Reflections on Consumerism

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In recent years the country has been swept by a consumer movement whose imprint is visible in a host of new statutes and judicial rules concerned with the plight of the deceived, the coerced, or the endangered consumer. My purpose here is to sort out the major kinds of consumer-protection programs that have emerged, to discuss their economic foundations and consequences and—less hopefully—to attempt an explanation of why consumer protection has become a significant element of our public policy.

Ten years ago one could have justly described the consumer as typically the victim rather than the beneficiary of economic regulation. We had an agricultural policy designed to increase the income of farmers at the expense of consumers; a labor policy designed to increase the income of workers at the expense of consumers (and other workers); the ICC, CAB and other administrative agencies in order to enforce cartel pricing. Looking broadly at government regulation of the economy one could find substantial support for the conclusion that the purpose in fact of most regulation (with a few notable exceptions, such as the Sherman Act) is to redistribute wealth from consumers.

Such a conclusion was attractive not only because it coincided with the results of observation but also because it was plausible on theoretical grounds.

The theory of cartels would lead us to predict that consumers, by virtue of their large number and the small stake that any individual consumer has in a particular regulatory program, would be especially difficult to organize into an effective political group.

This approach worked well with most of the older regulatory statutes. Even in the case of the Federal Trade Commission’s consumer protection activities, one could find evidence that a major albeit covert purpose was to protect established firms from the competition of new products.

The old consumer-victimization programs are still with us but the past few years have seen a series of legislative and judicial initiatives—the product, apparently, of the resurgent consumer movement whose most prominent advocate has been Ralph Nader—that seem to contradict the theory that economic regulation redistributes wealth from consumers to concentrated groups of producers. Consumer-protection programs may not, as we shall see, do much for the consumer; but they are not readily explicable as devices by which other groups exploit the consumer.

These programs can be divided into three major groups. The first comprises measures designed to increase the consumer’s information about a product. A notable example is the “truth-in-lending” legislation. The second group comprises measures designed to protect consumers against sales methods deemed exploitive, but where no issue of deception is involved. Here the courts have been the principal innovators, a noteworthy example being the Supreme Court’s recent Fuentes decision which outlawed statutes that permit installment sellers to repossess goods from a defaulting purchaser without a prior hearing. The third group comprises meas-
ures designed to protect consumers from physical hazards in products. The law requiring seat belts in automobiles is an example. These measures should be distinguished from safety regulations designed to protect, also or only, people whom the consumer might endanger. Thus laws regulating the brakes on cars, unlike seat belt rules, are not pure consumer-protection measures. The courts have also been active in this area. More and more state supreme courts are ruling that the seller of a product is strictly liable (that is, even if he was not negligent) to anyone injured as a result of a defect in the product.

These laws limit the freedom of action of, and impose costs on, the sellers subject to them. I do not see that the sellers derive benefits from them analogous to the benefits that airlines derive from being regulated by the CAB or motor carriers from being regulated by the ICC or lawyers and physicians from occupational licensure by the states. Perhaps some day the sellers will succeed in twisting these laws to their benefit, but meanwhile they are sustaining costs not offset by benefits from them. I may be overstating the point. Conceivably the automobile safety laws, for example, operate to reduce the price advantage of imported cars and so strengthen the competitive position of the domestic manufacturers. But it seems unlikely that this kind of explanation will be able to reconcile the consumer statutes with the view of the consumer as a cat’s paw of producer groups.

Let us examine the economic effects and possible economic justifications of the consumer-protection movement. I begin with measures designed to increase the flow of accurate information about consumer products.

I would not argue that as a matter of theory governmental measures to increase or improve the consumer’s information are never appropriate. The theoretical question, it seems to me, is a difficult one. On the one hand, it is surely incorrect to argue that since the theory of perfect competition, as conventionally formulated, explicitly assumes perfect knowledge about product qualities and prices, measures for increasing the existing, and obviously imperfect, knowledge of consumers are prima facie warranted. The conventional formulation is misleading. It ignores the fact that market processes themselves generate information about products; consumer knowledge is therefore not an exogenous condition of effective competition. Moreover, since information is costly both to create and to absorb, the optimum amount of such information is not infinite.

On the other hand, one cannot be confident that market processes alone will generate the optimum amount of information. There are free-rider problems that may be serious. Suppose one of my competitors is misrepresenting the qualities of his product. If his false advertising is effective the sales of my product will be impaired and this will give me an incentive to incur costs to combat his deception. But my incentive to rebut his falsities will be limited by the amount of injury my business has sustained. In cases where the amount of sales diverted from any single seller is small, no seller may have an incentive to take effective steps to dispel the deception even though the aggregate injury to the consuming public may be substantial. Perhaps this is why disparagement of competitors is apparently infrequent.

A partial answer is provided by trade associations, a traditional function of which has been to police against false advertising. But in a way this is part of the question, for it is something of a mystery how trade associations are able to exist in the face of the free-rider problem. Certainly where the association is engaged in suppressing false advertising, rather than in selling a service to members that is not available to nonmembers, the nonmember derives about the same benefits as the member, and at zero cost. Trade associations do exist and do engage in a certain amount of policing of false advertising; there are also important intermediaries between sellers and consumers, such as department stores, that ascertain and guarantee the quality of products. There are, in short, private methods that operate to prevent deception and provide consumers with accurate information about product qualities and prices but there is enough of a free-rider problem to make one cautious about claiming that the free market will provide as much information as consumers would be willing to pay for.

Whatever the theoretical uncertainties, there are practical reasons for suspecting that the recent measures designed to increase the consumer’s information about products are misconceived. The truth-in-lending law is an illustration. The assumption of
the law is that if people knew the percentage interest rate that they were paying to borrow money, they would, in many cases, not borrow, or they would shop successfully for a cheaper lender. There is in fact little basis for expecting these behavioral consequences except in the case of the professional investor, who does not require the protection of the act.

A person borrows either to invest or to buy a good. In the first case it is useful to know the percentage interest rate because that is the form in which the return to invested capital is ordinarily expressed. If you are planning to invest borrowed money in real estate that has an expected return of nine per cent per annum, you want to know what the annual cost of the borrowed money, expressed also as a percentage, will be. But for a consumer, the percentage rate of interest is usually a quite useless detail of the transaction. He is interested in the total cost of the product he is buying. This will include an interest charge if he is using borrowed money to buy the product. He will therefore purchase from the seller (or the combination of seller and lender) where his total cost, including interest charge, is lowest. To repeat, it is the total cost that he is interested in, not the interest component, and in being able to compare total cost as between competing sellers of the product.

Assume that a consumer, shopping for a color television set, is quoted three prices: $450 cash; $20 a month for 36 months; $22 a month for 36 months. He should be able to figure out readily enough that if he buys from either the second or third seller the total cost will be higher than if he buys from the first and that if he decides to buy on time, the second seller is cheaper than the third. He will have to compare the advantage of paying a lower price all at once with the advantage (crucial if he does not have $450) of paying a larger amount in monthly installments that he can afford. He will not be helped in this comparison by an interest-rate figure unless he is in the habit of saying to himself: "my personal discount rate is ___%." He would be well advised to find out what a bank would charge him, per month, if he borrowed $450 from it to buy the set for cash, but if he does this, he will still be comparing dollar amounts, not percentages. Thus will he be guided to the purchase that is optimum from his standpoint without ever being given an interest-rate figure.

To require the seller-lender to compute and disclose the interest rate does not give the borrower useful information. The interest rate is superfluous if the cash charge, the monthly charge, and the number of months are known by the consumer. To require a seller to disclose information that is not useful to the consumer is to impose a cost without a corresponding benefit.

The preceding analysis is somewhat oversimplified, however, in that it ignores such complications as balloon payments and service charges which may make it difficult for the credit buyer to compare the cost of alternative transactions (a similar problem is said to plague comparison of life insurance policies). I would still argue that the consumer will normally have all the information he wants without disclosure of a percentage interest rate. Suppose in our example of the color-television set that one seller offers the following terms: $10 a month for 24 months, plus $600 due the twenty-fifth month. The buyer can readily compute that under this payment plan, the total amount he pays—$840—is greater than under the alternative plans available to him. He must balance the additional burden against the advantage to him of a lower monthly payment the first two years. Again I would contend that unless the purchaser is accustomed to thinking in terms of percentage discount rates, a disclosure that the interest rate is higher—or lower—under the balloon-payment plan than under the other plans will not be useful to him.

The concern with exploitation (other than deception) of the consumer has centered on various devices for the enforcement of creditors' rights. There is the holder-in-tide-course rule that permits the holder of commercial paper to enforce the consumer's debt to him free of the defenses (such as defective merchandize) that the consumer might interpose in a suit by the seller of the good for non-payment. There is the creditor's right of summary repossession, extinguished by the Fuentes case (at least for some consumer transactions). There is the more general problem of clauses in so-called "adhesion" (standard or printed) contracts that waive various rights that the consumer enjoys under general contract law.

The attacks on these provisions proceed from the premise that the seller enjoys greater bargaining
power than the buyer and so is able to impose coercive provisions that the buyer would reject were there parity of bargaining power. Analysis must therefore begin with an examination of the concept of “bargaining power.”

The level of discussion of consumer problems would surely be raised if the use of the term were banned and the user forced to find a synonym. Such an exercise would show that when a person alleges unequal bargaining power he means, or can be shown to mean, one of three things: one of the parties to the transaction is ignorant of an essential term, perhaps due to misrepresentation by the other; one of the parties has a monopoly; one of the parties is compensated for accepting a term that is favorable to the other party.

The holder-in-due-course rule will illustrate the utility of thus decomposing the charge of unequal bargaining power. It is possible that many consumers are unaware that one consequence of buying on the installment plan is that the seller may discount the consumer's note to a finance company which can then sue the consumer, if he defaults, in an action in which the consumer cannot assert the defenses he would have against the seller. If such ignorance is widespread, and if the cost of the seller's dispelling it is lower than the cost of ignorance to the consumer and the cost to the consumer of becoming informed, the appropriate remedy is to require the seller to disclose the consequences of an installment sale more clearly; it is a deception case. To be sure, the information may be of the useless sort because most of the people who are sued by finance companies may not be willing to pay more in order to preserve all of their defenses. But in any event the complaint would be deception rather than coercion.

A second possibility is that sellers and finance companies have conspired to force all installment purchasers to agree to waive their defenses against sellers in actions by the finance companies. It is most unlikely that there is such a conspiracy. Retail selling and consumer financing are both highly competitive fields. If there is a conspiracy the solution is to attack the conspiracy, lest the conspirators simply switch the focus of the conspiracy to another term in the sales relationship.

The third and most realistic possibility is that the holder-in-due-course rule is accepted by consumers because it minimizes the cost of goods to them. It does, after all, enable the lender to dispense with an investigation of the quality and probity of the seller's operations. Were the lender liable for the seller's misconduct, the lender might have to conduct such an investigation or include an additional risk premium in the lending charge; in either case the cost of purchasing goods on credit would be higher. (Alternatively, the seller might agree to indemnify the lender for any loss resulting from interposition of a defense against the seller in a collection suit; this would presumably decrease the seller's costs and be reflected on an increase in his prices.) It is quite rational for consumers to prefer lower prices for products or credit to retention of certain legal defenses.

Outlawing the holder-in-due-course rule is a goal of the consumer movement but if the foregoing analysis is correct the abolition of the rule is likely to make the consumer worse off rather than better off by making credit purchases more costly. If there are problems of deception or monopoly in the application of the rule they can be dealt with directly, without forcing up the cost of installment purchases generally.

The third major thrust of the consumer protection movement has been toward increasing the safety of consumer products. My analysis here is a little similar to my earlier analysis of deception. The market itself creates incentives to approach the optimal level of safety but they may not be sufficient to attain it.

The cost to the consumer of a product that involves a hazard to health or safety has two elements: the price of the product and an expected accident or illness cost that can be viewed as the cost of the insurance premium necessary to insure against the hazard created by the product. Competition should operate to compress this cost. If methods can be developed for reducing the expected accident cost at a cost lower than the saving, they will be developed. To be sure, this conclusion must be qualified by reference to the existence of divergent attitudes toward risk. If consumers are risk averse, the cost-justified level of safety will be higher than the expected accident cost; it will be lower if they are risk preferring. In either event, the competitive process should work toward an optimum level of product safety.

There is, however, an information problem that
undermines this conclusion. Most people have very little direct experience of accidents and it is difficult for them to judge whether, say, seat belts reduce the expected accident cost of driving an automobile, or whether a special type of bottle construction would reduce the chance of a coke bottle’s exploding in one’s face. In principle, the innovator of such a safety advance has an incentive to inform the consumer of the reduced hazards that the advance makes possible. An inevitable consequence of such a campaign, however, is to bring to the consumer’s attention safety problems of which, lacking direct experience, he may be unaware. The result might actually be to induce some consumers to substitute different products that were safer. Very few people, for example, think often (or ever) about the danger of exploding bottles; the danger is indeed slight. If a soft-drink manufacturer advertised that his bottle reduced the danger, one effect would be to plant a concern in the consumer’s mind where none had existed before.

Recognition that advertising of this sort can backfire led the cigarette manufacturers, with the FTC’s blessing, to agree to discontinue references to tar and nicotine content in their advertising. The example is two-edged: the fact that the members of the industry had to agree to discontinue such references suggests that, in the absence of such collusion, they would have continued. Still, this kind of advertising may be relatively infrequent because of its boomerang potential.

To complete the analysis, if producers are reluctant to inform consumers of safety improvements, and if the information is not otherwise forthcoming, producers will be reluctant to undertake them: such improvements will lack clear-cut marketing value. Of course it does not follow that the particular safety measures required by the government for automobiles and other products have been cost-justified; but this is a question on which I am ill informed.

The movement toward the imposition of strict liability for injury resulting from defective products is frequently defended on the ground that it will lead to safer products. This may be correct if the alternative is no liability (caveat emptor), although for reasons not expressed by the judges and lawyers who take this position. First, if many consumers are risk preferring, a strict-liability standard will induce firms to take safety precautions that they would not take if they were not liable. Since under a strict-liability standard the cost of accidents is a cost to the seller, he will adopt any safety precaution that is cheaper than that cost. If he were free to negotiate with his risk-prefering consumers over the level of safety, the result would be a less safe product, as they would prefer.7 Observe, though, that it is the lower, not the higher, safety standard that is optimal in terms of consumer preferences.

Second, the information point discussed above suggests that firms may sometimes forgo opportunities to reduce the (net) expected accident cost of their products, due to difficulty in marketing safety improvements. A strict-liability standard induces them to make any improvements that reduce their net expected accident costs.

But the foregoing discussion is somewhat misleading, since the movement in the law has not been from no liability to strict liability but, in recent years anyway, from negligence to strict liability, and to this latter movement the above two arguments do not apply. Assuming that the manufacturer is forbidden to disclaim liability for his negligence, a negligence standard will lead him to adopt any cost-justified improvements.7 If disclaimer is permitted, then either a negligence or strict liability standard becomes the equivalent of no liability.

Thus, given negligence liability, a movement to strict liability seems unlikely to increase product safety. And, again given negligence liability, the utility of many direct governmental regulations of safety is called into question.

I conclude that there are economic grounds for questioning whether a completely free market will bring about an optimum level either of product information or product safety. (The argument of “exploitation” based on “unequal bargaining power,” however, lacks, so far as I can see, any economic basis.) But that the free market is unlikely to work perfectly is not a sufficient condition for government intervention, since government, too, is invariably imperfect in actual operation. If truth-lending legislation and restrictions on consumer financing practices are typical examples of how government intervention to protect the consumer is likely to operate, we may well prefer to rely on a
highly imperfect market. The evaluation of the government's efforts in the area of safety is somewhat more complex, although Sam Peltzman's recent paper suggests that here too government intervention may often be counterproductive.

I also conclude that the efficiency justifications for the consumer-protection movement are too tenuous, in theory and practice, to explain the movement. Here, then, is an important area of public policy that seems explicable neither on traditional public-interest grounds nor on grounds of effective political power. How then is it to be explained? This, it seems to me, is our most challenging and baffling question.

The following points occur to me as elements of the answer:

1. Ignorance of the economic dimensions of the consumer problem is a pervasive characteristic of public discussion of the problem. The efficiency (and distributive) effects of forbidding certain methods of financing consumer transactions are obvious to a few people steeped in economic theory and profoundly unobvious to everyone else. This ignorance is to be distinguished from the ignorance of a businessman who cannot tell you what the term "marginal cost" means. Since the concept, although not the term, is an inescapable and intuitive feature of business activity, his ignorance of formal theory has no consequences for his behavior; and so with the consumer who has never heard of a "utility function." But there is nothing intuitively obvious about the economic effects of outlawing the holder-in-course rule. The finance companies should understand its effect on their practices and they may try to educate the consumer advocates; but to the latter, the concepts will be alien and the source suspect.

2. The costs of consumer-protection programs tend to be (a) diffuse rather than concentrated and (b) low. The programs typically cover entire industries so that the added costs they impose (which anyway represent only a small fraction of the cost of the industry's product) can be reflected in higher prices with only a small decline in sales and profits. Hence, the incentive of the affected sellers to incur costs in opposing such programs is relatively small.

3. The interest-group theory of the political process does not hold that consumers never get legislation passed in their favor, only that it is hard for them to do so. It is politically very difficult to eliminate the motor carriers' cartel because the consequences would be very severe for shareholders and employees of the affected firms, and the benefits to consumers, in contrast, would be highly diffuse. But diffuse benefits may be sufficient to procure enactment of measures, such as consumer-protection measures, the costs of which are also diffuse. Moreover, there are concentrated and substantial benefits conferred by such measures, not on consumers, but on a small but influential minority who believe passionately in the abuses of the competitive process and the iniquities of large firms. I doubt that the minority is strong enough to obtain legislation that would impose substantial and concentrated costs on American industry, but perhaps it can obtain a symbolic victory over the forces of deception, exploitation, and hazard—which may be all that it really wants.

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3 It should be noted, however, that the effective-political-group approach, properly understood, allows for redistribution to particular consumer as well as particular industry groups. See Richard A. Posner, "Taxation by Regulation," 2 Bell J. Econ & Management Sci. 22 (1971).


6 Suppose the expected accident cost to the buyer of a coke bottle, which may explode, is .16. Under a strict-liability standard the bottler can expect to be liable for this cost and he will therefore adopt any safety measure that can reduce it. If he were not liable, and ignoring the information point discussed earlier, he would adopt only those safety measures whose costs are willing to cover the cost in the form of a higher price for the product. Consumers who are risk preferring will not necessarily be willing to pay for a safety measure that brings about a net reduction in expected cost. They may prefer the higher risk of an accident to the certainty of paying to reduce that risk.


8 The Benefits and Costs of New Drug Regulation (Dept. of Econ., U.C.L.A.).

9 Cf. James Q. Wilson, The Politics of Business Regulation (Dep't of Gov't, Harv. Univ.).