

Estimating The Information Component in
Switching Costs: A Structural Approach
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Conference on Banking Development, Stability, and Sustainability,
Santiago, Nov 2018

- Demand Side: Demand Estimation with Forward-Looking Consumers who face Switching Costs
- Supply Side: FOC of Banks
- Combine the policy change to infer switching costs from reduced form estimations
- Use estimates of switching costs and demand parameters to compute the Welfare consequences of the CAE regulation.

- Switching Costs versus Searching Costs
- What did the CAE Regulation change?

$$U^i(\varepsilon_t) = \rho r_t^i + \max_{j \in \{1, \dots, J\}} \{\varepsilon_t^j - C^{ij} + \beta V(B_{t+1})\}$$

where $V^j(B_{t+1}) = E_\varepsilon[U^i(B_{t+1}, \varepsilon_t)]$

- Single Source of Uncertainty: ε
- Switching Costs favour statu-quo: $C^{ii} = 0$
- No outside good, No New Borrowers.

Reduced Form Regression

$$F(\text{share}_{st}, \text{share}_{s,t+1}, \beta) = G(\beta, \nu) C^{ij} + H(\beta, \nu) \underbrace{\rho E_t(r_{t+1}^j - r_{t+1}^i)}_{\rho(r_{t+1}^j - r_{t+1}^i) + v_{t+1}}$$

Parameters β and ν are not identified. Calibration exercise.

- Allow for more standard uncertainty in prices
- Allow for standard Outside Good
- Allow for New Borrowers
- $\rho E_t(r_{t+1}^j - r_{t+1}^i) = \rho(r_{t+1}^j - r_{t+1}^i) + v_{t+1}$?
- Use GMM to add extra moments that helps to identify β and ν

Standard Monopoly Pricing

$$r_j = MC_j \left(\frac{\epsilon}{\epsilon - 1} \right)$$

- No dynamic considerations, No Switching Costs, (No competition?)
- No typical Trade-Off of Switching Costs as in Farrel-Klemperer.

Demand Estimation for Banks

- Standard Logit Model: No dynamic considerations, No Switching Costs
- Inconsistent with your own Demand Side

- Allow for New Borrowers: Standard Trade Off with Switching Costs
- Use Dynamic Demand Estimation already have.
- Dynamic Supply?

Overall an interesting and ambitious approach to a very challenging problem!