

The Power of Defaults with Inattentive Consumers

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Abstract

Consumer inertia plays a key role in a number of services markets. Typically, consumers do not switch service providers even though the tariffs they are holding are suboptimal. This paper aims to unpack two key psychological determinants – tariff complexity and consumer inattention – in the context of an experiment closely modelled on the UK electricity and gas markets. By employing an experimental methodology, we are in a position not only to identify the causal role of different psychological dimensions, but we are also able to test the effectiveness of policies designed to improve consumer outcomes. Policies we are able to evaluate are a regulatory bar on complex tariffs as proposed by the UK regulator Ofgem and two nudge manipulations where either advice of the existence of a better tariff or an automatic switch of default tariff takes place.

Tariff complexity matters. It is a function not only of the complexity of the tariff for the individual good, which would fall under the remit of Ofgem’s regulatory bar, but also of whether tied tariffs are provided for two goods rather than one. However, even with simple tariffs we show that, in the presence of a default tariff and of consumer inattention, markets are still affected by large amounts of consumer inertia. Similarly, providing advice on the existence of a better tariff does not improve outcomes. Intuitively, the reason why reducing complexity of the task or providing advice on the task solves the consumer inertia problem only limitedly is because subjects do not pay enough attention to the task in the first place and instead just stick to the default.

A nudge policy of automatically switching default tariffs is a pragmatic and effective solution to obtain better consumer outcomes. The policy automatically changes default tariffs to the optimal one in a given time period, and by doing so it exploits inattention-based consumer inertia to achieve better consumer outcomes while leaving consumers free to choose an alternative tariff if so they wish.