

CPI's Europe Column Presents:

Do behavioural insights matter for competition policy?

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Intro by Juan Delgado

Behavioural insights make use of behavioural economics and psychology to analyse how humans behave when adopting economic decisions. The use of behavioural insights to improve policy-making is becoming increasingly popular all over the world. Pensions, taxes, unemployment, energy efficiency, adult education, charitable giving and, of course, competition policy have benefitted from the application of behavioural insights. Emanuele Ciriolo, from the European Commission Joint Research Centre, explains the role of behavioural insights to improve consumer, regulatory and competition policies.

It is traditionally assumed that a reasonable level of competition is the condition *sine qua non* for markets to work well, and generate the best allocation of resources. This view explicitly relies on the *homo economicus* postulate, that is on the idea that consumers are fully informed, utility-maximisers and intertemporally-consistent agents. If so, it is clear that consumers would play a pivotal role in the competitive process, by reacting swiftly to the best available deals, thereby exerting pressure on firms to cut prices and improve on quality. But is that a realistically convincing description of consumer behaviour?

1. The rise of behavioural insights

In the last decades, a growing body of *behavioural* evidence – mainly drawing on psychology, sociology, anthropology as well as economics – has come to question the capacity of the *rational choice theory* to describe and predict the decision-making behaviour of individuals. In a way, these scientific developments have almost led to the (theoretical) extinction of *econs* and shown that we rather live in a world populated by *behavioural* individuals, often exhibiting non-standard preferences, biased beliefs as well as limited cognitive skills. This has direct consequences for public policy, and specific implications for competition policy, too.

Indeed, on the basis of these new premises, competition alone would hardly suffice. As John Kay (2010) vividly put it, competition with complex products and opaque prices is “no basis for capitalism”. “If the winner of the competitive race is the company that is most innovative, not in productive efficiency or customer service, but in the ingenuity and opacity of its tariff structures, consumers will not be happy, or well served, in the long run.” There is evidence of markets – for example in energy, mobile telephony, financial services – that, despite becoming more competitive, underperform for consumers. For example, financial products are inherently complex, which can lead to errors, such as when consumers focus only on headline rates as a means to simplify their decisions.

The last few years also saw a mushrooming of mobile telephony tariffs, which *de facto* prevents comparison and shopping around. And the same applies to energy, as shown by the work of Hviid and Waddams (2014). The uncontroversial evidence led UK Ofgem (2012) to observe that “the large number of tariffs and their complexity discourage many from exploring alternative deals. Even the more active consumers can find it difficult to make the right choice.”

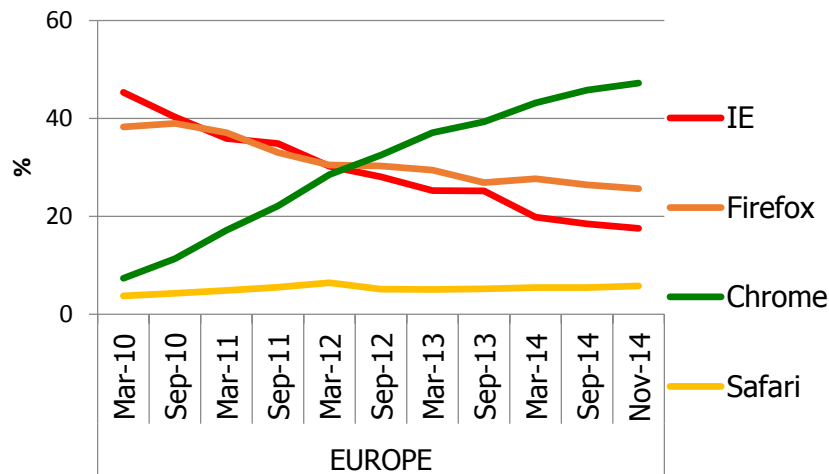
2. The importance of behavioural insights for consumer and competition policy

Behavioural economics provides invaluable insights for consumer policy, to such an extent that in recent years it has become a key part of every regulator's toolkit (e.g., see Lunn, 2014). Indeed, behavioural biases can potentially be seen as a 'fourth market failure'—which can be added to the list of market failures already taken into account in consumer and competition policy.

Since 2008, the European Commission has been a front-runner in bringing behavioural insights into legislation and regulatory intervention. This approach has been used in a number of cases, from the Directive on Consumer Rights, and other consumer protection interventions, for example in relation to online gambling and financial services (Sousa Lourenço *et al.*, 2016).

In addition, the European Commission also used behavioural insights in a competition case, to tackle a case of abuse of dominant position, linked to Internet Explorer (IE) being tied to Windows. Contrarily to its traditional approach, DG Competition did not impose a fine for infringement of competition law, but rather tackled the supply-side issue by leveraging the demand side. Users of Windows-based PCs were provided with the option to choose an alternative browser, via an on-screen ballot box. This remedy – at work between 2010 and 2014 - pushed consumers to make an active choice as to their preferred browser, and implicitly removed the impact of the default option (Ciriolo, 2011).

The available evidence suggests that the remedy was more effective than the traditional ones adopted in the past: among the users who viewed the ballot box, one in four downloaded an alternative browser. To this respect, it is illustrative to run a comparative analysis of the web browsers market shares, in Europe and North America, since in the latter region no ballot box was in place. Excluding tablets and smartphones, between March 2010 and November 2014 (the period when the ballot box was active), the market share of IE in Europe dropped from 47% to 17%, whereas it decreased by 23 percentage points (from 55% to 32%) in North America.



Instead of a monetary sanction by the antitrust authority, the imposition of a simple device - which entailed small programming cost for Microsoft - *de facto* translated into an EU market for web browsers that is substantially more competitive. The recent increased rate of innovation in this sector further strengthens this finding.

More generally, it is clear that behavioural economics also applies to firms (see Armstrong and Huck, 2010), and provides insights into situations where firms may have non-profit objectives, thereby affecting competitive interaction. For this very reason, behavioural insights matter for remedy design, too, suggesting regulatory interventions need to become smarter, rather than necessarily harsher (Mehta *et al.*, 2013). For example, behavioural insights cast doubt on the effectiveness of fines in properly sanctioning anti-competitive behaviour. Transposing the results of the experiments carried out by Gneezy and Rustichini (2000), it is clear that a fine may just be seen as a price and, when this occurs, non-compliance may still remain the preferred strategy, especially when the probability of undergoing the sanction - and therefore its expected amount - is low. In this sense, regulators should investigate the use of reputational sanctions or proportionally heavier sanctions that, if designed and implemented effectively, may exert more of a deterrent effect.

As we saw, there is little reason why remedies should not tackle the demand side, regardless of whether consumer behaviour is proved to be an important driver of problems in the market at stake. Indeed, recent UK market investigations focussed on markets where consumers are susceptible of displaying specific biases. These included the extended warranties on electrical goods, personal current accounts, store cards, home credit, and payment protection insurance (PPI). In these cases, empirical evidence was collected to try and estimate the likely effects on consumers, as it is often not sufficient to suggest that biases exist, and that a given remedy will correct them (Oxera, 2015).

For markets to work smoothly, *you need two for tango*, both a competitive supply-side and confident, empowered and well-informed consumers on the other side. Recent market

developments, including the widening choice of products and services, and the growing complexity of tariff schemes, imply that competition and consumer policy are more than ever inter-twined. If the collection of behavioural evidence through trials and road-testing may be costly and time-consuming, prospective welfare gains make it worth it.

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