SWEDISH ECONOMIC POLICY REVIEW 12 (2005) 3-5

Introduction: Regulating unhealthy consumption

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Most countries regulate the trade and consumption of alcohol and nicotine, and many countries completely prohibit the sale of cocaine and heroin. Potentially unhealthy behaviors such as gambling and prostitution are also frequently regulated. Some countries even tax sugar for health reasons.

Regulation of unhealthy consumption is usually not justified by standard economic arguments. If people are rational, the only reason for regulating consumption is if one person's pleasure generates pain for others, and it is quite possible that the prohibitions on drugs create more pain for non-users than would legalization. (For example, prohibition drives up drug prices, leading in turn to more crime by addicts—and drug selling networks may more generally foster organized crime.)

So what is wrong—the regulation or the theory? At one level, it is obvious that the theory is flawed. Too many behaviors violate the standard model. For example, large fractions of the population have serious problems controlling their addictions, either succumbing to temptation or leading highly restrictive lifestyles in order not to do so. Thus, the real question is whether a more accurate description of human motivation will justify the regulations that we observe in practice and, if not, which regulations are preferable.

Perhaps the most astonishing feature about economic analysis of regulation in the 20th century is the almost complete neglect of irrational behavior. David Hume, who is one of the favorite philosophers of many modern economists, argued that irrationality is the main reason for government to exist—partly because self-serving biases entail conflicts and the need for third party intervention—and partly because people lack self-discipline. In Hume (1739, Book III, Sect VII) he wrote:

> In reflecting on any action that I am to perform a twelve-month hence, I always resolve to prefer the greater good, whether at that time it will be more contigu-

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> ous or remote; nor does any difference in that particular make a difference in my present intentions and resolutions. My distance from the final determination makes all those minute differences vanish, nor am I affected by any thing, but the discernible qualities of good and evil. But on my nearer approach, those circumstances, which I at first over-look'd, begin to appear, and have an influence on my conduct and affections. A new inclination to the present good springs up, and makes it difficult for me to adhere inflexibly to my first purpose and resolution. This natural infirmity I may very much regret, and I may endeavour, by all possible means, to free my self from it. I may have recourse to study and reflection within myself; to the advice of friends; to frequent meditation, and repeated resolution: And having experienc'd how ineffectual all these are, I embrace with pleasure any other expedient, by which I may impose restraint upon myself, and guard against these weaknesses.

Over the last decade, leading economists have finally risen to the challenge of building more realistic models of irrational and unhealthy behavior. We have been extremely fortunate to have so many of the star economists in this area taking part in the conference. As a result, this issue of SEPR is right at the research frontier.

The issue consists of four papers. (A fifth paper, discussing the role of default options for consumption and saving behavior, was given at the conference by Richard Thaler.) The papers are both sophisticated and eminently readable, so we hesitate to review them. Instead we offer only a brief glimpse of their main messages.

"Optimal taxes for sin goods" by *Ted O'Donoghue and Matthew Rabin* asks whether it is justified to tax unhealthy consumption when a fraction of the population has self-control problems. Their answer is largely affirmative. Indeed, they show that a proportional consumption tax can benefit all consumers if the tax revenue is spent appropriately. The authors also study a variety of more sophisticated schemes, such as requiring licenses for buying unhealthy products.

The next paper, "Early decisions: A regulatory framework" by *John Beshears, James Choi, David Laibson, and Brigitte Madrian* investigates a variety of publicly provided non-tax regulations, including opening hours, location restrictions, and delayed delivery. They also study the possibility of novel schemes that would allow individuals to choose their own future terms of trade, and begin to discuss the extent to which markets can provide all desirable self-control devices.

Botond Köszegi's paper "On the feasibility of market solutions to self-control problems" focuses precisely on the latter issue. The paper concludes that the market can often not be expected to provide all the desirable self-control devices. For example, if a seller of a harmful substance contracts with a customer never to engage in temptation, there will only be a new profit opportunity for sellers who did not contract with the customer.[1] These issues have been discussed informally for a long time, and we are very pleased to be able to publish the first in-depth treatment of them.

Finally, *Douglas Bernheim and Antonio Rangel* provide a new economic perspective on the regulation of addictive substances, relying on new evidence from neuroscience. Their thought-provoking conclusions to some extent contradict those of the other three papers. Sin taxes may be harmful in this framework, because addicts are price-insensitive in their "hot" state and because the financial burden adds to the misery of addicts.

Without further ado we wish you an exciting read.

P.S. For your own good: don't postpone it!

[1] Maybe the drug Xenical is an example of a successful market solution to a self-control problem. The drug makes the user dislike eating fatty products. On the other hand, there is now a market niche for a product that neutralizes the effect of Xenical. For the drug market to solve the problem of over-eating in the long run, the access to neutralizers must probably be regulated.