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Designing A Consumer Policy Framework For Small States

This briefing paper concludes that consumer policies need to temper free market attitudes with specific considerations arising out of the implications of small size, human resource scarcity, excessive vulnerability, inadequate financial and physical resources and social and cultural peculiarities. These considerations also imply that the design of regulatory and enforcement agencies cannot be based completely on that in large or developed economies.

1. Introduction

Consumer concerns in states of all sizes and at all levels of development span wide issues of access, pricing, safety, quality and choice of goods and services. The increasing fluidity of borders and influence of technology means that the design and implementation of a robust consumer policy has become increasingly problematic. However, consumers in small states are particularly affected by limited choice of goods and services, poorer quality and safety of goods produced by larger countries solely for export, unenforceability of manufacturer warranties and lack of availability of repair services and spare parts.

These consumers should be adequately protected and greater attention must be paid to ascertaining whether policy solutions advocated and utilised by larger jurisdictions have equal efficacy in smaller states.

Several definitions of "smallness" have been proffered including population size, measures of economic achievement such as Gross Domestic Product (GDP), composite measures of population, and land area (Crowards, 2002). A competition policy approach looks at a small economy as one that "can support only a small number of competitors in most of its industries" (Gal, 2004).

The population threshold for defining smallness seems the simplest and most useful as the use of the competition approach will cover states with very different levels of economic development. The threshold used by the Commonwealth Secretariat/World Bank Small States Forum of 1.5 million includes over 45 countries and also incorporates states with populations in the range of 1.5-5 million that have similar market and development characteristics (World Bank, 2000).

Smallness impacts the economic as well as the political, legal and socio-cultural environment of a state. Constraints on economic diversification coupled with export dependence and severe human and financial resource constraints lead to economic vulnerability. In addition, small island states are very susceptible to natural disasters and environmental change (World Bank, 2000).

These similarities as well as shared experiences of small states allow general lessons to be drawn for consumer policy prescriptions. It is difficult to disentangle the effects of size from that of the level of development. This paper aims to stimulate a debate on issues relating to the design, implementation and enforcement of consumer protection measures in small developing states.

2. The Relationship of Market Failure to Smallness

Market failures, the primary economic rationale for intervention in consumer markets, are more pronounced in small states where conditions required for free operation of markets leading to welfare maximisation are unlikely to exist include: numerous buyers and sellers in the market with perfect information about products; no barriers to entry or exit from the market; and consumers and producers bearing entirely the respective costs of their production and consumption activities (Scherer, 1990).

Markets in small states, by contrast, are characterised by highly concentrated markets with monopolies (including natural monopolies) and oligopolies, significant barriers to entry, public goods, imperfect information and consumers and producers not bearing the full cost of their respective activities. These factors necessitating regulatory intervention are discussed in detail below.

Impact of Small Markets

The small market size and limited internal market contribute to reduced choices of goods and suppliers and higher prices for consumers. Small states generally support fewer firms as the market usually cannot support a large number of firms operating at the minimum efficient scale of operation. Natural monopolies may also exist for utility services, such as electricity as high overhead costs of these services mean that they cannot be viably supplied by more than one supplier.

The general openness of markets in small states, caused by the physical location of island states, encourages dependence on the imports of goods and services and a lack of effective control by the government. Poor quality of imported goods is also tolerated on the grounds of affordability.

High per unit transport costs caused by the small volume of cargo lead to higher import costs. Large stocks are not bought as they are often difficult to dispose off before the expiry date. Reasonableness of rail and road transport costs for small quantities cannot be exploited by island states which depend on water based transport.

Barriers to entry occur because the high fixed cost of new investment cannot be offset by revenues from large production. This leads to lower competition and poor quality. Domestic markets are often dominated by multi-national corporations (MNCs). The economic power of MNCs also grants them disproportionate bargaining power with governments as the potential effect of their withdrawal from a small economy can be economically and socially devastating.

Public Goods and Other Externalities

Public goods are characterised by "non-rivalry" and "non-excludability", which means an additional person consuming the good does not deprive others of it, and it is difficult to target the consumption of a good to specific individuals. Collective actions taken on behalf of consumers are examples of public goods as consumers benefit regardless of their contributions. Negative (positive) externalities arise where the costs (or benefits) of a consumption or production activity not only accrues entirely to the involved agent but also affect some other party. As the market fails to make people pay for the costs that they impose on society the production of the involved good might not be optimal. These factors are commonly cited in the case for regulatory intervention in consumer markets.

Information Asymmetries

Consumers often possess inadequate information on quality, price or terms of trade. Besides, costs incurred by consumers in searching for information have a significant impact on amount of information gathered. In larger developed countries, information agents, such as magazines and consumer reports provide valuable information. However, country specific product information for small states is largely unavailable due to the high cost of conducting research and the limited available resources.

Information problems are also acute for 'experience' goods, where consumers cannot determine the quality of goods by inspection prior to purchase and there is no commercial incentive to provide improved quality and 'credence' goods where consumers cannot verify the quality of the goods even after purchase, e.g. drugs, legal services etc. The limited capacity of individuals in understanding and processing information is a constraint, which needs to be taken into account while providing information about the market and crafting policy solutions.

3. Competing Analytical Framework for Consumer Protection

A sound analytical framework facilitates the identification of the consumer problem in small states and the targeting of specific objectives. It is critical to consider frameworks that incorporate social justice, equity and fairness in dealing effectively with market failure.

Efficiency Framework

The objective of efficiency-based approaches for consumer policy is to facilitate consumption, which is consistent with consumer preferences, indicated by willingness to pay. Issues of distribution, fairness, respect and community values, which intuitively seem relevant for formulating consumer policy, are neglected (Ramsay, 1984). There is only a limited role for legal coercion or regulation in such approaches.

Market-based solutions, such as using prices as indicators of quality, warranties, voluntary standards and self-regulation are preferred. Intervention to mitigate the effects of imperfect information, such as mandatory disclosure of information in certain circumstances may be allowable; however; intervention must be subjected to cost/benefit analysis (Duggan, 2001). This focus on cost/benefit analysis ignores hard to measure benefits of greater equity in a society that can produce long-term benefits.

Information Framework

Consumer policy measures in several jurisdictions, including the European Community appear to give primacy to information norms over more interventionist measures. This approach looks at preference formation through social conditioning. Interventions to improve information are judged by weighing benefits against the underlying costs.

Information remedies include information on deceptive claims, product labelling and consumer education. Information remedies tend to benefit wealthier and well-educated consumers who will search more effectively, have greater choice and are more likely to use information to pursue individual claims. Social and cultural characteristics of small states, such as the average level of affluence and education and level of trust in regulators must be taken into account in drawing up information mechanisms for the 'average consumer'.

Social Justice Framework

Poverty and social exclusion of consumers provide compelling reasons for consumer protection. Evidence points to high poverty levels and unequal income distribution in small states (World Bank, 2000). This, in turn, results in large disparities in consumption and access to basic services. A social justice framework can be used to incorporate goals of public interest. It may be linked to commitments to provide public education and effect redistribution of income to ensure minimum levels of welfare for all members of society.

Inequality in bargaining power

Inequality in bargaining positions between suppliers and consumers has been historically used to justify consumer protection policies. Consumers are often forced to purchase or contract on the standard terms of large sellers who have advantages in terms of information and experience. In small countries, this inequality of bargaining power exists not only between the domestic consumer and supplier but also between the domestic and foreign suppliers. Remedies include control of standard contracts and provisions that prohibit unconscionable conduct.

Paternalism

Traditional paternalistic approaches assume that policymakers cannot be confident that transactions reflecting present preferences are really in the long-term interest of parties. This approach uses product safety laws, particularly for the safety of children and laws for prevention of over indebtedness.

Rights Framework

The UN Guidelines, adopted in 1985, recognise that consumer policy has a bearing on economic and social development and provide for rights to: (a) satisfaction of basic needs; (b) safety; (c) be informed; (d) choose; (e) be heard; (f) redress; (g) consumer education; and (h) a healthy environment and international cooperation. This rights-based approach also seeks to provide a moral force to acceptable behaviour by recommending 'the right to promote just, equitable and sustainable economic and social development'.

A basic set of consumer rights can be used to overcome the problems that consumers face in establishing the quality of goods by prescribing a set of rights/remedies for consumers with regard to faulty goods. This approach has been explicitly set out in the legislations of some small states. For example, the 2002 Consumer and Competition Law of Papua New Guinea expressly recognises that consumers have the right to safety, choice, consumer education, information, representation and redress.

It must be acknowledged that rights are likely to prove more useful for advocacy than enforcement as these are couched in lofty language which makes their translation into enforceable legislative instruments more difficult.

4. Tailoring Tools to Protect Consumer Interests

Critical analysis ensures that the values adopted in the choice of framework are congruent with those of the receiving society. In framing consumer policies for small developing countries, it is important that the policies also act as a tool for development and are not purely efficiency-based.

From Market-based Solutions to State-backed Regulatory Intervention

Techniques for consumer policy would range from market-based solutions in a competitive market, such as voluntary standards, manufacturer warranties and industry self-regulation to the introduction of regulatory measures, such as prohibitions and bans, labelling requirements, compulsory standards, sanctions and redress mechanisms.

Policy prescriptions favoured by international financial institutions are based on the "Washington Consensus" favouring minimal intervention in markets. In some instances, the necessity of consumer policy is questioned and replaced by a recommendation to utilise competition policy as a tool for protecting consumer welfare. Consumer and competition policy do share some synergies and complement each other; however, competition policy does not provide an adequate solution to consumer issues of health or safety or problems arsing from asymmetry of information between consumers and suppliers.

Similarly, market-based solutions, such as self-regulation through charters and codes of practice will be inadequate because of weak private sector capacity and are unlikely to work effectively. Private law tools, such as contract and tort, criminal law together with public law and administrative controls must be utilised as part of the consumer policy framework. Non-legal tools are also pivotal in the development of an effective regime. Advocacy, education and the development of consumer groups must be encouraged.

The lack of consumer activism may be linked to the nature of politics in small societies, which are characterised by fewer interest groups. The role of civil society will need to be strengthened by incorporating formal consultative committees in statutes, providing funding mechanisms and bringing in traditional social institutions like churches and village communities as partners.

5. Institutional and Enforcement Challanges

Smallness gives a level of flexibility in crafting policy solutions but the legal reform process is hampered by a paucity of legislative drafters often leading to transplanted models that may not adequately reflect society's needs. Regulatory capture may be easier in small economies because a small group of regulators and business-persons interact on issues on a regular basis. Governments may also be unwilling to enact comprehensive laws that may deter foreign investment. Corruption in political and policy processes may also be a factor. However, smaller parliamentary constituencies imply that consumers can easily air their complaints.

Cost of Regulation is Higher

The cost involved in enforcement of fair consumer standards in small markets is high because of the large underlying fixed costs. Statistics reveal a higher per capita cost for agencies in developing countries. The amount of human resources required to man regulatory agencies does not decline proportionately with the size of the economy. Agencies in small states are often constrained by the unavailability of appropriate human capital and the inability to compensate staff adequately.

Cultural Values Play a Critical Role

Cultural issues arise as some small societies have co-operative approaches to business activity which are not found in larger developed societies. Close family and friendship ties between regulator and subjects of regulation is another important cultural factor that poses difficulties in investigation and collection of evidence. Additionally, administrators in small states may face peculiar pressures created by their multi-functional roles, close inter-personal relationships and limited promotion opportunities (Farrugia, 1993).

6. Capacity Building in Consumer Policy – A Small State Solution

Diversity of experiences and problems can be recognised even within the category of small states. However, clear identifiable differences between large and small states lie in: (a) endemic market failures (both structural and informational); (b) the importance of incorporating social justice considerations in consumer policies; and (c) severe institutional and resource constraints.

The lack of regulatory and enforcement capacity, which exists in all developed countries is even more constraining in the case of small economies'. Solutions need to incorporate convergence of regulatory roles in enforcement institutions, utilisation of formal and informal cooperation mechanisms and regional initiatives.

Need for Regulatory Convergence

The creation of a single authority, particularly for consumer and competition policies results in the sharing of skills and expertise in pursuit of the common goal of consumer welfare. Single regulators enforcing both competition and consumer law have been created in Papua New Guinea and Jamaica.

For small states, maximising the use of human capital, minimising regulatory cost and avoiding duplication of administrative costs are critical objectives which are partially addressed by structuring multi-sector regulatory enforcement institutions (see Box 1). However, the efficacy of these institutions in fairly and effectively executing their mandates requires greater study as the regulators are tasked with conflicts in prioritising enforcement and in implementing instruments that have competing values.

Informal and Formal Cooperation Needs to More Strongly Encouraged

Information sharing and mutual assistance are avenues for formal cooperation in consumer and competition policy. Similarly, establishing links with other territories with respect to enforcement issues is another important avenue, given the prevalence of international electronic transactions and fraud.

Examples of cooperation can be found in the Pacific region. For instance, in 2002 the Australia Competition and Consumer Commission (ACCC) and the Commerce Commission of the Fiji Islands signed a memorandum of understanding to promote cooperation on consumer protection and competition issues. ACCC also has an agreement with the Consumer Affairs Council of Papua New Guinea.

Small states risk being 'shut out' from new approaches to policy matters, particularly those affecting cross-border trade. International convergence is driven by larger states as small states have limited capacity to participate in international meetings and forums. Cooperation mechanisms can assist in developing domestic expertise

Box 1: Barbados Fair Trading Commission

The Fair Trading Commission of Barbados was established on January 02, 2001 as an economy-wide regulator to safeguard the interests of consumers, regulate utility services, monitor and investigate conduct of business enterprises and to promote and maintain effective competition in the economy. The Commission has been charged with responsibility for the administration and enforcement of several pieces of legislation including the Fair Trading Commission Act, Utilities Regulation Act, Telecommunications Act, Consumer Protection Act and Fair Competition Act.

The agency was designed to capitalise on the synergies between the disciplines of utility regulation, fair competition and consumer protection. It has a staff complement of 30 persons responsible for investigations and a board of 11 part-time Commissioners for adjudication and the provision of overall guidance and control.

and capacity to participate in international dialogue. There is a particular need for greater South-South cooperation and the creation of epistemic communities on small state issues.

Regional Solutions Provide Threefold Benefits

<u>Larger market</u>
The integration and creation of regional markets has been offered as a partial solution for the economic vulnerabilities of small states as this creates a larger economic space and encourages the attainment of economies of scales by firms.

<u>Additional impetus for new laws</u>
Access to a regional common market can act as a spur for the introduction of robust consumer policies. An example is the case of Malta where access to the European Union market led to the development of a new consumer policy framework (Fabri, 2006).

<u>Capacity for enforcement</u>
The creation of regional regimes should facilitate new types of enforcement and strengthen the role of existing domestic agencies. For example, the regional Caribbean Community (CARICOM) arrangement may support the national authorities by increasing their profile and authority. However, legal arrangements in cases where there is no "supra-nationality" are likely to be fraught with difficulties and regulatory challenges may need to be addressed (see Box 2).

Box 2: CARICOM Competition Commission

The CARICOM Competition Commission provides a formal framework for consideration. The Caricom Single Market became operational in January 2006 with the underlying objective of sustained economic growth and development for Member States. The Revised Treaty of Chaguaramas, which sets out the new architecture for this deepened integration, establishes, *inter alia*, obligations on Member States for the creation of new domestic and regional regimes for the regulation of consumer markets. The provisions, heavily influenced by the international trends on market-based reforms, incorporate both competition and consumer policy tools.

Under the Revised Treaty, Member States are required to enact harmonised domestic consumer and competition legislation and establish competent enforcement authorities. These national authorities will be required to cooperate with the proposed regional enforcement authority, the CARICOM Competition Commission which is charged with the investigation and enforcement of cross-border rules on anti-competitive conduct, such as collusive action by enterprises and the abuse of dominant position. In contrast, the Commission plays a supportive and advocacy role utilising education, review and research activities to protect consumer interests on the quality and safety of goods.

Conclusion

If consumer policy in small states is to address social justice considerations and ensure broad based benefits of market-based reforms and development, market-led economic growth must be balanced with equity. In fashioning a responsive and effective consumer protection framework, small states need to set their own policy agenda and establish institutional agencies that reflect their realities. Sound research in this area would provide a platform for fashioning an appropriately tailored framework for consumer protection in small states.

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