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Equal protection for differentiated con sumers: *The paradox of Heterogeneity* in Consumer Law

Tutela igualitaria para consumidores diferenciados: la paradoja de la heterogeneidad en el Derecho del Consumidor

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ABSTRACT: Consumers have different preferences, needs and limitations. Despite this unquestionable fact, consumer protection systems tend to bet blindly on egalitarian protection schemes. Even more seriously, many egalitarian schemes operate as mandatory schemes. In this work, it is argued that such schemes severely injure the principle of consumer sovereignty and harm the consumer since they move away from the spontaneous market process and replace it with rigid designs.

KEYWORDS: Consumer, market, liberty, competition, economics.

RESUMEN: Los consumidores tenemos diferentes preferencias, necesidades y limitaciones. No obstante ese dato incuestionable, los sistemas de protección al consumidor suelen apostar ciegamente por esquemas de tutela igualitarios. De manera incluso más grave, muchos esquemas igualitarios operan como esquemas mandatorios. En este trabajo, se plantea que tales esquemas lesionan severamente el principio de soberanía del consumidor y agravian al consumidor dado que se alejan del proceso espontáneo de mercado y lo reemplazan por diseños rígidos.

PALABRAS CLAVE: Consumidor, mercado, libertad, competencia, economía.

CÓDIGO JEL: D41, F12.

INTRODUCTION

All individuals are different. We each have our own needs, expectations, desires, frustrations, virtues, budget constraints, and so many other traits that make us genuinely unique. This does not mean, of course, that individuals cannot share needs and preferences, but this is a possibility that will be verified to a greater or lesser extent empirically and depending on the extent of the grouping tested. The group of wine lovers may be composed of a relatively large number of subjects while the group of Cabernet Sauvignon - Merlot blend lovers is likely to be more limited. Given the heterogeneity of individuals' preferences and budgetary constraints, designing a consumer protection system composed of egalitarian rights established by mandatory rules is an undertaking doomed to introduce harm to multiple consumers rendered invisible by the proposed grouping.

John F. Kennedy's famous 1962 speech, recognized as a milestone for the development of the discipline of consumer protection, begins with the phrase: "consumers, by definition, include us all" which conveys precisely the idea that the term "consumer" is comprehensive of all individuals. That this is so, however, does not mean that all consumers must imperatively be protected equally. The reinforcement of unitary protection in consumer law - under an explicitly or implicitly statutory logic - undermines what should be the foundation on which a sensible consumer law is built: the principle of consumer sovereignty. This paper aims to argue that any reflection on consumer law,

and the design of any regulation on the matter, must have as an unavoidable starting point the recognition of heterogeneity. Failure to do so will pave the way for protective rules that will harm a good portion of those consumers that we want to protect.

Consumers have different budgetary constraints and different expectations, so it necessarily follows that their interests are also differentiated on both fronts. Consumers do not ordinarily expect the highest possible level of protection regardless of the price to be paid for this protection. On the contrary, each consumer calibrates his or her interests in such a way that he or she tries to get the best that can be obtained at the lowest possible price. The result of this calibration is unique: each consumer identifies the best offer presented to him taking into account the economic front (price) and the tuitive front (security).

In the same vein, it has been pointed out that a distinction must be made between the consumer's economic interest - in lower prices and more convenient purchases - and the guardianship interest - protection against product or service insecurity, for example (Whitman, 2007). The artificial elevation of guardianship, i.e. guardianship set at an arbitrary level by the legislator or authority, has an impact on price. For example, if an administrative authority or a judge considers a clause in a consumer contract to be unfair and therefore finds it unenforceable against the consumer, it will raise the risk for the supplier (the risk that the clause was intended to mitigate). The increased risk will lead to higher prices or eventually, if the risk is very high, to a disincentive to supply to the detriment of consumers.

In our example, the alleged unfairness of the hypothetical clause in the consumer contract is analyzed without consideration for the individual calibration referred to above. The authority assumes that the clause introduces unacceptable disproportionality for all consumers and that all consumers would also be willing to pay a higher price in order not to be bound by such a clause. The assumption is, of course, hasty and, as we shall develop, contrary to the principle of consumer sovereignty. Moreover, by assuming that all consumers equally wish not to be bound by such a clause, it generates in practice a differentiated impact since consumers, as we have already said, have differentiated expectations and budgetary constraints.

1. TOWARDS A FULL UNDERSTANDING OF THE PRINCIPLE OF CONSUMER SOVEREIGNTY

In a market economy, the price of products or services responds to the interaction between supply and demand. Supply, in particular, is delineated by taking into consideration the needs and expectations of demand. In other words, there is a process of discovery whereby certain individuals discover the needs and wants of other individuals and develop a response for them in exchange for something. A supplier's success comes from being closer to what consumers want. The supplier who offers something that consumers do not value will suffer the consequences. The consumer determines with his consumption decision which offer deserves a positive response and which does not.

Indeed, if demand for a product falls to a very low level, the profits -if any- from producing or manufacturing that product will not be a sufficient incentive to engage in such productive activity. It is often assumed that the exit of companies from the market is an unfortunate reality, but the truth is that the

exit from the market, in the first place, of those with higher production costs, is efficient. Note that it is the consumer, with his preference, who is signaling when production should stop or in any case should be concentrated on fewer (more efficient) producers. This effect, at the same time, frees up capital or labor for the expansion of another possible industry (the one in which consumer preference signals the need for an increase in supply).

Put in simpler terms, what drives the use of resources in an economy is the behavior of consumers in buying or not buying based on their quest for greater satisfaction. Market interactions coordinate economic life. To the extent that the establishment of mandated egalitarian configurations - for all products - is established, it distorts the price system and, with it, its ability to guide the spontaneously occurring process of discovery and adjustment (Boettke, 2010).

It is a choice that is at the heart of consumer sovereignty. In line with this, it has been pointed out that it is through the choice of certain options over others that consumers satisfy their desires and send signals to the economy, and thus the protection of the exercise of consumer choice is critical (Averitt and Lande, 1997). Products, it should be noted, are shaped in response to this discovery process and it is consumers whose decisions determine the final fit. Thus, how safe, for example, a product is, depends on consumers and, in particular, on their willingness to pay. It is consumers who determine what level of security is worth paying for, and thus what level of security is worth offering.

Precisely along these lines, Ramseyer (2012) argues that beyond the security standard defined by law, the providers that survive and thrive are those that offer the level of security that

consumers want to buy. One product may be more secure than another, and its price will predictably be higher than that of the less secure product. The same, returning to our previous example, can be said of the content of the rights and obligations set out in a proposed contract. One consumer might value more a price reduction in exchange for waiving the right to take legal action at a later stage and another consumer might be willing to pay a higher price in exchange for more possibilities to complain. Thus, ordinarily, when the market functions without unnecessary distortions, the offers that tend to be made are in line with consumers' choices.

The principle of consumer sovereignty implies that consumers should be able to make the calibration exercise that fits their needs, expectations, and budgetary constraints. In a simplified way, the consumer has the right to decide whether he/she prefers a "lower price - riskier product" combination or a "higher price - less risky product" combination. When it is consumer law that imperatively sets a level of risk, without giving the consumer the option to choose a different combination, it empties the principle of consumer sovereignty of its content. In such a regulatory context, it is the law that indirectly determines the type of product offered to the consumer and the price at which he can obtain it.

Of course, it is no secret that many authors have been emphasizing the informational and cognitive problems that may conspire against the consumer's right to choose. This emphasis has served to justify paternalistic interventions in the face of problems arising from the exercise of choice under an assumption of bounded rationality. At the same time, the findings of certain experiments can hardly serve as an unquestionable basis for or against the full exercise of

consumer sovereignty. Indeed, some studies seem to confirm that consumers make better decisions when these decisions are made for their benefit, which corroborates that consumers engage in this calibration process and that this process does indeed lead to choices that lead to a better valuation of the individual (Waldfogel, 2005).

This is not the place to discuss behavioral analysis approaches and their complications. Of relevance to our development, suffice it to point out that, even taking the extensive evidence of biases and limitations at face value, none of it sheds light on what the consumer's hidden preference might be when making a decision. In other words, for better or worse, we need to take consumers' revealed preferences as a clear indicator of what maximizes their welfare given the impossibility of speculating on what the preference would have been in the absence of these biases and constraints (Wright and Ginsburg, 2012).

The call for caution must be eloquent. Nothing in the recognition of genuine limitations on consumer choice justifies the transfer of decisive consumer power to the legislator or to interest groups oriented to advocate the introduction of certain regulations under the guise of being "pro-consumer" proposals. The denial of the principle of consumer sovereignty would result in steering consumers away from those products that they actually or misleadingly want (Dam, 1970) and would fundamentally affect the most budget-constrained consumers by depriving them of a range of choices. In a sentence, to disregard the principle of consumer sovereignty is to expropriate them from control over the resources available in the market (Hutt, 1940).

Some conceptual care is, however, necessary. If one understands the expression "consumer sovereignty" as

limited to the fact that production is geared towards satisfying consumption, we move into a terrain with which we can feel more or less comfortable. The problem with misusing the concept of "consumer sovereignty" is that it could be misinterpreted as referring to the superiority of the consumer's interest - in the sense that the consumer can exercise power over the supplier by compelling or forcing him to take some action - over that of the supplier, to construct, based on this misreading, precisely those regulations aimed at securing misunderstood consumer sovereignty (Murphy, 2018).

This misleading reading suggests a consumer-supplier trade-off and reinforces the equally misleading belief that the free market operates as a zero-sum game. It emphasizes the popular (but misleading) idea of competitive process as a competitive process rather than the (correct but unfortunately little understood) idea of competitive process as a cooperative process. Indeed, the main point of supplier A and supplier B competing is not that one beats the other but that the supplier who does a better job is rewarded by giving the consumer what he wants (a faithful expression of the principle of consumer sovereignty as we are defining it). The notion of competition as mere competition ignores the consumer and loses sight of the fact that the process is aimed at generating a positive-sum outcome (Rubin, 2019).

As we will see below, the establishment of egalitarian and mandatory protective rules in consumer law necessarily offends the principle of consumer sovereignty - therefore, we deem appropriate - because it takes away choice from consumers. We use the term "consumers" to express that the affectation may extend to each consumer - albeit in a differentiated manner - and not as an example of what we are questioning: the false assumption that all consumers want the same level of protection.

2. PROTECTING THE CONSUMER WITHOUT SPECIFYING WHICH ONE: THE ASSUMPTION OF HOMOGENEITY OVER HETEROGENEOUS CONSUMERS

The use of the term “consumer” often distracts us from the obvious fact that each individual has different preferences. In the same way that some consumers are willing to pay extra for an extended warranty on an appliance while others are not, each faces different trade-offs that are responded to according to their preference, according to their freedom of choice. Thus, the decision to purchase from supplier A a certain product at a certain price with a delivery time of approximately five days or the decision to purchase from supplier B that product at a higher price with a delivery time of 24 hours depends on the subjective assessment of the individual.

The reasoning is often clouded by the fact that in both cases the consumer is buying the same product. However, the illusion of being faced with the same product must be dispelled. A given good may be physically identical but the product is not confined to the good but comprises the set of features associated with the good offered - including the contractual terms on which the good is offered. For example, the greater availability of stock in an establishment or the more expected attention from the staff, or even a more attractive decoration affect the consumer’s subjective valuation of the product as a whole (Sowell, 2013). It is therefore not the same to order a plate of food in a modest business as it is to order the same dish in an award-winning restaurant run by one of the most prestigious chefs in the city.

A good portion of the attributes of the product chosen by the consumer are not apparent (Baird, 2006). Not all mobile phones have the same features even though they all allow us to communicate by phone. The consumer may not know the

speed of the microprocessor in the personal computer he is using in the same way that when buying a flat in a building he may not know the technical specifications of the lift he will use morning, noon, and night. All these attributes make up the product and make it different from other products, even if they appear to be identical goods or services.

Each consumer, of course, according to his or her interests and capabilities, will inquire to a lesser or greater extent about the attributes of the product and will value each of them. There is not and cannot be a rule that obliges the consumer to privilege the speed of the microprocessor over the aesthetic appearance of his personal computer in the same way that there cannot be an obligation to privilege the quality of the coffee over the comfort of the place where it is served. An imperative rule aimed at protecting consumers as a group - as if it were class-based protection - ignores the heterogeneity of consumers and harms the principle of consumer sovereignty.

The note of heterogeneity does not preclude that consumers may have certain more or less homogeneous needs (e.g. the need for food beyond preferences which, of course, will always be individual). The existence of this possible grouping of needs explains the benefits of mass procurement given that, on the supplier's side, grouping reduces the cost of producing products and also reduces the level of investment that must be made in discovering what the consumer wants; and, on the consumer's side, it reduces the cost of acquiring information on a given product as well as the price at which it can be accessed (Saavedra, 2019).

However, offering a standard product or service in response to a grouping of homogeneous needs does not undermine the principle of consumer sovereignty as it preserves the possibility

of choosing a specific product or service that satisfies a specific need. Thus, standard offers and offers aimed at satisfying more specific needs will converge in the market and it will be up to the consumer to choose the combination of attributes (price, quality, safety, among others) that suits him/her according to the exercise of personal calibration.

The consumer who wishes to buy a birthday cake can go to a supermarket and buy a standard cake for a given price or hire someone to prepare a special cake that will meet the specific requirements formulated in exchange for an undoubtedly higher price. Nothing in the bundling exercise has emptied the principle of consumer sovereignty of its content, as the exercise of consumer choice in the market is unaltered as long as actual or potential competition is preserved.

Bundling by suppliers based on the discovery of homogeneous needs does not allow a leap towards bundling by the state as a justification for unitary and mandatory "protection". The former, as we have seen, is compatible with the principle of consumer sovereignty because it preserves freedom of choice, whereas the latter type of bundling falsely assumes that all individuals, falling into a generic category, necessarily prefer one calibration:

that which the legislator or authority has drawn up for all of us.

Some authors (Durand, 2015) take this confusion to extremes when they refer to a generic category of consumers in need of protection in the face of information asymmetry. Firstly, because information asymmetry is, as is obvious, variable, given that the amount of information held by market agents is not homogeneous. Secondly, because informational asymmetry is

characterized by an elusive opposite - informational symmetry. This would presuppose that everyone has the economic resources to acquire information, that everyone has the preference to acquire it, and that everyone knows to understand and execute it at a "symmetric" level (Ely, 2015).

To argue that all consumers want to know the information of a product ingredient on the label, that all consumers want to know a certain floor plan when purchasing a property, and that all consumers want to be allowed to prepay a loan, to mention three examples, assumes that the legislator or authority knows the subjective preferences of all consumers as well as their willingness to pay for such prerogatives or rights.

Not only that, by making the aforementioned assumption and not allowing the consumer to choose an alternative to the imaginary calibration of the legislator or the authority, the principle of consumer sovereignty is emptied of its content. As can be seen, there is no longer freedom of choice under this model. It is the legislation or the action of the competent authority that determines the level of consumer protection and, in that sense, it is a totalitarian system that denies the market process.

This mandatory level of enforcement translates into a price that does not respond to the interaction between supply and demand so that those consumers who do not have the economic resources to access the product or service are mainly affected. In other words, the definition of an equal and forced standard of protection reduces the options for consumers to two: to purchase or contract the product or service at the increased price or to be left without access to the product or service and have to look for an option that can, in some way, operate as a substitute.

Eloquently, it has been pointed out that "when consumers are heterogeneous, an egalitarian mandatory solution inevitably disadvantages certain subgroups of consumers" (Ben-Shahar and Bar-Gill, 2014). Just as one group of consumers would not agree to take out an extended warranty, many consumers would be unwilling to purchase insurance to cover the risk of any cracks appearing in their homes. By mandating protection against such a risk, the same effect is created as imposing insurance on the consumer.

We find the analogy with insurance illustrative. In a competitive market, it is the very interaction of consumers with suppliers that reveals the valuation that is assigned to the product or service by the former. Establishing protection, and consequently, liability, on the supplier above the level defined by the market is tantamount to bundling insurance with the product that would result in a price above what the consumer would voluntarily pay (Priest, 1992). This causes many products or services to become unprofitable due to the effect of mandatory egalitarian trusteeship by reducing the incentives to supply products or services, which affects consumers by reducing competition.

Indeed, when the government tries to force suppliers to give consumers a better deal than what emerges through competition and voluntary exchange, the results can easily be counterproductive because the imposed option is not worth it (Tacker, 2019). If a supplier does not earn enough, it will stop offering its products, and that hurts consumers. If the consumer is forced to pay a certain amount of money, those with fewer economic resources are unable to access the product and must resort, for example, to the black market. It is not possible to replace the coordination generated by the market in interaction with the assumptions - however well-intentioned - of a group of public officials.

Imagine that we oblige companies offering parking services to assume liability for any damage to a vehicle. For those people who value such "insurance", the obligation generated would not affect them. However, for those who had to choose between expensive insurance and placing their vehicle on an unsafe public road, the "in-between" options may be of paramount importance. Those "in-between" options vanish when the person who intended to merely offer a space for the vehicle is forced to package forced insurance. That entrepreneur wanted to offer space, not security. And some consumers wanted that space, not a comprehensive insurance premium. This is an aspect that is also often forgotten: a product is not safe or unsafe. An attribute such as security can be offered in marginal units (Hoppe, 2006) with each individual determining how much security suits his or her personal preference.

The attribution of liability for not observing the level of safety - or information, or the suitability or any other standard set by legislation - on the supplier generates an equally differentiated effect on consumers. Ideally, the consumer protection authority would like the price of products to also reflect the expected impact that the product could have on the consumer. Thus, a product could have a hypothetical price X that takes into account the cost of production of such a product and the expected harm that the product would generate. The consumer would buy the product if he or she values it at more than X. However, if litigation introduces an additional cost Y to the supplier of the product and an additional cost Z to the consumer himself for bringing the litigation, the minimum price would have to be X + Y (the price that allows the supplier to recover his costs including the cost of litigation) and, for the consumer, the valuation of the product would have to be X + Y + Z (he would have to value the product more than the

cost he would bear for litigating the litigation). In this scenario, consumers who value the product at more than X + Y - but less than X + Y + Z - would not buy the product, which would remove that consumer from the possibility of making a profit (Polinsky and Shavell, 2010).

An additional consequence associated with the implementation of an equal and mandatory guardianship regime is that it reduces competition and innovation among suppliers. A company has incentives to offer better customer service because it is a differentiator. A supplier can differentiate itself in the market by offering the possibility of a return of the product without cause or by allowing the consumer to fragment a debt without interest, to mention a few examples. If legislation mandates that every supplier must allow the return of the product without cause, the differentiator is lost because the purpose of the legislation is precisely to standardize certain features of the product or service.

Curiously, consumer protection legislations are committed to standards of this kind that have the same effect as a collusive agreement between suppliers.

Thus, if several companies agree to offer their product on a certain condition, this is anti-competitive conduct. However, if the legislation makes the same companies offer the product with a certain condition, this is an intervention in the name of consumer protection. In both cases, the purpose is the same - to equalize a certain attribute of the offer - but the regulatory treatment changes depending on whether it is promoted by the state or sought by private parties.

The situation is particularly unfortunate if we take into account that small and medium-sized suppliers have special

incentives to be creative precisely as a differentiating element. These suppliers try to establish a special communication with consumers and adjust their offer, as far as possible, to the needs that have been identified. Forced egalitarian tutelage forces small suppliers to design their products or services with the same attributes as the offer of large suppliers, thus depriving them of the ability to deploy their creativity (Zywicki, 2015) and consequently depriving consumers of the possibility of obtaining an offer on the market that is more in line with their individual preferences.

Small suppliers play an important role in the economy from the point of view of consumer welfare because they particularise their supply a little more, i.e. they bring it closer to the demand of specific consumers (Priest, 2003). Large suppliers certainly benefit from economies of scale which reduces costs, but it is the preference of each consumer that determines whether a reduced price is more valuable than an offer closer to his or her need. Each consumer would prefer, if willingness to pay were not relevant, that products or services come closer to his or her particular preference. Ordinarily, however, the costs of producing for specific demands discourage large suppliers from undertaking such a task and lead them to concentrate on more general (standardized) offers. The consumer with a very particular demand needs more choice in the market, not less.

Note that the introduction of regulatory costs does not impact equally on all providers. In the same way that equal guardianship does not have an equal effect on consumers, regulatory cost does not impact equally on all suppliers. For a small supplier, regulatory compliance is more costly. Since small suppliers find it more difficult to carry out their economic activity than large suppliers, the regulatory cost tends to affect

especially consumers with specific demands that are those that presumably could have been more likely to be satisfied by the offerings of small suppliers.

This brings us to the last consequence of a mandatory equal protection regime: the potential generation of regressive effects as the protection afforded to wealthier consumers comes at the expense of the welfare of less wealthy consumers. Imagine a regulation mandating shopping centers not to charge for parking visitors' vehicles. Potentially, this is equal access as any visitor will be able to enjoy free parking. In reality, however, the egalitarian outcome is an impossibility, since not all visitors drive to the mall in their vehicle (some of them, foreseeably, will not be in a financial position to own a vehicle). Since ensuring supposedly free parking is undoubtedly costly, and since that cost is spread across all consumers (whether or not they have a vehicle) to ensure free parking rights for those with their vehicles, the measure diverts economic resources from lower-income consumers in favor of higher-income consumers. In sum, legally mandated equal access cannot ensure an equal outcome (Ben-Shahar, 2016).

In short, the establishment of mandatory features, attributes, or characteristics of the offer necessarily generates a differentiated impact given the heterogeneity of consumers. Assuming that equal protection protects us all equally is probably the first major assumption that must be discarded when approaching the study of consumer law. Unfortunately, we have the impression that the legislative technique in the form of unwaivable rights for all consumers is an unfortunate rule and not an exception, which, as we have seen, is a significant aggravation of the principle of consumer sovereignty.

CONCLUSIONS

Even advocates of the thesis that consumers are especially weak given existing cognitive biases and limitations will have to recognize that such weakness is not homogeneous. Then, no mandated egalitarian response can be the way to help each consumer in his or her particular situation. Thus, even those who accept a space for the existence of general default rules and tailor-made default rules seem to admit that free choice should be preferred if the decision architects -the legislator, in our case- lack relevant information, when it comes to situations familiar to the consumer, when the consumer prefers to choose, when learning is relevant and, in general, when there is relevant heterogeneity (Sunstein, 2012).

The situation is no different for products or services that one might consider more complex. For example, the credit card market is a dynamic one in which more choice means allowing each consumer, according to his or her preferences and possibilities, to choose the alternative he or she considers appropriate. Imagine now that financial institutions are mandated not to charge an annual membership fee. Predictably, the operational costs of issuing such financial products will have to be recovered in other ways, e.g. by raising the requirements for accessing a credit card. In this scenario, a measure aimed at benefiting all consumers is again particularly detrimental to those consumers who find it more difficult to become creditworthy. The legislator cannot equally and mandatorily establish the level of simplicity of a financial product - or any product - given that such simplicity must be valued as an attribute of the product or service by each consumer (Zywicki, 2016).

Consumers are different in several ways - observed and unobserved. Strengthening consumer sovereignty, i.e.

consumer choice, is incompatible with a consumer protection system structured based on mandatory protective rules. Along these lines, we believe, as a first step, that legal systems should abandon any protection scheme composed of non-waivable rights for consumers. Then, as the next item on the agenda, a comprehensive review of consumer protection systems is required so that we move away from regulations aimed at standardizing or mapping attributes or characteristics of products or services. Finally, it is important to note that technological progress is opening up an interesting space for discussion around the feasibility of customized rules (BenShahar and Porat, 2019) that can gradually bring us closer to a system that is more sensitive to heterogeneity.

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