

Interactions between competition and consumer policy

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FOREWORD BY AMELIA FLECHTER

The mission of the Office of Fair Trading (OFT) is to make markets work well for consumers. Competition and consumer policy are complementary in achieving this. The OFT has enforcement powers in both areas and carries out a number of 'softer' activities in both areas such as education and guidance. The OFT has been working to exploit the synergies between competition and consumer policy in order to promote and protect consumer welfare and drive productivity.

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This report is part of the OFT's Economic Discussion Paper series. If you would like to comment on the paper, please write to me, Amelia Fletcher, at the address below. The OFT welcomes suggestions for future research topics on all aspects of UK competition and consumer policy.

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1 INTRODUCTION¹

1.1 The objective of both consumer and competition policy is to deliver well-functioning markets, something which requires both a strong supply side (competition) and a strong demand side (consumers). For many products, vigorous competition is the single best protection for consumers, and only minimal consumer protection (general contract law, forbidding deceptive marketing, the ability to return faulty goods, and so forth) is needed. As a former Chairman of the Federal Trade Commission (FTC) writes: '[R]obust competition is the best single means for protecting consumer interests.'² However, in some markets some consumers do not always obtain a good deal, even when substantial competition is present, and in such cases additional policies to aid consumers have a role to play.

1.2 What prevents markets from delivering good outcomes to consumers? Familiar reasons include abuse of dominance and collusion between suppliers, and these fall broadly within the domain of competition policy. However, there are several other reasons why competition need not work well (e.g., imperfect information about product attributes, imperfect information about market prices, consumer costs of obtaining market information, supplier costs of advertising, or consumers possessing imperfect information about their own needs). These features, which are explored in Chapter 3 below, fall broadly under the heading of consumer policy.

¹ I am very grateful for discussion, information and corrections to Nick Chater, Yongmin Chen, Carli Coetzee, Amelia Fletcher, Steffen Huck, Phillip Leslie, David Pinch, David Ruck, David Sappington, Rani Spiegler and John Vickers. All views expressed are entirely my own. I am grateful for funding assistance from the Office of Fair Trading and from the Economic and Social Research Council (UK).

² Timothy Muris, The Interface of Competition and Consumer Protection, Paper presented at Fordham Corporate Law Institute's 29th Annual Conference on International Antitrust Law and Policy, New York (Oct. 31, 2002).

1.3 It seems hard to define precisely 'competition policy' versus 'consumer policy'. One could say that competition policy comprises 'the set of policies and laws which ensure that competition in the marketplace is not restricted in such a way as to reduce economic welfare.'³ Whereas consumer policy 'consists of preventing sellers from increasing sales by lying about their products or by engaging in unfair practices such as unilateral breach of contract or unauthorized billing.'⁴ Alternatively, one can define consumer policy in terms of the fundamental problems it seeks to prevent, cure, or remedy, which are:

- (i) duress and undue sales pressure;
- (ii) information problems pre-purchase; and
- (iii) undue surprises post-purchase.⁵

1.4 Nevertheless, many policies (such as policies which act to reduce consumer search costs or switching costs, or which reduce industry advertising costs) could be said to fall under both headings.

1.5 In the past, consumer policy and competition policy ran along quite separate lines, with little interaction between the two. For better or worse, there was a lot more economics informing competition policy than consumer policy. However, in recent years economists have shown a greater interest in consumer policy. This stems from at least two, probably related, causes. First, the modern consumer arguably faces more difficult decisions, involving more choices, than in the past. Second, the economics profession has recently seen the dramatic rise of 'behavioural economics', a branch of the discipline which takes into account imperfect consumer decision making—consumers can be less 'rational', more prone to various 'biases'—more so than in earlier analysis. As leading behavioural economists put it in a 2003 paper:

³ MASSIMO MOTTA, *COMPETITION POLICY: THEORY & PRACTICE* 30 (2004).

⁴ Muris, *supra* note 1.

⁵ J. Vickers, *Economics for Consumer Policy*, 125 *PROC. BRIT. ACAD.* 287-310, 289 (2004).

'Recent research in behavioural economics has identified a variety of decision-making errors that may expand the scope of paternalistic regulation.'⁶

1.6 Over recent decades, competition policy has tended to be implemented in a more similar fashion across countries than in the past. As the Internet enables more products to be marketed globally, this same trend of convergence is now starting to affect consumer policy too. As Muris (2002) puts it:

If different arbiters apply different standards in these areas, then marketers who wish to apply identical techniques across borders may have to design a strategy that complies with the standards of the most restrictive jurisdiction in most countries, a result that might not maximize consumer welfare.⁷

1.7 This is another reason why there is currently more interest in consumer policy than before.⁸

1.8 In this paper, I describe some of the interactions between competition and consumer policies: when are they substitutes or complements, and when does one approach actively interfere in the implementation of the other? In Chapter 2, I give a very brief outline of how competitive markets often offer sufficient protection to consumers without the need for extra publicly provided protection. In Chapter 3, I point out some ways in which competitive markets may fail some consumers, and how consumer policy might then be needed. Some scenarios in which more

⁶ C. Camerer, S. Issacharoff, G. Loewenstein, T. O'Donoghue & M. Rabin, *Regulation for Conservatives: Behavioral Economics and the Case for 'Asymmetric Paternalism'*, 151(3) U. PENN. L. REV. 1211-54 (2003).

⁷ For a discussion of recent convergence in the area of consumer fraud, see Muris (2002), *supra* note 1.

⁸ The current European Union *Unfair Commercial Practices Directive* is an important step towards harmonizing consumer policy within Europe. See Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, 2005 O.J. (L 149) 22 [hereinafter UCPD].

competition might actually make some consumers worse off are outlined in Chapter 4, while situations in which poorly designed consumer policies could harm consumers are presented in Chapter 5. Chapter 6 concludes and offers some suggestions for where future research might be most usefully targeted.

2 COMPETITION ON ITS OWN CAN OFTEN PROTECT CONSUMERS

2.1 The aim of this section is not to present the various benefits of competitive markets in general; rather, I wish to discuss the ways in which markets can provide consumer protection measures without additional government intervention. In well-functioning markets, supported by general contract law, competitive pressure means that only those firms which give consumers what they want can prosper. There is little role for consumer policy when all product attributes and prices are easily observed and evaluated at the time of sale, when search costs are not significant, when consumers sample offers from multiple suppliers, and when most consumers are capable of making reasonably good decisions concerning the product in question. These stringent conditions probably apply when someone buys a new diary for the start of the year, for instance.

2.2 But many, perhaps most, products do not satisfy these restrictive requirements. In particular, it is rare that all product attributes and prices are known when a choice is made. The more important insight is that even in markets for experience goods, the competitive mechanism can often still work well unaided.⁹ Consider novels, for instance, which are a clear-cut experience good since consumers do not know how much they will enjoy a particular book until they read it.¹⁰ Here, many signals of a book's likely quality are available:

- (i) the consumer enjoyed previous books by the same author (a 'brand' effect);
- (ii) there are useful blurbs on the back (which most readers know are not always to be trusted);

⁹ It is conventional to divide products into three classes, depending on the extent of the information problem. 'Search goods' are products whose attributes are fully observable at the time of purchase; 'experience goods' have attributes which are only revealed after purchase; and 'credence goods' have attributes which are not fully revealed even after purchase.

¹⁰ See Vickers (2004), *supra* note 4, at 297.

- (iii) the bookseller provides informative comments;
- (iv) word-of-mouth from friends may be valuable; and
- (v) electronic versions of word-of-mouth, such as 'reader comments' on retailer websites such as Amazon.com, provide useful information.¹¹

2.3 There is no obvious 'consumer protection' policy which could improve on the laissez-faire outcome in this market.

2.4 Even credence goods, the most challenging type of good, can sometimes be supplied effectively in a laissez-faire competitive market. Consider repairing a particular kind of machine (which could be the human body). The consumer does not know the cause, which may be trivial or may require a major repair. An expert can repair the fault to the satisfaction of the consumer, but the consumer might never know if the expert exaggerated what was needed in order to increase the bill. But if the search or diagnosis cost is relatively small, many consumers will shop around for several quotes for repair, and competitive pressure may force the cost of repair close to the minimum cost.¹² Nevertheless, consumer search costs for credence goods may be extremely high (as is plausible for car repair, for instance), and experts may presume that most consumers are captive and the severity of the fault can be exaggerated safely.¹³ Moreover, if consumers cannot tell if the repair has been

¹¹ On this last point, see J. Chevalier & D. Mayzlin, *The Effect of Word of Mouth on Sales: Online Book Reviews*, 43(3) J. MARKETING RES. 345-54 (2006).

¹² U. Dulleck & R. Kerschbamer, *On Doctors, Mechanics, and Computer Specialists: The Economics of Credence Goods*, 44(2) J. ECON. LIT. 5-42 (2006). The result referred to is Lemma 7 in that survey. In addition, in situations where consumers commit to get treatment when they get diagnosis from an expert, and where experts post prices for treatment, competition can, under stringent conditions (such as all consumers having the same probability of needing a serious repair), deliver the ideal outcome (see Proposition 1).

¹³ Illustrative anecdotes are provided in W. Emons, *Credence Goods and Fraudulent Experts*, 28(1) RAND J. ECON. 107-19 (1997). For instance, in a region in Switzerland the general population had significantly more medical operations than medical doctors and their families, consistent with a degree of over-treatment among the uninformed. Likewise, H. Schneider,

successful ex post (say, the medical treatment only cures the patient some of the time, even when the treatment is appropriate), then under-treatment as well as over-treatment presents a danger, and the market may break down altogether without intervention.¹⁴

2.5 A seller's concern with its reputation is another means by which opaque markets can work relatively well. Reputation can be established through two main channels: via repeat purchases from the same consumer, or via publicity, including word-of-mouth from one consumer to another. The reputation literature is concerned with how and when an appropriate level of product quality is supplied in the market. The term 'quality' can be interpreted very broadly and encompasses hidden charges in the small print, unexpected exclusions in insurance contracts, and so forth. For instance, it is quite unrealistic to suppose that consumers are aware of the prices of all products inside a supermarket before they visit, and so many of the store's prices are only observed at the point of sale. The store could set high prices in order to exploit the fact that the consumers are 'locked in' once they enter the store. If this were the end of the story, this market would perform very badly, and there would be scope for beneficial consumer policies, such as publicizing price indices for supermarkets.¹⁵ But a supermarket is a leading example of a seller that relies on repeat purchases, and this hold-up strategy is unlikely to be profitable for a store since many consumers will experiment with a rival store if they are exploited by their current choice.

2.6 A more serious information problem is that many consumers may not be aware even of the prices of the products they put into their baskets. Therefore, if a supermarket marks up its price for, say, butter by 500 percent, many of its customers will mistakenly buy it, yielding the store

Agency Problems and Reputation in Expert Services: Evidence from Auto Repair (2007) (mimeo, Cornell) reports results from a field experiment where the same faulty car was taken to 40 garages for diagnosis and quotes for repair. He found that 27 percent of garages suggested unnecessary repairs, while real faults were missed in 77 percent of cases.

¹⁴ See Dulleck & Kerschbamer (2006), *supra* note 11, at Proposition 4.

¹⁵ See the later discussion of the 'Diamond paradox' in Chapter 3 Section C of this paper.

a short-run profit. But at least some people will notice the trick, either in the store or once they get home, and there will quickly be substantial negative publicity which will wipe out any short-run gains to the shop. (Note that reputational effects are greatly enhanced when there is a vigorous free media operating in the jurisdiction.) Here, a supermarket's concern to maintain its reputation is a more powerful constraint than any externally-imposed informational remedy could be. Similar issues arise with financial products, where the product often requires signing a lengthy contract involving many clauses and potential hidden charges. Indeed, when a consumer does not realize the importance of a small-print clause or price until after the product is purchased, the effect is very much like an experience good. For instance, a firm concerned with its reputation selling a life insurance policy would not put in exploitative clauses (such as 'We will not pay out if death occurs on Tuesday'), even if they were legal, since the negative publicity would be enormous.

- 2.7 Modern technology provides new ways in which the reputation mechanism can be harnessed. For instance, one situation which on the surface seems problematic is buying objects on an Internet platform such as eBay, where a consumer hands over money while having to trust that the seller will actually send the object. Since there is little chance that a buyer and seller will interact repeatedly, or even that a friend of the buyer will interact with the seller, there seems to be little scope for direct reputational concerns to play a role. But the use of 'seller ratings', a kind of collective reputation mechanism, apparently provides a powerful constraint on the seller's ability to exploit consumer vulnerability (unless the seller has only one item to sell).¹⁶
- 2.8 All of this suggests that reputation (generally conceived) is a powerful force to constrain firms to behave well, even when they supply highly complicated products. However, in some markets, reputation cannot play a strongly disciplining role, for instance if the product is not

¹⁶ P. Bajari & A. Hortacsu, *Economic Insights from Internet Auctions*, 42(2) J. ECON. LIT. 457-86, §5 (2004), surveys the empirical work on the effectiveness of the reputation mechanism in online auctions, which is mixed in its conclusions.

purchased repeatedly and if word-of-mouth or other publicity is ineffective.¹⁷ The textbook example is a restaurant in a tourist area, although in reality tourist guidebooks or star rating systems can provide large incentives to provide good food.

2.9 Advertising is a prime means by which to get information—price and non-price—to consumers with search costs. Consumers do not always have to visit a retailer physically to find out its prices and other product characteristics. In addition, advertising can provide important information about product characteristics which consumers would otherwise find hard to discover even at the point of sale, thus ameliorating experience or credence good problems. Suppliers of breakfast cereals, for instance, may advertise useful information about the healthiness of their products.¹⁸ While advertisers can be trusted to point out the good aspects of their products, they will not voluntarily advertise the bad product characteristics. However, comparative advertising (when permitted) may step in here, and rivals will often be willing to point out defects in a product to the benefit of all consumers. Even advertising messages which do not contain useful information to consumers may indirectly act as a signal of the price or quality of the product. If consumers follow the rule of thumb that a more heavily advertised

¹⁷ G. Jin & P. Leslie, *Reputational Incentives for Restaurant Hygiene*, AM. ECON. J.: MICROECONOMICS (forthcoming 2009) provide evidence showing that restaurant hygiene tends to be higher in local markets which have a greater proportion of repeat buyers. Schneider (2007), *supra* note 12, tests for the impact of reputation by informing some (randomly chosen) garages that he has just moved to the area (thus indicating scope for repeat business) and informing others that he is about to leave the area. He finds that while the potential for repeat business appears to lead to a lower charge for diagnosis, it appears to have no significant affect on the quality of the diagnosis.

¹⁸ In 1984, Kellogg launched an advertising campaign focusing on the health benefits of one of its cereals, All-Bran. This was in direct violation of the U.S. Food and Drug Administration's then-policy which essentially banned health claims on food products. A subsequent relaxation of this ban acted to facilitate information flows to consumers, which led many consumers to change their consumption behavior. Moreover, it seems that government and general information sources before the ban was lifted had little impact on consumer behavior. See P. Ippolito & A. Mathios, *Information, Advertising and Health Choices: A Study of the Cereal Market*, 21(3) RAND J. ECON. 459-80 (1990).

product is likely to be better or cheaper than its rivals, it may often be in the interests of the better (or lower cost) supplier to advertise most intensively.¹⁹ Finally, advertising—including direct marketing methods—may be the only way to reach those consumers who do not wish to research the market actively themselves.

- 2.10 To aid those consumers who do wish to undertake market research, there is a flourishing market for market information that can help overcome consumer search costs as well as provide information about shrouded product attributes. This market includes commercial magazines and websites offering consumer reports on various items, as well as price comparison websites and the certification intermediaries discussed in the next paragraph. Other commercial websites offer detailed 'consumer protection' advice.²⁰ The market for market information has several special features which can limit its efficient operation, some of which are discussed later in Chapter 3 Section B, but it undoubtedly is important in helping active consumers to make better decisions.
- 2.11 Institutions often exist to allow sellers to communicate the quality of their products to consumers. These institutions include advertising (when supported by policy to combat misleading advertising) and 'certification intermediaries' who are trusted to convey accurate information about products they test. (An example of the latter are firms seeking to provide 'green' certification standards.) When these institutions exist, the opportunity that sellers have to reveal product quality can mean that there is no need for a policy of mandated disclosure, and consumer policy needs merely to facilitate the emergence

¹⁹ See Kyle Bagwell, *The Economic Analysis of Advertising*, in 3 THE HANDBOOK OF INDUSTRIAL ORGANIZATION 1701-1844 (M. Armstrong & R. Porter eds., 2007). Likewise, if users of a search engine tend to click on suggested links in the order in which they appear on the page, then websites which are most likely to fit the user's need will often pay the most to be listed first. (And in this case, consumers indeed should click on the links in the suggested order.) See S. Athey & G. Ellison, Position Auctions with Consumer Search (2007) (mimeo, MIT and Harvard University).

²⁰ See, e.g., Money Saving Expert: Consumer Revenge (United Kingdom), at www.moneysavingexpert.com (last visited Jan. 17, 2008).

of these institutions. The basic idea is that a seller with a high-quality product will choose to disclose this information, and (rational) consumers will assume that sellers that choose not to disclose their quality have lower quality. In theoretical models, it can be that *all* sellers will choose to reveal their product quality.²¹

- 2.12 In markets with switching costs, it is likely that rivals will choose to make it as easy to switch as possible. For instance, an energy company might offer to do all of the work involved in switching supplier. More controversially, a firm may offer new customers a better deal than its existing customers, in order to overcome its new customers' cost of switching.²² The result then is that there could be too much switching in the market, not too little, which could provide a novel role for policy. Finally, several price comparison websites (e.g., for energy, insurance) provide a 'one-stop' switching service too.
- 2.13 A contentious issue when discussing the competition versus consumer policy interface is whether more competition acts to simplify the deals offered to consumers (to the appropriate extent), or whether firms in competitive markets resort to trying to 'confuse' consumers in order to relax competition. The evidence on this question is very mixed, and often anecdotal. But it is clear that at least sometimes firms compete by offering simpler deals than their rivals, in order to attract those consumers who find consideration of complex tariffs or products psychologically costly. For instance, a mobile phone entrant might try to differentiate itself from incumbents by offering a tariff with a uniform call charge regardless of the network being called or the time of day. Or a firm might 'unshroud' a rival's tariff, for instance by pointing out that the price for its car is 'all inclusive' while the rival's advertised price

²¹ P. Milgrom & J. Roberts, *Relying on the Information of Interested Parties*, 17(1) RAND J. ECON. 18-32 (1986). In fact, this 'unraveling' argument works even with a monopoly seller, provided that consumers think strategically and have accurate information about the market environment (see Section 2 in that paper). When there is competition, consumers do not need to reason in such a sophisticated way for this result to hold (see Sections 3 and 4 in that paper).

²² Y. Chen, *Paying Customers to Switch*, 6(4) J. ECON. MGMT. STRATEGY 877-97 (1997).

excludes some core features. Situations in which firms do attempt to confuse consumers are discussed in Chapter 3.

- 2.14 Markets can deliver products which help consumers deal with their own imperfect decision making. For instance, many consumers have problems of self-control to do with impatience—say, spending too much on a credit card now, and not thinking enough about high interest charges later—and many of these consumers are aware of their weakness of will (e.g., they have learned this over time). These sophisticated, but weak-willed, consumers have a demand for commitment devices to constrain their subsequent choices,²³ which the market will often supply. The most obvious of these are illiquid savings products (e.g., where someone automatically pays in a certain amount of money each month, and it is hard to extract the savings on short notice).²⁴ Other examples include addiction treatment clinics, where consumers sign up for a period of time and are kept apart from their vice, season tickets to 'high-brow' cultural events (where consumers may be tempted to stay in and watch TV if they had to buy a ticket for each performance), and exercise gyms offering lump-sum membership contracts so that consumers are not discouraged from exercise by a per-visit fee.²⁵ Thus, the presence of time-inconsistent, or otherwise boundedly rational, consumers is not a sufficient reason to intervene in a market.
- 2.15 Finally, many retailers compete by voluntarily offering warranties or 'no quibble' return policies that are substantially more protective of their consumers than is required by consumer law. In sum, consumer

²³ For evidence that consumers have demand for commitment devices, see N. Ashraf, D. Karlan & W. Yin, *Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines*, 121(2) Q.J. ECON. 635-72 (2006).

²⁴ D. Laibson, *Golden Eggs and Hyperbolic Discounting*, 112(2) Q.J. ECON. 443-77 (1997).

²⁵ S. DellaVigna & U. Malmendier, *Contract Design and Self-Control: Theory and Evidence*, 119(2) Q.J. ECON. 353-402 (2004) and K. Eliaz & R. Spiegler, *Contracting with Diversely Naive Agents*, 73(3) REV. ECON. STUD. 689-714 (2006). An alternative and less benign reason why gyms might set low per-visit charges, with respect to exploiting over-optimism on the part of consumers, is discussed in Chapter 3 Section E of this paper.

protection in its various forms is undoubtedly a vital service, but it is usually provided without the need for government intervention. The next chapter considers those situations in which intervention might still be needed.

3 HOW CONSUMER POLICY CAN SOMETIMES AID CONSUMERS

A. Deceptive marketing

- 3.1 An implicit assumption in the discussion in the previous chapter was that firms could not engage in deceptive marketing. For instance, without constraint a firm could make false claims for its products, or it could advertise one price while consumers find they must pay a higher price once they arrive at the store (or the advertised product is not available in the store, and only the more expensive versions are—the so-called bait-and-switch technique). If firms could do such things, some of them would do so when the practice enhanced profit. Consequently, consumer faith in the reliability of the advertising mechanism would be eroded, to the detriment of consumers and honest firms. However, it is important to recognize that many firms would not take advantage of the ability to make deceptive claims, since their reputation would quickly be harmed.
- 3.2 Similarly, if firms could freely denigrate their rivals' products, many would choose to do so, and consumers may eventually view advertising as meaningless babble, shutting down this crucial channel of information. (Reputational considerations may have somewhat less force for misleading comparative advertising, since, if the advertising campaign were successful, consumers might not try the rival product and so might not discover that the claims made were deceptive.)
- 3.3 Naturally, though, there is a fine line to be drawn between outright deception and adverts which mislead many consumers but which are technically accurate. To cope with this issue, it is common to use 'copy tests' to determine how many people are misled by a particular advert. The consumer body still needs to decide the vexed question of how many consumers need to be misled in order for the advert to be withdrawn.²⁶ (In Chapter 5, it is argued that past policy in the United

²⁶ For discussion of this point, see H. Beales, R. Craswell & S. Salop, *The Efficient Regulation of Consumer Information*, 24(3) J.L. & ECON. 491-539, §1B (1981). The UCPD, *supra* note 7, at

States set the barrier too low, requiring only a few people to be misled before an advert was withdrawn.) Such policy can never be perfect, since adverts which are useful for sophisticated consumers may mislead others.

- 3.4 Likewise, if a firm has built up a reputation for high-quality products, a rival firm may wish to pretend to be that firm by choosing a similar brand name or packaging (the phenomenon known as 'passing off') in order to charge the brand price but offer a product of a lower quality, thus harming both consumers and the original brand. Here, trademark laws and their enforcement will be useful for consumers.
- 3.5 Of course, misleading marketing practices can go beyond advertising false prices, and suppliers can make false claims about their products. Common scams include claims that a particular 'natural health cure' is effective, that 'Professor X can predict the next winning lottery numbers', or that a stranger genuinely needs to deposit money in my bank account.²⁷ Sometimes policy towards scams and scam-like products can be hard to formulate. Since people (even policymakers) differ in their beliefs about the efficacy of some products, and objective data can be unavailable, it can be hard to determine whether a product is fulfilling a genuine need or is really a scam. We might agree that Professor X cannot really foresee the winning lottery numbers,²⁸ but

para. 18, takes the view that a commercial practice is unfair if the 'average' consumer in that market is misled (among other hurdles which need to be passed). If a product is marketed at a particular sub-group of consumers (e.g., the elderly), then the average consumer should be taken with reference to that sub-group. Specifically, the UCPD states that '[t]he average consumer test is not a statistical test. National courts and authorities will have to exercise their own faculty of judgment [...] to determine the typical reaction of the average consumer in a given case.'

²⁷ For a long list of the scams being used in Australia at the time of writing (2008), see ScamNet – Complete Listing of Scams, at www.docep.wa.gov.au/ConsumerProtection/ScamNet/content/pages/full_list.html (last visited Jan. 25, 2008).

²⁸ 'Claiming that products are able to facilitate winning in games of chance' is one of the 31 practices which are in all circumstances considered unfair in the UCPD, *supra* note 7.

there are many grey areas, including: services which predict the outcome of horse races,²⁹ clairvoyants, astrology, some beauty products, some alternative health remedies, or the health benefits of organic food. The consumer body could publicize warnings about those products it felt confident were indeed scams,³⁰ but it is perhaps unlikely that those consumers taken in by outlandish claims will be the kind of consumer who browses consumer protection websites. The use of misleading marketing regulations is probably the most effective and proportionate method of controlling exploitative conduct here, and sellers should be prevented from making claims which are false or which cannot be verified. In addition, if there is objective information available about the efficacy or otherwise of these products, then that could usefully be brought to consumers' attention.³¹

- 3.6 Generally, policy to combat fraud and misleading marketing is the least contentious area of consumer policy. (In this regard it is similar to cartel and horizontal merger policy in competition policy.) However, some commentators are sceptical of the need for public intervention even here. For instance, Richard Posner (1969) has written:

In the political arena we posit a marketplace of ideas in which good ideas can be expected to prevail in open competition with bad, and one can take the same approach to advertising. Individuals know more about household products than they do about political questions, so if we trust them to evaluate competing and often fraudulent claims by political candidates, we should also trust them

²⁹ For details of recent intervention against a racing tipster, see Press Release, U.K. Office of Fair Trading, OFT obtains injunction against bogus racing tipster (Jan. 22, 2008), available at <http://www.offt.gov.uk/news/press/2008/12-08>. In return for a membership fee of GBP 590, members received tips on likely winners in horse races. Some 3,000 consumers signed up for the service. The marketing materials for the service were judged to be misleading, and falsely claimed for instance that the tipster owned a team of race horses and had ridden regularly for some of the most successful horse trainers. In addition, members were told they would make a 'minimum of £47,000 in 30 days.'

³⁰ See *supra* note 26.

³¹ See the discussion of 'quacks' in Chapter 3 Section C.

to evaluate competing product claims. Since other sellers, like rival candidates, have every incentive to counter the misleading representations of a competitor, false claims should eventually be unmasked.³²

- 3.7 A situation in which even Posner admits may require public intervention is when no seller has an incentive to provide accurate information and no rival has an incentive to unmask a rival's misleading claims. He suggests that cigarettes are an example of such a market, where no supplier has an incentive to advertise that smoking is unhealthy.³³ Here, there may be a role for carefully designed health warnings on cigarette packets, for instance, as well as other education campaigns.

B. The market for market information

- 3.8 Internet-based, price-comparison websites and other information intermediaries mitigate problems of costly consumer search.³⁴ However, information intermediaries are not a panacea for several reasons. First, while the market may provide market information, it cannot force consumers to undertake market research. For instance, in 2003, only 10 to 12 percent of consumers in a survey who had made price comparisons for energy suppliers that year had used the internet as their

³² R. Posner, *The Federal Trade Commission*, 37(1) U. CHI. L. REV. 47-89, 62 (1969).

³³ Posner (1969), *id.* at 68.

³⁴ J. Brown & A. Goolsbee, *Does the Internet Make Markets more Competitive? Evidence from the Life Insurance Industry*, 110(3) J. POL. ECON. 481-507 (2002) provide evidence that the growth of price-comparison websites for life insurance drove prices down for this product. An interesting study in the pre-Internet era had related findings. In 1974, two districts in Canada were chosen for a market transparency experiment in supermarket pricing. In one district, prices were collected but not publicized; in the other district, average price indices for individual supermarkets in that area were publicized in local newspapers. The result was that price dispersion and price levels fell in the second district relative to the first. See G. Devine & B. Marion, *The Influence of Consumer Price Information on Retail Pricing and Consumer Behavior*, 61(2) AM. J. AGRIC. ECON. 228-37 (1979).

source of market information.³⁵ (Doorstep selling was a much more significant source of information, which at times is indeed a way of forcing consumers to investigate market options.) Of course, though, this does not imply that government intervention to make markets transparent can do any better in this regard.

- 3.9 Second, there is still a good deal of price dispersion on price-comparison websites. A detailed study of one such website over a long period suggests that price dispersion is significant and non-transient: the gap between the lowest and the second-lowest listed prices averaged 23 percent when just two firms listed prices for the product, although this fell to 3.5 percent when 17 suppliers listed prices.³⁶ Suppliers also change their listed prices frequently over time, so that consumers (and rivals) need to keep on their toes. As discussed in the next chapter, it is the search cost of the marginal searching consumer which is likely to determine the degree of price dispersion in market, and it could be that the number of consumers who use price-comparison websites is not yet large enough to have a major impact of price dispersion in many markets.
- 3.10 Third, if consumers visit just one such information broker (e.g., because of search costs for using more than one price-comparison website), then a broker will hold a monopoly over providing access by sellers to its exclusive consumers. This will often mean that consumers are treated well by the broker (e.g., they obtain the service for free, as is often observed) while sellers may have to pay inefficiently high charges to list their prices. Moreover, as the broker makes its revenue mainly from the supplier side, it may have an incentive to restrict competition between sellers so that sellers have a better ability to pay high fees for being

³⁵ OFFICE OF GAS & ELECTRICITY MARKETS (OFGEM), DOMESTIC COMPETITIVE MARKET REVIEW 2004: A REVIEW DOCUMENT Tables 2.14 & 2.16 (Apr. 2004); and U.K. OFFICE OF FAIR TRADING (OFT), INTERNET SHOPPING: AN OFT MARKET STUDY ¶ 9.18 (Jun. 2007), reports that only 47 percent of Internet shoppers had used a price comparison website.

³⁶ M. Baye, J. Morgan & P. Scholten, *Price Dispersion in the Small and the Large: Evidence from an Internet Price Comparison Site*, 52(4) J. INDUS. ECON. 463-96 (2004).

listed.³⁷ The result of this skewed pricing could be that too few suppliers choose to be listed on the broker's website or suppliers may choose to bypass the broker and try to market their services directly to consumers. (For instance, we now see the increased use by airlines of their own websites to sell tickets directly to travellers, and some insurers have forbidden their products to be sold on price-comparison websites.) If such bypass goes too far, many consumers will have to search supplier-by-supplier once more, and the search efficiency introduced by the brokers in the first place will be eroded.

3.11 Fourth, the intermediaries are commercial operations, and must be funded from some source.³⁸ The funding may come from non-discriminatory listing fees (as described earlier), but alternatively it may come from just one or a few suppliers. In such cases, the broker may be biased and give undue prominence to its funders' products. In extreme cases, a 'price-comparison website' might just be a marketing front for one supplier. As such, a consumer body needs to be open to consumer complaints about the accuracy of price comparisons, as well as ensuring that the funding basis for the website is transparent. (These issues are already familiar in the market for financial advice.)

3.12 Fifth, many price comparison websites attempt to rank their various products by price (or give consumers the option to rank in this way), and

³⁷ The recent literature on 'two-sided markets' is relevant here, one example of which is M. Armstrong, *Competition in Two-Sided Markets*, 37(3) RAND J. ECON. 668-91, §5 (2006). Similar issues arise with the (typically non-price) market information found in Yellow Pages directories, where most consumers consult just one directory. See M. Rysman, *Competition Between Networks: A Study of the Market for Yellow Pages*, 71(2) REV. ECON. STUD. 483-512 (2004). M. Baye & J. Morgan, *Information Gatekeepers on the Internet and the Competitiveness of Homogeneous Product Markets*, 91(3) AM. ECON. REV. 454-474 (2001) present a model with a monopoly intermediary, and show that the intermediary restricts competition among sellers in order to increase the listing fee it can charge them.

³⁸ It is worth noting that consumer-testing organizations often do not permit a good product review to be used in a product's advertising. This is in part because the consumer organization wishes to maintain revenue from consumers buying its magazine or subscribing to its website, but it does act to impede information flows about product quality to the wider consumer population.

