Comments on Benjamin and Laibson

Benign Paternalism: Sounds good to me.

New attitude toward deviations from neoclassical behavior: rather than embarrassed jokes, exploit them for policy goals.

Specific proposals:

Thumbs up for #1 (encourage savings), #2 (regulate asset allocation), #4 (stimulate aggregate demand).

Behavioralists should be skeptical of #3 (privatize Social Security). B-L argue it forces people to face facts about deficits. Instead, it fools people into thinking there is a costless solution to the Social Security problem.

#5 (downward nominal wage rigidity) is plausible a priori. But most studies fail to find major efficiency losses from downward rigidity. (B-L cite only the most positive studies.)
Behavioral economics and monetary topics:

- Foundations of the Phillips curve:

  Much policy analysis based on the "New Keynesian Phillips curve" derived from optimizing sticky-price models. But this equation is absurdly counterfactual; in particular, it implies inflation jumps costlessly when policy shifts (e.g. Fuhrer).

  A behavioral solution: the "sticky information" model of Mankiw and Reis (2002). Price setters only occasionally observe the state of the economy. This assumption generates an empirically reasonable Phillips curve. Ball, Mankiw, and Reis (2003) study policy implications (bottom line: price-level targeting preferred to inflation targeting).

- The falling NAIRU of the 1990s: Productivity growth accelerates and "wage aspirations" adjust sluggishly, causing a favorable Phillips-curve shift (e.g. Blinder, DeLong, Ball-Moffitt 2002). This work uses basic behavioral ideas about fair wages (e.g. Akerlof-Yellen) to help explain a specific macro episode.
Two suggestions for behavioral research:

- Costs of inflation:

  Embarrassingly, neoclassical economics fails to explain why we dislike inflation.

  It must have something to do with confusion about nominal vs. relative prices. With such confusion, buyers and sellers react incorrectly to price signals, financial planning is distorted, and so on.

  From a neoclassical point of view, it seems easy to distinguish nominal and relative prices. Behavioralists should explain why we don't.
• Adjustment to changes in monetary regime:

For example, a switch from inflation targeting to price-level targeting. Arguably good in long run. But disastrous if people continue to expect persistent inflation. How long will it take expectations to adjust?

Can we apply behavioral ideas about learning? Do they support the common assumption of least-squares learning? Do people faced with regime changes use discounted least squares (Sargent)?