Abstract:
Regulators often generate quality scores to help consumers with limited information about product quality, as in schooling, healthcare, and financial markets. When designing scores, reg[1]ulators must not only anticipate how they will influence consumer choices but also the resulting impact on firms' incentives to invest in quality. In this work, I draw on theoretical insights, econometric strategies, and computational methods to develop an empirical scoring design methodology. I apply it to a large health insurance market and find an alternative policy which vastly improves the market's performance. The new design coarsens consumers' information about lower-quality insurance options but refines it for higher-quality ones. Changes to avail[1]able product information generate a shift in demand towards higher-quality plans, triggering additional firm investments and making consumers better informed about a menu of superior options. The new design also optimally aggregates different quality dimensions, tackling a multitasking moral hazard problem. The friction is due to firms' (agent) private incentives to attain scores using cost-efficient investments instead of consumer-valued ones, preferred by the regulator (principal). Overall, the alternative policy increases welfare by $669 per enrollee per year. The analysis reveals that simple scores can be remarkably effective if well-designed and provides a method to construct them.