

The Curse of Education

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May, 2008

2 Competition need not be protective

- Firms do not have an incentive to educate or debias consumers if debiased consumers are not profitable
- “Curse of education”: educating the consumer makes her unprofitable.

Examples of education that will make a consumer unprofitable:

- "If you buy this large house, you will be spending too much of your income on housing. Stay in your old house."
- "If you extract more home equity (and spend it on current consumption) you will be spending too much of your income on interest. Don't take out this home equity loan."
- "If you refinance now, you will give up a valuable option to refinance in the future. Don't refinance now."

3 Shrouded attributes

Gabaix and Laibson (QJE, 2006)

- Many contracts/goods have “shrouded attributes” that some people don’t fully consider.
- Buying a printer
 - Some consumers only look at printer prices.
 - They don’t look up the cost of cartridges.

- Taking out a mortgage
 - Some consumers focus on the current interest rate
 - And underweight expected future interest rates

3.1 Shrouded attributes

- Mortgage fees, including closing costs (Woodward 2003).
- Credit card fees and long-term interest rates (Ausubel 1990, Agarwal et al 2006).
- Mutual fund fees: Most individual investors report that they do not know the fees that they are paying (Alexander et al. 1998, Barber et al. 2002).
- Printer cartridges: only 3% of printer buyers report that they knew the ink price per page when they bought their printer (Hall 2003).
- Hotels (phone fees), banking (minimum balance fees), video stores (late fees) (Ayres and Nalebuff 2003, Ellison 2005).

3.2 Mortgage Illustration

- For the purposes of illustration, consider a market with perfect competition.
- Consumers fully weight up-front costs and underweight shrouded costs

Total value of buying house = V

Total perceived cost of mortgage = $p + \beta p_s$

- $0 < \beta < 1$
- Assume that only so much cost can be shrouded: $p_s \leq \bar{p}_s$
- Assume that economic cost of providing loan is c .

Consumer education is not profitable.

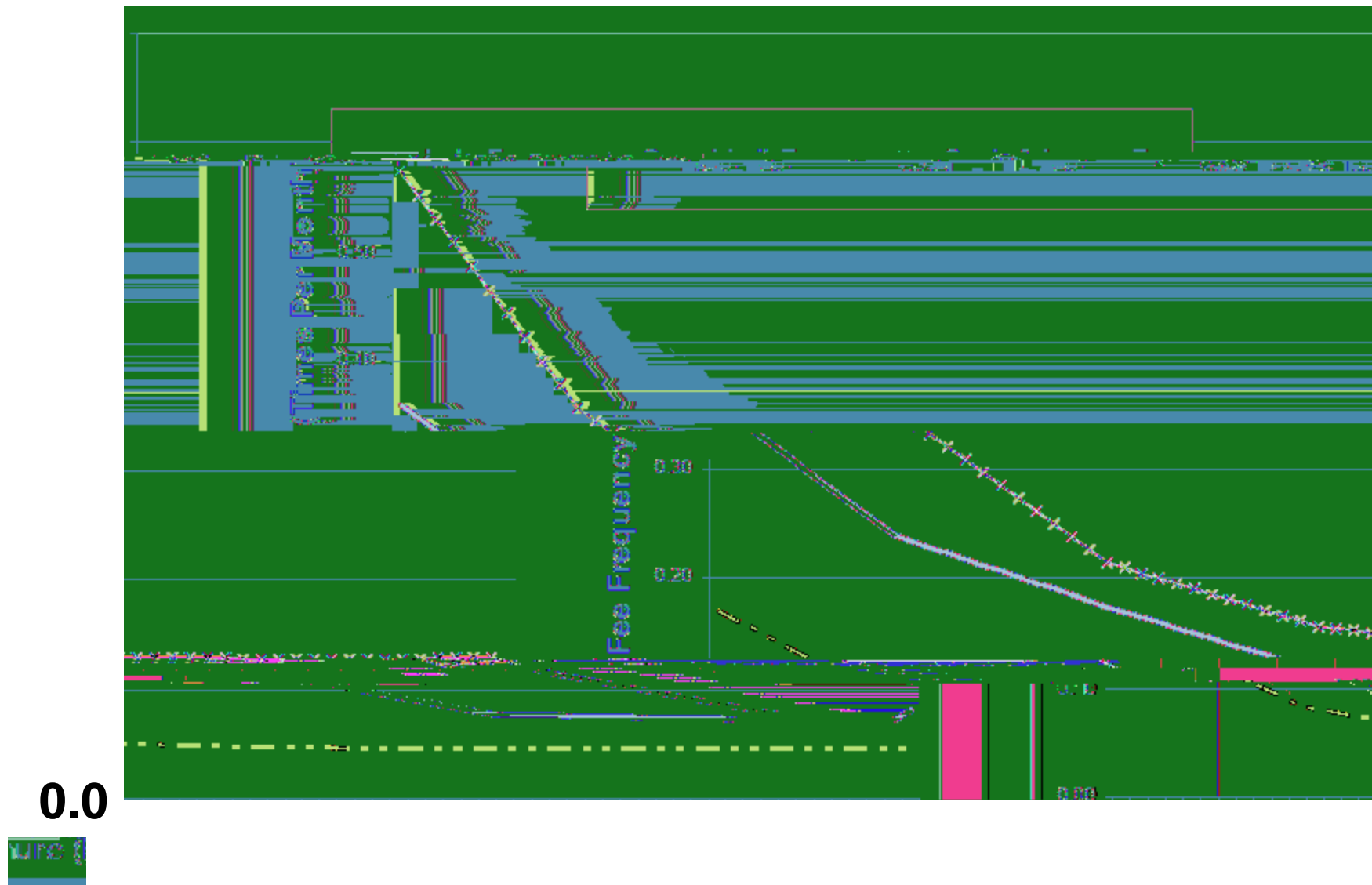
- Unshrouding costs will not win any business, since *perceived* costs rise with unshrouding.
- Unshrouding costs can only lose business for the transparent firm.

Measuring shrouding?

- Consumer surveys
- Structural estimation of normative optimum
- Learning dynamics

Learning to Avoid Fees in the Credit Card Market

Agarwal, Driscoll, Gabaix, and Laibson (2008)



Can the market for advice ameliorate such problems?

- The advice market functions poorly.
- Problem 1: it's hard to separate good advice from bad advice.
- Problem 2: in many circumstances, most of the advice is bad (conflicted, or just plain wrong)

Example of a market for advice: Re-financing.

Agarwal, Driscoll, Laibson (2008)

- Study re-financing advice recommended by 25 leading books and websites.
- None of these sources provide a calculation of the optimal re-financing differential.
- The break-even NPV rule is the only theoretical benchmark.
- Most of the advice boils down to the following necessary condition for re-financing – only re-finance if you can recoup the closing costs of re-financing in reduced interest payments.

4 Regulation

- Solution I: publicly provided consumer education (teach consumers to look for shrouded costs)
- Solution II: regulated transparency (force firms to stop shrouding)
- Skeptical of I (education) and II (unshrouding) on empirical grounds.

SEC disclosure study

Beshears, Choi, Laibson, Madrian (2008)

- Harvard staff were asked to allocate a hypothetical portfolio of \$100,000 among equity and bond funds
- Two randomly assigned treatment groups
 - One treatment group given statutory prospectuses
 - Second group given SEC’s proposed “summary prospectus”
 - “A result should be disclosure that is layered in a manner that allows each mutual fund investor – and each intermediary, analyst and other user – to quickly find and use the information that he or she needs and wants”
Director of SEC division of investment management
- Investment horizon either 1 month or 1 year

Summary Results

- Annual horizon

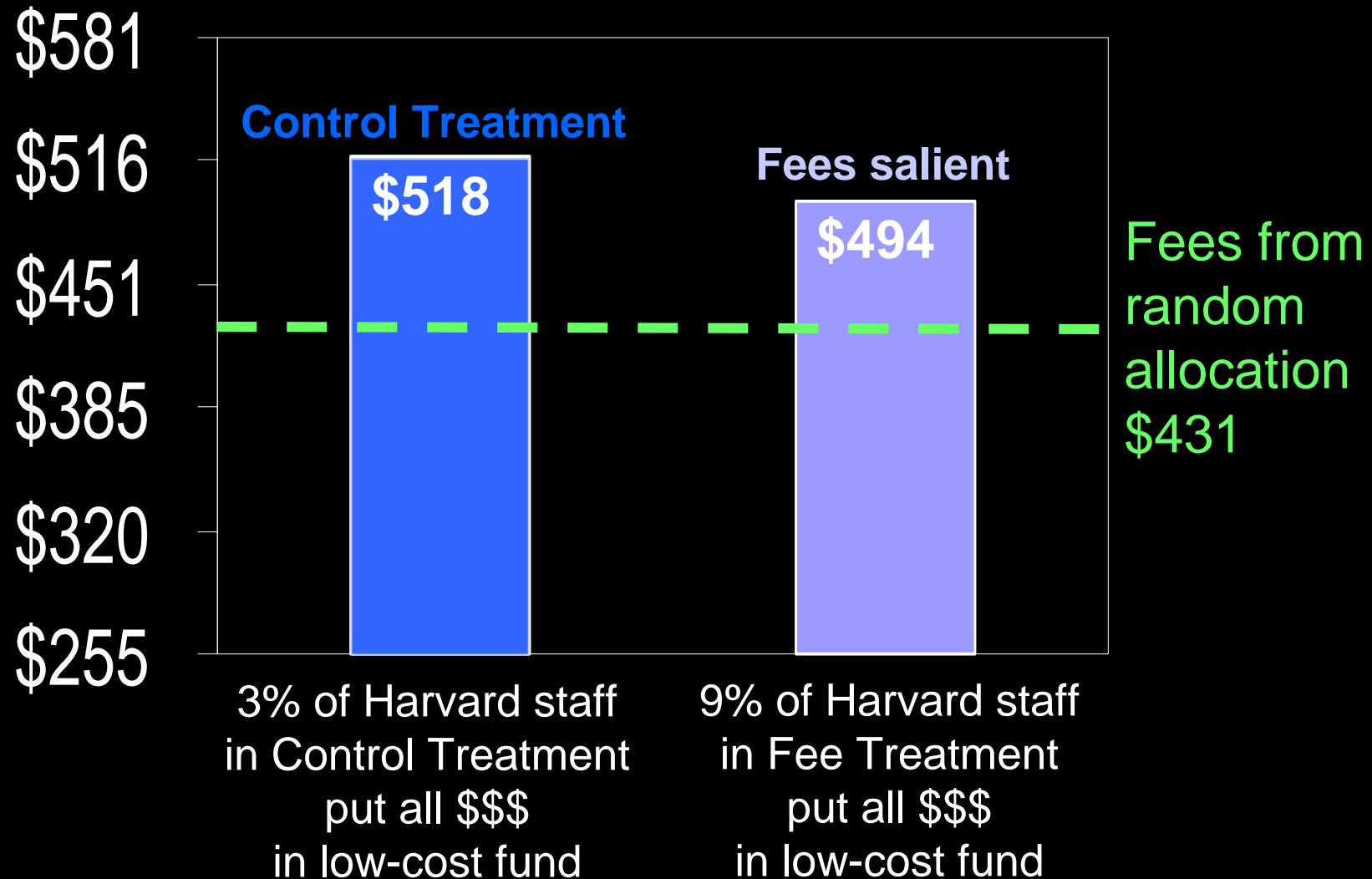
	1.82%	1.82%
Mean fee actually paid	3.73%	3.71%

Fee insensitivity

Choi, Laibson, Madrian (2007)

- § **Experimental study with 400 subjects**
- § **Subjects are Harvard staff members**
- § **Subjects read prospectuses of four S&P 500 index funds**
- § **Subjects allocate \$10,000 across the four index funds**
- § **Subjects get to keep their gains net of fees**

Data from Harvard Staff



- Disclosure does not lead people to choose low fee mutual funds (even when the choice is among index funds).
- Would better disclosure work in the mortgage market?
- Is there some educational intervention that would work?
- A series of educational studies that I have coauthored with John Beshears, James Choi, and Brigitte Madrian has led me to be skeptical that educational interventions pass basic cost-benefit tests.
- We need to study proposed interventions/education/disclosure in controlled experiments (in the field or in the lab) before we make them national policy.