the mind receives and processes information, some of which can skew decision-making (Kahneman and Tversky, 2000). In general these cognitive concerns are endemic to all people, not limited to a small subset of deficient problem-solvers. The identification of these specific problems (e.g., framing issues, self-attribution bias, impulsiveness, and difficulties in making useful statistical inference) forms the foundation of behavioral economics and behavioral finance and produces a growing body of research on systematic departures from rationality (e.g., financial bubbles). These difficulties in decision-making lead to proposals for corrections that can get individuals back on the rationality track, so to speak.

For example, low savings rates by individuals might be caused by a lack of self control; people seemingly cannot reject short-term consumption at the loss of greater valued (properly discounted) future consumption. Assuming that this is an accurate assessment, should government step in to rectify this deficiency? Many behavioral economists are inclined to accept this bit of paternalism to "save us"

from ourselves. From their perspective, some beliefs held and choices made are evidence of failure to reason rationally. Thus, the application of a well-intended paternal hand to guide the wayward consumer might improve his welfare.

A guiding thought experiment here is that the consumer generally would *not* reject being paternally led—if he were able to remove himself from the particular circumstances that caused the apparent failure, and then reasoned through the problem. For example, a tax law that penalizes the early use of accrued retirement funds (or borrowing on the account) might, on reflection, be seen by the affected party as a good thing. In essence, the paternalistic pill goes down easier when we know, in our hearts...or more contemplative minds...that the restraint is for our own long-term good. As points of evidence that we, indeed, are not well endowed with self control and yet often are aware of our own deficiencies, behavioralists point to the games we play with ourselves to avoid short-term temptation—rationing out cigarettes or chocolate, publicly committing to arbitrary task deadlines, or hiring personal trainers whose main task is to force us to exercise—all in our own self interest.

B. Evolutionary Psychology: Hard-Wired Preferences

A second set of issues related to personal behavior comes from evolutionary psychology (sociobiology) research that examines the “adapted mind.” This research probes the underlying nature of preference “formation,” suggesting that behavior systematically and predictably is tied to the “wiring” of the brain. This work takes us beyond the preference exogeneity of most economic models and seeks explanations of human behavior, not as the result of biases or mental computing failures, but rather as the result of a mind that evolved for survival in the Pliocene era of several million years ago (Cosmides and Toobes, 2000).

The work of evolutionary psychologists, now coupled with that of neurobiologists and geneticists, pushes into ever-more detailed

exploration of the intricate networked structure of the human mind. Evolutionary theory suggests that underlying genetic fitness (maximizing the chances for one's genetic material carrying forward into the next generation) is the primary driver for the brain's development. Unfortunately, a mind well-suited for solving genetic fitness problems of a hunter-gatherer world of millions of years ago may not be particularly well-adapted to the complex environment of the 21st century. Thus, our minds may be solving problems well with respect to the embedded "preferences," but these preferences often reflect conditions quite *different from the current environment*. In sum, much of this research demonstrates ample opportunity for exhibited behaviors to reflect the brain's "personal preferences"—its structure suggests how it will work through problems triggered by evidence and circumstances.³

To evolutionary biologists, categorizing reasoning problems as failures to behave rationally is largely misplaced. Instead, the evolutionary biologist views behaviors as emanating from aspects of a mind adapted to solving specific problems of a long-past environment. Behaviors that we observe today may seem dysfunctional, but still can be closely in tune with that evolutionary stable mind. For example, a common penchant for overconfidence in one's skills and knowledge is seemingly a dangerous attribute. Is this a bias (taking us away from rational decision-making) or simply an evolved predisposition that presumably had significant value in the evolution of the species? Part of the problem arises from lack of precision in defining bias. If one

³This is not to deny a large portfolio of adaptations to particular circumstances and the ability of individuals to learn and modify behaviors. The point, however, is not to give "nature" and "nurture" each a discrete proportion of the credit for affecting behavior. Instead, as Pinker (2003) notes, if the brain's structure affects how we process information, then that structure clearly must be intimately engaged in all our behavior. How we interact with our environment and how we learn and adjust behaviors (are nurtured), therefore, must be intrinsically linked to our mental hardware (our nature).

begins with a clean notion of a rational decision-making process, including well-defined, exogenous preferences, then we can speak of biases meaningfully. On the other (evolutionary biologist's) hand, the very objectives sought are derived from the structure of the complex networked mind which cannot be directly understood.

C. Responding to Biases or Hard-Wired Preferences

Why might it matter whether the mind is viewed as merely limited or biased in its capabilities, and thus unable to compute rationally in many circumstances, or whether the mind is responding to deep-seated subconscious mental routines? The pragmatic answer is that paternalistic remedies could differ depending on the assessment. In cases where mere bias exists, we might act to improve an identified limitation in our cognitive process by, for example, reframing information or forcing the gathering of more information before a decision is made. Paternalistic government policies that do these things might be widely accepted and obeyed with little cheating or resistance because the policies do not go against any deep-seated personal preferences. For example, some impulsive behavior (leading to short-term biases in personal investment decisions) might be "corrected" by forcing a waiting period on decisions and reframing investment decisions to encourage choices that take a longer-term perspective. But the nature of these problems is recognizable by the individual, and so, too, are the likely remedies. Thus, there seems little added value for a government to replace the self regulation that the individual can impose on himself.

On the other hand, corrective policy that seeks to alter or prevent a behavior predicated on strong underlying preferences (however destructive these behaviors may seem on reflection) may cause individuals to channel their behavior elsewhere to satisfy the preferences. Restricting such behavior would be much more difficult. For example, the human mind seemingly prefers strong bonds to family and a small cohort of our fellow humans with whom we closely interact

(Dunbar, 1996). This preference has been a mixed blessing for mankind in a complex, market-oriented world. A closely woven social fabric permits great trust and comfort among the chosen few, but also has the unfortunate consequence of partitioning the small group, or tribe, from much useful interaction with a wider population. However, if government were to try to alter tribalism by “reeducating” individuals about the virtues of accepting outsiders as easily as they do those within the smaller group, it is unlikely that our preference for embedding in small groups would change much.

The “trick” of course is to accurately discern both the nature and strength of these underlying preferences and how they interact in affecting how we engage the world. A vast amount of research remains to be done before we have a useful map of the human mind, and it is that map that will explain much about what are termed biases and hard-wired preferences in this paper. In sum, we can say at present that a paternalism that acts directly to control strong, hard-wired preferences would have far less success than a paternalism that acts on weaker ones.

Among the strong preferences, as mentioned above, is that for small-group socialization. Why it may be that some societies and cultures have found ways to get beyond the tribal or extended-family perspective and others have struggled greatly with this leap is well beyond this paper. However, establishing the major social and cultural institutions necessary to become a broadly open market economy and free society, where trust extends beyond the family and tribe to encompass mere acquaintances (Fukuyama, 1995), cannot be easy. Seabright (2004) suggests that these adaptations to a more complex world, well beyond the small group hunter-gather activities that predominated when the human mind evolved, are the consequence of 5,000 years of institutional trial and error. From this experimentation have come several sound institutions that delicately bridge the demands of operating in a “modern” world, while still recognizing and supporting the complex predispositions of the evolved mind of man. By contrast, attempts to suppress underlying preferences to attain some societal goal

are costly—we can enter into ceaseless war on our own nature. The Soviet Union is an example of the tragedy of enforcing expansively paternalistic policies that are inconsistent with the evolved nature of human preferences.

Perhaps an intuitive understanding that most aspects of human behavior have deep, unyielding roots guided the political philosophy of such children of the Enlightenment as James Madison. Today, we can articulate a more complete scientific basis for many hard-wired preferences than Madison could, and this knowledge suggests two tentative conclusions regarding the ways in which we might design paternalistic policies and institutions to improve outcomes. First, these governmental efforts will be resisted and circumvented if the underlying preferences are powerful, regardless of the expected improvements that might result from the regulation of behavior. Thus, it is sensible to craft policies that “use the force” of such underlying preferences to channel behavior rather than to expunge it. Second, the institutions through which we seek to improve behavior are always fragile. It seems probable that these institutions that have evolved would be extraordinarily difficult to recreate in any deliberate sense, should they be lost; they cannot merely be turned on again. This argument supports a cautious view regarding promotion of extreme social or political changes by edict, a point of view with which social conservatives may agree.

Two Examples

A: The Social Security Private Accounts Debate: How Much Personal Choice?

In section II, I briefly identified some of the alleged problems that the average citizen might face in deciding how and how much to save for his or her retirement. I turn here to that issue in the context of the debate over social security reform that would permit individuals to put a portion of their payments into private retirement accounts. Although opponents have come up with a large set of concerns about

social security “privatization,”⁴ here I put the citizen’s alleged irrationality at center stage in explaining why privatization would not work—that individuals often lack sufficient rationality to determine how to manage these funds efficiently. Two often-mentioned decision-making concerns are the likelihood of “excessive risk taking” and the misuse or misallocation of funds. Privatization opponents fear that individuals will “gamble” away their portfolios as if they had boarded a riverboat casino, will borrow against their assets for short-term consumption and then be unable to repay, and will not reposition their investment portfolios to include more low-risk instruments as they near retirement age.

Would individuals make foolish, impulsive decisions—perhaps “gambling” on extremely risky investments, given the opportunity? This seems implausible for the average citizen. Very good investment advice is available today at low cost and one can count on capable agents to assist—mutual fund managers for example. Most small scale investors are cautious with their 401(K) plan funds—perhaps excessively so. Indeed, fund managers often urge their clients to expand their equity holdings to increase expected returns at a modest increase in risk. Seemingly, a consistent paternalist should be as concerned about individuals taking on *too little* risk as well as too much, but that has not entered the debate.

A somewhat more plausible concern over excessive risk-taking is that some poorer citizens with very little to lose may be inclined to take great risks. But the very act of building private accounts gives these people control over more personal wealth, and that should temper

⁴ Among these concerns are: a) introducing private accounts will increase short-term federal borrowing requirements in a transition period; b) the reform will do nothing to reduce long-term program liabilities; c) costs of administering private fund accounts will be high; and d) privatization would do nothing to increase aggregate national savings.

extreme risk-taking. In general, the argument that people cannot get beyond impulsive, risky financial behavior is largely overstated. Forcing all private account holders into more passive investing is costly, sacrificing both information and judgment. Most people can quite rationally work through their risk-reward tradeoffs, and doing so reinforces a norm of personal responsibility. Opponents of extensive privatization argue that individuals nearing retirement will not reallocate their portfolios to include more fixed income assets, a common tactic for many soon-to-be retirees. These skeptics would force all older workers to shift to some minimum proportion of fixed securities in their portfolios in order to avoid risk of losses of retirement funds for their imminent retirement years. Although such misjudgment could occur among some older workers, the likelihood is low for a reasonable citizen.

A major cost to loading on such restrictions, beyond the obvious loss of specific information about circumstances and personal preferences, is the sacrifice of a public good: a citizenry broadly free to choose. Political compromises that emerge in social security reform erode each citizen's personal rights and responsibility for making key financial decisions affecting his or her life. The more extensive these restrictions are, the less viable is the notion that private ownership is embedded in any social security reform. While this is applauded by some critics of a robust social security reform, these critics rarely consider the cost borne by a free society that depends critically upon an informed and engaged citizenry. When treated as children, we no longer have incentive to be so informed and engaged.

B: School Choice

Friedman devoted a full chapter of *Capitalism and Freedom* to government education. Among the arguments for public schools that he examined, those based on paternalistic grounds are relevant for the purposes of this paper. Friedman identifies neighborhood effects resulting from an educated citizenry as the primary basis not only for

publicly subsidizing much basic education, but also for mandating a minimal level of education across the population. Some parents may anticipate too little return on educational investments in their children to bear the full cost of an extended education, and a few may care little for the well-being of their children. These reasons for subsidizing and forcing minimum levels of education are fairly uncontroversial to most.

However, a controversial paternalism comes directly into play in the restrictions imposed on parents' choice of *who* shall educate their children. As Friedman persuasively argues, one can accept the premises for subsidizing K-12 education without also accepting that the state must be the sole provider of that education (Friedman, 89). The inefficiencies of monopoly provision of any service are manifest. While rent-seeking behavior by the public education industry explains much of why the monopoly continues, it does not explain why so many citizens believe that we are well served by restricting school choice in the face of evidence of poor public school performance.

A reasoned argument for intervening would be that real parents are incapable of making sound investment choices about their children's education (considered separately from the "neighborhood effects" issues discussed previously). But considered from the perspective of the evolutionary psychology, there is little to support the notion of underinvestment. Instead, the bias suggested is toward *overinvestment* in the education of our offspring. Our hard-wired preferences are for our own genetic material to succeed, carried forward by our children. Therefore parents typically should expend great effort in seeking advantages for them to succeed and procreate. Concerns about personal educational choices cannot be that parents would place too little attention and resources on educating their children.

The reasons for the widespread willingness of citizens to accept the public school monopoly must lie elsewhere. An intriguing argument indirectly relies on evolutionary psychology. Daniel Klein (2005) argues that individuals have a strong preference for engaging in shared

experiences within communities.⁵ Privately, we see this preference played out in various acts of spontaneous coordination that delight us, a topic that Adam Smith (1976 [1759]) wrote about extensively in *The Theory of Moral Sentiments*. The danger is that we are tempted to acquire this “sharing” by applying non-spontaneous government force. Ironically, the behavioral problem here is not with private decision-making, but rather with public choice: the ease with which we can indulge pervasive preferences by government coercion, eroding the rights of citizens and damaging the framework of a free society.

When government regulates personal behavior of citizens, it presumes for itself a level of rationality superior to that of the average citizen. However, government policies are not immune to the types of decision-making problems that have been outlined in this paper. In the case of restricting parents’ choice of schools for their children, the widespread desire for some type of shared community experience is too easily accommodated by a government eager to act, pushing aside rational analysis of the issues. Once public policy was used to indulge our underlying predisposition for this sharing, it has been extraordinarily difficult to reverse course, in part due to inevitable rent-seeking activities by those in the rent chain of the monopolized educational service. These suppliers can effectively appeal to these general predispositions in defense of an inefficient service.

How might practical reasoning enter the political process to deal with these problems in public education? Perhaps the beginning of enlightenment lies with a citizenry better informed about the nature of the problems faced. A large part of the problem in this case is the lack of general understanding that the public school monopoly rests significantly on primitive emotional roots for desiring shared communal

⁵This parallels the discussion about preferences for small group socialization in Section III.

experiences for our children and that these have been sought using government force, without much concern for the larger costs to a free society. In a democracy, responsible citizens often must play the role of parent to government. As discussed early in this paper, privately we are motivated to find the means to respond to our own personal damaging biases or inappropriate expressions of underlying preferences, as best we can understand them. Similarly, government institutions might well do better if pressed by a thoughtful citizenry.

Conclusions

Perhaps policy debates on the scope of paternalism should be decided, as Friedman put it in 1962, by imperfect and biased men in open discussion and by trial and error. What differs now is that more specific reasoning problems have been unearthed by cognitive psychologists, evolutionary psychologists, biologists, and neurogeneticists. Friedman's advice to seek reasonableness in such policy discussions remains particularly useful because of our still very imperfect knowledge about the nature of the enormously complex human mind.

The reasoning problems that I have discussed in this paper fall into two general categories—first, biases and computation shortcomings due to the way that the brain functions, and, second, evolved preferences (predispositions) of the brain. The categorization of a reasoning problem matters in framing how we might respond, if at all. For biases and cognitive limitations, it seems more likely that light-handed parental intervention could be effective, perhaps in keeping with Sunstein and Thaler's "libertarian paternalism." In cases where paternalism applies to private transactions, it often is uncontroversial, and reasonable individuals often willingly cede to others some personal authority, both in decision-framing and decision-making. Even when government uses the force of law to deal with such problems, the results may not be contentious when the government's action echoes a personally understood need to rectify a

personal deficiency. However, when behavior is linked more intimately to deep-seated preferences, the individual's sense of being, blunt paternalistic policies to change that behavior can lead to strong resistance and displacement behaviors.

As understanding of the origins of behaviors grows, the political impulse to respond in the name of paternalism also will expand. But reasoning problems are pervasive to humans in all settings, and therefore it makes sense to turn this analysis to decisions made by all individuals, in all settings, including within government where such problems seem endemic and more dangerous if not understood and acted upon. While errors of judgment generally have immediate negative consequences for private citizens and organizations, the same does not apply to government decisions that go badly wrong. This suggests the need for a vigilant citizenry and perhaps for constitutional restraints that keep us from using government to indulge such preferences without considering the damage done to a free society.

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