

JOINING CONSUMER AND COMPETITION POLICIES

**...or ten reasons why competition specialists should
be interested in consumer policy**

**Matthew Bennett and John Fingleton
UK Office of Fair Trading**

9 December 2009

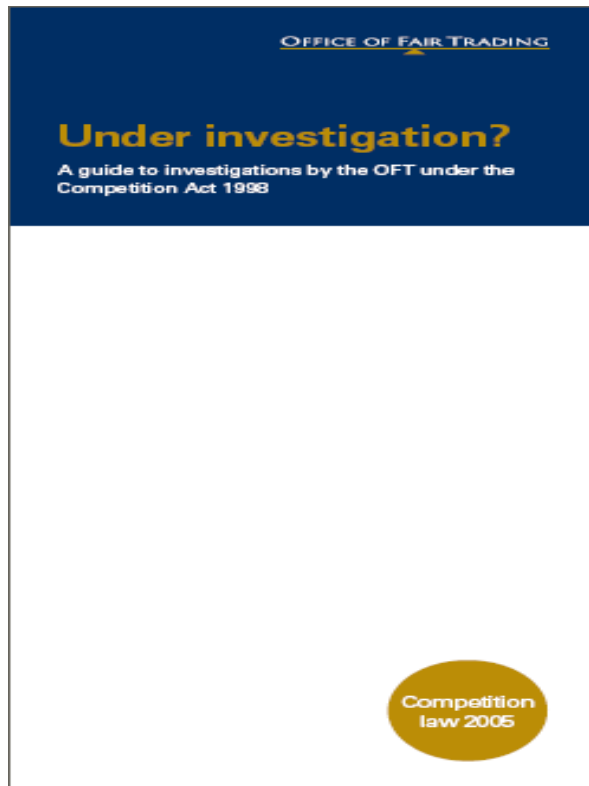
**Charles River Associates Conference on Economic Developments in European
Competition Policy**

Overview

- **Context of consumer work in OFT**
- **Ten reasons for competition practitioners to be interested in consumer policy!**
- **Conclusions**

Context

OFT Competition instruments



- **Anti-competitive agreements (includes cartels):**
 - Chapter I of CA98; Article 81 of EC Treaty
- **Cartel offence and director disqualification**
 - Part 6 and section 204 EA02
- **Abuse of a dominant position**
 - Chapter II of CA98; Article 82 of EC Treaty
- **Anti-competitive mergers**
 - EA02 (previously FTA); ECMR

OFT Consumer instruments



GUIDANCE on the UK Regulations
(May 2008) implementing the Unfair
Commercial Practices Directive

BERR | Department for Business
Enterprise & Regulatory Reform

- **Unfair contract terms**
 - Unfair Terms in Consumer Contracts Regulations (UTCCRs)
- **Unfair commercial practices (Misleading actions/omissions and aggressive practices)**
 - Consumer Protection from Unfair Trading Regulations (CPUTRs AKA UCPD)
- **Consumer Credit Act**
- **Distance Selling Regulations**

Other OFT instruments



- **Other factors that harm consumers or prevent, restrict or distort competition**
 - Market studies and market investigations/EA02
- **Industry specific regulations**
 - Banking (FSMA)
 - Estate agents
- **Softer non-enforcement tools:**
 - Competition advocacy
 - Business guidance (Self regulation)
 - Consumer advice/education
 - Research reports
 - Codes

Why consumer/competition policy?

Why consumer policy?

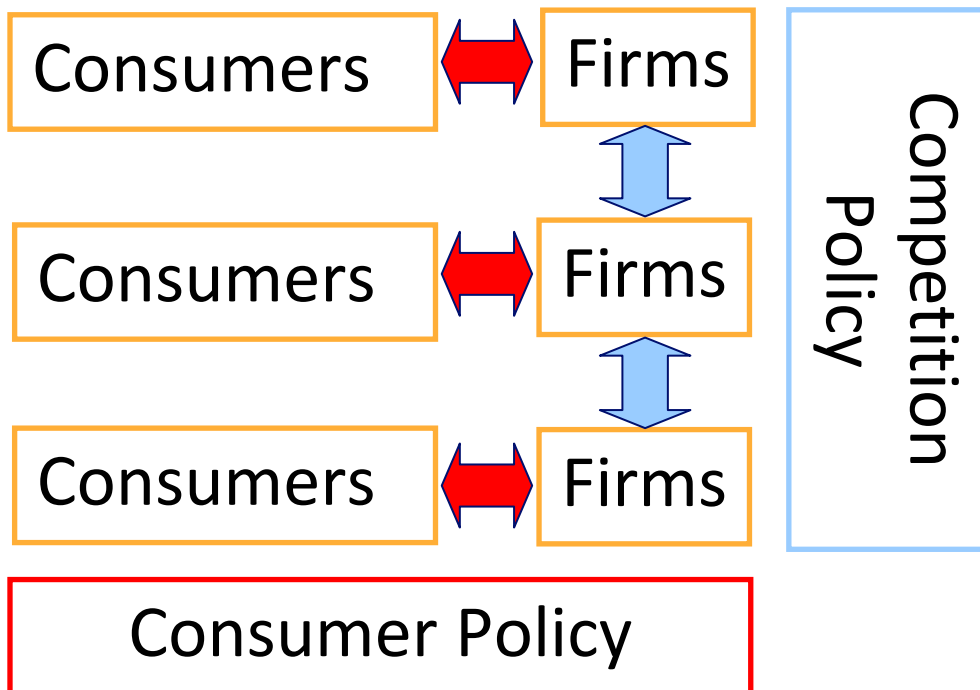
- ensures that firms don't exploit individual consumers or act **unfairly**.
- ensures that consumers can purchase from the most **efficient** firms without fear that they will be **exploited** subsequently.

Why competition policy?

- ensures competition between rivals is **unfettered**.
- ensures that firms can **compete** for consumers
- ensures the most **efficient** firm is able to do the best on the market.

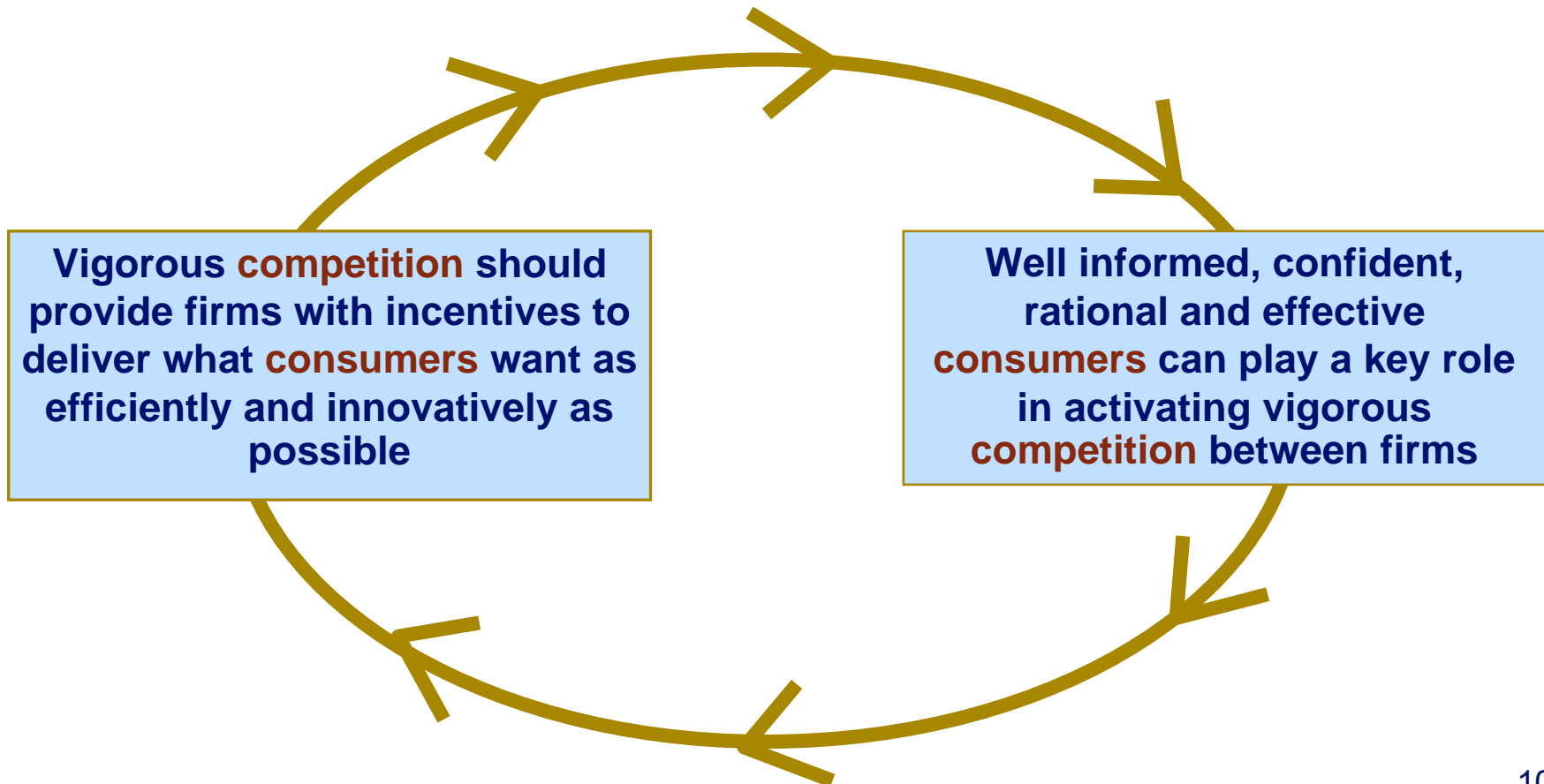
So what are the ten reasons?

Reason One: Competition is only half the picture for a well functioning market (i)



- Competition policy has concentrated predominantly on the relationship between firms.
- Consumer policy has concentrated predominantly on the relationship between consumers and individual firms.
- *Both are required to ensure a well functioning market which implies a need for a more integrated approach.*
- Firms look at competition and consumers together, why shouldn't we?

Reason One: Competition is only half the picture for a well functioning market (ii)



Reason One: Competition is only half the picture for a well functioning market (ii)

- In the UK this trend towards convergence is most clearly seen within market studies:
- PCA Market Study executive summary:

Consumer behaviour... ...A significant number of consumers do not know how much they will effectively pay in bank fees or how individual elements in the charging structure will be implemented, either before or after they are incurred...

impacts banks behaviour... ...this means banks have less incentive to provide better offers on insufficient funds and interests. Without better offers from banks, however, consumers have little incentive to switch."

which impacts market outcome ...The OFT believes that the market may be stuck in an equilibrium that does not work well for many consumers.

Reason One: Competition is only half the picture for a well functioning market (iii)

- **Sale and Rentback market study**
 - *“Many consumers do not shop around, which means that the market mechanisms (price competition, reputational effects) that deliver good outcomes for consumers in many markets are weak or absent.”*
- **Significant issue in Market Investigation References**
 - Liquid Petroleum Gas
 - Payment Protection Insurance



Reason Two: Can we assume the market always solves consumer problems? (i)

- **Generally even most ardent free marketers think that preventing outright scams is a good thing.**
- **BUT...what about practices that may harm consumers more generally?**
 - Do firms have an incentive to 'exploit' consumer ignorance?
 - Can we always assume that firms 'innocent bystanders' in such exploitation?
 - What impact might this have on the wider market – trust?
- **Traditionally, competition economists don't intervene in add-ons:**
 - Chicago aftermarket literature suggests complete waterbed and hence no profit from obfuscating add-on prices.
 - Even if was, Shapiro (1995) has argued that firms would have an incentive to reveal (i.e. obfuscation is not stable equilibrium).

Reason Two: Can we assume the market always solves consumer problems? (ii)

- **New literature suggests assumption that market always solves may be too simplistic.**
- **Several papers looking at relaxing key Chicago assumptions of consumer rationality and commitment.**
 - Borenstein, MacKie-Mason and Netz (2000)
 - Dellavigna and Malmendier (2005)
 - Gabaix and Laibson (2006)
 - Genakos and Valletti (2007)
 - Spiegler (2007)
 - Ellison (2007,2009)

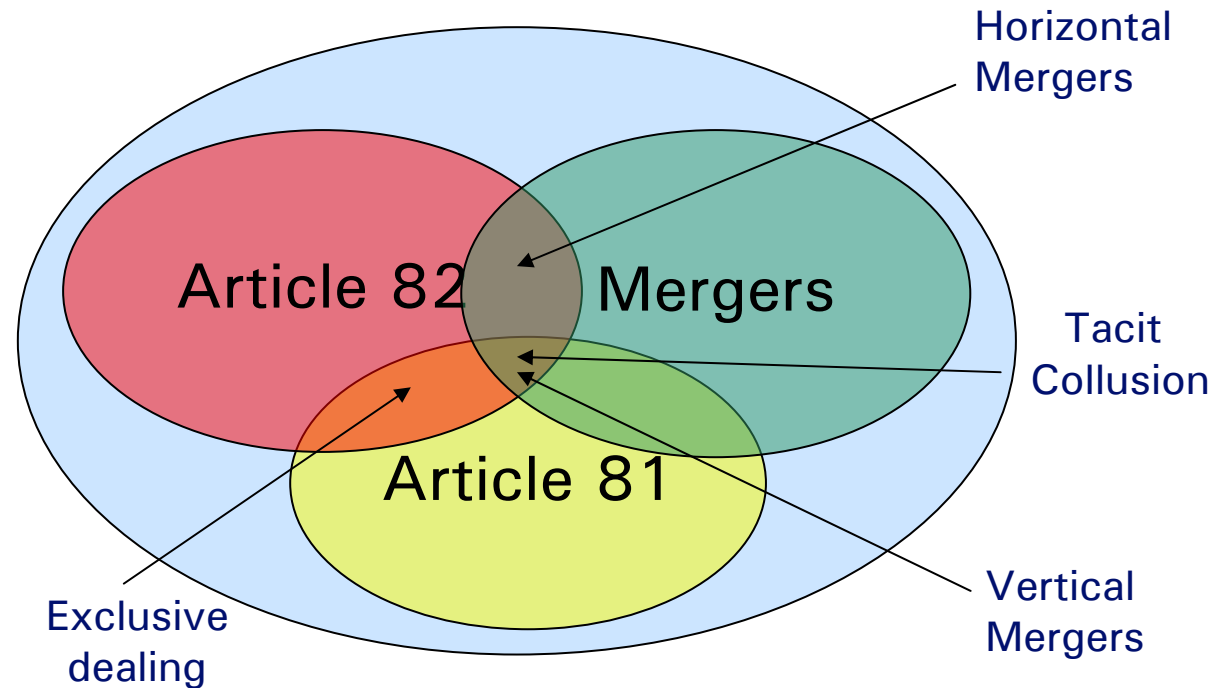
Reason Two: Can we assume the market always solves consumer problems? (iii)

- **Lack of rationality can lead to greater profits**
 - Exploit twice. (Dellavigna and Malmendier)
- **Waterbed is proportional to the degree of competition.**
 - Higher competition greater degree of waterbed. (Genakos and Valletti)
- **Firms have no unilateral incentive to break equilibrium.**
 - Reduce number of profitable naïve consumers who go to other firms (to be cross subsidised) (Gabaix and Laibson).
- **These findings don't all rely on consumer irrationality.**
 - Distortions due to lack of commitment (Borenstein et al)
 - Distortions due to desire to discriminate customers (Ellison)

Reason Three: Consumer instrument may be the best instrument for the job (i)

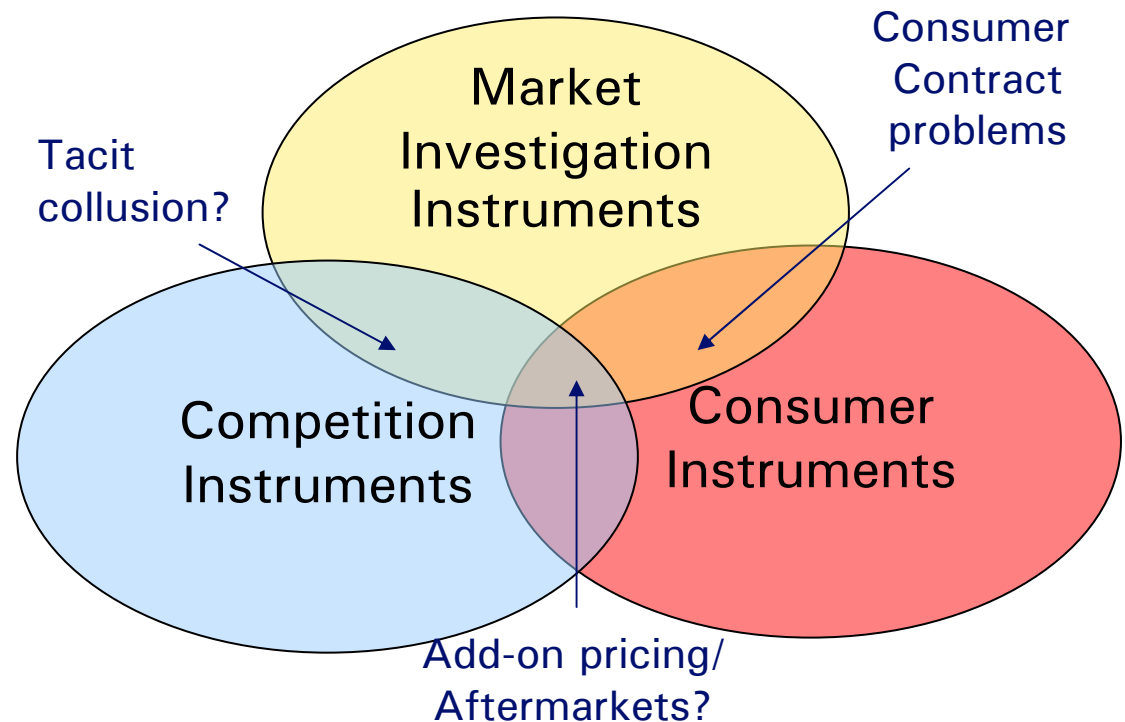
- Competition policy has many overlapping instruments with different tradeoffs when thinking about their use.
- Authorities must choose the right instrument to deal with the issue.

Competition Instruments



Reason Three: Consumer instrument may be the best instrument for the job (ii)

- Same issue occurs across wider set of OFT instruments.
- Nothing fundamentally sacred about each instrument.
- OFT must pick the most effective instrument to deal with the problem.



Reason Three: Consumer instrument may be the best instrument for the job (iii)

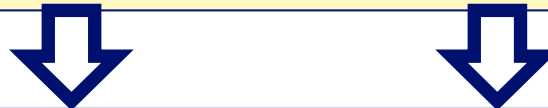


- Intersection of competition and consumer policy potentially seen in Article 82 Prioritisation:
 - *“Conduct which is directly exploitative of consumers, for example charging excessively high prices or certain behaviour that undermines the efforts to achieve an integrated internal market, is also liable to infringe Article 82. The Commission may decide to intervene in relation to such conduct, in particular where the protection of consumers and the good functioning of the internal market cannot otherwise be adequately ensured.”* EC Guidelines on 82 Prioritisation para 7.
- Use of 82 as a way of protecting consumer and enforcing consumer policy or vice versa?

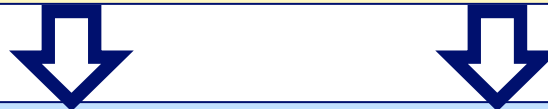
Reason Four: Consumer policy can benefit from lessons learnt in competition policy (i)

- **Consumer policy is increasingly taking into account the wider market implications of firm interaction.**
 - Approach to airlines was to move the industry from a bad equilibrium (not including non-optional costs in upfront price) rather than prosecute individual firm.
 - Sale and Rentback study took a market wide approach.
- **Just because the OFT has the tool to intervene does not mean that the OFT should always intervene.**
 - Is there an 'efficiency justification' for why practices that harm consumers may be necessary/desirable for market as a whole?
- **Prioritisation principles have been expanded from competition work to consumer policy work.**
- **This means understanding extent of any consumer detriment which means embedding economics in what we do...**

Consumers complain about low quality



Consumer enforcement action: Min quality standard



But...may generate potential competition concerns



Limits innovation?



Firms gravitate to one quality level?



Favours Some Firms?



Sets quality too high?



Prevents consumers choosing low quality?

Reason Four: Consumer policy can benefit from lessons learnt in competition policy (i)

- **Market study tool has increasingly been used instead of consumer policy tools in order to address entire market rather than just a single firm.**
- **Self regulation schemes (such as ABTA or ASA), popular to address consumer policy aims, are increasingly being told to ensure that they are compliant with competition policy.**
- **UCPD including a 'black list' of 31 activities banned in all circumstances**
- **Discussion of fines in consumer policy within the UK.**
 - **Macrory opened door to OFT gaining fining powers.**
 - **Still an open issue.**
 - **Much greater consideration being given to deterrence generally.**
- **Need for concurrency regime similar to competition?**

Reason Five: Competition policy benefits from developments in consumer policy (i)

1. Consumer policy very good at looking at how consumers *actually* behave.
- Competition policy models have some way to catch up on this regard:
 - Most models of firm interaction assume 'rational consumers'.
 - Consumer behaviour assumed exogenous from firms behaviour.
 - Competition policy empirical analysis is much better, but often used to inform theoretical models that assume rational consumers.
- Does it matter?
 - Many of the Chicago critique results don't hold up in the face of non-rational consumers.
 - Aftermarkets 'one monopoly' rent theory falls away in presence of consumers unable to see or predict prices in the aftermarket.
 - May impact on the risks of type one and type two errors.

Reason Five: Competition policy benefits from developments in consumer policy (ii)

2. **Non-structural remedies need to consider actual consumer behaviour.**
 - Behavioral biases may drive consumer inertia, but different biases imply different remedies.
 - More information does not necessary equate to better consumer behaviour and hence more constraints on firm – more could mean less. Telephone Directory Inquiries example.
 - Better consumer remedies that engage consumers may imply less interventionist/more effective Article 82 remedies.
- **Implication:**
 - Importance of testing remedies for effectiveness rather than assuming effectiveness. OFT report.

Reason Five: Competition policy benefits from developments in consumer policy (iii)

- **December 2002 deregulation of directory inquiries led to 200+ new entrants**
 - Average prices went up
 - Quality went down
 - Complaints increased
- **May have been offset with innovation?**
- **Basic issue was how do people know prices charged by providers?**
 - Overall cost in relation to telephone bill small
 - Takes time to check even one provider's prices
 - Even incumbent's prices went up from 40p to 51p with new entry!
- **Well meaning introduction of competition needed to be complemented with better understanding of consumers and information.**



Reason Six: Economic crisis likely to increase pressure for consumer intervention

- **Exploitative abuses? Reinterpretation to consumer policy?**
 - Has the pendulum swung back on exploitative abuses?
- **Current environment has increased government concern that consumers are not being fairly treated by firms.**
 - Use of the word 'fair' and calls for companies to act 'responsibility'.
- **Several governmental initiatives in this area:**
 - Consumer White Paper (BIS)
 - Financial Stability Paper (HMT)
 - Implementation of Consumer Credit Directive (BIS)
- **Important to ensure baby is not thrown out with bath water!**



Reason Seven: Area of growth for claims companies (otherwise know as big bucks!)

- Increasing sums of money at stake.
- Companies starting to specialise in follow on claims for large consumer protection cases.

Claim Back Mis-Sold Payment Protection Insurance... Today!

If you have a loan or finance agreement you could be due thousands of pounds in compensation.

 Start Your PPI Claim
it's quick and easy

DO THEY OWE YOU MONEY?
DID THEY MAKE YOU FULLY AWARE WHEN YOU BOUGHT

ENDOWMENT MORTGAGES..... Yes / No
STATE EARNINGS RELATED PENSION SCHEME...(SERPS)..... Yes / No
PROTECTED PAYMENTS INSURANCE...(PPI)..... Yes / No
HAVE YOU PAID EXCESSIVE BANK CHARGES..... Yes / No

If the answer to any of these questions is **YES** Then they probably **DO** owe you **MONEY**
What can you do about it... [Click Here](#).

RIGHT CONCLUSION LIMITED MISOLD EQUITIES
www.rclme.com
robert@rclme.com
Tel: 0208 133 7056
Regulated by the Ministry of Justice Reg No. CRM8855

Your Bank Charges Claimed

No Win No Fee
(cancellation charges may apply)

No Upfront Charges

Reason Eight: Changes in OFT are likely to increase number and size of cases (i).



- **Consumer enforcement is not all about rogue traders**
 - Banks case
 - Airlines
 - Manchester United
 - Foxtons
- **More significant for Trading Standards Services**
- **Key area for OFT**

Reason Eight: Changes in OFT are likely to increase number and size of cases (ii).



GUIDANCE on the UK Regulations
(May 2008) implementing the Unfair
Commercial Practices Directive

BERR | Department for Business
Enterprise & Regulatory Reform

- **OFT restructure.**
- **Increased use of economics in consumer policy.**
 - Prioritisation
 - Efficiency justifications
- **Enforcement:**
 - Court orders
 - Criminal sanctions
- **Greater role for wider deterrence in consumer enforcement?**

Reason Nine: Interesting questions: Allocation of responsibilities?

- **Should firms be held responsible for irrational consumer behaviour?**
 - *“not only that the typical customer is reasonably well-informed and reasonably observant and circumspect, but also that he or she is taken to read the relevant documents and to seek to understand the contractual terms from that reading”* (COA Banks para 117, and Foxtons para 29).
 - But... we also know from economic literature that firms can profit from confusing customers and consumers don't always understand terms as COA in Foxtons acknowledged.
- **Where do firms' responsibilities end and consumers' rights/responsibilities start?**



Reason Nine: Interesting questions: What if there is a waterbed?

- If profits made through penalties are competed away in the 'core-market' (the waterbed) does this make the contract fair?



- Chicago school criticises Kodak case because Kodak didn't have market power in the primary market. Any profits are competed away to the benefit of customers.
- But recent literature suggests that profits are unlikely to be completely competed away, and even if they are, there are allocative inefficiencies in the market.
- Even if no efficiency issues, consumer policy still raises questions if a minority of consumers incurring penalties subsidising all consumers. Is this fair? What would an 81(3) type analysis imply?

Reason Nine: Interesting questions: How do you remedy irrational consumers?

- **If the problem lies in irrational consumers, can this be remedied?**
 - Behavioural solutions, transparency and consumer education?
 - Market structure solutions, PPI?
 - Strike the term out of the contract?
 - Allow the customer to break the contract with minimal costs?
- **How do we road test such remedies?**

Reason Ten: Its simply not going to go away...more changes on horizon!

- **Macrory report.**
- **Consumer White Paper.**
- **More European legislation.**
 - Consumer Rights Directive.
 - Consumer Credit Directive.
- **DG Sanco more pro-active.**
 - Behavioural economics unit.
 - Consumer Scoreboard.
 - Potentially sectoral inquiries.



Conclusions

- **Getting the right answer or better answers.**
 - We need a holistic analysis that looks at both firms' and consumers' behaviour and incentives.
- **Using the right instrument where we find a problem.**
 - Avoid unnecessary intervention - each should be less interventionist if the other is done well.
 - Avoid the wrong intervention - hammer and screw.
 - Avoid inconsistent intervention - where each policy creates its own solution.
- **Competition policy brings economics and structured analysis of effects to consumer policy which in return brings understanding of consumer behaviour to competition policy.**

Conclusions

- **Feedback and balance over time.**
 - If competition policy succeeds in creating more competitive markets, may expect an increased need for consumer protection to avoid a race to the bottom.
 - In other direction, over protection of consumers can lead to dependency, and less ability for competition to deliver. Less faith in markets, implies running to government to solve issues.
- **Big philosophical questions remain about where responsibilities begin and end, to solve this there is a role for:**
 - Economic and legal thought and analysis,
 - Agencies to ask the right questions,
 - Courts to give good answers.

Much improvement needed in all three of above.

Any questions?