

# With a little help from an anchor Discussion and evidence of anchoring effects in contingent valuation

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## Abstract

Contingent valuation enjoys increasing popularity among transport, environmental and health economists, though the method has often been criticized. We discuss the main points of controversy, with a focus on anchoring effects. Available literature indicates that higher ambiguity, lower familiarity, relevance or involvement with the problem, a more trustworthy source and a more plausible bid tend to be associated with stronger anchoring effects. In two studies among informal caregivers we found that respondents use all sorts of anchors when eliciting their value of time. We end with a discussion of the substantive significance of CV for economics.

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## 1. Contingent valuation

Contingent valuation (CV) enjoys an increasing popularity among economists from different subject areas for eliciting values for commodities that are not normally traded in markets

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or the non-use or existence value that is not reflected in prices. In such cases, economists cannot rely on revealed preferences – the favorite method and have to find other ways to retrieve monetary values for these non-market goods. CV is rooted in applied welfare economics and starts from a hypothetical market situation, asking people to elicit their maximum willingness to pay (WTP) for an additional unit of the commodity under investigation, or alternatively, their minimum willingness to accept (WTA) as compensation for one unit less. It is important to keep in mind that CV is a measure of intention and therefore says more about a person's attitude than about his actual behavior: "saying" and "doing" may differ (Smith, 2003; Luzar and Cossé, 1998). CV has been applied among others to value time and safety in transport economics, to value environmental benefits in environmental economics, and is increasingly used to value health and health care services – which is the domain of this paper. After a brief discussion of the main points of controversy concerning CV, we focus on anchoring effects and provide empirical illustrations from two recent studies. We end with a discussion of the substantive significance of CV for economics. For a general overview of CV, we refer the reader to Mitchell and Carson (1989) and Smith (2000, 2003). For recent applications of CV in health care we refer to Phillips et al. (1997), Diener et al. (1998), Klose (1999), Olsen and Smith (2001) and Olsen et al. (2004).

Application of CV in health economic studies has been promoted at least since the early 1990s (Johannesson and Jonsson, 1991). In spite of its theoretically sound roots and increasing use, CV has often been criticized and the method is still highly controversial in health economics (Frew et al., 2003; Blumenschein et al., 2001; Cookson, 2000). Evidence for the validity and reliability of CV in health care is mixed: evidence is strong for internal validity, but much less convincing for measures of external validity and for test-retest reliability (Klose, 1999; Hanemann, 1994; Diamond and Hausman, 1994). A further concern is that although from the standpoint of conventional economic theory WTP and WTA are equivalent measures of economic value and should therefore generally yield equivalent values,<sup>1</sup> empirical applications have demonstrated a persistent and robust disparity between WTP and WTA elicitation, the latter typically exceeding the former by a 2:1 ratio or more (Sheffrin and Caldwell, 2001; Brown and Gregory, 1999; Bromley, 1995). Many economic and psychological reasons have been put forward to explain for this WTP/WTA disparity (Zhao and Kling, 2001; Brown and Gregory, 1999; Bateman et al., 1997). In brief and broadly categorized:

- (1) Income- and substitution-effects: while in the limit, a WTP elicitation is bounded by the person's income or wealth, WTA could be infinite. Furthermore, the perceived ease with which the good or service being valued can be substituted tends to affect valuation: the fewer substitutes available, the greater the disparity between WTP and WTA (e.g., Hanemann, 1991).
- (2) Ambiguity, regret and risk aversion: the uncertainty generally associated with especially major, not easily reversible and unfamiliar transactions and the accompanying anticipation of regret, makes many people risk averse in their (hypothetical) choice behavior. This leads to lower WTP and higher WTA values. (Brown and Gregory, 1999; Loomes and Sugden, 1982; Zhao and Kling, 2001).
- (3) Endowment effect, status quo bias and loss aversion: overvaluation of a commodity purely due to the possession of that commodity, leads to a reluctance to part with it (Kahneman et al.,

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<sup>1</sup> This may not be true, as exceptions, when the value amounts to a significant proportion of the person's income or in case large transaction costs apply.

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