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# SOME NOTES ON CONSUMER PROTECTION

When two individuals engage in a transaction whereby a good is exchanged for money, it is to be presumed that, if the transaction is undertaken voluntarily by both parties, each gains from it. The buyer presumably prefers the good he receives to the money he parts with - otherwise he would not have made the purchase. Similarly, the seller would not have made the sale unless he prefers the money to the good. This simple logic - usually elaborated through such devices as indifference curves and Edgeworth Boxes - underlies the economist's belief that *voluntary exchange is mutually beneficial.*

A number of assumptions are implicit in the argument:

1. Both buyer and seller are well-informed about the things that are exchanged, e.g., the buyer knows the shirt is not drip-dry (i.e., he doesn't think it is when it isn't) and the seller knows the buyer's cheque won't bounce.

2. Both parties know what they prefer.

3. Individuals are the best judges of their own self-interest.

Most arguments about consumer protection revolve around the question of the validity of these assumptions. And most proposals designed to protect consumers are based on the belief (or can be rationalized on the basis) that consumers are *ill-informed,* and/or *irrational,* and/or *do not know what is good for them.* (Not all proposals or policies can be neatly associated with one of these beliefs - the motives for some are mixed. Also, some types of intervention affecting voluntary exchanges are designed to protect third parties - e.g., laws dealing with drinking by drivers.)

## Ignorance

If a buyer has a false belief about a product, he may be adversely affected by the exchange. The same is true of the seller, and either may lose as a result of false beliefs about the medium of exchange.

A false belief needs to be distinguished from ignorance. A buyer may be ignorant about certain aspects of a product (e.g., the mechanical condition of a used car) yet may "take a chance" and buy it, in which case it is to be presumed that he has benefitted from the exchange - just as a person who buys a lottery ticket judges that the chance of winning a prize is worth at least the cost of a ticket, and hence is better off.

There is no doubt that consumers are ill-informed about many of the goods they buy or could buy. That is not in dispute. The question is whether they are less well-informed than they "ought" to be. For clearly some degree of ignorance is optimal: information and its dissemination are not free goods, and it is only rational to seek more information if the value of the additional information exceeds (even if only slightly) the cost of obtaining it. As Stigler has remarked:

"Ignorance is like sub-zero weather: by a sufficient expenditure its effects upon people can be kept within tolerable or even comfortable bounds, but it would be wholly uneconomic entirely to eliminate all its effects."[1]

The gathering and disseminating of information about goods and services is undertaken predominately by the interested parties, viz. buyers and sellers. Sellers advertise their wares, and buyers their requirements. Middlemen of all sorts provide what is essentially an information service, of putting buyers and sellers in touch with one another, charging a commission or marketing margin for their services (e.g., estate agents, used-car dealers). Some traders go further, and in effect certify - to some degree - the quality of the goods they sell (e.g., department stores). Some individuals and groups offer to sell *disinterested* information about goods and services (e.g., trade journals that test products or compare their specifications, consumer organizations that do the same, - e.g., *Choice,* consultants of all kinds, etc.).

Government activity in this area takes many forms. Its most basic contribution is to provide an environment in which exchanges are facilitated through the reduction in uncertainty facing buyers and sellers. The maintenance of law and order and the definition of property rights and contractual obligations are clearly of basic importance. So is the provision of a stable currency, and the adoption of standard weights and measures. The transmission of *misinformation* is inhibited by laws against fraud, misrepresentation, and false or misleading advertising.

Other types of government intervention, in roughly increasing order of "activism", include the following:

- Informative labelling requirements, e.g., it may be required that clothing and fabrics carry labels showing their fibre composition; that the ingredients of packaged foods be stated on the package.

- Official grading schemes. Farm produce is invariably sorted into different grades, either formally or informally. Governments sometimes legislate to define grades and require that all produce be graded and labelled according to the official scheme.

- Programmes of consumer education, e.g., anti-smoking campaigns.

- Certification of products or practitioners. In the case of the latter, this is often delegated to educational institutions and professional societies.

- Minimum standards of legislation, particualrly with respect to hygiene and safety, e.g., pure foods acts.

- Licensing of practitioners.

The last two activities mentioned go beyond the provision of information, in that they prohibit the sale of goods that do not meet the required standard, or the sale of services by unlicensed persons. However, they do have informational content, in that consumers can be assured (provided the regulations are enforced) that the goods they buy comply with the minimum legal standard, and that the practitioners they hire have met the licensing requirements. Note, however, the following points:

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[1] George J. Stigler, "The Economcis of Information", *Journal of Political Economy,* LXIX (June 1961), pp.213-224.

(a) Hygiene and safety regulations may be lax (either deliberately or through inadvertence, failure to keep up with scientific knowledge) or they may be laxly enforced, in which case their informational content may be negative: consumers may be lulled into a sense of false security, and not be as careful as they would be if they did not believe they were being protected.

(b) Prohibition of the sale of shoddy goods is not necessarily an unalloyed benefit. Some people may prefer to buy shoddy or "unsafe" goods provided they are cheap enough.

(c) Licensing is often used in practice to restrict entry into an occupation and raise the earnings of the licensees.

**Irrational and Non-rational Behaviour**

Rational behaviour, according to the dictionary definition, is *reasoning* behaviour. Economic theory postulates that consumers behave rationally in the sense that they have a set of preferences and that they behave consistently in accordance with those preferences. At times people's behaviour may be at variance with their underlying preferences, because their reason was impaired, or, so to speak, set aside. Such behaviour could be called *irrational*, and would be recognized as such by the person concerned when his reason was restored.

Criticisms of the economist's model go beyond the assertion that consumers sometimes behave irrationally: the usefulness of the model is queried on the grounds that much human behaviour is not rational choosing of means to fulfil well-defined ends, but is rather guided by instinct, or unconscious motivations, or sheer random impulse - in short, that it is *non-rational.* Other critics have stressed the importance of habit and tradition in consumer behaviour.

No one would deny that irrational and non-rational elements (including habit[2]) are important in human behaviour: the question is whether they are so important as seriously to impair the usefulness of the rational behaviour model. Economists tend to believe that the rational model holds up reasonably well - not simply because it is in their professional interest so to believe, but also because they have had considerable success in making predictions based on it. From their point of view habit is seen as introducing an element of inertia into the system (and this is one reason why people's responses to economic stimuli are greater in the long run than in the short run), while impulsive behaviour introduces random "noise" (in the statistical sense). (Other social scientists of course view the matter differently; their focus of interest being on those behavioural elements (e.g., habit or impulse) that the economist tends to set aside.)

Some legislation attempts to protect consumers against their own irrationality (as defined above). An example is the mandatory "cooling off" period prescribed for certain types of contract, whereby the buyer has the right to renege on his purchase within a prescribed period. This is designed to protect consumers from the consequences of suspending their better judgement while under the influence of a persuasive saleman.

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[2] Allowing oneself to fall into habits, or being guided in one's behaviour by traditions, or buying popular brands (because they *are* popular) are not necessarily non-rational forms of behaviour They may represent a rational response to a lack of information and the cost of remedying it. Thus I might quite reasonably decide to buy a Holden, without considering alternative makes of car, on the grounds that (a) there can't be too much wrong with a make that is so popular, and (b) I have no reason to believe that my requirements in a car differ very much from those who buy Holdens.

**Paternalism**

Consumers may be quite rational in the sense that they behave in accordance with a set of well-defined preferences, yet we may judge that they do not know what is good for them, and should be protected from their own folly. In short we find their values repugnant and seek to prevent them (or dissuade them) from following their desires. Thus our society recognizes the right of parents to exercise guardianship over their children until the latter attain their majority; suicide is regarded as a criminal offence in some countries: the sale or purchase of some addictive drugs is proscribed by law; the sale of sexual favours is illegal in Victoria; restrictions are placed on cigarette advertising; the consumption of tobacco and alcohol is discouraged by the imposition of heavy excise taxes.

The liberal tradition - to which, by and large, mainstream economics belongs - is opposed to paternalism. The liberal position exalts individual freedom, i.e., seeks to allow an individual "the maximum freedom to follow his own desires, consistent with the freedom of others to do likewise". Paternalistic interventions seek to restrict an individual's freedom, not in the interest of others, but in the supposed interest of the restricted individual, which presupposes that those imposing their will "know better" (either in the sense of having more information, or in the sense of espousing higher values) than those whose freedom is being restricted. The liberal position is not so much that these conditions will not often be met, but rather that (a) it is difficult to know when it is met - and who is to judge?; (b) even if it is met it is in conflict with the principle of individual freedom and responsibility, which has a positive and not merely instrumental value; and (c) paternalism is a dangerous principle to espouse in that it "opens the door" to interventions that are maleficient in fact and/or intent, and may lead to a substantial loss of freedom.

Yet even the most doctrinaire liberal will allow some place for paternalism - e.g., some restriction on the rights of children, or the certifiably insane. Once this much is admitted, it must also be admitted that the desirability of paternalistic interventions cannot be settled simply by appeal to abstract principle, but by some judgement in which the likely benefits and possible costs are weighed.

**Consumer Protection in Practice**

Enough has been said to show (I hope) that the question of whether and how much protection should (ideally) be extended to consumers is a complex one, and that one's answer to it will depend very much on one's "vision" of the world and one's moral and political values. But even if it were agreed that a substantial amount of protection were warranted, it would not necessarily follow that "the government should do something about it". To jump from the premise that some market imperfection exists to the conclusion that corrective intervention by government is required is to commit the same logical error as that made by the Roman emperor, who, acting as the adjudicator in a contest between two musicians, listened to the first perform, and immediately awarded the prize to the second.

Indeed, there is a good reason to suspect that governments are far from ideal institutions for upholding the consumer interest, especially where it is in conflict with the interests of producers. This is because producers usually constitute particular distinct groups that are electorally identifiable, whereas consumers are a much larger more diffuse and amorphous group. A transfer from consumers to producers of a particular product is likely to involve a small and insignificant loss to many but a significant gain to a few, and the latter is much more "politically visible" than the former.

The triumph of producer over consumer interests is probably more evident in the behaviour of statutory bodies set up to regulate certain industries or professions. Such regulation is usually ostensibly done in the interest of consumers (or at least partly in their interest) but almost invariably the regulatory bodies become dominated by the groups being "regulated" Thus regulation of the profession of medicine, including entry into the profession, is largely in the hands of doctors. This helps account for doctors' high earnings.[3] The Victorian Transport Regulation Board regulates the taxi industry: as a result taxi-owners earn economic rents such that a licence to operate a taxi in Melbourne (set of plates) had a market value a few years ago of $16,000-$20,000.

Government interventions in the consumer interest, though genuine enough in motivation (it seems reasonable to suppose, though sometimes one wonders) are often clumsy and ineffective or have unfortunate side effects. This is because of a superficial or incorrect analysis of the causes of the evil being combatted or of the effects of the corrective measures. It also may be because in political affairs appearances are more important than realities, so that so long as a measure "looks good" to the relatively unsophisticated voters it is likely to be enacted, even if expert opinion advised against it. (Similarly workable measures that are difficult to explain to the electorate are unlikely to be enacted.) Consider the following examples.

1. Mandatory safety features in cars (seat belts, collapsible steering columns, etc.)

An "engineering" approach suggests that a substantial reduction in road deaths could be achieved if cars possessed these features. An economic approach, whereby drivers are assumed to make rational choices, suggests that drivers might trade off some of the increased built-in safety of their cars for harder driving, and so have more accidents. There is some evidence that in the U.S. mandatory safety features have led to more accidents, fewer in-car deaths per accident, more pedestrian deaths, and overall to no reduction in total road deaths.

2. Tougher licensing procedures for new drugs

Following the thalidomide affair, the U.S. Federal Drug Administration became more reluctant to approve the release of new drugs. The number of new drugs introduced has fallen substantially. More lives may have been lost through the failure of drug companies to develop new drugs (which has become more costly as as result of the tougher testing procedures), and through the delays in introducing those that are developed, than have been saved through the prevention of the release of unsafe drugs.

3. Banning of cigarette commercials from television and radio

This was done in the United States. According to one researcher, the expected net result was for cigarette consumption, and the profits of tobacco companies, to increase. Before the ban, radio and television stations were obliged to broadcast "counter-commercials" designed to discourage smoking. These were apparently more effective than the commercials, so that when both ceased, cigarette smoking could be expected to increase. Profits would rise because the main effect of advertising is to increase or maintain a brand's share of the market, i.e., it is a form of competition among tobacco companies; and when they were denied their most effective advertising medium, they would reduce their total expenditure on advertising, and thus compete less among themselves.

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[3] Whether doctors' earnings are high, given their long training period and the nature of their work, is not altogether clear. Leffler (*Journal of Law and Economics*, April 1978) has presented evidence that occupational "rents" accruing to American physicians are positive but not very large.

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