



Seduction by Contract: Law, Economics, and Psychology in Consumer Markets

Oren Bar-Gill

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Consumers routinely enter into long-term contracts with providers of goods and services - from credit cards, mortgages, cell phones, insurance, TV, and internet services to household appliances, theatre and sports events, health clubs, magazine subscriptions, transportation, and more. Across these consumer markets certain design features of contracts are recurrent, and puzzling. Why do sellers design contracts to provide short-term benefits and impose long-term costs? Why are low introductory prices so common? Why are the contracts themselves so complex, with numerous fees and interest rates, tariffs and penalties?

Seduction by Contract explains how consumer contracts emerge from the interaction between market forces and consumer psychology. Consumers are short-sighted and optimistic, so sellers compete to offer short-term benefits, while imposing long-term costs. Consumers are imperfectly rational, so sellers hide the true costs of products and services in complex contracts. Consumers are seduced by contracts that increase perceived benefits, without actually providing more benefits, and decrease perceived costs, without actually reducing the costs that consumers ultimately bear.

Competition does not help this behavioural market failure. It may even exacerbate it. Sellers, operating in a competitive market, have no choice but to align contract design with the psychology of consumers. A high-road seller who offers what she knows to be the best contract will lose business to the low-road seller who offers what the consumer mistakenly believes to be the best contract. Put bluntly, competition forces sellers to exploit the biases and misperceptions of their customers.

Seduction by Contract argues that better legal policy can help consumers and enhance market efficiency. Disclosure mandates provide a promising avenue for regulatory intervention. Simple, aggregate disclosures can help consumers make better choices. Comprehensive disclosures can facilitate the work of intermediaries, enabling them to better advise consumers. Effective disclosure would expose the seductive nature of consumer contracts and, as a result, reduce sellers' incentives to write inefficient contracts.

Developing its explanation through a general framework and detailed case studies of three major consumer markets (credit cards, mortgages, and cell phones), Seduction by Contract is an accessible introduction to the law and economics of consumer contracts, and a powerful critique of current regulatory policy.

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