The Timing of Active-Choice Policy*

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Abstract

This paper analyzes welfare consequences of active-choice policies when a firm can change its strategy in response to a policy. In the model, a firm automatically enrolls consumers in a service and potentially exploits procrastination on their switching decisions. We show that an active-choice policy which has been used in some industries—enabling consumers to make an active choice when they sign a contract—can decrease consumer and social welfare. This is because only sophisticated consumers may opt out of the service under the policy, and hence the firm may increase its future prices for the service to exploit unsophisticated consumers. In contrast, an alternative active-choice policy—enabling consumers to make an active choice when the firm charges a higher price for the service—does not have such a perverse effect of selecting unsophisticated consumers, and hence can increase consumer and social welfare. Our results highlight that the timing of enabling an active choice matters when firms can respond to a policy.

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