



## 2006 Consumer Affairs Victoria Lecture

In honour of Professor Maureen Brunt AO

### *The Interface between Consumer Policy and Competition Policy*

Louise Sylvan, Deputy Chair

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## Introduction

It is with much pleasure that I agreed to give this lecture in honour of Professor Maureen Brunt.

When speaking to those members of the economic and legal professions in Australia who spend some of their time in the trade practices arena, the name of Maureen Brunt is legendary.

Professor Brunt is known as the doyen of Australian and New Zealand competition law and policy – and with good reason. From her return to Australia after her first stint in the United States - having been trained at Harvard in the economic analysis of competition (or anti-trust) - through to her path breaking publication with Professor Peter Karmel of *The Structure of the Australian Economy*<sup>1</sup> (which laid the foundation of the need for proper competition laws), to her subsequent appointment as Chair of the Economics Department at Monash in 1966 (the first woman professor at Monash and the first woman to hold a chair in economics in Australia), to the subsequent decades of teaching of publishing, through to her recent submissions to the Inquiry into the Competition Provisions of the *Trade Practices Act 1974*<sup>2</sup> (Dawson Inquiry), she has been a force shaping the content and practice of competition economics and law in Australia. ‘The Law and the Market’<sup>3</sup> – the title of a book arising from a conference held to honour Professor Brunt - is only one of many tributes to her scholarly and practical contributions.

Competition policy is one of those areas of constant contemporary debate. Take the ‘national champions argument’ as an example; this is the argument that Australian firms should be allowed to be dominant or to be monopolies in Australia in order that they can compete overseas – in other words, one should allow or perhaps encourage mergers to create monopolies in the Australian economy. Just when you think that you’ve got this type of thinking properly dead and buried, it resurrects itself in some CEO’s bottom line self-interest. In her own words, Maureen’s ‘papers exhibit a certain missionary

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<sup>1</sup> Peter Karmel and Maureen Brunt, *The Structure of the Australian Economy*, Cheshire, 1962.

<sup>2</sup> Inquiry into the Competition Provisions of the *Trade Practices Act 1974* (Cth) – Dawson Inquiry.

<sup>3</sup> Megan Richardson and Philip Williams, *The Law and the Market*, The Federation Press, Leichhardt, 1995.

quality<sup>4</sup> about the importance of controlling restrictive practices and anti-competitive mergers – and her messages are as pertinent, and possibly *more* pertinent, today than they were when Professor Brunt initially penned them.

What is less well known to the competition economists and lawyers, but is much more widely known in general in Victoria and among those interested in consumer protection, is Professor Brunt's contributions to consumer policy. She served in Victoria on the Consumer Affairs Council for almost 10 years. In 1983, during her tenure as Chair, the Council delivered its *Inquiry into Deceptive Trade Practices Law in Victoria* and found that '[t]he deficiencies are so patently obvious that they can be quickly summarized and the relevant provisions of the Act dismissed. A totally new legislative approach should be pursued.'<sup>5</sup> What exemplary clear language for an Inquiry report. As a result of this inquiry into deceptive trade practices law in Victoria, a law of universal ambit was enacted in this State governing all business dealings – essentially the mirror of the provisions of Part V of the *Trade Practices Act 1974* prohibiting misleading and deceptive conduct.

Professor Brunt is a role model of which there are very few examples and one that I personally am very grateful for. There are few people that one can characterise as having a strong personal and rigorously thought through commitment and engagement with both competition protection and consumer protection, and who can add to the latter element a serious concern about vulnerable and disadvantaged consumers as well.

## **Interface between Competition and Consumer Law and Policy**

I have written on the competition – consumer interface previously, and won't re-travel in detail all of that ground today. It seems obvious that sometimes one can characterise the two policies as complementary. The prime example is the misleading conduct provisions of the trade practices which are a key consumer protection in a market economy. They are also a competition protection – protecting honest traders from those who would capture market share through a form of anti-competitive conduct (i.e. deceiving consumers who might otherwise have brought from the honest trader) and also protecting the integrity of the marketplace. Sometimes the two policies can be in tension – as when professional standards regulation or licensing goes beyond the consumer interest in ensuring competent professional service into restrictions on supply, in other words into an anti-competitive restraint on trade. Where the line is drawn in these instances is a matter of great public interest and appropriately should be the subject of both a consumer protection and competition protection analyses.

But the aspect of consumer protection on which this lecture will focus is one that receives far too little attention – it's the category of consumer protection

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<sup>4</sup> Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law*, Kluwer Law International, The Hague, 2003.

<sup>5</sup> Victorian Consumer Affairs Council, *Inquiry into Deceptive Trade Practices Law*, Report to the Minister of Consumer Affairs, March 1983.

that might best be described as consumer empowerment. It is the analysis that addresses not the question of ‘what does competition do for consumers?’ but the equally crucial question of ‘what do consumers do for competition?’ I call this area of inquiry ‘economics for the demand side’. Competition policy is concerned with the supply side structure of markets and the behaviours of firms. Consumer policy starts from the position that the structural soundness of markets should be being properly attended to, and focuses on a well-informed understanding of what’s happening on the demand side.

## Competition – Consumer Interface

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“Consumers not only benefit from competition, they activate it, and one of the purposes of consumer protection law is to ensure they are in a position to do so.”

Ron Bannerman



We have all observed markets where consumers seem entirely capable of driving competition, while in other markets, consumers appear to have serious difficulty or some consumers appear to have difficulty. I take it as a given that without consumers activating competition, you don’t have competition. As Ron Bannerman has put it so concisely ‘Consumers not only benefit from competition, they activate it, and one of the purposes of consumer protection law is to ensure they are in position to do so.’<sup>6</sup> If we had a theoretical world where consumers could never be bothered, for example, to differentiate between prices or quality, then the market – in our sense of that word - just wouldn’t work. There would be a sort of market – goods would probably be being exchanged - and quite possibly a variety of choices, but no driver for competition and the benefits that it delivers in terms of efficiency and innovation. So, basically, efficient market outcomes result from a particular set of interactions between suppliers and consumers.

The reason the question ‘what do consumers do for competition’ is important, is it challenges a simplistic notion that has come to almost be seen as an article of faith in some quarters. You will often hear it articulated as ‘choice is good for consumers therefore the more choice there is, naturally, the better.’ The behavioural economists would call this heuristic simplification. It’s one of the classic behavioural economic biases. Heuristic simplification is something people are very good at: they simplify complex things to achieve a rule of thumb that saves a lot of time and effort, and it often works exceedingly well, but applied incorrectly, can lead to quite poor outcomes.

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<sup>6</sup> R Bannerman in Trade Practices Commission, *Annual Report 198e - 1984*, AGPS, Canberra, 1984, p 184.

## Economics for the Demand Side

In order to create an economics for the demand side, one actually has to look at the outcomes for consumers in markets and you are inevitably drawn into looking at consumer behaviours in markets. Over the last fifty years, a great deal has been learned about actual consumer behaviour; there is all the excellent work on the impact on consumers of transaction costs – such as search and switching costs<sup>7</sup> – and information asymmetries. A lack of information about quality or difficulties in comparisons or absence of meaningful price information - all can result in consumer detriment. And public policy has often responded to this; there is legislation requiring disclosure for example or provision of warranties and so on.

I am not going to concentrate on the information economics work tonight although it is fascinating and important. It is, however, moderately well known, even if its public policy implications have not yet been fully explored. The aspect of examining consumers in markets that I wish to highlight is the set of insights that are the result of that branch of economics known as behavioural economics, though some people believe it should more properly be called cognitive economics. These studies have been conducted using laboratory experiments – the initial results of prospect theory being the best known example - as well as, and increasingly commonly, studies of consumers operating in actual markets.

### Economics for the Demand Side

- Outcomes for consumers in markets
- Consumer behaviour in markets
- Transaction costs (search and switching), information asymmetries
- Cognitive biases – studied in behavioural economics



There is one particularly significant difference that arises from what I will call the conventional (or neo-classical) economic work on consumers and the behavioural economic work. The neo-classical model has an assumption of rationality as it's called – essentially, that well-informed consumers rationally calculate their best options in market transactions. That is not an assumption that all consumers behave rationally at all times, but that in aggregate, consumers will exhibit rational behaviour. More specifically, the rationality assumption is that consumers have preferences and that if they prefer A to B, then they'll buy A, and that they will seek to maximise their satisfaction – in other words if this type of widget is \$10 and that one is \$5 and it's exactly the

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<sup>7</sup> See for example Klemperer's seminal work on transaction costs.

same, we'll buy the \$5 one because it leaves us with \$5 to spend on something else. Intuitively, one agrees with the sensibleness of the rationality assumption.

What behavioural economics is finding is that consumers exhibit systematic departures from what neo-classical economists would classify as 'rational' behaviour. In other words, even when markets are structurally sound on the supply side, there can still be adverse outcomes for consumers and thus a misallocation of resources. To be even more precise, we are talking here about behaviour which is not well ameliorated by the supply of information. The availability of comparable information is necessary, obviously, for consumers to activate competition, but it may not be sufficient. Even well-informed consumers exhibit consistent patterns of behaviour leading them away from decisions that would better satisfy their preferences.

## Behavioural Economics – Consumer Biases

I won't provide you with all the biases that have been examined by the behavioural economists. I'm going to touch on just a few and for those of you who are particularly interested, there's lots of literature available – although this discipline is not, in my view, in a coherent theoretic form at the moment. I'll quickly cover a few biases and then concentrate on the most important behavioural effects.

### Over-confidence



90% of drivers believe and say they are  
better than average drivers



- Over-confidence – is a very typical behavioural bias, as you can see by the figures for how people rate their driving in comparison with others. Over-confidence has been especially well studied in financial markets such as the stock market. John Kenneth Galbraith has a wonderful quote which illustrates the bias – “Genius is a rising market.” The public policy ramifications relate in particular to what investments companies, for example, should have to disclose about their performance especially when examined over the long term; as well, this particular bias is relevant in public policy decisions about things like whether or not one should have paternalistic policies such as seat belt laws.

## Confirmation bias

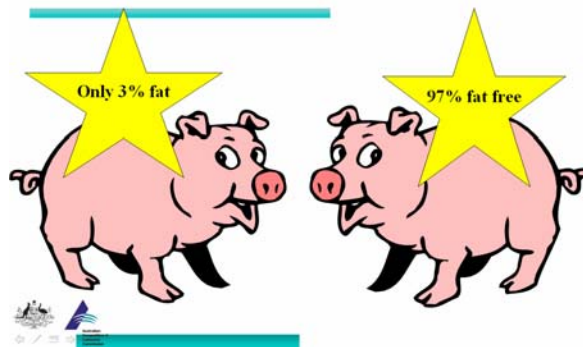
ELVIS LIVES



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- Confirmation bias – is a bit related to the over-confidence bias. Basically, once we have taken a decision, we subconsciously select information that reinforces that view, while downplaying information that contradicts it. The scientific method, which requires scientists to experiment against a null hypothesis, is designed to counteract a tendency of people – including scientists – to try and confirm their views. It's a very prevalent bias for people who invest in the stock market – having selected a share, people barrack for it. A stockbroker friend of mine says the best advice he has for amateur investors is to remember that the stock does not know you own it.

## Framing



- Framing bias – is especially important in markets in relation to how advertising claims are dealt with. Two differently worded claims – which in fact convey identical information – are not perceived by people as identical. Framing bias is especially important in terms of how options are given to people. Cashback offers, for example, can be much more attractive than a similar or even greater discount. Shopper docket, like 4 cents off each litre of petrol (which are a type of cashback offer), can potentially alter consumer behaviour – such as the decision where to shop - far more effectively than just lower prices in the supermarket, despite the fact that a significant proportion of people will never exercise the cashback feature.

## Loss Aversion

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- Loss aversion – is related to framing and is also a very well documented behavioural bias. Basically, people’s reactions to the possibility of losing \$500, for example, is not equivalent to the feelings associated with gaining \$500. The preference for avoiding losses is almost twice as strong as the preference for gains – even in cases of a 50-50 bet. Try playing this game with children – it generally works. You have two black boxes – one showing a picture of a single candy on the lid, the other box showing two candies on the lid. The child can put 5 cents down in front of either box – the chance of getting two candies in the box showing just one is 50%, the chance of getting one candy from the box showing two is 50%. So this is an identical bet. After a few runs at this, children don’t want to bet on the box showing two candies and get only one. There is some kind of perceived loss involved. An adult example in a different type of case – if you’re doing a hard sell to consumers (for example some kind of scam or grossly overpriced product), frame it strongly as a loss aversion situation. “This is a once in a lifetime opportunity – you will never have this kind of chance again.” In other words, present the decision not to buy as the risky decision – it triggers loss aversion, even in very well-educated sensible people. It’s why cold-calling investment scams work. I was very amused last year to read the publication of an experiment with monkeys, done at Yale University, who were playing a version of the candies game above - they exhibit really strong loss aversion. So this might be hard-wired into us.

## Heuristic simplification (rules of thumb)



- Heuristic simplification – are the ‘rule of thumb’ biases. Here’s one in operation, though probably not the only reason people don’t read the fine print.

## Decision paralysis – Choice overload



- Choice overload – is another serious behavioural bias in terms of its effects on competition. People look for a rationale for choosing one option over another – and sometimes that can be quite easy even with a very large range of choice. At other times, when no easy rationale presents itself, or the decision making is very complex, the consumer gets into decisional conflict. They can walk away from the market, leading to deadweight loss, or they just pick something even though it turns out to be a rather poor choice for them. The classic illustration of this was the tastings conducted in an upscale supermarket – where the opportunity was given to taste 6 jams in one situation, and to taste 24 jams in the second situation. Of those who stopped to taste, 30% purchased jam in the 6-jam condition, with only 3% purchasing in the 24-jam condition.<sup>8</sup> How many people do you know that regret the mobile phone plan they’ve locked themselves into? This is a classic

<sup>8</sup> SS Iyengar and MR Lepper, ‘When choice is demotivating: Can one desire too much of a good thing?’ *Journal of Personality and Social Psychology*, 79, 995-1006.



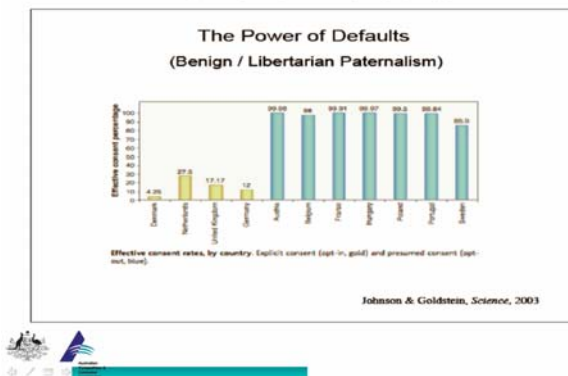
decisional conflict situation with a very complex set of calculations and a vastly confusing array of plans available. The term for this, by the way, is a confusopoly, and it can often be deliberately created where that serves the purpose of firms to reduce competition.

## Anchoring



- Anchoring – is an obvious situation where people tend not to stray far from the anchor point which is provided. People actually make better decisions about value when no anchor points are provided to them.

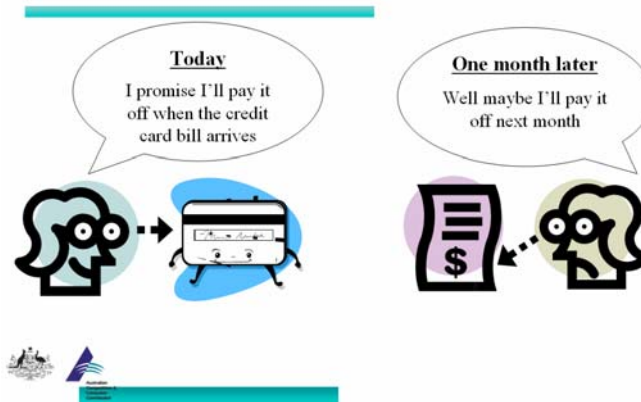
## Power of Defaults



- Default bias – is one of the most important behavioural biases in public policy terms. The decision of whether to opt-in or opt-out is not the same decision for people. This chart shows the organ donation rates of a set of European countries. The countries on your left are countries that have an opt-in default – the consumer needs to tick the box in order to leave their organs for transplant in the event of a fatal car accident. The countries on your right are the countries that have an opt-out default – the consumer needs to tick the box in order not to leave their organs for transplant in the advent of a fatal accident. It makes a world of difference. The difference in rates is about 15% on average versus a 98% rate on average in the second situation. The public policy position in many other areas – like retirement savings – is crucially impacted by this bias. For those of you who would like to check out the new KiwiSaver, a work-based savings scheme to be

launched in 2007 in New Zealand, you will see the first government scheme in the world designed using behavioural finance principles.

## Time Variant Preferences



- Time variant preferences – is also a crucial bias because it usually manifests as hyperbolic discounting. Hyperbolic discounting refers to the fact that people do not have a fixed discount rate to weight present and future costs and benefits. Generally, your discount rate increases the shorter the time period outstanding. So, for example, my discount rate when I agreed to give this lecture two months ago is not the same as my discount rate three days before it when the paper wasn't finished!

## Policy Implications of Behavioural Economics

What behavioural economics shows is that consumers often don't rationally calculate their best options in market transactions – they can exhibit *systematic* departures from what economists would predict should happen.

The crucial question for us tonight is: does this matter? And if it matters, or it matters some of the time, what is the appropriate public policy response.

Let me give you two market situations where behavioural economic insights clearly matter in public policy terms.

### Behavioural Economics – Policy Implications

- Market deregulation
  - Importance of default bias
  - Importance of enabling choice – confusopoly problem
  - Importance of endowment issues
- Financial sector markets
  - Importance of contexts for decisions
  - Importance of defaults
  - Importance of hyperbolic discounting



### ***Example 1- Market Deregulation***

The first is in situations of market deregulation. Analysis of deregulation of markets is done almost entirely from a supply-side perspective in respect to how one can improve productivity in the economy through such reform. There is very little – or no – attention paid to what consumers might be likely to do. Where such reform is simply doing away with a form of government protection – such as would occur with pharmacy reform for instance – that analysis probably suffices. Where the situation is more complex than that, a lot more thinking about consumers should be done.

For example, in deregulating a market where there is a former government-owned or private monopoly or oligopoly, one can reasonably predict a strong default bias will operate. In other words, consumers won't do much about changing provider; the default acquires a privileged status. So, if one was serious about creating significant competition, it would be crucially important to deal with that bias, remembering that information does not generally overcome the bias. If one is considering telecommunications for example, which has been deregulated in many countries throughout the world, the deregulation could be much less successful than otherwise without dealing with the likely consumer behaviour, even in this area where there is strong technological change in evidence. As well, one would predict a strong incentive by the incumbent or incumbents to create a confusopoly – in other words, to make the choice difficult. That adds the choice overload phenomena which reinforces a default bias. Add to this an endowment effect – people like the telephone number they have, they've had it for awhile, their friends know it – and you've got a further brake on competition unless you quickly deal with that through number portability for example. In other words, looking at the deregulation of a market from the supply side, isn't the same at looking at it from the demand side. And the policy solutions are quite distinct.

One of the difficulties being experienced the world over is with consumer behaviour in the deregulated energy markets. The model is essentially that if you provide competitors in energy then consumers will respond (a variation on the build a better mousetrap and consumers will beat a path to your door). At the joint meeting of the OECD Competition and Consumer Policy Committees, one government competition economist threw up his hands in disgust and said "We've deregulated the energy markets to get more competition for the benefit of consumers – and they won't switch. What is wrong with these consumers?!" I thought at the time that this was an amazing triumph of theory over reality. And I am not at all certain that any answer about "irrational" consumer behaviour would be all that comforting as an answer to his question – since it has no place in the model being used.

### ***Example 2- Financial Services***

The next examples are taken from the financial services sector. A bank in South Africa wanted to make more loans and decided not to compete only on interest rate but to look at contextual factors. It sent out some 60,000 letters to existing clients saying "Congratulations! You're eligible for a special interest rate on a new loan." The interest rate was randomised like a clinical

trial of a drug – some people got low rates, others got high rates. This real-life experiment was designed by 5 behavioural economists testing a variety of their thesis.<sup>9</sup> The paper they published expresses the relevant contextual factors in equivalent interest rate terms – in other words, what does doing such and such mean in terms of whether people will pay more for their loan or not. In general, and consistent with standard economics, people offered the higher rates were less likely to take up a loan than those with lower rates – thank goodness.

But context also mattered – it is a behavioural economic truism that context or the decision-making situation is influential in terms of the ultimate consumer decision. As you might predict from behavioural economics, offer letters with just one example of a loan size and term with its monthly payments was far more successful than the letter with four examples of different loan amounts – the effect was equivalent to more than 2 percentage points in terms of take up. And, the letter with the smiling picture of a person was also more successful. In fact, for the men in the sample, the presence of a smiling woman's picture in the bottom corner of the offer letter had the same positive effect on take-up as dropping the monthly interest rate on the loan by 4.5 percentage points. Bear in mind that these loans often represented 10% of a person's income in terms of repayments – you would think that you wouldn't be affected by a photo! But interest rate, overall, didn't even seem to be the third most important factor. For the bank, competing on interest rates costs a lot of money; the psychological elements cost nothing.

I mentioned the KiwiSaver initiative based on behavioural economic research – which means that the employer will automatically set up a savings account to put employee savings into it. The employee has to choose not to do it. One piece of relevant research on which KiwiSaver was based was conducted in the US where setting up a retirement account with your employer is voluntary – the consumer needs to make it happen. So the default is that there is no retirement account. Many employers match the employee contribution up to a certain amount – and that's often \$3 - \$4,000 a year in employer contributions. Laibson, the foremost expert on this in the US, has documented how people – even those who are aged 59 ½ and could withdraw their money and the matching employer money immediately without penalty – just don't set up their savings plans.<sup>10</sup> The general response in public policy terms is that people need to be educated – they're not financially literate enough to 'get it'. Laibson has run educational interventions with employees; he walks people through the calculations, how much free money they get, why they should immediately set up their account, what delay means in terms of accumulation – and virtually all of them still don't do it after his interventions.<sup>11</sup> This is not an information problem. Because it's a financial transaction – it's unpleasant for many people even when they're quite clear about it in financial literacy terms, for others it is possibly confusing; the

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<sup>9</sup> M Bertram, D Karlan, S Mullainathan, E Shafir, and J Zinman 'What's psychology worth?: A field experiment in the consumer credit market' Massachusetts: National Bureau of Economic Research, Working Paper 11892.

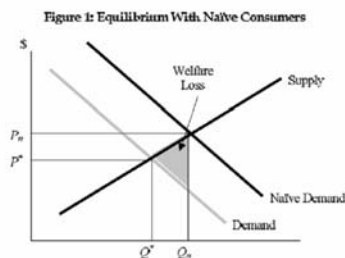
<sup>10</sup> Craig Lambert, 'The Marketplace of Perceptions', *Harvard Magazine*, February 2006.

<sup>11</sup> *Ibid.*

upshot is that it's best done tomorrow (which means never for the majority of people). Whether people realised or not, Australia's superannuation system was designed quite sensibly as a compulsory system; the only alternative to no compulsion is the NZ choice of the correct default. We'll know in a few years how the NZ scheme works, but one can fairly confidently predict the outcome.

So when one asks why so many people fail to pay off the credit card – an information intervention pointing out just how expensive that type of credit is might well assist many who are possibly unsophisticated about the cost of credit cards; but there are behavioural elements operating – like hyperbolic discounting - that may be far more or equally important for many people. In a situation like financial services where you have a lack of sophistication combined with behavioural biases, so that people despite their best intentions and somewhat unwittingly can get trapped into large amounts of very expensive debt, you have to be quite careful about how competition is handled. One is in a situation where a group of consumers may be over-consuming to their disadvantage and that could be people who are already vulnerable or disadvantaged or who are most at risk. Putting even more choice on the market – especially in areas of the market where complexity can allow choice to be delivered through costly bells and whistles rather than price competition – may actually decrease consumer welfare. Joshua Gans' analysis of this in economic terms is extremely useful.<sup>12</sup>

## Equilibrium with Naïve Consumers



## Conclusion

The purpose of looking at these behavioural economic issues is twofold.

Firstly and surprisingly, despite the fact that there are now three or four Nobel Laureates who are basically from either behavioural or experimental economics, there is very little known about, or academic work being done, in Australia. People like Lawrence Summers, the current President of Harvard and former US Secretary of the Treasury, identify themselves as behavioural economists. But, curiously, there actually is not a behavioural economist in

<sup>12</sup> Joshua Gans, 'Protecting consumers by protecting competition': Does behavioural economics support this contention? *Competition and Consumer Law Journal*, July 2005.

Australia as far as I am aware. So, the kind of influence and expertise that one would draw on in relation to consumer protection considerations is not readily available to us and doesn't form part of our ongoing discussions.

Secondly, it seems to me that the powerful combination of conventional economics and behavioural economics – I don't see these as in conflict as some do, but as complimentary – makes ultimately for better implementation of policy decisions in consumer protection. If one is intervening in a market, either for the purposes of reform and improvements in competition or in relation to consumer empowerment and protection, one wants to be sure to have the desired effect and to get the results intended. That needs rigour and research about consumers just as much as it does about firms.

So, to conclude, my vision is of much better evidence-based work on the demand side of the market complementing the extensive work that has been carried out on the supply side.

Maureen Brunt is known in particular for her innovative analysis of the interaction of the disciplines of law and economics and for her meticulous approach to economic analysis. I think economic analysis of that calibre needs to be much more significant in consumer protection law and policy as well – it is needed to underpin our decision making. And it needs to be economics that deals with consumers as the fallible human beings they are – behavioural economics is the intersection of the disciplines of psychology and economics, and offers very fertile ground for new thinking.

We were lucky in Australia to have Professor Brunt's skills in the investigation of misleading conduct laws – you can see both the analytic skill and the commitment to outcomes for consumers in that Inquiry. I hope that many others will follow the example she has created.