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Literature review on analytical frameworks

This paper reviews the major theoretical approaches to consumer policy by drawing on academic literature. The purpose is to identify considerations in formulating the goals of consumer policy and appropriate high-level frameworks that support those goals.

The paper proposes that the goal of consumer policy should be to: (a) remove barriers; and (b) shape expectations, so that with respect to any particular transaction, consumers receive what they intended and expected. This goal is derived from the efficiency framework, but is broader in that it gives consumer policy a role in shaping consumer expectations and the process of preference formation. However, it stops short of making choices for consumers or judgements about what consumers should want. This goal is supported by an information-based framework that is less wedded to certain premises of the efficiency framework.

In general, consumer policy is an inappropriate vehicle for distributing resources or losses. Such goals are only appropriate in limited and defined circumstances and must still be justifiable in terms of costs, benefits and trade-offs.



MINISTRY OF CONSUMER AFFAIRS

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Introduction

This paper reviews the major theoretical approaches to consumer policy by drawing on academic literature. The purpose is to identify considerations in formulating the goals of consumer policy and appropriate high-level frameworks that support those goals.

The first part of this paper discusses the scope and boundaries of consumer policy. The academic literature generally assumes a narrow scope, focused on the consumer as a purchaser of goods and services in a market setting. The consumer movement uses a broader definition, and its focus is on the consumer as a recipient of goods and services in a wider setting, including public services.

This paper then discusses the goals of consumer law. Writers have noted that consumer protection policy lacks a robust theory or a clearly defined set of goals. Duggan (1991) suggests that there are three theoretical approaches: efficiency, equity and paternalism. Other approaches are libertarian, rights-based and information-based.

While no single framework will provide answers to every consumer problem, it is hoped that this paper highlights the useful role of theory in exposing alternative ways of conceptualising consumer problems and alternative approaches to dealing with those problems.

What is the scope of consumer policy?

There are two definitions of the consumer interest: narrow and broad. The narrow definition focuses mainly on citizens entering into transactions in order to obtain products and services from commercial enterprises (Cranston, 1978). This definition is consistent with the thrust of consumer protection legislation, which confines itself to transactions involving goods and services. The definitions of goods and services exclude such items as tenancy agreements, social welfare benefits and land. Although the scope of the legislation may extend to transactions between commercial enterprises—for example the Fair Trading Act—its primary focus (and its *raison d'être*) is on transactions entered into for domestic or personal purposes.

The theoretical literature also adopts the narrow definition of the consumer interest. Its overwhelming concern is with transactions that take place in a marketplace, with a particular focus on the institution of the contract. Discussion only occasionally extends to transactions outside the marketplace—such as the social welfare or public education system—or between commercial enterprises, even when one party is at a bargaining disadvantage.

Under the wider view of the consumer interest, the term 'consumer' is virtually equivalent to that of 'citizen' (Cranston, 1978). It is said that the "consumer interest is involved when citizens enter exchange relationships with institutions like hospitals, libraries, police forces and various government agencies, as well as businesses" (*ibid*).

The non-governmental consumer movement has adopted this broad view. Cranston describes Ralph Nader's move from a narrow to a broad definition. Similarly, the definition of a consumer used by the United Kingdom's National Consumer Council is "everybody in society in one part of their life: that is, as the purchaser or user of

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goods and services, whether privately or publicly supplied” (Mitchell *et al*, 2001).

In their guidelines for consumer policy, Mitchell *et al* (who represent various international consumer groups) draw a distinction between the consumer interest and the producer issues: “... issues about wages and conditions of employment are clearly producer issues and do not come within the scope of consumer policy”. Also excluded are ‘citizen’ issues such as “constitutional matters, taxation and the distribution of public resources”. There is an overlap with citizen issues such as “the quality of public services, the most effective ways of delivering public services to consumers, the administration of justice, data privacy” and environmental and trade policies.

The goals of consumer law

Writing in Canada, Cayne and Trebilcock (1973, 396) observed:

Even the most casual observer of contemporary legal literature could not help but note the proliferation of consumer protection rules. The growing importance of consumerism has not yet, however, resulted in a concise statement of the goals which these rules are designed, or should be designed, to achieve.

The authors go on to say that for realistic goals to be set, they must be capable of justification against a broad conceptual framework.

Writing in Australia, Duggan (1991) also refers to a proliferation of consumer protection statutory initiatives and states, “there is no clearly articulated philosophy of consumer protection”. Further, taken as a whole, the initiatives that exist are “marred by a failure to be sufficiently explicit about values and to focus sharply enough on objectives” and, further, consumer protection lacks a “robust theory”.

Frameworks for consumer protection policy

Duggan (1991) says that there are three frameworks (or “sets of values”) that underlay nearly all consumer protection measures. This section adapts the frameworks presented by Duggan, so as to help define the goals of consumer policy. The frameworks centre on:

- *welfare considerations* - the phrase ‘efficiency’ is preferred to ‘welfare’ and will be used from here on. Under the efficiency approach, the objective of consumer policy is to help consumers meet their preferences in order to achieve an efficient allocation of society’s resources. A consumer’s preferences are not to be questioned and any intervention which interferes with a consumer’s pursuit of these preferences is *prima facie* inefficient and undesirable;
- *equity considerations* - under an equity framework, the objective of consumer policy may relate to a ‘fair’ distribution of losses or resources, or to the power relationship between supplier and consumer (inequality of bargaining power);
- *an eclectic mix of concerns grouped together under the heading ‘paternalism’* - an information-based framework is derived from the efficiency framework. However, it is less wedded to certain premises, such as the premise that

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consumers will always act rationally in a self-interested manner. It also defines a broader agenda for consumer protection, which is concerned with the process of preference formation. The objective of the information-based framework is to protect consumers from the 'bad deal': the transaction where what the consumer gets is not what they intended or expected.

Further frameworks include: a libertarian framework; an information-based framework; and a 'rights' framework.

These frameworks are considered further below.

The efficiency framework

The fundamental goal of the efficiency framework is that 'people should get what they want'; in other words, that consumers' individual preferences should be satisfied. Underlying this goal are the following premises:

- individual consumers know better than anyone else what their preferences are;
- although they are not infallible, consumers are less likely to make a mistake about what is wanted than a third party (such as the State); and
- the only externally-valid indication of a preference held by consumers is their willingness to pay.

From an economic perspective, allowing consumers to pursue their own preferences is the most efficient way to allocate society's resources. It therefore follows that there is only limited scope for consumer protection intervention by the government. Any intervention that takes place must enhance the ability of consumers to meet their individual preferences and therefore must also enhance economic efficiency.

The grounds for intervention under this framework are slim. For example, Hynes and Posner (2001) state that a proper defence of consumer protection regulation must explain why the market would not supply its benefits if consumers were willing to pay for them.¹

Theorists in this vein seek to demonstrate that there are a number of seemingly unfair contractual outcomes that in fact perform a valuable signalling and informational function between supplier and consumer, and help consumers meet their preferences.

For example, consumers who agree in a credit contract to offer all personal belongings as security for a loan may be signalling that they consider that they are unlikely to default—given the inconvenience that would be caused by repossession—and are therefore a good credit risk. The creditor may respond by offering a lower interest rate. In contrast, debtors who are reluctant to put all their personal belongings on the line may be signalling that they think they are likely to default and this risk will be reflected in the interest rate. Regulation² may interfere with these informational outcomes and lead to cross-subsidisation (for example, the

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¹ The examples of benefits given are from the consumer credit context, being information about terms and conditions, insurance against shocks and protection from discrimination.

² For example, regulation that prohibits the taking of security over household items.

creditor may charge all debtors the same interest rate (good credit risks therefore subsidise the bad)) and other inefficient outcomes.

The efficiency framework does leave room for intervention if it will enhance efficiency or, in other words, resolve market failures. Imperfect information is the most common barrier to consumers meeting their individual preferences and thus causing market failure. Imperfect information has a number of manifestations:

- information may be costly to acquire and interpret;
- there may be information asymmetries between supplier and consumer, allowing scope for the supplier to take advantage of the consumer, including through fraud; and
- consumers may underestimate the value of information about a particular product or service.

The consequence of this is that consumers face information barriers to the satisfaction of their preferences, and the result is that in particular transactions the outcome may not be what they expected. This is sometimes referred to as the “bad deal” (Hadfield *et al*, 1998).

Consumer protection measures, to the extent that the efficiency framework justifies them, generally focus on mitigating imperfect information. However, to be efficient, the benefit of such measures must outweigh the cost and, if there is a choice of measures, the least costly must prevail. On this basis, the efficiency framework favours measures such as mandatory disclosure of information over alternatives such as occupational regulation or prohibition of particular contractual terms.

The grounds for intervention on the basis of imperfect information remain limited. For example, in an influential formulation, Schwartz and Wilde (1979) argue that intervention, whether to regulate terms or require information disclosure, is not justified because a number of consumers are ill-informed—“... rather, the normative question should be whether the existence of imperfect information has produced noncompetitive prices and terms” (631). The same authors (1983) also state that “supracompetitive pricing ... is often the only problem serious enough to justify regulatory concern” (1391).

Akerlof (1970) developed a concise model to describe the effects of quality uncertainty on an individual’s decision-making in the market. Under Akerlof’s model, where consumers are unable to ascertain the quality of the goods being offered by the seller, there is an incentive for sellers to offer poor quality goods. The presence of poor quality goods may drive high quality goods out of the market, thus reducing the average quality of goods and also the size of the market.

Akerlof suggests that institutions could develop to counteract the effects of uncertainty. Such institutions could take the form of guarantees, brand names or occupational licensing. These need not be government institutions. For example, while the Consumer Guarantees Act 1993 implies certain minimum quality standards, Akerlof’s framework suggests that these guarantees could also be provided privately by manufacturers or sellers to signal quality standards.

Schwartz and Wilde (*ibid*, 1392-93) also succinctly describe the underlying premise of the efficiency framework:

Consumer protection measures, to the extent that the efficiency framework justifies them, generally focus on mitigating imperfect information. However, to be efficient, the benefit of such measures must outweigh the cost and, if there is a choice of measures, the least costly must prevail. On this basis, the efficiency framework favours measures such as mandatory disclosure of information over alternatives such as occupational regulation or prohibition of particular contractual terms.

... we assume that competitive outcomes in markets for contract terms are normatively desirable ... When a market is in competitive equilibrium, firms provide goods and contract terms at the lowest possible cost consistent with the continued existence of these firms. Thus, assuming a given distribution of wealth, consumers cannot do better than purchase in competitive markets.

The efficiency framework does not concern itself with goals such as equality or the fair distribution of resources. The argument is that such goals should not be achieved by consumer protection regulation that restricts the contracting process and thereby interferes with consumers pursuing their preferences; rather, they should be achieved through instruments such as the taxation and social welfare system.

The libertarian framework

This framework shares many of the assumptions of the efficiency framework. The difference is that the fundamental goal is not efficiency but individual autonomy and freedom. Thus, government intervention that subverts individuals pursuing their preferences is not objectionable on the grounds that it threatens a misallocation of society's resources, but is *prima facie* bad because it infringes individual freedom. 'Freedom of contract' is a moral imperative of the libertarian framework.

Much of 'law and economics' scholarship, particularly the Chicago School, demonstrates a libertarian bent and is generally unsympathetic to consumer protection measures.

The grounds for intervention to protect consumers are limited and restricted to aspects of a transaction that call into question the voluntariness of the parties to the transaction—for example, physical coercion or serious externalities.

The equity framework

The overriding goal of the equity framework is fairness. However, Duggan (1991) points out that there is no universally accepted standard of fairness. He highlights three theories of justice based on equity considerations that have relevance in the consumer protection context: commutative justice; loss-shifting; and distributive justice.

Each of these is discussed below, as well as a more general standard of fairness based on inequality of bargaining power.

Commutative justice

Duggan (1991, 257) states that:

Commutative justice is concerned with preserving each citizen's share of the prevailing distribution. It is complementary to the notion of distributive justice which is concerned with how society's wealth is divided among its citizens in the first place.

Redistribution of wealth should be carried out according to societal standards of fairness and not as a result of ad hoc interactions between parties.

Under the libertarian framework, government intervention that subverts individuals pursuing their preferences is not objectionable on the grounds that it threatens a misallocation of society's resources, but is prima facie bad because it infringes individual freedom... The grounds for intervention to protect consumers are limited and restricted to aspects of a transaction that call into question the voluntariness of the parties to the transaction—for example, physical coercion or serious externalities.

Duggan points to a number of legal doctrines that appear to be based on commutative justice principles, for example the concept of unjust enrichment, the doctrine of penalties and tort rules on damages. All of these doctrines are designed to restore the respective positions of parties to a transaction following a breach of some legal standard by one party against the other, and also to prevent parties from making windfalls from the breach.

In the consumer context, an example might be a rule that sets aside a contract because it is unduly one-sided, such as in the credit context where the Court has the power to reopen credit contracts.³

Loss shifting

This is a legal rule that shifts a loss from a party that might normally be expected to bear it, to some other party.

An example arises under the Consumer Guarantees Act 1993 and the Hire Purchase Act 1971. If a consumer purchases a good on hire purchase and the good is deficient, the consumer may claim various remedies from the supplier. If the supplier is insolvent, normally the consumer must bear the loss. However, the Consumer Guarantees Act gives the consumer the right to sue the financier.

The rationale for this rule is that it is *fair* that the loss should be borne by the creditor because the creditor is more likely than the consumer to be able to absorb it (that is, the creditor has 'deeper pockets').

Distributive justice

This relates to the distribution of resources in society and notions of equality. A distributive justice framework sees consumer protection policy as a vehicle for achieving greater equality in society.

Measures considered to fall within this framework include interest rate controls and restrictions on a creditor's remedies following a debtor's default. Such measures have the economic effect of transferring resources from creditors to debtors.

Proponents of a distributive justice framework reject the efficiency framework on a number of grounds:

- the efficiency framework overlooks the "detailed complex of legal, social and economic factors, which constitute the institutional framework of the transactions in these markets and which structure the exercise of power within these relationships" (Ramsay, 1995, 189). For instance, it ignores the existing distributional impact of judicially created "ground rules" of the common law, and power inequalities between suppliers and low-income consumers (in particular). It is therefore wrong to think of market transactions as "simply a consequence of voluntary and mutually beneficial exchanges" (*ibid*); and
- distributional goals are not necessarily achieved more efficiently through the taxation system than through contract regulation (Kronman, 1980).⁴ Similarly,

³ However, in practice, judges are very reluctant to reopen a contract because of its one-sided nature. They are more likely to be concerned with abuse in the contracting process.

⁴ Kronman does not argue that contract law should pursue distributive goals, merely that if distributive goals are to be pursued contract law is no more inefficient and distortionary than the taxation system. Ramsay, by contrast, appears to argue that consumer law should pursue distributive justice goals.

the taxation and social systems are under pressure and less able to deliver on distributional goals (Ramsay, 2000).

Proponents of the distributive justice framework argue that the goals of consumer law are aligned to the goals of the welfare state. Ramsay (1995) cites an argument by Wilhemsson for a general principle of social *force majeure* where individuals have been unable to maintain payments on a credit contract because of illness, unemployment or changes in family circumstances. Here, consumer law shares one of the goals of the welfare state, “that of security against consequences of unemployment and illness” (Ramsay, 1995, 195). Ramsay states “this new principle might influence the development of the law, injecting discussion of unemployment and social divisions into the world of contract doctrine and texts” (*ibid*).

While the efficiency framework is dominant in North American scholarship, a distributive framework has more support in Europe. Brownsword, Howells and Wilhemsson (1996) discuss three concepts of “welfarism” which expand on the point above made by Ramsay: minimal welfarism; personal welfarism; and maximal welfarism. These are discussed below.

Minimal welfarism

Brownsword *et al* (1996) write:

Contract being viewed as a competitive activity, it follows that the regulatory objectives of minimal welfarism are twofold: to provide contractors who deal from below a notional line of minimal wellbeing; and to adjust outcomes that are liable to push a contractor below the line. In other words, the most adverse effects of social inequality and of contractual exchange are cushioned. Where transactions produce cases of severe individual hardship (need) the law should be willing to protect the party in need.

Personal welfarism

This system abandons the competitive model of contracting and seeks to introduce a regime of co-operative contracting such that contractors assume responsibility for one another's welfare. Co-operative dealing thus replaces a purely self-interested contractual ethic (in which each side acts with a view to maximising its own utility) and seeks to protect the interest of the weaker party (*ibid*).

Maximal welfarism

This framework is based on inequality of bargaining power. Duggan does not discuss this as a distinct ‘set of values’—his equity frameworks are more concerned with distributive aspects of equity. However, it is a commonly cited rationale for consumer protection. For instance, Tokely (2000), in her text on consumer law in New Zealand, states that the basis of justification for consumer laws is “the unequal bargaining power between consumers and traders”.

The distinction between distributive concerns and the more general equity framework based on fairness is usefully summarised by Brownsword *et al* (1996) under the concept of maximum welfarism:

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... the basis of justification for consumer laws is “the unequal bargaining power between consumers and traders”.

Rather than looking at the contractor's position in the overall social order (or hierarchy), maximum welfarism focuses specifically on the power relationship between the particular contracting parties. If one side has greater bargaining strength than the other, then the weaker party will be protected against abuses of contractual power ... The general regulatory objective is to act against inequality of bargaining strength and unfair contractual outcomes that can be generated from such inequality.

This approach underlies a lot of the consumer literature that attacks standard-form contracts, broad security terms and contracts that are substantively unfair. The principal assumptions seem to be that consumers have few options but to purchase and contract on terms set by increasingly large and powerful sellers: disparity in size and resources between sellers and buyers was often thought to equate to bargaining power. Sellers were also able to exploit significant information and sophistication asymmetries in their favour (Hadfield *et al*, 1998).

Paternalism

As noted above, the efficiency framework does not question that consumers themselves know what are their best interests. An alternative argument is that one cannot always be confident that transactions that reflect parties' present preferences are really in their long-term interests. Intervention that runs counter to the preferences formed by consumers themselves is pejoratively called 'paternalism'.

There are a number of examples of paternalistic interventions, particularly with respect to children—for example, the Minors Contracts Act and various product safety laws. Duggan (1991) argues that there are three shades of paternalism, the distinction being based on whether the intervention was intended to correct perceived deficiencies in:

- the way a choice was exercised in favour of a particular preference;
- the way a preference was formed; or
- the outcome of the choice.

However, as the first two points above do not aim to limit consumer choice, or try to exercise it for them, it is not necessarily appropriate to label them as 'paternalistic'. Secondly, it is hard to determine whether there is any real distinction between those points—for example, the way a preference was formed may involve a choice on the part of the consumer. On that basis, these two points are not treated as 'paternalism'.

The third type of paternalism is what Duggan calls 'true' paternalism and is based on substantive judgements about the validity of particular preferences. Choices are prohibited because the outcome is considered not to be in the consumer's best interest and people are assumed to need 'saving from themselves'. A number of consumer protection measures, particularly those designed to prevent over-indebtedness, seem to be motivated by this form of paternalism.⁵

⁵ Such measures have not been enacted in New Zealand, but are a feature of Australian consumer credit law.

In another context, a paternalistic motivation would be to attempt to bring consumer preference-forming into line with scientific 'objectivity' when consumers perceive a risk that science does not (Hadfield and Thomson, 1998). This is highlighted in the debate over genetically engineered food. Hadfield and Thomson point out that, if consumers perceive a risk that science does not, a *non-paternalistic* approach to consumer protection will set as its goal to convey to consumers the information they need to act on their perception. The fact that consumer perceptions are not scientific, is not a basis for substituting a principle that those transactions that science would make are those that should guide policy.

On the other hand, where the consumer is underestimating or unaware of a risk that a scientific approach would reveal, it would still be paternalistic to close the gap in favour of the scientific approach—in this case, however, such paternalism is appropriate (*ibid*).

An information framework

A strict efficiency approach does not question a consumer's preferences and sees no role for the law in shaping preferences. This is because preferences are presumed to be subjective, so there is no basis for enquiring into whether they were validly formed or not, and no way of distinguishing qualitatively between one set of preferences and another (Duggan, 1991).

However, the way consumers form preferences is not inviolable, for example:

- preferences may be formed on the basis of social conditioning (for example, sex and race discrimination), lack of opportunity or habit (*ibid*);
- consumers operate under conditions of 'bounded rationality'—they use heuristics to simplify complex decisions (Korobkin and Ulen, 2000). Hadfield *et al* (1998) discuss how an "important and durable" heuristic device is the general expectation consumers have that products are safe, aside from risks that are obvious. In the case of hidden defects, reliance on this heuristic leads to detriment;
- consumers often underestimate the value of information (that is, the benefit information is likely to bring to the consumer in terms of making a different choice about what goods and services to buy and on what terms (*ibid*)).

These considerations may go some way towards justifying an agenda for consumer protection that is broader than traditional efficiency considerations would allow—while sharing the same goal that consumers should get what they want.

This appears to be the approach of Hadfield *et al* (1998) in their recommendation of an information-based framework. Emerging theories in the areas of law and behavioural science, with their emphasis on the consumer decision-making process, are likely to add weight to this framework.

Hadfield *et al* (*ibid*) begin their discussion with a review of the economic theory that underlies early consumer protection initiatives. This theory was based on simplistic assumptions about market power and inequality of bargaining power. The

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On the other hand, where the consumer is underestimating or unaware of a risk that a scientific approach would reveal, it would still be paternalistic to close the gap in favour of the scientific approach—in this case, however, such paternalism is appropriate.

Under a modern approach for analysing consumer protection problems, the central concept is that of the 'bad deal', namely consumer transactions in which there is a deviation in what consumers get out of transactions from what they intended and expected to get. The concept captures the essential way in which the analysis of consumer protection is grounded in consumers' expectations and desires.

This follows the basic principle of the market economy: that consumers assess for themselves the costs and benefits of various transactions... This basic approach highlights two important characteristics of the market setting—the value of information and the cost of information.

paper then covers a wide range of modern theories relating to market structure, bargaining and game theory, transaction costs and comparative institutional analysis to arrive at a modern approach for analysing consumer protection problems.

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This follows the basic principle of the market economy: that consumers assess for themselves the costs and benefits of various transactions. The fact that consumer perceptions are not scientific or fully rational is not a basis for substituting a principle that those transactions that science would make should guide policy. It is the divergence between what consumers expect, in fact, and what they get, in fact, that drives policy.

This basic approach highlights two important characteristics of the market setting—the value of information and the cost of information. Having established these premises, a framework would follow the steps common to policy analysis, with the following emphasis:

- in defining a public policy problem, the focus should be on the quality and cost of consumer information;
- in deciding whether regulation is a necessary and feasible response, it is suggested that consumer protection regulation is only likely to make consumers better off if it either improves consumers' estimates of the value of information or reduces the cost of information to consumers (or both). In trying to improve consumers' estimates of the value of information, regulation is most likely to be effective where it addresses:
 - hidden risks or hazards that create a gap between consumers' general expectations and reality; and
 - certain demonstrative cognitive failures to appreciate certain kinds of risk.

Any chosen regulatory instrument should not generate information that is costly for consumers to interpret or access. Nor should the instrument have the effect of increasing the gap between expectations and reality.⁶ There may be trade-offs with respect to instruments that restrict consumer choice (and freedom of contract) but are more successful in reducing information costs (for example, in respect of product safety), and instruments that lower information costs but also restrict competition or trade.

A rights-based framework

Consumer policy is sometimes framed in terms of 'consumer rights'. It is most common for the consumer movement to articulate consumer policy in this way. For instance, Consumers International states:

⁶ For example, licensing systems, and border control measures in respect of odometers, may provide a false sense of assurance if not linked to rigorous quality control standards.

Consumer policy promotes the establishment of legislation, institutions and information that improve quality of life and empower people to make changes in their own lives. It seeks to ensure that basic human rights are recognised, and promotes understanding of people's rights and responsibilities as consumers. These are:

- *the right to satisfaction of basic needs*
- *the right to safety*
- *the right to be informed*
- *the right to choose*
- *the right to be heard*
- *the right to redress*
- *the right to consumer education*
- *the right to a healthy environment.*

Consumers also have responsibilities to use their power in the market to drive out abuses, to encourage ethical practices and to support sustainable consumption and production.⁷

General conclusions on frameworks

Having reviewed what appear to be the major analytical frameworks with respect to consumer policy, it is useful to draw a few general conclusions.

The role of theory

Theory (and empirical evidence) represents collective, albeit contestable, wisdom in relation to a particular problem. It can suggest approaches to issues, highlight costs and benefits of a particular approach, reveal aspects where trade-offs and compromises are required, and uncover assumptions, values and linkages.

Consumer policy should be based on the best insights that theory has to offer. Any particular intervention should be supported by and tested against current (and competing) theoretical frameworks. The alternative, to act on "atheoretical intuition" (Schwartz and Wilde, 1983), would seem unsound.

Obviously, however, it does not follow that theory is to be pursued for its own sake. Theory is a tool, not an end in itself, and an aid to, not a substitute for, judgement.

No particular framework

It would seem to follow from the above observation that it would be inappropriate, if not impossible, to simply adopt any of the frameworks discussed above, with the intention that they could be applied to any particular problem that may arise. To attempt this would ignore real life considerations (such as political imperatives and institutional arrangements) that affect the goals that are chosen, and the path taken to achieve those goals, with respect to any particular intervention.

It is more likely that a mix of considerations must be adopted, and as Duggan (1991) states, the "challenge is to strike the right balance". This will often apply on a

⁷ www.consumersinternational.org; accessed 10 October 2002.

case-by-case basis, although broader, high level themes should be applicable across the range of issues.

Framework must be economically grounded

While the efficiency framework may be open to criticism on a number of grounds, it remains important that whatever approach is adopted is economically grounded. After all, that is the basis upon which other important institutional players will assess interventions.

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- *be aware of relevant economic theory;*
- *be able to identify the costs and benefits of the policy, and identify the trade-offs, in economic terms. In particular, trade-offs at the expense of efficiency and competition must be justified; and*
- *be cognisant of the dynamic effects of interventions.*

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- be cognisant of the dynamic effects of interventions.

This is not to say that economic considerations must always take precedence. Other non-economic values are important, as are insights offered by other disciplines, especially the behavioural sciences.

Selecting a framework

This section briefly comments on the frameworks discussed above.

The efficiency framework

While the economic efficiency of any particular intervention must be considered, it is not necessarily appropriate to select efficiency as the overriding goal. There are a number of grounds for objecting to the efficiency framework.

First, and perhaps a little superficially, many of the formal models used to argue for or (more often) against government regulation, or which attempt to explain the functioning of consumer markets, are of such mathematical complexity that they are difficult for a non-specialist to understand and of limited practical utility.

Secondly, traditional cost-benefit techniques are often difficult or impractical to apply to live policy issues.

There are also the objections pointed out by Ramsay (1995, 2000) and others that much of the law and economics literature ignores existing power relations within markets and the various ground rules set by common law and the social order that affect relationships between supplier and trader. Instead, there is a questionable assumption that common law (but not necessarily statute law) seeks economic efficiency (Stigler, 1992).

Similarly, the 'rational choice theory' which underlies the efficiency framework, ascribes too much rationality to market actors (and judges) and ignores the way consumers and suppliers actually make decisions and behave (Korobkin and Ulen, 2000; Ramsay, 2000).⁸ Behavioural scientists have challenged many of its assumptions.

⁸ However, much efficiency-oriented discussion does attempt to deal with psychological literature, for example Schwartz (1983).

Likewise, following Akerlof's (1970) model, without the presence of government intervention or private institutions to counteract the effects of quality uncertainty, poor quality goods may drive out high quality goods so that no market exists at all.

In some markets, too much faith may be placed on the forces of competition. Hadfield *et al* (1998, 153) note the tension in perspectives between competition and consumer protection policy:

From a competition policy perspective, markets with low barriers to entry, low sunk costs, many rivals and rapid rates of entry and exit will tend to conform with the textbook model of a fully competitive market. Yet from a consumer protection perspective, such markets (eg used cars, home renovations) may present some of the most severe information problems that consumers confront.

There is also the criticism that the efficiency framework ignores issues of distribution, as well as values such as fairness, respect and various community values (Cranston, 1978).

The equity framework

With respect to the concept of commutative justice, Duggan (1991) argues that it sits uneasily with efficiency frameworks, because the former is preoccupied with the transaction process (free choice), whereas the concern of the latter is with outcomes (wealth preservation). However, in cases of extreme one-sidedness of outcomes, inferences may be drawn about the quality of the transacting process.

The regulation of contracts for shifting losses or redistributing income receives little support and much criticism in the theoretical literature (for example, Cayne and Trebilcock, 1973; Hadfield *et al*, 1996). The general ground for objection is that such measures involve significant compromises with respect to efficiency and create 'substitution effects'—that is, they raise costs, lead to cross-subsidisation or deny access to goods or services for particular consumers. Such measures, therefore, often harm those consumers they intend to assist.⁹

On more pragmatic grounds, explicit adoption of distributive justice goals, or an attempt to align consumer policy with the goals of the welfare state, would not appear to be consistent with goals relating to sustainable economic development. This is because of the substitution effects referred to above. Similarly, adoption of some of the European models of welfarism would involve a fairly radical reconception of aspects of contract law and, on that basis, the Ministry of Consumer Affairs is not well placed to instigate such a project.

The only scope to explicitly adopt distributive goals may, therefore, be in respect of markets that are not workably or highly competitive (Hadfield *et al*, 1996). Beyond those circumstances, it seems outside the mandate of the Ministry.

The problem with inequality of bargaining power as a framework is that it is insufficiently economically grounded—in the words of Schwartz (1995), it is "obviously shallow". In particular, it ignores competitive dynamics within markets. For instance, if firms are operating in competitive markets, they are "price takers" (*ibid*) and do not really have significant economic power (Williamson, 1995).

⁹ This is contested by Ramsay (2000), who argues that the empirical evidence suggests otherwise.

The only scope to explicitly adopt distributive goals may, therefore, be in respect of markets that are not workably or highly competitive (Hadfield et al, 1996). Beyond those circumstances, it seems outside the mandate of the Ministry.

Paternalism

With respect to what Duggan (1991) labels “true paternalism”, the consensus is that it should be given “a very tight rein” or “treated with considerable caution” (Hadfield *et al*, 1996), particularly in a liberal society which values individual freedom. Duggan argues that once a case for paternalism is admitted in a particular circumstance, there is no logical stopping place: “[i]f there is insufficient discrimination, collective solutions will become the norm, and the market-based economy will collapse”.

In addition, paternalism and efficiency frameworks are incompatible in the sense that they derive from competing premises (Duggan 1991); that is, the efficiency framework assumes people are, in most cases, capable of making their own choices.

However, within the rubric of paternalism Duggan includes a range of considerations relating to measures designed to influence the formation of preferences by consumers, but which stop short of making normative judgements about what it is that consumers should want (Hadfield *et al*, 1996). This approach should be distinguished from “true paternalism”.

An information-based framework

This framework has a number of attractions:

- while being economically grounded, it is not as strict as the efficiency framework. In particular, it seems to allow scope for measures that help shape consumers’ preferences (which might be labelled as paternalistic from a pure efficiency viewpoint). For instance, one justification for intervention under the framework would be if the intervention improved consumers’ estimates of the value of information;
- it covers, and is derived from, a vast economic literature, including insights from game theory, theories of market structure and the economics of information and is consistent with the developing field of law and the behavioural sciences;¹⁰
- it ties in well with, and refines, earlier work by the Ministry of Consumer Affairs looking at transaction costs¹¹ as the basis of a theoretical framework. In that work (Ministry of Consumer Affairs, 1998), it was stated that:

A major objective of the Ministry of Consumer Affairs, in its policy advice and its operational activities, is to remove impediments to voluntary transactions and to minimise the costs of transactions between consumers and businesses.

However, the information-based framework has the advantage of being more specific and providing greater guidance.

¹⁰ This appears to be a new movement in law and economics, but as yet scholarship has not considered consumer protection policy in detail.

¹¹ Hadfield, Howse and Trebilcock (1998) define transaction costs as “broadly understood to include informational barriers that prevent a perfect alignment between incentives and goals”.

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Similarly, the central concept of the 'bad deal' aligns with the concept of 'reasonable expectations' that underpins the Consumer Guarantees Act 1993. The analysis can also be applied to areas such as product safety and other consumer issues.

It explicitly avoids the pitfalls of truly paternalistic approaches. It defers to consumer preferences and consumer judgements about their own interests, including judgements from ethical, cultural and spiritual standpoints.

A rights-based framework

The problem with a rights-based framework is lack of clarity about the basis upon which rights are derived. For instance, it does not indicate how trade-offs are to be made between different rights, or between rights and other considerations (such as cost), or how the rights apply to specific contexts.¹²

A rights-based framework is more suited to an advocacy group, rather than a government agency that must balance the interests of a wide variety of stakeholders.

Conclusion

While a particular framework should not be adopted at the expense of all other considerations, the following conclusion is suggested.

The goal of consumer policy should be to: (a) remove barriers; and (b) shape expectations, so that with respect to any particular transaction, consumers receive what they intended and expected.

This goal is derived from the efficiency framework, but is broader in that it gives consumer policy a role in shaping consumer expectations and the process of preference formation, while stopping short of making choices for consumers or judgements about what consumers should want. This goal is supported by an information-based framework that is less wedded to certain premises of the efficiency framework.

In general, consumer policy is an inappropriate vehicle for distributing resources or losses. Such goals are only appropriate in limited and defined circumstances and must still be justifiable in terms of costs, benefits and trade-offs.

The goal of consumer policy should be to: (a) remove barriers; and (b) shape expectations, so that with respect to any particular transaction, consumers receive what they intended and expected.

¹² For instance, what does the 'right to choose' mean in the context of a single provider of a public service (assuming a broad view of the consumer interest is taken)?

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