THE POLITICAL ECONOMY OF REGULATION IN MARKETS WITH NAÏVE CONSUMERS

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Abstract
In a model of a competitive industry selling base goods and add-ons, we investigate the conditions under which citizen-consumers will support policies that eliminate behavioral inefficiencies induced by naïve consumers. Unregulated competitive markets have two effects: they produce deadweight losses, and they redistribute income away from biased consumers. Both unbiased and naïve consumers believe that they benefit from this redistribution (the naïve consumers are wrong), so support for efficiency-improving regulation is limited. Extending our model to consumers with partial sophistication about their naïveté, we predict patterns of regulation consistent with the form and timing of the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009. (JEL: D03, D78)

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