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Consumer protection and competition policy

Note by the UNCTAD secretariat*

Executive Summary

Both competition and consumer policies act to protect consumers' well-being and are usually mutually reinforcing. Competition policy seeks to spur suppliers to offer better deals to consumers. Consumer policy aims to suppress deception and other conduct and market conditions that impede effective consumer comparison- and decision-making, while providing consumers with tools to make more informed choices. However, remedies for one policy can inadvertently impede the attainment of the other policy's objectives. New products, new pricing and marketing practices and new understanding of their effects on consumer decision-making can suggest a re-evaluation of policy interventions.

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Contents

Introduction

1. Both competition and consumer policies act to protect consumers' economic interests. Competition policy seeks to help markets work better, and consumer policy aims to protect consumers against deceptive and fraudulent conduct and to help consumers choose in accordance with their preferences and interests. If consumers can compare offers adequately and make buying decisions that reflect their preferences, then they can effectively drive sellers to make offers that better serve their requirements. Thus, more effective consumers spur more effective competition. In addition, if firms vie to provide competitive products that follow consumer interests such as safety, then competition supports other consumer protection objectives. However, if consumers are vulnerable to deception, then sellers may compete in ways that are not beneficial to consumers. Likewise, if consumers face a dominant supplier or a cartel, or if competition does not prevail in upstream markets or at the international level, then consumers are likely to be harmed.

2. Parts of consumer policy can be seen as competition policy on a human scale. For example, a seller using high-pressure sales tactics such as making an offer that is valid only at a certain instant, or bait-and-switch, where an advertised object is unavailable so customers are steered toward a pricier version, exploits consumer biases in ways that can result in consumer detriment. In prohibiting these forms of conduct, consumer policy improves the ability of consumers to make decisions that more accurately reflect their underlying preferences, thereby enhancing their market power: It is therefore, at this level, a microcompetition policy.

3. However, one policy's remedies can sometimes have implications in the other's domain. For example, consumer policy includes the development of standards to protect consumer interests. If standards are set too high, they could exclude safe but lower-quality competing products. A second example is introducing consumer choice in electric power markets to promote competition. The low rates of consumer switching in some markets raises the question of whether both competition and consumer protection goals would be better achieved by consumer education and or by a different design of default and switching rules, usually seen as consumer policy tools, based on their implications on competition.

4. Greater institutional cooperation between competition and consumer policy authorities may engender better coordination of investigations and remedies. For example, a consumer contract that makes switching suppliers unexpectedly difficult may not only affect consumers' economic interests but also competition and market entry. A shared perspective may help identify a better policy framework and remedy to promote both policies' objectives. Further, informal discussions may lead to better analyses. Effects-based analysis in competition policy mostly relies on industrial organization economics, which assumes rational actors without cognitive limits, whereas in consumer policy there has been more acceptance of behavioural economics, which relaxes these assumptions.

5. The mobile telephony market in Zambia, as reported in preliminary research on consumer experiences, illustrates the role that information could play in empowering consumers.[1] Despite three competing networks, interviewees were dissatisfied with service quality and prices. Few of the interviewees knew the prices of the various services, and some did not know how to ascertain them. The price of a text message was unpredictable

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[1] Mukosa D and Lewis C (2010). Empowering regulators to protect consumer rights in the ICT sector. Working paper. University of Zambia and LINK Centre, University of the Witwatersrand, South Africa.

since charges were sometimes incurred for undelivered messages. Only a minority knew where to lodge consumer complaints or that a responsible regulator existed. Illiterate, low-income and rural persons exhibited different consumer disadvantages. In sum, consumers seemed to lack the information to make good choices, and competition did not deliver what interviewees wanted.

6. This paper addresses the interactions between competition policy and consumer policy to provide an overview for the topics to be further discussed during the first Ad Hoc Expert Meeting on Consumption Protection on 12 and 13 July 2012. The focus is on final consumption markets that may generate consumer protection concerns. Two types of market are particularly relevant. One type is where information is imperfect, i.e. where information about product characteristics and prices is not known to everyone. An example is dental services, where a consumer may not discover the quality until years later. Another example is markets, where consumers live in small, geographically or linguistically isolated communities, where they incur high costs getting information about competing offers. The second type of market is where consumers may have decision-making biases that discourage searching for competing offers or that make it difficult to assess and compare competing offers. An example is mobile telephony services, where the plethora of time of day, on-/off-network, starting-/subsequent- minute, voice/text/data and other pricing variations makes it difficult for a consumer to choose the best offer for his use pattern. Consequently, consumers often use rule of thumb to decide. The focus on these two types of market does not obscure the general observation that, if anti-deception and anti-fraud laws are in place and applied, then competition delivers good outcomes for consumers in many markets.

7. The paper covers a limited number of topics and therefore several extensions are possible.[2] For instance, unfair competition policy may also interact with consumer protection and competition policies, as in the case of misuse of trademarks or disparagement. In addition, the paper does not cover competition issues in intermediate or upstream markets related to final consumers' interests or discuss matters of access to basic services or international issues, such as cross-border mechanisms of dispute resolution and redress.[3]

8. The rest of the paper is organized as follows. First, the objectives of competition and consumer policies are compared. Next, two types of market, where consumer policy interacts with competition policy, are discussed. Then, the discussion is applied to insurance and savings products, remittances, counterfeit medicines and unsafe consumer products. The paper ends with conclusions and policy options.

[2] Some of these possible extensions are expected to be covered by participants during the Ad Hoc Expert Meeting on Consumption Protection on 12 and 13 July 2012.

[3] Growing opportunities for consumers from e-commerce and international retail give rise to initiatives of international cooperation and cross-border mechanisms of resolution and redress. Experiences such as the Cross-border Consumer Centre in Japan, or the Mesa Andina, an ongoing project in the Andean Community (Peru, Ecuador, Colombia and the Plurinational State of Bolivia) to create mechanisms for consumer protection agencies to exchange information and for mutual recognition of case evidence, should provide important insights in this area.

I. Consumer protection and competition policies: Objectives and institutions

9. Consumer and competition policies pursue related objectives. Consumer policy means, broadly, to protect the legitimate needs of consumers.[4] Consumer policy tools include suppressing unfair market practices and providing consumer information, education and redress.[5] While consumers are increasingly empowered to defend their rights as customers, in many developing countries, the problems of consumers are still more related to the provision of essential services.[6]

10. Competition policy should enhance consumer or total welfare. Consumer welfare is higher when the price is lower, all else being equal, and can also be enhanced through quality innovation and range of choice resulting from intensive competition.[7] However, the origin of low prices may sometimes compromise consumers' economic interests if competition in related economic areas does not prevail.[8]

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[4] The *United Nations Guidelines for Consumer Protection* identify the legitimate needs of populations as:

(a) The protection of consumers from hazards to their health and safety;

(b) The promotion and protection of the economic interests of consumers;

(c) Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs;

(d) Consumer education, including education on the environmental, social and economic impacts of consumer choice;

(e) Availability of effective consumer redress;

(f) Freedom to form consumer and other relevant groups or organizations and the opportunity of such organizations to present their views in decision-making processes affecting them;

(g) The promotion of sustainable consumption patterns

[5] The *Consumer Policy Toolkit* (2010), published by the Organization of Economic Cooperation and Development (OECD), contains these concepts.

[6] The global federation of consumer groups, Consumers International, defines consumer policies as being directed towards the satisfaction of eight consumer rights. These are understood as rights to:

(a) The satisfaction of basic needs;

(b) Safety;

(c) Choice;

(d) Redress;

(e) Information;

(f) Consumer education;

(g) Representation;

(h) A healthy environment

[7] Consumer welfare and total welfare are economic concepts defined with respect to markets. Total welfare in a given market is consumer welfare plus suppliers' surplus. Consumer welfare is consumer surplus aggregated across consumers, where consumer surplus is the difference between a consumer's willingness to pay and price.

[8] This would be the case, for instance, of agricultural dumping, where subsistence farmers may be dramatically harmed in their consumption choices (see footnote 13), or when the presence of subsidies to infrastructure services, which may only help a better off minority, at the expense of other consumers' welfare.

11. Consumer detriment links these two strands. The concept developed out of work to quantify the detriment to consumers of harmful commercial practices in order to help steer consumer policy interventions.[9] A recent definition is "[The] loss in economic welfare [incurred by consumers] if they are misled into making purchases of goods and services which they would not otherwise have made or if they pay more for purchases than they would if they had been better informed"[10] While the definition links consumers' economic losses from deception to consumer welfare, other concerns, such as health, safety and privacy, could be incorporated by giving them monetary value.

12. The *United Nations Guidelines for Consumer Protection* and the *United Nations Set of Principles and Rules on Competition* (TD/RBP/CONF/10/Rev.2) recognize the relationship between the two policy domains. Illustratively, while the former asserts that "governments should encourage fair and effective competition in order to provide consumers with the greatest range of choice among products and services at the lowest cost", the latter includes the objective "to protect and promote social welfare in general and, in particular, the interests of consumers in both developed and developing countries" .

13. The coverage of consumer protection laws differs. There is no definition for "consumers" in the *United Nations Guidelines for Consumer Protection*. While consumer protection laws generally cover natural persons in their household setting, some laws extend coverage to natural persons in their roles as sole proprietors or subsistence farmers.[11] It is argued that the concerns related to health, safety, economic interests, asymmetric information, cognitive biases and access to redress are similar in these settings to those in the household setting.

14. Policy tools partially overlap: Both policies use market studies, advocacy, guidelines and law enforcement. Indeed, authorities, including the OFT, have found that market studies and sector enquires are extremely useful as a dual competition-consumer tool. Consumer investigations are apparently more numerous but less resource intensive. This has been acknowledged by a number of authorities, including the Australian Competition and Consumer Commission, as an opportunity to fully develop team skills along more frequent less complex cases in the area of consumer protection, which can later be applied in the area of competition. Consumer authorities also partner with consumer organizations to deliver information and advice to consumers[12] and provide consumer redress.

15. Responsibility for competition and consumer protection policies may lie with a separate or a common agency; it may also be either general or sector specific. For example, a telecommunications regulator may also be responsible for competition and consumer protection policies in that sector, as in Zambia. Also, financial regulators in many countries have been given the main role in the protection of consumers in this sector. The respective agencies can cooperate by sharing or referring complaints or information. When a complaint is received, it may be unclear whether the concern is better addressed through a competition or consumer protection framework, raising some coordination challenges. For example, if a consumer complains that he or she can buy repair parts only from the original supplier, does that constitute deception – he/she would have chosen differently if he/she

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[9] Office of Fair Trading (OFT) (2000). *Consumer Detriment*. OFT296.

[10] OECD (2010). *Consumer Policy Toolkit*, p. 52.

[11] India, Consumer Protection Act of 1986, section 2(1)(d), provides the same protection of goods and services bought for earning a livelihood as for personal or household consumption. Other examples, for example, China and the Philippines, can be found in Approaches to consumer redress, manuscript, UNCTAD secretariat (2010).

[12] A concern is the appropriateness of the media used to deliver consumer education to the target group. Elderly, illiterate or minority language inhabitants may need different approaches compared with urban, Internet-savvy youth.

had known the aftermarket was monopolized – or is it a competition problem – barriers to entry and monopoly in the aftermarket? Consumer organizations may report not just consumer, but also competition problems. Forwarding complaints and sharing the results of investigations, where appropriate, between relevant agencies can make it easier to apply the most suitable policy framework.

II. Markets where competition and consumer protection policies may interact

16. In many markets, competition delivers good outcomes for consumers, provided general contract law and anti-deception laws are in place and enforced.[13]

17. Redress plays an important role for consumer rights to be observed by firms. The creation of new substantive rights by means of consumer protection laws is meaningless unless the beneficiaries of these rights are in a position to enforce them when necessary. Without redress, consumer rights can be ignored with impunity.[14]

18. The markets of interest here, however, are those where there is a greater likelihood of both competition and consumer protection policy interventions, on substantive matters other than redress and contractual compliance. Thus, attention is restricted to markets with final consumers, and within the universe of consumer markets, to those with elevated risk of consumer protection issues.

19. When competition and consumer policies are brought together, they reinforce each other. Furthermore, in certain cases, coordination is the only way to achieve the ultimate policy goals, since one policy area can be the key to achieve the objectives of the other.

20. The firsts markets of interest are those where consumers do not know the true quality of the goods or services on offer, i.e. markets with imperfect information. Not all such markets fail; there are institutional fixes. For instance, stores advertise their prices, and respected stores stake their reputations on the quality of the products sold. In these markets, however, unscrupulous sellers may find it profitable to mislead consumers.

21. The second type of market of interest relates to the one where consumers may be prevented from making choices in accordance with their own preferences. Pricing can be complex, as in the aforementioned Zambian mobile telephony market, or complexities may be at the level of contracts, as with some financial products.[15] Another possibility is that consumers may misperceive the likelihood that they will incur a particular charge such as a

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[13] In many countries the application and observance of contractual terms and norms of consumer protection may not be the general case. If so, attention should be given to transaction costs (time and money) that consumers face in order to access redress, before the company or tribunals, and to obtain solutions or sanctions after deception.

[14] Redress mechanisms and claim procedures may impose an excessive burden on consumers at the extent of making them impracticable. Firms, in particular, may either increase or decrease the concerning transaction costs for consumers. Well-informed consumers, however, help encourage firms to offer good standards of customer services, including facilities for redress, when necessary. Yet the main factor favouring the exercise of substantive consumer rights is that adequate redress rules and mechanisms are in place along with the scope of actions of consumer organizations. Regarding dispute resolution, the use of judicial mechanisms is costly, and it generally has less impact than alternative mechanisms developed by governments, industry and consumer organizations, such as statute-based tribunals, arbitration, mediation, statutory ombudsman schemes and voluntary ombudsman schemes.

[15] Standard form consumer contracts may be necessary for the reduction of transaction costs, but their complexity could favour the introduction of controversial terms affecting large groups of consumers.

late fee, or suffer a particular event such as an accident. Unscrupulous sellers may exacerbate the situation. They may increase the complexities, reduce comparability or hide charges in the small print, thus creating the false illusion of a good deal.

22. This section discusses the competition and consumer protection issues related to markets with incomplete information and the main result when consumer decision-making biases affect competition. It argues that increased consumer information helps both consumer protection and competition, and that decision-making biases that hinder consumer search for better offers can imply, counter-intuitively, that more competition harms consumers.

A. Markets with imperfect information

23. Consumer policy interventions are common in markets where consumers do not know the true quality of the products on offer. Products are conventionally categorized according to which aspect of the information asymmetry is most relevant:

(a) Search goods are goods that make it easy to ascertain pre-purchase attributes;

(b) Experience goods are goods for which is costly to get information about the product before use but easy to observe attributes after use;

(c) Credence goods are goods of which, even after use, the consumer does not know all the attributes or qualities.

B. Search goods

24. With search goods, it may still be costly for a consumer to learn about the price and quality of alternative offers, as with the presence of transport costs or when information on goods and prices is not easily found. Where search costs are high, consumers are less likely to search for a better offer and, if they do switch away from a price-raising seller, are less likely to continue their search until they find the lowest-priced competitor. Even small search costs may deter consumers from shopping around, when the number of products subject to search is large. Consequently, competition is less intense and high prices can persist in a market despite the presence of multiple competing sellers.

25. Studies[16] comparing prices over the Internet and traditional distribution channels support these results. Another study found, however, that lower search costs raised prices when some high-priced suppliers targeted those consumers who did not shop around, a result relevant to section II.C.

26. An OFT market study of personal accounts[17] shows how higher search costs dampen competition. Information about the cost of the accounts – foregone interest and expected value of fees – was difficult to obtain, so consumers did not compare offers, despite often benefiting if they switched banks. Consumers over-estimated the difficulty of switching. Forty-seven percent of consumers never considered switching and few actively monitor their accounts' competitiveness. The result: Only 6 per cent of consumers had switched accounts within the previous 12 months. "Without consumers willing to switch accounts and actually doing so, the banks have little or no incentive to compete by offering better

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[16] OFT (2010). *The Impact of Price Frames on Consumer Decision Making*. OFT1226. London, pp. 31–32.

[17] OFT (2008). *Personal Current Accounts in the UK: An OFT Market Study*. OFT1005. United Kingdom.

terms […]. Without better competing offers from banks, however, consumers have little or no incentive to switch accounts.”

27. Advertising and price comparison websites can reduce search costs. Truthful advertising may also help entry into markets when consumers rely on advertising to help their search. Mandatory posting of prices (e.g. outside a point of sale) helps reduce search costs too. In addition, several agencies offer price-comparison websites, such as for electricity and remittances.[18] Yet enhanced transparency also facilitates the monitoring of anticompetitive agreements.

28. Consumer agencies may require or encourage a standardized presentation of key figures for complex products. For example, the United Kingdom credit card industry established a standard presentation of credit card charges in 2003.[19] An OFT study found, nevertheless, that about 70 per cent of consumers taking out a credit card did not shop around.[20]

29. The “choice screen” remedy imposed in the European Commission’s Microsoft web browser case can be considered a competition remedy to lower search costs.[21] European Economic Area consumers who have the Microsoft browser as their default browser on a new computer are able to select competing browsers from a screen and install them. The remedy relies on reducing consumer search costs to spur competition.

30. Only 6.2 per cent of consumers in the European Union switched electricity suppliers over a two-year period. Despite “mystery shopping” revealing significant savings from switching, consumers who did switch saved little.[22] Electricity markets were liberalized to increase competition, although little switching suggests that competition has not been as dynamic as perhaps expected in this case. Default and switching rules and lowering consumer perceptions of switching costs are generally viewed as consumer tools that should be considered for the effectiveness of competition remedies, illustrating the potential role for coordination between competition and consumer protection policies.

31. To summarize, consumer protection interventions in markets with search costs aim to lower search cost. They not only help consumers directly but also promote competition, including market entry.

C. Experience goods and credence goods

32. An experience good cannot be evaluated before purchase, but all attributes are easily observed after use. Examples include novels, products where durability is important, such as washing machines or products whose true operating cost becomes apparent over time (e.g. electric generators). Credence goods are goods of which, even after use, the consumer does not know all the attributes or qualities. Professional services and pharmaceuticals are examples. Can a patient’s recovery be attributed to a drug when other interventions were carried out at the same time?

[18] Further examples of information provision can be found in OECD (2010), box 2.3.

[19] UK Cards Association (2011). The credit card summary box. Available at http://www.theukcardsassociation.org.uk/individual/credit-card-summary-box.asp.

[20] OFT (2008). *Credit card comparisons*. OFT987.

[21] European Commission (2010). Antitrust: Commission welcomes Microsoft’s roll-out of web browser choice. IP/10/216, 2 March; Commission Decision of 16.12.2009 COMP/C-3/39.530 Microsoft, particularly pp. 15–22.

[22] ECME Consortium (2010). The functioning of retail electricity markets for consumers in the European Union. EAHC/FWC/2009 86 01.

33. If consumers cannot evaluate offers before they buy, how can they evaluate the quality of a product and avoid being deceived? On what basis can competition occur? A market for experience goods requires other market practices in order to operate.[23] Market practices and consumer policy interventions are similar for experience and credence goods.

34. Market participants have established practices to overcome information asymmetries. For experience goods, repeat purchasing or credible word of mouth are direct solutions. Suppliers often offer warranties.[24] By ensuring that warranties meet minimum requirements and are complied with, consumer authorities also ensure a minimum quality, since very low-quality products would incur costly warranty obligations. Branding and reputation[25] have a similar effect, since a supplier's reputation is damaged by a shoddy product.

35. Truthful provision of information on quality can facilitate competition. Third parties such as consumer magazines or newspapers test the quality of various brands and publish their results. The consumer agency OFT encourages the publication of fair and meaningful complaints data about professional services.[26] Consumer agencies may require the use of "plain language" and the presentation of key price components in a simple, standard format. The credit card summary box mentioned above and the energy labelling of white goods are examples.

36. Mandatory minimum standards, such as health and safety standards, constitute a different type of consumer protection intervention. They benefit consumers in many ways. With standards, consumers do not risk inadvertently buying unsafe or unhealthy products. In addition, if there are negative externalities from low quality, e.g. building users are harmed as a consequence of poor engineering, minimum standards limit buyers' deliberate under-investment in quality. As for the market, it may expand as consumers rely more on the quality and safety of products (more consumers will buy as they are ensured that none of the products on offer will be dangerous or fraudulent). This effect can be exemplified in the reluctance of many consumers to participate in financial markets because of suspicion

[23] The classic reference for experience goods markets disappearing entirely is Akerlof's market for lemons (low-quality used cars): Used cars have different qualities, known to their sellers. Buyers are aware of the range of qualities, but not the quality of an individual car until after purchase. For any given price *p*, no cars with a quality exceeding that corresponding to price *p* would be offered. Buyers recognize this, so offer only the *p* corresponding to the average quality attracted into the market at price *p*, which of course is lower than *p*. A few iterations lead to no used cars being offered for sale. Akerlof G (1970), The market for lemons: Quality uncertainty and the market mechanism, *Quarterly Journal of Economics*, 89:488–500.

[24] A warranty is a promise by the manufacturer or seller to the consumer that the product will do what it should do and there is nothing significantly wrong with it. It is also a promise to correct problems should they arise.

[25] Reputation conveys information about the quality of experience goods. Brand owners are aware of the value of the signal of quality, so have incentives to maintain quality across their product line as well as to fight trademark infringements. Retail outlets can also develop a reputation as a seller of high-quality products, so a consumer is more willing to buy an unknown brand sold by that retailer. Other retailers can free-ride on the quality signal by carrying the same products without making the costly investments in assessing the quality. Consequently, manufacturers may restrict who may retail the product to a select group of retailers. Some competition laws prohibit or limit selective distribution.

[26] "Fair and meaningful" implies that issues such as adverse selection – where some providers get consumers in worse health or with more intractable legal problems – must be overcome. See, for example, Collins P, Competition in professions 10 years on: The liberalization of professions and consumer empowerment. Speech delivered on 12 December 2011.

(confirmed after those who suffered damage from products without a minimum standard) that it is beyond their reach to fully understand the potential risks of products.[27]

37. Excessively high standards, however, can harm competition. Some consumers may prefer a low-priced lower-quality alternative and some producers can only be able to produce low quality (yet safe and healthy) products.

38. The imposition of minimum standards can also, paradoxically, lower the average quality of products in the market. If a sufficient proportion of consumers are informed about the true quality of products, they limit the share of the low quality suppliers. If minimum standards are imposed, fewer consumers will make the effort to become informed. The share of low-quality suppliers increases, reducing quality overall, although not below the standard.[28] Finally, standard-setting could facilitate some forms of collusive agreements.

39. Conveyancing, a bundle of legal services related to buying and selling real property, is a credence good. Entry into the market in England and Wales had been reserved to solicitors until opened to paralegal "licensed conveyancers" in the 1980s. Other changes about the same time removed scale fees and prohibitions on advertising. As of 2010, solicitors accounted for 97 per cent of the conveyancing market.[29] Why so little entry? Perhaps because 80 per cent of consumers purchase the conveyancing service recommended by their real estate agent – more than half did not even shop around – and such agents are paid referral fees by conveyancers. Would consumer education about the referral fees and the benefits of shopping around, as well as credible measures of quality, increase competition?

40. In short, consumer protection interventions in markets for experience goods or credence goods often provide information about quality, or quality assurances, or prohibit products not meeting minimum standards. Minimum standards should be set on a case-by-case basis, as appropriate, weighing their benefits for consumers against the potential risks on competition.

41. This section considered how consumers' choices and competition can be affected by asymmetric information in markets. The next section uses results from recent developments in behavioural economics to describe when consumers' own decision-making characteristics can harm competition.

[27] Consumers International (2011), Safe, fair and competitive markets in financial services: Recommendations for the G20 on the enhancement of consumer protection in financial services, p. 4: "Many financial service products are now so complex that consumers, regulators and even the financial service providers themselves cannot understand them. This complexity needs to be managed and if necessary, overly complex products should be kept off the market. Regulators should introduce a requirement of comprehensibility and prohibit products that are not comprehensible, they should require the availability of simple standard financial service products, and key financial service products should be required to meet minimum standards of consumer protection."

[28] This moral hazard – that consumers will reduce their efforts to become informed if regulation reduces the returns to doing so – is explored with respect to high prices in Armstrong M, Vickers J and Zhou J (2009), Consumer protection and the incentives to become informed, *Journal of the European Economic Association*, 7(2–3), pp. 399–310. They reference Posner's application of the idea to fraud in Posner R (1969), Federal Trade Commission, *University of Chicago Law Review*, 37(1), pp. 47–89.

[29] OFT (2010), Home buying and selling: A market study, pp. 44, 132 and 133; Sparkes P and Sebastian S Case studies: England and Wales, in Schmid U, Sebastian S, Lee G, Fink M and Paterson I (2007), Study – COMP/2006/D3/003 – Conveyancing services market, pp. 179–196.

D. Consumers' decision-making biases

42. Consumers are neither fully rational nor are they supercomputers; they are, for example, subject to emotional forces and personal attitudes that play a part in decision-making.[30] Consumers may also misperceive their future demand, buying gym membership they barely use, using the bank's overdraft facility more than anticipated or relying on rule of thumb to decide what to buy rather than try to make sense of the different prices in a complex financial product.

43. Some consumer protection interventions address consumer biases. Educational materials advise consumers to look for the key numbers and clauses in contracts and how to understand their implications. Agencies may prohibit excessively large fees being mentioned only in a contract's small print. They may prohibit high-pressure sales tactics that impede consumers making comparisons.

44. For the purpose of this paper, the key distinction is between consumer decision-making biases that distort demand and those biases that distort search. Biases that distort demand include over- or under-estimating one's demand (the gym and overdraft examples above) and responding to how products are presented, like adjusting one's choices after viewing the most expensive version first. Search can be distorted if the consumer is averse to comparison shopping or is unable to properly compare products. Reasons could be laziness or just aversion, or complex pricing or products that require more expertise to assess than the consumer has available.

45. If biases distort consumers' search for better deals, then more competition does not necessarily generate better outcomes for them. The logic is as follows: Suppliers may target those consumers who do not compare offers or who have difficulties assessing qualities, that is, those customers who will buy from them regardless of the price or quality offered. Increasing the number of these suppliers does not improve customer welfare. For example, it is difficult to see how increasing the number of suppliers who target uneducated consumers by offering deals that would not appeal to informed consumers in the same circumstances would improve the welfare of the targeted consumers.

46. This subsection has briefly introduced ideas from behavioural economics that increasingly influence consumer policy. Combined with the preceding subsections on search, experience and credence goods, these sections show how consumer protection and competition policies can interact and mutually reinforce each other to enhance consumer welfare. Consumer policy should aid consumer decision-making. This facilitates competition when there are multiple competitors to choose from. Competition policy protects consumers from potentially harmful exercises of market power. In some circumstances, consumer policy tools can help consumers counteract a certain degree of market power.

III. Competition and consumer protection policy interactions in selected areas

47. This section applies the above discussion to four areas in which consumers are active: Insurance and savings products, remittances, counterfeit drugs and unsafe consumer products.

[30] Much of this subsection is from Huck S, Zhou J and Duke C (2011), Consumer behavioural biases in competition: A survey, OFT Economic Discussion Paper No. 1324; competition implications from p. 7 and pp. 32–42.

A. Insurance and savings products

48. Insurance and savings products are valuable but present risks to consumers. Indeed, substantial work by the Financial Stability Board, the World Bank and other international organizations is aimed at reducing future harm from the counterpart, credit.[31] Insurance and savings products involve one entity such as a consumer contracting with another entity to get something of value under specified conditions in the future. A consumer makes regular payments in the expectation of a payout under specified circumstances, such as flood damage or to attain a defined goal, such as savings for education or retirement. However, the "pay now, get later" character presents consumers with risks: fraud, mis-selling, and poor choices because contracts are difficult to understand. Regulation is required to channel competitive incentives towards conduct that benefits consumers.

49. The provision of insurance and other savings products is often tightly regulated. Prudential regulation, which is beyond the scope of this paper, aims to ensure that providers are in a position to pay out when contractually obliged to do so. It is important for consumers to be able to distinguish licensed, regulated providers from unregulated parties.

50. Truthful information about financial products is necessary for consumers to make good decisions. Risks, costs, benefits and duration are among the key characteristics. Disclosure that is useful for consumers may look different to disclosure that is useful for financial professionals. Timely, accurate and understandable information that is comparable between products helps protect consumers and spur competition.

51. Mis-selling is a particular consumer concern. Mis-selling means selling an investment product that is not suitable for a consumer after having taken reasonable steps to understand his or her circumstances. For example, it would be mis-selling to sell insurance that pays out if one loses one's job to unemployed students and retirees.

52. Financial products are often sold via intermediaries. To counteract intermediary bias, consumer rules may require the disclosure of intermediaries' incentives. The disclosure of, for example, commission rates, alerts the consumer to the possibility that the intermediary may have incentives to recommend a product that is not the best choice for the consumer. Competition among intermediaries with different incentives may help inform the consumer.

53. Reflecting consumers' more limited resources, consumer rules may make consumer complaints easier to file than would a similar complaint under contract law.

54. The complexity and contingent nature of these products – their value depends on random events such as floods – makes it difficult for consumers to assess offers. Long, detailed contracts written in legalese can be incomprehensible. Consumers may mis-estimate the likelihood of various conduct or events in the future. Competition does not necessarily spur suppliers to offer better choices: Some suppliers may target consumers less capable of assessing offers, offering more profitable but not necessarily better choices.

55. Financial education is an important complement to prudential regulation and consumer protection in these markets.[32] It may include not just self-help indicators of how to detect fraudsters, but also how to make use of financial sector regulators who register, monitor and regulate companies that offer insurance and savings products.

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[31] Financial Stability Board (2011), Consumer finance protection with particular focus on credit; World Bank Global Programme on Consumer Protection and Financial Literacy.

[32] OECD (2008), Recommendation on Good Practices for Financial Education Relating to Private Pensions; World Bank, OECD, Department for International Development, and Consultative Group to Assist the Poorest (CGAP) (2009). *The Case for Financial Literacy in Developing Countries*.

56. In sum, insurance and savings products are valuable in that they link consumer savings in one area to payouts in another. However, financial sector regulation, consumer protection, financial education and competition each play a role.

B. Remittances

57. Remittances are household earnings from abroad. Originating mainly from migrant workers, they are a significant capital inflow into developing countries. In 2009, worker remittances through formal channels totalled about $305 billion out of a total financial flow, through formal channels, of about $598 billion.[33] Migrants send large fractions of their income.[34] Methods include banks, money transfer companies, buses and taxis, and the hawala system. Increasingly mobile-phone-based money transfers perform the same function; for example, the M-PESA system in Kenya enables domestic remittances by phone.[35] The price of sending remittances varies significantly from one country pair to another, and different prices can persist in the same corridor. Senders have an even more difficult task of comparing offers when the price is not known in advance: The exchange rate may be unknown until the transaction is completed, and there may be fees at the receiving end.

58. Increased competition lowers the price of remittances sent from the Group of Eight countries.[36] Another study found the price of sending $200 from the United States to nine recipient countries varied from $7 to $26. The degree of competition was the key price determinant.[37] Lower fees increase remittances: One study found that a $1 transaction fee reduction increased monthly remittances by $25.[38]

59. Policies aim to increase both competition and consumer education. In the United States-Mexico corridor, market entry by banks greatly lowered prices. The Banco de Servicios Financieros, or BANSEFI, a Mexican government programme, forms banks, credit unions and microfinance institutions into a distribution network for remittances. A group of savings and credit institutions attempts to bring recipients of remittances into the formal banking system. At the sending end, a task force combining United States and Mexican agencies aims to facilitate Mexican immigrants' use of the formal banking system by providing and promoting acceptance of the *matrícula consular* (consular identification card) as identification to open bank accounts and to increase Spanish language financial education.[39]

60. Where there are few potential agents, exclusive agreements between money transfer companies and agents can raise entry barriers. In rural areas, there may be few small businesses, hence few potential agents. In 2003, for example, the Russian Federal

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[33] World Bank (2011). Global Development Finance. Table 1, p. 1.

[34] Senegalese in Spain send 49.9 per cent of their earnings, Mexican migrants to the United States of America interviewed in 2000–2009 sent 31.1 per cent. Further figures at Yang D (2011), Migrant remittances, *Journal of Economic Perspectives*, 25(3):129–152.

[35] Mas I and Radcliffe D (2010). Mobile payments go viral: M-PESA in Kenya. Bill & Melinda Gates Foundation. March. Available at http://go.worldbank.org/XSGEPAIMO.

[36] World Bank (2011). Remittance prices worldwide. Issue No. 3. November.

[37] Orozco M (2002). Market, money, and high costs. Testimony before the Senate Banking Committee to Examine Remittances Abuses. 28 February.

[38] Yang D (2011). Migrant remittances. *Journal of Economic Perspectives*. 25(3):129–152.

[39] Orozco M (2005), International Financial Flows and Worker Remittances: Best Practices, International Labour Organization, p. 23. As of 2009, only 27 per cent of banks in the United States accepted the *matrícula consular*: FDIC (2009), Findings from the FDIC Survey of Bank Efforts to Serve the Unbanked and Underbanked, *FDIC Quarterly*, 14 July.

Antimonopoly Service ordered Western Union to strike the exclusive dealing clauses in its agreements with a network of 40 Russian banks.[40]

61. Increased information about prices lowers the cost to consumers of searching for the best deal. The World Bank launched the Remittance Prices Worldwide database at http://remittanceprices.worldbank.org/, covering 213 corridors. It also certifies compliant national remittance price databases. The World Bank database shows the fixed fee, exchange rate margin and the total cost of sending $200 and $500. It shows the transfer speed and the coverage at the receiving end. Data are gathered as mystery shoppers. It is not clear, however, how widely disseminated the data are among remittance-sending migrants.

62. In sum, consumer protection measures to increase information available to remittance senders reinforce competition. Competition measures include encouraging entry and restricting exclusive agreements where there are few choices of agents. Cross-border cooperation by financial regulators seems also to be necessary to enhance consumer welfare. The remaining high and dispersed prices indicate that search costs remain significant, indicating room for improvements in terms of regulation, consumer and competition policies.

C. Counterfeit drugs

63. Counterfeit drugs are traded both in developing and developed countries. Up to 25 per cent of drugs in developing countries are fakes.[41] Counterfeit drugs are those designed to mislead the consumer into believing they are from another manufacturer. The consumer faces the risk that they may not in fact match the characteristics of the imitated product as claimed, and may therefore be ineffective or harmful. Low-dosage drugs generate negative externalities by accelerating the development of drug-resistant strains, and brand values can be undermined if patients or health workers associate a legitimate manufacturer with an ineffective counterfeit that falsely bears the manufacturer’s mark.

64. Drugs are credence goods in that, even after use, consumers do not know their quality. Consumers and pharmacists may be incapable of detecting counterfeits: Only laboratory analysis can detect some fakes.[42]

65. Information on counterfeit drugs is not widespread. WHO notes that only a few countries are willing to provide information about cases detected.[43] An association of drug makers established to fight counterfeits provides no public statistics on counterfeiting.[44]

66. The recommendations of WHO for consumer protection would exclude fakes and inform consumers to a certain extent. It recommends standards for drug development, manufacture and distribution, rigorously controlled by a strong national drug regulatory authority, as well as laws deterring counterfeiting. It rates only 20 per cent of its 191 member States as having well-developed drug regulation. WHO assesses products and

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[40] Decision on case No. 2 06/121-03 of violation of the antimonopoly legislation. http://en.fas.gov.ru/decisions/decisions_30691.html. The decision was upheld at the various levels of appeal.

[41] World Health Organization (WHO) (2003). Substandard and counterfeit medicines. Fact sheet No. 275, November, quoting the United States Food and Drug Administration.

[42] United Kingdom Medicines and Healthcare Products Regulatory Agency. Counterfeit medicines and devices.

[43] WHO. General information on counterfeit medicines. Available at www.who.int.

[44] The Pharmaceutical Security Institute (About us; Counterfeit situation-incident trends: www.psi-inc.org.) provides statistics for incidents of which counterfeiting is one part.

manufacturers of HIV/AIDS, malaria and tuberculosis medicines.[45] It also recommends informing consumer organizations about the possible presence of counterfeit drugs, as well as advising consumers to buy only from legitimate sources and to report conditions not responding to drug treatment. The implementation of these recommendations should raise barriers to entry against fakes, while lowering barriers to entry for genuine drugs.

67. An alternative strategy is to give consumers information directly.

68. The mPedigree network in certain West African developing countries gives consumers access to information about individual drug packets. The consumer scratches off a panel to reveal a unique code on the packet, then sends the code via text message to a central registry. There, the number is instantaneously checked against a list of genuine codes.[46] In other words, genuine suppliers and consumers have generated a new arrangement that allows competition in a credence good. Manufacturers could employ multi-use, i.e. not scratch-off, codes to monitor distribution flows for anticompetitive purposes such as market division.

69. In sum, counterfeit pharmaceuticals could make consumers and pharmacists sceptical of even genuine drugs. Laws and institutions to control genuine drugs and to suppress counterfeits are recommended. But developments in information and communications technology can enable credible, timely proof of genuineness and thus enable competition in a credence good.[47]

D. Unsafe consumer products

70. Consumers buy and use products that have varying degrees of safety. A product, safe in its intended used when new, can become unsafe when used differently or after excess wear. Consumers, therefore, enjoy a certain responsibility for their own safety, even when consumer protection rules prohibit the marketing of unsafe products. Also, consumers differ in the tradeoffs they make between safety and price: Some consumers may choose riskier but lower-cost products.

71. Riskier consumer products may be cheaper to supply. More robust construction, more electrical insulation, traceable materials and better design are costly. Indeed, an argument against airline competition was that competition would drive companies to save on costs with lower maintenance, thus lower safety. In the event, airlines were so keen to maintain a safe reputation – insecure consumers could easily switch to rivals and deprive them of any revenue – that the long-term trend towards greater safety continued after the introduction of competition, at least in the United States.[48]

72. Many suppliers have incentives to ensure that consumer products are safe. Trademarks and warranties help suppliers commit to safe products. The value of a brand falls if the brand becomes notorious as a result of consumer harm,[49] and warranty

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[45] WHO (2003). Substandard and counterfeit medicines. Fact sheet No. 275. November. Available at http://www.who.int/mediacentre/factsheets/2003/fs275/en/.

[46] World Intellectual Property Organization (2010). Dialling for development: How mobile phones are transforming the lives of millions – Toll-free drug verification. *WIPO Magazine*. September. See also www.mpedigree.net.

[47] To a large extent, a related issue is that intellectual property rights introduce competition concerns in relation with potential abuses of rights holders.

[48] United States General Accounting Office (1996). Airline deregulation: Changes in airfares, service and safety at small, medium-sized, and large communities. GAO/RCED-96-79.

[49] Harm to reputation is less if consumers do not know the true identity of the producer of products found to be unsafe. See Freedman S, Kearney M and Lederman M (2010), Product recalls, imperfect

obligations are costly to fulfil for shoddy products. Suppliers may also establish easier access to consumer redress. This also raises the costs of supplying low-quality products. By establishing these institutions, suppliers can commit to producing high-quality consumer products.

73. Consumer protection responses to unsafe consumer products include ex ante prohibitions and ex post actions, such as public warnings, prohibitions and product recalls, and judicial actions. The use of ex ante prohibitions implies an objective, scientific basis for the prohibitions, i.e. sampling, testing, evaluation and the establishment of a standard. The cost and duration of the process,[50] which can exclude safe but low-profit goods, can be balanced against expected consumer harm.

74. Increasing international trade in consumer products implies a role for better coordination of domestic product safety regimes.[51] Greater coordination between domestic regimes pursuing similar objectives can reduce barriers to trade, thus enabling the exploitation of scale economies.[52] Regional groupings, mentioned below, promote information exchange about injuries caused by unsafe products, better and more consistent product labelling and greater compliance with international standards. Mutual recognition of technical standards and harmonization of regulations would make it easier for suppliers that conform in one jurisdiction to also supply other markets, thus increasing competition.

75. The Consumer Safety and Health Network[53] is an inter-American network under the auspices of the Organization of American States to facilitate access to timely information about unsafe products and to train officials. Inter alia, it receives alerts about unsafe products from consumer safety authorities throughout the world and processes and publishes them on a website to make them easily accessible to authorities and consumers. It also collects and publishes regulations and technical standards of various jurisdictions, as well as best practices on market surveillance.

76. The International Consumer Product Safety Caucus[54] is a voluntary network of consumer product safety regulators and market surveillance authorities. Their recent work concerns product traceability and information exchange or recalls. Various bilateral understandings or agreements support bans and recalls in consumer markets with restrictions on further export.[55]

77. Increased international trade in consumer products has thus prompted more cross-border coordination in terms of information exchange, market surveillance and testing. Consumer protection can be strengthened if the experience of jurisdictions pursuing similar objectives can be pooled, for example in recalls and product tracing. Lower barriers to cross-border trade in safe products also promote competition.

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information and spillover effects: Lessons from the consumer response to the 2007 toy recalls, NBER Working Paper No. W15183, forthcoming *Review of Economics and Statistics*.

50 The testing of 36 baby-walkers and standards development took 13 months for Prosafe, an association of European market surveillance authorities. See press release of 14 December 2010: Joint action on baby walkers finished.

51 Prosafe (see above) estimates that 85 per cent of all toys sold in the European Union are made in China and that 50 per cent of all products notified under RAPEX – dealing with unsafe consumer products excluding food, pharmaceutical and medical devices – are made in China. EMARS Strategy Document (http://www.prosafe.org/read_write/file/EMARS_Strategy_Document.pdf).

52 Mutual recognition of technical standards and the harmonization of regulations help suppliers that conform in one jurisdiction to also supply other markets.

53 The description is from its website, http://www.oas.org/en/sla/cshn/default.asp.

54 Members include China, the European Union, the United States, Japan, Canada, the Republic of Korea and Australia. www.icpsc.org.

55 See, for example, the RAPEX-China alert system for unsafe product notifications.

IV. Conclusions and policy options

78. In many markets, competition supports consumer interests, provided general contract law and anti-deception laws are in place and enforced. Competitive sellers vie to attract consumers. Informed, educated consumers are able to understand the offers and make sensible choices, which reward the more efficient and innovative suppliers. However, where consumers do not have reasonable access to the right information, or have decision-making biases, then suppliers can behave strategically to increase their profits at the expense of consumers. Consumer policies may be the best policy solution to help markets work better in these circumstances.

79. This example makes it clear that improving the coherence between consumer and competition policies should be a central consideration to help markets work better, from the perspectives of both consumers and business. Improved cooperation between consumer and competition authorities could include referring complaints, sharing the results of investigations, taking into account the impact of remedies on other policy objectives, and, where appropriate, working together in investigations as well as to generate policy responses. Such investigations should take on not just retail practices that have a face-to-face impact on retail consumers, but should also deal with upstream issues relating to industry structure and the need for international action to prevent global competition issues.

80. Consumers are being presented with new products and marketing strategies, and are increasingly engaging in cross-border commerce in consumer products. Technological change has also created new challenges for consumers, for example in finding an appropriate balance between intellectual property protection and access to knowledge. In the light of these and other developments, consideration could be given to revising the *United Nations Guidelines for Consumer Protection*.