

# Competition policy and the issue of fairness

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## Context and background

In the UK, regulators, policy makers, competition authorities and consumer interest groups have shown growing concern about the perceived “unfairness” of certain markets in recent years.

Predominantly, this perceived unfairness relates to the distributional impact of price discrimination, with the variation in prices paid and/or service levels received by different groups of consumers, with the same cost to serve, being increasingly characterised as “unfair”.

## What has prompted this concern regarding price discrimination?

Largely, the increase in concern regarding price discrimination has been caused by rapid technological advances, and the commercial opportunities presented by big data as a result.<sup>1</sup> These advances have given firms an ever-increasing ability to gather and process far greater quantities of personal information about their existing and prospective customers.

Such information can be used to set highly personalised pricing—allowing firms to come ever closer to achieving what was conventionally perceived as an unrealistic concept of “perfect” price discrimination (i.e. pricing to each individual consumer’s willingness to pay).

Due to this, for the same product or level of service, there are a far wider set of prices offered by any individual provider to consumers than had previously been possible. This is the case across a number of markets, but particularly in the mobile, broadband, cash savings, home insurance and mortgages markets.<sup>2</sup>

As a result, regulators and competition authorities are only more recently having to think carefully about the implications of a level of price discrimination that was hitherto impossible.

## What are the key concerns?

Setting aside the fact that companies gathering and using far greater quantities of personal data to set these prices raises its own ethical debate,<sup>3</sup> in and of itself, price discrimination is not necessarily unfair, and can lead to a range of positive consumer outcomes.

For instance, in circumstances where there is a high level of consumer engagement in the market, price discrimination can result in lower average prices overall. This is the case when market characteristics are such that there is strong competition on both: (i) the introductory rates offered to new customers, to succeed in attracting new business; but also (ii) the prices offered to longstanding customers, in order to prevent them from being enticed by a rival firm’s introductory rates.<sup>4</sup>

In addition, price discrimination can provide a greater number of consumers with access to a particular product or service, by offering a lower price than they otherwise would have had to pay under a uniform pricing structure.<sup>5</sup>

However, some are concerned that consumer engagement in markets is often insufficient to realise lower average prices overall, with firms able to charge increasingly high prices to longstanding customers unlikely to switch to a competitor. In this case, not only does the market fail to benefit from lower average prices than under a uniform pricing structure, but it is also often a firm’s most “loyal” customers getting the worst deals; being subjected to what is termed the “loyalty penalty”.<sup>6</sup>

Further, the argument that price discrimination delivers increased market access rests on the assumption that those consumer groups who are worse off are paying the lower prices, benefitting from cross-subsidisation by wealthier groups who pay more. Unfortunately, it is not always the case that those groups paying more are the ones considered to be able to afford it. In certain cases, such as in the UK General Insurance market, there is some evidence to suggest that consumers identified as vulnerable are in fact paying higher margins for home insurance than others.<sup>7</sup>

Ultimately, price discrimination necessarily means that certain customers pay higher prices than others, despite having the same cost to serve. The greatest level of concern regarding the fairness of price discrimination appears to have been shown when it is these “loyal” or vulnerable groups paying the higher prices, and particularly, when the good or service in question is considered “essential”.<sup>8,9</sup>

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<sup>1</sup> Financial Conduct Authority, “Price discrimination and cross-subsidy in financial services: Occasional paper No.22” (September 2016), p.5.

<sup>2</sup> Citizens Advice Bureau, “Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority” (28 September 2018), pp.9–10.

<sup>3</sup> The Geneva Association, “Big Data and Insurance: Implications for Innovation, Competition and Privacy” (March 2018), p.11.

<sup>4</sup> Financial Conduct Authority, “Price discrimination and cross-subsidy in financial services: Occasional paper No.22” (September 2016), p.18.

<sup>5</sup> Financial Conduct Authority, “Fair Pricing in Financial Services: Discussion Paper 18/9” (October 2018), para.3.3.

<sup>6</sup> Citizens Advice Bureau, “Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority” (28 September 2018), p.2.

<sup>7</sup> Financial Conduct Authority, “General insurance pricing practices: Interim Report, Market Study MS18/1.2” (October 2019), para.6.45.

<sup>8</sup> Financial Conduct Authority, “Fair Pricing in Financial Services: Discussion Paper 18/9” (October 2018), fig.1.

<sup>9</sup> Ofcom, “Making communications markets work well for customers: A framework for assessing fairness in broadband, mobile, home phone and pay TV” (January 2020), fig.1.

## What is being done about this?

Growing concern for these “loyal” (or disengaged) and vulnerable consumer groups has prompted a flurry of action in the UK.

In particular, the UK has seen the publication of the Citizen’s Advice Bureau’s (CAB’s) super-complaint in 2018, calling the Competition Markets Authority (CMA) to action to “protect people from being ripped off” and “penalised for their loyalty” across five distinct UK markets.<sup>10</sup>

Now, multiple sector regulators, namely the Financial Conduct Authority (FCA) and Ofcom, are considering intervention on fairness grounds alone.<sup>11,12</sup> Other regulators, such as Ofgem, have already imposed price cap protection to protect disengaged consumers from being overcharged.<sup>13</sup>

In addition, the UK’s Competition and Markets Authority (CMA) has put forward proposals to extend its powers, beyond a statutory duty to promote competition, towards an overriding consumer interest duty,<sup>14</sup> in order to allow swifter intervention in cases of perceived unfairness, regardless of whether the market suffers from a competition problem.

## Complications in moving forward

There are however multiple complications that mean intervening on the grounds of fairness alone are both contentious in the first instance, and complex to implement in practice.

First, fairness in and of itself is a contested concept, and it is therefore not immediately clear what a fair outcome would, or should, look like. This makes it difficult to both define the desirable outcomes any intervention is aiming at, but also to appraise the intervention after the event.

In particular, the potential remedies proposed to correct for fairness take two general forms: (i) transparent information policies designed to help consumers understand that a better deal may be available to them; and (ii) more interventionist remedies that directly limit the level of price discrimination firms can engage in.<sup>15</sup> While the former may overwhelm and/or further confuse consumers<sup>16</sup>; the latter could result in welfare transfers between different customer groups (particularly in a competitive market), and effectively, lead to a redistribution. Given the lack of clarity regarding what a fairness looks like, it is not immediately clear what makes this redistribution between consumer groups “fairer”.

Secondly, any intervention to correct for fairness could also have an effect on the overall competitiveness of the market, with longer-term implications for consumer welfare.

These issues raise the following questions, which must be answered in order for the regulators to find an appropriate solution going forward: (i) what is fairness, and therefore, what would a fairer outcome or distribution look like? and (ii) should a duty for fairness come first and foremost above promoting competition? In other words, is it acceptable to intervene to the detriment of competition, but for the benefit of fairness?

While these questions are far too complex for the answers to be found here, the remainder of this article looks to unpick the detail of these questions and set out what further discussion needs to be had in order to effectively answer them.

## What would a “fairer” outcome, or distribution, look like?

Turning to the first question, this section briefly delves into the concept’s philosophical underpinnings, to shed light on what it is we are really searching for in the pursuit of fairer outcomes for consumers. This understanding may better help intervention design and appraisal moving forward.

## What is “fairness” anyway?

While *procedural fairness* concerns the *process by which the allocation of a scarce resource, burden or responsibility is decided upon*; i.e. a firm’s conduct; *distributive fairness* concerns the *welfare distribution resulting from the process*, or in other words, the actual prices charged and who ends up paying what. As such, when assessing the fairness of price discrimination, we are appealing to notions of distributive fairness.

Dating back to Aristotle, philosophers, economists and lawyers have attempted to build a comprehensive set of universal principles that underpin, and truly capture, the essence of distributive fairness. Despite lengthy debate, consensus remains out of reach.

Therefore, although failing to provide a clear definition of what a fair distribution looks like, the literature does instead make clear that there are a variety of contrasting perspectives on the matter.

<sup>10</sup> Citizens Advice Bureau, “Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority” (28 September 2018), pp.9–10.

<sup>11</sup> Financial Conduct Authority, “General insurance pricing practices: Interim Report, Market Study MS18/1.2” (October 2019), para.1.9.

<sup>12</sup> Ofcom, “Making communications markets work well for customers: A framework for assessing fairness in broadband, mobile, home phone and pay TV” (January 2020), para.1.4.

<sup>13</sup> Ofgem, “Decision – Default tariff cap – Overview document” (November 2018).

<sup>14</sup> Please see Letter from Andrew Tyrie, CMA Chair, to the Secretary of State for Business, Energy and Industrial Strategy (February 2019), p.9. Available at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/781151/Letter\\_from\\_Andrew\\_Tyrie\\_to\\_the\\_Secretary\\_of\\_State\\_BEIS.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/781151/Letter_from_Andrew_Tyrie_to_the_Secretary_of_State_BEIS.pdf) [Accessed 6 May 2020].

<sup>15</sup> For instance, the FCA has put forward a number of possible remedies to reduce the harm caused by price discrimination in the market for general insurance, from “restricting or banning margin optimisation based on consumers’ likelihood of renewing”, to “requiring firms to engage with customers to give them information about alternative deals”. Please see Financial Conduct Authority, “General insurance pricing practices: Interim Report, Market Study MS18/1.2” (October 2019), p.7.

<sup>16</sup> P. Siciliani, C. Riefa and H. Gamper, *Consumer Theories of Harm: An Economic Approach to Consumer Law Enforcement and Policy Making* (Hart Publishing, 2019), Ch.2.2.

## The current regulatory debate is anchored to one particular perspective of fairness

The current regulatory debate is coloured by the perspective that vulnerable and loyal (or disengaged) customers are paying more than other groups is unfair.

However, there are a plethora of other theories that would not necessarily take this stance. For instance, luck egalitarianism is the perspective that a fair distribution is an equal distribution, *unless individuals themselves are responsible for receiving more or less*.<sup>17</sup> As such, from this perspective, the fact that disengaged consumers who do not shop around receive a worse deal than engaged consumers, is fair.

On the other hand, strict egalitarianism posits that *fairness is characterised by an exactly equal distribution*, and therefore fundamentally disagrees with the practice of price discrimination.<sup>18</sup>

Under this view, although vulnerable and loyal consumers ought not to be paying more than other groups, they should pay exactly equal to everyone else. As such, what is often viewed as a potential benefit of price discrimination—increased market access through cross subsidisation between wealthier and poorer consumer groups—is viewed as morally egregious.

## How do we know the current perspective colouring the debate is the right one?

It is therefore questionable that the perspective currently underpinning the debate and motivating any potential intervention is the “right” one.

Establishing whether this is the case before implementing any intervention is of utmost importance, as any remedy aimed at correcting for fairness is effectively aiming at an alternative distributive arrangement, where loyal and vulnerable customers have a better outcome. Not only may the outcomes for these groups change, the outcomes for other groups may change too.

This is particularly likely in the case of intervening to alter the pricing structure in competitive markets. Specifically, in markets such as the UK general insurance market, where evidence shows that firms do not benefit from excessive profits,<sup>19</sup> reducing the prices paid (and thus detriment suffered) by vulnerable and disengaged groups will necessarily have the effect of rebalancing this detriment across other consumer groups. In the case of the general insurance market, the detriment to be redistributed amounts to an estimated £750 million.

Depending upon one’s perspective on fairness, any resultant redistribution achieved by intervening could be perceived as either successfully achieving a fairer outcome for consumers, or as making the situation worse.

Finding out whether the perspective currently taken by regulators is the right one, in order to help appraise these outcomes is problematic in itself. One way, proposed by the FCA as a core part of their fairness framework, is to pose the question: “would society view the price discrimination [in question] as egregious/socially unfair?”<sup>20</sup>

Setting aside the complications of practically gathering society’s perception, interpreting it may be even more problematic. First, it is likely that any individual’s views of the fairness of a distribution will be coloured by the outcome they are expected to obtain under such a distribution. This is precisely why influential philosopher John Rawls proposed that reaching a view on distributive justice requires the principles underpinning it to be “chosen behind a veil of ignorance”, so as to ensure that “no one is able to design principles to favor his particular condition”.<sup>21</sup> As such, any public opinion gathering exercise would be plagued by biases.

Secondly, and possibly unsurprisingly, people’s perspectives of fairness have been shown to change over time. For instance, it has been found that a significantly smaller proportion of respondents to the European Social Survey would class large differences in income acceptable to reward talents and efforts in 2016, than did in 2008.<sup>22</sup> This shows a current trend towards a strict egalitarian, as opposed to luck egalitarian, view. This has the implication that, any intervention to correct for fairness now may become outdated in future, as society’s perceptions change to favour an alternative arrangement.

Ultimately, it is clear that we need to gain more clarity than “we’ll know fairness when we see it”, in order to achieve a more structured approach to designing and appraising any proposed remedies.

## Should fairness concerns trump competition concerns?

Not only could intervention result in a redistribution that fails to satisfy consumers as being “fair”, but it could also create a number of other inefficiencies.

Namely, and as mentioned before, this issue of unfairness has been raised in competitive markets. Intervening in an otherwise competitive market on the grounds of fairness could have negative effects on competition. Once again, this is particularly the case if intervention takes the form of altering current pricing structures.

<sup>17</sup> G. Elford, “The Coherence of Luck Egalitarianism” (2017) 20 *Ethical Theory and Moral Practice* 617.

<sup>18</sup> J. Lamont and C. Fodor, “Distributive Justice” in E.N. Zalta (ed.), *The Stanford Encyclopedia of Philosophy* (Stanford University, 2017), please see: <https://plato.stanford.edu/archives/win2017/entries/justice-distributive/> [Accessed 6 May 2020].

<sup>19</sup> Financial Conduct Authority, “General insurance pricing practices: Interim Report, Market Study MS18/1.2” (October 2019), para.5.68.

<sup>20</sup> Financial Conduct Authority, “Fair Pricing in Financial Services: Discussion Paper 18/9” (October 2018), fig.1.

<sup>21</sup> J. Rawls, *A Theory of Justice* (The Belknap Press of the Harvard University Press, 1971).

<sup>22</sup> The National Centre for Social Research, *British Social Attitudes 36: 2019 Edition* (The National Centre for Social Research, 2019), p.164.

For instance, the FCA acknowledges that intervening to promote an alternative pricing model in the market for insurance “might lead to changes in competition that result in greater harm to more consumers”, since new entrants to the market

“may see introductory offers and price discounts as useful ways to attract customers and build the sort of market share that will allow them to compete effectively with existing providers.”<sup>23</sup>

Limiting the ability of firms to offer such introductory offers and price discounts, and thereby hampering the competitive process, may limit the additional choice, downward price pressure and innovation brought about by potential new entrants, providing consumers with worse long-run outcomes.

If this is the case, and fairness in the short-run can only be achieved to the detriment of competition and long-run consumer outcomes, it begs the question, which should be prioritised? The pursuit of fairness, or competition?

In the UK, the CMA has recently proposed reforms to override its current statutory duty to “promote competition, both within and outside the United Kingdom, for the benefit of consumers”, in favour of a new “consumer interest” duty.<sup>24</sup> This could indicate that the CMA will attach more weight to fairness than it has done in the past.

Fundamentally though, it is not clear that there needs to be this particular trade off. Historically, regulators have tended to focus on issues relating to a firm’s conduct, meaning that only procedural fairness is within their remit. Distributive justice has remained a political concern, with other tools such as taxation at the disposal of government to achieve the desired redistribution of wealth between consumer groups.

Ultimately, if the issue at hand is the concern that vulnerable and disengaged consumer groups ought to benefit from better outcomes across multiple markets, it is not immediately clear that intervention in each of these individual markets by regulators, which may have onerous effects on competition, is in fact the most appropriate solution, and therefore that the remit of regulators ought to change.

## Concluding remarks

It is clear that the issue of price fairness is firmly on the regulatory agenda, and concern only looks to be picking up pace.

However, before the wheels on any intervention are set into motion to tackle it, further scrutiny is required across a number of areas. Only once we have reached a view on the answers to the questions set out here, will we be able to say with any certainty what outcome we are aiming at, and which remedies, if any, are therefore best placed to tackle it.

<sup>23</sup> Financial Conduct Authority, “Fair Pricing in Financial Services: Discussion Paper 18/9” (October 2018), paras 4.24–4.26.

<sup>24</sup> Please see Letter from Andrew Tyrie, CMA Chair, to the Secretary of State for Business, Energy and Industrial Strategy (February 2019), p.9. Available at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/781151/Letter\\_from\\_Andrew\\_Tyrie\\_to\\_the\\_Secretary\\_of\\_State\\_BEIS.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/781151/Letter_from_Andrew_Tyrie_to_the_Secretary_of_State_BEIS.pdf) [Accessed 6 May 2020].