

## This Deregulation May Be Hazardous to Your Health

Millions of dollars of monopoly profits are at stake for those who can gain control of a regulation. Rewards of this level induce salivation in unsavoury people and decent folk alike. Yet the challenge facing a consumer who wants to understand a regulation exceeds the resources an individual has. A "consumer purpose test" is a crucial first step to see if a regulation proposed "to protect consumers" is actually in the public interest. Unhappily, there are economic reasons to explain why the sensible regulations are singled out for attack. *Either* regulation *or* deregulation may be a foe dressed up as a friend.

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### Regulation: The Long and the Short of It

Short carrots. Why would the consumer need protection from short carrots? Does Hollywood have the answer? Several years ago a camp movie was so bad it was being considered as the worst film ever made. Its title was "The Attack of the Killer Tomatoes." Can this explain why amendments to Canada's grading regulations for fruits and vegetables would set a minimum length for imported carrots? Were consumers out in the streets demanding protection from the attack of the short carrots?

Of course not. The regulation promulgated "to protect consumers" served only to protect domestic carrot producers from competition. Consumers are "protected" from lower prices and competitive quality. The regulation is a clear illustration of the way that producers twist the consumer protection argument to achieve an end that can best be described as perfect perversion. How is it achieved?

### The GRAS List

The United States Food and Drug Administration produces a list of additives Generally Recognised As Safe (the GRAS list). This can be adapted to a GRAS List of seven economic reasons for intervening in the market. The first five come under the general heading of "Market Failures": each of the five is a reason for the failure of a free market, so each is a "safe" rationale for regulation. The five: 1. externalities, 2. monopolies, 3. information deficiencies, 4. undersupply of a "public good," 5. incomplete markets. Two additional rationales under the heading of fairness are: 1. distributional goals, and 2. merit goods. These seven economic rationales are Generally Recognized As Sound (GRAS). What every lobbyist must do as the first step, is to choose a rationale from the GRAS List so it can be deployed - as a cover - to "justify" a regulation. The private interest is thus much like a wolf clothed in the vestments of the public interest, much like the kindly

grandmother of Little Red Riding Hood. The second step in privatising the public interest is gaining the right to draft the regulation (who else has the "expertise"?) Perfect success requires a third step: one must gain the right to administer the regulation . . . preferably at public expense. The carrot example serves well: border guards are to be paid by the public to check for terrorists carrying concealed carrots.

### Some Magnitudes

Under "free trade" US consumers gain the benefits from imported steel, right? Not exactly. The President of Stelco, recently demonstrated that to get steel into the US market one must file a report containing 55,000 lines of computer data. Is this an unusual example? Not unusual enough: One European effort to count such regulations was abandoned in despair after 100,000 trade barriers had been identified.

### Regulations: Friends or Foes of Consumers?

Lobbying is the art of concealing the public interest from the public. The easiest way to dress a wolf in sheep's clothing is to clothe the real objective in the consumer interest. Tens of thousands of regulations are contrary to the public interest . . . but not *all* of them.

What about rules that autos must have brakes? What about safety and efficacy tests for new medicines? When Dr. Frances Kelsey of the FDA refused to allow Thalidomide onto the US market - in the face of enormous industry pressure - she saved hundreds, probably thousands of US families from the characteristic birth defects so evident in Germany, France, Canada and many other countries. Dr Kelsey, a Canadian, won a U.S. medal for her integrity. With this second type of example of regulation, we find a clear consumer purpose. The dilemma with regulation is the same as The Little Red Riding Hood (RRH) problem: Is a regulation consumer-friendly (Grandma) or is it a hungry foe wearing a deceptive

suit? A wolf in Grandma's clothes?

#### Deregulation: Wolf or Grandma?

If consumer-unfriendly regulations are removed, the price of steel, and carrots will go down, while quality and price will improve. But the wolves may be first in line in Washington, Brussels or in provincial capitals because they see an urgent need to remove binding restraints. Recall the deregulation of Savings and Loans (S&Ls) in the US during the 1980s. The change made it easier for charlatans and thieves to get their hands on one of the most attractive incentives in existence: other people's money. A moral hazard problem already existed with deposit insurance but deregulation allowed as few as three persons to own an S&L. With deregulated supervision, these owners could lend to related parties - leaving the risk with the Federal Deposit Insurance Commission (FDIC). If the borrower struck it rich, she or he paid back the loan. If not, the company declared bankruptcy and the FDIC got to reimburse depositors at the S&L. The looting was not small: more than 500 billion dollars in most estimates.

The crucial lesson on the targets for deregulation is illustrated by the response of the bank robber Willie Sutton to the question "Why do you rob banks?" His answer: "Because that's where the money is." Why do we change S&L rules instead of deregulating barriers against imports? The wolf in sheep's clothes is back, this time seeking deregulation. The regulations which actually serve the consumer - say by keeping scam artists from looting S&Ls - are special targets for deregulation. Their release is worth billions to somebody.

#### Who Wins With Regulation? With Deregulation?

With the Red Riding Hood problem, industry-inspired regulations obviously harm her. If these are removed, she wins. The important case occurs where an effective regulation, well administered, keeps the wolf from thriving at RRH's expense. If a *necessary* regulation is removed, so is Red Riding Hood.

#### Policy

In developing countries fewer regulations exist, though some of the earliest rules are dedicated to maintaining the quality of *exports* (especially food). The sorry state of markets is partly related to the inability to offer what the U.N. Secretary-General calls

the "irreducible minimum" of consumer protection. The European Union, which has "too many" rules, has a logical policy. Regulations are permitted if they have a health or safety objective. We must ask: Does the original regulation pass the consumer purpose test? If so, is it efficient in achieving its objective? Is some other method superior?

Just as the defence of a country is a public good, so too, is consumer defence. Scale economies in search are also important. For any individual, the degree of difficulty in a consumer choice,  $d$ , depends on the complexity of the decisions,  $C$ , and the decision-making resources,  $R$ , available to the consumer:  
$$d = C/R.$$

Education increases  $R$ , thereby decreasing  $d$ , clearly an improvement. Yet complex decisions (as with Thalidomide) require more investment in  $R$  than anyone can make as an individual. A Food and Drug Administration is a public good that makes up a crucial component of  $R$ . These public goods need to be stocked with trained and effective scientists and professionals.

The forces explaining difficulty ( $d$ ) also explain why there will always be a need for some regulations protecting consumers. Thus there will continue to be the sheep's clothing of consumer protection in which a wolf can conceal the true intent of his quest for regulation . . . or deregulation. Many regulations do not pass a public interest test even though the lobbyists used that rationale. They have been introduced to protect producers of everything from beer to steel. Similar methods are being used (or sought) by real estate agents, insurance sellers, travel agents and liquor marketers to gain special privileges and inhibit potential competitors.

The multitude of wounds - ranging from the small nicks from small carrots to major haemorrhage from S&Ls - provide the lesson that the benefits from understanding things are high indeed. It is not only the consumer who loses: firms lose too, especially those that would have been able to supply superior goods and services if the marketplace had fairer rules. A "Consumer Purpose" test is essential if we are to sort out regulations that are friends or foes.