Submission to Productivity Commission Review of Australia's Consumer Policy Framework
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Introduction

This submission focuses on the rationale for consumer policy, though it sometimes comments on the kinds of policies that are implied by the arguments being explored. The first part critically examines from the standpoint of information economics the rather limited rationale for consumer policy implied in mainstream economic theory. It emphasizes the significance of the context of choice but shows the limitations of using the search good, experience good and credence good taxonomy as a starting point for classifying markets in terms of their need for policy intervention. The second part of the submission show how issues look rather different from the standpoint of behavioural economics, wherein consumers are seen: (i) as problem solvers trying to cope in the face of complexity via decision rules of varying degrees of functionality, rather than optimizing in terms of well-defined preferences; (ii) as suggestible and hence prone to manipulation. In the third section I comment on the implications of the modern consumer's tendency to lack a hard budget constraint due to access to credit. The submission ends with a concluding comment about the basic dilemma that faces designers of deregulatory policies.

1 Information and Choice from the Standpoint of Mainstream Economics

In terms of mainstream information economics, where consumer are assumed to have a good idea what they want and the rationality of their decision processes is only compromised by shortages of information, the case for consumer policy and the form it should take varies according to whether the product is a search good, experience good or credence good. These three categories came into the literature primarily via the work of Nelson (1970) and Darby and Karni (1973). In this section I explore standard thinking and reflect on it in terms of the challenges these different classes of goods present in terms of the 'institutionalist' view of markets set out by Hodgson (1988), and I give particular attention to ways in which market institutions are being affected by the information technology revolution. It should be noted, however, that poorer sections of society, and perhaps also older members of society, may be prone to get poorer deals insofar as they have less access to the kinds of Internet-based market institutions that I explore.

Search goods are those about which the consumer can in principle become well informed in terms of their availability, what the rival brands have to offer, and how the features offered relate to the consumer's wants *prior to purchasing them*. The rational consumer, faced with scarce time and other search costs, may not check out the market completely but will search until the marginal costs of search exceed the expected marginal benefits.

Seen thus, there is either no need for consumer policy in the context of search goods (if the range on offer is sufficiently limited to ensure all can be considered or if all the necessary information can readily be gleaned from websites, consumer magazines, etc.) or there is a need for consumer policy merely to alert consumers to the benefits of searching more extensively than they might have done due to pessimistic estimates of the benefits of further search. The latter role is diminished insofar as firms that offer better deals can advertise this – as has increasingly begun to be evident in the insurance sector – though economies of scale in advertising may mean that messages of new, smaller players about their better deals get swamped by bigger and more frequent messages from established firms.

If most consumers opt to economize on search costs and sample only a fraction of what is on offer when they gather information, firms may face an insufficient probability of winning market share if they set out to compete for business from those who shop around carefully. If the market is characterised by a high dispersion in the prices that consumers are quoted and there are many potential suppliers, a new entrant has no particular incentive to be the cheapest of all because potential customers have a high probability of not discovering a cheaper supplier. If choices are based on price, it might seem to be important not to be quoting a higher price than everyone else even if customers are only seeking a few quotations. However, the difficulty of knowing what rivals are charging at a point in time and variation in what rivals quote depending on their opportunity costs through time (in, say, markets for housing renovation services) may allow price dispersions to persist rather than prices converging to a the lowest possible level consistent with suppliers merely to earn normal profits. The persistence of price dispersions may not, however, imply that suppliers are generally earning supernormal profits, for if the sector is one that is easy to enter it is possible that many producers will end up with spare capacity.

The persistence of dispersions may also be facilitated if firms introduce noise into price data by periodically having 'sales', making it harder for consumers to work out whether on average they are more expensive than others or what the probability of getting a particular kind of deal from them will be. This point, noted by Phlips (1988), can readily be appreciated if one considers the problem of which car dealer to visit in pursuit of a particular used model, given that they are scattered around the city and may not advertise all of their stock simultaneously. If 'sales' are common but are held erratically, as well as on a seasonal basis, it is hard to know which dealer to visit as past observations may be little guide to the price that will be discovered on site. The actual prices will also be made harder to compare in this context by the variability in the trade-in offers that they may receive, and getting as far as finding out what the 'changeover' cost is for comparable products from different dealers may involve considerable time and stress.

Much the same issue arises where supermarkets compete in some cases by offering 'everyday low prices' and in other cases by offering 'specials': it takes a lot of effort to discover where the cheapest supplier of one's intended trolley-load of goods is to be found, something that supermarket managers make worse by not following a standard layout and by periodically changing their layouts. Given these search costs, consumers may opt to stay with suppliers whose prices and layouts they find acceptable, until their preferred store lets them down for some reason (e.g. persistent failure to stock particular items). They get the benefits of one-stop shopping but without really knowing whether the claims of rivals about better deals are true or not. It may take the entry of a new supermarket chain to signal that incumbents have been using the difficulty of comparing prices as a means to generate supernormal profits. But entry barriers are far from trivial in this sector.

Designers of consumer policy need to be aware that the information technology revolution is changing the economics of market institutions that consumers can use to economise on search costs. The price dispersion arguments above begin to look very different if, despite a lack of comparable print advertisements, rival car dealer's stock positions can be compared on the Internet before one chooses which to take time to visit, or if supermarkets start posting all of their prices (for online shoppers) on sites that enable shoppers to bookmark their favourite products separately from the thousands of lines stocked and readily read off the total cost of the week's trolley load from each store. Clearly, if supermarkets fail to provide website listings of all their prices to enable consumers to bookmark and check the cost of their favourite items easily, then policymakers might require that they do so. One would imagine that these websites could be readily integrated with the stores' scanner information systems. However, it should not be forgotten that third-party websites can attract potential customers to view them by exploiting economies of scale in gathering information to provide information about where is currently the best place to buy a particular product or basket of goods (for example, a used car dealership might offer on its website reports on where the cheapest petrol in town can be found, and in becoming a place that those in the know visit regularly it becomes a market institution for the petrol market as well as increasing its own probability of winning sales).

The information revolution is also changing the role that consumer magazines can play as transaction cost-reducing market institutions. Consumer magazines emerged in previous decades as ways of making money for their proprietors whilst helping consumers to solve the problem of choice amongst a greatly widened range of options. Their viability depends on the willingness of a big enough body of customers to pay for the information they offer, and on their ability to attract advertising revenue, the balance of their two sources of income depending on their willingness to be brutally frank rather than running 'advertorials'. But they now have to compete with websites whose economics are very different from their own.

In the past, one of the problems with the provision of such information and knowledge via the market was that of matching the sale of it to the time when the consumer was actually 'in the market'. If a consumer was thinking of buying a product that had been around for a while, there would be problems in tracking down which consumer magazines had assessed it and then obtaining a back-number (often not possible) or a public library copy. This problem is

probably falling in significance due to the archiving of reports on magazines' websites, and much easier search that the Internet permits. The integration of product information and product availability websites (such as those that enable would-be used car buyers to find past road tests and the location of prospective vehicles) is also tending to solve the willingness to pay issue by having the advertisements of availability fund the provision of information about the products.

There is, however, a potential market failure problem for the consumer magazines or newspapers whose test reports get archived: if consumers come to expect to be able to find information archived for free on the Internet when they want it, there is far less incentive for them to be regular purchasers of the original source of the information. The market solution, of course, is for the websites themselves to internalize the product appraisal role and publish their own test reports as well as advertising sources of supply. This 'solution' may be problematic unless such websites can find a method of charging consumers for browsing their test archives, for otherwise they stand to incur higher costs than rivals who merely advertise products for their customers and run the risk of people researching at their archives but placing their advertisements/looking at advertisements at the other sites if cheaper advertising results in a bigger search pool. This problem is the modern day equivalent of that faced three or four decades ago by full-service retailers who demonstrated products such as hi-fi system components to consumers only to find the latter buying them more cheaply at discount warehouses. It is an manifestation of the 'Arrow paradox' of information economics (Arrow, 1962): if people are not charged for information before they are shown what they are getting, they will have no need to pay for it after they have been shown it. However, the problem is not intrinsically intractable in terms of consumer welfare: the demise of full-service retailers did not result in consumers having no basis for choice in discount stores if it provided a profit opportunity for a new consumer magazine.

It is unclear whether this 'free browsing' problem (akin to reading magazines in a newsagents' store without buying them) will be acute here, as the peculiar economics of Internet businesses need to be considered. The key point is that such businesses are basically fixed-cost operations with virtually zero marginal costs, so their crucial concern is market share: the firm that initially gets the biggest market share stands to win in the long run due to network effects. On the one hand, offering product review services adds to fixed costs but may increase market share if one's advertising charges do not exceed those of rivals that do not offer comparable product review services. On the other hand, the website with the higher fixed costs is more vulnerable in the event of a price war over advertising rates.

Experience goods are those where the consumer can only discover what they really have to offer *after purchasing them and consuming* them, as with restaurant meals, movies, and many tourism products. (Many goods normally seen as search goods, such as motor vehicles and household appliances, have an experience good aspect, too, with consumers often coming to realize that there were extra questions they could have asked before buying them even though at the time of purchase they may obtained answers to all the questions they had. Experience may also reveal more about the relative worth of certain product features.) Here, there may be scope for consumers to be given very

poor value for money, particularly if it is clear to the provider that they will not return as customers even if they receive a good deal and will not be able to affect sales to other potential customers by word of mouth. Even so, from the mainstream perspective, there is no inherent need for consumer policy in this case. It will be rare for the consumer to have no idea at all about what they may receive if they choose one product rather than another. There are many ways that suppliers can signal what their products are likely to offer, some more credible than others. For example:

- A movie production company can signal the likely quality of a movie by demonstrating that it has signed up particular stars, each of whom has a good incentive to choose carefully the movies in which they appear in order to cultivate their own reputations.
- Heavy investment by a firm in their own brand on a national or global basis may be treated be treated as a signal of quality (Klein and Leffler, 1981): the firm has an incentive to deliver what it promises, since any bad publicity could wreck the entire business in much the same way that Arthur Anderson collapsed after losing credibility due to involvement in the Enron scandal.
- A restaurant or winemaker can demonstrate how it has fared in terms of a rating guide, or by awards that it has won.
- Indications of reliability of service of on-line suppliers might be available if they trade through eBay, and so on.
- Advertisements can signal quality by reference to how long the firm has been in business and its membership of the relevant trade association.

On this basis, it may not be necessary to regulate a market such as that for taxis, despite the potential for taxi drivers to take, say, foreign tourists (who do not know the local geography) to their departing flights via needlessly long routes. A taxi collective has to worry about its image with local repeat customers. Competition amongst brands of taxi collectives should therefore be sufficient to ensure that their members are policed for appropriate practices by their respective central coordinating offices. All that a foreign tourist needs to be able to do to find a reliable taxi is to choose from a brand that has a lot of taxis evident on the streets, for an unreliable brand would have collapsed due to bad publicity spreading amongst local consumers.

The kinds of products where such reputation signals may be absent and where consumer protection is needed thus appears to reduce to the set of products with what might be called a 'cringe factor', for reports about poor reliability of particular supplier may not get around via word of mouth. Examples here include introduction agencies and retailers of other kinds products that people would rather not be known to have consumed (e.g. online pharmacies who fail to deliver Viagra after billing credit cards).

To some degree, *any* mistake that we make in choices of what to buy has a 'cringe factor', for if we make our disappointments known to our peers, we are revealing something about our decision-making competence. If disappointed consumers face these or other costs should they try to generate bad publicity for a particular supplier, they may opt to suffer in silence unless driven by a sense of social obligation or considerable anger. As with search goods, designers of consumer policies will find their task changing with changes in

information technology. The rise of the Internet has greatly reduced the costs of letting the world know just how poorly served one was by a particular supplier: for example, those who have been disappointed by a hotel can spell out why on traveladvisor.com, and some hotel booking sites routinely request feedback about the businesses that they list. The 'cringe factor' is also changing. Whilst Australian consumer policy legislators may have rather limited powers for dealing with dubious overseas online retailers, their need to do so is limited insofar as the genuine operators list their products via established portals such as Amazon Marketplace and eBay that provide opportunities for customers to rate them. Likewise, traditional business types such as introduction agencies are being rendered obsolete by online dating services that offer a vastly superior range of choice at a fraction of their cost and more closely mimic 'normal' ways of finding partners by leaving much more of the task of making selections in the hands of the would-be dater. More generally, the rise of businesses such as eBay means that the costs face by consumers if they make a mistake and buy a product that does not suit them are much reduced because they now have a much easier means of getting some of their money back via the much thicker second-hand market that these Internet outlets makes possible.

Credence goods are products whose buyers remain unclear about the kind of deal they have received even after the product has been delivered, either because they are unable to verify whether the product was indeed delivered or because they remain unsure whether they needed to buy it to reach the goal they were advised it would help them to reach. Car servicing, medical procedures, legal services and complementary medicines/dietary supplements typically come into this category. It is debatable, however, whether policy intervention is needed to safeguard consumers against over- or under-servicing.

In some cases, third parties with a long-run interest in cultivating customers may be better placed than the customer to know what service the latter should be receiving. For example, motor vehicle manufacturers have an interest in their products not developing reputations for breaking down and for high maintenance costs. They seek to contain these risks and costs by specifying recommended service schedules for their products and by authorising certain businesses to carry out such work. The replacement of, say, all major engine hoses at 100,000km as routine precautionary maintenance may seem entirely in order if it is in the service schedule, whereas it may sound like over-servicing if recommended merely by the servicing agent. Similarly, under-servicing by service agents (for example, claiming to have done something they have not done) is deterred by the risk that the manufacturer may audit what they do and withdraw the valuable authorisation.

In other cases, however, regulation may be needed for credence goods. Consider the supply of legal services. Lawyers might be capable of being better judged by their peers than by their customers in terms of the quality of the work they do. Lawyers who behave in an unprofessional manner risk being debarred after this has come to the attention of their professional society. However, this only applies in extreme cases. Whilst lawyers may win many customers on the basis of recommendations and keep them on the basis of how well they seemed to be doing business in the past, potential customers would find it easier to assess their quality if there were ready access to league tables

of performance. If such tables were available in this sector, in the manner that they are increasingly available to those who are trying to find a reliable surgeon, someone needing to sue over, say, a workplace injury would find it easier to judge between firms that got cases settled rapidly but for small sums, most of which were absorbed in their fees, versus those that did much more work and charged more but typically got far higher net benefits in the end. In the absence of performance measures, prospective clients may have to use proxies to judge whether a particular lawyer is any good, and these proxies may not be effective. For example, judging a lawyer's success by whether or not he or she operates from the 'top end of town' might be a bad mistake if the lawyer is actually merely renting office space and services by the hour in a prestigious office block and is otherwise working from home with limited experience and resources. Likewise, choosing a lawyer who is familiar merely because of extensive advertising may result in poor service because of the firm's need to keep turning over cases to generate the fees to pay for the advertising.

The crucial question, for those seeking to work out which credence goods and experience goods will need regulating so that trustworthy suppliers can be found, is what determines whether a sector will voluntarily post performance data or whether its suppliers will find themselves getting rated by a credible authority. The answer seems likely to hinge upon the comparability of individual transactions undertaken within the sector. For example, hip replacements and MBA degrees are two categories of product involving uncertainties about suppliers but where supplier rankings are available. They are much more standardized kinds of products than many legal cases. With the latter, outcomes are heavily dependent on the specific circumstances of the parties involved and how well their lawyers made the most of them. Legal professionals would thus have a basis for arguing against being rated or for a rating agency of some kind to prepare summary evaluations of their work, whereas it would be hard for surgeons to appeal to the peculiarities of each patient as a basis for not publishing their death rates when they perform particular risky procedures. However, if lawyers were at least required to provide data on the types of cases they have handled, and their respective fees and outcomes, then prospective clients might be able to infer patterns that were far better guides than the proxies they might otherwise be forced to use.

2 The Behavioural Perspective on Consumer Choice

Some of the critical comments made so far, such as those involving consumers limiting their search for alternatives until a supplier falls short of their requirements, or involving the use of proxies to judge quality, are underpinned by the view of decision-making that is to be found in behavioural economics. This kind of economics has recently attracted considerable attention and nowadays tends to be associated with North American scholars such as Rabin, Thaler, Camerer and Lowenstein. It is important to realize that their version of it is somewhat different from the earlier wave of writing in the 1950s and 1960s that helped earn Herbert Simon his 1978 Bank of Sweden Prize in Economics in Memory of Alfred Nobel (see Earl, ed., 2001; Earl, 2005), even though both generations of writers may refer to the notion of 'bounded rationality'.

The newer contributions tend to be focused on the implications for economic theory of what has been discovered experimentally about how actual behaviour differs systematically from what economists have traditionally expected to see 'rational' economic agents doing. These systematic differences are summed up under the heading of 'heuristics and bias'. The Simon-inspired version of behavioural economics is aware of these phenomena and has long used them to explain phenomena such as the escalation of commitment to failing projects, but it generally has a somewhat different focus that probably has more significance for consumer policy. Instead of assuming that taking good decisions is merely a matter of getting good information so that satisfaction can be maximized subject to a budget constraint, it sees consumers as

1. problem-solvers who use systems of rules to deal with problems of information and knowledge (the two terms are not seen as synonyms);
2. not necessarily having a clear idea what they want (and hence being suggestible and open to manipulation); and
3. often working with poorly defined budget constraints.

This has led to a new behavioural approach to law and economics, the key works being Hanson and Kysar (1999a, 1999b), who focus particularly on manipulation of consumers, and papers collected in Sunstein (ed.) (2000). Free-market economist might wish to point out that it is possible for consumers to buy books that reveal the findings of behavioural economics to the lay audience (for example, Thaler, 1992, Belsky and Gilovich, 1999, and Gigerenzer, 2002). Having purchased these books, consumers could follow their advice on how to improve the quality of their choices. However, the failure of these books to become global bestsellers on the scale of, say, Harry Potter novels suggests that market processes are decidedly limited as means for ensuring consumers make the most of their decision-making potential.

Although consumers may indeed make disappointing choices due to a lack of information about the products between which they are choosing, or due to being unaware of products that they could have considered, behavioural economics recognizes that the information problems that consumers face often take a different form:

- *Information overload*: consumers have limited information processing capabilities (typically they can handle only about 10 yes/no or identification questions per second: see Marschak, 1968) and limited memory capacities (they can keep in mind between 5 and 9 things at a time: see Miller, 1956). If they are choosing between many complex products and have information about the attributes of these products, they will simply not be able to handle all the information, particularly if they are not given time for careful reflection, note-taking and perusal of specification sheets. Consumers who are suffering from information processing fatigue may be liable to take impulsive choices based on a fraction of the information at hand, particularly if under pressure from a sales person. If market mechanisms do not provide them with means of avoiding this, policies such as those involving cooling-off periods for major purchases may be necessary. Products such as superannuation funds with

complex fee structures, and mobile phone contracts with masses of fine print are exemplars of this. Consumers may even face firms deliberately creating overload for strategic reasons, a possibility that has led to the term 'confusopoly' coming into the literature of economics. Market deregulation can exacerbate information overload by resulting in more suppliers between which to choose.

- *Ambiguity regarding the significance of information*: consumers may need to have particular kinds of expertise to assess the significance of information. Suppose a consumer has researched car safety and managed t6o memorize laboratory safety ratings (or even rankings in terms of marks scores) at the ANCAP website and on websites that report safety in-use, such as http://www.howsafeisyourcar.com.au. The consumer has avoided information overload but may still have trouble judging, say, whether it is best, if one is being hit by a large car, to be in a 2004 Mitsubishi Magna (only *** safety rating despite side airbags) than much smaller and lighter 2005 Toyota Yaris with it optional safety pack (***** safety rating). The consumer may have a hunch that the relative masses of colliding vehicles could be an issue but needs more information to overcome the disadvantages of being without formal expertise in the laws of physics. If no one is providing this, firms can keep making potentially misleading claims about their products serving safety requirements well. With relevant knowledge (expertise), consumers can work out the significance of a mass of information but, without it, they may need more information of a particular kind to cut through a mass of conflicting information.

In some cases consumers may be able to access services that enable them to obtain knowledge needed to resolve uncertainty due to conflicting information being available, and that help them to deal with information overload. But these services, like those considered in the previous section, will only be provided by profit seeking organizations if there are enough consumers who are sufficiently interested in solving such puzzles and willing to pay enough to do so, unless they can be funded by advertising.

Despite the rise of the Internet as a means for boundedly rational consumers, in effect, to outsource their brains when making complex purchases, we should remain concerned about the extent to which they will bother to seek relevant information from the market. Herbert Simon's version of behavioural economics sees decision makers as target-setting satisficers, not as optimizing agents. This does not mean that they necessarily operate in a very casual manner and hardly look at alternatives: how much effort they put into their choices will depend on how high they set their aspirations, and the ease of finding products that seem likely to meet their aspirations. In fact, some decision rules, though very simple, are remarkably efficient (see Gigernzer *et al.*, 1999). However, it is clear from Waterson's (2003) survey of how consumers have responded to market deregulation in the UK, that in some areas people simply are not bothering to take up opportunities to improve their well-being that they could discover and act upon easily. If they are prone simply to roll-over what they are already doing, then regulators may consider requiring providers to present consumers with hurdles they need to get over before they

can sign up for continued supplies (for example, with banking services and electricity supplies where contracts are typically open-ended). Economic growth should be a spur to setting new aspiration levels as it enables people to enjoy new levels of performance from products that they buy. However, they may well end up failing to raise their new standards as high as they might have done. The problem is that, on being faced with products they have never previously been able to afford, they may opt to deal with the complexity of their new choice problem by opting for the default choice, a familiar brand that has wide social credibility. If they make such choices, they will probably be happy with what they get (since it is much better than what they are used to), but only in the 'ignorance is bliss' sort of sense.

From the behavioural perspective, then, policy interventions may be needed to protect consumers from their own shortcomings. Such interventions may be important for long-run welfare in a world of increasingly open economies: those who tend to be undemanding will get presented with local products that meet their low standards if they do not experiment with imports made in economies whose consumers are more discerning, while firms that have built their businesses around undemanding local customers will find it difficult to break into more sophisticated overseas markets. Consumers who *are* assiduous seekers of information about better products and better deals will tend to find even better prospects on offer if they live in societies in which *other* consumers are similarly assiduous and not prone simply to opt for the default option. In order to wish to search for information that the market provides, one must first be aware of the possibility of benefiting from incurring the costs of such search activities. Hence the extent to which the population at large goes beyond the default option may depend upon policies that draw to their attention just how much better they might be able to do.

The suggestible consumer

If consumers are not born with preferences to cover all possible situations, they need to acquire them at a price, whether this involves investing their own scarce time in research and experimentation or paying someone else for them, one way or another. Hence advertisements and sales personnel, along with market institutions such as consumer magazines and websites have potentially beneficial roles as sources of ideas and potential decision rules when consumers need to develop preferences as they move into new phases of their lives, with new levels of income and new products between which to choose (Littlechild, 1982, Earl and Potts, 2004). It is thus entirely reasonable to expect a full-service retailer to need to charge more than a no-frills retailer of the same product. Business practices need to be questioned, however, if giving consumers ideas and decision rules involves misrepresenting the benefits they may get from consuming the product or the cost of purchasing it. To be sure, if one supplier is lying and, say, creating needless anxieties as a basis for purchasing the product, other suppliers may have an incentive to expose the lies and tell the truth if they stand to benefit from doing so. But firms with different advertising budgets may be unequal competitors in the battle for the consumers' attention. There may also be market failure problems when it comes to demolishing misleading advertisements. In some cases the truth might cause the particular market to collapse completely with consumers then diverting their purchasing power in no particular direction. If so, a firm that

invested in a myth busting advertising campaign would find it hard to capture the benefits of doing so. In such cases, there will thus be a need for policies to regulate advertising and sales methods.

The suggestible consumer also is prey to more subtle ruses and lures, as discussed at length in the new literature on behavioural law and economics. The car market is a good example of potential for this with big ticket items. In Australia, the difference between manufacturers' 'recommended price's and 'drive away prices' of motor vehicles is considerable, with delivery charges listed in fine print, if at all, in advertisements sometimes amounting to 5-10% of the eventual cost of cheaper vehicles. The motor industry's excuse for the continuation of the practice of advertising the manufacturer's recommended retail price, namely, that delivery costs and taxes vary between states, seems dubious given that the bulk of advertising is in state-based newspapers and it would be possible to advertise indicative 'national average drive away prices' in other contexts, such as motor magazines or national newspapers. Just as the big print captures attention better than fine print, so consumers will have their attention grabbed better by $19,995 than by $20,000 and may experience difficulties keeping in mind that a product is really much more costly than other parts of their brain are trying to tell them about its price. Consumers also may find their time being wasted or become at risk of being sucked into more expensive deals if they try to pursue products advertised in, say, car dealers' websites, that simply do not exist and never existed as stock for sale at the special advertised prices and about which even the most assiduous website watcher will be told 'Sorry mate, it's already been sold'.

At the cheaper end of the price spectrum, the consumer may unknowingly be falling prey to devices such as the use of lighting and types of packaging to affect the look of products in supermarkets' fruit and vegetables sections, or placement of certain products at eye level or by checkouts for reasons based on careful research. Hanson and Kysar (1999b) explore common ploys in these and other markets at considerable length and the following list summarizes their main areas of concern:

- Fear appeals.
- Diversion of attention from hazards of thrill-seeking products.
- Shaping perceptions of product safety.
- Misrepresenting the environmentally friendliness of products.
- One-sided use of 'expert' (but partial) opinion.
- Strategic use of framing effects (for example, presenting food products as 75 per cent fat-free, not as 25 per cent fat!).
- Exploitation of psychological thresholds (just noticeable differences).
- Misrepresenting products as 'New', 'Special', etc.
- Careful management of the 'atmosphere' of purchasing environment.

The research on consumer behaviour that underpins the behavioural approach to law and economics clearly suggests there is a major potential role for consumer policies aimed at limiting consumer manipulation.

Clearly some groups are more vulnerable than others and it should be possible to regulate markets to prevent firms from exploiting such groups. For example, teenagers could be prevented from getting sucked into ploys that run up large bills on their mobile phones (or on the credit cards of their parents,

from which they were allowed to recharge their phones) if the mobile phone service providers were required to put an automatic age bar on accounts against the use of such services, rather than expecting the youngsters to read the fine print as it flashed past them on television advertisements for such products. However, it is also clear that consumer policy has a role to play in improving the welfare of consumers who believe themselves to be more at risk than they actually are.

Consider the case of elderly consumers who are suspicious of all tradespeople and will not use EFTPOS or credit cards out of a distrust of computers. These fears may result in such consumers being at risk due to their homes having become dangerous in areas that they will not get fixed, and being more at risk of being mugged or burgled for their cash. Whilst less anxious consumers with more extensive social networks may be happy to choose plumbers, electricians and the like with the aid of recommendations from friends or in the light of market institution signals such as the age of the business, its membership of the relevant trade association, and so on, the anxious consumers may need some kind of social welfare intermediary to ensure they get together with a reliable tradesperson who will not then return to rob them. The benefits of policies aimed at making elderly shoppers more comfortable about using EFTPOS and credit card may, however, be rather mixed: some might be rapidly transformed from having excessive amounts earning little in current accounts into problem debtors due to not understanding how credit card interest charges work.

3 Consumers and Credit

If consumers are suggestible and lack skills for doing complex calculations, their access to credit is an area where policy interventions may be needed to protect them from falling into temptation and ending up highly stressed, or in denial, about becoming problem debtors. Behavioural economists know from the work of Ainslie (1999) that consumers have a tendency to discount the future hyperbolically rather than exponentially. That is to say, they are likely to run into problems in the face of temptation because they greatly overweigh present benefits compared with future cost consequences. If they have soft budget constraints due to access to credit, processes of cognitive dissonance reduction are likely to kick in to reconcile getting further into debt with the benefits they imagine coming from bringing consumption forward: an attitude of 'I'll cross that bridge when I come to it' is what we might expect if probing on how a consumption splurge can be reconciled with the need to self-fund retirement. That there might be a potential problem is an issue which can be avoided by not doing the sums, even if one is able to deal with compound interest calculations, or by telling oneself that one's finances will very likely be restored via, say, a legacy from one's parents (even though they, too, might have been operating in precisely the same manner, 'spending the kids' inheritance').

From the behavioural perspective, measures to deter consumers from making heavy use of their capacity to borrow are worth considering not merely for their potential to reduce the growth of foreign debt or the incidence of consumer bankruptcies and the generation of environmental costs associated with more consumption. Rather, insofar as having debt imposes stresses, it is a

thing to be avoided in terms of psychological well-being if the objects or activities funded by the debt do not result in increased ongoing happiness. New products may themselves bring new stresses rather than (or instead of) solving the problems they were bought to solve, because they present further complexity to be coped with, or they break down. Consumers rapidly habituate to the new performance levels offered by their upgraded cars and houses, etc., rather than benefiting in terms of personal development by acquiring new skills in the process of 'learning to live' with what they already have. Most of all, behavioural economists know from research on happiness that it is a function of how we look at things, rather than how much we have, and that in many cases happiness is a matter of our relative income and consumption compared with our social reference groups, not a matter of absolute levels (see Easterlin, ed., 2002; Layard, 2005).

The modern consumer faces two areas of credit temptation that may warrant attention from designers of consumer policy. The first is the growing use of home equity loans and credit cards, and the second is the availability of in-store credit. Home equity loans and credit cards differ significantly from traditional bank loans or hire purchase agreements in that no new form filling activities are required to use them and they involve no particular repayment horizon. There is thus nothing to concentrate the consumer's mind on the financial implications of the act of purchase that they are contemplating. It is all too easy, after having been attracted to explore a product, to end up spending far more than one had planned and yet have little idea of what the long-run implications of this might be. Consumer policies that required consumers to make the effort to get over some hurdles before they could use up some more of their credit limits might have a useful role to play in enforcing further reflection on the opportunity costs of what they are considering doing, and on whether they really want the benefits the product offers.

Compulsory cooling off periods before purchases of big ticket items can be finalised are one way of achieving this but they are unlikely to be very effective if they involve the consumer having to return to the retailer to say 'I've changed my mind and no longer want to complete this transaction', for this may involve considerable loss of face. A more appropriate approach may be to require consumers to give several days' notice to their credit suppliers of intentions to add a particular large amount to their credit usage, with such pre-authorisations having an expiry date far enough into the future that they did not feel they needed to rush into spending, but having an expiry date nonetheless to deter strategic abuse of the measure via always having a big option that was immediately available. It would also be possible to make the authorisation of such a sum for credit contingent on the consumer being shown what the monthly sum needed to repay that debt in a particular period (say, three or five years) would be, so that the consumer goes shopping with a clear picture of this in mind.

The suggestions just made clearly are the polar opposite in their thinking to the transaction cost-reducing 'one-stop shop' idea in which the retailer provides both the product and the credit with which to buy it. The sequence of events in a typical transaction seems back to front in relation to consumer welfare: the consumer works out what he or she wants and then finds a way of paying for it. Once again, pre-authorisation of credit to a particular limit could be imposed as a policy, so that the credit amount was not talked up during the

decision about what to buy. Another approach would be for cooling off periods that end with the consumer returning to the store to sign the final authorisation and taking delivery, or simply not returning, whereupon the deal would lapse without any loss of face on the part of the consumer except regarding credibility in the eyes of those sales personnel should they return to consider a further possible transaction. (Customer credibility may affect the kind of service that one can expect, given that sales personnel have to allocate their time between rival customers.) A more radical proposal would be to prevent firms from supplying in-store credit, in much the same way that in some jurisdictions optometrists cannot also be in the business of retailing spectacles and contact lenses. These kinds of suggestions clearly go against the idea the consumer policy should not impose burdens on consumer, but if consumers are prone to lack self-control these kinds of measures may well be socially desirable.

4 The Regulator's Dilemma

Over the past couple of decades deregulatory policies have been introduced to increase the range of choice that consumers face and to promote further increases in consumer wellbeing by stepping up competitive pressure and thereby forcing firms to be more innovative and find ways of cutting costs and prices. However, little attention has been given to the possible downsides of these policies, even if they are successful at increasing the range of choice and value of money, and in promoting innovation. An increased range of choice also increases the complexity of choice and hence the risk that a confusopoly will emerge. For example, if Telstra were the only mobile phone and broadband service provider, life would be far simpler. Instead of being overcharged and poorly services by a monopoly, consumers of mobile phone and broadband services now face a bewildering array of choice and much fine print. They might have been better off if Telstra had been allowed to remain a monopolist but had been turned into one whose performance might have been improved by making its top manager's jobs depend on their success in meeting standards based on international best practice, rather than by increasing competitive pressure in Telstra's marketplace. Bewildered consumers may need protecting but, as Waterson (2003) points out, if regulators try to make prices clearer, the producers may simply retaliate by making it harder to compare their products on non-price grounds. Unfortunately, there is an inherent problem for firms who might be inclined to cut through attempts to obscure the deal on offer by offering something transparent, because that product needs to be compared to its opaque rivals before its performance in relative value for money can be assessed.

Quite apart from the confusopoly issue, it is also important to recognize that market deregulation aimed at increasing competitive pressure on the supply side may increase the likelihood that there will be attempts to manipulate consumers. Hanson and Kysar argue that if it is difficult to make normal profits in a market, because there are few impediments to entry, then this is precisely the kind of environment in which we should expect firms to engage in dubious practices, if they think they can get away with them, as a means of keeping viable. If profits are easy to make in an honest manner, then there is less incentive to cheat. The basic problem is how to prod firms into

offering consumers better deals and improving their dynamic efficiency without putting them under such great pressure that they are driven to exploit consumers' shortcomings by devious means.

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