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Consumer Protection Policies, Economics, and Interactions with Competition Policy

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Paul A. Pautler

The Spring 2008 issue of *Competition Policy International* features four papers focusing on consumer protection policy.[1] The papers by Armstrong, Beales, Rubin, and Tesauro & Russo present a tour of the logical basis for consumer protection policy and a review of the recent legal rules in the European Union and Italy. There is no book (yet) on consumer protection economics, but this collection of papers would make a nice start for such a text, particularly with regard to the advertising regulation component of consumer protection. There are some topics that cut across the various papers. I will discuss three of those topics:

1) market-based incentives for firms to disclose information in markets;

2) the application of behavioral economics in consumer policy; and

3) the connections between consumer protection and competition policies at a practical level and at the more important conceptual level.

Before discussing these common elements, I provide a description of the papers.

1 *See A Symposium on Consumer Protection*, 4(1) COMPETITION POL'Y INT'L 83-222 (Spring 2008).

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I. The Four Papers

A. ARMSTRONG[2]

Armstrong's paper defies brief description. It is centered on fairly standard consumer protection issues, but it is packed with thought-provoking topics ranging from economic models of firm and consumer behavior (e.g., consumer search), to price distributions in markets for price information, to recent behavioral economics models of consumer and firm behavior. Armstrong diligently works to find connections between his main subject, consumer policy, and competition policy. As one can tell by reading his paper, the task is formidable. It can be done, but many of the linkages are at a conceptual level rather than at a practical enforcement level.

Armstrong provides food for thought about new avenues for consumer policy intervention. The most ingenious arguments flow from ideas about economic models of price searching and competition. There are instances where competition does not lead to good outcomes for all consumers. This includes environments where consumers are passive, where entry by new sellers does not reduce search costs, where consumers cannot handle quality variation, and so forth. Armstrong sprinkles behavioral economics literature throughout his tour of consumer policy issues. That literature relates to exercise gym memberships and credit card fees (e.g., do consumers systematically have overly optimistic beliefs?), shrouding of various characteristics, and small print disclosures (e.g., are consumers misled?). On the policy front, Armstrong discusses various mandated disclosures of pricing information and terms and conditions of sale in instances where sellers fail to disclose various aspects of the transaction. While Armstrong sees more room for policy intervention than either Rubin or Beales, he is not an ardent proponent of regulation in general, and he concludes with an admonition for more study and rigorous cost-benefit analysis prior to undertaking such interventions.

B. BEALES[3]

Beales presents a remarkably tight paper on consumer protection economics. He discusses the advent of the economics of information and much of the intellectual basis for current U.S. policy toward consumer protection in general and advertising regulation in particular. The main thrust of the paper, however, is to examine whether the blossoming behavioral economics literature provides substantial new ideas for applying consumer policy. Beales argues that at this point it does

2 Mark Armstrong, Interactions between Competition and Consumer Policies, 4(1) COMPETITION POL'Y INT'L 97-147 (Spring 2008) [hereinafter Armstrong].

3 Howard J. Beales, III, *Consumer Protection and Behavioral Economics: To BE or not to BE?*, 4(1) COMPETITION POL'Y INT'L 149-67 (Spring 2008) [hereinafter Beales].

not, and further, that many of the valuable innovations in that literature are already incorporated in consumer protection practice at the U.S. Federal Trade Commission (FTC) under the traditional economics of information paradigm. Beales provides at least five reasons for his skepticism regarding behavioral results:

1) in real markets money and time are at stake, while little is at stake in laboratory experiments;

2) the positive findings (at least with respect to endowment theory) may be artifacts of the experimental settings;

3) the biases are not found in many circumstances, in large part because it is the marginal consumer who drives market equilibria and such marginal consumers are not likely to be subject to the decision-making foibles;

4) consumers in real markets will learn; and

5) firms will respond to missing information and fill in gaps left by rivals.

C. RUBIN[4]

Rubin presents a discussion of advertising regulation and some history of that activity since the 1950s. He asks and answers the question: what is the best way to regulate commercial speech? Rubin's paper makes it clear that one must be very careful to consider the regulated firms' reactions to restrictions on their ability to converse with consumers, since they are the consumer's main source of information regarding products. If regulation causes them to provide less useful information, then consumers will be less well-informed. Policies designed to induce truth-telling can actually result in less truth being told. Clearly, if enough costs are imposed on an advertiser, at some point he will quit advertising. Much of Rubin's analysis focuses on the historical actions of the U.S. Food and Drug Administration (FDA) and compares them to that of the FTC. His view is that a generalist agency with an expertise in advertising (e.g., the FTC) does a better job of regulation than does the safety-focused, industry-specific agency with much less background in advertising regulation. One of the key reasons for the difference is the FTC's focus on both Type-I and Type-II decision errors in regulating advertising claims. The FTC knows that one can over-regulate and that over-regulation is not free to consumers. In addition, the FTC has learned from its previous mistakes (which Rubin makes an effort to point out). Rubin's analysis will surely not be well-received by those with a pro-regulatory bent, but he forces one to consider the costs of policies that might have seemed innocuous, but are not.

4 Paul H. Rubin, *Regulation of Information and Advertising*, 4(1) Competition Pol'y Int'l 169-92 (Spring 2008) [hereinafter Rubin].

D. TESAURO & RUSSO[5]

Tesauro & Russo describe the May 2005 EU Directive on unfair business-to-consumer commercial practices and its relationship to Italian consumer protection law and enforcement.[6] The Directive was intended to make EU markets more effective by fully harmonizing the rules and regulations affecting traders and consumers so they know and follow a common set of rules.[7] The authors discuss the Italian implementation of the rules; and some of the implementation receives criticism. Presumably all the Member States had some existing consumer protection laws that may have been more or less restrictive on traders than are the current rules.

The goal of the Directive is protection of the "average consumer", who is reasonably observant and circumspect in the circumstances of the transaction. This notion seems similar to the U.S. construct of a "consumer acting reasonably in the circumstances."[8] The EU law defines unfair practices broadly and then goes on to specifically discuss protection of the average consumer in any definable vulnerable group. The law discusses misleading advertising, misleading comparative advertising, aggressive practices (intimidation and coercion of various types that alters decisions or significantly restricts consumer choice), and 31 banned practices (23 of which are misleading and eight of which are aggressive). The banned practices include lying about price, product origin, and other product characteristics, claiming a product is free if it is not, bait and switch marketing, pyramid marketing schemes, switching languages from the one used to make the sales pitch, statements in adverts aimed directly at children, inducing false urgency by saying that offers are good for only a very limited time, claiming brand uniqueness that is false, requiring payment for unordered merchandise, and so forth.[9] Aggressive practices include threats, intimidation, persistence that coerces, exploiting known misfortunes of the consumer, etc. In each case to be actionable, the EU law requires that the practice alter consumers' decision-making.[10] The authors do not analyze each of the specific provisions in the lists, but they worry that the increase in legal certainty that derives from the lists may come at a cost. For exam-

5 Claudio Tesauro and Francesco Russo, *Unfair Commercial Practices and Misleading Comparative Advertising: An Analysis of the Harmonization of EU Legislation in View of the Italian Implementation of the Rules*, 4(1) COMPETITION POL'Y INT'L 193-222 (Spring 2008) [hereinafter Tesauro & Russo].

6 Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, 2005 O.J. (L 149) 22.

7 Tesauro & Russo, *supra* note 5, at 211.

8 *See* M. Salinger, P. Ippolito & J. Schrag, *Economics at the FTC: Pharmaceutical Patent Dispute Settlements and Behavioral Economics*, 31 REV. INDUS. ORG. 85-105, 97-104 (Sep. 2007) for an economist's view of a similar FTC unfairness law and how it works.

9 Tesauro & Russo, *supra* note 5, at 209-11.

10 This is similar to the notion of "materiality" in U.S. consumer law. If a claim is material, then it presumably can alter the consumer's decision.

ple, they worry that the specificity of the law may make enforcement less flexible in the future.[11] In addition, they worry about potential under-deterrence in the Italian application of the law by the Autorità. They are particularly concerned that firms may be able to violate the rules and obtain absolution simply by promising not to do it again.[12] Although that is a weak penalty, for minor, harmless infractions where the line of illegality is unclear, it is not obviously silly, so long as it does not devolve to lawlessness (no harm, no foul).

II. Issues Cutting Across the Various Papers

A. THE UNFOLDING PRINCIPLE

There are several issues that cut across many of the papers and one of the key arguments involves the ability of markets to reveal information. If unregulated markets do not provide information, then there is a better argument for aggressive consumer protection. Beales and Rubin rely fairly heavily on the principle that almost all information, including adverse information, about products and services will be revealed to consumers through the competitive process.[13] This idea has been dubbed the unfolding principle. The argument first put forward by Grossman (1981) is that in a world with homogeneous and skeptical consumers and competitor firms, rivalry will force firms to reveal even the bad aspects of their products.[14] All but the very worst will disclose, so long as consumers want the information and its provision is not too expensive. This is a great story, and it clearly works often, but it is not clear whether it works well all the time.

> THE ARGUMENT IS THAT IN A WORLD WITH HOMOGENEOUS AND SKEPTICAL CONSUMERS AND COMPETITOR FIRMS, RIVALRY WILL FORCE FIRMS TO REVEAL EVEN THE WORST ABOUT THEIR PRODUCTS. THIS IS A GREAT STORY, AND IT CLEARLY WORKS OFTEN, BUT IT IS NOT CLEAR WHETHER IT WORKS WELL ALL THE TIME.

Armstrong is less of a believer in the unfolding principle. He discusses Jin and Leslie's 2003 work where forced revelation of a credence characteristic (Los Angeles restaurant kitchen cleanliness ratings) resulted in benefits to consumers in the form of reduced illness.[15] Similarly, Mathios (2000) reviews some of the more recent refinements on the theory of unfolding and pro-

11 Tesauro & Russo, *supra* note 5, at 198, 211.

12 *Id.* at 219.

13 Beales, *supra* note 3, at 151-52 and Rubin, *supra* note 4, at 187-88.

14 S. Grossman, *The Informational Role of Warranties and Private Disclosure About Product Quality*, 24 J.L. & Econ. 461-83 (Dec. 1981).

15 G. Jin & P. Leslie, *The Effects of Information on Product Quality: Evidence from Restaurant Hygiene Grade Cards*, 118(2) Q.J. Econ. 409-51 (May 2003).

vides evidence on unfolding in the labeling for salad dressings before and after such labeling was mandated in the early 1990s.[16] Prior to the mandate, all low-fat salad dressings disclosed fat content, while the higher-fat dressings did not, even though there was substantial variation across the higher-fat dressings and disclosure was not costly. Market incentives were insufficient to induce disclosure of the information. As a result, gains were available from mandating information in markets for Los Angeles restaurants and salad dressings.[17]

B. APPLICATIONS OF BEHAVIORAL ECONOMICS TO POLICY

A second issue that cuts across the various papers is the relevance of behavioral economics for consumer policy. Beales and Armstrong devote substantial segments of their papers to describing the blossoming behavioral findings and discussing policy based on them. Behavioral economics alters the standard consumer optimization assumptions of traditional economic theory in various ways. The list of human decision-making foibles seen in economic psychology labs is vast.[18] Surely human consumers are not calculating machines, but it is easy enough to think that market incentives of rival sellers and the self-interested actions of imperfect humans in a market setting might combine to produce outcomes that would look remarkably like those that would be produced if consumers were calculators. Good outcomes occur mainly because profit-seeking suppliers try to outdo each other in providing what the marginal consumers in a market want. Beales makes this point well.

The question is whether these foibles uncovered in the lab are important in real-world markets. Furthermore, if not, why not, and if so, will learning solve the problem? That appears to be the current question regarding the application of behavioral theory to policy. What persistent problems do we see in market equilibrium following an opportunity to learn? Some studies find that learning occurs, and then forgetting occurs. Some studies find that lab outcomes do not appear in markets, while other results do seem robust to leaving the lab. Some

16 A. Mathios, *The Impact of Mandatory Disclosure Laws on Product Choices: An Analysis of the Salad Dressing Market*, 43(2) J.L. & Econ. 651-78 (Oct. 2000).

17 For additional examples, *see* P. Ippolito & A. Mathios, *The Regulation of Science-Based Claims in Advertising*, 13 J. Consumer Pol'y 413-45 (1990). They discuss research showing nearly complete unfolding for ready-to-eat cereals and butter and margarine, but substantially incomplete unfolding in frozen pizzas and cigarettes.

18 The list of factors that cause consumers to fail systematically to optimize includes emotional states, inattention, disinterest, inability to solve complex problems, myopia (present bias caused by imperfect discounting in time dimension), framing effects, anchors, over-optimism, overconfidence, endowment effects, lack of self-control, status quo bias, excessive risk aversion (overestimation of some risks—choosing too low an insurance deductible, and underestimation of others—ignoring small, distant risks that have a high cost if they occur), and projection bias (what happened to my friend will happen to me), to name a few. D. Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93(5) Am. Econ. Rev. 1449-75 (2003) describes human tendencies to revert to inexact intuition when problems are hard or decisions must be made quickly.

studies find that the lab techniques themselves likely drive many of the results. While the area is producing a wealth of new and interesting insights, much of it is still untested and it is not clear whether consumer experience and learning allows for reasonable outcomes in the unregulated markets where human behavioral foibles are most evident.[19]

Armstrong sees more room for useful application of behavioral results than does Beales. Armstrong focuses on one of the most interesting recent developments in the behavioral literature: models indicating that firms will not necessarily have individual incentives to disclose hidden attribute prices (add-ons) in equilibrium, even when doing so would be cheap and easy. One of those models does not appear to rely on any particular consumer decision-making foible for its result (where as many behavioral models do), but rather relies simply on firms' individual profit incentives in a setting where some consumers are sophisticated and some are naive.[20] If such results can be shown to apply generally to important markets, then perhaps more economists will convert to behavioralism.

MUCH OF BEHAVIORAL ECONOMICS THUS FAR HAS DEFINED MARKET FAILURES BASED ON THE INABILITY OF HUMAN CONSUMERS TO MAKE TIME-CONSISTENT, MAXIMIZING DECISIONS. THAT IS A USEFUL FIRST STEP IN THE PROCESS OF RATIONAL REGULATION. MORE WORK REMAINS.

The difference of opinion regarding application of behavioral insights to consumer policy may be a matter of the burden of proof. We all know that markets do not always work. If you think a market is failing to deliver a good outcome, you want to define the failure, obtain evidence that it is systematic and persistent, identify the lowest cost remedy for the failure, gather information indicating that the remedy will provide benefits in excess of its costs, and then pursue the remedy.[21] Much of behavioral economics thus far has defined market failures based on the inability of human consumers to make time-consistent, maximizing decisions. That is a useful first step in the process of rational regulation. More work remains.

19 The need to examine consumer behavior and market outcomes following a period of learning was the most obvious lesson from the FTC's April 20, 2007 Behavioral Economics Conference. For the agenda, some of the presentations, and a summary of the conference authored by Joe Mulholland, *see* Federal Trade Commission, Bureau of Economics, *at* http://www.ftc.gov/be/consumerbehavior/index.shtml. *See also* M. Salinger, P. Ippolito & J. Schrag, *Economics at the FTC: Pharmaceutical Patent Dispute Settlements and Behavioral Economics*, 31 REV. INDUS. ORG. 85-105, 97-104 (Sep. 2007).

20 *See* X. Gabaix & D. Laibson. *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121(2) Q.J. ECON. 505-40 (2006).

21 This list ignores the teachings of the economic theory of regulation that one cannot treat the regulator as a benign social planner. One would need to evaluate the outcome of the policy change to be sure that the results were welfare enhancing.

C. THE INTERACTION OF CONSUMER PROTECTION AND COMPETITION

Armstrong discusses various models that might have implications for both consumer protection and competition, but the interactions are difficult to characterize. A more concrete way to think about the interactions is to consider that there are two levels at which one can consider overlaps between competition and consumer protection: the practical day-to-day enforcement level, and the underlying conceptual level. The interaction differs at each level. At the enforcement level, there is interaction in a fairly narrow set of areas related to specific professions and regulated markets. At the underlying concepts level, there is substantial interaction, but it occurs slowly as new ideas and evidence drive case selection and enforcement. This latter interaction tends to affect policy design in the long run.

Although both consumer policy and competition policy have welfare maximization as a goal and both are based on an understanding of how markets operate, the conceptual basis for the policies (in economics) developed independently. Economics had a significant impact on the development of competition policies over the last century (the supply side of microeconomics), but until 1961 there was no economic basis for consumer policy beyond very simple notions of aggregate consumer reactions to prices (the demand side of microeconomics). Starting about that time, economists began to investigate the incentives of firms to provide information and respond to consumers and to regulators.

The two sides of any market almost always have some connection. For example, suppose the government initially banned health claims for foods. Firms' reaction to that state of affairs is to care little about health aspects of their products. Now suppose a change in regulatory strategy allows such truthful claims. Firms now have an incentive to tout their current brand's differences on health dimensions and to alter their products to be better on differentiable health dimensions. So the information environment affects both the supply of information and the supply of product characteristics to consumers. This happened in food production in the United States when the FDA altered its rules to allow more competition on health dimensions.[22] When the production of truthful health claims in a market was hindered, firms reacted in ways that made consumers worse off. This episode showed that the demand side and supply side of markets are clearly connected, but notice that this is not a competition-consumer connection; rather it is an information-supplier connection. Bad consumer policy can indeed adversely impact markets. Mark Armstrong's contribution recognizes more such areas of interaction between the demand side and the supply side of markets.

22 Firms altered their behavior to market healthier ready-to-eat cereals and better versions of fats and oils. A policy reversion at one point caused certain heart health claims to virtually disappear. Paul Rubin's paper in this issue recounts part of that story and more of the history of the health claims debate is provided in L. Froeb, D. Hosken & J. Pappalardo, *Economics Research at the FTC: Information, Retrospectives, and Retailing,* 25 Rev. Indus. Org. 353-74, 355-60 (2004).

Competition policy typically focuses on the prices consumers pay, so in that sense it has always been about consumer protection; competition policy has centered on the ways that firm interactions in pricing and output affect consumers. The consumer protection "side" is less about prices and more about consumer information sets, specific marketing strategies of firms, legal rules and liability, firm's reactions to the legal rules, search behavior, and instances where the incentives of firms and the goals of consumers do not seem to align. The competition and consumer sides are not completely separable, but the overlap in the research has not been large.[23]

THE COMPETITION AND CONSUMER SIDES ARE NOT COMPLETELY SEPARABLE, BUT THE OVERLAP IN THE RESEARCH HAS NOT BEEN LARGE.

By way of analogy, consider the connection between vertical restraints issues in competition policy and horizontal competition issues. Are they related? Yes, but it is possible to specialize in one and see relatively little connection. A theorist who is currently working on vertical issues need not revisit her knowledge of horizontal market power issues very often to be sure she has not missed some important insights. They are, however, related. Vertical restraints could lead to horizontal market power in certain well-defined situations. That, in fact, may be about the only completely settled issue in the theories and policy on vertical control. (And in situations where horizontal markets are unconcentrated, vertical restraints are unlikely to have any deleterious impact.)

1. Interaction at the Enforcement Level: Occupational Regulation, Self-Regulation, and More

The situation is similar with competition and consumer protection policies. The clear overlap occurs in the analysis of issues in occupational regulation, self-regulation, standard-setting, and in some regulated industries. In the first two areas, there is an obvious tension between protecting consumers from hard-to-observe quality variation (e.g., via minimum quality standards) and a potential reduction in competition caused by such protection policies. The relevant literature here has to do with lemons markets, credible signals of quality, implicit collusion, restraints by licensing boards and similar bodies, and the theory of regulation.[24]

23 For a brief description of consumer protection as seen through the eyes of two economists, *see* L. Froeb & P. Pautler, *Consumer Protection*, *in* INTERNATIONAL ENCYCLOPEDIA FOR THE SOCIAL SCIENCES 102-03 (2nd ed. 2008). One FTC Commissioner has analogized the legal overlap of consumer protection and competition to the wings of a house. *See* T. Leary, *Competition Law and Consumer Protection Law: Two Wings of the Same House*, 72 ANTITRUST L.J. 1147-51 (2005). Other than being inanimate, the winged house is not a bad analogy. The wings are largely separate, but they meet in a central area that often involves some form of regulation or legal complication (e.g., occupational regulation, standard-setting organizations, regulated industries, etc). At a conceptual level, an understanding of markets is the foundation for the entire house, including each wing.

24 Armstrong discusses occupational regulation and restraints on advertising (*supra* note 2, at 117-18, 133-36 and n. 95, 96), as does Rubin (*supra* note 4, at 176-78).

Such trade-offs of additional consumer protections versus loss of competition and variety come up fairly frequently in enforcement and competition advocacy work at the FTC in connection with occupational regulation, real estate settlement services, real estate listing systems and brokerage services, mortgage disclosures, out-of-state wine distribution, and advertising restrictions by various professions. In many instances, incumbent supplier groups argue that restrictions on entry or marketing are needed to avoid various harms to consumers, such as avoiding alcohol sales to youths or protecting home buyers from exploitation. Surely some of the consumer protection arguments made in support of various restrictions on entry and marketing of products are legitimate, but just as surely many of the restrictions are overly broad and provide no net gains for consumers.[25]

In addition to entry restrictions, the FTC has undertaken a large number of related advocacy efforts aimed at reducing unnecessary restraints on truthful advertising by professional groups including optometrists and attorneys.[26] Unfortunately, despite at least 25 years of FTC efforts, some states still tightly constrain advertising and marketing efforts by attorneys and other professionals.[27]

Although the FTC often scrutinizes entry restrictions and overly broad restrictions on advertising, the agency also has a history of encouraging various forms of self-regulation by industry. This can occasionally raise competition tensions similar to those in the licensed professions, but typically the restraints imposed by the collective are narrowly tailored to address a particular legitimate concern and the restraints therefore are not likely to have a significant effect on competition within the collective. The self-regulatory approach is often fostered because it can be more flexible and adaptable than the likely alternative of direct regulation. The goals of such self-regulatory activity include reducing misleading advertising, minimizing the reach of advertising of alcoholic beverages to those less than 21 years of age; limiting advertising of violent material in movies, video games, and music to youths; encouraging compliance with marketing rules for funeral goods and services; and enhancing product compatibility in various stan-

25 M. Ohlhausen, *Identifying, Challenging, and Assigning Political Responsibility for State Regulation Restricting Competition,* 2(2) Competition Pol'y Int'l 151-60 (Autumn 2006) describes challenges to entry restraints in wine distribution and real estate. A recent U.S. submission to the OECD describes efforts by the FTC and U.S. Department of Justice (DOJ) to alter agent activities that deter innovative service offerings in real estate service provision. *See* Federal Trade Commission, The Interface between Consumer Protection and Competition Policies, U.S. submission to OECD discussing U.S. Real Estate Markets, Mortgage Financing, and Real Estate Settlement Services, OECD Global Forum on Competition (Feb. 21-22, 2008), January 2008 DAF/COMP/GF/WD (2008)19, *available at* http://www.oecd.org/dataoecd/18/4/39915760.pdf.

26 On optometry, *see* R. Bond, J. Kwoka, J. Phelan, & I. Whitten, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry, Bureau of Economics Staff Report, Federal Trade Commission, Washington, DC (Sep. 1980). For a recent attorney advertising comment, *see* Federal Trade Commission, Comments to the Louisiana State Bar Association regarding attorney advertising and solicitation (Aug. 14, 2007).

27 N. Koppel, *Objection! Funny Legal Ads Draw Censure*, Wall St. J., Feb. 7, 2008, at A-1, A-10.

dard-setting organizations, among others. In each case, the right balance between allowing useful self-regulation while avoiding adverse effects on competition in the self-regulating industry must be assessed.[28]

Appropriate consumer protection efforts to deter fraud and deception may benefit consumers by reducing noise in the information environment and increasing confidence in markets, but not all well-intended consumer protection efforts benefit competition. Such a case presented itself in connection with potential reform of real estate settlements in the United States. One piece of that reform was a requirement that mortgage brokers should disclose any compensation they received from lenders. The proposed disclosure would alert consumers (home buyers) to the fact that the brokers might not be acting solely in their interest. There are, however, two offsetting concerns. First, disclosing the broker's compensation might distract consumers from focusing on the bottom-line price that they would actually pay for the loan, which is the issue of ultimate concern. Second, this compensation disclosure would be required only for broker loans, the growing part of the market, but the same issues exist in loans provided directly by banks. Would the added, asymmetric, information improve or interfere with consumers' ability to make an informed decision in choosing mortgage loans? A consumer experiment to test the issue found that the compensation disclosure misdirected consumers' attention and led consumers to systematically choose loans that were more costly.[29] So the proposed mandated disclosure of compensation would likely mislead consumers (a consumer protection effect), but it could also reduce competition between the segments of the market for loan generation (a competition effect). Armstrong discusses a similar problem with "headline pricing" that could distract consumers from focusing on the more relevant totality of a transaction.[30]

A unique instance of consumer protection and competition interaction occurred in connection with a case of deception by a "copy-cat" seller of abdominal belts. The original hucksters claimed that you could achieve "six-pack abs"

28 For a description of the FTC's efforts to support many activities in the self-regulatory area, *see* FTC Chairman Deborah P. Majoras, Self-regulatory Organizations and the FTC, Speech before the Council of Better Business Bureaus (Apr. 11, 2005), *available at* http://www.ftc.gov/speeches/majoras/050411 selfregorgs.pdf. *See also* FTC General Counsel D. Valentine, Industry Self Regulation and Antitrust Enforcement: An Evolving Relationship, Speech at the Seminar on New Developments in Antitrust Policy, Herzlia, Israel (May 24, 1998), *available at* http://www.ftc.gov/speeches/other/dvisrael speech.shtm.

29 J. Lacko & J. Pappalardo, The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment, Bureau of Economics Staff Report, Federal Trade Commission, Washington, DC (Feb. 2004).

30 Armstrong, *supra* note 2, 110-12, 119-21, 141. One significant difference is that if consumers are misled via "headline pricing", that problem could be offset by rivals who choose to disclose more or run counter-advertising. In the mandated disclosure case, private firm incentives cannot readily fix the regulation-induced problem. In any event, the correct policy to solve the problem would have been a disclosure about broker incentives (and lender incentives), not a disclosure about their compensation level.

simply by wearing an electrified belt that stimulated your abdominal muscles. The claims were ubiquitous for a short time on TV, radio, and the Internet. The firms sold such devices for about $40. Not very surprisingly (to me, but apparently not to the buyers), the belts did not work. A new firm entered the market, made no explicit claims in its advertising (but showed pictures of people with nice tight stomachs similar to those shown in the ads by the original marketers), and cut the price to $10. Sales by the original hucksters plummeted as the entrant stole much of the business and forced price reductions by rivals. Competition works. Now consumers lost only $10 on each belt rather than $40, and the profit from running the fraud declined. In this case, competition affected the outcome for the better, albeit without really removing the fraud from the market. That task was left to the FTC, which ultimately sued all the marketers and the marketing of miracle-producing abdominal belts faded away.

Having discussed a few areas of competition and consumer protection overlap at the enforcement level, it should be noted that this is not the tip of a large iceberg; rather, it is almost all of the ice flow. In practice at the FTC, the two areas seldom meet outside of the competition advocacy areas discussed above.[31] One could easily be a consumer protection attorney and never interact with a competition attorney during a 30-year career. That is somewhat less true for the economists who work on the different missions of the agency (but the difference may be more due to the fact that all the economists are housed in the same organization than due to inherent interaction between the two areas at the law enforcement level).

2. Interaction at the Conceptual Level

The narrow range of interaction between consumer protection and competition at the enforcement level hides the fact that there are substantial undercurrents that affect both areas at the conceptual level and in the long run. These undercurrents ultimately alter case choices in both consumer protection and competition by altering the conceptual bases of enforcement activity. It is surely true that an understanding of how competition works and how markets behave will temper the instincts of consumer protectors to regulate almost all aspects of consumer dealings. The market can do a good bit of the work, if it is allowed to do so.[32] Such an understanding of the

> SUCH AN UNDERSTANDING OF THE PROCESS OF MARKET COMPETITION IS ONE REASON THAT THE FTC REGULATES IN A MANNER THAT IS LESS RIGID THAN MANY OTHER REGULATORY AGENCIES.

31 Muris provides some additional examples of competition and consumer protection connections during the past 25 years. The importation of remedies from consumer protection to antitrust may be the most significant. T. Muris, The Interface of Competition and Consumer Protection, Presentation at the Fordham Corporate Law Institute's 29th Annual Conference on International Antitrust Law and Policy, New York (Oct. 31, 2002), *available at* http://www.ftc.gov/speeches/muris/021031fordham.pdf.

32 Armstrong, Beales, and Rubin all appear to agree that the market can provide much of the needed consumer protection.

process of market competition is one reason that the FTC regulates in a manner that is less rigid than many other regulatory agencies.[33]

At a conceptual level, the economic analysis that undergirds consumer protection has affected the way competition is analyzed. Beginning in the 1960s, the economics of information forced antitrust economists to come to grips with the value of advertising and the value of branding. No longer would the world of homogenous consumers and products be sufficient. Economists also had to consider the solution to a "consumer issue" involving the sustained production and distribution of high-quality consumer products, when judging quality was both subjective and uncertain. That led to increased thinking about reputation, quality-assuring premiums, and agency issues. We had to study why distribution chains mattered as much as they do. The heterogeneity of consumers and matching those consumers to products had to be understood. Retailing and marketing had to become more than "black boxes". These conceptual changes in economics were very significant and they almost surely influenced what economists later considered a "good" antitrust or competition case, but the changes occurred sufficiently slowly and at a high enough level of abstraction that the connection is hard to observe in short-run enforcement decisions. It is clear, however, that advertising and branding are no longer reflexively thought of as entry barriers, positive product margins are no longer evidence of poorly performing markets, and vertical distribution restraints are no longer considered suspicious, as was true in an earlier era.[34]

III. Conclusion

This set of papers provides a smorgasbord of views on the basis for consumer policy and the correct application of that policy. Readers have the option of embracing the minimalist approaches of Rubin and Beales, the more interventionist approach of Armstrong, or the Italian legal approach described by Tesauro & Russo. While readers are likely to have various reasons for choosing among these alternatives, which approach is best for consumers should be determined by empirical evidence regarding the strength or weaknesses of market forces in correcting market imperfections.

On the issue of interaction between competition and consumer protection, there is a clear connection based on the analysis of markets. Markets matter and

33 This is a theme in Paul Rubin's paper in this issue.

34 Saying that policy is affected by the underlying crosscurrents is not to say that everything is affected. For example, the authors of the DOJ and FTC's *Horizontal Merger Guidelines* in 1982, 1992, or 1997 were not actively using their knowledge of consumer protection principles. Similarly, the FTC's key consumer policy documents—the deception statement, unfairness statement, and advertising substantiation statement—were not likely impacted by "antitrust thinking," although all these documents were clearly affected by consideration of the process of market competition.

an understanding of how both sides of a market work is a key to formulating rational policy, whether it is competition policy or consumer policy. The narrow range of interaction at the day-to-day enforcement level should not misdirect us from the need to get the concepts correct by thinking about the process of competition so that competition and consumer policy can be as useful as possible.