Session 2: Emerging Issues in Consumer Protection: New Conceptual Frameworks

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Emerging Issues in Consumer Protection: New Conceptual Frameworks

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What does competition policy gain from consumer policy?

- Richer understanding of consumer detriment and consumer interaction with firms
- Learning about how consumers actually behave
- Accounting for perverse effects
- Alternative remedies
What does consumer policy gain from competition policy?

- Guards against over-enforcement
- Diagnosis of market origins of consumer problems
- Better understanding of private sector market responses
- Consumer detriment can be analysed with additional economic rigour
Joining up competition and consumer policy

Vigorous competition provides firms with incentives to deliver what consumers want as efficiently and innovatively as possible.

Effective consumers play a key role in activating vigorous competition between firms.
What is behavioural economics?

- **Homo economicus vs homo sapiens**
- **Irrational and imperfect consumer behaviour**
  - Heuristics
  - Biases
  - Imperfect information
  - Loss aversion
- **Bounded rationality**
- **Consumer protection, competition law and behavioural economics are all concerned with choices**
Improving consumer decision making

1. Access relevant information
2. Assess it (or not!)
3. Act on it

**Behavioural biases**
- Inertia
- Access complexities
- Limited memory

**Behavioural biases**
- Myopia
- Over-confidence
- Framing/anchoring
- Choice overload
- Calculation inability
- Lack of self-control

**Learning**
- Misperception of desired attributes
- Misperception of desired quantities
- Misjudgement of quality
- Misjudgement of prices

**Competition**
- Reference points and loss aversion

**Standardisation**
- Inertia

**Information**
Behavioural economics at the OFT

● **Research**
  - What does Behavioural Economics mean for Competition Policy? (OFT1224)
  - The impact of price frames on consumer decision making (OFT1226)
  - Advertising of Prices (OFT1291)
  - Consumer behavioural biases in competition: A Survey (OFT1324)

● **Key examples**
  a) Price framing
  b) Personal current accounts
Price framing

- **Value is an abstract concept.** People use cues from the world around them to decide if an offer is good or bad value

- **Price framing** - the way in which prices are presented - therefore **has the power to influence and mislead**

- Misleading price frames may lead to consumers **spending more than they need to, buying a product which is not best for them, wasting time or suffering annoyance, disappointment or regret**

- Misleading pricing is not only bad for the consumer, it is also **bad for competition**, and creates an uneven playing field between fair dealing businesses and those that push the boundaries too far
The OFT 2010 price frames study

● In December 2010 the OFT published a study focusing on the impact of price frames on consumer decisions. The study:
  - Explored the behavioural psychology literature on how price frames trigger behavioural biases
  - Included an economic experiment to measure how search and purchasing decisions are affected by price frames, and
  - Surveyed 3000 consumers about their experience and attitudes toward price frames.

● 6 price frames were considered: Drip Pricing, Reference Pricing, Time Limited Offers, Volume Discounts, Complex Pricing/Tariffs and Bait Pricing

● Drip pricing was found to have the most egregious effects
An overview of drip pricing

Still a bargain at twice the price?

Drip pricing triggers a number of common behavioural biases:

- Anchoring
- Endowment effect
- Commitment and consistency

Overall, drip pricing results in:

- Consumers making the wrong choices
- Firms competing on the wrong dimensions
- Reduced switching

Ticket price: 20 euros
Payment charge: 10 euros
Admin fee: 10 euros

Still a bargain!
The effects of drip pricing

- Psychology literature identifies a number of effects on consumer behaviour triggered by drip pricing:
  - Higher demand and perceived value of the deal
  - Lower recall of the total price
  - Reduction in shopping around and comparing prices
  - Increased difficulty in comparing total prices
  - Strengthened belief that, as the consumer is choosing a product based on their particular need, prices will be about the same everywhere
  - Consumer purchasing decisions are driven by who has the cheapest headline prices – disadvantaging firms that include all charges in the headline price
Personal current accounts

● 2008 market study looked at ‘the psychology of personal current accounts’ (OFT1005e)

  - Over-optimism: Do consumers underestimate the likelihood of triggering charges?
  - Myopia: Do consumers overly discount the future when choosing provider?
  - Calculation inability: Are consumers unable to calculate what charges will mean for them?
  - Failure to learn: Are consumers unable to learn about liability and extent of charges?
OFT action to improve switching

- Steps to reduce problems that arise from transferring Direct Debits
- Measures to reduce the impact on customers of any problems with transferring Direct Debits
- A new consumer guide and website on switching accounts
Complementarities and tensions

- Care is needed and behavioural economics is not a substitute for traditional analysis
- But both competition and consumer policy can benefit from stronger understanding of real consumer behaviour
- Behavioural economics can be particularly useful when looking at new markets where:
  - products are heterogeneous
  - pricing is complex
  - information is poor
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