

Discussion of Michael Grubb
“Penalty Pricing:
Optimal Price-Posting Regulation with
Inattentive Consumers”

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Research Question:

What happens if consumers are inattentive?

- A very timing question, applicable to many markets and consumer protection policies
- Ambitious and comprehensive
 - Attentive and inattentive consumers
 - Consumers with correct or biased beliefs
 - Homogenous versus heterogeneous consumers
 - From monopoly to competition
 - Regulators can require price-posting or ban penalty fee

Summary of Results

- Not surprisingly:
 - Firms will exploit consumer inattention and underestimation of demand by imposing steep penalty fee on high usage
 - Firms will exercise price discrimination on heterogeneous consumers
- Surprisingly:
 - If consumers are homogenous and have unbiased beliefs, results are *equivalent* with and without regulation: firms replace penalty fee with other charges
 - In a competitive market with heterogeneous but unbiased consumers, consumer inattention and price discrimination lead to *more* social welfare
 - “transparency” regulations can be more important in redistributing surplus than in enhancing total welfare

Define consumer inattention

- Considered:
 - Consumers do not pay attention to their past usage
 - Consumers are fully aware of their future inattention before contract
 - Consumers have belief on future demand
- Not considered:
 - Consumers may be inattentive to some contract terms before contract
 - Some contract terms may be vague or hidden before contract
 - Consumers may not realize the risk they expose themselves to when they sign a lock-in contract

Comments on consumer protection policies

- If the need for consumer protection policies is driven by consumer underestimation of demand, shall we target consumer education instead of firm regulation?
- Why do consumers underestimate demand?
 - Random occasions in the future
 - Not familiar with the future service
- Will consumer protection policies encourage consumer inattention and generate problems in the long run?

Potential extensions

- Endogenous type of attentive vs inattentive
 - What about allowing inattentive consumers choose to be attentive at contract time (by opt in price-posting)?
- Endogenous demand
 - If demand underestimation is driven by the “addictive” nature of services, penalty fee (and price posting) could limit that addiction.
- The interactive effects of risk aversion, contract lock in, switching cost and inattention
- How does the design of different usage plans depend on consumer inattention and penalty fee restrictions?

Overall

- Really interesting questions
- Provocative results
- High relevance for consumer policies
- Encourage all to read!