



**DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS
DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY**

**COM/DAFFE/DSTI/CP/WD(2003)90
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INTERFACE OF COMPETITION AND CONSUMER POLICIES

-- Note by the US Federal Trade Commission --

This note is submitted by the US Federal Trade Commission FOR DISCUSSION at the joint meeting of the Competition Committee and the Committee on Consumer Policy on 16 October (starting at 3 mp).

JT00150898

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1. We appreciate the opportunity to submit this paper in preparation for the upcoming joint session of the OECD Competition Committee and OECD Committee on Consumer Policy. We believe it is important for delegates of the two Committees to have an ongoing dialogue because competition policy and consumer protection policy share a common goal: enhancing consumer welfare.

2. Competition policy and consumer protection policy are key to the American economic system. These disciplines should enhance consumer welfare by fostering a vigorous, competitive marketplace that gives consumers greater choice and leads to greater availability of products with the qualities desired by consumers at the lowest prices. Strong competition benefits consumers by encouraging new market entrants and creating incentives for innovation. It also benefits consumers by motivating sellers to provide more truthful, useful information about their products and driving them to fulfil promises concerning price, quality, and other terms of sale.

3. At the same time, robust competition alone is not enough to maximize consumer welfare. Consumer willingness to participate in the marketplace also depends on their confidence in a marketplace that is safe and will provide them with value. Whether these conditions exist in turn depend on the ability of institutions to enforce the basic rules governing transactions, and on the ability of consumers to make informed choices. For example, consumer decisions may be affected by deceptive or incomplete information that even a competitive marketplace will not completely deter. Consumer protection policy should work to ensure that consumers are empowered to participate in the marketplace by enabling them to make well-informed decisions about their choices with confidence that sellers will fulfil promises about the goods and services they offer. In short, fraud and deception, if unaddressed, may diminish the value to consumers of the choices that competition provides.

4. This submission will first discuss how we believe the intersection between competition and consumer protection policy should work. We will then illustrate this intersection using three examples: comparative advertising, price advertising, and globalization of markets.

I. Intersection Between Competition and Consumer Protection in the United States

5. Consumer assessment of market conditions is based largely on three elements.¹ The first is competition based on free enterprise. The second is consumers' ability to take advantage of a legal structure of contract, property, and other private law that largely focuses on the relative rights of particular parties. The third element is consumers' ability to rely on public agencies entrusted to promote consumer welfare by preserving competition and protecting consumers.²

A. Competition

6. Competition presses producers to offer the most attractive array of price and quality options possible. In competitive industries, the imperative to gain new sales by satisfying consumer needs increases the choices available. In competitive markets, when consumers dislike the offerings of one seller, they can turn to others. This ability to shift expenditures imposes a rigorous discipline on each

¹ Part I of this paper is based on a recent speech given by Chairman Timothy Muris of the U.S. Federal Trade Commission (FTC) before the Progress and Freedom Foundation in Aspen, Colorado. See Timothy J. Muris, Remarks before the Aspen Summit, Cyberspace and the American Dream, Progress and Freedom Foundation (August 19, 2003).

² In the United States, such agencies include the U.S. Federal Trade Commission, the Antitrust Division of the Department of Justice, parts of the Food and Drug Administration, many state attorneys general, and local, state, and federal criminal enforcement agencies.

seller to satisfy consumer preferences. Competition does more than simply increase choices for consumers, however. It motivates sellers to provide truthful, useful information about their products and drives them to fulfil promises concerning price, quality, and other terms of sale. Consumers can punish a seller's deceit or failure to fulfil a promise by voting with their feet - and their pocketbooks. This punishment is usually swift for sellers of products purchased frequently whose qualities purchasers can readily evaluate.

7. For products purchased infrequently, for which an individual consumer cannot usually rely on personal experience to evaluate a seller's truthfulness, private institutions can help provide the information that augments or substitutes for such experience. For example, third-party evaluations, such as Consumer Reports or Test d'Achats magazine, provide information on cars and appliances, which an average consumer may buy once every five, ten, or even twenty years. In addition, rivals may emphasize the gap between a competitor's promises and the product it delivers. Reputation is also important to sellers, and items like company brands and logos implicitly convey quality and other important product information.

8. Sometimes robust competition alone will not punish or deter seller dishonesty or renegeing. For products called "credence goods," consumers cannot readily use their own experiences to assess whether the seller's quality claims are true. Typical consumers know whether a food product "tastes great;" they cannot judge whether consuming the same product reduces the risk of cancer or whether the cost of a car repair included items not necessary to restore the vehicle to its full capacity. Private rating systems help. The concern of national firms that their reputations would be severely damaged through exposure of deceit or fraud also helps. Nevertheless, when information is costly to produce and to use, these market mechanisms will not correct all problems. Moreover, in certain circumstances, competing firms may not have strong incentives to identify their rivals' misrepresentations if it would highlight a deficiency common to all such products.

9. For credence goods, the market may not identify and discipline a deceptive seller because the product's qualities are so difficult to measure. Legitimate companies care about how consumers regard them. They count on repeat business and word-of-mouth endorsements to increase sales. By contrast, the commercial thief loses no sleep over its standing in the community and is unconcerned about repeat business. Those committing fraud cheat consumers, grab the revenues, and disappear from sight, often to re-emerge in another guise to steal again.

10. When market forces cannot overcome these threats to consumer welfare, *e.g.*, because some sellers are unconcerned about repeat business and reputation or because deception is difficult to detect because of information asymmetries, there are other ways to regulate exchanges. Private legal rights not only complement the competitive market but can also overcome, or at least mitigate, some of these market problems.

B. *Private Legal Rights*

11. One of the crucial roles for government is to define and allocate property rights. Courts and government agencies can both be useful in defining and protecting those rights. The triad of property, contract, and tort law provide a basic set of legal rules permitting ownership, voluntary transference, and protection from involuntary transactions.

12. One of the most useful roles for the government is to provide what are called default rules -- terms that apply when the parties do not explicitly specify otherwise. The more efficient these rules, the greater the scope for exchange and thus the greater the gain in consumer welfare. When contracts are formed, even in the most complex transactions, parties do not find it useful to define the terms for every

contingency possible. Many of these rules of exchange are so basic - for example, rules against fraud, breach of contract, and deceptive advertising - that we do not even think about them as rules at all.

13. Market factors, such as a business's concerns about repeat business and reputation, can augment the effectiveness of legal rules of exchange and overcome some of the incentives a seller might otherwise have to dishonour its agreements. In return, legal rules of exchange can complement the operation of the market. For example, having a judicial remedy reduces the risk of engaging in a transaction with a new entrant to a market, allowing the transaction to take place at lower cost. This remedy encourages market participants to patronize new entrants, with whom they have not previously transacted business, who have no prior pattern of repeat dealing, and who have not yet established a reputation.

14. In some cases, however, even market forces and legal rules of exchange together may be insufficient to discipline bad actors. One can easily imagine sellers unconcerned about repeat customers or reputation, or who make product claims that are difficult to verify, and who rely on the fact that few injured consumers will undertake the often difficult task of suing to vindicate their rights. When the injury to any individual consumer is small, the costs of seeking redress through the courts – including the value of the consumers' time – will exceed the benefit of the expected remedy. This is especially true when such sellers are adept at concealing assets and avoiding the reach of traditional judicial processes.

C. Public Enforcement Agencies

15. When the ability of private actions to protect consumers' rights falters, as when injury claims are small individually but significant in the aggregate, and market forces are ineffective for the reasons discussed earlier, another institution may overcome these weaknesses and thereby reinforce the effectiveness of competitive markets and legal rules of exchange. Public agencies entrusted to promote consumer welfare by preserving competition and protecting consumers reinforce competition and private legal rights of action in support of the market economy.

16. Our faith in the market is firmly grounded in the principle that free enterprise and competition best guarantee commercial freedom, economic efficiency, and consumer welfare. The United States has chosen antitrust law to provide the governing rules for competition in most sectors of the economy. Competition policy protects consumers, not competitors.³ Antitrust law helps maintain effective competition by prohibiting conduct that unreasonably restricts markets.

17. Consumer protection policy also has a vital role in supporting markets. It helps ensure that consumers can make well-informed decisions about their choices and that sellers will fulfil their promises and not increase sales by lying about their products. Thus, prevention of deception helps consumers in two ways: first, most obviously, by deterring deceptive sellers; and second by making it easier for honest sellers to make credible claims about their products.

18. Loss of sales to a dishonest competitor is not the only harm the dishonest inflict on legitimate businesses. If many sellers lie about their products, a pernicious atmosphere of consumer distrust may develop. Such an atmosphere harms society in several ways. Deceit by one group of sellers may lead consumers to doubt the integrity of an entire industry or to distrust markets generally. Deception by Internet sellers, for example, could discourage consumers from using the Internet to gather information and make purchases. In such a world, truthful sellers must resort to extraordinary measures to persuade

³ See, e.g., *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (noting that federal antitrust laws are designed "for the protection of competition, not competitors") (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

consumers of their honesty. Even if honest suppliers take such precautions to show their trustworthiness, some consumers may avoid purchases that otherwise would improve their well-being. By striving to keep sellers honest, consumer protection policy does more than safeguard the interests of the individual victim - it serves the interest of *consumers* generally and facilitates competition.

19. Under the FTC Act and similar laws enforced at the national, state, and local level, enforcement agencies seek to stop unfair or deceptive acts or practices, thereby helping to reinforce the legal rules of exchange. Simply stated, the core of modern consumer protection policy is to protect consumer sovereignty by attacking practices that impede consumers' ability to make informed choices, such as fraud, unilateral breach of contract, and unauthorized billing. As discussed above, resort to courts for enforcement against harmful consumer transactions often does not work well when many consumers suffer small injury. While private class actions can provide some relief for class members, public enforcement action can be undertaken in the interest of all consumers, free from the conflicting incentives in current class actions. In addition, administrative agencies like the FTC have developed areas of expertise, such as interpreting implied claims in advertising, that provide an advantage over courts when ruling on consumer matters involving certain complex issues. The Commission also can go beyond enforcing a particular contract provision to provide "rules of the game" that reduce consumer harm in the future. The Commission can establish new default rules and procedures for transference of rights when it is otherwise difficult to do so.

II. Examples of the Intersection of Competition and Consumer Protection

A. Comparative Advertising

20. Comparative advertising provides a clear example of how advertising can implicate both competition and consumer protection issues. A company engages in comparative advertising when it claims that its own product is superior in price or other attributes to the products of its competitors, *e.g.*, "A is 10% cheaper than B," or "Brand X has fewer calories than Brand Y." Up until the late 1970s, many trade associations in the United States prohibited or discouraged the use of comparative advertising.

21. In 1979, after conducting an extensive study, the FTC concluded that:

Comparative advertising, when truthful and non-deceptive, is a source of important information to consumers and assists them in making rational purchasing decisions. Comparative advertising encourages product improvement and innovation, and can lead to lower prices in the marketplace.⁴

22. Because truthful comparative advertising has such a positive effect on competition and consumers, the FTC announced that it will "scrutinize carefully" restrictions upon its use.⁵ Most trade associations no longer impose limits on comparative advertising.

23. A similar evolution has taken place in the European Union. Many years ago, national advertising regulation ranged from outright prohibition of comparative advertising to widespread acceptance. After a long debate, the European Commission adopted a directive that set a minimum standard for comparative

⁴ FTC Policy Statement in Regard to Comparative Advertising, 16 C.F.R. § 14.15(b) (2003); *see also* R. Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 Harv. L. Rev. 661, 671 (1977) (discussing the advantages to consumers and competition that flow from comparative advertising).

⁵ FTC Policy Statement in Regard to Comparative Advertising, 16 C.F.R. § 14.15(b) (2003).

advertising throughout the EU.⁶ This Directive permitted a broader range of comparative advertising claims, with the European Commission stating that, if the conditions in the Directive are met, “this will help demonstrate objectively the merits of the various comparable products.”⁷ The European Commission further recognized that “comparative advertising can also stimulate competition between suppliers of goods and services to the consumer's advantage.”⁸ Thus, the benefits of comparative advertising to competition and consumers have been well articulated on both sides of the Atlantic and incorporated into advertising law and policy.

B. Price Advertising

24. Price advertising is another example of the intersection of competition and consumer protection issues. Truthful price advertising benefits competition and consumers. It gives consumers bargaining power by allowing them to shop around for the lowest prices. It can encourage firms to decrease prices to compete for consumers. This is true not only of advertising based on direct comparison of prices, but also of various types of innovative price advertising, such as advertising of sales, discounts, rebates, “buy-one, get one free” programs, etc.

25. The United States believes that prohibitions on truthful, non-deceptive price advertising undermine both competition and consumer protection. Indeed, the Federal Trade Commission has taken action against trade associations and state agencies for prohibiting professionals from making truthful claims about prices. For example, in the 1980s, the FTC took action against the Massachusetts Board of Optometry, a state agency, for prohibiting optometrists from truthfully advertising discounts from their usual prices and fees. The Commission alleged that this prohibition injured consumers by depriving them of truthful information about optometric prices and fees and by denying them the benefits of vigorous price competition. The Commission further charged that the alleged anticompetitive practices caused some consumers to pay higher prices for optometric services, to delay or forgo needed optometric services, or to purchase optometric services that were less desirable to them than those they would have purchased in the absence of the practices.⁹

26. The benefits of truthful price advertising have been discussed in the European Commission's Proposal for a Regulation on Sales Promotion, which specifically addresses the benefits of sales promotions.¹⁰ According to the Explanatory Memorandum accompanying the Proposal,

⁶ Directive 97/55/EC of European Parliament and of the Council of 6 October 1997 amending Directive 84/450/EEC Concerning Misleading Advertising so as to Include Comparative Advertising, (OJ L 290, 23.10.1997, p. 18), available at <http://europa.eu.int/eur-lex/en/consleg/pdf/1997/en_1997L0055_do_001.pdf>. Under the directive, comparative advertising must be permitted if certain minimum conditions are met, including that it not be misleading; that it compares goods and services intended for the same purpose; that comparison be based on material, relevant, verifiable, and representative features; and that it does not create confusion about matters such as trade names or trademarks and does not discredit, denigrate, or take unfair advantage of them.

⁷ *Id.*, Preamble, ¶ 12.

⁸ *Id.*

⁹ *Mass. Bd. of Registration in Optometry*, 110 F.T.C. 549 (1988).

¹⁰ Amended proposal for a Regulation concerning sales promotions in the Internal Market, COM (2002) 585(01) (October 2002).

The use and communication of sales promotions contribute to the growth and development of all businesses in the Community; they are particularly important tools for small and medium-sized enterprises who rely on such affordable practices as inputs and outputs to develop their cross-border activities; such promotions therefore stimulate competitiveness in the European economy and accordingly allow consumers to benefit from greater choice and competitive prices.¹¹

27. Similarly, the Communication from the Commission introducing the Proposed Regulation states that

As regards distortions in competition, certain general bans on types of sales promotions may give rise to appreciable distortions of competition. For example, the fact that premiums are prohibited in some Member States and authorised in others prevents certain businesses, notably in the area of direct marketing, from entering these markets, with considerable repercussions on the competitive conditions for undertakings associated with such operations.¹²

28. Conversely, the pitfalls associated with lack of price advertising have been pointed out in a recent study conducted by the U.K. Office of Fair Trading on competition in the dentistry industry.¹³ The study reported that, among problems that the U.K. Consumers' Association identified with the dentistry industry were lack of price transparency, a failure of competition and little impact from new entrants to the market to trigger greater competition.¹⁴ According to the Consumers' Association, "poor price transparency may encourage potentially unnecessary treatment, or treatment that is of higher or lower quality than the consumer would wish, since it limits the consumer's ability to judge the cost of treatment, and so make an informed purchase choice."¹⁵ As a result, the report recommended that dentistry practices provide more transparent and accurate pricing information to consumers.

C. Globalization of Markets

29. The intersection between competition and consumer protection is further illustrated at the international level. The emergence of new technologies, especially global communication systems, has changed the marketing landscape. Today, we see satellite networks broadcasting advertisements around the world, with operators waiting to take orders in the caller's own language. Telemarketers have long routinely called U.S. consumers from Canada and are now doing so from such locations as Ireland, India, and the Philippines. Most significantly, in many markets the Internet is transcending national borders.

30. International consumer protection policy should encourage robust competition. To this end, international convergence of consumer protection rules is especially important. Greater consistency among consumer protection rules will reduce compliance burdens for businesses selling internationally. In particular, the more commonality among different consumer protection regimes, the less burdened

¹¹ *Id.*, Preamble, ¶ 2.

¹² Communication from the Commission on Sales Promotions in the Internal Market, COM (2001), 546 Final, at 6.

¹³ Office of Fair Trading, *The Private Dentistry Market in the U.K.*, March 2003, available at <www.oft.gov.uk/Market+investigations/Investigations/dentistry.htm>

¹⁴ *Id.* at 1.1.

¹⁵ *Id.* at 4.47.

merchants are in complying with different, and potentially conflicting, rules. Indeed, the European Commission recently found that 68% of businesses it surveyed agreed that harmonization of national consumer protection regulations would make cross-border advertising within the European Union more efficient.¹⁶ A study by the European Mail Order Trade Association found that five of the top ten barriers to selling across borders related wholly or in part to differences in national rules on commercial practices.¹⁷

31. More consistent consumer protection rules internationally also benefit consumers by ensuring that they have more choices. Inconsistent rules can drive businesses from the marketplace, or create barriers to their entry in the first place, thus reducing consumer choice. Because there will be more competition with better rules, consumers should also benefit from lower prices.

32. For these reasons, the development of international consumer protection policies is a priority. We believe that the convergence of international consumer protection rules should take place along the same lines that convergence among competition rules took place in recent years. Convergence in the antitrust area was based on a convergence in economic thinking. A consensus began to emerge that competition was good for economic efficiency and, by implication, for consumer welfare. We believe a similar convergence can take place regarding the economic underpinnings of consumer protection policy.

33. As with consumer protection in general, we believe the first priority of an international consumer protection program should be combating fraud. Indeed, as our *domestic* efforts have become more effective, scam artists have recognized that consumer protection enforcement agencies and their foreign counterparts face significant obstacles in trying to fight *cross-border* fraud. Increasingly, scam artists take advantage of these law enforcement difficulties by using facilities in one country to target consumers in others. In 2000, 11% of consumer complaints reported to the Federal Trade Commission involved cross-border fraud; by 2002, the number of cross-border fraud complaints had risen to over 14%.¹⁸

34. Fraud harms any economy, even a well-established one. In emerging markets, the damage of fraud may be even greater. It is bad enough that consumers suffer out-of-pocket losses. In a transition environment, fraud can undermine consumer confidence amid the uncertainty that often accompanies the abandonment of central planning. The inability of Albania, for example, to address effectively the pyramid schemes that masqueraded as legitimate investments led to the fall of the government and a was serious setback to market reforms.¹⁹ Unless a nation visibly and effectively suppresses seller deceit, consumers may perceive that in a market system commercial dishonesty is the norm, not the exception.

35. A major advantage of having competition and consumer protection officials work closely together is that work in one area can benefit from the expertise gained in the other. For example, years ago, governments saw that international cartels cause grave economic harm. To address this problem,

¹⁶ European Opinion Research Group EEIG and EOS Gallup Europe, *Public Opinion in Europe: Views on Business-to-Consumer Cross-Border Trade*, 57.2 Eurobarometer 52 (Nov. 14, 2002).

¹⁷ Proposal for a Directive of the European Parliament and of the Council Concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, Extended Impact Assessment at ¶ 1.4, available at <http://europa.eu.int/comm/consumers/cons_int/safe_shopping/fair_bus_pract/impact_assesment_en.pdf>

¹⁸ For complete statistics on the growth of cross-border fraud, see <<http://www.consumer.gov/sentinel>>.

¹⁹ E.g., Radio Free Europe/Radio Liberty, Albania, *Pyramid Schemes Common Across Eastern Europe* (Jan.16, 1997), available at <<http://www.rferl.org/nca/features/1997/01/F.RU.970116172653.htm>>. Chris Jarvis, *The Rise and Fall of Pyramid Schemes in Albania*, 47 I.M.F. Staff Papers No. 1 (2000), available at <<http://www.imf.org/external/pubs/ft/staffp/2000/00-01/jarvis.htm>>.

competition agencies realized they had to work together, on a bilateral and multilateral basis, to fight the proliferation of international cartels. Competition authorities endorsed an OECD Recommendation against hard-core cartels.²⁰ This step, among others, encouraged legislative reform and spurred enforcement by myriad jurisdictions, and improved cooperation and information sharing among enforcement authorities.

36. In consumer protection, the rise of cross-border fraud necessitates similar cross-border cooperation. In cross-border fraud cases, we face many of the same challenges we faced in our international cartel program at its inception. To stem the tide of cross-border fraud, we can borrow many tools used to enhance international cooperation against hard-core cartels and other anticompetitive practices. These tools include legislation to allow greater cooperation and information sharing, increased enforcement cooperation, more bilateral agreements, and more multilateral initiatives. A prominent example of an initiative in the cross-border fraud area that tracks our work in the anti-cartel area is the OECD Guidelines on Protecting Consumers From Fraudulent and Deceptive Practices Across Borders.²¹ Just as the OECD Recommendation on Cartels set forth a commitment to enforce anti-cartel laws, the Guidelines express a commitment among OECD member countries to cooperate on combating fraudulent and deceptive practices. In the United States, we have begun to implement these Guidelines to ensure that the FTC has the tools it needs to combat cross-border fraud. In June, the FTC proposed legislation to Congress that would make it easier for it to share information and cooperate with its counterparts abroad.²²

III. Conclusion

37. We believe that competition and consumer protection policies should work toward the same goal of improving consumer welfare. There may be multiple ways to ensure that competition and consumer protection policy work together. Experience has shown it beneficial not only to use this approach but also to combine both the competition and the consumer protection functions in a single public institution. Our experience at the Federal Trade Commission suggests several synergies from this arrangement, as illustrated in the examples set forth in this paper. We welcome further discussion of these and other topics at the upcoming Joint Meeting of the OECD Competition Committee and Committee on Consumer Policy.

²⁰ Recommendation of the Council Concerning Effective Action Against Hard Core Cartels, OECD C(98)35 (1998).

²¹ OECD Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices Across Borders, C (2003)116 (June 2003), *available at* <<http://www.oecd.org/sti/crossborderfraud>>.

²² *See* S. 1234, 108th Cong. (2003); H. 3143, 108th Cong. (2003).