An ESRC Research Centre
CCP
CENTRE FOR COMPETITION POLICY
Newsletter

Issue Number 11
November 2006
Editor: Cheryl Whittaker

Consumers, Collusion and the Commission: Some Competition Concerns

Director's Letter

Catherine Waddams

This edition of CCP's Newsletter reports on different aspects of Competition Policy, including the Commission's role in energy mergers, fuel surcharges, private enforcement, the importance of an active consumer role in competition policy, and public perceptions of collusion. The articles demonstrate a mix of law and economics approaches to Competition Policy, reflecting our research interests. We not only look forward to continuing our own research within CCP, but also to discussions with academic and practitioner audiences on these issues. We would be delighted to receive comments on these, or our other work. We also hope you will be at one of our forthcoming conferences in 2007. The Network of Industrial Economists (NIE) are holding their Christmas Conference on January 12th, and our third annual Summer Conference will be held on June 14th-15th, both at UEA; in addition, a Workshop for our South Eastern Europe Electricity Reform Project will be held on July 2nd-3rd in Romania.

As the Centre celebrates its second birthday several of our members are moving on to new opportunities elsewhere, but they will remain as associate members of the Centre and will continue to work with us. We welcome Andrew Bugg, Luke Garrod and Pham Dung Khac as part-time research associates as they finish their doctorates, and look forward to recruiting new colleagues at post-doctoral level in the next few months. We also look forward to welcoming visitors to our temporary accommodation in the Old Medical Centre on the Campus while our Norfolk Terrace offices are refurbished.

The 'Endesa File': National Champions and the Resurfacing of Tension in European Merger Control

Andrew Scott*

The provision of an effective merger control regime was a celebrated omission in the founding treaty of the EC. Moreover, notwithstanding the tabling of a proposal as early as 1973,[1] political antagonism between important member states served to preclude the introduction of such a policy until the imperative of single market completion dictated its necessity in the late 1980s. The more recent history of merger control in the EC, however, has been one of concord and co-operation between member states and the Commission. The widely acknowledged success of the Merger Regulation has dissipated political sensitivities. Indeed, previously sceptical member states have been mollified to the point where they were happy to engineer a purely functional set of case allocation mechanisms in the recast regulation.[2] Recent events in the biography of Spanish energy firm Endesa, however, have highlighted lingering tensions in the tiered system. The interface between Community goals and divergent perceptions of key national interests remains problematic.

The saga surrounding the ownership of Endesa has proved long-lived and complex. In September 2005, a second Spanish energy firm – Gas Natural – launched a hostile takeover that was resisted by the target firm. On the basis of the 'two-thirds rule', this bid was considered as a national case by the Spanish competition authorities; both companies, while large, earned more than two-thirds of their Community-wide turnover in Spain alone.[3] Thinking that the Commission might be more receptive to its case, Endesa sought a transfer to the supranational level. The Commission had reluctantly to concede, however, that it was not competent to act. Subsequent to this decision, and perhaps contrary to expectations, the Spanish competition authority recommended that the transaction should be blocked. Nevertheless, in early 2006 the Spanish

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government passed the merger subject to twenty conditions. Gas Natural's bid has since encountered legal obstacles.

The emasculation of the Commission's competence in *Gas Natural /Endesa* moved the Competition Commissioner promptly to moot the legislative repeal of the two-thirds.[4] It highlighted the sometime arbitrariness in the allocation of cases under the existing jurisdictional rules, and the risk that different authorities may reach disparate results on equivalent cases. The Commissioner's view was that the two-thirds rule "no longer reflect[s] an optimal allocation of competence between the national and the Community level, and even constitutes in some instances an obstacle to the consistent treatment of cases". Following a consultation with stakeholders, she hoped to publish a proposal for reform.

Endesa meanwhile attracted another suitor as German firm E.ON sought to trump the original approach. It was incontrovertible that this second transaction would possess a Community dimension, and the Commission cleared the merger on competition grounds in April 2006.[5] Shortly after the announcement of E.ON's bid, however, the Spanish government passed a law which bolstered the powers of the energy regulator to review mergers in the sector that affect national strategic interests.[6] Using these powers, in July 2006 the regulator imposed 19 conditions on the E.ON acquisition purportedly to protect national security of supply and public security. They included obligations to maintain the firm's debt and projected investment levels, and to divest substantial interests in nuclear and coal-fired generation. Under Article 21(4)ECMR, it is open to a member state to take action in respect of a merger that possesses a Community dimension in order to protect some legitimate national interest, although the exercise of such reserve powers is tightly supervised by the Commission.[7] Latterly, the Commission has reached the preliminary determination that the Spanish authority's action is unlawful being neither justified by, nor necessary or proportionate to, the needs of public security.[8]

From the Commission's perspective, this history involves two separate instances of strategic game-playing on behalf of the Spanish government not justified by vital imperatives. Each manoeuvre has tested – albeit in different ways – the legal accommodation reached in the Merger Regulation between national and community level interests. In both instances, Spain has sought to protect national concerns that arguably diverge from the competitive single market goal. In the latter case, because of the detail of the legal design, the Commission was left with the final say. In the former, it found itself incompetent to act so that its only remaining option was to call for reform of the existing rules.

The underlying problem for the Commission is that both strands of the 'Endesa file' highlight a persistent dichotomy in economic thinking. The Spanish government is by no means alone in seeking to foster or sustain 'national champion' companies in contravention of the general premises of the EC project and the widely acknowledged lessons of economic history. The French,[9] German,[10] and Swedish governments have each flirted with this mercantilist approach to industrial policy in recent times.[11] There have also been calls for the UK to resile from its more open attitude,[12] and for the EC to foster the creation of 'European champions'.[13]

The creation of national champions is sometimes seen as the only way for firms based in a particular country to compete in a global market populated by giant competitors. The approach might involve, for example, the making of soft loans, the unwarranted award of significant public procurement contracts, or – importantly – the bending of merger laws to defend or promote national companies. Notably, it tends to benefit firms that are already large with well-established political connections. The social welfare implications of the decline or failure of such firms can leave it difficult for politicians to resist supportive intervention. Commissioner Kroes has acknowledged that, "in difficult times, it is sometimes appealing to launch ideas about champions and sectoral initiatives".[14]

From the outset, in its implementation of the EC merger control regime the Commission has rebuffed industrial policy arguments of this nature. The national champions approach is considered anathema to the essence of the single market concept, which is thought to lie in open competition and the free movement of capital and not in protectionist state intervention. Alongside the Competition Commissioner, this stance has recently been commended by the former Chairman of the UK Competition Commission.[15] Their shared basic contention is that firms that operate in competitive national markets are more likely to be efficient and thus able to flourish on global markets than contemporaries that are insulated from competition. The grant of support to national champions is perceived as pathological. For Professor Geroski, "it is competitive markets that produce such champions, not national governments…national champions are more likely to become national basket cases than national breadwinners". Ms Kroes concurs that "when industrial policy turns inwards, when protectionism leads to economic isolation, the consequence is diminished growth, stagnation and lost prosperity". The consensus among other commentators confirms this attitude: "no industrial policy has been more comprehensively discredited than the notion that the best way to achieve competitiveness abroad is to suppress it at home".[16]

Thus, at one level, the Endesa file offers a salutary lesson on how legal design can frustrate, almost serendipitously, wider system goals. At a deeper level, it highlights a latent, but crucially important, dichotomy of views on the best approach to achieving economic development both within and across the member states of the EC. In the short term, the Commission may well seek to tinker with the rules by which jurisdictional competence is accorded between tiers of the integrated European merger regime. Ultimately, however, it may be best advised to move to undercut the persistent faith in the national champions approach to economic policy. The Commission should promote a wider and deeper appreciation among Europe's political classes of the futility of protectionist industrial policy.

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1 [1973] OJ C92/1.
2 The early operation of this regime is viewed by the Commission as a "considerable success" – Ryan (2005) 'The Revised System of Case Referral', *Competition Policy Newsletter*, 3, pp. 38-42.
3 Scott (2006) Last Rites for the two thirds Rule in EC Merger Control? *Journal of Business Law*, 619.
4 SEC (2005) 1518/1.
5 Case M.4110 *E.ON/Endesa* (25 April 2006).
6 *Real Decreto-Ley* 4/2006 of 24 February 2006.
7 Three such interests – public security, plurality of media and prudential rules – are stated explicitly.
8 Commission, MEMO/06/312, 25 August 2006.
9 Wheatcroft, *The Times*, 1 September 2005.
10 Benoit and Major, *Financial Times*, 13 May 2004.
11 Whish, *Competition Law* (5th edn, Butterworths, 2003), p. 847.
12 MacAlister and Gow, *The Guardian*, 7 March 2006; Hutton, *The Observer*, 5 March 2006.
13 Strauss-Kahn *et al* (2004) *Round Table: Sustainable Project for Europe* (Brussels).
14 Kroes, speech delivered at Bocconi University, Milan, 7 February 2005.
15 Geroski, speech delivered to WIFO, Vienna, 8 March 2005.
16 Kay, *Financial Times*, 11 January 2005.

Fuel for Thought[1]: Surcharges that Facilitate Higher Prices

Luke Garrod

When firms interact repeatedly, they can form an understanding to dampen competition, which may enable them to maintain high prices and acquire larger profits. Firms can sustain high prices if each firm's short-term gain from breaking the understanding (by setting a low price) is outweighed by the long-term benefit from maintaining the high price. When firms find it difficult to reach an agreement they may adopt certain practices which potentially increase the likelihood that collusion will be sustained. In general, these practices either help firms to reach an agreement or affect the incentives of maintaining the understanding, by decreasing the short-term gain of setting a low price or increasing the long-term benefit of maintaining the high price.

Separately itemised surcharges have become a standard practice for firms (including cartels) when industries experience a temporary price shock of an essential input. Usually surcharges are assigned to pass some fraction of the essential input's cost on to the buyer. This form of pricing is observed in the steel industry and many of the transport industries, especially in the airline industry since the unprecedented increases in oil prices in recent years. For example, BA at present has a £35 fuel surcharge per sector on long-haul flights – that's £70 on a return flight from London to New York. It is usually argued that these surcharges may help firms reduce the costs associated with changing prices (called 'menu costs'); surcharges are commonly not thought to facilitate higher prices.

However, in the airline industry, BA is currently being investigated by the Office of Fair Trading (OFT) for allegedly fixing the level of its long-haul fuel surcharge with its rivals[2]. This raises an interesting question: in the presence of low menu costs, why would firms illegally fix price increases and then precariously highlight the act by separately itemising the increase as a surcharge, which could increase the risk of alerting a competition authority? The reason may be because the surcharge has a critical role to play in the process that enables the firms to set higher prices in the first place.

It is well known that firms' incentives to maintain or break their collusive agreement are affected by fluctuations in market conditions. When an industry's marginal costs are temporarily high firms face a problem created by the uncertain future expectation of costs decreasing, which is amplified when firms commonly match rivals' prices as observed in the airline and steel industries. Given the high costs, firms need to agree upon which new higher prices to set (which is difficult in itself under tacit collusion, especially in asymmetric oligopolies where firms have different preferences over a range of prices and as a result they may get stuck at a suboptimal price). Furthermore, if firms expect costs and prices to return to their original state in the future, they have an incentive to lower their price earlier than expected in order to capture more of the market, because they will receive a short-term gain in profit with little or no long-term loss. As a result, firms may prefer to maintain rigid prices throughout the cost shock to avoid the agreement breaking down.

Typically surcharge levels are preannounced by firms and they publicly commit to when they will be removed during the implementation. This practice may be able to help overcome the incentive to break the collusive agreement when firms expect prices to fall in the future. Preannouncing the level of their surcharges rules out the ability of firms to gain profit by not setting a surcharge; whilst committing to the duration of their surcharge during its implementation effectively commits the firm to a price decrease when costs return to their original state. This makes the long-term benefit of maintaining the high price more attractive because breaking the collusive agreement by setting a low base price (with the surcharge added) during the cost shock will make firms set even lower prices in the future when costs fall and the surcharges are removed.

Prominent examples of pre-commitment to surcharge duration can be found in the airline industry where many carriers have preannounced certain oil prices which must occur before their fuel surcharge is removed; buyers in the steel industry also know that suppliers adjust alloy surcharges monthly and the new level that becomes effective is announced a month in advance. Obviously, cartels can have even more elaborate private incentives to enforce the longevity of surcharges.

Competition authorities rarely prohibit recognised facilitating practices because many that potentially help sustain higher prices have equally plausible innocent explanations; this is also very true for surcharges. However, developing theory on potential facilitating practices is important, not only for recognising markets that may have some degree of tacit collusion which could effect merger decisions, but also for discovering cartels.

[1] This article is based upon "Surcharging as a Facilitating Practice" L Garrod, CCP Working Paper (Forthcoming)

[2] Office of Fair Trading Statement, OFT investigation into alleged price coordination in relation to long-haul passenger flights to and from the UK, 22 June 2006, available at www.oft.gov.uk

The Aims of Private Enforcement of Competition Law

Morten Hviid

The decision on 19th July 2006 by the House of Lords[1] in the *Crehan* case – to overturn the only case so far in the UK where a private litigant had been successful in claiming damages related to a violation of competition law – ensures that private enforcement continues to be a hot topic. This article steps back from the issues of the positive and negative effects of, as well as the likely impact of the HoL decision on the future of, private enforcement, and instead focuses on the more fundamental question of what it might add to public enforcement undertaken by competition authorities in the EU and UK. There are three areas where it might contribute positively: enhanced deterrence, compensation for losses suffered and access to justice.

Enhanced deterrence

Firms are more likely to be deterred from violating competition law if they are more likely to be caught and if the consequences of being caught are more severe. There are broadly three, often interlinked, ways in which private enforcement can add to deterrence. Firstly, it raises extra funds for enforcement and investigation, again increasing both the likelihood of detection and conviction. Secondly, it increases the penalty and hence the expected cost for a transgressor from being caught. Thirdly, it leads to revelation of information not immediately available to the competition authorities, increasing both the likelihood of detection and conviction.

It is often said that competition authorities have very modest resources, preventing them from pursuing all cases, following all leads or engaging in targeted monitoring of industries or firms. The cost of private enforcement is not paid for out of the budgets of the competition authorities, and hence frees up the competition authority to pursue other cases. A point which often seems to be overlooked in this supposed win-win situation is that these costs are nevertheless incurred and have to be borne by someone. Either the plaintiffs, the defendants, or both, will have to pay for the legal and economic analysis required to pursue and establish their respective cases. It is by no means obvious that such costs are borne by those who have benefited from the violation of competition law. Thus the extra funds come with a price tag, and one which those paying may not have been aware of. Public funding for competition enforcement comes via taxation, where the Treasury carefully analyses the implication of the increase in taxation in terms of distortions to the economy as well as distributional effects. Because no-one has the task of assessing the impact of the cost of private enforcement on firms and consumers, distortions may neither be accounted for, nor necessarily identified, let alone corrected for. As an aim itself, generating additional funding through private enforcement may be politically expedient as it reduces the need to raise taxes; however, it comes with hidden costs.

Some see private enforcement as a way to increase the punishment on firms and in particular on price-fixers. This has certainly been the effect in a number of celebrated cases, such as vitamins, where damages from follow-on private actions have exceeded the public fines significantly. This supposed benefit rests on a belief that public punishment provides an inadequate deterrence. Except possibly in the case of the EU, the state always has more power to punish than do private actors. If public punishment is inadequate, it must either be that the authorities have been granted inadequate powers or that the sentencing guidelines are ignored. Surely, this can be rectified without resorting to costly follow-on private actions.

One of the problems for competition authorities is that they often lack information about infringements. The parties who are more likely to have this information are those who deal immediately with the infringers, such as direct buyers, direct suppliers and rivals. Private enforcement can add to deterrence where it incentivises those with information to make use of it. Such incentives could be provided by allowing those with information to collect significant rewards in terms of damages from a private action.[2] It is not, however, always beneficial to provide such incentives; nor is it easy. For example, rivals may have good information, but they may have ulterior motives and hence lack credibility. With buyers and sellers, the problem is different: it arises partly because they typically deal with the infringers repeatedly and hence may be unwilling to “rock the boat”, and partly because they are, in many cases, smaller or less powerful in the procurement relationship and hence potentially reluctant to upset a powerful firm. For private enforcement to incentivise such firms to bring their information out into the open there must be a credible promise of a pot of gold at the end of the case. One way to do this is to apply a multiplier to the damages established through the case, such as awarding treble damages.[3] It is also important that the pot of gold is not reduced through what is referred to as “the passing-on defence”. If the litigant is not a final consumer, it may have an opportunity to pass on any price increase to its buyers. In that case the damage suffered by the litigant may be relatively small and hence, even if trebled, may not offer sufficient incentive. To provide incentives, one may therefore have to rule out this passing-on defence.

Using private cases as a means to increase the information available to competition law enforcement is commendable, but designing a system which gives just the right incentives is, at the same time, fraught with problems.

Compensation for losses suffered

The classic argument in favour of private enforcement that 'someone has been harmed and they deserve compensation' raises two questions: Can this be achieved by private enforcement? If it can, is private enforcement the most efficient or fair way to achieve this?

Where each final goods consumer has been harmed relatively little, even though the aggregate harm is considerable, the costs of individual private action may be prohibitive. This may be remedied by class actions, or by third parties such as consumer organisations suing on behalf of consumers. However, it should be remembered that there are costs of organising class actions, as well as distributing awards, which may outweigh the benefits.

Another issue arises where the injury occurs upstream of the consumer who is harmed. Take as an example a price-fixing cartel which sells to processors, who sell on to retailers, who in turn sell to consumers. In such cases estimating the exact harm to the consumer is difficult because at each level only a part of the over-charge is passed on.[4] This difficulty lies behind two landmark (if controversial) US cases related to private enforcement of competition law, *Hanover Shoe, Inc*. v. *United Shoe Machinery Corp*.[5] and *Illinois Brick Co*. v. *Illinois*.[6] Partly to avoid measurement problems, *Hanover Shoe* rules out a passing-on defence on the part of a violator at the US Federal level. That in itself would not deny a plaintiff from arguing that they had been harmed because an overcharge had been passed on to them. However, given that treble damages are awarded in the US, if such a claim was allowed, this could potentially give rise to claims many times the established harm. In our example, the processor, the retailer and the consumer could, in theory, sue and get awarded each three times the total harm, leading to damages nine times the original harm and hence possible over-deterrence. The *Illinois Brick* decision implies that at the US Federal level, only direct purchasers are able to sue. One consequence of this approach is that, at least in the US, compensation of consumers appears to take a back seat.

The US example also illustrates a tension between the aim of compensation and the wish to provide incentives for those with information to sue. The combination of *Hanover Shoe* and treble damages ensures that at least some direct purchasers have an incentive to sue. More generally if we are focused on providing incentives to direct buyers, but at the same time are concerned about over-deterrence, then we will either have to focus on providing these incentives or on offering consumers a means of getting compensation. We may not be able to do both.

Finally, if compensation is the key aim, this has implications where the case follows on from an action by a competition authority. The latter, when determining the size of the fine, must ensure that the violator can meet its civil liabilities. But this requires the competition authority to assess both the extent of the harm and the identity of those harmed. In that case, why not simply require the authority to disgorge part of the fine to those harmed? More generally, it may be worthwhile considering what could be achieved directly by the competition authorities.

Access to justice

While often ignored, securing access to justice where competition authorities are unwilling to undertake an investigation may well provide one of the most compelling arguments in favour of private enforcement. While one might be reluctant to accept that supposedly independent competition authorities occasionally give in to political pressure, there are other reasons for authorities to prioritise cases. Publicity may be important to raise awareness and hence achieve deterrence; but this is more easily secured in "interesting" cases. Because of the externality element of deterrence, it may be sensible for the authority to shift resources to higher profile cases. Publicity may also be important when the authority argues with the Treasury over the size of its budget. Finally, publicity may help the career aspirations of the officers of the authority.

Conclusion

To design a well-functioning private enforcement regime requires an understanding of, and agreement about, the aims of such a tool. This is not yet settled and the article contributes to the discussion by arguing in favour of information revelation and access to justice as dominant aims.

[1] [2006] UKHL 38

[2] There are subtle differences between the cases where the informed party starts the enforcement and the cases where the informed first goes to the competition authority and then follows up any adverse finding with a private claim, see Harker and Hviid (2006) [CCP Working Paper 06-9]

[3] When choosing the appropriate multiplier one must be sure that it limits the temptation to initiate frivolous (costly) cases.

[4] The obvious exception is where the consumer has a cost-plus contract with the firm who has suffered the direct harm in terms of the overcharge. In that case we know that the whole overcharge has been passed on.

[5] 490 U.S. 93 (1989).

[6] 431 U.S. 720 (1977).

Behavioural Revolution: Workshop on Consumer Behaviour and Bounded Rationality


Tina Chang* *and* ***Chris Wilson*****

In a recent joint venture with the ESRC Centre for Economic Learning and Social Evolution (ELSE) at UCL, the CCP organised a joint workshop on Consumer Behaviour and Bounded Rationality. The two-day workshop aimed to stimulate discussions about a very recent wave of economic research, referred to as boundedly rational industrial organisation, among an international, multi-discipline representation of academics and practitioners[1].

Following the rapidly growing behavioural revolution in economics more generally, boundedly rational industrial organisation aims to gain new and deeper insights into competition and competition policy by replacing the standard model of rational consumer behaviour with a set of more realistic, psychologically-based alternatives. In contrast to firms, which are often assumed to have sufficient incentives and opportunity to make 'optimal' decisions, consumers are assumed to depart from traditional rationality in either of two main regards. Firstly, in complex decision environments, instead of attempting to make the first best decision, consumers may prefer to use simple rules of thumb to save the costs of thinking too hard or out of sheer confusion. Secondly, consumers may exhibit systematic preference biases that lead them to rank decision options in unconventional ways. One common example of such a bias, loss aversion, has been demonstrated in a variety of experimental settings and suggests that agents often value the disutility of a given loss by almost twice as much as they value the benefit of an equivalent gain. Boundedly rational industrial organisation examines the potentially anti-competitive incentives that firms face in exploiting such behaviour through their choice of pricing strategies, product range or advertising[2].

One dominant theme that has emerged from several papers has regarded obfuscation strategies that aim to restrict the ability of consumers to compare different offers. By, for example, deliberately using complex tariffs, or by adding meaningless product dimensions, firms may be able to make consumers' demand less responsive to price, increasing equilibrium profits. Ellison and Ellison introduce the topic and document the use of confusing add-on prices on the internet, Gabaix et al demonstrate how firms' profits can increase as consumers' decisions become more noisy, while Speigler shows the incentive for firms to add variance to their offers[3]. The workshop provided an opportunity for several CCP members to contribute to this literature.

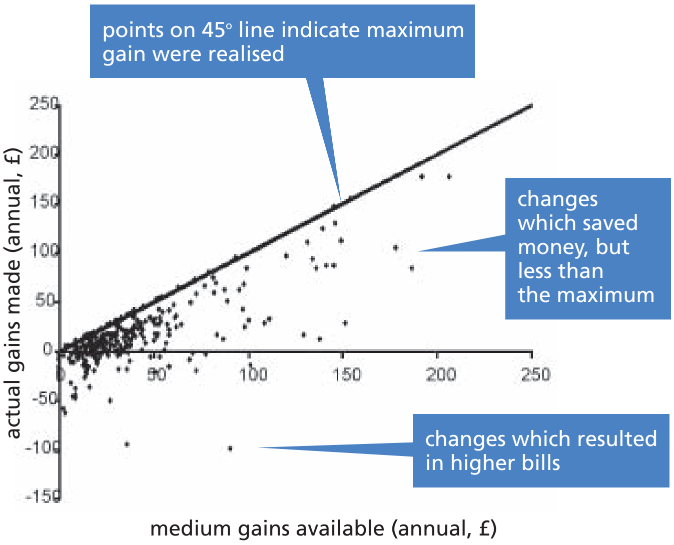
Alex Gaudeul (CCP & UEA) and Bob Sugden (UEA)[4] consider an opposing force to obfuscation which they label as the common standard effect. Driving the incentive to obfuscate is the ferocity of price competition that results from a firm presenting its offer in a standard that is common to other firms, allowing consumers to make easy comparisons as to which firm offers the best buy. However, as the authors demonstrate, this incentive may be reduced or even removed if, recognising this relationship, consumers gravitate to those firms using a common standard in the belief that such firms will be more competitive. Such an effect would thus limit the possibility of firms exploiting consumers with unnecessarily complex offers.

While this theoretical debate continues, two related papers authored by CCP members Tina Chang, Catherine Waddams and Chris Wilson attempt to gain a different, empirical perspective with the use of a specially commissioned CCP survey[5].

If consumers really are confused or misled in any way, one would expect them to forgo possible gains in surplus by making poor decisions when choosing between alternative suppliers. In the first of the two papers, Wilson and Waddams attempt to measure the magnitude of such forgone gains by estimating the actual gains made by consumers in their electricity switching decisions relative to the maximum surplus each consumer could have made by picking the best alternative[6]. Attempting to make such measurements is, of course, inherently difficult, not least because consumers may choose a particular supplier for a variety of potentially immeasurable reasons. To bypass this problem, the paper focuses exclusively on those consumers in the sample who indicated that they had switched suppliers only to gain a lower price. Given highly inelastic electricity demand, one can then proxy the change in surplus from each consumer's switching decision by calculating the associated change in expenditure using a historical set of tariff data and the consumers' own consumption estimates. To compare this estimate with what each consumer could have achieved, one can then expand the calculations to include estimates of the change in expenditure had each consumer, instead, chosen each of their possible alternative suppliers. The results from using this methodology on both the CCP sample of consumers and on another, independent sample suggest that consumers' decisions were remarkably inaccurate, as can be seen in Figure 1. Figure 1 plots the estimates of consumers' actual switching gains against the gains they could have made by choosing their cheapest supplier (annual, pounds).

More generally, the results across the two datasets and a range of assumptions show that only 8-11% of consumers switched to the firm offering the highest surplus. Moreover, on aggregate, consumers only appropriated between 26% and 39% of the maximum available gains through their choice of new supplier. Such behaviour could be explained by the existence of high search or information costs, but more worryingly, and inconsistent with such an explanation, the results also show that 27-38% of consumers appear to have lost surplus through choosing a more expensive supplier. Such consumers lost an average amount of between approximately thirteen and twenty-five pounds per year, even when any additional switching costs are excluded.

Figure 1: The Actual Gains Made from Switching relative to the Maximum Gains Available (Wilson and Waddams Price, 2006)



In understanding consumers' seemingly poor switching decisions it is useful to consider their preceding decision of how deeply to search the market for information about alternative suppliers. Indeed, it is of interest for policy in understanding what prompts consumers to search and to switch and how their decisions vary between markets. The second paper, by Chang, Waddams Price and Wilson, addresses these issues by making use of the cross market feature of the CCP survey - aside from the electricity market, the survey provides detailed information about consumers' decisions in the markets for mobile phones, fixed line calls, broadband, car insurance, mortgages and current bank accounts[7]. As Table 2 illustrates, consumers' awareness of the possibility of switching, and consumers' search and switching activity varies greatly between markets, with relatively few consumers actively searching for new information. Preliminary findings suggest that consumers' choices are better explained by market type than by demographic characteristics, and consumers are likely to either search and switch in most markets or in none at all. Further work will concentrate on analysing direct measures of consumers' search and switching costs and what determines them, and compare these with the gains which consumers expect to make from searching around for better deals.

Table 2: Consumer Awareness, Search and Switching across Markets (Chang et al)

Market	Aware	Searched	Switched
Average	86	23	17
Electricity	88	28	24
Mobile	90	29	24
Fixed line	84	14	8
Calls	82	17	13
Broadband	68	26	17
Car insurance	85	40	29
Mortgage	78	22	14
Current account	93	8	5

Other presentations at the workshop covered a wide selection of topics. Empirical research ranged from James Banks (UCL) studying how cognitive ability is associated with individuals' understanding and choice of pensions, to Xavier Gabaix (MIT) presenting two jointly authored papers based on consumers' choices and firms' practices within the credit card industry. Again using the pensions industry, Dan Goldstein (LBS) discussed a jointly authored paper that offered a new method of measuring consumers' risk attitudes. Fiona Scott Morton (Yale) used data from the US car market to provide a test of a consumer bias - the endowment effect, before Glenn Ellison (MIT) discussed some evidence of how consumers evaluate different price structures, using data from the online market for memory chips. Two theoretical papers considered how the choice of product lines could influence consumers' choices - Rani Spiegler (Tel Aviv) and Emir Kamenica (Harvard). Jesse Shapiro (Chicago) discussed some results under the assumption that advertising can changes consumers' recollections of past experiences, while Peter Lukacs (OFT) presented some thoughts on the related policy issues, concerning consumer protection policy.

The workshop discussions certainly broadened the scope for interdisciplinary research on consumer behaviour and bounded rationality while highlighting its potential importance for the future of industrial economics and indeed, of competition policy.

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1 The workshop programme, together with all the associated working papers, can be viewed at http://else.econ.ucl.ac.uk/conferences/consumer-behaviour/
2 For an overview of the field and its early findings see Ellison G. (forthcoming) "*Bounded Rationality in Industrial Organisation*" in "Advances in Economics and Econometrics: Theory and Applications" Ninth World Congress Blundell et al (eds), Cambridge University Press
3 Ellison G. and Ellison S.F. (2004) "*Search, Obfuscation and Price Elasticities on the Internet*" NBER Working Paper 10570, Gabaix X., Laibson D. and Li H. (2005) "*Extreme Value Theory and the Effects of Competition on Profits*" Working Paper March 2005, Spiegler R. (2006) "Competition Over Agents with Boundedly Rational Expectations" Theoretical Economics 1, 207-231
4 Gaudeul A. and Sugden R. (in progress) "*Is it possible to exploit innumerate consumers with confusing contract terms? A discussion of the common standard effect*"
5 The survey was conducted by MORI for the ESRC Centre for Competition Policy in the second quarter of 2005 and was co-funded by the DTI and OFCOM.
6 Wilson C.M. and Waddams Price C. (2006) "*Do Consumers Switch to the Best Supplier?*" Forthcoming CCP working paper
7 Chang Y.T., Waddams Price C. and Wilson C.M. (in progress) "Search and Switching Across Relationship Markets"

Dates for your Diary

NIE:
Network of Industrial Economists Christmas Conference
12 January 2007 UEA

CCP Summer Conference:
Comparative Perspectives on Multi-jurisdictional Antitrust Enforcement
14 – 15 June 2007 UEA

CCP Workshop:
Electricity Reform in South East Europe
2 – 3 July 2007 Sinaia, Romania

"No Worse than Shoplifting": Public Perceptions of Collusion at the 2006 BA Festival of Science

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People's attitudes towards offences such as price fixing can have a direct impact on the enforcement of cartel policy. For one thing, competition authorities have limited resources with which to detect cartels and may rely on complaints from customers and employees of colluding firms to better direct their investigations. In addition, a number of jurisdictions are attempting to strengthen enforcement by adopting criminal sanctions against individuals such as those contained in the Enterprise Act 2002. Unlike the purely pecuniary sanctions currently imposed by the European Commission, the imposition of criminal sanctions depends on the ruling of a jury, comprised of ordinary members of the public. Intuitively, people's perceptions about the severity of cartel offences (and the stigma they attach to them) will directly impact both their willingness to report a cartel, and to send individuals involved in such an offence to jail.

On Friday 8th September 2006 CCP conducted a two hour event on collusion as part of the BA Festival of Science, held in Norwich.[1] The event discussed why collusion is illegal, and asked when it is bad for firms to talk to each other. Case studies presented included replica football shirts, public schools and television rights for live professional football. The audience were also shown a video of Lysine cartel meetings held in the US during the early and mid 1990s – these were secretly filmed by the FBI as part of the DOJ investigation into Lysine.

At the beginning of the event we asked the audience of 45 members of the public to fill in a questionnaire designed to gauge their attitudes towards cartels. The results of this questionnaire were presented to the audience at the end of the event and produced some very interesting findings.

The majority of those questioned considered price-fixing and market-sharing to be wrong, demonstrating an understanding of why such behaviour is illegal. However, when asked what price fixing is equivalent to in terms of how bad it is, the majority chose "shoplifting" rather than more serious offences[2]. The audience also displayed a remarkable acceptance of collusion under certain circumstances: almost three quarters believed that it was acceptable for farmers to meet and agree on what price to charge for milk; over half believed price-fixing is acceptable if it protects jobs in deprived areas; and the same amount believed that two corner shops in a country village should be allowed to fix prices if they choose (*see Fig. 1*).

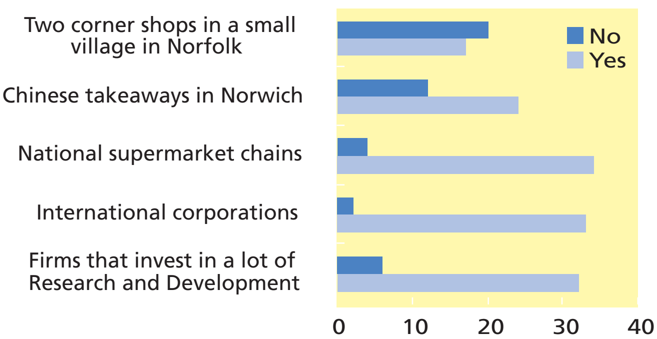
These findings suggest that audience members' conviction that price fixing is wrong may be very sensitive to social issues which can be affected by cartels and the laws enforced against them. Protecting jobs and small village shops appears to be more important than punishing collusion. This perhaps demonstrates affection for "the little guy", particularly in contrast to significant intolerance of price fixing by supermarket chains.

The majority of those questioned believed that the appropriate penalty for firms involved in price fixing should be at least equal to the illegal profits earned by the cartel. Only 6 questioned believed that high fines and imprisonment of individuals was appropriate and, interestingly, a quarter of those questioned felt that merely naming and shaming was appropriate. The former may suggest that people view imprisonment as an excessive sanction for collusion. The latter may reflect a misperception that price fixing will only affect end customers, whereas in reality, cartel cases prosecuted by the European Commission typically concern upstream producers whose customers are other firms. Many of these firms have no alternative but to continue buying from the same companies after the cartel is exposed due to non-substitutability.

After presenting the results of the survey to the audience at the end of our BA event we asked them whether their opinions and attitudes were changed by the information and discussion presented during the two hours. The overwhelming consensus was that their attitudes towards cartels were very much hardened by what they learned during the event. A number of audience members commented on being particularly appalled by the extracts of the FBI lysine video which showed top level management from the colluding firms mocking both enforcement authorities and customers. However, audience members were not swayed in their attitudes towards social issues such as protecting jobs and small businesses, and stood by their original answers.

We found the results of this survey very encouraging and plan to carry out a more academic survey on a much larger sample size sometime in the near future. We look forward to discovering whether the results of the pilot survey are confirmed, and to researching in more detail the policy implications that any results will have for cartel enforcement.

Figure 1 Do you think the law banning price-fixing should apply to the following?



[1] Those presenting were Morten Hviid (Law), Steve Davies (Economics), Matt Olczak (Economics) & Andreas Stephan (Law)

[2] The options ranged from 'parking on a double yellow line' to 'murder'.