

note on how we estimate (should estimate) money measures of utility changes

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Or said more generally, how do we estimate preferences.

To estimate preferences we need

1. Theory
2. as much information as we can collect about individuals' preferences

What is our theory?

ordinal preferences (individual can rank bundles, states of the world)
of all the bundles in the individual's feasible set (those he can afford), the individual chooses a bundle that is ranked at least as high as all other bundles in the set.

This whole theory can be described in terms of an indirect utility function

$$u_i = u(I_i, \mathbf{P}, \mathbf{A}, \mathbf{C}, \mathbf{S}_i, \boldsymbol{\varepsilon}_i)$$

where \mathbf{S}_i is a vector of relevant characteristics of individual i .

As part of estimating preferences (consumer's surplus measures), we impose restrictions on preferences. We typically do this without much influence from the data. That is, we specify a functional form for the indirect utility function (or direct), including its stochastic specification, if any. It is important that we keep in mind that we are making restrictive assumptions about preferences.

Then, collect as much information as we can about the preferences of the individuals in our population of interest.

Population of interest? Defining the population of interest.

Sampling from that population

Your approach to this data collection effort should not be technique based, but rather based on your thoughts on preferences for the commodities of interest, and where information can be

found about those preferences

Ask if behavior is influenced by the changes you want to value

- If you expect behavior to be modified, try and collect data on the allocation of individuals' time and money under different levels of the commodity being valued.

How do we get this information? Either observe behavior (the allocation) or ask them how they allocated (what they did and bought)

- Where else can we obtain information about preferences? We can ask individuals about their attitudes, opinions, and what they would do or pay in a hypothetical setting.

We might ask

Individuals to rank things

Ask wtp or wta questions

Ask contingent behavior questions,
etc.

Get as much information as you can

Then use your theory (both its deterministic and random components), along with all the data you have to estimate preferences and then express them in money terms.

This can lead to some very interesting econometrics because you often have different types of data.

questions?