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What we talk about when we talk about consumer welfare

The role of consumer welfare in competition policy is evolving—both in Europe and further afield. What is clear though is that the concept is central to our understanding of properly functioning markets. Phil Evans, Director, FIPRA, considers the potential of competition authorities and regulators to develop their thinking on consumer welfare and its place in competition investigations and merger analysis

One of the finest short stories by perhaps the greatest 20th-century exponent of the genre, Raymond Carver, bears the title 'What We Talk about When We Talk about Love'. If we insert the term 'consumer welfare' in place of 'love', we pretty much get to the heart of the project that FIPRA has been carrying out for the last year or so.[1] As active participants in cases and policy debates, we were struck by how often the welfare of consumers was invoked, and by how little what is meant by the term was spelt out. Over the course of 2007 we carried out a series of interviews with past and present senior competition officials, lawyers, economists and commentators. We had a series of conversations around the issues of consumer welfare, consumer behaviour, efficiency, and the history and philosophy of competition law and policy. The conversations supplemented desk work on the development of a consumer-focused approach to competition policy that we have been engaged in for many years. We will focus in this article on the main findings of our research and discussion, and on what policy implications we think are raised.

Who is the marginal consumer?

In some policy discussions the marginal consumer crops up like the *deus ex machina* of Greek theatre, the character who descends from the heavens to explain the workings of the play and tie together some of the rather confusing threads the audience were getting lost with. For example, when an official wants to explain why a particular market reform process will work, or why a merger should be blocked/allowed, the marginal consumer is called upon to deliver the required result.

In a properly functioning market the marginal consumer, through their consumption decisions, will indeed ensure that the firms that meet consumer needs prosper and those that do not fail. However, we need to know a good deal more about the marginal consumer than we currently do. Essentially, we need to know, on a market-by-market basis, who the marginal consumer is, how they make choices, and to what extent they can actually act as the market-disciplining force. We need to work out how likely it is that the marginal consumer will act in as near to a rational manner as possible, and we need to know what impediments there are in the way of the marginal consumer acting in such a manner.

Taking what we know about the bounds to consumer behaviour, it is instructive to address four questions in looking at any individual market.

– What affects the way a consumer approaches a decision?

– How does the consumer make a decision?

– How does a consumer learn from the decision?

– How much does the decision count?

Long-term consumer welfare is about efficiency and innovation

Any view we take of consumer welfare has to recognise that, in the longer run, consumer welfare is enhanced by an innovation-driven efficient market. Indeed, in the long term, one can almost equate the two. Unfortunately, the current debate has become rather polarised between a vision of the world that sees a short-term assessment of efficiency as the be-all and end-all of competition policy and one that sees it as a fall-back defence for otherwise indefensible acts. Getting innovation and efficiency 'right' as a part of consumer welfare is an important step in rebalancing the current debate. Efficiency is not a defence, nor is it a trump card, and it must be brought more 'up front' into competition analysis.

Short-term consumer welfare is more prosaic

Having said that long-term consumer welfare is closely correlated to an innovation-driven efficient market, we also have to accept that, in the short term, consumer welfare in any particular case is likely to focus on price, as the first among equals of all factors, balanced against choice and access. In the first instance this will mean that a practice is against the consumer interest if it raises prices, reduces choice or impairs access. Price is the first among equals of factors and can be trumped only by choice and/or access in exceptional circumstances.

Balanced consumer welfare: a transatlantic bridge

The current ideological splits between US and European regulators are largely the result of the 'priors', or assumptions that underpin the different cultures of economic regulation. Where the division is most acute is in the assessment of exclusionary behaviour cases. In Europe the priors of the competition community lean towards intervention; in the USA the priors lean towards a very limited willingness to act. The recent report from the Department of Justice on single-firm conduct has clearly highlighted these differences.[2] In terms of our own categorisation of consumer welfare, Europe has a tendency to focus on short-term consumer welfare factors, while the USA has a tendency to focus on a long-term view where efficiency trumps short-term price rises. A lack of a bridge between short-term consumer welfare and long-term efficiency gains, and an overly narrow interpretation of both terms, are primarily at fault in the division between approaches.

The beginning and end of things are important

If we are to treat efficiency, innovation and long-term consumer welfare as essentially the same bundle of issues, the question then becomes where in the analytical process we need to address them. As we have argued above neither can, nor should, be used as a trump or a defence. We need to bring this more broadly conceived view of consumer welfare into the start of investigations during the market definition stage and at the end of cases in the assessment of remedies.

Consumer behaviour needs to be adopted by agencies

There is an urgent need for competition officials to educate themselves about real-world consumer behaviour and to find practical ways to build this learning into market definition and the assessment of remedies. Competition agencies should employ behavioural economists and begin to work with neuro-economists now rather than wait the decades it has taken them to respond to the advances in behavioural economics.

Competition policy cannot be an island

The recent experience of the global financial crisis is evidence, were it needed, that competition policy is not an island. Competition authorities need to develop closer ties and more effective links to 'flanking policies' that can help to provide a pressure valve for civil society and political pressure to be deflected from the day-to-day work of authorities. Without such an approach there is a danger that what may appear in the short term to be sensible in the face of a crisis will hamper the ability of authorities to carry out their jobs in the longer term. Authorities also need to be more willing and able to take on vested political and departmental interests that seek to undermine competition regulation through slow or inappropriate regulation.

Consumer organisations have to do more and be encouraged to do so

Competition policy is one of the few policy areas where agencies actively seek the views of consumer organisations, often with little response. Consumer organisations simply need to engage more in competition policy. Recalcitrant organisations should be cajoled by competition authorities into action and, at the same time, authorities and law firms should offer more direct aid by loaning staff or pro bono hours. Once they have proved their skill and interest, consumer organisations should be given standing in competition cases and interventions.

Ideology matters

EU/US divergences are located in the ideological traditions from which regulation has sprung. They are further exacerbated by the fact that the lack of tools and a consensus on the balancing of consumer welfare, efficiency and innovation tends to drive the ideological traditions apart. The only way to allow these traditions to meet and understand each other is by focusing on a more nuanced behavioural approach to consumer welfare and a concerted effort to bring efficiency and innovation criteria more firmly into the assessment of long-term consumer welfare.

Greater input is needed from European thinkers

The ideological division in competition policy requires the differing viewpoints to be well argued out. The increasing numbers of EU cases on exclusionary behaviour are starting to resemble a canon of literature. However, there is a lack of well-argued and researched papers, particularly in economics, that places the developing European view within a wider theoretical context. The position of thinkers on exclusionary behaviour in the USA is not as monolithic as it would appear, and the developing European position is more nuanced than critics allow. Debate about assumptions can only really happen when both parties recognise their own positions and can clearly articulate them.

Language matters

There are many apocryphal tales in the competition world that highlight how important language is. One such tale recounts how when the term 'competition' was first translated into Japanese characters at the turn of the 20th century it was translated as 'fighting with each other to succeed'. The immediate response of Japanese politicians was, 'but we succeed through cooperation not conflict'—the translation missed a vital cultural tradition and approach. It is also telling that a number of agencies around the world are anti-monopoly agencies, something that reflects the importance of the control of monopoly power in many formerly state-run economies. In short, language matters, and matters a good deal in competition advocacy and promotion. Messages that work in the USA may not work in the UK, let alone the Ukraine or Uzbekistan. It is also the case that many of the most advanced agencies treat their origins with a rather embarrassed silence. The first real attempts at competition law in Canada, the USA, and Australia came from a revolt of the rural poor and isolated against the untrammelled power of urban industrial elites. The rather backwoods' origins of competition law are hidden away like an uncomfortable family secret.

Rather than hide our past, we should return to the sort of language used to promote the first wave of competition law. During our interviews it was interesting that US interviewees did not shy from using terms like 'economic democracy' and 'empowering the little guy'. Such an approach can surprise opponents (and Europeans!) and place competition policy more firmly in a progressive set of policies designed to manage globalisation.

Conclusion

The benefit of interviewing practitioners, past and present, is that you get a relatively unvarnished version of the truth. This is particularly important for a subject like consumer welfare, and the relationship between consumer organisations and competition authorities. Both issues tend to be overweighed with platitudinous statements and well-meaning proposals, but often little substance. There is also a more ideological dimension to the discussion of consumer welfare. While economists may be reasonably comfortable with the microeconomic measure of consumer welfare, the model that appears to be most readily accepted, this comfort is not shared across disciplines. Indeed the very term consumer welfare is not without serious baggage. In a US context it is taken as representing a particular, Chicago School, view of the world. In Europe it is much less baggage-laden, and indeed is rather lacking in a generally agreed approach. The US approach to consumer welfare has taken a rather narrow path, which is rather ironic given the enormous steps in the fields of behavioural and experimental economics that have been taken in the USA. The gradual move to a post-Chicago view of consumer welfare is well advanced in the US Federal Trade Commission, in academia, and among competition regulators in Europe and elsewhere in the world. It has, however, hit a brick wall with the Department of Justice in the USA. This lack of progress in one head of the double-headed US competition regulator creates problems in global competition enforcement and debate. It also, perhaps, allows those with a restricted view of consumer welfare to exert more influence than their numbers justify. The post-Chicago view of consumer welfare takes greater account of the advances made in behavioural economics and experimental work, and tries to apply it in imaginative ways to merger analysis and the study of markets. Those regimes that have market study programmes, like the UK's Office of Fair Trading and increasingly the European Commission, have found this transition to a broader view of consumer behaviour easier than those whose job is to largely litigate or enforce competition laws. It is instructive to note that it was DG Competition, in its assessment of the proposed Ryanair bid for Aer Lingus, that carried out an interview of travellers at Dublin Airport to assess their views of the merger and its likely impact on their choices.

What we talk about when we talk about consumer welfare is changing. The discussion used to be a fairly sterile and divisive one that centred on a Chicago School view of the world or a loose collection of social welfare approaches. The locus of that debate has shifted to a post-Chicago view of the world that takes on board the lessons from behavioural economics and psychology and uses a much more developed view of consumer behaviour as a result. The more rigid view of consumer welfare could well be going through its death throes in the USA, and the post-November antitrust landscape could be very different on that side of the Atlantic. If that comes to pass then regulators in Europe will have a great opportunity to develop their own thinking on consumer welfare and its place in competition investigations and merger analysis and to influence developments in the USA at a critical juncture.

Phil Evans

[1] See Evans, P. (2008), 'In Search of the Marginal Consumer: The FIPRA Study'.
[2] US Department of Justice (2008), 'Competition and Monopoly: Single-firm Conduct under Section 2 of the Sherman Act', September.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email d_holt@oxera.com

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