Welfare Assessment of Default-Setting Policies

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The Argument

i. *Default effect* an empirical regularity between context and behaviour

ii. Explanation of this regularity controversial: 5 different accounts

iii. Welfare assessment of default policies dependent on which explanation is assumed to be correct

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⇒ Non-robustness, context-dependence of welfare assessment.

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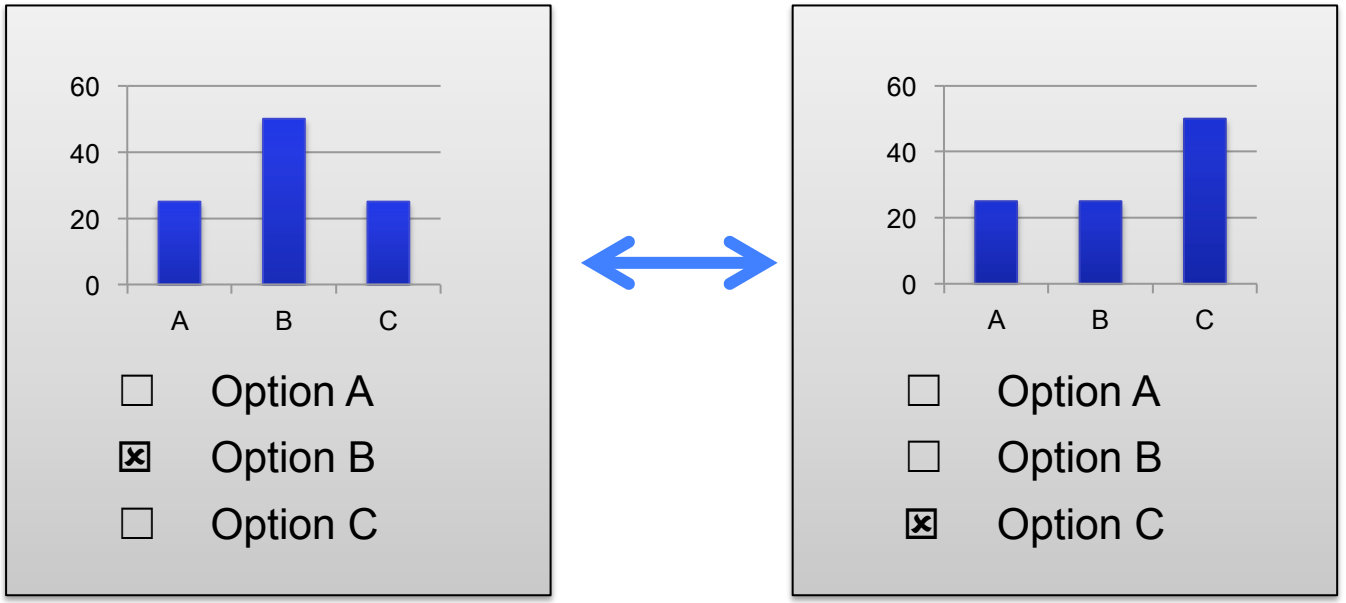

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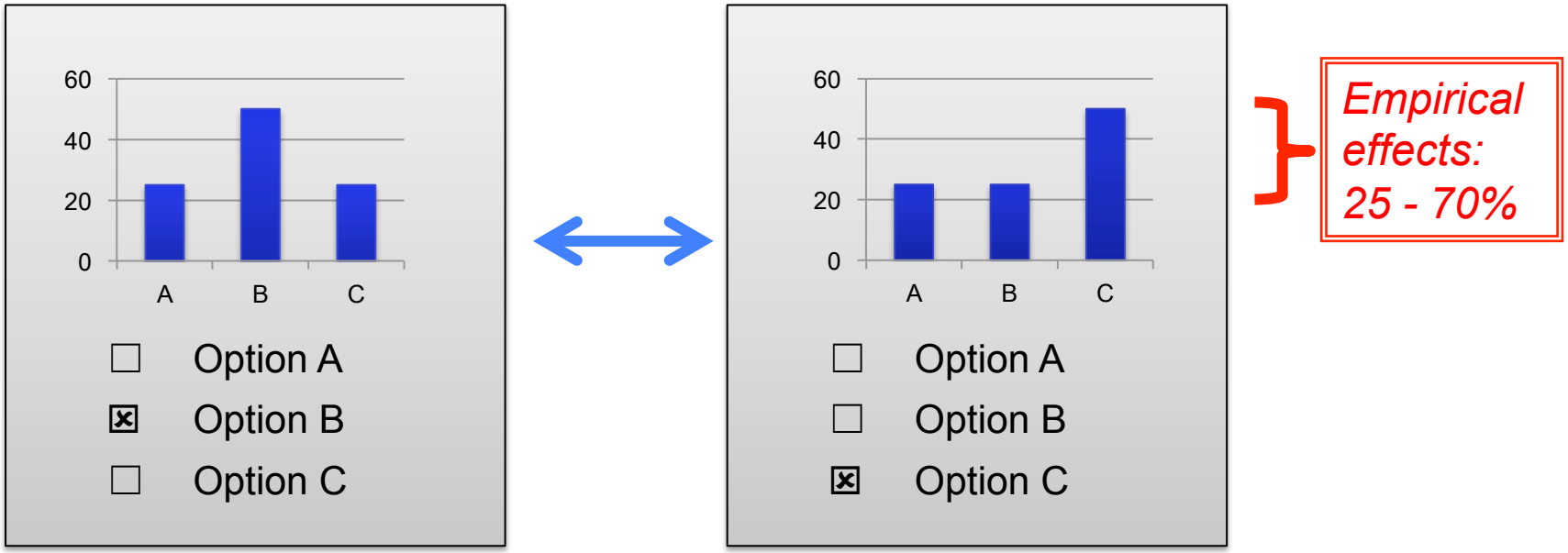

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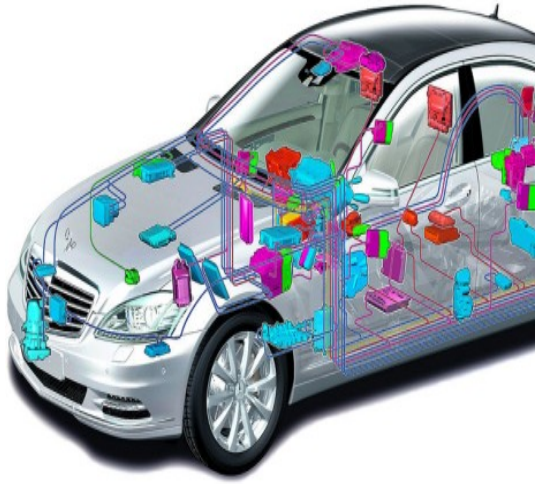

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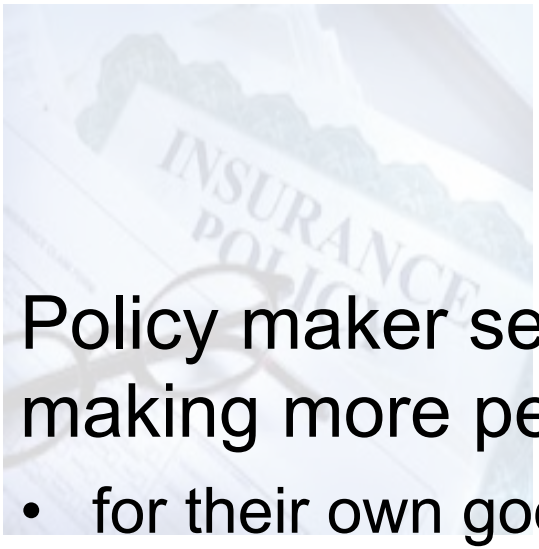
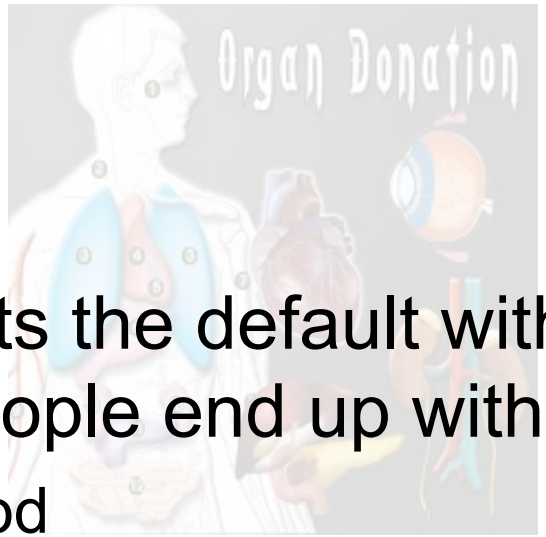
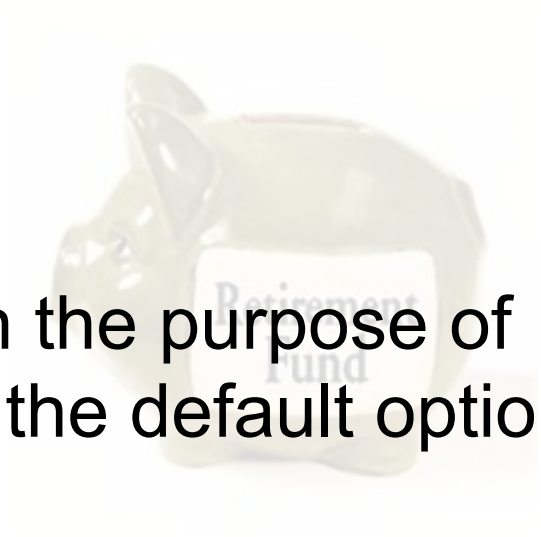
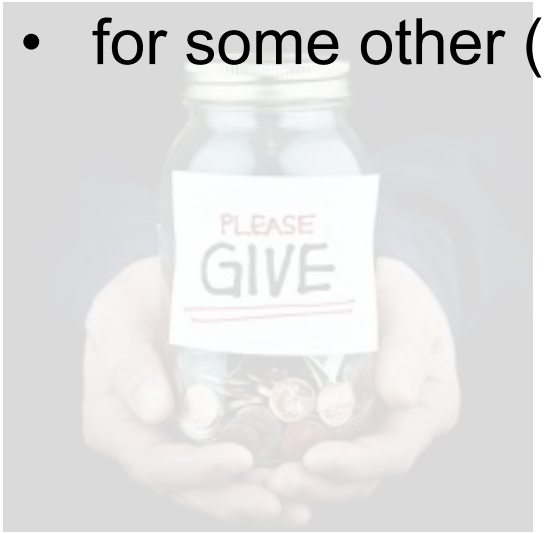


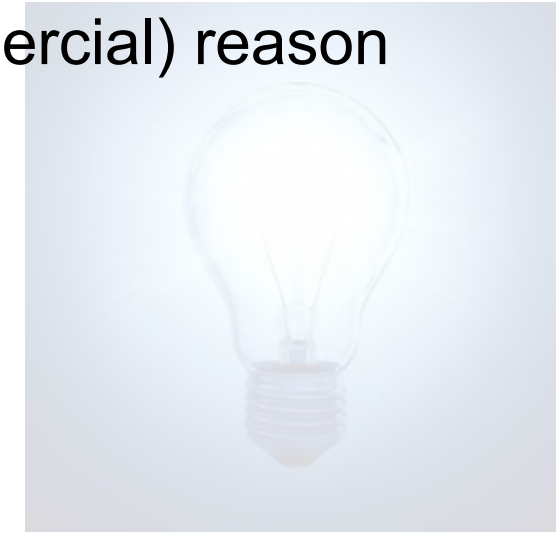




Policy maker sets the default with the purpose of making more people end up with the default option

- for their own good
- for some other (e.g. social or commercial) reason





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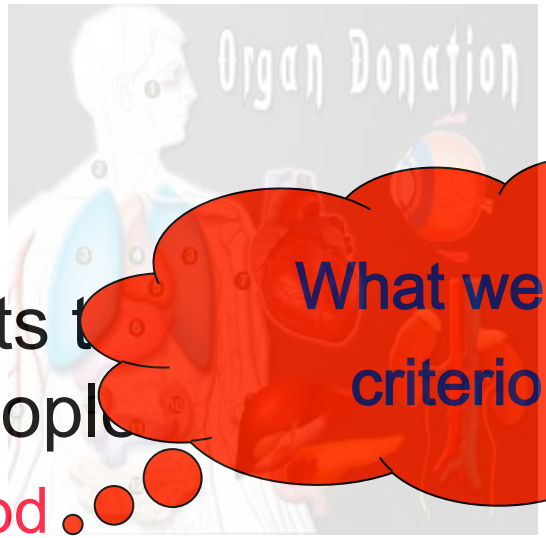

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What welfare criterion?

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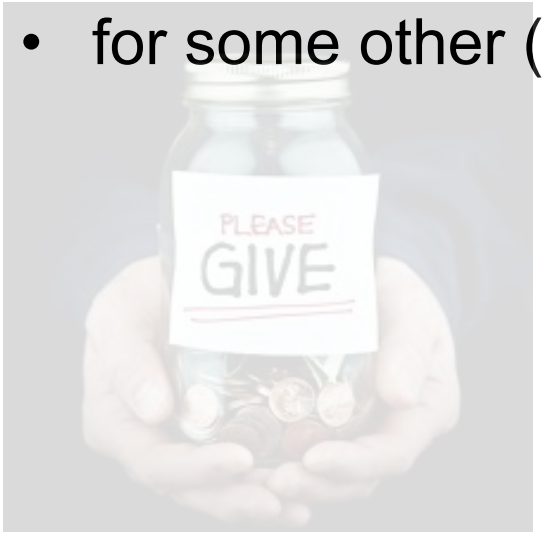

What Welfare Criterion?

> *"In some cases individuals make inferior decisions in terms of **their own welfare**— decisions that they would change if they had complete information, unlimited cognitive abilities, and no lack of self-control." (Sunstein and Thaler 2003, 1162)*

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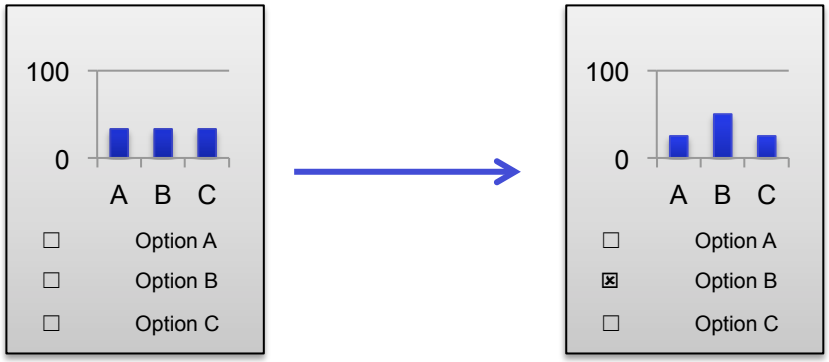
W = Proportion of people who have their optimum (according to their true preferences) satisfied.

3 Differential Effects of Defaults on **W**

1. Individual Welfare Relevance



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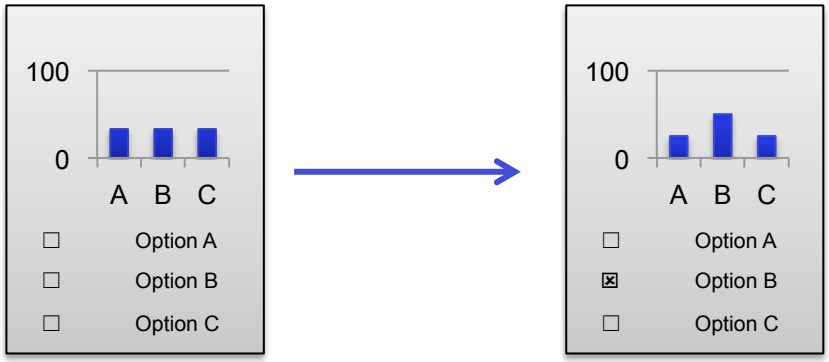

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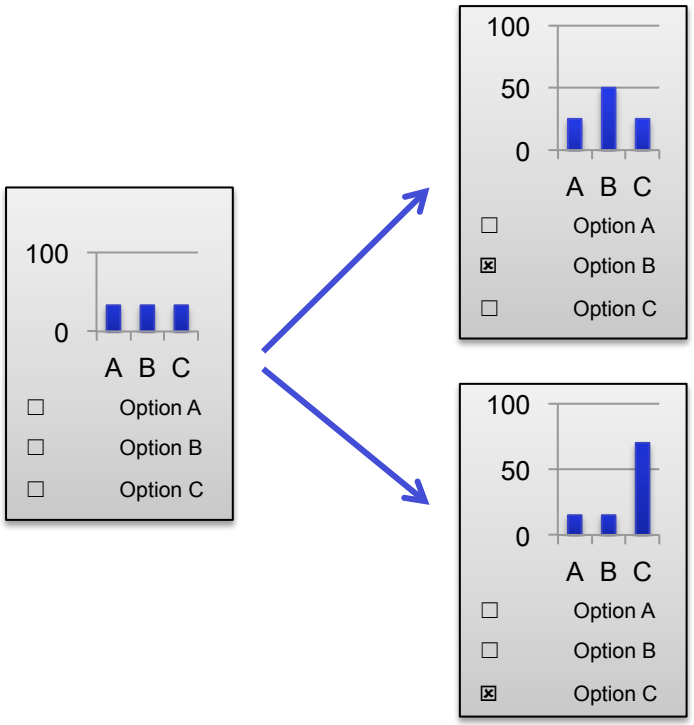

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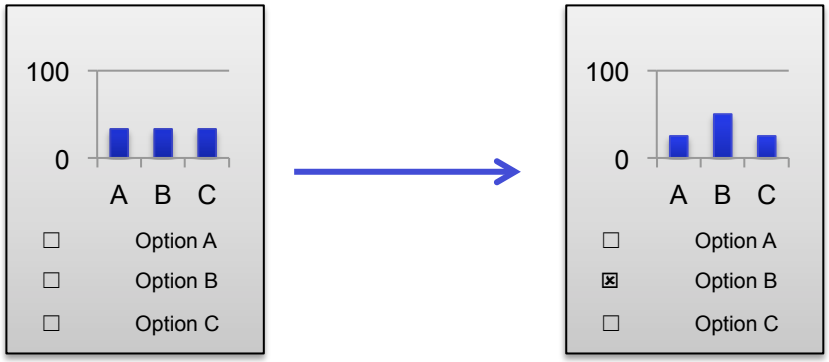

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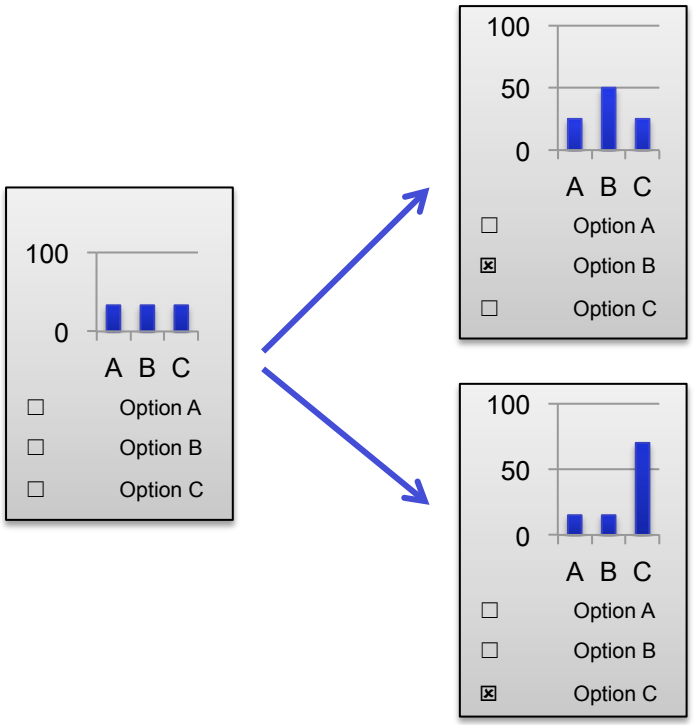
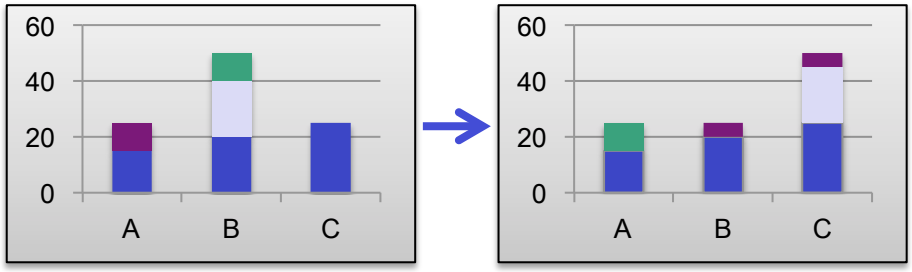


3. Heterogeneous Switching



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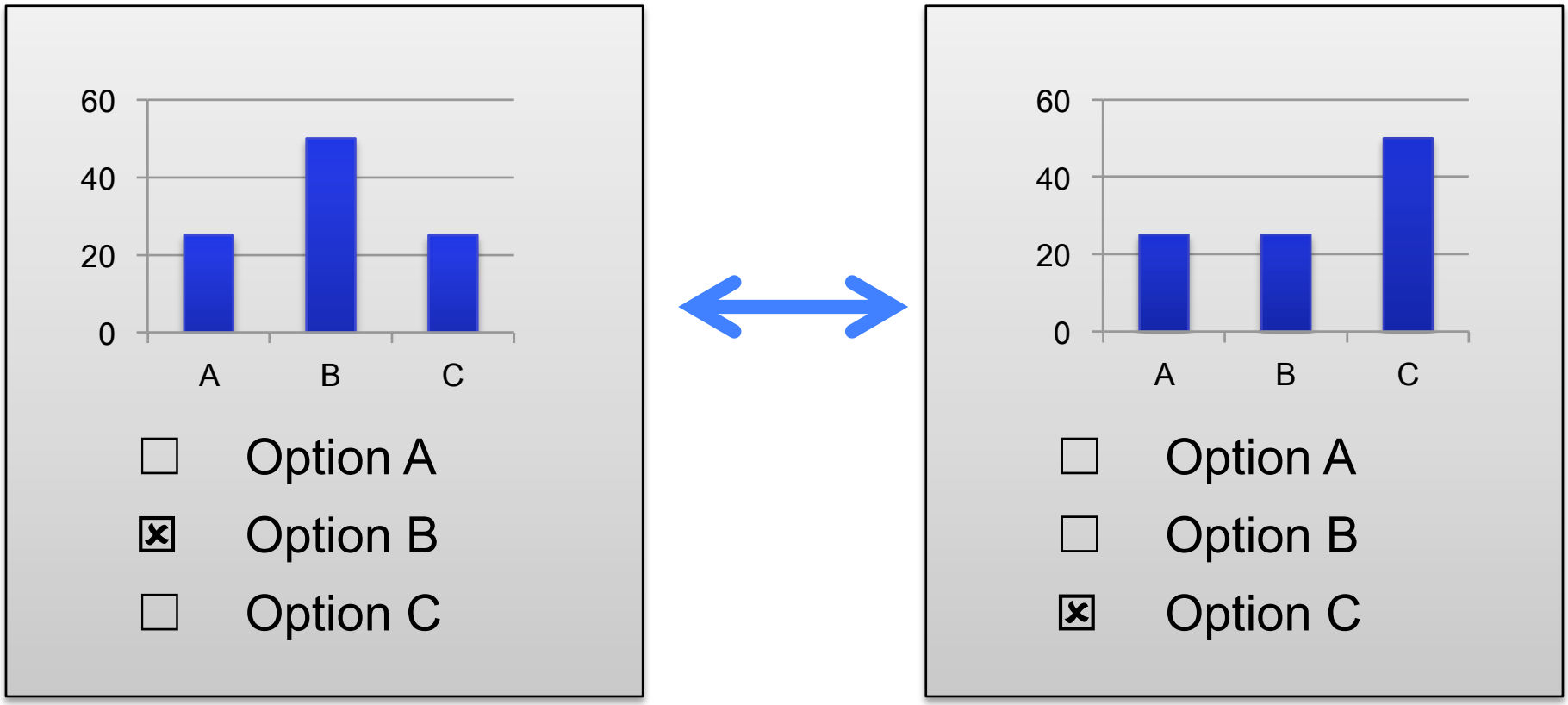

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5 competing explanations:

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Choosing non-default option incurs costs in terms of time, search effort or money.

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Preferences between options involve trade-off between dimensions. Default setting increases impact of those dimensions that are considered a "loss" on preference judgment.

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Setting default affects meaning of options. E.g. under opt-in, being a donor means something different than being a donor under opt-out.

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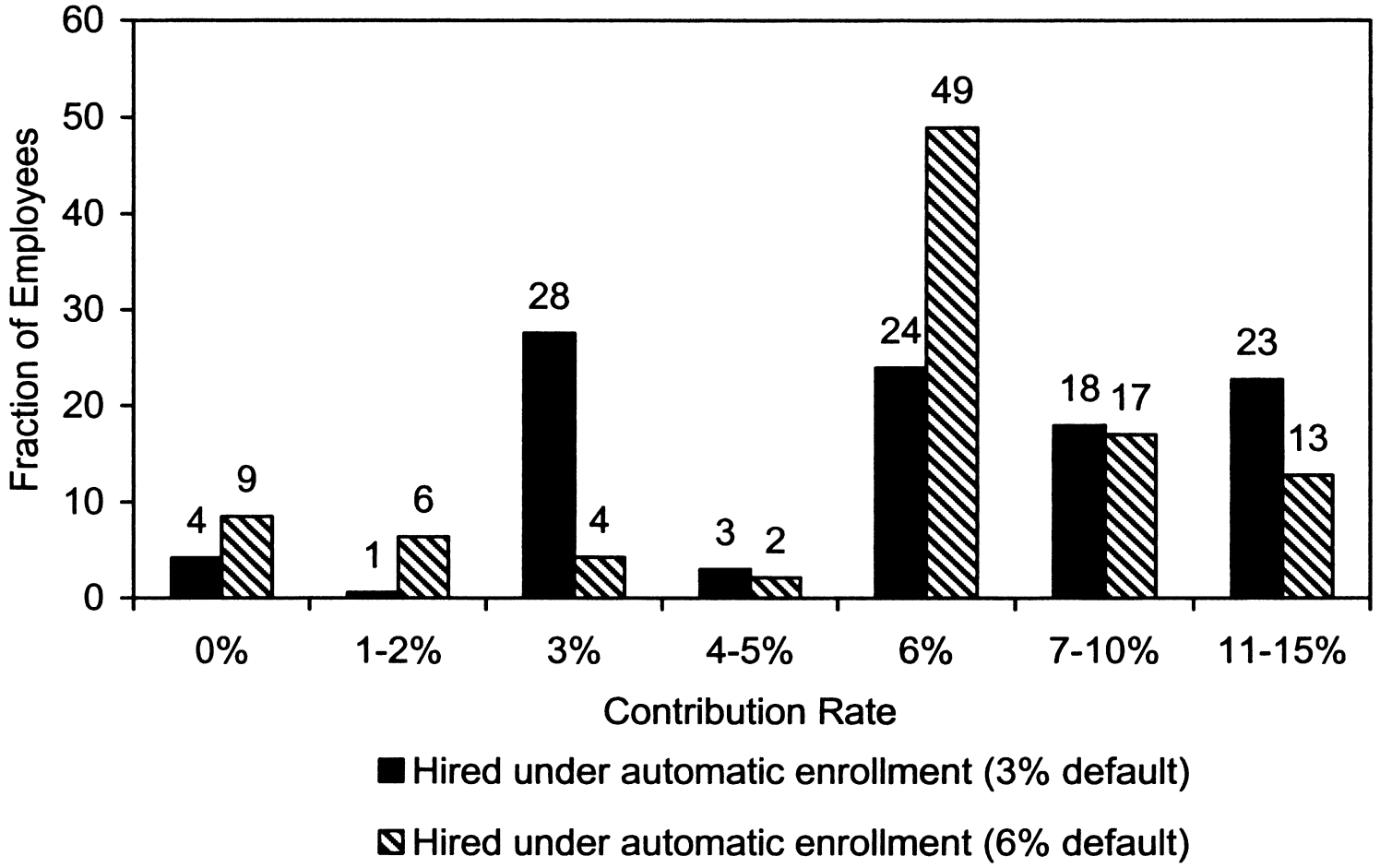
Summary: Differential W-Effects by Explanation

	Individual welfare relevance	Asymmetric effect	Heterogeneous Switching
Cognitive effort	No	Symmetric	Heterogeneous
Switching costs	No	Symmetric	Homogenous
Loss aversion	No	Asymmetric	Heterogeneous
Recommendation	Yes	Asymmetric	Homogenous
Meaning Change	Probably yes	Asymmetric	Heterogeneous

A Numerical Example



Distribution of 401k contribution rates under two defaults (Beshears, Choi, Laibson and Madrian 2009, 173)

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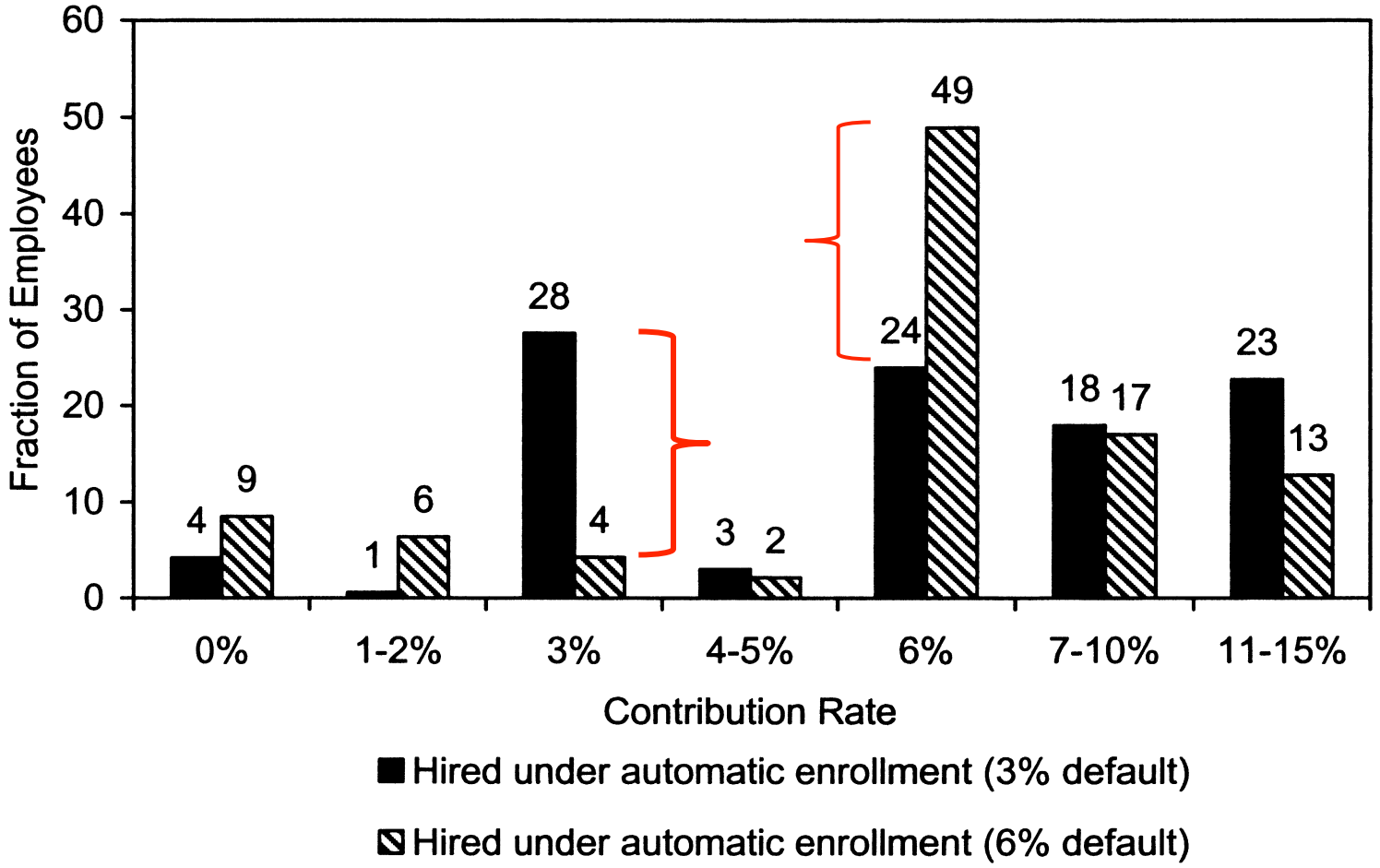

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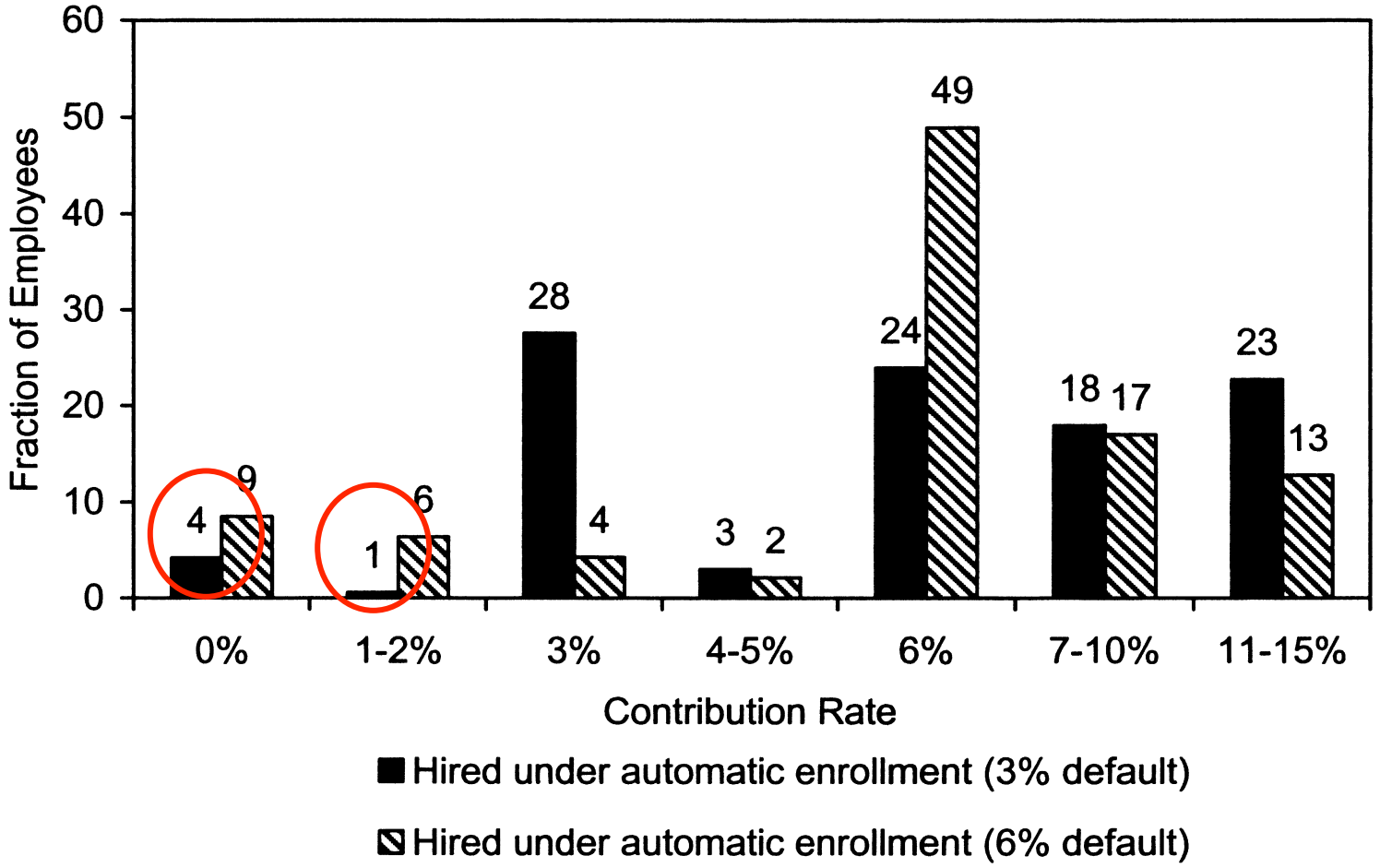

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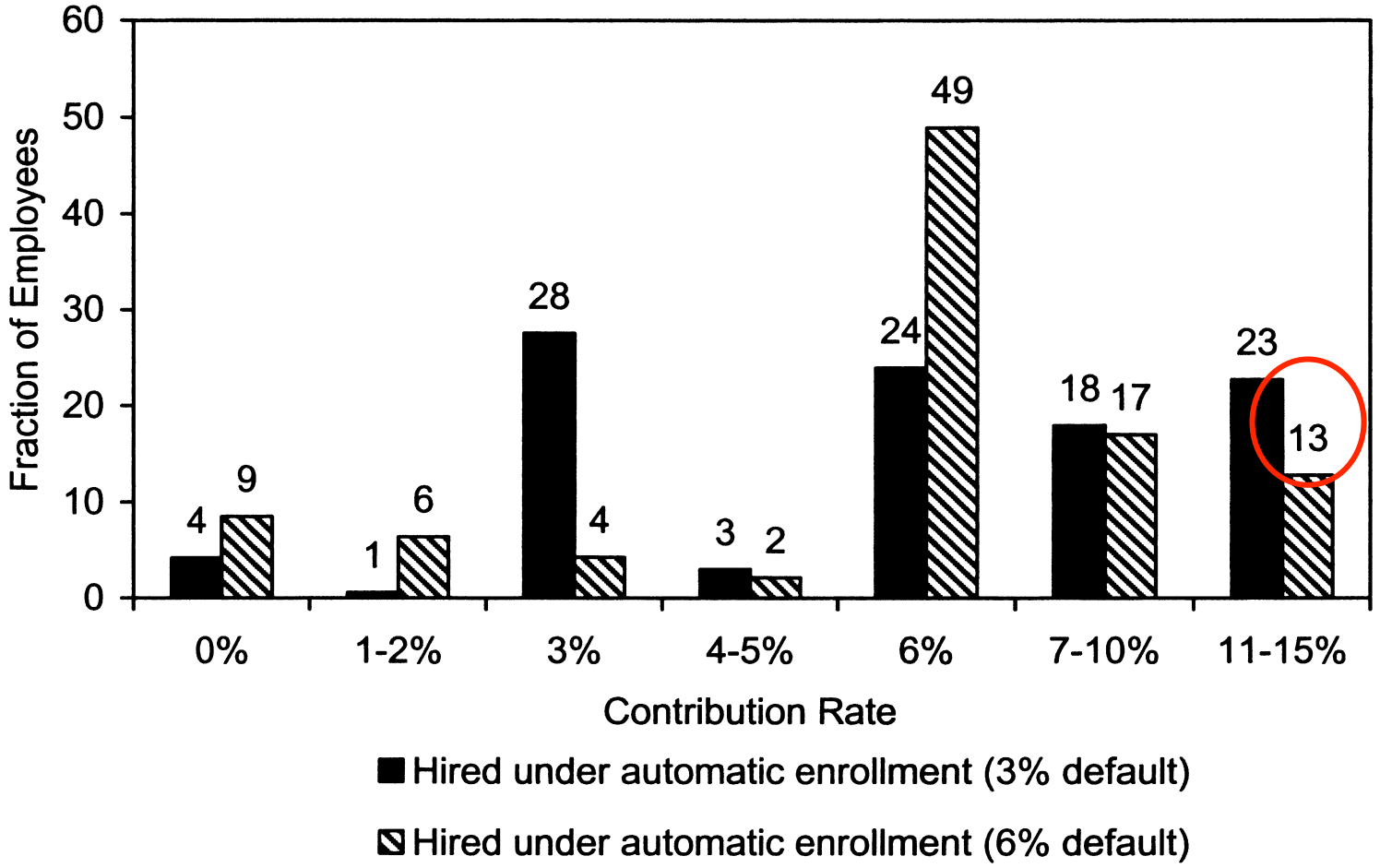

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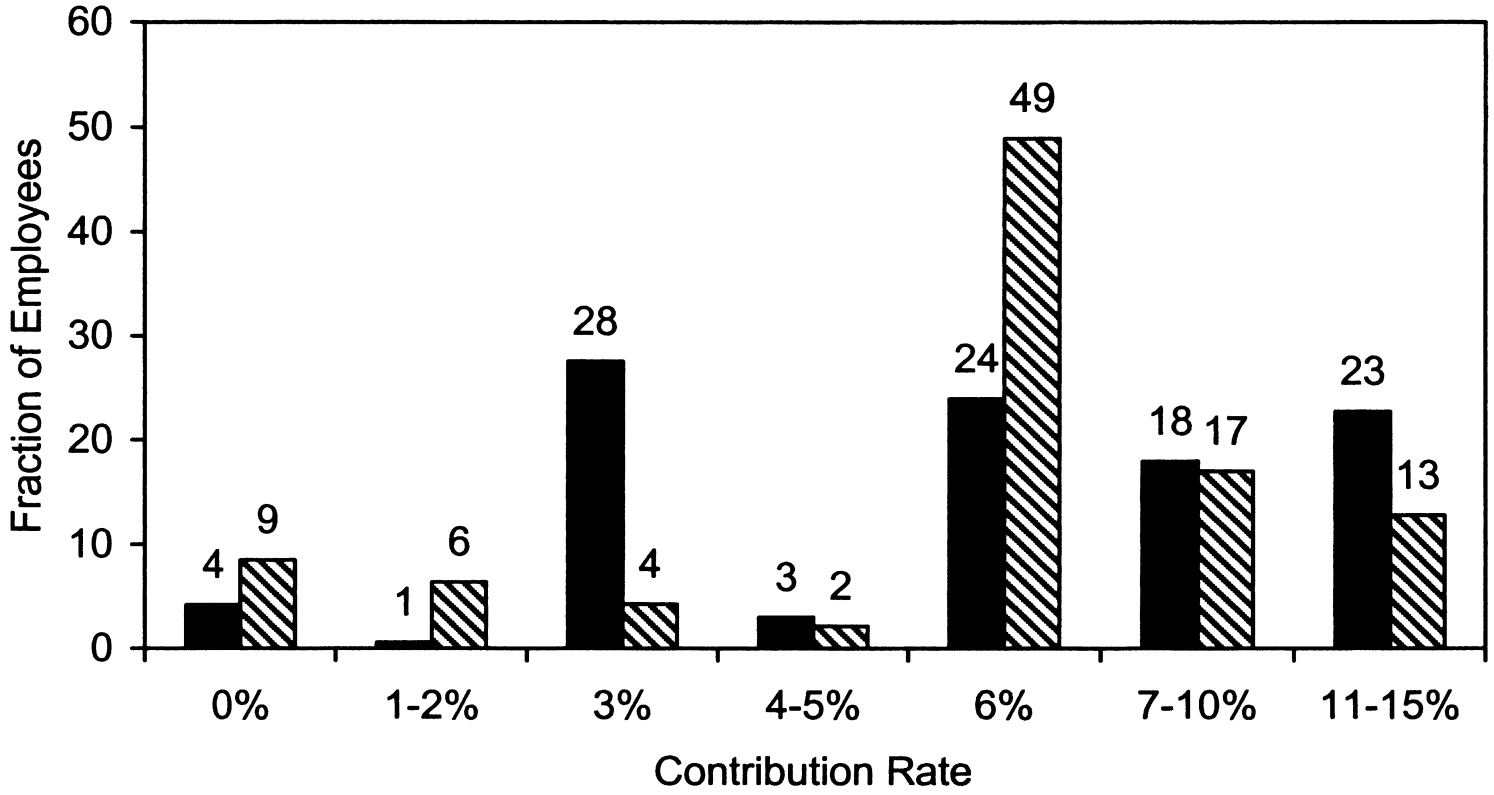

Mean: 6.88% ■ Hired under automatic enrollment (3% default) **σ=3.97**

Mean: 6.31% ▨ Hired under automatic enrollment (6% default) **σ=3.47**

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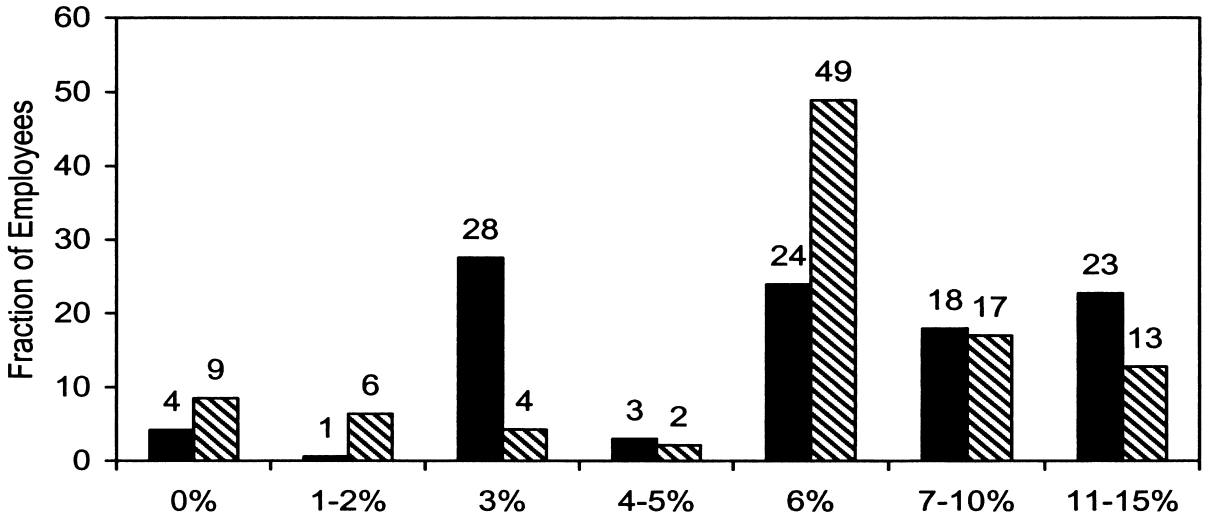

Worst-Case Scenario: e.g. Loss Aversion

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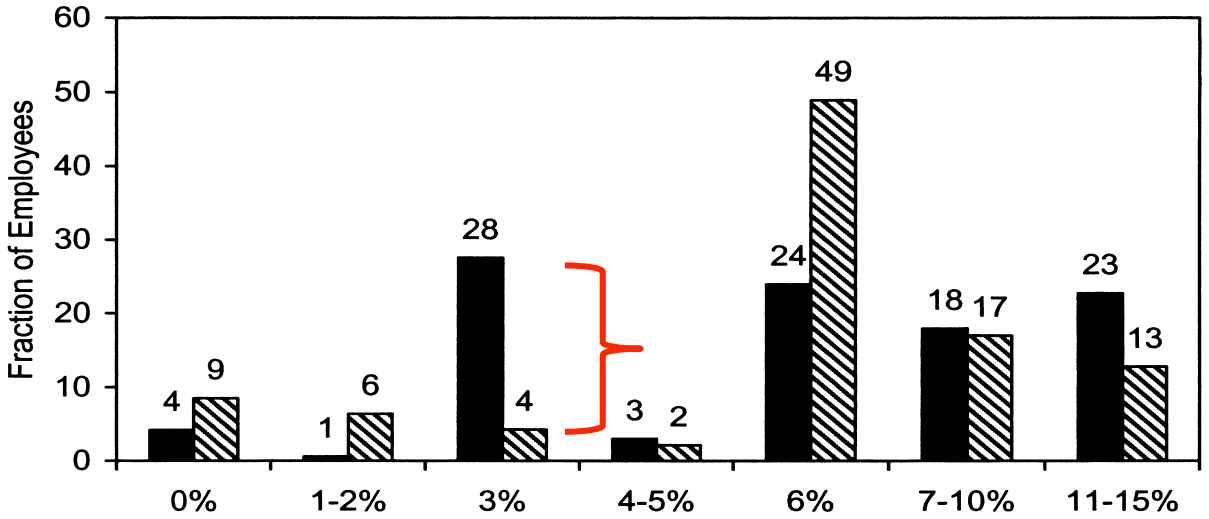

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- Default set at 3%: 24 individuals choose against their preferences

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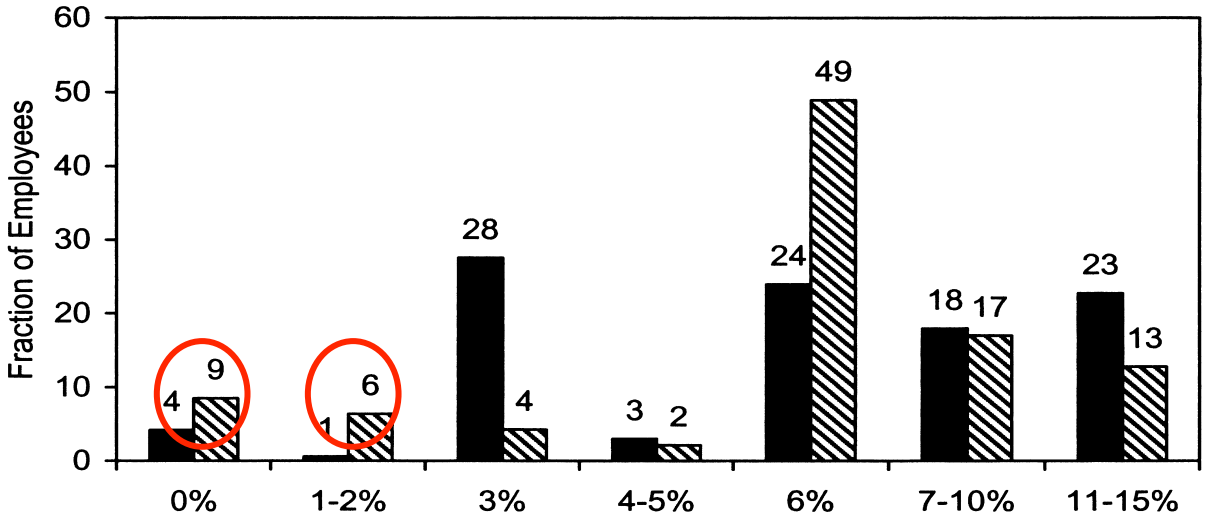

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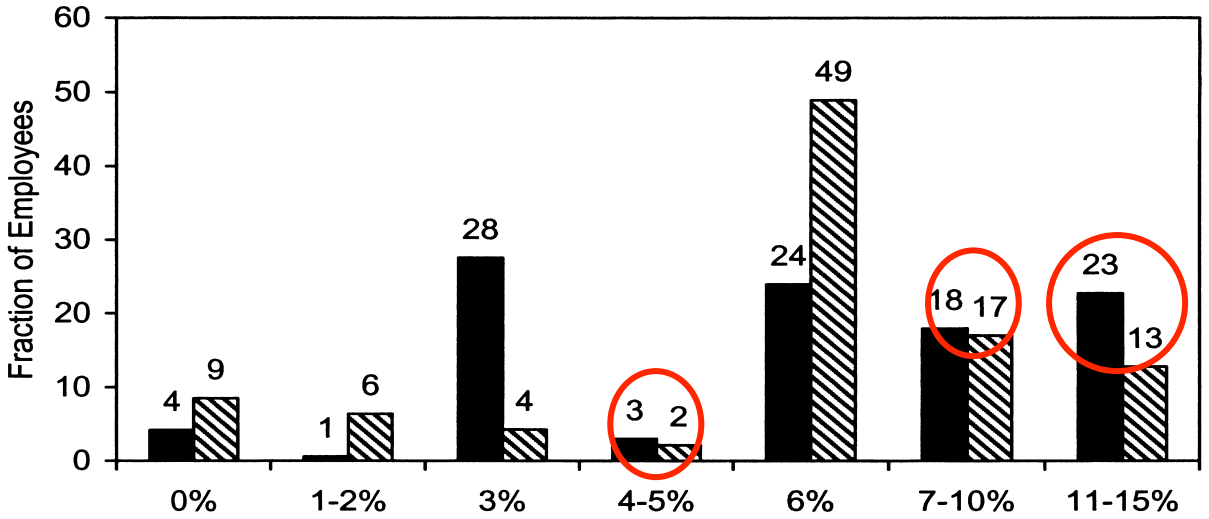

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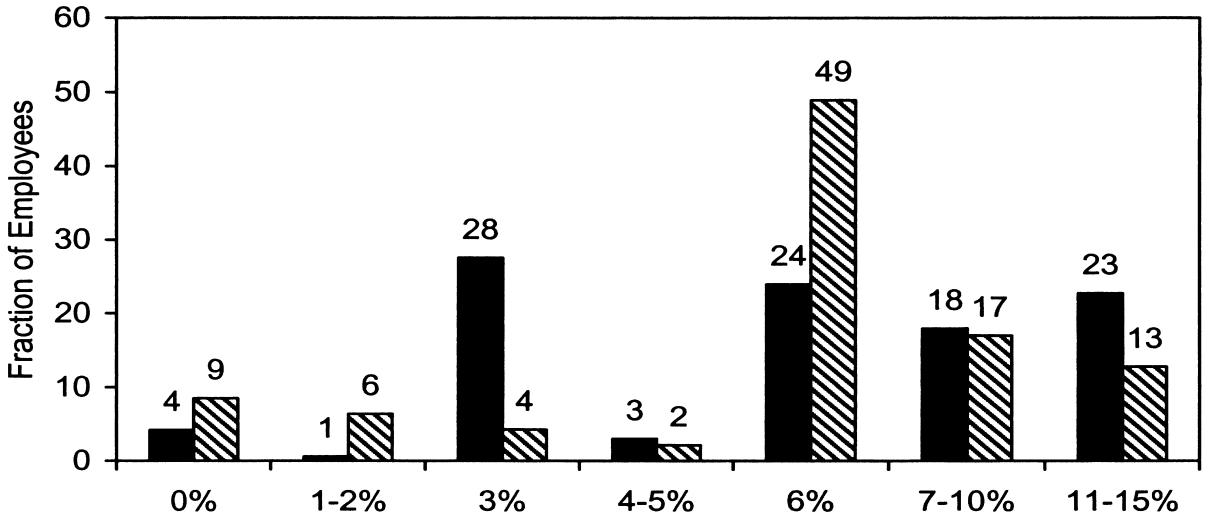

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Altogether 46 individuals choose against their true preferences

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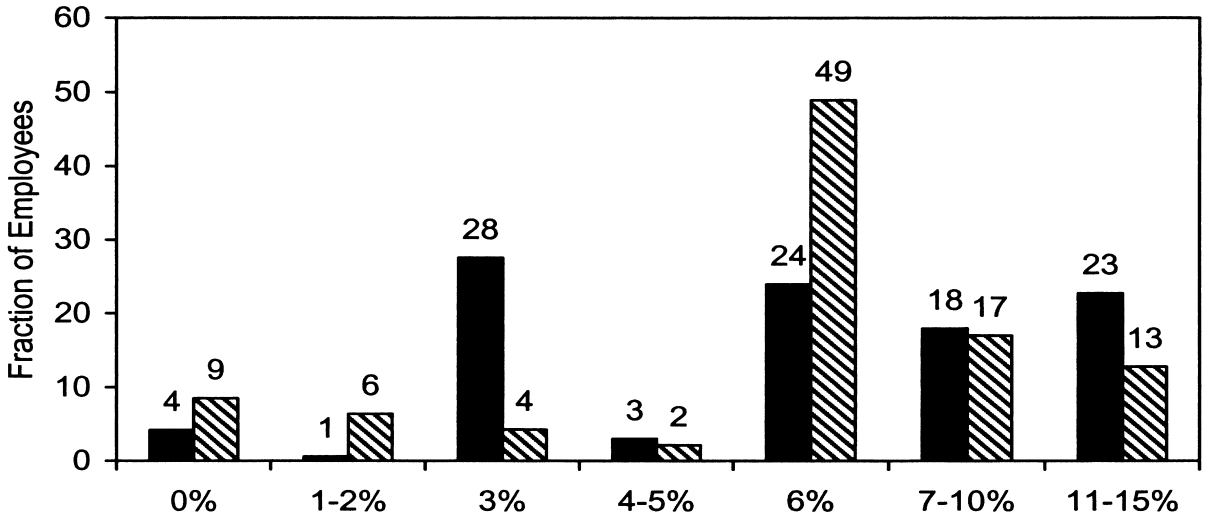

Best-Case Scenario: e.g. Recommendation Effect

- Default set at 3%: 24 adjust their preferences according to recommendation
- Default switched to 6%:
  - For 10, new recommendation isn't strong enough to choose default
  - For 12, recommendation is strong enough to choose default

Everybody's welfare-relevant preferences are satisfied

Conclusion

- Non-robustness result: welfare assessment of default policy depends on assumption about underlying causal mechanisms
- Need for detailed investigation of context before policy is implemented
- A welfare economics that relies only on choices and ancillary conditions (e.g. Bernheim & Rangel 2009) is hopeless