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Rethinking Consumer Protection: Escaping Death by Regulation

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Introduction

This book is designed to appeal to anyone who is at all interested in topics related to making life better and safer—for all us consumers. Our current approach to consumer protection is extremely flawed; sometimes costing lives rather than saving them. There are better ways to protect ourselves and the people we love.

Whether you are a beginner or an experienced practitioner or scholar, there will be some relevant content for you here. However, scholars and other experts would likely be most interested in the case studies in chapters 2, 3, 4 and 6. These studies are not overly technical, easily comprehensible without prior study, but they do thoroughly cover existing scholarship along with some practical extensions. Chapters 1 and 5 are primarily targeted toward readers who are not experts on economics and consumer protection, or for professors and instructors looking for some teaching ideas on these topics. The material in these chapters has been shaped by hundreds of class discussions with thousands of students over my teaching career. That teaching experience is mostly with college students but I've also taught a fair amount in high schools, Elder hostels, and on-site to industry practitioners since I began teaching these topics in the 1980s. (Let's assume I was a child prodigy economist, starting my teaching career at age 7!) Hopefully, all this varied experience and feedback has helped to make this material more stimulating and easier to understand.

Chapter 1 covers some foundational economic and moral issues, beginning with regulatory concerns and problems inherent in attempting to protect consumers from high prices. Chapter 2 details unintended dangers created by our current regulatory approach regarding the approval of new medicines, while Chapter 3 explains how we can dramatically reduce the cost of those medicines while also saving many thousands of lives every year. The study of consumer protection regulation, like the study of most anything involving politics, can be a bit depressing. Politicians so commonly disappoint; so much harm continues to be needlessly inflicted on consumers by the corruption and ineptness of the political process. But once in a while, reason prevails, harmful policies are reformed, and we actually have a mostly happy ending. We see this in Chapter 4 for the case of taxi regulation reform. Moreover, the rise of Uber and other rideshare services demonstrates how the modern technology used to make both passengers and drivers safer might be applied more broadly to better protect consumers everywhere.

Chapter 5 addresses various issues that people tend to raise when first exposed to some of the surprising implications of the economics of regulation.

The discussion there is eclectic not intended to be comprehensive. Instead, the idea of chapter 5 is too briefly address some worries that occur to people as they begin to contemplate leaving consumers more free to make their own choices. Hopefully, it will help readers begin to reconcile common preconceptions with some unexpected implications of economic analysis. Chapter 6 details the fatal flaws inherent in our approach to airport security screening, and explains both ideal reform as well as a feasible beginning. Chapter 7 wraps things up with a short discussion of lessons learned and practical steps we can take on the road to ideal reform. The essential idea is to more or less keep the regulations that mostly work while replacing ineffective, sometimes even harmful, command and control regulations with systems that advise consumers rather than rigidly limit their choices. Government becomes less a dictator and more an advisor. This is how we can escape death by regulation. If this book is half as interesting to read as it was to research and write then you’re going to love it.

Chapter 1 Economic Foundations of Morality and Consumer Wellbeing

Moral Judgements and Knowledge

Is it immoral to saw off someone's arm? Not if the arm is so seriously infected that it is impossible to save, and amputating it is the only way to save the patient's life. In this dismal scenario, morality requires amputation. Even so, a young child informed that a doctor plans to amputate the limb of someone they love might well believe that such an action is just inherently wrong. A lack of knowledge and understanding can sometimes sabotage one's moral compass. Our society's lack of knowledge in the area of economics often renders most of us confused about the workings and morality of an economy with substantial elements of free enterprise. We sometimes condemn certain behavior in business, falsely seeing immorality when, if we were better informed, we would see things in an entirely different light. In short, if one lacks a working understanding of economics—and most people do, then reasonable moral judgment involving economic issues is sometimes difficult if not impossible.

Consider, for instance, the issue of "price gouging," defined loosely as firms charging an "unfairly" high price. Notice, for starters, that there is no term in our language, or it seems any language, for unfairly low prices. Rock bottom, going out of business sale prices might well reflect tremendous suffering of a firm's owners and employees, soon to be unemployed. Nevertheless, consumers think of these prices as being simply "good deals!" So, we have a theory of morality where we consumers have a firm moral "right" to a "fair" price yet sellers have no rights at all. A moral theory with only self-serving rights and zero responsibility is clearly suspect; but, this is just the tip of the iceberg regarding flaws in this view.

Price Gouging Confusion

Price gouging often emerges as an issue in the aftermath of hurricanes and other natural disasters. Let us delve into a representative example—the price of a bag of ice in Charleston, South Carolina after the devastation from hurricane Hugo back in late summer of 1989. In that year, under normal circumstances, a bag of ice cost around 80 cents. In the immediate aftermath of the hurricane the price shot up to a staggering $20 (Laband, 1989)! The vast majority of people, including ourselves before we got into economics, would naturally assume that such a price was a prime illustration of immoral price gouging, sellers ripping off consumers because they could. But, in reality, that $20 price was the best possible price for consumers in the awful circumstances created by the hurricane.

Most surprisingly, even the poor are best served by channeling aid through the extraordinarily high price. If you are like most people you're probably thinking, "Economists must be crazy; the poor will just suffer and be forced to do without if that price is $20." Well, first keep in mind there are two possible main strategies to help the poor, somehow force the price lower or give them money so they can afford to buy at that high price. Forcing the price lower seems like a simple, expedient solution, one that allows us to help the poor (and ourselves if we are ice buyers in this case) without any actual sacrifice on our part--as long as we aren't the ones selling the ice. But, as we'll soon see in some detail, the expedient solution, as is often the case, is no solution at all and would make things much, much worse. The high price is analogous to the amputation example, a harsh treatment but still the only viable treatment. One problem with forcing price lower is that it will discourage some potential ice sellers from bringing ice in, especially if they live far away and will incur high costs to get to Charleston.

Economists virtually unanimously support giving the poor money rather than attempting to manipulate price in their favor. (If one counts only honest, drug-free economists this support is probably exactly unanimous, as we will see!) Actual government policy, to understate, does not always follow economic logic and consensus but in this regard it usually does. Let us leave the post-hurricane scenario for a moment, and consider the various standing government programs we have to help provide low-income people with enough food. These agencies may not be perfect but, thankfully, not a single one of them is so foolishly structured that it mandates that grocers must sell to the poor at below market prices. Main federal programs include Temporary Assistance for Needy Families, the Supplemental Security Program, the Supplemental Nutrition Assistance Program (food stamps), the Special Supplemental Food Program for Women, Infants, and Children (WIC), and the Supplemental

Security Program (Jones and MaCurdy, 2018). These programs either give cash or vouchers, such as food stamps, to people with lower income so as to increase their buying power. There is controversy in the details, but increasing someone's buying power is a sensible way to try to aid them. Price control regulations requiring merchants to sell food to the poor at super low prices do not exist in these programs because such regulation would discourage sales to the poor and be far less effective than income supplements. Some might find a legal loophole to avoid selling to the poor altogether. Failing that, grocers might locate far from poor neighborhoods and convenient bus lines, or manage to be rude and offer poor quality and service to the poor as firms perversely compete to drive them away rather than attract them. Price controls are more likely to starve people than feed them. There are no circumstances, including hurricanes, which can alter this logical law of supply, suppressing price will suppress supply. To best aid the poor we need to increase their income; rather than sabotaging the pricing system we need to work within it.

The Real Conflict: Urgent Medical Needs versus the Masses with Spoiling Food

Returning to post-hurricane Charleston, there was a crisis, due mainly to virtually all electrical power being knocked out, that created an ocean of need for ice (enormous demand) while simultaneously wiping out almost all available ice leaving only a few bits of supply. In other words, it was quite impossible to get ice to everyone who needed it. In such a case, it is vital to conserve the ice mainly for those who need it most. Consider, for example, someone with lifesaving medicine that must be refrigerated, and if it is not refrigerated that person will die. In addition to preserving some vital medications ice can also be crucial in treating certain injuries and high fevers. But, if the price stays at a low, “fair” level, then most people, without urgent needs, will not stop to think that they should leave the tiny amount of available ice for those who really need it. Instead, most of us will grab any ice we can find to preserve food or chill down some cokes. (Or, perhaps chill something stronger to ease the pain imposed by the giant storm.)

The key struggle here is not between rich and poor but between those who need ice for urgent health needs and those who do not, those who will suffer and even die without ice versus those who might see some food items spoil. Furthermore, those with desperate medical needs are always vastly outnumbered in these situations; at a normal price these hordes of typical consumers will swarm everywhere, gobbling up every cube of ice they can find. The only feasible way to keep ice available for the greatest needs is to let the price rise so high that most people conclude purchase is uneconomical; they would generally spend more on ice than their spoiling food is worth. This “exorbitant” price firmly drives us to conserve ice. Granted, a few will splurge and spend $20 just to cool down drinks but most will not. The soaring price happens naturally, virtually instantaneously, and is the only practicable way to make sure the meagre amount of available ice is used primarily to treat human health problems rather than preserving food or chilling drinks.

So, step one, making sure scant ice supplies are held back for urgent needs, is achieved. The vast majority of people with health needs for ice will be able to come up with the cash on their own or through family and friends, though not always without some hardship. Major hurricanes truly are disasters. But what about those people with urgent health needs who are destitute? Those who don't have $20, have nothing to sell for $20 and have no capacity to earn $20. The high price works wonders to screen out most (relatively) casual demand for ice but it doesn't, by itself, solve this problem. We, as a society unquestionably need to assist such people in need. But the only way to effectively help them is to buy the ice for them, or give them the cash to buy it themselves. Happily, ours is an often generous society, and it is far easier to transfer purchasing power to the desperately needy than it is to transport ice. Charities such as the Salvation Army are quickly on the scene; FEMA may also be helpful, though perhaps not quite as quickly. The point is that these organizations have plenty of resources to buy ice for the destitute with health needs but, like all of our society, they aren't able to readily transport massive amounts of ice quickly. The hard part is finding those few bags of ice amidst an ocean of need; financing is comparatively easy. The high price makes sure ice is available to meet health needs, whether paid for by consumers, a charity or government agency.

To drive this point home, consider a philanthropist with a truckload of ice anxious to help. Suppose this humanitarian has only two options to distribute ice: 1) Give it away to whoever shows up in time to claim it, or 2) sell it for the going rate of $20. Giving it away, a natural impulse, would result in more people having ice to preserve that food or icing down those drinks, but very few, if any, of those with critical health needs would happen to show up just as the ice was being given away. Alternatively, charging $20, aka price gouging, would result in most of that ice being used for important health needs. The ice would not be quickly snatched up, providing high priority buyers time to find and buy the ice, or arrange for someone to buy it for them. So, an enlightened philanthropist would wisely target her aid by price gouging, then maybe giving the profits to the Salvation Army, as opposed to freely (randomly) distributing this suddenly rare, potentially life-saving commodity to whoever happens to be around with a hankering for something cold to drink. Of course, our society praises the person giving ice away and vilifies the seller charging $20. We'll discuss just why there is pervasive economic confusion in our culture, and elsewhere, shortly.

Law of Supply: To get much More Ice with Fast Delivery, Pay a Higher Price

Just as the high price sorts out priorities on the demand side, it works a similar magic regarding supply. To minimize suffering, in these situations, we need everyone who possibly can to drop whatever they're doing and rush into town with as much ice as they can handle, then leave and hurry back with more ice, and repeat. At the time of Hugo I was teaching at Embry-Riddle Aeronautical University in Daytona Beach. A number of our students who were young pilots were happy to fly ice into Charleston and, thanks to the price soaring to $20 a bag, they could afford (barely) to do so. Likewise, for other people, perhaps not quite so far from Charleston, taking time off work and renting a refrigerated truck became financially viable. This is the law of supply—an “unfairly” high price enables many more people to supply much more ice than does a normal, low “fair” price.

Even so, one can imagine that some suppliers were getting a much higher price than needed to motivate them. Perhaps, some teenagers living just out of the hurricane zone would willingly bring ice in for just $2; instead, they greedily enjoy “excessive” profits at $20. However, even “excessive” profits can sometimes be socially useful. For instance, these suppliers may rush back and forth frantically several times a day for $20 per bag versus a trip once a day for $2 bags. The higher price empowers them to buy more ice chests or use larger capacity, gas-guzzling vehicles, and it creates a lot of excitement and publicity that will help entice other people to join supply efforts. Still, there are likely to be some suppliers who in some sense are overpaid. Sellers, for example, who bring in no more ice at $20 than they would have brought at, say, $18 Just as a few buyers will splurge and buy ice just to chill their beer a few sellers may earn “excessive” profits. But such imperfections are impossible to eliminate and relatively unimportant in the scheme of things. Amidst all the post-hurricane chaos the price, rather miraculously but also naturally, immediately leaps to $20 and thereby coordinates a disparate society, motivating appropriate conservation and supply efforts by the selfish and kind-hearted alike, and by those who can barely cover the cost of bringing in ice as well as those of great wealth. Moreover, this super-high price will last only exactly as long as it is needed. As power is restored demand for ice will decrease while supply simultaneously increases, the forces combining to bring price relentlessly lower until power is generally restored and price returns to its normal "fair," pre-hurricane level.

Price Control Problems

Unfortunately, the above scenario was not allowed to progress in this fashion at that fateful time in Charleston. Instead, politicians stepped in and set a legal maximum price of $2 per bag in order to prevent "price-gouging" and ensure that the price was "fair." Law enforcers became "ice police," and a hotline was established so consumers could readily report "price gougers" and have them arrested and fined (Laband, 1989). This regulation was extremely popular and, as is not uncommon with popular regulations, disastrously harmful. Our Embry-Riddle students immediately stopped flying ice in since they could no longer cover the cost of the aircraft and fuel. Likewise, almost no one could afford to rent a refrigerated truck or even drive in with a bunch of filled ice chests. Only well-heeled or at least well-funded humanitarians, along with people barely outside the hurricane zone making a few sporadic trips, continued to bring in ice. The flow of ice, which had already been so small compared with the tremendous need, now slowed to a tiny trickle. In attempting to justify price controls politicians will often cite "concern for the poor." Bu this is of no help to the poor. A low hypothetical price is useless when there is nothing to buy.

Even worse, perhaps, than the suppressed supply effects, the artificially low \$2 price brought virtually all consumers back into the market, looking for ice to chill food and beverages. The extreme conservation practiced when the price was \$20 gave way to virtually no conservation as an avalanche of demand was unleased. The hordes of \$2 consumers, or, more accurately, would-be consumers were like locusts frantically scouring the area and stripping away the last remaining morsels of food in an already barren land. Most of this swarm would end up with no ice but what little ice there was ended up mainly being devoured by some random few in their group. Thus, that tiny trickle of ice supplied was mainly snatched up by comparatively casual users. The low price helped essentially no one, least of all those with urgent medical needs, rich or poor. It merely unleashed a costly but mainly fruitless ice quest by the horde of consumers-cum-locusts who did not have urgent needs.

Figure 1-1 summarizes the harm done by the government price control. Initially, the \$20 price motivated substantial, though still far from adequate, quantity supplied while simultaneously restraining quantity demanded, motivating the extreme conservation needed. Moreover, as market prices do, the price coordinated the actions of buyers and sellers so that ice, though expensive, was relatively easy to find since quantity demanded equaled quantity supplied, at Q*. Then, government forces the price down to \$2, quantity supplied collapses to QS2 and quantity demanded explodes to QD2 as virtually all conservation efforts cease. Note, these results are a certainty, as inevitable as gravity; there is no competing economic theory that people might somehow conserve more when prices are lower or that suppliers will want to sell more when price is forcibly reduced to 1/10 of market value. There is no way that having far less ice and using it far less wisely can benefit society.

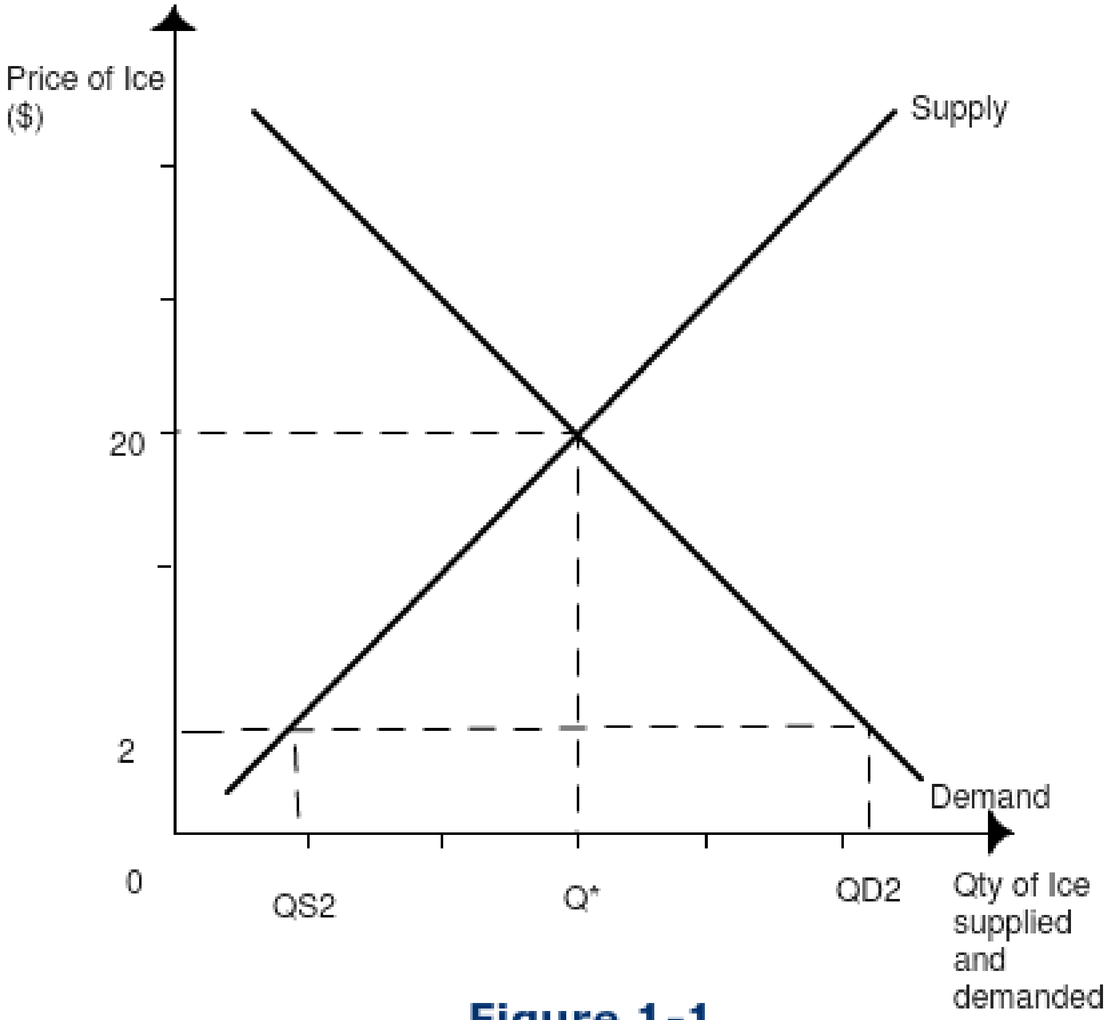


Figure 1-1

Also, since QD2 is huge, likely hundreds, even thousands of times greater than the measly QS2, ice sellers will quickly run out, finding ice becomes difficult, often impossible. This massive imbalance between supply and demand lead to a brutal, first come first served, competition as consumers fought over the few morsels of ice available. Long lines quickly formed whenever a rare chance to buy ice presented itself. Next, fights broke out and expanded into riots as people fought for position in line, realizing the ice would be grabbed up long before people at the end of the line would have a chance at it. The National Guard was called out to keep peace and order in these ridiculous lines that shouldn't even have existed (Laband, 1989). Most observers probably assumed that the massive lines, riots and commonly fruitless treasure hunts for ice were all a product of the deadly hurricane and its aftermath. In reality, these particular disasters were unrelated to Hugo, a product of corrupt politics, though politicians gave us exactly the "fair price" most of us would demand.

Beginner students often suggest that maybe there could be some sort of compromise between the efficient price of $20 and a "moral" price. Economists maintain that efficiency and morality are synonymous in this example, as is often the case generally. Part of the students' confusion relates to our opening analogy of amputation. If the patient will die unless the whole arm is amputated there is nothing moral about compromising by just cutting off a few fingers. What moral good is achieved by suppressing supplies of ice and encouraging casual consumption that denies ice to people with urgent needs? Furthermore, that $20 price was already a compromise; this is the direct implication of the facts as depicted in Figure 1-1. For consumers, the lower the price the better; a zero price would be optimal from our viewpoint, or maybe even a negative price. Oh my, wouldn't it be great if the law required producers to just give us $20 and a free bag of ice! For producers, on the other hand, the higher the price the better. If the law required ice to be priced at $40 a bag, there likely would have been plenty of ice supplied. Many pilots could afford to fly ice in from all over the country!

We would never think of imposing a $40 legal price floor to make sure producers could afford to bring plenty of ice so that, "hypothetically," consumers could buy all the ice they wanted. We know better than to focus on producer affordability exclusively, ignoring affordability for consumers. But what we actually did with the price control was exactly equally foolish, as we myopically focused on only the consumer half of affordability. In our self-centered, foolhardy quest for a normal price in the midst of completely abnormal, massive disaster we end up with no ice for most people. A unilateral approach to affordability only made things far worse. Only mutual affordability is worthwhile.

The price that maximizes mutual affordability, maximizes the amount of ice that consumers actually get, is the price where supply and demand intersect, the equilibrium price, in this case $20. A lower price increases quantity demanded by consumers but simultaneously depresses quantity supplied. Any price below $20 means fewer people, not more, actually get ice. People would be willing to buy more ice if only they could find it but it is certain that they won't be able to find it. Of course, imposing a $19 price would not have harmed consumers nearly as much as the $2 price did but the general result is the same—less ice not as well conserved for the most crucial uses. Similarly, any price above $20 will depress quantity demanded, trumping the increase in quantity supplied, and also resulting in fewer people actually getting ice. We get ice to the most people with the most crucial needs at $20; there's no better compromise. It is actually amazing how prices naturally tend to move to this optimal level as sellers, through trial and error, rush to find the price the market will bear, the highest price that enables them to sell their full inventory.

Of course, pricing logic applies to all goods. In disastrous situations, with government imposed "fair prices" gas stations quickly run out of fuel as those consumers who get there first fill up every vehicle they own as well as every gasoline container. Many evacuees who can't find fuel anywhere run out of gas, further clogging roads and delaying evacuations. With "price gouging" motorists will conserve fuel, sometimes cramming into a single vehicle rather than driving multiple cars, and filling the tank only half full—reasoning, correctly, that prices will moderate as they drive out of the hurricane zone. Likewise, hotels quickly fill up and turn numerous evacuee families away when prices are "fair". "Price gouging" drives large families to cram into a single room, and sometimes motivates acquaintances, or even strangers, to share a room to offset expenses. Of course, this pricing also increases supplies, leading affected businesses to hold greater inventories in hurricane season, and opening new supplies of rooms, including spare bedrooms via services like Airbnb. Regarding the latter, some people might offer a spare room for free just to be nice to evacuees. On the other hand, sharing one's house with a stranger can be an awkward hassle, the compensation of a high price would bring much more total supply into the market.

Yet, despite all this, we can generally count on politicians to use brute force to depress prices. We can count on government to make any disaster far more disastrous by discouraging conservation and depressing crucial supplies, even life-saving supplies—all in the name of protecting consumers from price gouging.

Economically Speaking, Voters Still Believe the Earth is the Center of the Universe

How is it possible that governments across the U.S. and around the world can continue to make such a tragic, fundamental policy error again and again? A simple answer is that politicians are more followers than leaders; if a huge majority of people want something then politicians generally give people what they want, and we the people want price controls in emergencies. So, next then, how is it that most otherwise reasonably educated people want price controls? Economists, liberal and conservative alike, have understood, and frequently taught, this pricing logic for more than a century. The folly of price controls is covered in some form in virtually every basic economic textbook, it's a staple in ECON101 classes everywhere. Yet, what is common knowledge to people well-versed in economic principles remains completely unknown to the vast majority of people. Why? Sure, it's a little counter-intuitive that high prices can benefit consumers, but grasping the fact that a surging price motivates conservation and massive supply efforts is hardly quantum physics.

The physical sciences seem not to have this problem at all. Few of us know all the details, but any reasonably well-educated person accepts that, despite all appearances, it is the earth revolving around the sun, not vice versa. Matter appearing to be solid is actually full of space, electrons orbiting a nucleus and all that. Even the freakishly strange theory of relativity is commonly accepted—time slows as speed vastly increases. Wow! How is it physicists have convinced us to drop our mistaken preconceptions and believe all these weird, very counter-intuitive ideas yet economists have had virtually no success in eliminating common misperceptions in our field? Of course, the physical sciences had some rough patches earlier in history—after astronomers figured out the sun was the true center of the universe it was several centuries before they were able to spread that knowledge through society broadly. Scientists had trouble getting ideas through an education system where leaders feared, perhaps needlessly, that learning the earth wasn't the center of the universe would trigger a crisis in faith.

It seems that acceptance by the education establishment is the key factor in the dissemination of counter-intuitive knowledge. Obviously, children and young adults more readily accept teaching that contradicts their preconceptions. I didn't fully appreciate this until, as a young professor, I attempted to teach the logic of pricing and illogic of price controls to a group of senior citizens attending an Elderhostel, using the same approach I used in my undergraduate classes. I got through to some of them but many angrily dismissed pricing logic out of hand. It's a cliché but for good reason: Adults tend to assume they already know the important stuff and the longer people have believed a myth the more difficult it is for them to learn and accept the truth.

Economists have the same problem today that astronomers had back in the day—the education establishment does not teach economic principles well. Public schools dominate education, with 90% of all K-12 students (U.S. Department of Education, 2016). Every book and all aspects of curriculum in these schools is controlled by politicians. Unsurprisingly, politicians are universally reluctant to approve curriculum and books that would make them look bad. It's not exactly a conspiracy; essentially government blundered into price controls and other bad but very popular policies first. Then, as teaching some form of economics became common, politicians just made sure material that would expose their poor policies was never included. From the politicians' viewpoint, the beauty of suppressing and censoring counter-intuitive ideas is that one generally doesn't have to lie. If we want children to ignorantly believe the sun orbits the earth we don't have to even address the subject, they will naturally believe what their senses seem to tell them. Likewise, if one wants people to believe price gouging is harmful and evil, and that we should all be thankful for noble politicians saving us with price controls the topic need never be addressed. And it isn't. I've been teaching freshmen economic classes since the 1980s. High school economics classes in public schools have become the norm but, based on our own in-class surveys, only about one public school student in a thousand is taught these pricing principles, no doubt by a rogue teacher who happened to know economics and didn't follow the state dictated curriculum.

Private schools are only slightly better on average, probably because many private school teachers went to public schools, or if not, perhaps their teachers' teachers went to public schools. As long as public schools dominate education, entrenched economic myths are likely to persist. Even in the college setting, where outright censorship is rare, I have known colleagues who avoided thoroughly debunking price controls, often just to avoid controversy, particularly in this politically correct age. In extreme cases I've known economics professors who taught economics so abstractly and theoretically that students gained virtually no insight about price controls or any other misguided policy. In other words, even though college economics course generally expose the myth of price controls, this is sometimes too subtle or abstract to penetrate entrenched preconceptions. Of course, many students never even take a single economics course. Bottom line: as long as incoming college students have no clue that obvious errors in standard economic policy exist there won't be enough students learning enough economics to change much.

Still, anyone at all curious can google "economic impact of price controls" and learn the truth with an hour or so of reading with an open mind. But such curiosity and open-mindedness are not common. In fairness, people have no reason to believe the topic is worth investigating since there seems to be such a solid political consensus; Republicans and Democrats alike virtually unanimously continue to perpetuate the myth of virtue in price controls. No doubt politicians have heard from economic advisors and, hopefully, understand the truth but if so they remain afraid to challenge public misconceptions. Similarly, economists in key government positions play politics with the issue as well. Most are reluctant to lie in their writings (again, just google the issue) but a fib or carefully worded evasion works well with television reporters and audiences. Harsh to say but it seems many economists outside of government are also willing to sacrifice integrity on this and other issues, perhaps because they hope to work for government one day or to obtain a key government grant. In this age of universal politicization even economists who seek no personal gain sometimes seem willing to fib just to protect a favored politician.

All of this is compounded by the problem economists have termed "rational political ignorance." Voters the world over tend to not be well-informed because the chance of one person changing the outcome of an election is typically about zero. Obviously, a majority of voters can impact elections, but there is no way to harness that group impact to individual incentives. The motivation for an individual to become informed is mainly intangible; the only reliable benefit is gaining a sense of fulfilling one's civic duty. In contrast, the cost of becoming well-informed is enormous in terms of the time it would take to research each issue. Morally, we all have a duty to be well-informed voters. Alas, when moral duty entails high personal cost but no tangible benefit to anyone we tend to neglect moral duty. So, while it is probably immoral for a voter to be uninformed it is logically consistent with our preferences—we prefer to spend our precious time on activities that generate tangible benefits. In this sense, we say it is rational, though certainly not good or desirable, for voters to remain uninformed. Of course, voters have no idea that a knowledge of economics would radically change their view of price controls and other policies. How can anyone judge the value of knowledge they don't have? News media personalities apparently are generally no better informed than the public so news reports primarily reinforce beliefs in mythical benefits of price controls and other confused policies. Although some reporters must know the truth, and for others it wouldn't take much investigative reporting to find it, the truth remains buried.

Thus, we have a sort of perfect storm of ignorance in this area. Politicians continuously fail to deliver the right policy, public education failure perpetually covers up the error, some economists participate in the cover-up—especially those economists working for politicians, and most of the media fails to unearth the truth or, seemingly, to even look for it. While politicians and the media may deserve our scorn, we the people may not be blameless. Perhaps politicians and media have little interest in finding and fighting for the truth because many of us voters prefer politicians and media personalities who confirm our own biases rather than challenge our misconceptions.

What Government Got Right

Despite the fundamental problems, it's worth mentioning that government did some important good things in the aftermath of Hugo. The post-hurricane ice market was left wide open; government wisely did not insist that sellers obtain an ice license or work through time-consuming inspections and paperwork to assure that proper water quality was used in making the ice. Anyone was free to come in and sell ice to a population in desperate need. This sensible lack of explicit regulation was feasible in part because of government implicit regulation through laws regarding liability. Sellers who sold ice made of seriously contaminated water would have been held financially liable, perhaps could even have faced criminal charges. There is room for improvement in liability (tort) law but most economists agree this is probably the most useful thing government can do for consumers.[i] Basically, consumer protection via tort law can help assure that a voluntary trade is truly voluntary, that the consumer is not surprised by some shocking quality problem that really wasn't part of the deal. This can greatly increase the scope and power of voluntary trade; we can, to some degree, trust strangers enough to trade with them. Thus, when they could actually find it, people were comfortable buying ice from strangers, often quite young, with no brand name to protect; strangers who would likely soon be gone never to be seen again. No small achievement.

It's much Harder to Implement Beneficial Regulation than it would seem

While the government response to the disaster of Hugo wasn't irrational in every regard there is no denying the colossal failure of their price controls. Politicians that can't get emergency pricing right, can't successfully get a very basic supply and demand issue right, are politicians that cannot be relied upon to necessarily get any consumer protection policy right. A social-political system that can't reach the economically clear conclusion that suppressing price will depress supplies and lead to wasteful, inefficient consumption is a completely unreliable, untrustworthy social-political system. While not all policies are this bad, neither is this, as we will see, a rare case. We cannot automatically assume that any existing government consumer protection policy makes any sense whatsoever, or that it will naturally evolve in a sensible manner, even over a century or so. We can't even assume that an economic policy enjoying virtually unanimous bipartisan support, a policy that the media and "everyone knows" is right, is in fact a good policy. It is worth re-examining our entire approach to consumer protection regulation.

Narrow Self-Interest Can Be Channeled to Benefit Society

Just as this ice example exposes government failure it also reveals how the dynamic rough and tumble of free enterprise is not always the disaster many imagine. Self-interested economic behavior by sellers is not automatically harmful to consumers. Adam Smith, often regarded as the father of economics, spoke of how people acting in their own interest are sometimes guided, "as if by an Invisible Hand," to also act in the interest of society. The person who spends a week-end delivering ice into the hurricane zone, in the worst case, may be completely selfish, thinking only of selling ice bags for $20 a pop. Even so, the ice he provides will reduce human suffering, quite possibly even save lives. Noble results can ensue from ignoble motives; this is essentially how free enterprise, though imperfect, works as well as it does in such a flawed world. By definition, a voluntary purchase only occurs because both trading partners see themselves benefited. Any government regulation may risk preventing that beneficial trade, stifling crucial cooperation, as we have seen. On the other hand, it is possible for some government policies, such as efficient tort law, to augment and reinforce the Invisible Hand.

We have all had some bad experiences with private businesses, the Invisible Hand is hardly perfect. Of course, bad experiences also occur with government and every other human institution, nothing involving humans is perfect. We often fail to behave honorably even with loving spouses, children and parents. Even in a great marriage or loving family, we let each other down at times. Given our nature, it is hardly surprising that economic cooperation between strangers sometimes breaks down badly. Perhaps it is more surprising how well things work out in the vast majority of our trades with people we hardly know or don’t know at all. For many of us the day begins with the alarm on our smart phone rousting us out of bed. It’s easy to love these phones; it’s hard to think of a product that better epitomizes the triumph of entrepreneurship in a free enterprise system.

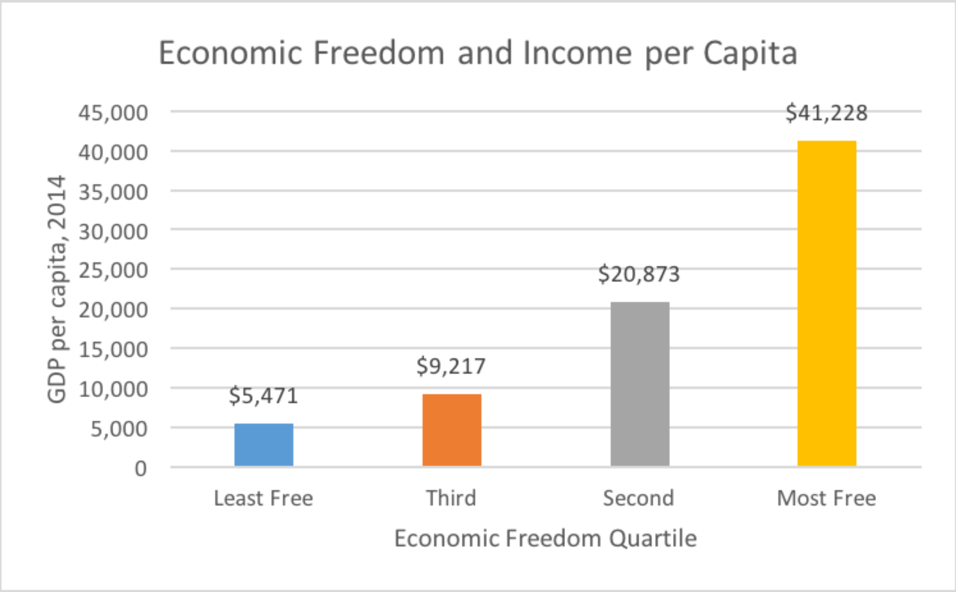
I’m old enough to truly marvel at all the everyday miracles delivered via that phone. Just being able to hear virtually any recorded song in existence at any time is well worth the cost of the service. Anyway, once up, one might toss some frozen breakfast into the trusty microwave and gulp down some food. Start the car up, Bluetooth audio hooks up and away we go. Whoops, the car is almost out of gas. No worries, quickly fuel up, pay right at the pump and easily make it in time to for work or the day's first class. Throughout the day, we use a myriad of products bought from businesses-- teams of complete strangers, often massive teams, likely focused more directly on benefiting themselves and their families than on benefitting strangers (customers), and these products typically work exactly as they should. My daily consumer experience is not constant perfection, but it is generally positive, though we often take the successes for granted and notice the occasional glitches more. Are your consumer days so different?

Compared to other places and other times, there is little doubt that we live in a sort of consumer paradise today. But, since we have substantial elements of both free enterprise and government command and control, it isn't always clear who to credit for our success, or even who to blame for the failures. Culturally, we have some tendency to have faith that government regulation generally works reasonably well to make things better. We've seen a case where that faith is not at all justified, and we'll get to some others. On the other hand, economists generally believe government has some useful role to play, such as in establishing appropriate tort law. Sometimes government makes things worse, sometimes better. But, is there a way to judge the impact more generally? There's no precise measurement but we can get some insight through international comparisons. Countries vary substantially in the degree of government control of the economy; we can see how government intervention correlates with income, real GDP, our approximate barometer of economic well-being. To show this most concisely we can group countries by degree of free enterprise, commonly referred to in the literature as degree of “economic freedom.”

In Figure 1-2 countries are divided into quartiles based on their degree of economic freedom in 2014, the latest available data; the countries with the comparatively lowest levels of regulation, taxes and government spending are in the top quarter and have average income of $41,228 per person. It is clear that as government intervention increases (defined here as economic freedom declining) income (adjusted for purchasing power) plunges dramatically, to the point where countries in the quarter with the most government intervention have a meager income of only $5,471 (Gwartney, et al, 2016).

There are limitations to studies of this sort. For instance, only the level of government regulation is measured, since there is no distinction between productive and harmful regulation,

Figure 1-2



Source: Gwartney, et al (2016, p. 25)

it may still be true that there are many useful regulations; these statistics provide no specific guidance concerning a particular existing or proposed regulation. It could be possible that a high level of *ideal* regulation would be helpful. Still, this data strongly indicates that *actual* government intervention is often harmful. In fact, the clear implication is that at least three fourths of the world's governments intervene in such a manner that, in practice, they make their economies worse, harming consumers rather than protecting them. The U.S. incidentally is nowhere near the top, we are ranked 16th in economic freedom in this study, but we are squarely in the top quarter. With only 15 countries ranked higher there, perhaps, is not enough in this particular data to necessarily have clear implications for us. Still, given the frequency of harmful regulation in the world, these statistics provide added reason to closely scrutinize regulation in the U.S.

Helpful Pro-Consumer Regulation Must Take Producer Preferences into Account

When government attempts to force sellers to give consumers a better deal than the one that emerged through competition and voluntary trade the results can easily backfire, harm consumers because the option imposed by government isn't worth making. Short of totalitarianism, we can't really regulate young pilots such that we force them to fly ice in for $2 bag. The regulation can only stipulate that, "*IF* you fly ice in. the price can be no greater than $2." The response from 100% of the pilots I knew was simply, "Okay then, can't afford that, no more flying ice in." This point is worth emphasizing: Producers can always just take their ball and go home. If sellers don't have enough to gain they will not show up. If regulators hassle them too much about a given product they are likely to simply stop making it. Being too tough on sellers is automatically harmful to consumers.

Consumers clamored for regulation, a price ceiling, largely because they naively assumed sellers were generally earning "excessive" profits and that they would offer about the same amount of ice for $2 as they would for $20. It is generally ridiculous to assume that forcing a price 90% lower will leave supply unchanged, as we've seen in this example. Yet, society frequently makes this sort of mistake; we wildly overestimate sellers' profit. For example, when the price of gasoline peaked in 2011 at over $4 per gallon, Exxon famously earned annual profits that set an all-time record. However, the profit was only about 7 cents per gallon, about 1.5% of the selling price (Bradley, 2011). More generally, surveys show consumers wildly overestimate profit rates. In a recent Roper Poll the average consumer estimated the profit rate was 36%, about 7 times the actual rate (Perry, 2015.) So, with such a thin profit margin most any regulation runs some risk of harming consumers by driving producers out of the market.

Some Notes on Safety

Firms are naturally very interested in improving safety, primarily because consumers value it and are more likely to buy safer products and be willing to pay more for them. The auto industry illustrates how the Invisible Hand drives profit seekers to make products safer and safer. Innovations like seatbelts, safety glass, airbags, anti-lock brakes, and, now, anti-collision technology and automatic driving that may ultimately end traffic fatalities altogether. All of these were created or are being developed by profit-seeking entrepreneurs. Sometimes these safety features naturally become standard while at other times government eventually mandates that safety innovations be universally adopted rather than continuing as options left to consumers to choose or decline. Producers likely have some natural preference for making safety innovations standard since there are economies of scale involved; it is typically much cheaper per car to make safety innovations standard rather than optional. Product standardization is almost always cheaper than product differentiation. Improving standard safety also generates good publicity and is likely to win brownie points with politicians and regulators. There is really only one reason to not make a safety feature standard, many consumers don’t want it, or more precisely, they don’t value the added safety enough to pay for it.

We often assume that people who value a given safety feature substantially less than we do are simply mistaken, perhaps they haven’t thought it through, are not very bright or maybe are mentally ill. This is not such a reasonable assumption when dealing with adults who are not obviously incompetent generally. Safety is valuable but it is not sacred, even if we completely accept as a given that human life is sacred. We all routinely sacrifice some degree of safety in a trade-off to save money or have more fun. None of us attempt to be as safe as we can possibly afford to be. As you read this, are you wearing a helmet? Any true safety maximizer who could afford a helmet would, by definition wear that helmet all the time, since one never knows when a possible head injury might occur, perhaps from a plane or meteor crashing onto your roof. In addition to the helmet, the safety maximizer would wear body armor, a mask to inhibit germs and would avoid most human contact since people spread disease and occasionally attack other people. Beyond that, a society that wanted to maximize safety would, for starters, ban swimming, skiing, any other sport, flying, driving faster than 15 miles per hour, and having babies, not to mention even having sex! Some reduction in safety is well worth the risk inherent in many enjoyable activities. Again, this is not saying that human life is not sacred. It’s saying that living an enjoyable, meaningful life entails accepting at least some slight physical risks.

How much risk should we accept? This is somewhat like asking, “What’s the most attractive color to paint a house?” The answer is subjective; it depends on your unique personality and subjective preferences. Hang-gliding is inherently fairly risky but can also be thrilling fun. Some people do it all the time, while others think it’s too risky to ever do once. No one has to be wrong. So, consumers are not wrong to buy, say, a standard sedan when they could afford to buy a far safer vehicle, such as an optic yellow dump truck. Consumers are not necessarily idiots even if they buy motorcycles, death traps compared to that dump truck. So, it is not so certain that the consumer who didn’t want to pay for ant-lock brakes or airbags is less intelligent than you and me. Even if they buy that motorcycle we still can’t confidently throw stones, especially if we aren’t driving that optic yellow dump truck ourselves. Given the complexities of life, it is even possible that a motorcycle allows the purchaser to improve her safety overall by, say, saving enough on transportation to be able to afford a home in a much safer neighborhood or obtaining better healthcare.

In a business, it may be occasionally true that a manager who resists improving safety is just stupid but it is probably more likely that the manager is actually fighting for the right of adult consumers to make their own choices in the pursuit of their own overall happiness. Remember, profit-maximizing firms are always willing to improve safety if consumers are willing to pay for it. In fact, there are few things firms won’t sell to satisfy paying customers; safety is probably their favorite thing to hawk given the inherent good publicity and politics.

When businesses oppose proposed safety regulations it is often said that "these companies are putting profits ahead of their customers' safety." This is at best a misleading half-truth since safety improvements only depress profits if consumers don't value the safety feature enough to pay for its cost. Firms that don't fulfill their customers' wishes risk their very existence, given the thin profit margins already discussed.

Even though, usually, firms are merely reflecting their consumers' wishes when they oppose safety improvements there are some complications. Some paternalistic regulation may reasonably override consumer freedom. The obvious examples involve children and clearly incompetent adults but a case might be made for other occasional exceptions. Also, when safety concerns spill over to people other than the consumers themselves, there can be good reason to restrict consumer freedom, the justification for pollution controls. Pollution produced by one driver spills over to others so pollution is clearly more than an individual choice.

However, the broader, key point here is that firms are, contrary to common myths of our culture, generally trying to benefit their customers, since that is how they benefit themselves. But we can only get these benefits if we are willing to fully pay for the production costs entailed. When these costs are unusually high we tend to leap to the often erroneous conclusion that profits must be extraordinarily high. In disastrous emergencies we even unthinkingly assume that using brute command and control to force price radically lower will have no impact on supply and demand. Regarding safety, we have some tendency to see villainy in any resistance to improved safety when firms are typically just reflecting customer reluctance to pay the cost of a given safety feature, reluctance that every human exhibits in one situation or other.

In summary, if we consumers aggressively use politicians to fire regulations at sellers we are likely to shoot ourselves in the foot, since consumer and business interests are inherently intertwined via a voluntary trade that only occurs if sellers and consumers both agree to the terms of that trade. We consumers have a tendency to try to use government regulation to basically get something for nothing. But it's generally not possible to get something for nothing in a voluntary trade. Consumer protection regulation is most likely to be helpful if it is focused on encouraging businesses to supply products and making sure firms meet the terms promised to their consumers.

Looking Ahead to the Rest of this Book

The utter failure of consumer protection via price regulation was considered first largely because it is probably the easiest issue to debunk. However, the central thrust of this book is more about promoting product safety and quality. Of course, price and quality issues are inherently intertwined, just as consumer and producer preferences are inherently intertwined. In other cases, as we shall later see, regulation can lead to higher prices that render products unaffordable for many, especially the poor. Or, legally mandated quality improvement in one area can lead to declines in quality in another. Thus, despite common impressions, regulatory issues seldom boil down to a simple good versus evil, moral versus immoral conflict with an easy answer. Even if consumer safety and wellbeing are our only concern we have to consider the impact on producers, to make certain they remain motivated to bring their products to consumers while maintaining needed quality. Unrealistic regulatory pursuit of a hypothetically cheaper, safer, more perfect product can easily become the enemy, the destroyer of a very good actual product. Consumer protection is vital but regulation can so easily backfire, harming rather than helping consumers.

Government has a useful role to play; establishing appropriate tort law is particularly crucial. With that in place, in a system where both buyer and seller naturally guard their own interests it is sometimes possible to give buyer and seller more room to creatively figure out and negotiate how to help themselves and thereby help each other. With government acting more like a partner and less like a dictator we can unleash a good deal of creativity to better protect and benefit consumers.

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[i] There are some scholars who argue that it is actually better to have a private system of law. See, for example, Benson (2011) and Boudreaux (2003).

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