

# **Consumer Law and Economics Workshop**

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**18 August 2016**

# Overview

- The history of Law and Economics
- The law of unintended consequences
- The role of incentives
- The benefits and costs of policy and law
- Principles for good practice regulation
- Limitations of regulation?
- Closing comments

# The history of Law and Economics

- “Many of the great political economists of the past, such as Adam Smith, Jeremy Bentham, John Stuart Mill, and Karl Marx understood the intimate relationship between the configuration of a country's legal system and the configuration of its economy.”: Michael Trebilcock

# The history of Law and Economics (cont.)

- “...beginning in the early 1960s with pioneering articles by Guido Calabresi on tort law and Ronald Coase ...on property rights, followed by prolific writings and a comprehensive text by Richard Posner on a vast range of legal issues, the field of law and economics has burgeoned with many lawyers and economists around the world now exploring the economic implications of almost every aspect of the legal system.”: Michael Trebilcock

# The law of unintended consequences

- A very large amount of the activity of governments, regulators and accountability agencies alike occurs for the right reasons – it is conceived, considered and implemented with unquestionably good intentions.

# The law of unintended consequences (cont.)

- But, not all of that which is designed with good intentions necessarily achieves good outcomes.



# The law of unintended consequences (cont.)

- In an episode of the ABC television program the *Hollowmen*, the Prime Minister has announced a “National Carbon Challenge”. The Prime Minister’s office responds by introducing initiatives to reduce their carbon emissions. After a week of the initiatives being in place, Holly, the Office Unit Manager, hands the results of their work on the “carbon challenge” to Tony, the Principal Private Secretary:

# The law of unintended consequences (cont.)

- Tony: That can't be right?
- Holly: It is, our energy consumption has actually gone up.
- Tony: Up? What happened to low-watt fluoros? What happened to freezing for the last week?



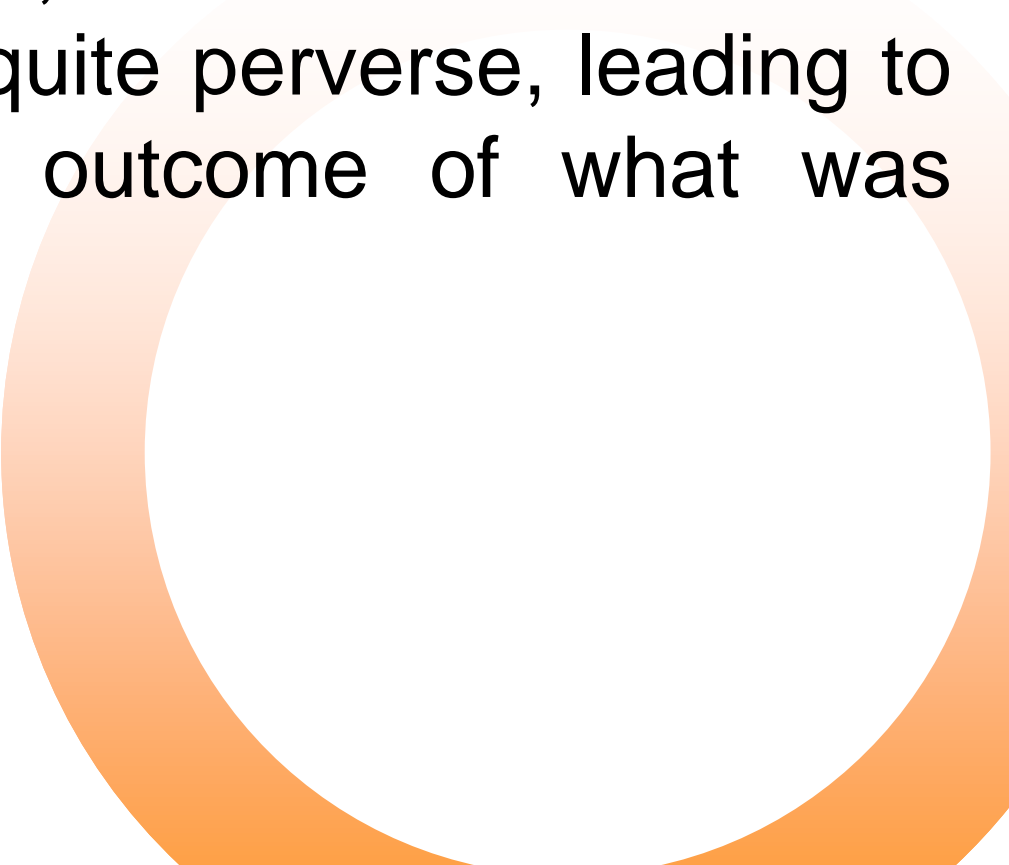
# The law of unintended consequences (cont.)

- Holly: Well it turns out that to get the temperature down to 18 degrees the air conditioning was kicking in ... Which chewed up twice as much power as the heater.
- Tony: So for all of our efforts we've actually managed to increase emissions. Imagine if we ran the country like that.

# The law of unintended consequences (cont.)

- We must be aware that no matter how well-intentioned are our plans, these plans may either (1) not necessarily achieve their desired outcome or (2) have unintended consequences. Sometimes unintended consequences can in fact be desirable.

# The law of unintended consequences (cont.)

- Unfortunately, unintended consequences can also be undesirable, indeed in the worst cases, they can be quite perverse, leading to the exact opposite outcome of what was intended.
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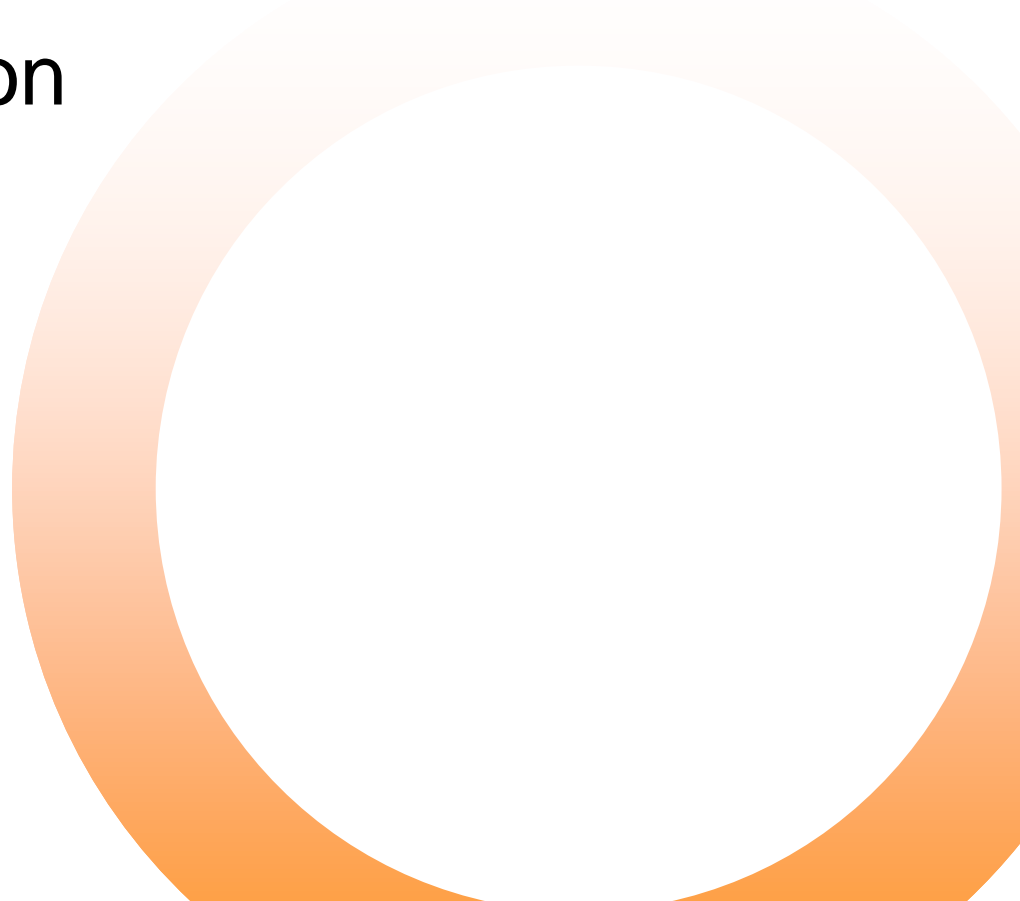
# The law of unintended consequences (cont.)

- Class discussion



# The law of unintended consequences (cont.)

- American Prohibition
- Home Insulation Scheme
- Bank Fees Regulation
- Health Education



# Laws blamed for card rate rises

Jane Searle

Credit card companies have jacked up interest rates by an average of 0.37 of a percentage point since December despite no increases in official interest rates over the same period.

Twenty-one card issuers have raised rates in recent months, according to financial comparison website Infochoice, which said credit card rates of 20.74 per cent were now common.

The increases have been blamed on tougher laws to protect consumers, which came into effect for major banks from January and place greater onus on lenders to assess borrowers' ability to repay debt.

The laws apply to all consumer lending products, including mortgages and personal loans, but major banks have pointed to their credit card operations as the most affected.

As unsecured lending in smaller amounts, credit cards were traditionally subject to less scrutiny than mortgages, but now require far more paperwork.

ANZ Banking Group's chief executive of Australia, Phil Chronican, recently noted that the changes could have the unintended effect of limiting emergency credit access.

"When you enshrine things in legislation rather than codes of practice you don't have a commonsense overlay," Mr Chronican told *The Australian Financial Review*.

"There were questions during the Queensland floods as to whether providing short-term overdrafts to existing customers could be dumb when you were meant to test suitability. "The net effect has been more work [compared with] things which used to be done relatively easily on the basis of previous behaviour or a scorecard."

Additional changes to credit card rules will take effect from next July.



Credit cards have been subject to less scrutiny than mortgages, but now require far more paperwork.

Photo: MICHEL O'SULLIVAN

## Credit isn't cheap

### Recent increases in credit card rates

- |  |         |
|--|---------|
| • Citibank Ready Credit*                       | ▲ 0.50% |
| • Macquarie Visa RateSaver                     | ▲ 0.50% |
| • Commonwealth Bank corporate & business cards | ▲ 0.45% |
| • Bank SA & St George Vertigo MasterCard       | ▲ 0.50% |
| • Community CPS                                | ▲ 1.75% |

The average rate on low-rate cards is now around 13.5% – almost double the average standard variable mortgage rate.

\*Revolving credit line

SOURCE: INFOCHOICE.COM.AU

They will include moves to ban issuers from charging fees when consumers exceed their balance limits by more than 10 per cent, and prevent issuers from making offers of credit limit increases.

The most expensive credit cards include GE Money's 21.74 per cent GO MasterCard and the Citibank Emirates Platinum and Gold MasterCard/Visas at 20.99 per cent, according to financial comparison site RateCity.

Mortgage rates at major banks sit around 7.8 per cent.

Out-of-cycle mortgage rate increases, attributed to higher funding costs, have provoked political outcry, but there has been little scrutiny of other banking product price increases.

Independent credit card analyst Mike Ebstein said new laws were a key driver of credit card rate rises.

"These changes to credit card practices will provide enhanced protection, but at what cost?"

Mr Ebstein suggested a recent rise in mortgage delinquencies reported by Westpac Banking Corporation and ANZ meant a likely rise in credit

card bad debts as well. "It's concerning as it suggests financial distress in a market with near full employment," he said.

The Consumer Action Law Centre's director of policy and campaigns, Nicole Rich, said there had been an increase in people struggling with credit card debt over the past year.

"Generally credit card interest rates are quite high in Australia and not subject to the same competitive discipline as mortgage rates," she said. "You know mortgages are a loan but many people see credit cards as a payment mechanism and shop on features and annual fees – they tend to be too optimistic on their ability to pay cards off."

The introduction of positive credit reporting later this year is expected to help issuers lend more responsibly.

Spokespeople at Citibank, GE Money and Macquarie Bank declined to comment.

# Teenagers don't see enough sun in winter

**CATHY O'LEARY**  
MEDICAL EDITOR

Half of Perth teenagers have low vitamin D levels in winter and another one in 10 are considered deficient, WA researchers have found.

A Telethon Institute of Child Health Research study of almost 1400 teenagers found that in summer, 81 per cent of 14-year-olds had enough vitamin D (more than 75 nanomoles per litre), but in winter this almost halved to 41 per cent.

In winter, half of the teenagers had "insufficient" vitamin D and 9 per cent were classed as deficient.

The findings come ahead of a free public seminar into vitamin D being hosted by the institute tonight.

Vitamin D levels have become a controversial health issue, with some experts saying our increasingly sedentary lifestyle means many people are missing out on the vitamin that is needed to keep bones strong and help ward off asthma, cancer and multiple sclerosis.

But others say it could encourage people to get too much sun.

Professor Prue Hart, who is speaking tonight, said it was important to get the right balance.

"The message we need to give is that there are safe ways to get more sun, or we may need to look at supplements, because so many diseases start in childhood and we know

## VITAMIN D

LEVEL	SUMMER	WINTER
<b>Sufficient</b> >75 nmol/L	81%	41%
<b>Insufficient</b> 50-75 nmol/L	19%	49%
<b>Deficient</b> <50 nmol/L	0%	9%

SOURCE: TELETHON INSTITUTE FOR CHILD HEALTH RESEARCH

that deficiencies start at that time," she said. "But we have to be aware of the skin cancer message.

"It's important to monitor your vitamin D and try to get that optimal level, but it's an individual thing because we all make vitamin D at a different rate."

The Cancer Council Australia's national skin cancer committee chairman Terry Slevin said he was concerned about the confusion on vitamin D.

"We are clear about the effect excessive sun exposure has on skin cancer and problems with chronic vitamin D deficiency but finding a clear middle ground is where the confusion lies," he said. "The last thing I'd like to see is more people getting excessive UV exposure, thinking they are getting a health-giving vitamin D boost."

Anyone wanting to attend the seminar should register by phone 9489 7779 or email [events@childhealthresearch.com.au](mailto:events@childhealthresearch.com.au)

# The role of incentives

- These examples also demonstrate one of the most vital lessons from economics – incentives matter.
- “...the fundamental presumption of neo-classical economics: that economic agents, in all their various activities, *respond to incentives* [original emphasis].”: Michael Trebilcock



# The benefits and costs of policy and law

- Costs might be one-off implementation costs or ongoing compliance costs.
- Similarly, in considering cost, we do need to consider the value that the community places on the various choices that can be made with limited resources.

# The benefits and costs of policy and law (cont.)

- It might not be costly to fix a problem but if the expenditure of money in one area will come at the cost of expenditure in an area more valued by the community, it still may not be desirable.

# Principles for good practice regulation

- Generally, regulatory work is undertaken on a 'no surprises' basis, addresses material problems, is well-targetted and proportionate to the problem identified. Some problems are wide-ranging and deserve similarly wide-ranging solutions. Other problems may be limited or not so serious and the remedy similarly limited;

# Principles for good practice regulation (cont.)

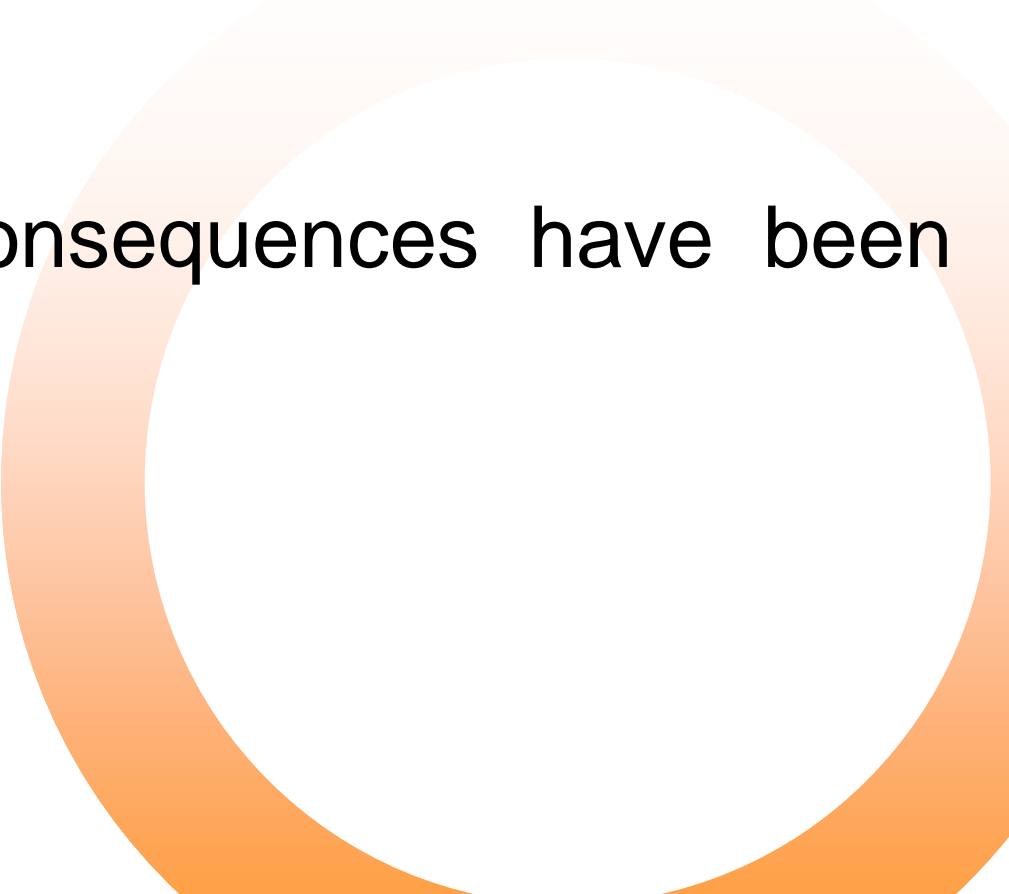
- That there is an evidence base that establishes the need for regulatory activity;



# Principles for good practice regulation (cont.)

- Proposed regulations are the least costly solution to an identified problem;
- The approach taken to work to be done preserves as much as possible positive risk taking, innovation and freedom;

# Principles for good practice regulation (cont.)

- The costs imposed are outweighed by the benefits; and
  - That unintended consequences have been considered.
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- A large, semi-transparent orange circular graphic is positioned in the lower right quadrant of the slide, partially overlapping the text area.

# Limitations of regulation?

- “Neo-classical economists in general attach strong normative value to rules of private exchange and private ordering, and often bring some degree of scepticism to bear on the capacity of collective decision-makers ... to adopt policies or laws that will unambiguously increase net social welfare”:  
Michael Trebilcock

# Limitations of regulation? (cont.)

- “Even when we are quite sure that the market is not working perfectly, the market can be improved upon only if a court or legislature can ban the inefficient terms without also banning the efficient ones. This requires the court to be able to determine whether any given clause is inefficient or not.



# Limitations of regulation? (cont.)

- But a direct analysis of the efficiency of any given clause will often be very difficult, and courts (or other legal institutions) may not be very good at this task”: Richard Craswell

# Closing Comments

- Resources are limited and therefore costs are important. Regulation must be undertaken in this context.
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# Closing comments (cont.)

- There is no such thing as a free lunch  
(Milton Friedman)



# Closing comments (cont.)

- “The statesman who should attempt to direct private people in what manner they ought to employ their capitals would not only load himself with most unnecessary attention but assume an authority which could safely be trusted to no council and senate whatever, and which would nowhere be so dangerous as in the hands of man who have folly and presumption enough to fancy himself fit to exercise it.”: Adam Smith

# Closing comments (cont.)

- “...there could hardly be a more unbearable – and more irrational – world than the one in which the most eminent specialists in each field were allowed to proceed unchecked with the realization of their ideals”: Friedrich Hayek