

RESPONSE TO PRODUCTIVITY COMMISSION ISSUES PAPER

Perth Public Hearing, Friday 23 March 2007, 9.00am.

Professor Chris Field

Introductory comments

- I appreciate the opportunity to appear at the hearing.
- I currently hold the following positions: Member of the Economic Regulation Authority, Western Australia and Professorial Chair in Consumer Law at La Trobe University. I am also the Chair of the Consumer Utilities Advocacy Centre, a Director of the Energy and Water Ombudsman Victoria, an Adjunct Professor in the Centre for Advanced Consumer Research at the University of Western Australia and undertake research consultancies. On Monday 26 March, I will commence my appointment as the Western Australian Ombudsman.
- The views expressed today to the Commission are mine alone and do not necessarily represent the views of any organisation with which I have been, am, or will be, involved.

Comments on overall approach

- In my view, the Issues Paper is a very good starting point for the Commission's review and, more generally, the important debate that we will have this year about Australian consumer policy. I think the Issues Paper sets out the most important issues to be considered.
- The Commission should also be commended for the consultative processes it has committed to undertake as part of the review.
- The Commission's decision to focus "on high-level institutional, procedural and policy issues" (page 11) is one that I strongly endorse. Australian consumer law and administration is vast and complex and would present a formidably difficult challenge to review in detail. The Commission's adopted approach should encourage a "first-principles" framework approach to policy design and, it follows, encourage stakeholders to resist the temptation to move immediately to solutions for particular problems, before considering the principles upon which we build solutions.
- Consistent with this, in my presentation today, I have deliberately kept my comments at a high-level, rather than addressing particular questions or detailing examples of consumer regulation. I would be delighted to appear before the Commission again as the review progresses to discuss any matter of detail that I am able to comment upon based on my professional experiences.

A first principles approach

- I believe Australian consumer policy should be based on a first principles approach. The review represents an invaluable opportunity to articulate these first principles (as well as a range of high-level issues that flow from the application of these principles).
- What might a first principles approach to Australian consumer policy entail? I believe, first and foremost, that our first principle should be to enhance the long-term interests of consumers. What flows from this?

- First, economic efficiency is the bedrock upon which the long-term consumer interest is built – we should recognise that it is, principally, the free operation of markets that will be the primary tool to achieve economic efficiency.
- Regulation is, however, important and desirable to ensure efficient and fair marketplaces, for example, to prevent monopoly abuse and other anti-competitive behaviour, to protect consumers from inappropriate market practices (such as misleading conduct), to provide redress for disputes (and enforcement of bargains) and to ensure that consumers are properly informed in their choices.
- I think the real issue here is not one of regulation versus no regulation, but ensuring that, since our starting point is the efficiency-enhancing effect of markets, that regulation is never introduced unless:
 - (1) there is a demonstrated need for the regulation;
 - (2) the proposed regulation will actually remedy the problem;
 - (3) the proposed regulation is the least restrictive on consumer sovereignty of the policy tools at our disposal; and
 - (4) that the costs imposed by the regulation are outweighed by the benefits of the regulation.
- In short, regulatory protections that stifle economic efficiency are undesirable, unless it can be clearly demonstrated that the cost of that inefficiency is outweighed by the benefits of our protective actions.
- Whilst I am of the view that social justice policies are among the most important for governments to pursue, we should generally be cautious when using consumer policy as a social (or distributive) justice mechanism. Generally speaking, although not exclusively, our otherwise perfectly reasonable redistributive aspirations are best served by more efficient means such as the taxation and welfare systems and spending on health, education and other sectors of the economy.

Removing red-tape, unnecessary regulatory duplication and achieving uniformity

[c]onsumers should welcome proposals to remove unnecessary regulatory controls on business in Britain – after all it is customers, rather than companies, that ultimately foot the bill. We do not support regulation as a knee-jerk response to emerging issues – it is too easy for advocacy groups to be drawn into calling for regulation as a solution to most problems. Instead, it should be considered on a case-by-case basis, and introduced only when the benefits outweigh the disadvantages. Some regulation is pointless or counter-productive, and both consumers and businesses would benefit from it being swept away.¹

- This view of regulatory burden, expressed by the UK National Consumer Council, is equally applicable in Australia. Australian consumer protection regulation exists in a vast and complex array of general statutes, industry-specific regulation, court-judgments, subordinate regulatory instruments, and self-regulatory mechanisms at both a state and commonwealth level. It seems inevitable that unnecessary duplication or inconsistency will arise and unnecessary regulation (or “red tape”) will creep into (some may argue, flood) the system.
- Achieving a reduction in the regulatory burden on business through the removal of ineffective and inefficient regulation, as well as achieving greater regulatory certainty and consistency for market participants (subject always to the first principles approach articulated above), will be a necessary and welcome part of this review – it will be of significant long-term benefit to consumers.

¹ National Consumer Council, *Policy Attitude (2005)* at 6 available at http://www.ncc.org.uk/about/board-papers_January05.htm

Behavioural economics

- The Issues Paper notes the role of behavioural economics in the design of consumer policy (p 13). I recognise potential value in the use of behavioural economics. How consumers frame decisions may very sensibly allow us to tailor our regulatory design to make it more effective.
- Moreover, behavioural economics challenges dominant economic thinking and the debate that is occurring is to be welcomed – it is a mechanism to enhance the rigour of our approach.
- My study of behavioural economics literature also suggests to me the need for caution.
- The Issues Paper highlights the role of behavioural economics in identifying when consumers are making “inferior purchasing decisions” (page 14) or are not acting in their own “best interests” (page 14).
- When it comes to making these judgments about the behaviour of other consumers an obvious question arises. In short, says who?
- More eloquently, John Stuart Mill famously stated that:

Mankind are greater gainers by suffering each other to live as seems good to themselves, than by compelling each other to live as seems good to the rest.²
- There is a potential here for paternalistic intervention that (1) adds red tape and costs to consumer transactions and (2) at a more fundamental level, goes to the heart of the exercise of liberty and autonomy by consumers.
- A second concern is the possibility of focussing on “transactional” decision-making at the expense of “whole of life” decision making (or, in a strict philosophical sense, the difference between occurrent and dispositional autonomy). In short, we learn from our mistakes and those experiences makes our subsequent decision-making stronger. More importantly, we are the authors, and the owners, of the mistakes and the successes from our learning.
- Though we can intervene to protect long-term autonomy by preventing a current “foolish” choice (where such a choice might diminish later autonomous action), it still leaves the great problem (and risk) of determining foolishness, and how a substituted judgment of a third party will actually be a better one than the individuals.
- It should also be noted that certain observed consumer behaviours said to be irrational by behavioural economists can, in fact, be seen to be perfectly rational when examined in the context of neo-classical economics. A very topical and high profile recent example was the use by McDonalds of the Heart Tick. This was criticised by behavioural scientists:

psychological research has shown us that humans are notoriously trusting, positive, and generally apathetic when it comes to thinking too much about habitual behaviours. So it takes only a little effort on the part of a big brand, such as McDonald's, to convince us that everything is OK. By getting the Heart Foundation tick, by publishing the ingredients in its food, by using point of purchase displays highlighting its "healthier options"...McDonald's is using a tried and tested psychological theory — often used by large brands in an abundant marketplace — called bounded rationality.³
- The author observes that consumers are subject to the operation of ‘bounded rationality’ – a key behavioural economics theory. The author notes that:

² Mill, *On Liberty*, 138.

³ Paul Harrison, ‘A tick goes far in consumers' minds’, *The Age*, 9 February 2007.

Simply put, bounded rationality is a theory that suggests most of our decisions are not fully thought through and, as such, we can be rational only within limits such as time, desire to expend effort, and cognitive capability.⁴

- The author goes on to say “You would be surprised how often, when calculating expected utility, we do not make the best choices.”⁵
- Of course, it could also be said that reliance on a well-known, trusted information source about healthy eating could be, for the time-poor modern consumer keen to limit their transaction costs, a perfectly rational act! (Indeed the author notes that “McDonald's has exploited our desire to simplify our busy, demanding lives and thought processes, particularly when it comes to the surfeit of choices that the marketplace offers us”.⁶)
- It is potentially more concerning when we seem to consider ourselves confidently in the position to declare a choice to eat a healthy (or healthier) fast food item as one of those times “where we do not make the best choices”.

Specific Comments

The Issues Paper sets out a series of particular areas to be considered. I comment on a number of these:

Disadvantaged and vulnerable consumers.

- Beyond market failure, one of the principal arguments used to justify consumer protection interventions is the existence of vulnerable consumers. There are at least four things to say about this.
- First, there will often be good reason to support exactly this approach. Vulnerable consumers may quantitatively be less significant, but qualitatively deserve the attention of policy-makers.
- Second, however, we should not abandon our first principles approach. If the regulation is not actually needed, if it is not the right regulation, if it will not actually fix the problem and if it imposes more costs than it does benefits, then making it in the name of vulnerable consumers does not make it virtuous – it is still bad regulation.
- Third, we must recognise that protective regulation for vulnerable consumers that distorts economic efficiency may, ultimately, lessen our productive capacity and wealth – the very wealth that can be used for health, education and other expenditure designed to create opportunity for vulnerable consumers.
- Fourth, governments and regulators might also potentially inefficiently misdirect scarce resources on addressing small, retail issues that appear to obviously harm vulnerable consumers, at the expense of allocating resources to address monopolistic wholesale market and other upstream issues, cartel behaviour and broad market design, which may be equally harmful (if not more so) to vulnerable consumers (but less immediately obvious to see).

General v industry specific regulation.

- The choice between general or specific regulation is generally a second-order choice. The first-order issue is to decide whether there should be regulation at all. As part of any decision to introduce regulation, the existence of a pre-existing general or industry-specific solution may sensibly influence us.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

- For example, there is generally no need (although it is done regularly) to introduce specific regulation prohibiting misleading marketing practices for particular industries given the existence of section 52 of the *Trade Practices Act*.
- Overall, I would state a preference for general rather than industry specific approaches as this will likely to lead to: (1) greater uniformity, certainty and consistency (2) less regulation, less cost and less conflict and (3) less likelihood of regulation designed to protect vested interests.
- There will be, though, times when it is sensible to use industry-specific regulation to ensure that its otherwise burdening effect does not impact across all industries in a way that general legislation will.

Unfair contracts legislation.

- In 2003, the Victorian Government followed international developments in consumer protection regulation and introduced (via amendments to the Victorian *Fair Trading Act 1999*) laws that prohibit the use of unfair terms in consumer contracts. In short, these laws give courts (and regulators) the power to examine and remedy substantive unfairness in consumer contracts. In this way, these laws go beyond the equitable remedy of unconscionability which provides relief for procedural (but not substantive) problems associated with agreements.
- The Commission is to consider the role of unfair contract term laws. In doing so, examination of international developments (particularly the EU, the UK and Scotland) and the precedent set by Victoria will be critical.
- The Australian academic literature so far published has unanimously supported the introduction of laws prohibiting unfair contract terms to remedy substantive unfairness in consumer contracts. While each supports the introduction of unfair contract terms laws, they fail (including my own work), in my view, to consider properly whether the introduction of the laws will involve costs to consumers. This is a major issue of importance to consumers. Compliance costs alone could be considerable. If every affected business was required to rewrite and issue new standard form contracts the cost to be borne could presumably range from the tens of thousands to millions of dollars.
- Costs to consumers may, however, be much more extensive than simply the passing on of compliance costs. Unfair contract terms laws have the potential to interfere with the complex balance of the contractual bargain – the deletion of one term as unfair may see another term, which the consumer values, affected adversely. What may seem on its face attractive – the protection of powerless consumers from the excessive power of business – may in fact upset the complex balance of the contractual bargain in ways that are harmful to consumers.
- Perhaps this is best demonstrated by example. It is currently common practice (and has been for some considerable time) for telecommunications companies to place termination clauses in their mobile phone contracts. On the face of it, these terms may well fall foul of unfair contract terms laws. Indeed, the UK Office of Fair Trading has already indicated that such clauses are likely to be considered unfair.⁷
- It is, however, presumably quite likely that as part of the complex considerations as to price offerings in modern competitive markets, such as the mobile phone market, trade-offs are involved. A telecommunications company may well determine to offer a lower entry price for consumers on the basis that it is confident that it will hold that consumer for a period of time. The consumer benefits from a lower price than might otherwise be had and the business is able to make an appropriate profit based on this longer-term view of the contractual bargain. Now let us

⁷ *UK Regulations Schedule 3 Indicative and Illustrative List of Terms Which May be Regarded as Unfair.*

assume that every consumer, no longer given any pricing disincentive to leave one provider and move to another, acts in a rational way – to seek out the lowest price offering in the market as soon as it is available. It seems inevitable that such a situation would lead to either (1) higher prices (as companies would not be able to recover an adequate return on capital if they kept the same prices for a two month contract as opposed to a two year contract) or (2) businesses would leave the marketplace. While the second concern is not obviously a problem for consumers, it is if it leads to significantly reduced competition for the provision of services where consumers would undoubtedly pay more for their mobile phone services.

- Here, interference with the complex dynamics of exit and entry in a competitive market has potentially unexpected results – what is done in the name of fairness to consumers, may not in fact, be in their long-term interests.
- The examination of unfair contract terms laws by the Commission is particular welcome as these laws provide a window on a broader set of challenges for all consumer protection regulation. Potential prohibitions on unfair contract terms, like many other areas of consumer protection regulation, demonstrate the need to understand that law and economics intersect. Put simply, terms unfair at law are not necessarily economically inefficient.⁸ Examining the true costs and benefits of the possible introduction of unfair contract terms can be a harsh, but necessary, way of exposing an important public policy truth: sometimes what is good for an individual or for some in the short term, may cause more significant long-term detriment for all consumers.⁹

Self and non-regulatory approaches

- These approaches should generally be strongly encouraged, although it is worth noting that too often self-regulatory approaches are adopted without a rigorous process of determining whether any regulation is required in the first place and what the costs and benefits of the self-regulation will be.

Consumer advocacy

- It is a matter of wide agreement that consumer voices are significantly under-represented in Australian (and overseas) political and regulatory processes. The direct result of this is an imbalance in the presentation of interests to those who develop public policy and make decisions. It is also a view that this imbalance leads to outcomes that favour the protection of producer groups at the expense of the interests of consumers. The regulatory protection offered to a range of businesses that serves their interests, rather than consumers, is unfortunately widespread in our economy, but typically cited examples include anti-competitive protections offered to pharmacists, media, airlines, agricultural marketing boards and taxis.
- I have previously argued that a ready precedent exists for a national consumer advocacy body – the government-created and funded, UK National Consumer Council.¹⁰
- The major concerns that exist in creating such a national consumer body are in my view (1) that such a group, to have long-term sustainability, will need to be strictly independent and strictly bipartisan (2) that it will need to focus on creating consumer advantage through economic reform – there are existing organisations who are articulate advocates for consumer protection. The Commission (in its review of National Competition Policy), made clear the principal reason why such a body might be desirable:

⁸ Craswell, “Freedom of Contract”, *The Coase Lecture* (Autumn 1994) p 20.

⁹ Trebilcock, “An Introduction to Law and Economics” 23 MULR 1, p 157.

¹⁰ Field C, “Competition, Consumer Protection and Social Justice – Providing a consumers’ voice” (2005) 33 *Australian Business Law Review* 51.

In a reform-specific context, it is the role of consumer advocates in providing a counterbalance to producer groups seeking to maintain anti-competitive arrangements that lead to higher prices, reduced service quality or less market innovation, that is most relevant.¹¹

Materials contained in this submission have been extracted from my previously published work:

Chris Field, *Current Issues in Consumer Law and Policy*, (2006), Pearson Australia. In particular, chapters three, four and five.

Chris Field, 'Reviewing Australian Consumer Protection' (2007) 35 *Australian Business Law Review* 46.

Chris Field, 'Interacting with consumer advocates', (2007) *Australian Journal of Public Administration* (forthcoming).

Consumer Affairs Victoria, *Consumer Advocacy in Victoria*, Research Paper No.7, March 2006.

¹¹ Productivity Commission, *Review of National Competition Policy Reforms* (February 2005) at 386. This report is available at <http://www.pc.gov.au/inquiry/ncp/finalreport/ncp.pdf>.