

Agenda

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Protecting consumers: is competition policy enough?

Competition policy and consumer protection policy are both meant to serve consumers, but there are tensions between the two. Dr Helen Jenkins, Oxera Director, illustrates these tensions, discussing some of the recent market investigations carried out under the new competition policy framework in the UK (the Enterprise Act 2002). The remedies proposed in those investigations protect consumers, but perhaps do not go as far as a consumer protectionist approach would

Consumer welfare is the primary driver of competition policy, and regulatory authorities see well-functioning markets as the best means of delivering good outcomes for consumers. Law enforcement and proactive policy aimed at promoting rivalry and effective competition is thus seen as a crucial aspect of providing benefits to consumers.

There is another arm of policy aimed at enhancing consumer welfare, namely consumer protection. A wide range of bodies have powers aimed at ensuring that consumers are protected (eg, the UK Department of Trade and Industry). For various competition authorities, most notably the Federal Trade Commission in the USA and the Office of Fair Trading (OFT) in the UK, these two roles go hand in hand, as they have powers to enforce both. As noted by Sir John Vickers, until recently the head of the OFT:

Good consumer and competition policies have one and the same goal—to help markets work well for consumers and for all the fair-dealing enterprises that serve consumers well.¹

Earlier this year, the Hampton Report recommended that a new regulatory body, the Consumer and Trading Standards Authority (CTSA), should be established with a remit to coordinate work on consumer protection and trading standards. It would consolidate the local aspects of trading and consumer standards and take over many of the consumer protection duties that currently reside with the OFT.² The OFT argued strongly that, as the competition authority with a remit for protecting consumer welfare, it was appropriate for it to remain responsible for consumer protection. In December 2005, the government confirmed in its Pre-Budget Report that

the OFT would take on the strategic role envisaged for the CTSA, rather than creating a new agency.

The UK competition regime has a strongly proactive element, most notably through the market studies and market investigations route. These investigations cover competitive concerns falling beyond the realm of Article 81 (agreements) and Article 82 (abuse of dominance). A number of the market investigation inquiries already initiated have been triggered as a result of concerns arising about consumer protection (see Table 1). This shows the close links between these two areas; however, the outcome of these inquiries may not always meet the expectations of those with a strongly consumer protectionist outlook. This article examines the links and tensions that may arise between protecting consumers and protecting rivalry, and how these are manifest in the recent investigations.

Links between consumer and competition policy

Competitive markets functioning well can provide the best consumer protection. They maximise consumer welfare, give customers choice and drive improvements in technology. However, they are not likely to achieve distributional policy aims, or policies aimed at protecting the vulnerable or socially excluded. Consumer protection policies have three main aims:³

- to prevent undue pressure on consumers (eg, by ensuring cooling-off periods);
- to remedy pre-purchase information problems (eg, through trading and advertising standards);
- to stop undue surprises post-purchase (eg, unfair terms).

Effective competition means that customers can exercise their freedom of choice, and that companies will strive to provide better services to encourage customers to choose their service over others. With reasonably symmetric information, freedom of contract (that is, allowing customers to purchase as they wish) leads to higher welfare through gains from trade. Thus, in an effectively competitive market, suppliers have the right incentive not to exploit customers and hence competition and consumer protection are achieved together.

In seeking to remedy any identified market problems, the two are also linked. A poorly informed customer does not make effective choices. They are like a separate market, with the supplier able to exploit its market power. Consumer protection legislation that is designed to reduce information barriers and switching costs will therefore also facilitate more effective markets.

Thus, consumer protection and competition policy complement one another in providing a fair infrastructure in which trading can take place to the benefit of both consumers and suppliers.

Tensions

Despite this, tensions can arise between these two policy goals. At its heart, a recognition of the benefits of freedom to contract relies on the principle of ‘caveat emptor’ (buyer beware). The framework described above is focused on ex ante intervention. Regulations ensure that markets work and that consumers have the tools to make effective choices. Ex post, consumers bear the consequences of their choices and regulators resist intervention. This can lead to certain consumers (having made unwise decisions) facing unpleasant consequences. Often these will be consumers who are vulnerable in other ways (eg, those on low income, unemployed or with poor levels of literacy). A desire to shield these consumers from the implications of their choices leads to pressure for more intervention in the

name of consumer protection. Figure 1 illustrates the underlying reasons for this tension.

For those who view market discipline with distrust, there is an underlying conflict between protecting vulnerable consumers and competitive markets. Under this view, such consumers cannot exert effective choice and the inherently asymmetric nature of a transaction means that a significant number of customers will be harmed. This leads to pressure for a set of remedies designed to constrain the choice set of customers to acceptable products or restrict the behaviour of suppliers. Examples are enforced quality standards (such as CAT Standards for financial products⁴), restraints on quantity (preventing certain products from being offered), and obligations for suppliers to make choices for consumers (such as requiring companies to ensure that customers are on the best tariff given their usage patterns).

By contrast, for those who see competitive markets as a driver of consumer welfare, there is a reticence to restrict the underlying freedom to contract without a clear rationale. According to this view, most consumers are assumed to be in the best position to determine their own needs and product variety is valued. Therefore, intervention should focus predominantly on ensuring that consumers are able to exert effective choice. Regulation should not limit the range of available products, or be overly judgemental about the actual choices made by consumers.

Recent inquiries and remedies

Against this background, we can examine a number of recent inquiries that have been triggered as a result of consumer protection concerns raised by the Treasury Select Committee (store cards inquiry), super-complaints from consumer organisations (energy bills), or from a large number of customer complaints (bulk liquefied petroleum gas, LPG, extended warranty) (see Table 1 below). The pressure for detailed scrutiny arises in these products because of concerns that certain customers are not receiving value for money, that the markets are not delivering adequate protection to all customers and therefore that intervention is required. The area is referred to the OFT or the sectoral regulator and from there to the Competition Commission, if the grounds are sufficient.

Each investigation has led to extensive inquiries of facts and behavioural data, resulting in detailed sector-specific conclusions. These inquiries all consider the issues from a similar approach—that consumers are best protected through effective competition. Thus, scrutiny will focus on market features that hinder entry, hamper switching or where consumers are ill-informed. In doing this, the competition authorities generally examine the experience

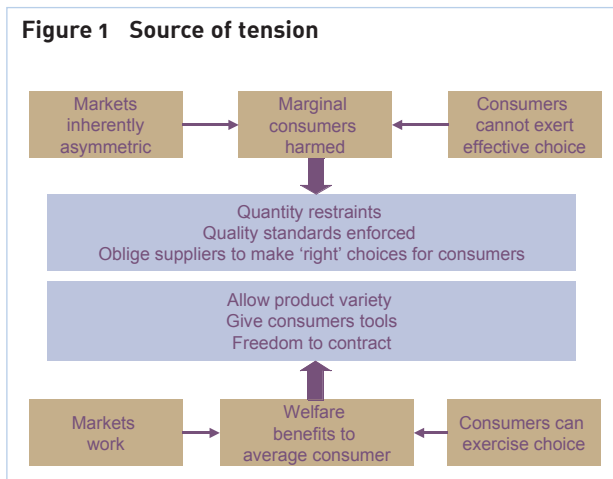


Table 1 Recent market inquiries

Inquiry	Triggered by	Investigated by	Remedy
Energy bills (2005) ¹	Supercomplaint from energywatch	Ofgem	Industry to improve information on bills
Bulk LPG (2004)* ²	Large number of complaints	OFT, then Competition Commission	Information and lowering of switching barriers
Store cards (2004)* ³	TSC	OFT, then Competition Commission	Information and possible cap on APR
Care homes (2003) ⁴	OFT	OFT	Information and transparency
Private dentistry (2002) ⁵	OFT	OFT	Information, customer awareness to encourage switching. Professional standards
Extended warranty (2000) ⁶	OFT	Competition Commission	Information

Notes: * Investigations not yet complete; remedies are therefore at the provisional stage.

¹ Ofgem (2005) 'Ofgem's Response to the Super-complaint on Billing Processes made by the Gas and Electricity Consumer Council', decision document, Office of Gas and Electricity Markets, July

² Competition Commission (2004), 'Domestic Bulk Liquefied Petroleum Gas', current inquiries; and Competition Commission (2004), 'LPG Market Inquiry: Notice of Possible Remedies under Rule 11 of the Competition Commission Rules of Procedure', current inquiries. Oxera is advising one of the providers in the bulk LPG market.

³ Competition Commission (2004), 'Store Card Credit Services', current inquiries; and Competition Commission (2004), 'Store Cards Market Inquiry: Notice of Possible Remedies under Rule 11 of the Competition Commission Rules of Procedure', current inquiries.

⁴ OFT (2005), 'Care Homes for Older People in the UK', market study.

⁵ OFT (2003), 'The Private Dentistry Market in the UK', market study; and Department of Trade and Industry website: <http://www.dti.gov.uk/ccp/topics2/dentists.htm>

⁶ Competition Commission (2003), 'Extended Warranties on Domestic Electrical Goods: A Report on the Supply of Extended Warranties on Domestic Electrical Goods within the UK: Volume 1,2 and 3', reports.

of the average consumer, while being aware of distributional effects. At the heart of this approach is a preservation of the 'caveat emptor' principle, as long as consumers know the choices they are making. Perhaps not surprisingly, remedies therefore focus on ensuring that customers are well-informed. Table 1 summarises the remedies imposed in a number of recent (and ongoing) inquiries.

All these remedies are fundamentally targeted at the customer, rather than the supplier. The aim is to inform consumers more effectively and to ensure that they can exercise choice if they wish to, but to leave that choice in their hands. This is at odds with a consumer protectionist instinct that generally seeks to improve constraints on the service provider, through restrictions on price discrimination or pricing level, or through a restriction of the products that can be offered.

The proposed store card remedy on APR level comes closest to such a protectionist intervention. The remedy is not a formal APR cap, but a requirement for retailers providing store cards with an APR higher than an as yet unspecified level to install signage indicating that consumers could receive a better deal on credit from another source. It is likely that this would operate as an implicit cap on APRs, as retailers may be sensitive to promoting the perception that they represent poor value for money on any offering. This remedy is still provisional.

The reason for such apparently low-impact remedies is a recognition of the costs of more interventionist regulation. Regulatory authorities are required to ensure that remedies are proportionate, which means considering the negative impact of certain types of obligation.

- Regulating prices will hinder entry and market expansion since one of the main attractions for switching supplier is lower prices. If regulation is keeping incumbent suppliers' prices down, there is less room for new, or smaller, players to grow successfully.
- Restricting supply and increasing costs harm consumer welfare. Preventing customers making certain choices may exclude them from a market, or mean that they have to select a less preferred product.

In the end, it is consumers who will pay for the additional costs imposed by any regulation. This must be balanced against the general benefits that arise, or any distributional gains. For example, improving information may lead to more competitive pressure on suppliers, which will in turn lead to reductions in prices to all consumers, not only those who act on the information. This is an example of a general benefit. In contrast, any remedy that acts as a price cap (eg, the APR cap) will lead to certain customers receiving services more cheaply, but may exclude other customers from the

service, as they are no longer profitable to serve at the regulated price. This is an example of a distributional trade-off of benefits.

In any market where more vulnerable customers may be more costly to serve (as a result of, for example, low levels of demand or higher risk of bad debt), there is an inherent tension between a consumer protectionist desire to see these customers facing the same prices as others and the supplier's decision to serve a higher-cost segment. In these situations, regulation can have the unintended consequence of harming the vulnerable customers it seeks to protect, by leading to withdrawal of services.

Is information the right remedy?

Remedying identified concerns with more information may not be straightforward in itself. First, too much information may be just as problematic as too little. The costs of acquiring and analysing a great deal of detailed information can dissuade people from using it. Even where the information is provided in a user-friendly fashion, the statistics on UK literacy and numeracy make uncomfortable reading.

In 1996, 45% of UK adults were found to be below the level of literacy (both verbal and quantitative) judged by the OECD as necessary to function in modern society.⁵ By 2002, this proportion had fallen to 21%.⁶ This is still a significant proportion of the population likely to struggle with the information provided by companies. Where there is little scope for price discrimination, or where products are homogeneous, effective competition is still likely to protect these customers. The fact that the well-informed will switch away from those firms offering poor-value services is a strong discipline on the products offered by firms. The choices of the literate protect the vulnerable, at least where prices are common to all purchasers. In areas of high product differentiation or bespoke pricing, however, issues will remain.

This suggests that there may be a need for more interventionist remedies because information alone will be insufficient to ensure that certain consumers are not harmed. The nature of such intervention must be carefully thought through. If there is a decision to restrict supplier behaviour explicitly (eg, to de-list certain products, use price caps, require advice to be given), with the concomitant benefit for those less able to exercise choice, the costs also need to be considered. Such a decision may:

- *impose costs on other consumers*—for example, a decision to require detailed advice to be given to consumers before a product is purchased will increase the product's cost. Many consumers may not

value the advice if they have already done their own research on product options. Where this has been implemented for mortgage advice, there is an opt-out for consumers;

- *lead to product withdrawal*—for example, where CAT standards for financial products are introduced, non-standard products (perhaps with many beneficial features, but limited access) may be withdrawn because the lack of the CAT approval affects demand for the product;
- *distort behaviour (moral hazard)*—where regulations place a requirement on suppliers to ensure that a customer buys the best product for their situation, this can distort behaviour. If the customer has a change of circumstance (arguably foreseeable), they can avoid paying for the product by arguing that the provider should have foreseen the issue and not sold it to them.

Regulatory impact assessments (RIA) become a very important tool to examine whether the implicit trade-offs are worthwhile. Such assessments need to be undertaken carefully, with a good understanding of likely market responses to regulatory change and a recognition that unfettered choice is valuable for many consumers. In situations where a burden is placed on the supplier to ensure that the product is well-matched to the consumer's needs, a firm may choose not to supply (or to restrict supply of) the product, rather than bear the risk of mis-selling. This may harm even the vulnerable consumers it seeks to protect.

It may be that other options, more directly targeted at the vulnerable, are a better means of achieving higher consumer welfare for all. The approach taken by the Department of Trade and Industry to the over-indebtedness issue is a good example of this. Information-based remedies are supported by a range of other measures associated with ensuring that a good safety net exists (eg, altering insolvency arrangements, more community-based support networks). Credit providers have implemented data-sharing to ensure that individuals are not over-extended across a number of supplier relationships.⁷ No part of this programme is limiting the range of choices of an individual to determine their own financial fate. Whether such broad-spectrum remedies fit well into the competition authorities' toolkits remains to be seen.

Conclusion

A framework where effective competition is seen as a key consumer protection tool will always focus on remedies associated with improving choices ex ante, with very limited interest in intervening in the actual set

of choices that can be made. The OFT retaining responsibility for both consumer protection and effective competition means that this policy position will continue. As a result, market-based solutions may conflict with a desire to protect the most vulnerable customers, who, even with better information, may continue to make poor choices. Over-zealous protectionist intervention can harm consumers (even those it is designed to protect),

by increasing the costs and risks of certain products, and therefore changing the incentives to supply them. However, innovative remedies designed to target the vulnerable may be successful. RIAs conducted with a good understanding of suppliers' response to obligations imposed are crucial, to make sure that there are no unintended consequences from a well-meaning remedy.

Helen Jenkins

¹ Sir John Vickers, Chairman, OFT, opening remarks at the European Competition and Consumer Day Conference London, September 15th 2005.

² Hampton, P. (2005), 'Reducing Administrative Burdens: Effective Inspection and Enforcement', March, the Stationery Office, paras 4.47 et seq.

³ Vickers, J. (2005), 'Abuse of Market Power', *The Economic Journal*, **115**:504, pp.244–61.

⁴ This policy was introduced by the Financial Services Authority to ensure that products had acceptable costs, access and terms (CAT).

Achieving the CAT Standard signalled to consumers that the product had been assessed by the provider as not having any 'hidden surprises'.

⁵ Literacy levels of adults: by gender and age from Office of National Statistics (1996), 'Social Trends 30'. The OECD has indicated that Level 3 is the requisite level to be able to cope with the demands of modern life.

⁶ Department for Education and Skills (2003), 'The Skills for Life Survey: A National Needs and Impact Survey of Literacy, Numeracy and ICT Skills', RB490.

⁷ See 'Accentuating the Positive: Sharing Financial Data between Banks', also in this issue of *Agenda*.

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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