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**Global Forum on Competition**

**THE INTERFACE BETWEEN COMPETITION AND CONSUMER POLICIES**

**Background Note**

-- Session IV --

*This paper was drafted as a Background Note by Henry Ergas (Regional Head, Asia Pacific, CRA International; Professor, Faculty of Business and Economics, Monash University, Australia) and Professor Allan Fels (Dean, The Australia and New Zealand School of Government – ANZSOG). It is submitted FOR DISCUSSION under Session IV of the Global Forum on Competition to be held 21 and 22 February 2008.*

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## **THE INTERACTION AND COORDINATION OF COMPETITION POLICY AND CONSUMER POLICY: CHALLENGES AND POSSIBILITIES<sup>(\*)</sup>**

### **Background Note**

#### **1. Introduction**

1. That consumer protection policy and competition policy are largely interdependent instruments of economic policy, both aimed at serving a common purpose of enhancing the efficiency with which markets work, has been stated on many occasions and is widely accepted. It is also widely recognised that there can be, and at times are, tensions between those policies. Moreover, as a practical matter, there are differences in how those policies work, and in the nature of the process by which decisions are taken and implemented. Recognition of these interdependencies and of the differences leads naturally to a consideration of the institutional arrangements for these policies and specifically, of how they should be coordinated.

2. This paper explores these themes, setting out the main issues as a basis for discussion without seeking to be comprehensive in their treatment. It makes the following main points:

- Competition policy and consumer policy generally share a common purpose while relying on differing instruments to achieve that purpose. Usually, they reinforce one another; however, it is not uncommon for them to clash, for example, when consumer policy is used in ways that unnecessarily restrict competition. Also, the introduction of competition may occur without sufficient regard to consequential consumer protection issues (section 2);
- While these issues about the balance and coordination between competition policy on the one hand and consumer policy on the other are hardly new, they have attracted increased attention in recent years for a number of reasons, including
  - Advances in behavioural economics, which have highlighted the cognitive limitations affecting consumer behaviour (section 3.1); and
  - The extension of competition to new and difficult areas (section 3.2), including the professions and markets for public utilities and services.

While these developments do not alter the appropriate role of, or respective balance between, competition policy and consumer policy, they do strengthen the case for a coordinated approach to these policy areas;

- This naturally raises the issue of how that coordination is best achieved (section 4):

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<sup>(\*)</sup> This paper was drafted as a Background Note by Henry Ergas (Regional Head, Asia Pacific, CRA International; Professor, Faculty of Business and Economics, Monash University, Australia) and Professor Allan Fels (Dean, The Australia and New Zealand School of Government – ANZSOG).

- While there can be benefits to integrating responsibility for the enforcement of competition policy and consumer policy within a single institution, the reality is that there will always be limits to the extent and effectiveness of that integration;
- Thus, the nature of these tasks associated with these policy areas differs in important respects; moreover, consumer policy inherently involves a very wide range of instruments, many of which are sector- or industry-specific, and which are not readily brought under a single umbrella;
- As a result, whatever view is taken of the appropriate degree, if any, of institutional integration of competition and consumer law enforcement, an important goal should be as a minimum to ensure that the competition policy authority has the expertise required to monitor developments in the design and administration of consumer policy and to act as an advocate for competition in the consumer policy process; similarly, consumer agencies should arguably, have the skills to monitor and assess competition issues.
- It is also likely to be important to ensure that there is within government, an entity that has “whole of government” oversight of consumer protection, and that exercises that oversight in a manner mindful of competition concerns;
- Periodic surveys of particular instruments – such as occupational licensing, or restrictions on advertising – aimed at reviewing whether they were consistent with efficient competition, may play a useful and important role in giving structure to this coordination process.

## **2. The Interrelation of Competition and Consumer Policy**

3. As a general matter, competition policy aims at protecting, and where appropriate and efficient extending, the range of choices available to consumers. At the same time, consumer policy seeks to protect, and where appropriate enhance, the quality of that choice, and to ensure that consumers can exercise choice effectively and with confidence in the fairness and integrity of market processes.<sup>1</sup>

4. That each of these policies largely promotes the goals of the other is readily exemplified.

5. Thus, as a general matter, the risk of displacement that bears on firms in effectively competitive markets creates incentives for those firms to develop and protect a reputation for being good quality suppliers, since this allows them to secure repeat business and reducing marketing costs. This reduces the burden that would otherwise fall on consumer policy in terms of enforcing product and service standards, as firms will have incentives of their own to meet and exceed customer expectations. In that sense, ensuring that a market is effectively competitive can help meet one of the central concerns of consumer policy.<sup>2</sup>

6. Equally, firms that operate in effectively competitive markets, and hence can hope to attract customers away from rivals, will have incentives to reduce those customers’ switching costs, both by informing them of the gains from shifting and by helping them to bear any once-off costs shifting involves. The result of firms investing in reducing the switching costs incurred by each other’s customers can be both to make competition more vigorous and to diminish the need for consumer policy interventions aimed

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<sup>1</sup> See Muris, T. (2002), ‘The interface of competition and consumer protection’, Prepared remarks at the Fordham Corporate Law Institute’s 29<sup>th</sup> Annual Conference on International Antitrust Law and Policy; and Sylvan, L. (2004), ‘Activating competition: The consumer-competition interface’, 12 *Competition and Consumer Law Journal*.

<sup>2</sup> OECD (2004), *Identifying and tackling dysfunctional markets*, p. 3.

at reducing switching costs. Here too, ensuring a competitive supply structure may be an effective way of dealing with what, in some circumstances, would otherwise be a consumer policy problem – that is, switching costs.

7. The same applies to many consumer policy interventions. For example, policies that ensure that advertising and product descriptions are honest and reasonably informative, that contract terms and the obligations they involve are understandable and not disproportionate, and that consumers can reasonably expect products to be safe and fit-for-purpose, will both make consumer choice a more effective discipline (thus directly strengthening competition) and will force firms to compete on the merits (rather than on the basis of fraudulent or misleading claims or of unfair contract terms).<sup>3</sup> Equally, product standards, by facilitating comparisons between products, increasing the ease with which products from one supplier can be replaced by products from another, and concentrating competition on performance rather than on features that are inessential to it, can directly improve both consumer choice and the competitive process.

8. In short, each of these policy instruments can be used to advance the goals also pursued by the other: competition policy, by keeping markets effectively competitive, can reduce the work that needs to be done by consumer policy; consumer policy, by enhancing the ability of consumers to exercise choice, can help make markets more effectively competitive and force firms to compete on the merits, thereby supporting the ends of competition policy.

9. At the same time, each of these instruments can create challenges for the other.

10. For example, opening a previously highly regulated market to competition may well raise new issues for consumer protection:

- Many OECD countries faced new consumer protection issues as a result of the liberalisation of financial markets, which, however beneficial it may have been, exposed consumers to new risks and difficulties.<sup>4</sup>
- Equally, the introduction of competition into some public utility markets (such as electricity and telecommunications) has created challenges in terms of regulation of service quality and of issues such as the management of churn, of customer complaints and of disconnection for non-payment.<sup>5</sup> It has also raised questions about the ability of consumers to understand what are often complex pricing schemes and exercise choice between them.
- Finally, liberalisation of professional services poses complex questions about balancing competitive pressures (for example, in terms of pricing and marketing, including advertising) with the protection of consumers in situations characterised by potentially large information asymmetries and substantial error costs.

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<sup>3</sup> European Commission (2004), 'Identifying and tackling dysfunctional markets', Note submitted to OECD for discussion at the joint meeting of the Competition Committee and the Committee on Consumer Policy, 13 October 2004, at pp. 2-3

<sup>4</sup> These challenges are discussed by Australia's Secretary to the Treasury at Henry. K. (2007), 'Connecting consumers and the economy: The big picture', Closing address to the National Consumer Congress, at pp. 7-8, available at [http://www.treasury.gov.au/ncc/content/download/Presentations/Transcripts/connecting\\_consumers\\_and\\_the\\_economy.rtf](http://www.treasury.gov.au/ncc/content/download/Presentations/Transcripts/connecting_consumers_and_the_economy.rtf)

<sup>5</sup> Some of these problems are discussed in Waddams, C. 'Reality bites - The problems of choice' and other papers following, in OECD (2006) *Roundtable on demand-side economics for consumer policy: Summary report*.

11. Moreover, when a market becomes more exposed to competition than it was previously (say, because of the removal of trade barriers), the incentives of market participants may change in ways that raise consumer protection concerns:

- For example, incumbent firms, faced with customers that are more mobile, may seek ways of locking customers in, including by building termination penalties into customer contracts. While those arrangements can be fully reasonable in some instances, they may raise both competition and consumer protection concerns in others.
- Additionally, to the extent to which an inefficient dominant firm realises that it will lose market share and perhaps even be entirely displaced, it may have less of an incentive to invest in long-term assets such as reputation, and therefore be more willing to take advantage of any customers it has that are locked in or otherwise vulnerable.
- Moreover, where the dominant firm was previously a monopolist operating in a highly regulated environment, it may well have very little experience with consumer-oriented marketing. Especially in the initial stages of competition, where the incumbent is seeking to slow and deflect competitive entry and clear consumer protection measures have not yet been put in place, this can result in a temptation to resort to tactics that are not fully consistent with accepted business practices.
- At the same time, the liberalised market may attract “fly by night” operators, whose unscrupulous practices undermine consumer confidence in the market as a whole, reduce consumers’ willingness to rely on information firms in that market provide, and thereby erode the incentives for all firms to act honestly. Moreover, those firms that do act honestly will be forced to bear additional costs in so doing (as they seek to signal to consumers the higher quality of the information they provide), increasing prices and reducing both consumer and producer surplus.<sup>6</sup>

12. In the same way, consumer protection policies, however well-intentioned they may be, can have adverse consequences for competition, with the ultimate outcomes being contrary to the goals that both consumer and competition policy should seek. Classic cases include prohibitions on comparative advertising, mandatory product standards that exclude low-cost entrants and products, and transparency and posted price requirements that facilitate collusion.<sup>7</sup>

13. In summary, the relation between competition policy on the one hand, and consumer policy on the other, is relatively complex. In most instances, the one supports the other; but there are cases where, in practice, they are in tension or conflict.

### **3. Emerging Challenges**

14. The issues associated the appropriate mix of competition and consumer policy have recently attracted increased attention partly as a result of developments in our understanding of consumer behaviour (discussed below at 3.1) and partly as a result of changes in the extent and functioning of markets (discussed at 3.2).

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<sup>6</sup> In the extreme case, this results in the so-called ‘lemons’ problem discussed in Akerlof, G. (1970), “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism”. *Quarterly Journal of Economics* 84 (3): 488–500

<sup>7</sup> A case study of inappropriate interventions can be found in the legal services market. See OECD (2004), *Identifying and tackling dysfunctional markets* at pp. 6-10.

### 3.1 *Developments in understanding of consumer behaviour*

15. The economics of consumer protection have received a considerable boost in recent years as a result of advances in “behavioural economics”. Those advances have stressed the impact that cognitive limitations have on consumer choice. The area of behavioural economics is very large indeed, and it is not possible or desirable to survey that area at all systematically here. However, a consideration of some important aspects of the results found in the literature on behavioural economics is helpful in illustrating how competition and consumer policy considerations interact.

16. Thus, economists have long recognised that information is costly and imperfect, so that consumers may not be able to allocate their budgets in ways that always secure the products they prefer, at the lowest prices available and hence from the most efficient supplier. That standard model of rational choice under conditions of costly and imperfect information remains an extremely powerful tool for understanding consumer and competition policy issues, and framing appropriate policy responses. What “behavioural economics” adds, relative to that model, is an emphasis on what appear to be departures from rational decision-making, at least as that is defined in conventional decision analysis. Those deviations from “rational actor” conduct could cause consumers to take decisions that appear inconsistent with welfare maximisation even when markets are reasonably competitive and search and information costs are not especially high. Indeed, some of these results suggest that increased competition, to the extent to which it leads to a proliferation of choices available to consumers, could yield only small, or in some instances even negative, welfare gains.<sup>8</sup>

17. While many of these findings are robust in experimental terms<sup>9</sup>, their interpretation is understandably controversial.<sup>10</sup> Even more importantly, it is by no means clear that they amount to a case for a more interventionist – “paternalist” – stance in respect of consumer protection policy generally. Nor is it clear that these findings diminish the value of, or weight that should be given to, protecting (and where appropriate, promoting) competition. In effect, a move away from primary reliance on competitive markets as the means of empowering consumers and/or to a more interventionist approach to consumer policy could involve substantial costs. These include the costs of the regulatory errors that are inevitable under a paternalist approach, especially one that involves limiting consumer choice.

18. Moreover, those costs need to be weighed against the fact that if cognitive limitations lead to potential gains from trade not being realised, then firms themselves may have incentives to seek ways of achieving those gains. There may, in other words, be market solutions to some of the welfare losses that would otherwise arise from constraints on individual rationality. Put slightly differently, competition and market forces may themselves be important ways of addressing concerns about the efficacy with which consumers take complex choices, because firms in competitive markets have incentives to offer consumers “solutions” that allow potential gains from trade to be more fully realised.

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<sup>8</sup> See Ergas, H (2007) “Policy Implications of behavioural economics: the case of consumer protection”, *Productivity Commission Round Table on Behavioral Economics*, Melbourne, Australia.

<sup>9</sup> See generally Guala, F. (2005) *The Methodology of Experimental Economics*. Cambridge University Press.

<sup>10</sup> For example, Plott and Zeiller, “Exchange Asymmetries Incorrectly Interpreted as Evidence of Endowment Effect Theory and Prospect Theory?”, *American Economic Review*, September 2007, and Plott and Zeiller, “The Willingness to Pay–Willingness to Accept Gap, the ‘Endowment Effect,’ Subject Misconceptions, and Experimental Procedures for Eliciting Valuation,” *American Economic Review*, June 2005, suggest that results that seem consistent with behavioural models of choice may also be fully capable of being explained by conventional rational choice models.

19. To take but one case, where the basic difficulty lies in frailty of will – for instance, with respect to commitments to save – products can develop that seek to at least reduce that difficulty through various forms of pre-commitment. For example, a successful voluntary superannuation scheme in Australia, offered by a number of major employers to new employees, relies on the lower likelihood of consumers “opting out” from a default position than “opting in” – that is, on an endowment effect. If employees do not choose to “opt out”, the scheme commits them to paying a higher than mandatory rate of superannuation contribution.

20. Equally, “confusopoly” – apparently deliberate attempts by firms to offer consumers choices that are confusing, for example, in terms of having prices that are difficult to compare with other offers in the market – may well be a serious problem for some consumers. However, just as some firms can seek to gain customers by making offers difficult to analyse or compare, other may compete by cutting through the confusion and offering simple pricing that consumers find attractive. Attempts by incumbents at “muddying the waters” create incentives for one or more suppliers to differentiate themselves by introducing a price structure that is simpler and hence more attractive. Experience highlights how powerful this mechanism can be.

21. Thus, in many countries, the initial stages of telecommunications deregulation saw a proliferation of complex pricing plans, especially for long distance service, making it very difficult for consumers to evaluate “value for money”. More recently, however, there has been a trend to simpler, clearer pricing, with “all you can eat” schemes bundled across multiple services coming into widespread use.

22. Equally, in aviation, competition between traditional full service airlines involved complex price discrimination, structured around restrictions on the date, day and time of travel, including through minimum stay and Saturday night requirements. The relatively high margins this permitted created opportunities for competitive entry, with Value Based Airlines (such as SouthWest in the United States, RyanAir in Europe and Virgin Blue in Australia) introducing a far simpler pricing scheme, in which there are no minimum stay restrictions and prices are set mainly according to time of purchase. Faced with this form of competition, full service airlines have responded by greatly simplifying their own pricing, facilitating effective consumer choice.

23. In retailing too, sales and other specials serve as useful forms of price discrimination, but also increase consumer search costs (indeed, that is an important part of how the price discrimination works). Walmart in the United States broke this pattern and adopted an “Everyday Low Prices” model, in which prices are set on the basis of low, but stable, mark-ups. That model has been widely taken up internationally, and studies find that those firms adopting this model have seen a significant increase in their market share and generally in their relative profitability, while competition in retailing has become more intense.<sup>11</sup>

24. The crucial point in all of these cases is that decision-making technologies are not merely the work of consumers – they also depend on the action of firms. Profit-maximising firms have incentives to exploit otherwise foregone gains from trade, including by improving the ability of consumers to act on their preferences. These incentives are likely to be strongest for the most efficient firms, as they have more to gain by reducing search costs. As a result, these firms can and in many cases do undertake actions that

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<sup>11</sup> Hoch, Stephen J. and Dreze, Xavier and Purk, Mary E. (Oct 1994), *EDLP, Hi-Lo, and Margin Arithmetic*, *Journal of Marketing*, 58; Lal, Rajiv and Rao, Ram (1997), *Supermarket Competition: The Case of Every Day Low Pricing*, *Marketing Science*, 16 (1); Ortmeyer, Gwen and Quelch, John A. and Salmon, Walter (Fall 1991), *Restoring Credibility to Retail Pricing*, *Sloan Management Review*, 55 (12); and Tang, Christopher S. and Bell, David R. and Ho, Teck-Hua (Winter 2001) *Store Choice and Shopping Behaviour: How Price Format Works*, *California Management Review*, 43 (2).

“internalise”, and thereby offset, the costs (in terms of foregone gains from trade) that would otherwise arise from cognitive constraints on consumer decision-making. This aspect of competitive dynamics is typically absent both from the laboratory settings in which much behavioural economics research has been undertaken.<sup>12</sup>

25. The response of firms to cognitive limitations affecting consumers is also largely absent from models of markets characterised by “shrouded attributes” – that is, situations in which some consumers, but not others, are unaware of hidden costs associated with certain products (such as cartridges for ink-jet printers and broadband charges in hotel rooms).<sup>13</sup> In these situations, it may not be profitable for producers to disclose the hidden costs, so long as sophisticated consumers have the ability to avoid them while still buying the products, which are cheaper because of the “subsidy” naïve consumers provide.

26. While these “shrouded attributes” models are elegant and at times suggestive,<sup>14</sup> they rest on strong assumptions. More specifically, as well as the conventional – and demanding – individual rationality assumptions required to solve games of this type, there is the assumption that no firm would gain a significant first-mover advantage by deviating from the “hidden costs” strategy.<sup>15</sup> This assumption seems quite inconsistent with the experience summarised above, where firms have derived significant innovators’ rents by being the first to exploit previously unrealised gains from trade.<sup>16</sup>

27. To suggest that market forces can, at least in part, correct some of the biases and limitations associated with consumer choice is not to say that businesses do not seek to exploit those very biases and limitations. Indeed, the opposite is likely to be case, most obviously in consumer marketing and advertising, which relies on an increasingly sophisticated understanding of how consumers choose. This makes it important for regulators to take account of those biases and limitations in assessing consumer marketing and advertising, especially in respect of products with direct consequences for health and safety. However, the point remains that to the extent to which cognitive biases and limitations prevent consumers from actually choosing in line with their preferences – whatever those preferences may be, and regardless of how well founded they are – one of the ways in which firms can seek to secure a competitive advantage

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<sup>12</sup> One of the few attempts to mimic the effects of this kind of innovation is the paper by Chu, Y. P and R. L. Chu (1990) “The Subsistence of Preference Reversals in Simplified and Market like Experimental Settings” *The American Economic Review*, vol 80, pp. 902-911. The authors introduce arbitrage into a money-pump game. Interestingly, they find that while subjects display preference reversals absent arbitrage, once they are exposed to arbitrage their preferences converge towards consistency with “rational actor” norms.

<sup>13</sup> See Ellison, G. (2005) “A Model of Add-On Pricing” *Quarterly Journal of Economics*, vol. 120, pp. 585-638 and Gabaix, X. and D. Laibson (2006) “Shrouded Attributes, Consumer Myopia and Information Suppression in Competitive Markets” *Quarterly Journal of Economics*, vol. 121, pp. 505-540.

<sup>14</sup> See for example, the application of such a model to residential mortgages in Campbell, J. Y. (2006) “Household Finance” *The Journal of Finance*, vol. 61, pp. 1553-1603.

<sup>15</sup> Campbell, for example, assumes that firms have no form of intellectual property protection, or that that protection is so weak that there are no innovator’s rents. Additionally, this type of model tends to be highly sensitive to the precise population shares of “sophisticated” and “naïve” consumers, to the willingness to pay of these respective groups of consumers and to search costs.

<sup>16</sup> Interestingly, economists very often assume that firms cannot make durable unilateral gains by deviating from a coordinated pricing strategy because pricing strategies are readily copied. (This underpins the concept of a “quick response equilibrium”, such as that embodied in the kinked demand curve.) In commercial reality, however, devising and implementing pricing strategies is often extremely complicated, and involves changes in systems, in training and billing, accounting and auditing arrangements. As a result, major changes in price structures are often very difficult to copy, and especially to copy well and quickly.

(and profit from the fuller realisation of gains from trade) will be by assisting consumers to improve on the choices they make.

28. In short, while the results of the behavioural economics may suggest a need for a consumer policy response – in the direction of greater paternalism – it may be that at least some of the issues it raises are best addressed through the competitive process: that is, by ensuring competitive forces are effective.

29. While it is important to recognise these limits of the policy inferences properly drawn from findings in behavioural economics, it would be a mistake to suggest that market incentives will cure all cognitive limitations.

30. This has long been recognised by economists with respect to that markets that are distorted by misrepresentation, which in its extreme forms amounts to fraud. As with all information asymmetries, misrepresentation can give rise to allocative inefficiencies (as trades will not reflect accurate valuations of the goods being traded), as well as to productive inefficiencies (because consumer search costs are increased, production may be allocated to less rather than more efficient firms, and firms may waste resources either in lying or in trying to establish a reputation for telling the truth). Of course, in the extreme (and even in conventional models of rational choice), bad information drives out good, no firm has the ability or incentive to disclose truthfully, and the market disappears.<sup>17</sup>

31. The same issues about the efficacy of the self-remedying properties of markets can arise, albeit likely in significantly less extreme form, in some of the cases that have been discussed in the consumer policy literature arising from behavioural economics.

32. For example, even when market solutions do emerge to problems such as “confusopoly” or to the pricing of “shrouded attributes”, those solutions may be directed at the more sophisticated consumers (who in any event would have likely suffered the least harm), leaving other consumers still exposed.

33. Indeed, it could be argued that the rise of the Internet as a marketing channel has aggravated the problem of vulnerable consumers. In effect, Internet marketing channels provide firms with considerable scope to differentiate their offers as between customer segments, and most obviously and immediately, as between consumers who are frequent and confident users of the Internet and those who are not. This reduces the extent to which sophisticated consumers “price protect” those consumers who are unsophisticated. While this problem may be merely transitory for some classes of consumers – who over time will become more adept at using the Internet and hence will benefit from the marketing features it provides – they will persist for others, such as the intellectually disabled, the very elderly and (at least in countries such as Australia) important parts of the indigenous population. The policy issue this raises is whether those more vulnerable consumers are best protected through the general instruments of consumer policy, or by more targeted interventions.

34. Moreover, for some of cognitive limitations highlighted in the behavioural research, market solutions may simply not emerge. “Addiction goods” are potentially a case in point, as consumers, prior to addiction, may not value “non-addictive” variants sufficiently to allow them to drive more harmful

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<sup>17</sup> This is the extreme case of adverse selection, in which the market collapses, so that all the potential gains from trade are lost. See Akerlof, G. (1970) “The Market for Lemons: Quality Uncertainty and the Market Mechanism”, *Quarterly Journal of Economics*, vol. 84, pp. 488-500 and Hillier, B (1997) *The Economics of Asymmetric Information*. St. Martins’ Press, Inc., New York, N.Y., pp. 46-49. The other way of stating matters is to note that complete distrust is a self-enforcing equilibrium: see for example, Gambetta, D. (1998) “Concatenations of Mechanisms” in Hedstrom, P. and R. Swedberg (1998) *Social Mechanisms*, Cambridge University Press, Cambridge, UK, pp. 102-124.

varieties out of the market.<sup>18</sup> Here too, the greatest risks are likely to fall on vulnerable consumers, such as young people who are vulnerable to the lure of advertisements for cigarettes, alcohol and other potentially addictive goods.

35. That said, care needs to be taken, in protecting those consumers who are most vulnerable and/or poorly informed, not to unduly undermine the rewards to those consumers who invest in information gathering.

36. It is true that there are cases where the nature of information as a pure public good means that duplicated search amounts to nothing but waste<sup>19</sup>; but there are also many cases where private investment in information is socially valuable, because it helps guide the price discovery process to ever changing fundamental values. In these latter instances, efforts at improving the position of less-informed consumers can reduce the return other consumers make by investing in information, and hence erode the quality of price discovery and welfare overall.

37. This trade-off has been extensively studied in the context of consumer protection issues in securities markets; suffice it to say most economists would place considerable weight on the need to ensure disclosure requirements do not eliminate incentives for costly information acquisition, while still encouraging widespread participation in the relevant markets.<sup>20</sup> This does not mean that vulnerable consumers should not be protected; rather, it means that the protection should be designed in a way that avoids unnecessary harm to the incentives that those consumers who are able to invest in information face to do so.

38. In short, there is a need for caution in drawing from the findings of “behavioural economics” generalised inferences about the stance of consumer and competition policies, all the more so given the fact that regulators too, suffer from cognitive limitations, imperfect information and other constraints on decision-making. Moreover, there will generally remain an issue about which instruments are most appropriate for dealing with the market imperfections arising from cognitive limitations on consumers’ ability to make complex choices.

39. This is important because the findings of behavioural economics do seem of obvious relevance to the *design* of consumer policy interventions, if not to the determination of the optimal extent of those interventions.<sup>21</sup>

40. Behavioural economics may, in other words, be even more valuable in helping shape *how* consumer policy agencies intervene than in determining *whether* to intervene. For example, labelling requirements need to take account of the way “information overload” can degrade the quality of consumer decision-making. Equally, an awareness of the biases associated with endowment or default positions may

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<sup>18</sup> Although for a contrary view with respect to narcotics, see O’Flaherty, Brendan (2005) *City Economics*, Harvard University Press, Cambridge, Mass., at Chapter 17.

<sup>19</sup> See Barzel, Y. (1982) “Measurement costs and the organisation of markets” *Journal of Law and Economics*, vol. 25, pp. 27-48 discusses these instances but concludes that when the relevant conditions apply, producers will take measures to avoid wasteful duplication of search.

<sup>20</sup> See O’Hara, M. (1995) *Market Microstructure Theory*, Blackwell Publishing and Harris, L. (2003) *Trading and Exchanges*, Oxford University Press, Oxford, UK. The need to protect the returns on investment in information, and the importance of maintaining a mix of investor types in the market, can justify limitations on disclosure requirements, such as allowing reduced transparency (i.e. somewhat reduced pre- and post-trade disclosure) for block trades.

<sup>21</sup> See especially Mulholland, J (2007), “Behavioral Economics and the Federal Trade Commission”, *Paper for the Productivity Commission Round Table on Behavioral Economics*, Melbourne, Australia.

be useful in deciding how schemes that involve opt-outs (for example, for liability) should be structured. Similarly, framing effects may be relevant to the design of regulations affecting advertising material, for instance with respect to the fat and sugar content of foods. Finally, the reliance that research in behavioural economics places on experimental trials has resulted in significant improvements in the practice and methodology of experimental economics; given those improvements, there is considerable scope for consumer protection agencies to use experiments in the design of policy instruments (such as labelling standards) and perhaps even in examining individual cases (for example, in assessing whether a particular advertisement is indeed misleading).

### 3.2 *Expanding role of markets*

41. Bringing the insights and methods of behavioural economics to bear on the design of consumer policy interventions may be especially important in the areas that are currently at the frontier of competition policy.

42. The last fifteen years have seen a far-reaching process of liberalisation in both the OECD countries and in many developing countries.

43. A forthcoming paper, for example, finds that taking the world's 57 largest economies from 1970 onwards, *56 out of these 57 countries have become less regulated over the period*: the only exception to the general trend is Venezuela.<sup>22</sup> Within the 21 countries in the OECD group, the greatest decreases in market-limiting interventions occurred in Portugal, followed by New Zealand, the UK and Sweden. Among the other advanced countries, Israel stands out. As for the developing countries, countries which significantly decreased the extent of market-limiting interventions include Mexico, Egypt, Turkey, India, Brazil, Argentina, Chile and Peru. Additionally and importantly, the difference in the extent of reliance on markets between the OECD group and the other 'advanced economies', on the one hand, and the developing countries and former communist countries on the other, has narrowed appreciably since 1970.

44. This change, which in many countries reflects a greater appreciation of the merits of competition as a means of allocating society's resources, has also created significant new challenges for competition policy and for consumer policy. Those challenges have been most acute in areas such as the traditional public utilities, where issues include the difficulties of preventing nascent competition from being eliminated and the difficulties consumers face in exercising choice in areas which have long been monopolies. There have also been significant difficulties in liberalised finance markets, especially in protecting consumers who are taking choices that are often highly complex.

45. More recently, there has been discussion of the scope to introduce, and in numerous instances moves to actually introduce, greater competition in the professions and in social services (which include education, health and aged care). These are markets that are often complex for consumers to operate in, all the more so as they are relatively new or rapidly changing. Moreover, in some instances, the decisions consumers take in these markets can have very serious consequences – as is obviously true for education, retirement savings and health care – but product quality and “value for money” are difficult to observe and assess. All of these difficulties are again more acute, and potentially more laden with severe consequences, for consumers who are poorly educated or otherwise especially vulnerable, such as the elderly, the sick and the frail.

46. The issues this poses for the interaction of competition policy and consumer protection can be illustrated by considering two cases: occupational licensing, especially of the professions; and the introduction of competition into markets for social services.

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<sup>22</sup> Henderson P. D. (2007) “The Uneasy Trend to Greater Economic Freedom” mimeo.

### 3.2.1 Occupational licensing of the professions

47. The term “professions” embraces a wide range of services in the modern economy including accounting, architecture, legal, medical, paramedical, engineering, perhaps estate agents and other categories which shade into skilled occupations such as electricians, plumbers, and many others. In most if not all countries, entry into these occupations is regulated, as is the conduct of those who are licensed to engage in them.

48. The primary justification for these regulations lies in information imperfections.

49. Thus, a person purchasing goods or services needs to make an assessment of the quality of the goods or services. The consequences of making incorrect judgments (i.e. the risk) for a relatively simple good with few characteristics are likely to be small, especially when consumers can form a reasonably accurate estimate of the value of the good.

50. However, professional services are significantly more difficult for consumers to assess. Five key characteristics of professional services will tend to magnify the information asymmetry and its consequences. First, services are generally not observable before they are purchased as the consumer cannot inspect a service before purchase in the same direct way as can be done with most goods. Second, professional services are by their nature complex and often require considerable skill to deliver and tailor to the consumer's needs. It can therefore be difficult for the consumer to assess the quality of the service before it is purchased. Third, the quality of many professional services can be difficult to assess even *after* the service has been purchased. For example, if a person hires a lawyer to undertake litigation which is ultimately unsuccessful, it can be difficult for the consumer to know whether the legal services were poorly delivered or that the case was inherently difficult to win. Fourth, many consumers are very infrequent consumers of professional services. Therefore, they do not have repeat purchases from which to assess quality. Fifth, the consequences of purchasing poor professional services can be significant. For example, the service may represent a large expenditure for the consumer and a defective service (e.g. a heart by-pass operation) can cause serious and irreversible harm.<sup>23</sup>

51. These characteristics can be used to justify regulation aimed at quality assurance. Such schemes are intended to provide a guaranteed level of service quality to consumers and therefore reduce risks associated with purchasing professional services. To some extent these schemes substitute search and information gathering by individuals with information gathering and assessment through some regulatory mechanism. These arrangements can reduce the transactions cost for consumers and help the market to function efficiently.

52. However, experience also shows that these regulations often have impacts that go far beyond assuring or seeking to assure the quality of the services consumers receive. Those impacts can include:

- The *creation of a monopoly* by the exclusive reservation of work and activity to the profession. Associated with that there may be a further division of work by the exclusive reservation of work to certain categories of that profession e.g. cosmetic surgery to be done only by “cosmetic surgeons”;
- The establishment of *anticompetitive restrictions on entry* to a profession by a licensing or accreditation arrangement or by restrictions on entry by a foreigner or by a person from another region in that country;

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<sup>23</sup> See Allan Fels, David Parker, Blair Comley and Vishal Beri (2001) “Occupational Regulation”, in the *Anticompetitive Impact of Regulation*, eds Guiliano Amato, Laraine L. Laudati, Edgar Elgar, pp 104 to 115.

- The imposition of *anticompetitive restrictions on behaviour* e.g. regarding prices or advertising or ethics; and
- There may also be *particular forms of anticompetitive conduct* e.g. price-fixing agreements and collective boycotts which, were they undertaken in other markets, would be in clear breach of the competition laws.

53. Faced with these consequences, the central challenge for policy is to find ways of addressing the legitimate concerns associated with the need for quality assurance, while creating scope for competitive forces to operate far more fully than they traditionally have. This will, by necessity, involve a tightly coordinated combination of competition policy and consumer protection tools:

- The consumer policy tools should seek approaches that are effective in protecting consumers, while not being unduly or unnecessarily restrictive of competition; while
- Competition policy should be brought to bear to ensure that subject to appropriate consumer protection safeguards being in place, competition is allowed to work where it can, including by the elimination of unjustified restrictions on entry and on competitive conduct.<sup>24</sup>

### 3.2.2 *Competition in social services*

54. A similar need for close coordination between competition policy and consumer policy also arises in moves to introduce market or market-like forces into the traditional social services.

55. Thus, as noted above, steps are being taken in a number of OECD countries to expand consumer choice in the social services traditionally provided by governments.<sup>25</sup> Similar moves have also been made in a number of developing economies, including Colombia (which recently ran a program that provided vouchers to students to attend private schools)<sup>26</sup>, Chile<sup>27</sup> and Indonesia<sup>28</sup>. Moreover, the World Bank has highlighted the contribution competition in the supply of services such as education and health can make to ensuring efficient use of the limited resources developing countries have for investment in social infrastructure.<sup>29</sup>

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<sup>24</sup> The Australian experience in this respect is discussed in Allan Fels (2006) "The Australian Experience Concerning Law and the Professions" in Ehlermann (ed.) *Competition Law and the Professions*, European University Institute, Florence.

<sup>25</sup> For an overview see Lundsgaard, J. 2002, 'Competition and efficiency in publicly funded services', OECD Economic Studies, available at <http://www.oecd.org/dataoecd/42/36/22027701.pdf>

<sup>26</sup> Angrist, J. et al 2002, 'Vouchers for private schooling in Colombia: Evidence from a randomized natural experiment', *American Economic Review* 92(5).

<sup>27</sup> Hsieh, Chang-Tai and Urquiola, Miguel S., "When Schools Compete, How Do They Compete? An Assessment of Chile's Nationwide School Voucher Program" (October 2003). NBER Working Paper No. W10008

<sup>28</sup> Bedi, A. and A. Garg 2000, 'The effectiveness of private versus public schools: The case of Indonesia', *Journal of Development Economics* 61(2).

<sup>29</sup> Hanushek, E. and L. Wolfsmann 2007, *Education quality and economic growth*, World Bank, pp. 20-21.

56. Although these moves have great potential to improve the efficiency with which those services are provided,<sup>30</sup> they also raise very challenging issues for both competition and consumer policy.

57. For example, while most countries have long had non-government schools, parents' ability to exercise choice within the public system has often been limited by rules that allocate children to particular schools (usually on the basis of place of residence). At the same time, funding rules have limited the extent to which public subsidies to schools follow the flow of students, distorting competition both within the public system (to the extent to which schools that gain students do not similarly gain in funding) and between the public system and the non-government sector. Allowing greater parent choice, and making the income stream to schools more dependent on that choice, can be a powerful way of increasing the responsiveness of the education system to parental preferences.<sup>31</sup>

58. However, securing those gains, and ensuring that they are to the ultimate benefit of students and society, involves myriad issues of policy design. To the extent to which schools move into the competitive arena, difficult questions need to be addressed about information disclosure (which is vital to the exercise of choice, but may distort the incentives facing teachers and school administrators),<sup>32</sup> about information sharing and cooperation between schools, and about how desirable information sharing can be reconciled with effective competition.<sup>33</sup>

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<sup>30</sup> Hanushek, E. and L. Wolfsmann 2007, *Education quality and economic growth*, World Bank, pp. 20-21; M Harrison 2004, *Education Matters: Government, Markets and NZ Schools*, NZBR, Wellington; C. Hoxby 1994, 'Do Private Schools Provide Competition for Public Schools?', NBER Working Paper No. W4978. S Bradley and J. Taylor 2002, 'The Effect of the Quasi-market on the Efficiency-equity Trade-off in the Secondary School Sector', 54, *Bulletin of Economic Research* p. 295-314; E Hanushek, and S. Rivkin 2003, 'Does Public School Competition Affect Teacher Quality?', *The Economics of School Choice* ; G Holmes, J. DeSimone and N. Rupp 2003, 'Does School Choice Increase School Quality?' NBER Working Paper No. W9683 May; and P Bayer and R. McMillan 2005, 'Choice and Competition in Local Education Markets', NBER Working Paper No. W11802..

<sup>31</sup> See Burgess, S., C. Propper and D. Wilson 2004, 'The impact of choice in education and health: a review of the economic literature', Centre for Market and Public Organisation, particularly on pp. 15-23. Such considerations are equally relevant to developing economies where as noted previously there has been a wealth of policy experiments – see for instance Patrinos, H. 2006, 'Public-Private Partnerships: Contracting Education in Latin America', World Bank; Barrera-Osorio, F. 2007, 'The Impact of Private Provision of Public Education: Empirical Evidence from Bogota's Concession Schools', World Bank; and Patrinos, H. and S. Sosale (eds) 2007, 'Mobilizing the Private Sector for Public Education : A View from the Trenches', World Bank.

<sup>32</sup> In reviewing the economic literature, Burgess, S., C. Propper and D. Wilson 2004, 'The impact of choice in education and health: a review of the economic literature', Centre for Market and Public Organisation conclude that (p. 16): "For choice to work, the supply side must be responsive to (changes in) demand. But the form that these responses take depends on the type of performance measure used and the incentives therefore created.. If parental choice is based on the information contained in performance measures, schools have the incentive to improve measured performance. This does not necessarily mean an improvement in actual outcomes... Different performance measures may be suited to the different objectives of accountability and facilitating a choice programme." The influence of target setting and information disclosure on providers (and the unintended consequences that can result in) are discussed in Hood, C. (2006) "Gaming in Targetworld", *Public Administration Review*, 66(4), 515.

<sup>33</sup> This is illustrated by cases in the UK and US where private schools and colleges have come under investigation or lawsuits for alleged anti-competitive conduct because of information sharing and cooperative practices. In the UK, private schools came under investigation in late 2006 for exchanging information on future fees – see Decision of the Office of Fair Trading No. CA98/05/2006, 'Exchange of information on future fees by certain independent fee-paying schools', 20 November 2006. In the US, in 1993 the federal government successfully challenged an agreement between universities limiting

59. Similar issues arise in health care. Particularly for countries that are experiencing rapid population aging,<sup>34</sup> the issues that are central to ensuring efficient provision of health care services are changing. While the provision of care for acute conditions remains of obvious importance, there is a growing emphasis on (and allocation of resources to) the treatment of chronic conditions, such as the various impairments associated with age (for instance, dementia), as well as those associated with obesity and other “life-style” diseases.<sup>35</sup> These are forms of care where choice by consumers (or their families) can be especially important, both because the care itself can involve a *de facto* choice of living conditions (as is the case, for example, for residential aged care), and/or because patient incentives and motivation matter greatly to the efficacy of treatment (as in the treatment of life-style conditions).

60. However, making choice work well in these areas is no easy matter; as with schools, it involves difficult questions about information disclosure and consumer rights and obligations, as well as difficult issues about how competition between providers can be reconciled with the wider social objectives that are also being pursued. Here too, different forms of expertise – of health practitioners and specialists, of competition authorities and of experts in consumer protection – need to be brought to bear in the design of market (or “market-like”) instruments.<sup>36</sup>

### 3.3 *Conclusions*

61. In summary, issues associated with the interaction between consumer protection and competition policy have received considerable attention in recent years, with some of that increased attention coming from research findings about inherent limitations on the quality and efficacy of consumer choice. It would be premature and likely incorrect to conclude from those studies that less reliance should be placed on consumer choice in a competitive market-place as the best means for promoting efficiency and social wellbeing. However, they do have important implications for policy design, most obviously of consumer protection measures. As competition and consumer policy are extended into new areas – such as emerging markets for the social services traditionally provided by governments – the lessons of that research need to be brought fully to bear.

## 4. **Institutional design and institutional challenges**

62. The discussion above has highlighted the interdependence between competition policy on the one hand, and consumer policy on the other, and the shared nature of the objectives they pursue. It has also highlighted the way they come together in policy design, most obviously when competition is being extended to new areas. This leads naturally to a consideration of the institutional arrangements for competition policy and consumer policy, including the question of whether they should be “housed” within a single institution.

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competition in the distribution of financial aid through an agreement to award aid solely on the basis of need through a common formula – see *United States v Brown Univ.* 5 F.3d 658.

<sup>34</sup> The Australian case is illustrative of the wider OECD trend. Thus, on current demographic projections, the number of Australians aged 85 and over will increase from 330,000 in 2006 to 580,000 in 2021 and then to over 1.6 million in 2051 – see generally Ergas, Henry and David Cullen (2007) *Providing and Financing Aged Care in An Aging Society*, (in press) available at [www.greenwhiskers.com.au](http://www.greenwhiskers.com.au).

<sup>35</sup> Extrapolating from similar trends in the US – see Reynolds, S. L., Y. Saito and E. M. Crimmins, 2005, ‘The Impact of Obesity on Active Life Expectancy in Older American Men and Women’, *The Gerontologist*, vol. 45, pp. 438-444. See Ergas, Henry and David Cullen, *ibid*, for a discussion of trends in chronic disease and their implications for provision and choice in aged care.

<sup>36</sup> For a good survey of the impact of consumer choice in health markets see Burgess, S., C. Propper and D. Wilson 2004, ‘The impact of choice in education and health: a review of the economic literature’, Centre for Market and Public Organisation, pp. 25-33.

63. There are both benefits and costs to placing competition policy and consumer policy within a single institution. We consider first the benefits and then turn to an assessment of the costs.

#### **4.1 Benefits of integration**

64. There are three major advantages to integrating the primary responsibility for competition policy and consumer policy within a single institution. These are:

- Gains from treating competition and consumer policy as instruments that can be flexibly combined and more generally managed within a single portfolio of policy instruments;
- Gains from developing and sharing expertise across these two areas; and
- Gains in terms of the wider visibility to the community, and understanding in the community, of competition and consumer issues.

##### *4.1.1 The portfolio of policy instruments*

65. By keeping markets effectively competitive, competition policy can reduce the work that needs to be done by consumer policy; equally, consumer policy, by enhancing the ability of consumers to exercise choice, can help make markets more effectively competitive and force firms to compete on the merits, thereby supporting the ends of competition policy. This interdependence is important because it means that there may be scope for substitution between these instruments. As a result, joining the instruments within a single armoury may allow both objectives to be pursued at lower net cost (or equivalently, with greater net gain), as the least cost instrument is used in each fact situation.

66. For example, as a general matter, competition policy, other than by prohibiting anti-competitive conduct, has relatively little scope to make markets more structurally competitive than they would otherwise be; moreover, policies that seek to “de-concentrate” oligopolistic markets, either through forced divestments or by subsidising or otherwise assisting entry, are often contentious and often seem likely to impose costs that are considerably greater than the benefits. In that sense, competition authorities may have few means to alter the supply side of markets so as to make rivalry a more effective discipline. However, in those cases, action on the demand side of the market may provide an effective alternative: for example, if better consumer information, or reduced switching costs, make the demand each firm faces more elastic, that will usually create incentives for each firm to price more aggressively for any given market structure.<sup>37</sup>

67. The value of seeing these instruments as being within a common portfolio of tools is accentuated by the fact that consumer policy can often be tailored to the needs of particular markets in ways that would be impossible and/or inappropriate for competition policy. For example, it would not be desirable to have a specific set of competition policy instruments that applied to (say) electricity retailing; however, the particular issues associated with improving customer information in that market may well be properly dealt with through consumer policy instruments (such as information campaigns) that are specific to the market at issue. In that sense, while competition policy is by its nature a relatively blunt instrument, interventions on the demand side of markets may be capable of addressing industry specificities in a more finely honed way.

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<sup>37</sup> This is not always the case. For example, in a market that is growing rapidly, switching costs may induce firms to bid more aggressively for customers so as to benefit from subsequent lock-in effects. Artificially lowering switching costs in such a market may attenuate price competition, at least in the growth phase. However, the reduced competition in the growth phase may be offset by more intense competition once the market size has stabilised. As a result, even in those cases, there is a trade-off between switching costs and competition.

68. At the same time, managing these instruments within a common portfolio may be an effective way of identifying, and thus avoiding or reducing, inconsistencies in policy settings. For example, mandatory product standards can limit competition by restricting low cost, low quality producers from entering markets. That harmful consequence is more likely to be revealed, and to cause corrective action, in an institution that is also attuned to the goal of promoting competition, and whose functions lead it to undertake competition investigations across a wide range of markets, than in one that is not. More generally, by ensuring that each market and the instruments brought to bear on it are seen as a whole – in terms of the functioning of both that market’s supply side and of its demand side – the risk of one set of policies being used to undermine the other can be better controlled.

#### *4.1.2 Shared expertise*

69. Particularly but not solely in smaller economies, the stock of expertise available to the public sector for analysing complex policy issues to do with the structure and functioning of markets is likely to be very limited. As both consumer and competition policy draw on similar types of expertise, managing what expertise there is within the framework of a single institution may allow it to be used more efficiently.

70. At the same time, such integrated management may provide opportunities for professional development in which individuals are exposed to, and develop a detailed understanding of, to both competition policy issues and consumer protection issues. This is especially important when analyses are required that take full account of both the supply and the demand side of markets.

71. For example, it can be difficult to understand what (seen from the supply side) may seem to be unduly restrictive agreements without an understanding of the way the demand side of a market works. Agreements whereby insurers “steer” consumers to particular suppliers of smash repair services – by requiring consumers to only use designated repairers – are a case in point. Those agreements may seem to restrict competition for smash repair services. However, their primary justification lies in the way they limit the moral hazard problems that would otherwise arise in the market for smash repair services. Those moral hazard problems arise because consumers do not bear the full costs of the repair services, while the quality of repairs is often difficult to fully observe. By seeming to limit consumer choice, the insurer can both reduce costs and increase quality directly and provide incentives for smash repairers to compete on the basis of cost and quality, rather than by exploiting consumers and insurers. A detailed knowledge of how consumers behave in situations such as these is obviously helpful to a proper analysis of what may seem an undue restriction on competition.

72. Equally, an understanding of consumer policy issues and instruments can be important in assessing possible changes in market structure, such as those associated with proposed mergers. At the simplest, knowing that an industry is one in which consumers have experienced persistent problems with the terms and conditions of service may assist in examining claims about how the relevant markets have operated in the past and might operate in future. For instance, if consumers typically face high information costs, the post-merger market structure may offer more scope for consumers to be exploited, particularly if post-merger competition would depend heavily on new entry or on the expansion of relatively small and perhaps little-known suppliers. At the same time, a close awareness of those consumer issues may help shape remedies, which could, for example, include information disclosure or product unbundling requirements.

#### *4.1.3 Community support and public accountability*

73. Finally, there may be benefits in terms of community support and public accountability.

74. As far as support is concerned, there is a natural appreciation in the community of the value and importance of consumer protection. By linking its competition policy activities to the consumer protection agenda, and explaining the linkages between its competition policy decisions and the promotion of the consumer interest, a competition authority can enhance public acceptance of competition policy. This may be especially important in countries where competition policy is a relatively recent development, and where there is little understanding of the importance, role and substance of competition policy. Potentially highly controversial decisions – such as those involved in opposing mergers between powerful domestic firms – may prove easier to make and sustain if they can be clearly explained as part of a broader mission aimed at protecting and promoting the interests of consumers.

75. At the same time, at least in some countries, consumer protection has found it difficult to obtain a high degree of political priority and indeed, of support within administrative and bureaucratic elites. This has compromised both its access to ongoing funding and its ability to attract the more ambitious elements in the public service. In contrast, having well-resourced competition policy authorities is broadly seen as an important component of sound economic management. Moreover, a stint working in a competition authority may be an attractive career move for talented young professionals. Competition authorities' resulting greater access to human and financial resources may more readily spill over to consumer protection in countries where the two areas of policy share a common home.

76. As well as these gains in sustainability, integrating the missions may lead to improved public accountability. Competition policy tends to be economy-wide in its reach, and the individual actions and decisions of competition policy authorities are of broad interest to the business, legal and academic communities, as they are seen as precedents that may be extended beyond the firms and industries directly at issue in those actions and decisions. As a result, the conduct of competition authorities in respect of their competition functions is subject to quite careful and effective monitoring, which helps ensure that those agencies operate to reasonable quality levels.

77. In contrast, consumer policy is at times highly-industry specific and additionally involves many decisions that individually, have quite low stakes in absolute, economy-wide, terms. This can lead to a situation in which relatively few social actors have the incentive or ability to carefully monitor decision-making by specialised consumer policy agencies. This absence of close monitoring can lead to regulatory failure, with the agency at issue being captured either by the ideology of consumer protection – without a proper appreciation of the costs regulation imposes – or by the regulated firms, which have an interest in using consumer protection to create barriers to the entry and expansion of new players. These risks are likely to be smaller in an entity that also has the competition policy functions, both because of the internal culture of such an entity and because of the close scrutiny that entity will naturally attract.

## **4.2 *Costs of integration***

78. Although integration of competition policy and consumer policy institutions can have benefits, it also has costs. Those costs arise from the inherent differences in the substance and implementation of these instruments, and the obstacles those differences create in practice to achieving full policy integration.

### **4.2.1 *Differences in substance and implementation***

79. Although consumer policy and competition policy share common goals, the specific instruments on which they rely differ, as does the context in which policy implementation occurs.

80. Thus, by and large, competition policy is implemented through the enforcement of the competition laws, which involves a mix of administrative proceedings (such as those used in merger clearance and in the authorisation (administrative approval) of agreements) and of litigation in courts and

tribunals. Typically, the case load involves relatively small numbers of cases, with individual cases that are often very large in absolute terms. Additionally, direct interaction with the public is often quite limited, with much of the information flow occurring through highly formalised processes, such as information filings and document discovery. These characteristics of the work flow have a significant influence on the structure and conduct of the agencies, including in terms of the training of staff, the types of skills and career paths that make for advancement, and the allocation of the time and attention of senior personnel.

81. In contrast, consumer policy is inherently more varied in its instruments, form and substance. As regards the instruments, while consumer policy has a conventional enforcement element (that is most marked in respect of misleading and deceptive conduct), it also covers weights and measures, product quality and safety standards, industry codes of conduct, the regulation of behaviour in individual professions and consumer ombudsman and dispute resolution mechanisms. While there are some important instruments that are economy-wide, they are usually paralleled by an extensive assortment of sector- or market-specific instruments. These rely on a broad range of enforcement instruments and in some cases (such as information and consumer education) are very “soft” forms of regulation. Moreover, the process of policy formation and implementation tends to be itself very varied and in many respects porous, with significant direct involvement with the public, a case load that involves many individually small cases, and considerable industry input into policy design. In turn, these features map into a policy process that is far more decentralised – in terms of the range of players involved – and far more geographically localised than is the formation and enforcement of competition policy.

82. One result of these differences is that consumer policy, when it is integrated within an agency that also has responsibility for competition policy, may find it difficult to attract the attention it deserves. The highly varied nature of the consumer policy case load, and the fact that many consumer policy cases are relatively small and have low stakes in absolute terms (though they may be of great significance to individual consumers), can lead to consumer policy receiving less top management attention and support than it should. The fact that much of consumer policy involves decentralised interaction with other agencies and territorial levels of government can induce a tendency to delegate the work to relatively junior levels and not to give it the funding, resources and profile that competition policy – with its ongoing stream of high visibility, large scale, litigation – invariably secures.

83. These issues arise from differences in the nature of instruments and tasks these respective policy instruments involve. In theory, of course, that could change.

84. In particular, there could be gains to consolidating consumer policy, in terms of giving it a more unified statutory and institutional basis, and in that respect making it somewhat more similar to competition policy. Indeed, in a very recent review of Australian consumer policy, the Productivity Commission (which advises the Australian Government on issues that affect economic efficiency) has recommended that it would be preferable to rely on the generic law, rather than resorting to industry-specific regulation, in dealing with many consumer problems.<sup>38</sup> In effect, such reliance on generic law:

- Facilitates consistency in approach across consumers and markets;
- Allows regulators to deal with emerging problems without the need for new statutes — an especially important feature given that many consumer markets are evolving rapidly;
- Generally avoids boundary line problems and the gaps in regulatory coverage that can ensue; and

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<sup>38</sup> Productivity Commission (2007) *Review of Australia's Consumer Policy Framework: Draft Report*, Canberra.

- Imposes relatively few costs on the overwhelming majority of suppliers who do the right thing by consumers.

85. Set against those benefits, industry-specific consumer regulation explicitly seeks to prevent certain behaviours rather than rely on the deterrent effect of the threat of prosecution for breaches of general law and possible liability for compensation. Its use, the Productivity Commission notes, is most likely to be desirable when:

- The risk of consumer detriment is high and/or the detriment suffered if things go wrong is potentially significant and possibly irreparable. (Such considerations are the primary reason why specific regulation is employed in the medical and consumer credit areas);
- The suitability and quality of services is hard to gauge before or even after purchase (the ostensible rationale for many other professional licensing regimes); and/or
- The technical nature of a product or service makes it easier for a regulator to assess breaches of appropriate behaviour against some 'objective' standards.

86. These considerations are well made and, at least as far as Australia is concerned, they do suggest gains in placing somewhat greater weight on achieving consumer protection objectives through economy-wide statutory instruments. Nonetheless, even with such a move, the major differences noted above between the nature of the tasks, skills and processes involved in competition policy on the one hand, and consumer policy on the other, seem highly likely to remain.

87. This, in turn, creates practical difficulties to seeking to manage both of these functions within a single agency of government. While these difficulties need not be insuperable, they limit the economies of scope between the functions and may make for their separate administration.

#### 4.2.2 *Limits on integration in practice*

88. Largely as a result of the characteristics noted above, it is an inherent feature of any effective regime of consumer protection that it will involve a number of quite distinct agencies of government. Moreover, those agencies may well span separate territorial levels of administration, especially in countries with a federal structure. This multi-agency character is especially marked when consumer protection issues arise in industries that are subject to extensive industry-specific regulation, such as financial services and health care. In those instances, the industry-specific regulators naturally play a substantial role in consumer protection issues, and indeed, often bear the primary responsibility in that respect.

89. As a result, it is not generally feasible to centralise responsibility for consumer policy to the same extent and in the same way that occurs as regards responsibility for the enforcement of competition policy. Even when aspects of the functions are combined in a single institution (as is the case with the ACCC in Australia), many important aspects of consumer protection fall outside its remit, and will likely continue to do so.

90. This implies that, in practice, the degree of integration between these policy instruments will never be complete. Rather, any integration will be selective, and hence will need to focus on those aspects of the policies which are most tightly interdependent and where the economies of scope in policy design and implementation are greatest.

### 4.3 *Conclusions on institutional design issues*

91. Overall, there are a number of respects in which gains can be achieved by locating responsibility for both competition policy and consumer policy in a single institution. Those gains include:

- Benefits in terms of better policy coordination, and in particular, in the selection of policy instruments to meet the needs of particular fact-situations;
- A better understanding by policy-makers and enforcers in each area of the role and limitations of the other; and
- The ability to secure economies of scope in access to resources and in the efficacy of monitoring and accountability processes.

However, there are also inherent limits to the possibilities for integration:

- The nature of the tasks involved in implementing consumer policy differs greatly from those involved in the administration of competition policy, reducing the economies of scope achievable through their integration; and
- It is an inherent feature of any effective policy of consumer protection that it will involve a range of agencies, and (especially in Federal countries) span several territorial levels of administration.

92. These conflicting pressures can obviously be addressed through a range of quite differing approaches. In practice, what appears most important is:

- To ensure that the competition authority has in-house access to the skills involved in the formulation of consumer policy, and at the very least a watching brief with respect to consumer policy, as well as scope to intervene in consumer policy decisions that have material competition implications; and
- That there be within government, an entity that has “whole of government” oversight of consumer protection, and that exercises that oversight in a manner mindful of competition concerns.

93. Periodic surveys of particular instruments – such as occupational licensing, or restrictions on advertising – aimed at reviewing whether they are consistent with efficient competition, could play a useful and important role in this respect. These surveys would provide a regular opportunity to review whether the objectives pursued through whatever restrictions are imposed using these instruments could be achieved in less restrictive, or more efficient, ways. Developing a program of such reviews, starting with those instruments that are most likely to be unnecessarily restrictive, could be an effective approach to giving such a process a structure and clear time-line.

## 5. Conclusions

94. It has recently been emphasised that consumer policy can “activate” competition policy – that is, can help bring competitive processes to life, giving them the vitality they need to achieve the objective of making markets efficient and effective.<sup>39</sup>

95. This is so even though there is also on occasions a risk that the instruments of consumer policy, rather than serving the interests of consumer, will be used to restrict otherwise desirable competition. As world markets become ever more integrated, this danger also becomes more pressing. Paternalistic justifications can be deployed for many purposes, and not all of them are socially desirable.

96. This is not to suggest, however, that there should be any doubt about the importance of consumer policy. Long-standing concerns about the need to protect consumers, and especially the most vulnerable among them, not only retain their validity but are even more significant as market mechanisms are

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<sup>39</sup> Sylvan, L. 2004, “Activating competition: The consumer – competition interface”, *Competition & Consumer Law Journal*, pp. 191-206.

introduced into ever more parts of our economies and societies. The introduction of competition into these areas needs to be closely coordinated with the development of effective consumer safeguards, which is a challenge which largely remains to be met. The imperative of policy coordination is therefore as pressing as ever.

97. There may, however, be no “magic bullets” that can fully meet that imperative. The reality is that competition policy and consumer policy will always differ in the range of instruments on which they rely, key features of the tasks involved in their implementation and the levels of government that they involve. This, as well as history, may limit the extent to which there can be institutional integration. As a result, what may matter most is that competition policy authorities have the expertise needed to be effective advocates in the many dimensions of the consumer policy process whilst consumer agencies likewise have competencies in competition policy; and that there is, in central government, ongoing attention to the need for consistency between these policy instruments. Periodic surveys of particular instruments – such as occupational licensing, or restrictions on advertising – aimed at reviewing whether they are consistent with efficient competition, could play a useful and important role in this respect.