

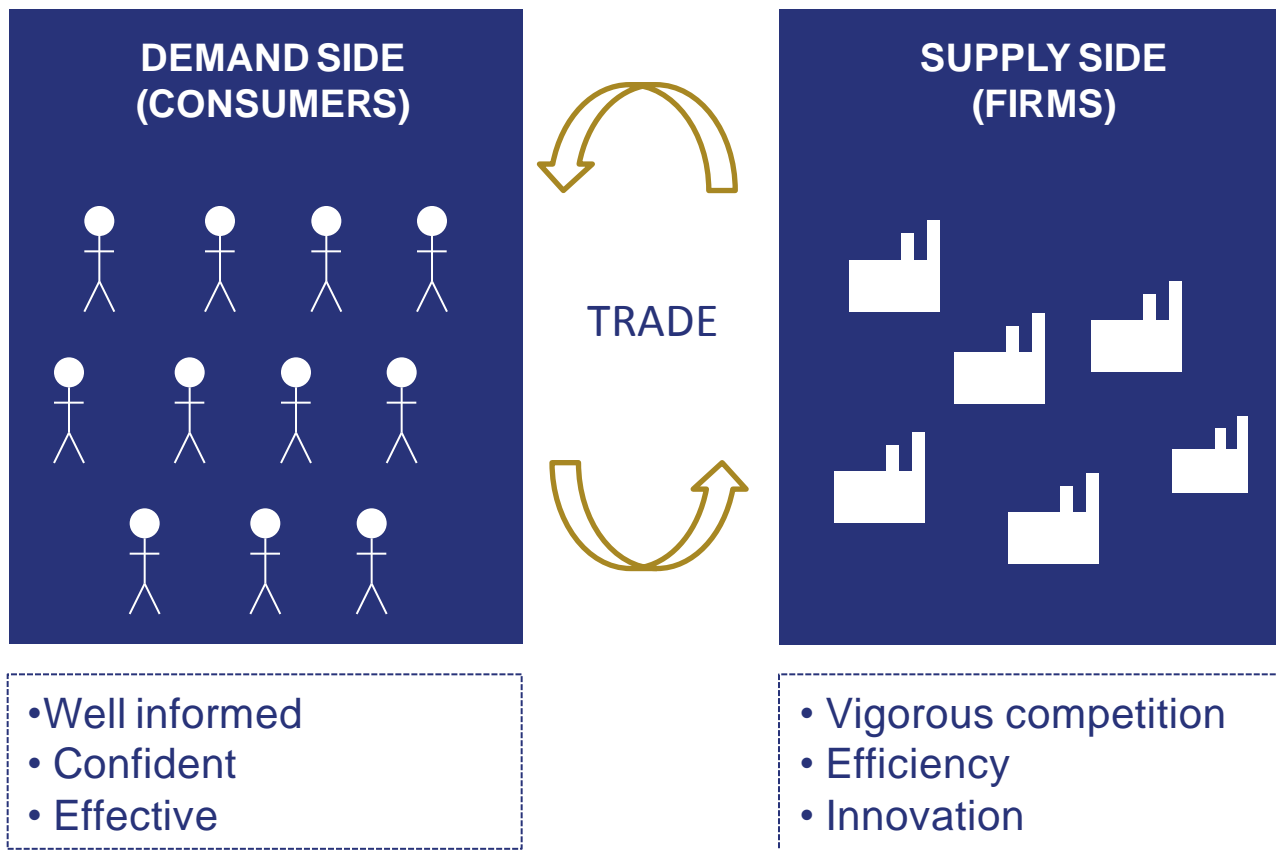
How does behavioural economics impact the OFT's work?

Kirsten Edwards-Warren

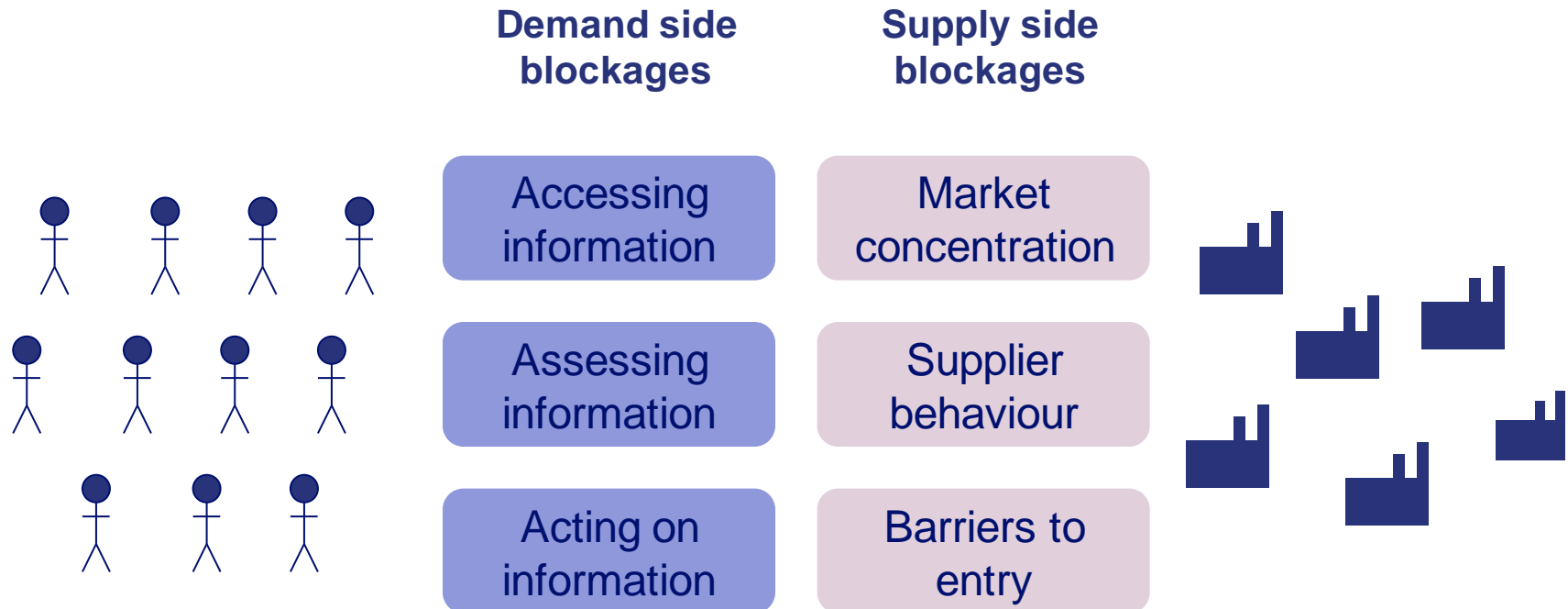
Director of Economics, Office of Fair Trading

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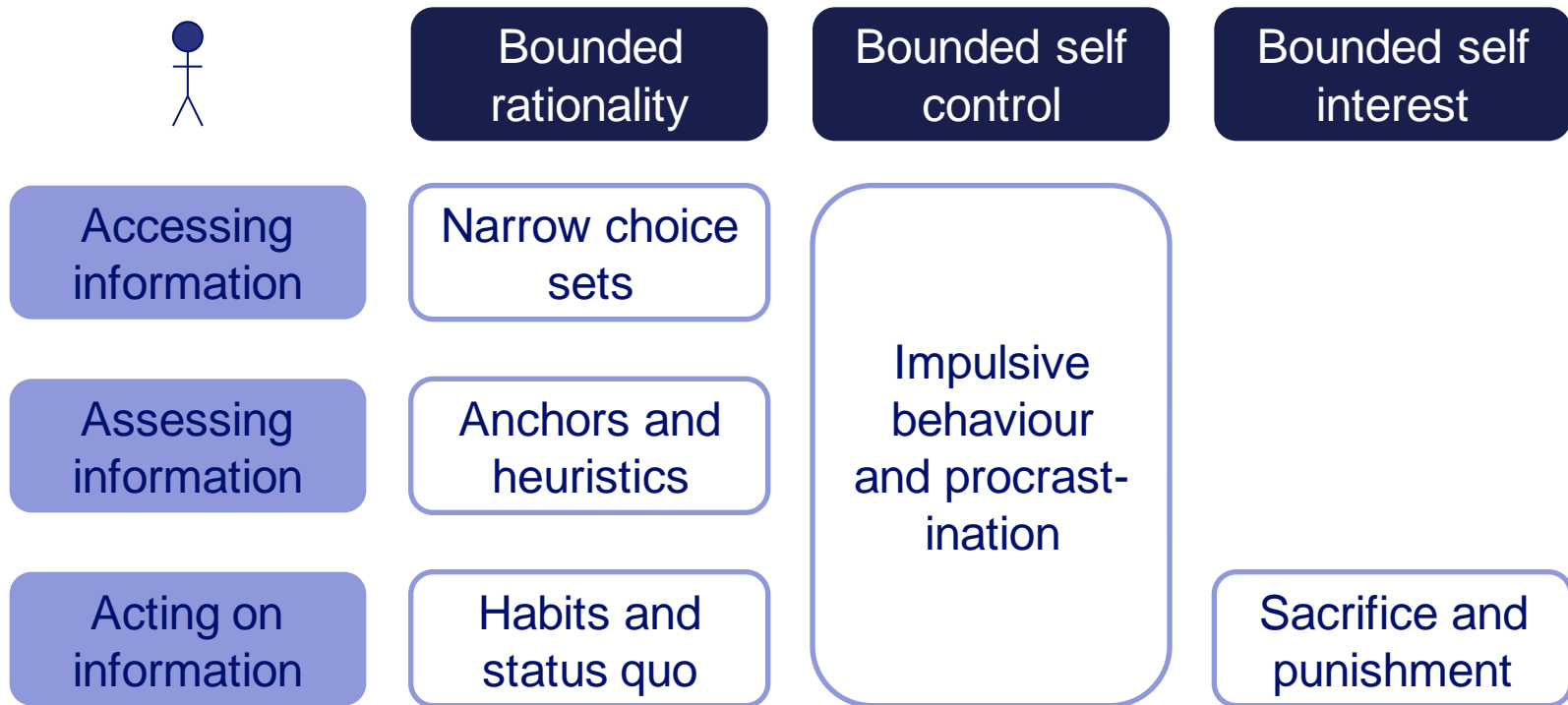
When do markets work well?



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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