

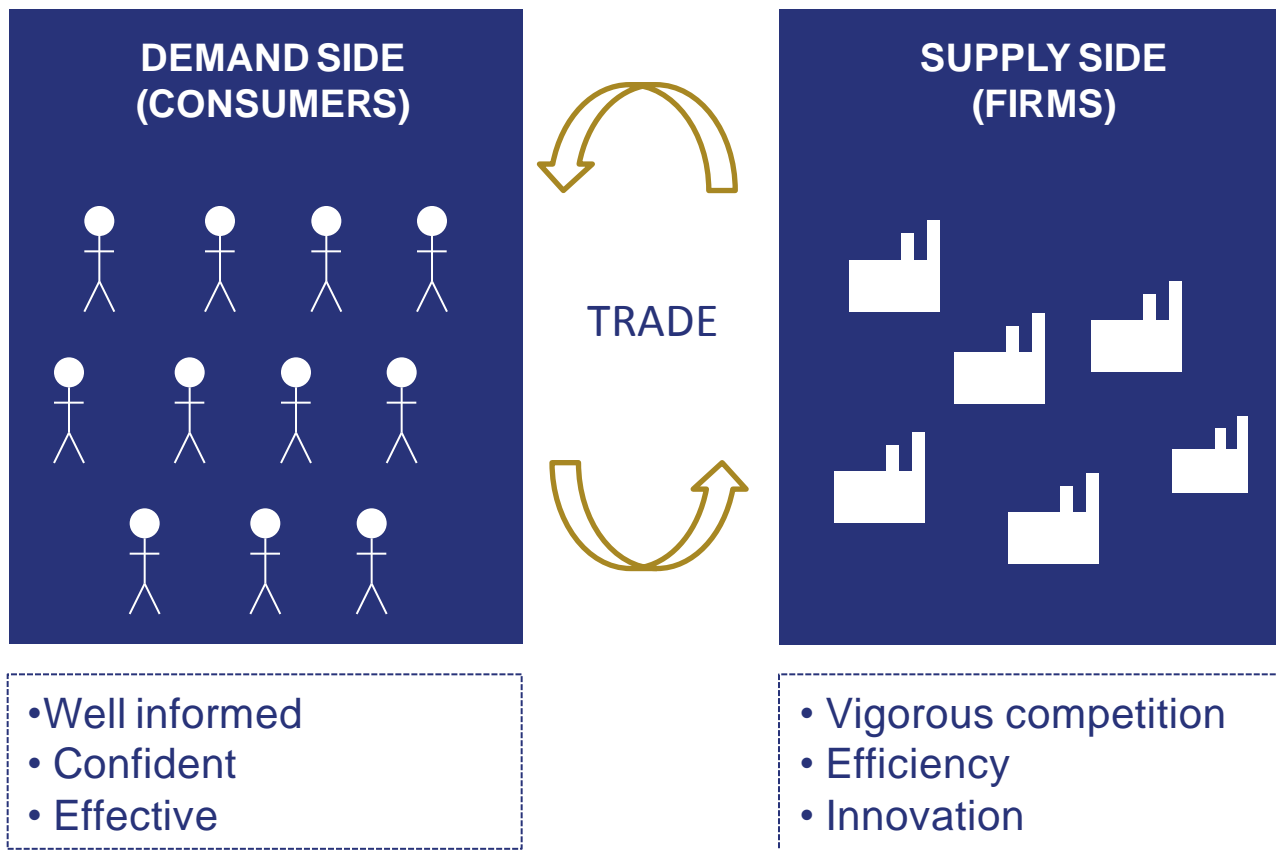
# How does behavioural economics impact the OFT's work?

**Kirsten Edwards-Warren**

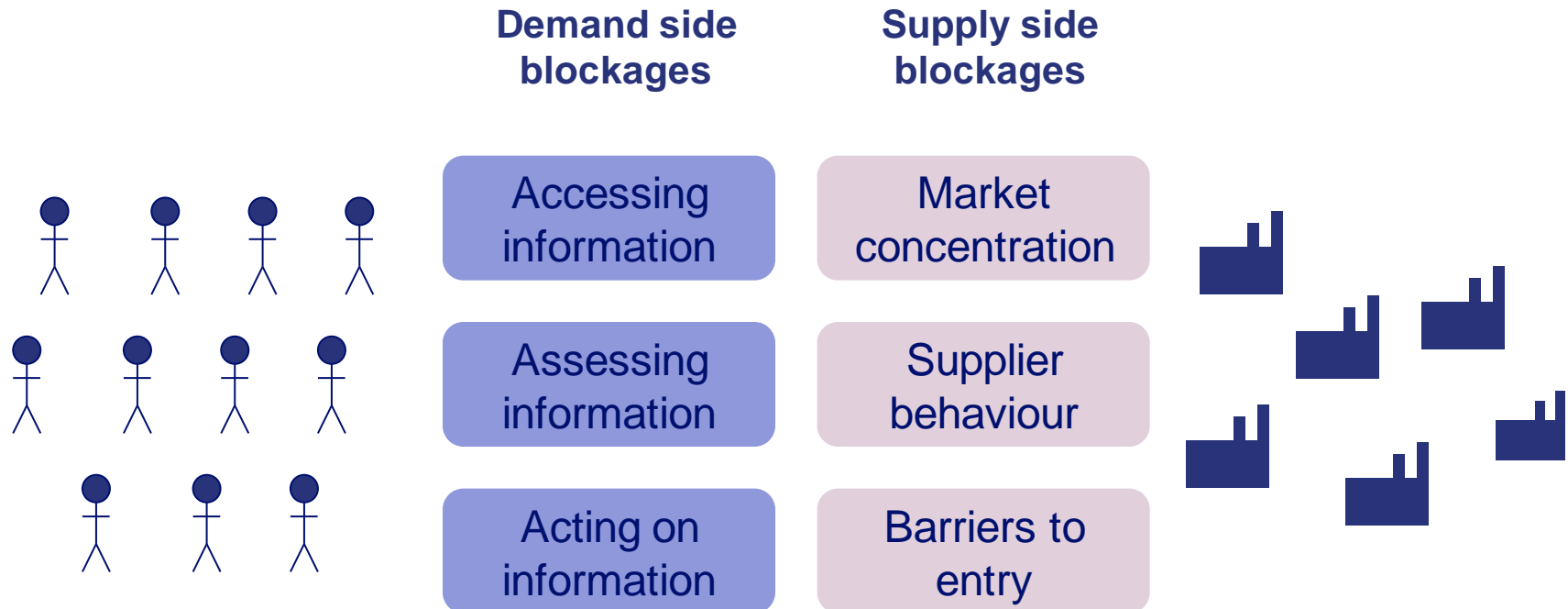
**Director of Economics, Office of Fair Trading**

**10 September 2012**

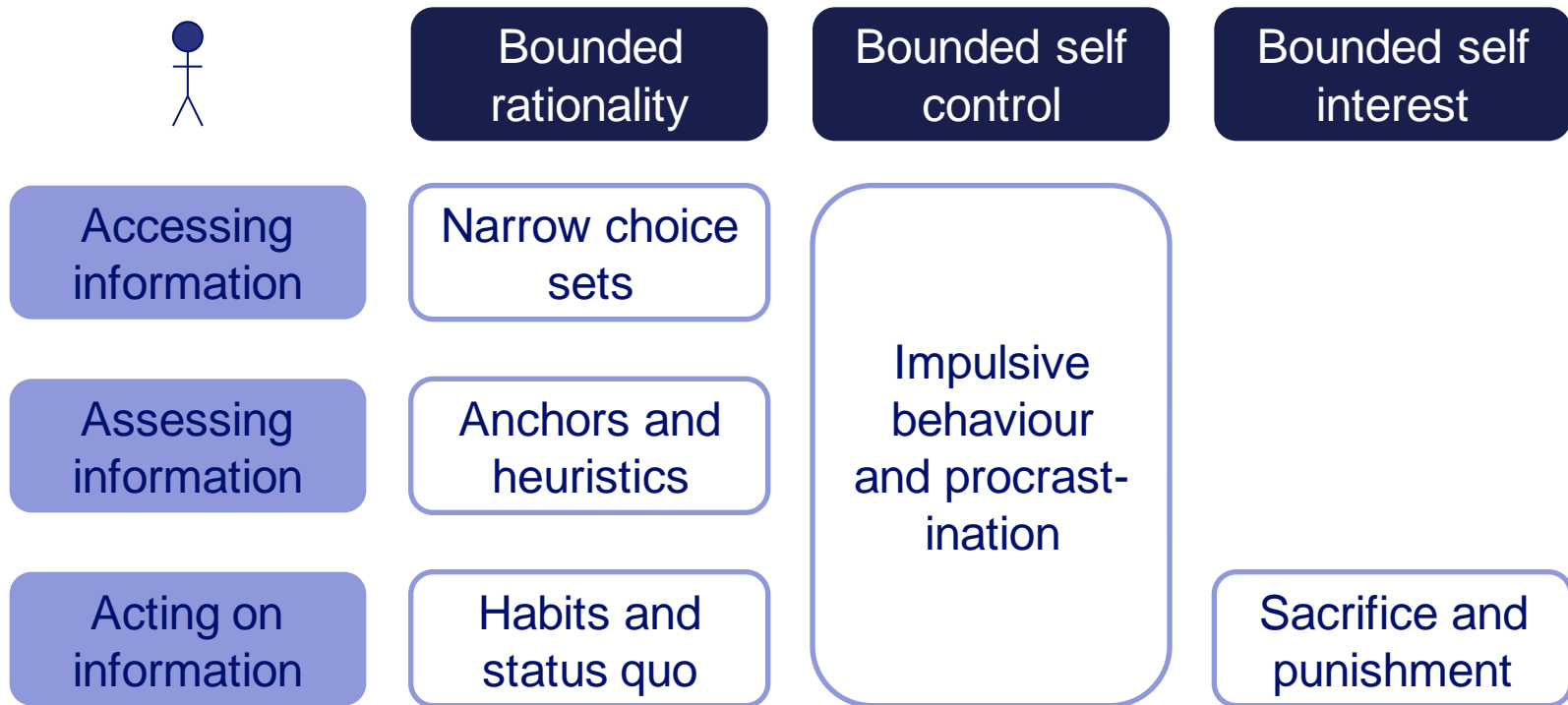
# When do markets work well?



# Why do markets sometimes work less well?



# Behavioural economics may help explain these blockages



## Possible concerns (i): firms might exploit behaviours to create / worsen the blockages



Accessing  
information

Assessing  
information

Acting on  
information



- Making information difficult to find
- Increasing search costs
- Obfuscating (e.g. drip pricing, complex pricing)
- Making choice difficult
- Surprise charges, automatic renewals and default charges
- Time limited offers

## Possible concerns (ii): reduced competition

Less shopping around

- Less switching softens competition
- Makes market entry more difficult
- Increases prices

Inability to judge own preferences

- Too much or too little demand (e.g. gyms)
- Under or over supply
- Impact on prices and output

Inability to judge offers

- Purchasing errors
- Regret

## Options for intervention

### Consumer law

Can prevent firms from exploiting consumer biases

Examples:

- Airline payment charges
- APR requirements
- Gyms

### Competition law

Can prevent anticompetitive behaviour that relies on consumer biases

Examples:

- Microsoft Internet Explorer case
- Lloyds TSB / Abbey National

### Regulation

May be required to make markets work well or protect consumers

Examples:

- Store Cards
- PPI
- Extended warranties

## Case study: OFT action on drip pricing

### Advertising of Prices market study, December 2010

- Found to have the highest **potential** to mislead compared to other pricing practices.
- Evidence:
  - 47% of consumers had encountered drip pricing in the past 12 months
  - 7% of adverts in a newspaper trawl had partitioned prices
  - Typically related to products purchased infrequently
  - Behavioural experiment found that drip pricing caused:
    - Significantly more purchasing errors
    - Significantly more search errors
    - Significant consumer welfare loss
  - The experiment also showed that learning helps





## Case study: OFT action on drip pricing

### Airline surcharges case, July 2012

- Airlines charging fee for making a payment by debit card, not clear in headline price.
- Concern:
  - Made it difficult for consumers to compare prices easily
  - Damaged consumer confidence
  - Impeded effective competition
- Outcome:
  - Voluntary undertakings to include all charges in headline prices
  - Free payment by debit card will be the industry standard



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