

HALF FULL OR HALF EMPTY? POSITIVE AND NORMATIVE TAKES ON INSURANCE BUYER BEHAVIOR

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Prepared for *The Irrational Economist* Conference and Bookwriting
The Wharton School, University of Pennsylvania
December 4 and 5, 2008

Abstract

The conventional economic and decision sciences model of choice under risk usually is presented as expected utility maximization. When it comes to whether consumers do or do not buy insurance, and what types and generousities of coverage they choose, there is plenty of empirical evidence that they do not behave according to the simple caricature in the conventional model. Faced with such empirical evidence, someone trying to explain behavior faces a fork in the intellectual road: should one posit a different kind of utility or choice function for consumers, or should one add constraints on time and money, and limits of information (and epicycles and *dei ex machine*) to provide an EU-based explanation?

Howard Kunreuther and I have spent 25 years trying to explore this question. The back-and-forth, it will come as no surprise, usually has Howard taking the part of an alternative utility function, and me playing the role of looking for modifications to assumptions or additional assumptions that will make the EU model fit (even if we have to lop off some corners, and fold, crease, tear), although sometimes, just for the fun of it, we reverse roles. This friendly argumentative dialog has itself been enormous intellectual fun, but it has also turned up some insights or models we could both agree on which did seem to fit the data. I would offer this personal experience as itself a model of how research should proceed, especially work that wants to carry the label “interdisciplinary” and not reflect the total surrender of one paradigm for another.

A distinct but important dimension of our lifelong discussion has also dealt with the policy question of what governments and markets should do if consumers are behaving in ways different from the EU model. Should it compel or cajole people to do what the EU model says they should do? Or should it respect the preferences of its citizens? Common sense says that some behaviors, like “it will never happen to me” when in fact it will, should be overridden? But what about preferences consistent with prospect theory? Where is the bright line? And from my own public choice background I need to contribute the thought that politicians who want to stay in office may need to cater to voter preferences, however unusual they might be. From time to time we have had the great good fortune to discover an institutional arrangement that will work regardless of what buyers think—like mutual insurance when buyers have different perceptions of loss probabilities. At other time, however, we have had to settle with a conclusion that explains why politics is messy and not always right. This dialog as well—nonpartisan, nonideological, but seeking to explain mysteries in the public insurance economy as well as in the private one—has been fascinating and productive for us.