

TOWARD A NEW CONSUMER PROTECTION

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Consumer protection is everywhere in retreat. Congress has rejected the Food and Drug Administration's proposed ban on saccharin,¹ and several courts and state legislatures have attempted to block the FDA's attack on Laetrile.² The Consumer Product Safety Commission's recent ruling that swimming pool slides must carry danger warnings³ has elicited widespread ridicule, brought a reversal in the federal courts,⁴ and contributed to rumors that the Commission itself will be abolished. Congress has rescinded the

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¹ The rejection took the form of an 18-month moratorium on the FDA's authority to ban saccharin. Saccharin Study and Labeling Act, Pub. L. No. 95-203, § 3, 91 Stat. 1452 (1977) (codified at 21 U.S.C. § 348 (Supp. 1977)). The moratorium expired in mid-1979, and the House moved quickly to extend it until 1981. 125 CONG. REC. H6485 (daily ed. July 24, 1979).

² The decision of the United States Supreme Court in *United States v. Rutherford*, 99 S. Ct. 2470 (1979), rejected an attempt to defeat the FDA's efforts to regulate interstate distribution of Laetrile, but made no findings as to the drug's safety or effectiveness. While the *Rutherford* decision appears to clear the path for further FDA involvement in the Laetrile controversy, it does not affect the validity of the various state legislative and judicial pronouncements on the legality of Laetrile. Despite the FDA's call for evidence of Laetrile's safety and effectiveness, seventeen states have legalized the drug. Pro-Laetrile campaigns were defeated, however, in fourteen states in 1978. [1978] FOOD DRUG COS. L. REP. (CCH) ¶ 42,292.

In other states, judicial decisions have paved the way for importation and distribution of the drug in specific instances. See, e.g., *People v. Privitera*, 74 Cal. App. 3d 936, 141 Cal. Rptr. 764 (1977); *Suenram v. Society of Valley Hosp.*, 155 N.J. Super. 593, 383 A.2d 143 (1977).

³ 16 C.F.R. § 1207.7 (1977), *revoked*, 43 Fed. Reg. 58,813 (1978).

⁴ *Aqua Slide 'N' Dive Corp. v. Consumer Prod. Safety Comm'n*, 569 F.2d 831 (5th Cir. 1978).

Department of Transportation's safety-belt/ignition interlock rule,⁵ removed its authority to require helmets for motorcyclists,⁶ and expressed distaste for its "air bag" regulation.⁷ Congress has also rejected the proposed consumer-protection agency.⁸ And the Federal Trade Commission's proposal to control television advertising of sugared cereals for children has prompted the *Washington Post* to accuse the agency of becoming the "national nanny."⁹

These events contrast sharply with those of just a few years ago, when Ralph Nader first argued that automobiles were "unsafe at any speed"¹⁰ and the consumer movement demanded and received protection against business malfeasance and nonfeasance. Why the difference? What has changed?

Unfavorable economic conditions offer one explanation. Since 1973, oil embargoes, soaring prices, recessions, and high unemployment have plagued the country. Consumer protection was fine when the economy was buoyant, but in times of belt-tightening it is regarded as an unaffordable luxury, since its benefits are often less immediately apparent than its costs. When auto sales declined drastically during the 1974 recession, for example, Ford and Chrysler asked for a moratorium on federal safety and environmental standards. Chrysler threatened to close a Detroit auto plant employing 5,000 people in one of the city's poorer neighborhoods if the volume of auto sales did not increase. Eventually the industry got its way.¹¹

Greater sophistication in the business community about lobbying and grass-roots politicking may also account in part for the decline in political support for consumer protection. Trade asso-

⁵ Motor Vehicle and Schoolbus Safety Amendments of 1974, Pub. L. 93-492, Title I, § 109, 88 Stat. 1482 (codified at 15 U.S.C. § 1410b (1976)).

⁶ Highway Safety Act of 1976, Pub. L. 94-280, Title II, § 208(a), 90 Stat. 451 (codified at 23 U.S.C. § 402(c) (1976)).

⁷ In 1977, the Senate sustained the Department of Transportation's decision to require air bags on 1984 models by a vote of 65 to 31. 123 CONG. REC. S17016 (daily ed. Oct. 12, 1977). The following year, however, Congress tacked on a rider to the Department's appropriations bill which provided that no funds could be used to enforce or implement the airbag requirement. Department of Transportation and Related Agencies Appropriation Act, 1979, Pub. L. 95-335, Title III, § 317, 92 Stat. 435. The House has added an identical amendment to the 1980 appropriations bill. 125 CONG. REC. H8066 (daily ed. Sept. 18, 1979).

⁸ The bill to create the agency was defeated by a vote of 227 to 189. 124 CONG. REC. H828 (daily ed. Feb. 8, 1978).

⁹ *The FTC as National Nanny*, Wash. Post, Mar. 1, 1978, § A, at 22, col. 1E.

¹⁰ R. NADER, UNSAFE AT ANY SPEED (1965).

¹¹ *Business Lobbying: Threat to the Consumer Interest*, 1978 CONSUMER REP. 526.

ciations have flooded Washington in the past few years. Since 1969, four hundred corporations have opened Washington offices.¹² And it is estimated that corporations and trade associations account for eighty-five to ninety per cent of about \$1 billion a year spent on grass-roots efforts.¹³

There is, however, another critical factor. Underlying the economic and political shifts of recent years has been a growing public unease about the function of consumer protection. It is not so much that the goal worries people. Ask the average consumer whether he wants unsafe cars, carcinogenic drugs, adulterated foods, dangerous toys, or advertising intended to exploit the gullibility of his four-year-old and he will answer with a resounding "no." But ask him whether government regulators should intervene to remedy these problems and his response is likely to be ambivalent. Increasingly, the public debate about consumer protection has centered less upon the question of which marketplace evils should be cured than upon the propriety of having the government administer the remedy. In its crudest form the question has become: whom do you trust less—big business or big government?

To take sides in this debate would be foolish—recent history offers no particular reason for trusting in either big business or big government. Moreover, *some* government regulation will always be needed to make sure that consumers are getting what they pay for, even if it is limited to inspecting the scales at the checkout counter and testing for contaminants in beef.

Yet the current crisis in consumer protection points up the need for a reexamination of the fundamental questions. That some form of consumer protection is conceded to be necessary only begins the inquiry. *Why* do consumers need protection? *When* should the government intervene to protect them? *How* should it do so? The government's current answers to these questions have yielded a regulatory policy fraught with difficulties. The need for consumer-protection regulation is seen as arising from the sale of unsafe, unhealthy, or inefficient products. Relying on risk-benefit analyses, existing policy calls for government intervention whenever the cost of making a product better is less than the benefit to consumers of the extra margin of safety, health, or efficiency thereby achieved. Typically, government intervention takes the form of requiring

¹² *Id.* 527; *Washington Information Boom*, DUN'S REVIEW, March 1979, at 60.

¹³ *Business Lobbying: Threat to the Consumer Interest*, 1978 CONSUMER REP. 526, 526. See also Epstein, *The Business PAC Phenomenon*, REGULATION, May-June 1979, at 35; *Washington Information Boom*, DUN'S REVIEW, March 1979, at 60.

manufacturers and sellers to bring their products in line with minimum official standards, or in some instances, of banning sales altogether.

The paternalism and potentially limitless opportunity for government intervention implicit in such an approach have, in turn, engendered a growing skepticism about the legitimacy of consumer protection, and thereby worked to the advantage of those organized interests hostile to the consumer movement.

This Article offers a way out of the current impasse by proposing a nonpaternalistic approach to consumer protection that takes account of the market's structure and its incentives.¹⁴ The need for consumer protection lies not in the existence of "bad" products, but in market relationships which make it unlikely that sellers will take efficient steps to prevent consumer mistakes. This will occur in markets where sellers do not have a significant stake in maintaining goodwill. It follows that the current regulatory method of directly supervising the quality of the product misses the mark. The least costly and most effective strategy for consumer protection is to increase the stake which sellers have in building and maintaining goodwill.

No discussion of consumer-protection policy can afford to ignore antitrust considerations. Part I of this Article discerns the origins of consumer protection in regulatory efforts to restrain competition within temporarily unstable markets. Part II analyzes the contemporary "purchasing agent" model of consumer protection, whereby government directly assesses a product's costs and benefits and the costs and benefits of improving product quality. Because the "purchasing agent" model lacks any connection to the dynamics of the market, it is unable to provide a basis for integrating consumer-protection and antitrust policies, a problem explored in part II by examining four kinds of market restraints typically condemned by antitrust law without consideration of their potential for significant consumer benefits.

Part III sets forth a new, market-oriented analysis of *why* consumers need protection. Parts IV and V address the *when* and *how* of government intervention: Part IV identifies four market situations that reduce incentives to maintain goodwill; part V outlines a number of strategies for increasing the seller's stake in goodwill,

¹⁴ This Article does not consider the possible effects of consumer purchases on third parties. If one dwelled only on such effects, some justification for government paternalism might be discovered. After all, a child's dangerous toy can injure his friend as easily as himself, and not even the rational consumer is likely to weigh this possibility fully in his purchasing calculations.

a program consistent with the basic concerns of antitrust, as well as consumer-protection policy.

I. CONSUMER PROTECTION AND MARKET INSTABILITY: GOVERNMENT AS FRANCHISOR

The American economy has paid lip service for two hundred years to the twin *laissez-faire* principles of vigorous competition and consumer self-reliance, the latter embodied in the maxim *caveat emptor*. But whenever major businesses faced unstable and uncertain markets, and consumers likewise confronted risky market decisions—when, in short, rapid social or technological change threatened long-standing and established business-consumer relationships—the government attempted to achieve stability by regulation. Government franchising in various guises served to promote consumer as well as private interests by restraining the operation of market forces. The murky origins of consumer protection are thus intimately bound up with protection of certain businesses from competition.

During the latter part of the eighteenth and the beginning of the nineteenth century, some of the nation's most rapidly changing and expanding businesses—banks, insurance companies, and steamboat, turnpike, and bridge operations—received exclusive franchises from state governments, assuring them both stable custom and freedom from local competition. In return, these businesses were vested with public responsibilities. In 1809, the Virginia Supreme Court of Appeals, upholding legislation amending the charter of an insurance company, made this *quid pro quo* explicit: “[acts of incorporation] ought never to be passed, but in consideration of services to be rendered to the public.”¹⁵ A few years later, New York's Chancellor Kent justified on a similar basis the finding of an implied monopoly in a corporate charter: “The consideration by which individuals are invited to expend money upon great, and expensive, and hazardous public works, as roads and bridges, and to become bound to keep them in constant and good repair, is the grant of a right to an exclusive toll.”¹⁶ The government thus

¹⁵ *Currie's Adm'rs v. Mutual Assurance Soc'y*, 14 Va. (4 Hen. & M.) 315, 347 (1809).

¹⁶ *President of the Newburgh and Cohecton Turnpike Road v. Miller*, 5 Johns. Ch. 100, 111 (N.Y. Ch. 1821), *quoted in* M. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860*, at 126 (1977).

agreed to restrict competition in these financial and transportation markets, so vital to a developing economy, in exchange for capital investment and a guarantee to the consuming public of safety and reliability.¹⁷

The period between 1870 and 1914 saw a great expansion of economic activity and the development of new markets in consumer goods and services; it also brought destabilization in the form of depressions and sharp upturns. A willingness to sacrifice competition in some industries in return for secure investment opportunities and consumer protection led to regulation. Principles of consumer and business protection, demanding government intervention and control over trade, coexisted peacefully with the principles of a free-market economy, which required unfettered contact among sellers and consumers. Tensions were avoided in large part because government intervention focused on particular markets where rapid growth, coupled with technological or social change, made participation risky for both business and consumers. Under those circumstances, unfettered competition rendered the outcomes of business-investment and consumer-purchasing decisions less predictable, and government regulation more palatable. Regulation thus served to fence in those providers who had been sufficiently bold or farsighted to make the initial investments, and to fence out the Johnny-come-latelies who otherwise would seek to exploit the new demand.

By the mid-1880s, for example, the established railroads faced new competition. They first reacted by attempting to create voluntary pools and agreements to prevent rate-cutting and raiding of established territories. These efforts failed, however, because of the legal unenforceability of such arrangements and the inability of the railroads to act in concert.¹⁸ Finally, the established railroads advocated and helped to create the Interstate Commerce Commission.¹⁹ In addition to promoting the railroads' private interests, federal regulation was intended also to end rate discrimination and to provide farmers, merchants, and consumers with consistent and

¹⁷ See M. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860*, at 109-39 (1977), for a discussion of the legislative and judicial roots of such agreements to restrict competition.

¹⁸ G. KOLKO, *RAILROADS AND REGULATION 1877-1916*, at 7-29 (1965); P. MACAVOY, *THE ECONOMIC EFFECTS OF REGULATION: THE TRUNK-LINE RAILROAD CARTELS AND THE INTERSTATE COMMERCE COMMISSION BEFORE 1900*, at 25-109 (1965).

¹⁹ G. KOLKO, *supra* note 18, at 26-44.

high-quality rail service.²⁰ Similarly, from its inception the Civil Aeronautics Board served to protect the fledgling aviation industry against new entrants; but it served also to protect passengers from the potentially unsafe consequences of untrammelled competition.²¹

A parallel development marked the growth of state occupational licensing statutes.²² By 1900, Wisconsin had restricted entry into ninety trades, enacting occupational licensing requirements for attorneys, teachers, peddlers, public showmen, pharmacists, dentists, and doctors.²³ By 1915, druggists, osteopaths, midwives, embalmers, barbers, plumbers, accountants, real estate brokers, employment agents, and stockbrokers were added to the list.²⁴ By the 1950s, aircraft dealers, land surveyors, investment advisors, motor-vehicle salvagers and wreckers, cemetery salesmen, hunting and fishing guides, auto salesmen, auto auctioneers, and operators of commercial driving schools were among the occupations in Wisconsin governed by new or substantially revised legislation.²⁵ Typically, li-

²⁰ See J. GARRATY, *THE NEW COMMONWEALTH, 1877-1890* (1968):

Although the commission [ICC] proceeded cautiously and some railroad executives failed to live up to the spirit of the new regulations, the commission's rulings had an immediate stabilizing impact on the transportation industry. By conducting investigations, collecting statistical data, and disseminating its findings widely, it made large strides toward forcing sounder financial practices on the railroads and encouraging them to rationalize their rate structures. Rate differentials between competitive and non-competitive points were reduced sharply. In some circumstances, the roads used the act as an excuse for resisting the demands of shippers for special favors. In countless subtle ways, it compelled railroad men to recognize some of their *public* responsibilities.

Id. 120 (emphasis in original). See also A. KERR, *RAILROAD POLITICS, 1914-1920* (1965); Carson, *Railroads and Regulation Revisited: A Note on Problems of Historiography and Ideology*, 34 *HISTORIAN* 437 (1972); T. Ulen, *The ICC as Cartel Manager: Was It Necessary?* (1977) (unpublished Ph.D. thesis, Stanford University).

²¹ See W. ADAMS & H. GRAY, *MONOPOLY IN AMERICA: THE GOVERNMENT AS PROMOTER* 64-69 (1955); E. SMEAD, *GOVERNMENTAL PROMOTION AND REGULATION OF BUSINESS* 280-81 (1969).

²² See COUNCIL OF STATE GOVERNMENTS, *OCCUPATIONAL LICENSING LEGISLATION IN THE STATES* 20-27 (1952), attributing the post-Civil War licensing legislation to the assumption by the states of "the responsibility of regulating the professions as a means toward greater protection of the public from incompetency, fraud, and quackery" and to the sponsorship of such legislation by occupational associations seeking to protect their levels of compensation and status. *Id.* 20-21. See also W. HOROWITZ, *OCCUPATIONAL LICENSING IN ARIZONA* (1966).

²³ L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 162 (1965).

²⁴ *Id.* 163-65. For surveys of similar movements in other geographic areas, see H. ALDERFER, *PROFESSIONAL LICENSING IN PENNSYLVANIA* (1962); M. CARROW, *THE LICENSING POWER IN NEW YORK CITY* (1968); W. HOROWITZ, *OCCUPATIONAL LICENSING IN ARIZONA* (1966).

²⁵ L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 170-71 (1965).

licensees were required to meet certain standards of safety and reliability; in return they received protection from potential competitors who did not meet these standards.²⁶ Such legislatively imposed occupational entry barriers usually were sustained by the courts as reasonable exercises of state police power.²⁷

Although intended to protect from competition certain industries and occupations—interests which were able to mobilize political support for entry restrictions far more easily than consumers could have mobilized against them—the advantages that accrued to consumers from these measures support a theory of mutual benefit. Consumers in effect accepted higher prices in exchange for security against marginal operators, who might otherwise have taken advantage of rapid changes to defraud or endanger them.

These moratoria on competition often tended to last far longer than necessary to cope with any temporary market instability. Licensees and franchisees found the fruits of monopoly to be enjoyable; they relinquished them, if at all, only after a political struggle. Most “professions” today remain sheltered from competition, long after the need to attract and reward high quality work or to protect consumers from poor quality has abated.²⁸ Deregulation of interstate trucking has proved difficult, although little justification can be found for maintaining entry barriers in that industry.²⁹ Indeed, perhaps the realization of the political difficulty of removing an exemption from the competitive economy once granted, explains the shift in the focus of consumer protection in recent years from the performance of particular markets to the merits of particular products.

²⁶ The relationship between consumer protection and restricted entry is well illustrated by the reaction of one Indiana barber to the licensing of his profession: “[I]t takes legislation to protect us from scab prices, pestilence and disease.” *Id.* 163.

²⁷ See, e.g., *Baccus v. Louisiana*, 232 U.S. 334 (1914) (ban on sale of drugs by itinerant vendors or peddlers); *Crowley v. Christensen*, 137 U.S. 86 (1890) (liquor licensing); *Dent v. West Virginia*, 129 U.S. 114 (1889) (physician licensing); *Slaughter-House Cases*, 83 U.S. (16 Wall.) 36 (1873) (exclusive slaughterhouse license). Notions of substantive due process surfaced occasionally to void various licensing statutes. Yet, even in these instances, the courts restricted their holdings to professions bearing little relationship to public health. See, e.g., *New State Ice Co. v. Liebmann*, 285 U.S. 262, 277 (1932) (manufacture and sale of ice not sufficiently affected by public interest); *State v. J. P. Harris*, 216 N.C. 746, 6 S.E.2d 854 (1940) (licensing of dry-cleaning business unnecessary for public protection).

²⁸ See NATIONAL COMMUNITY CONSUMER EDUCATION PROJECT, *OCCUPATIONAL LICENSING: A NEW ROLE FOR CONSUMERS* (1978).

²⁹ See A. FRIEDLANDER, *THE DILEMMA OF FREIGHT TRANSPORT REGULATION* 153-55 (1969); Moore, *Deregulating Surface Freight Transportation*, in *PROMOTING COMPETITION IN REGULATED MARKETS* 55-93 (A. Phillips ed. 1975).

II. CONSUMER PROTECTION AND PRODUCT INADEQUACY: GOVERNMENT AS PURCHASING AGENT

In the early days of consumer protection, the unstated principle guiding government interventions to protect consumers was to control the market instability which caused businessmen, investors, and consumers to feel particularly insecure in their relationships. The principle which has emerged during the last decade, however, has little to do with such instability. Instead, the government has increasingly assumed the role of purchasing agent, assessing the merits and demerits of particular products on behalf of consumers.³⁰ Meanwhile, competition policy, as shaped by the courts and antitrust enforcement agencies, has taken off on its own course, somewhat oblivious to consumer-protection interests.³¹

Corresponding to these developments, an analytic dichotomy has grown up between consumer-protection and competition policies. Law schools, for example, typically treat the two in separate courses; even when they are conjoined within the broad subject area of "trade regulation," they are treated as presenting quite separate issues. More serious for public policy, decisions to intervene in the economy on behalf of consumers have failed to take proper account of the market's structure and its incentives. As a result, the scope of government interference has acquired a limitless potential, and the government has sometimes intervened even though consumers themselves believe they need no protection. The following sections will serve to expand and clarify these points.

A. Assessing the Costs and Benefits of Particular Products

Within the last fifteen years Congress has enacted a startling amount of legislation governing the quality of particular products. Foremost has been product-safety legislation, including: The Poison

³⁰ One commentator theorizes that modern consumer-protection regulation has created long-term, collective contracts between consumers and producers which are administered by regulatory agencies. These "administered contracts" entail rules which allow adjustments and compensation for unexpected costs. The rules also allocate anticipated risks and benefits and identify the circumstances in which the contract may be terminated. See Goldberg, *Regulation and Administered Contracts*, 7 BELL J. ECON. 426 (1976).

³¹ For the view that competition policy in the Antitrust Division of the Department of Justice is indeed shaped by myriad factors unrelated to consumer-protection interests, see S. WEAVER, *DECISION TO PROSECUTE: ORGANIZATION AND PUBLIC POLICY IN THE ANTITRUST DIVISION* (1977). On the basis of extensive interviews with Division personnel, Weaver concludes, for instance, that Division attorneys adhere to a procompetitive stance, refusing to recognize that the value of competition may have to be balanced against other social or economic interests. *Id.* 169.

Prevention Packaging Act;³² the Lead-Based Paint Poisoning Prevention Act;³³ the Consumer Product Safety Act;³⁴ the Highway Safety Acts;³⁵ and the National Traffic and Motor Vehicle Safety Act.³⁶ Other legislation has extended government involvement in product packaging, labeling, and disclosure,³⁷ and product warranties.³⁸ Entire agencies, such as the Consumer Product Safety Commission and the National Highway Traffic Safety Administration, have been established to assay products posing "unreasonable risk" of injury.³⁹ Older agencies, such as the Federal Trade Commission, have grown increasingly bold in regulating particular products deemed inadequate or unsafe.⁴⁰

Mindful that consumers often bear the costs of consumer protection regulation, these agencies have applied increasingly elaborate risk- or cost-benefit analyses to products within their jurisdictions. In their role as "purchasing agents" they are assessing the health consequences of new drugs, foods, and cosmetics; the safety of toys, automobiles, and appliances; and the durability, efficiency, and reliability of a host of other consumer products. Regulatory tools are then fashioned for controlling the dissemination of products according to their relative risks and benefits.⁴¹ In its recently unveiled

³² Pub. L. 91-601, 84 Stat. 1670 (1970) (codified at 15 U.S.C. §§ 1471-1476 (1976)).

³³ Pub. L. 91-695, 84 Stat. 2078 (1971) (codified at 42 U.S.C. §§ 4801-4846 (1976)).

³⁴ Pub. L. 92-573, 86 Stat. 1207 (1972) (codified at 15 U.S.C. §§ 2051-2081 (1976)).

³⁵ Pub. L. 89-564, 80 Stat. 731 (1966) (codified at 23 U.S.C. §§ 401-406 (1976)) (amended in 1970, 1973, 1976, and 1978).

³⁶ Pub. L. 89-563, 80 Stat. 718 (1966) (codified at 15 U.S.C. §§ 1381-1431 (1976)).

³⁷ See, e.g., Federal Cigarette Labeling and Advertising Act, Pub. L. 89-72, 79 Stat. 282 (1965) (codified at 15 U.S.C. §§ 1331-1340 (1976)); Fair Packaging and Labeling Act, Pub. L. 89-755, 80 Stat. 1296 (1966) (codified at 15 U.S.C. §§ 1451-1461 (1976)); Motor Vehicle Information and Cost Savings Act, Pub. L. 92-513, 86 Stat. 947 (1972) (codified at 15 U.S.C. §§ 1901-2012 (1976)).

³⁸ See Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. 93-637, 88 Stat. 2183 (1975) (codified at 15 U.S.C. §§ 2301-2312 (1976)).

³⁹ See 15 U.S.C. § 2057 (1976) (applying "unreasonable risk" standard to Consumer Product Safety Commission); 23 U.S.C. §§ 401-406 (1976) (applying "unreasonable risk" of accident standard contained in National Traffic and Motor Vehicle Safety Act, 15 U.S.C. §§ 1381, 1391 (1976), to National Highway Traffic Safety Administration).

⁴⁰ See SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 94TH CONG., 2d SESS., REPORT ON FEDERAL REGULATION AND REGULATORY REFORM 57-110 (Subcomm. Print 1976).

⁴¹ See REGULATING THE PRODUCT (R. Caves & M. Roberts eds. 1975) for a collection of papers addressing the effect of various control mechanisms on product quality.

Long-Range Planning Options report, the Consumer Product Safety Commission's Office of Strategic Planning recommends, for example, that the agency adopt as its highest priority the reduction of "the unreasonable risk of injury from product hazards, with due regard to the social and economic impacts of government action."⁴² Similarly, the National Highway Traffic Safety Administration's newly announced Five-Year Plan bases its regulatory priorities on an assessment of the "lifesaving potential of a safety standard" and the "anticipated costs to consumers and industry."⁴³ The Commissioner of the Food and Drug Administration recently stated, meanwhile, that "risk-benefit balancing must be done for drugs because there is no such thing as a 'safe' drug."⁴⁴ Congress soon will begin a major review of the Delaney amendment, which flatly prohibits any food additive that "induces" cancer in man or animals, with a view toward authorizing the FDA to regulate additives according to benefits and risks.⁴⁵ And the Federal Trade Commission has been attempting to ensure that the benefits of its interventions substantially outweigh whatever increased product costs are thereby passed on to consumers.⁴⁶

In general, government intervention under this "purchasing agent" model is presumed to be desirable whenever product risks are reduced by the proposed regulation to a greater extent than costs are added.⁴⁷ The greater the disparity between these two measures, the more extreme the regulatory response. Outright bans of products are thought to be necessary whenever the risk and mag-

⁴² OFFICE OF STRATEGIC PLANNING, CONSUMER PROD. SAFETY COMM'N, LONG-RANGE PLANNING OPTIONS (1978). At the CPSC, application of a risk-benefit approach has been facilitated by the courts. In *Forester v. Consumer Prod. Safety Comm'n*, 559 F.2d 774 (D.C. Cir. 1977), the court defined "unreasonable risk" in the Federal Hazardous Substances Act, 15 U.S.C. § 1261(s) (1976), as involving "a balancing test like that familiar in tort law: The regulation may issue if the severity of the injury that may result from the product, factored by the likelihood of the injury, offsets the harm the regulation itself imposes upon manufacturers and consumers." *Id.* 789 (footnote omitted). Cf. *Aqua Slide 'N' Dive Corp. v. Consumer Prod. Safety Comm'n*, 569 F.2d 831 (5th Cir. 1978) (Commission's finding that safety standard was reasonably necessary to eliminate or reduce unreasonable risk of injury not supported by substantial evidence).

⁴³ NATIONAL HIGHWAY TRAFFIC SAFETY AD., DEP'T OF TRANSP., FIVE-YEAR PLAN (1978).

⁴⁴ FOOD CHEMICAL NEWS, Feb. 27, 1978, at 32. See also Hutt, *Unresolved Issues in the Conflict Between Individual Freedom and Government Control of Food Safety*, 33 FOOD DRUG COSM. L.J. 558 (1978).

⁴⁵ *Congress Plans Major Review of Food Laws*, 1979 CONG. Q. 230.

⁴⁶ See, e.g., Advertising of Ophthalmic Goods and Services, Notice of Proceeding and Proposed Trade Regulation Rule, 41 Fed. Reg. 2399, 2400-01 (1976).

⁴⁷ The cost of regulation should include, of course, any foregone product benefits. For an early statement of this formulation, see *United States v. Carroll Towing Co.*, 159 F.2d 169 (2d Cir. 1947).

nitude of physical or economic harm thereby avoided is deemed substantially greater than product benefits foregone. Regulators have placed within this category unvented gas space-heaters, lead-based paint, saccharin, and certain drugs. Design specifications or performance standards are thought to be appropriate when the disparity between product risks and benefits is less, but nevertheless significant, as with "childproof" aspirin bottles, flame-resistant sleepwear, nitrites in bacon, rotary lawnmowers, and auto seat belts and airbags. Bans on advertising may be justified in cases where the risk-benefit difference is still less determinative, but the risks remain of major concern, such as television advertising of cigarettes, children's cereals and candy, or alcohol. Mandatory disclosures in advertising or on labels are thought appropriate when risks and benefits, although substantial, are closely balanced, as, for example, with food ingredients, blood from paid or volunteer donors, and energy efficiency of home appliances.⁴⁸

This "purchasing agent" model of government intervention is, of course, open to the charge that it imposes additional costs upon members of the consuming public who, because they can use dangerous products more carefully or skillfully than others, or can make repairs more cheaply, or because they care less about physical and economic harms than other people do, would prefer not to pay more for the safer, healthier, more reliable, or more fully labeled product. Moreover, according to this argument, it is unnecessary to impose the costs of consumer protection on these voluntary risk-takers for the sake of protecting those risk-avoiders whose preferences more closely resemble the government's; presumably those risk-avoiding consumers would have opted for the safer, healthier, more reliable, or more fully labeled product on their own.

But this view ignores the fact that the market for consumer goods is less than perfect, and often cannot be relied upon to generate the degree or quality of information consumers need in order to make rational purchasing decisions. Product choice in some markets remains limited: risk-avoiding consumers seeking a safe automobile have no opportunity to choose a safer, more costly bumper from the restricted range of offerings produced by an

⁴⁸ Professor Richard Wilson has urged that, based upon linear extrapolation from animal testing, activities or products which create a 1-in-100 chance of death or serious injury with each discrete usage should be banned, while those which create a risk of less than 1 in 100,000 should be regarded as acceptable. For activities or products between those two levels, public education and warnings are appropriate. Testimony of Richard Wilson Before the Occupational Safety and Health Administration (Feb. 10, 1978) (OSHA Docket No. H-090) *cited in* Hutt, *supra* note 44, at 582-83.

oligopolistic industry.⁴⁹ Moreover, even under competitive conditions, sophisticated advertising and promotional techniques may well manipulate and ultimately distort consumer demand.⁵⁰

A more sophisticated analysis, however, reveals flaws in the "purchasing agent" model which stem from its antagonism to certain fundamental principles of American political economy. First, even if the government's calculations could exactly predict the quality of products and information that rational consumers would choose in a perfect market, the very insistence that government planners and policymakers intervene on behalf of consumers implies that consumers are unable to take care of themselves. Substitution of the choices of bureaucrats for those of consumers carries with it a not so subtle implication that consumers are relatively powerless, if not incompetent, when faced by the combined force of corporate greed and Madison Avenue hype. That message is apt, at the very least, to offend consumers' self-esteem. A saccharin ban implies that consumers cannot be trusted properly to weigh the risks of saccharin, just as a ban on television advertising to children implies that parents cannot be trusted to control their children's viewing. The charge of "big brotherism" in this context may come less as a total rejection of consumer protection than as an affirmation of a preferred self-image of competence. Consumers are not dumb; they recognize that bureaucrats, too, are fallible people, not necessarily more competent than the consumers they purport to protect.

Second, a consumer-protection policy based on a bureaucratic calculus of risks and benefits has no principled limits. Once it is accepted that the government can intercede between consumers and sellers whenever intervention can produce "better" purchasing decisions, no obvious stopping-place can be found. Such a rationale opens the entire economy to scrutiny. It suggests that products are "unsafe" or "defective" whenever the cost of making them safer or more durable is less than the value, as measured by regulators and policymakers, of the extra safety or durability thereby achieved. Similarly, it suggests that sellers should be required to provide more

⁴⁹ Albert Hirschman's juxtaposition of two consumer complaints to Ford and General Motors, with each consumer threatening to purchase from the other manufacturer in the future, is a telling illustration of the consumer's bind. Without regulation, an oligopolistic market cannot be relied upon to satisfy both the risk-avoider and risk-taker. See A. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY* 27 n.7 (1970).

⁵⁰ See, e.g., S. EWEN, *CAPTAINS OF CONSCIOUSNESS: ADVERTISING AND THE SOCIAL ROOTS OF THE CONSUMER CULTURE* (1976); J. GALBRAITH, *THE AFFLUENT SOCIETY* 149-54 (2d rev. ed. 1969); J. GALBRAITH, *THE INDUSTRIAL STATE* 272-73 (1967).

or higher quality product information whenever the cost of generating and communicating it is less than the value to the consumer, again as measured by regulators and policymakers, of acquiring it. At bottom, the risk-benefit rationale for intervention approximates the kind of calculation that consumers traditionally make when they choose a product, choose to do without it, or decide to consult first with friends or *Consumer Reports* before purchasing. But, because bureaucrats rather than consumers undertake the calculation, the risk-benefit rationale becomes a veritable slippery slope.

Instead of merely correcting those market imperfections which prevent consumers from making rational purchasing decisions, the "purchasing agent" approach to consumer protection goes much further; it replaces the decisions of consumers in the marketplace with government edicts, a method whose premise is fundamentally incompatible with the liberal assumption that each person is the best judge of his or her own needs.

If this underlying contradiction escaped attention fifteen years ago when consumer protection began focusing upon the merits of particular products rather than the stability of particular markets, perhaps it was because there were enough egregious abuses to justify ad hoc government interventions without appeal to any overreaching principle. The list of horrors included unsafe automobiles, teratogenic (fetus-deforming) drugs, deceptive advertisements, injurious rotary mowers, and schemes to sell worthless real estate. But the bureaucracy of consumer protection has grown in the past few years. The occasions for intervention have now extended beyond those most serious cases to instances which may be less compelling on their facts and more in need of a new and principled rationale. The current rationale is simply too grandiose and overreaching to coexist peacefully with principles of a free-market economy.

B. *Accounting for the Consumer-Protection Potential of Various Market Restraints—An Unfulfilled Need*

As the focus of consumer protection has shifted from markets to products, its rationale has lost any logical connection with the existence or nonexistence of competition. Accordingly, no coherent theory has emerged to explain how, and under what circumstances, various restrictions on competition might help ensure or inhibit the fulfillment of consumer expectations. Competition policy, aimed relentlessly at market power in any guise, has not had to compete with, or comprehend, a market-based rationale for consumer protection because none has been articulated. This has

unfortunately left courts and policymakers free to ignore situations in which certain restrictions on competition can work to the benefit of consumers. A brief survey of the current status of four potentially pro-consumer market restrictions—market division agreements, tying arrangements, occupational licensing, and trademark protection—shows that existing law and policy lack the basic analytical tools needed to understand the interplay between competition and consumer protection.

1. Market Division Agreements

Market-division agreements can make it profitable for an outlet within one vicinity to cooperate with outlets in others. Because such agreements ensure that each outlet's investment redounds to its own benefit rather than to the benefit of "free riders" selling the same product nearby, each has an incentive to promote the product and maintain uniform quality.⁵¹ Notwithstanding this potential consumer benefit, market-division agreements have been deemed illegal. In *United States v. Sealy, Inc.*,⁵² for example, the Supreme Court determined that the territorial agreements by which Sealy limited its manufacturer-licensees to sales in designated territories "gave to each licensee an enclave in which it could and did zealously and effectively maintain resale prices, free from the danger of outside incursions."⁵³ Finding this a sufficient connection with price fixing, the Court applied the rule of per se illegality to hold the agreements "unlawful under § 1 of the Sherman Act without the necessity for an inquiry in each particular case as to their business or economic justification, their impact in the marketplace or their reasonableness."⁵⁴ Application of the per se illegality test thus

⁵¹ The Supreme Court discussed this "free rider" effect in its recent opinion in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977).

⁵² 388 U.S. 350 (1967).

⁵³ *Id.* 356.

⁵⁴ *Id.* 357-58. The *Sealy* majority found the challenged arrangement a thinly disguised horizontal agreement among Sealy's manufacturer-licensees. Sealy was owned and directed almost entirely by the owners and operators of its licensees. Consequently, according to the majority, the agreements were in substance, if not in form, agreements among the manufacturers operating as equals in a competitive market. As horizontal restraints, the licensing agreements were subject to a more stringent standard—traditionally, a per se standard—than applied to vertical restraints.

In a lone dissent, Mr. Justice Harlan argued that Sealy's territorial divisions were vertical restraints and not, therefore, illegal per se. He noted also that such agreements tended to increase general market competition by sharpening Sealy's competitive edge, especially since Sealy did not dominate the relevant market. *Id.* 361 n.2. See Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-price Vertical Restrictions*, 78 *COLUM. L. REV.* 1 (1978), for a discussion of the distinction between vertical and horizontal restrictions, as well as mention of the consumer benefits from certain types of market restraints.

caused the Court to ignore the potential benefits from the market-division agreements, including the possibility that they would help to ensure the uniformity of products appearing under the licensed name and trademark. This test ignored also the district court's findings, never disputed by the government, that the agreements permitted national distribution of the uniform product and made it profitable for each licensee to contribute to national advertising, research, and promotion.⁵⁵

The Supreme Court recently determined, in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,⁵⁶ that some vertical market divisions are legal, in part, because they serve to "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."⁵⁷ Although it remains to be seen what sorts of market-division agreements or other vertical restraints will pass muster, presumably those which create efficiencies in maintaining product quality within the distribution process should no longer be deemed illegal per se—particularly if the manufacturer has no reasonable alternative means of ensuring quality.⁵⁸

2. Tying Arrangements

Tying arrangements, like agreements to divide markets, also may protect consumers from poor maintenance or servicing of products. But the courts have tended to strike down these arrangements without regard to potential consumer-protection benefit. In *United States v. Jerrold Electronics Corp.*,⁵⁹ for example, the court found illegal a tying arrangement through which Jerrold sold whole antenna systems only on condition that it install and service them itself and replace any parts with Jerrold equipment. Although the court did recognize that the arrangement guarded against unsatisfactory performance resulting from system installation and servicing by companies lacking the requisite knowledge and skill, the court perfunctorily determined that this did not justify the tying arrangement in the already mature community-antenna industry.⁶⁰ In

⁵⁵ *Id.* 358-62.

⁵⁶ 433 U.S. 36 (1977).

⁵⁷ *Id.* 54.

⁵⁸ Vertical restraints have been upheld where they are related to product safety, have no anticompetitive effect, and are ancillary to the seller's main purpose of protecting the public from harm or itself from product liability. *Id.* 55 n.23. See *Tripoli Co. v. Wella Corp.*, 425 F.2d 932 (3rd Cir.) (en banc) cert. denied, 400 U.S. 831 (1970). See also Pitofsky, *supra* note 54.

⁵⁹ 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

⁶⁰ *Id.* 557, 558.

drawing its conclusion, the *Jerrold* court assumed, but certainly did not prove, that consumer-protection interests would be served adequately by independent servicing. It ignored the considerable goodwill interest that any manufacturer, whether in a young or mature industry, has in maintaining its own product: the independent serviceman can always blame his failures on product quality, a luxury the manufacturer does not enjoy.

3. Occupational Restrictions

Occupational restrictions, in the form of state licensing laws and so-called "ethical" restraints imposed by professional associations, have traditionally been justified on the assumption that they protect consumers. But such restrictions have increasingly come under antitrust fire. The Federal Trade Commission has challenged certain state occupational licensing laws as unfair trade practices.⁶¹ Both the Commission and the Antitrust Division of the Department of Justice have challenged "ethical" restrictions on the delivery of professional services.⁶² Although these challenges have attempted to compare the benefits of competition with the costs to consumers of inadequate service which might follow the lifting of restraints, there has been no method for deciding which licensing statutes should be challenged in the first place. Because consumer-protection policies have lacked any dynamic market theory, it remains unclear when natural market incentives alone can be relied on to protect consumers without licensing, or when licensing may be the most efficient means of doing so.

Indeed, the Supreme Court has rejected any balancing of the benefits to consumer protection when "ethical" restrictions are challenged under section 1 of the Sherman Act.⁶³ In *National Society of Professional Engineers v. United States*,⁶⁴ the government brought a civil antitrust action against the professional association; the association's canon of ethics prohibited competitive bidding by its members, and the government alleged that this restriction violated the Sherman Act. As an affirmative defense, the association

⁶¹ See, e.g., Disclosure Regulations Concerning Retail Prices for Prescription Drugs, Proposed Trade Regulation Rules, 40 Fed. Reg. 24,031 (1975), *withdrawn*, 43 Fed. Reg. 54,951 (1978); Advertising of Ophthalmic Goods and Services, 16 C.F.R. § 456 (1979); Funeral Industry Practices, Trade Regulation Proceeding, 40 Fed. Reg. 39,901 (1975) (to be codified in 16 C.F.R. § 453).

⁶² E.g., *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679 (1978); American Medical Ass'n, No. 9064 (F.T.C., complaint issued Dec. 19, 1975), [1973-1976 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,068.

⁶³ 15 U.S.C. § 1 (1976).

⁶⁴ 435 U.S. 679 (1978).

contended that the canon was a reasonable restraint of trade because it minimized the risk to public safety that competitive bidding would induce engineers to cut prices and provide dangerously low-quality services. The district court granted an injunction against enforcement of the canon, and the court of appeals affirmed.⁶⁵ Acknowledging that there was a risk that competition would cause some suppliers to market a defective product and that the association had provided ample documentation to support its position,⁶⁶ the Supreme Court nevertheless unanimously affirmed. The Court reasoned that restraints of trade under the Sherman Act may be deemed reasonable only insofar as they promote competition, not because they protect consumers from dangerous products. "The judiciary cannot indirectly protect the public against [potentially defective products] by conferring monopoly privileges on the manufacturers."⁶⁷

4. Trademark Protection

Notwithstanding their potential importance to consumers in ensuring consistent quality and reliability,⁶⁸ trademarks also have been the object of antitrust attacks. In one recent FTC order, an administrative law judge found that Borden, Inc. had unlawfully maintained a monopoly position in the processed lemon industry.⁶⁹ In addition to a preponderant market share, the judge found to be "strongly demonstrative of monopoly power" the "overwhelming dominance of the ReaLemon brand, . . . its acceptance over the years by the trade and the public as the premium brand" and the premium price it commanded.⁷⁰ Ignoring the fact that this premium price may well have represented what consumers were willing to pay for consistent quality, the judge's reasoning proceeded strictly according to competition theory: "the heart of the monopoly power preserved and maintained by respondent Borden lies in the ReaLemon trademark and its dominant market position. For competition to enter the processed lemon juice industry, the barrier to

⁶⁵ The district court made no finding as to the risk that competitive pressures would result in the design of inefficient and unduly expensive structures, finding instead that the canon was illegal on its face. *Id.* 684-86.

⁶⁶ *Id.* 694.

⁶⁷ *Id.* 695-96.

⁶⁸ See Schmalensee, *On the Use of Economic Models in Antitrust: The ReaLemon Case*, 127 U. PA. L. REV. 994, 1036 (1979).

⁶⁹ Borden, Inc., No. 8978, slip op. at 167 (F.T.C., Aug. 19, 1976) (ALJ decision), [1976-1979] 3 TRADE REG. REP. (CCH) ¶ 21,194, *modified*, (F.T.C., Nov. 7, 1978) (opinion of the Comm'n), [1976-1979] 3 TRADE REG. REP. (CCH) ¶ 21,490.

⁷⁰ *Id.*

entry which inheres in the ReaLemon trademark must be eliminated."⁷¹ Accordingly, the judge required Borden to license use of its ReaLemon trade name.

Although the remedy of compulsory licensing was rejected by the full Commission on appeal,⁷² that action merely reflected the Commission's view that licensing was unnecessary to curb Borden's monopoly. Like the administrative law judge, the Commission made no attempt to evaluate the possible value of trademark protection to consumers.⁷³

This, then, is a brief survey of the present state of consumer-protection competition policy. Under a "purchasing agent" model, government has increasingly intervened to regulate distribution of particular products or services, restrained only by a balancing of the costs and benefits of intervention. Objections to the paternalism inherent in this approach are compounded by its illimitable sweep. Antitrust policy, on the other hand, has ignored the goal of protecting consumers against such "bad" purchases, possibly because no criteria have been proposed for deciding under what circumstances undercompetitive markets protect consumers more or less efficiently than fully competitive ones.

Having now considered the evolution of consumer protection, a rethinking of its fundamentals is in order. What criteria should guide government decisions to intervene on behalf of consumers? Once a decision to intervene is made, what form should the intervention take? Before these questions can be answered, however, it is necessary to arrive at an understanding of why consumers need protection, and what the goal of government intervention ought to be.

III. THE GOAL OF CONSUMER PROTECTION

Consumer-protection policy has suffered at bottom from a confusion about goals. An implicit assumption of the "purchasing agent" approach is that consumers cannot be trusted to make rational purchases.⁷⁴ Therefore, to protect consumers, government

⁷¹ *Id.*

⁷² Borden, Inc., No. 8978 (F.T.C., Nov. 7, 1978) (opinion of the Comm'n), [1976-1979] 3 TRADE REG. REP. (CCH) ¶ 21,490.

⁷³ The economic implications of heavily advertised brand names and trademarks are the subject of heated debate among economists. See W. COMANOR, & T. WILSON, ADVERTISING AND MARKET POWER 8-63 (1974); J. FERGUSON, ADVERTISING AND COMPETITION: THEORY, MEASUREMENT, FACT 15-53 (1974); Brozen, *Entry Barriers: Advertising and Product Differentiation*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 115 (H. Goldschmid, H. Mann & J. Weston eds. 1974).

⁷⁴ See text following note 50 *supra*.

must intervene to monitor the quality of products and services sold in the market. In essence, the "purchasing agent" rationale is an extension of paternalistic government efforts to protect consumers from the consequences of their own appetites—such as preventing consumers from buying sex, marijuana, pornography, or liquor.

An approach to consumer protection more sympathetic to liberal free-market principles that govern the American economy is possible. The problem lies not with "bad" products or irrational consumers, but in certain market conditions which do not provide sellers with sufficient incentive to prevent rational consumers from making costly mistakes. A consumer-protection rationale focusing on the likelihood that consumers within particular markets will misestimate physical or economic risks attendant upon their purchases can provide a strong basis for government intervention, untainted by paternalism.

A. Hidden Costs and the Costs of Information

Consumers bear several related costs when they purchase goods or services, only the most visible of which is the purchase price. Other costs are often hidden: the product may cause bodily injury, impair health, or damage property; it may require expensive or time-consuming maintenance or have to be totally replaced in a relatively short time; it may require enormous amounts of fuel; or it may be inadequate to perform the tasks that the consumer has in mind, requiring the consumer to forego those tasks or spend more to perform them.

The rational consumer⁷⁵ will wish to minimize the product's total cost (its purchase price plus these hidden costs), while at the same time receiving a product that fulfills his needs. But to accomplish this goal, he must bear still other costs. First, he must define his needs. Diagnostic information, which identifies and measures such particular requirements, can be expensive. To avoid gastric upset, the consumer may, for example, have to undergo a battery of tests to determine what foods his stomach cannot abide; similarly, to avoid the possibility that a newly purchased waterbed will crash through the ceiling, the consumer may have to employ a structural engineer to measure the tolerance of his upstairs floor. Second, after discovering his particular needs, the consumer must learn the capabilities of different products to fulfill those needs.

⁷⁵ The "rational consumer" is of course a fiction; no one contends that consumers are actually as rational as this hypothetical person. Nonetheless, the concept can be useful in predicting general patterns of behavior.

Product-testing information, revealing, for example, the contents of a particular can of food or the fully inflated weight of a particular waterbed, also can be costly. Third, for the diagnostic and product-testing information to be useful, the consumer must have meaningful access to it in a timely manner. Communication, in the form of product advertising and consumer searching, is then a third related cost.⁷⁶

For some purchases, the combined costs of diagnosis, product testing, and communication may exceed any savings in the total cost of the product sought. But it would be nonsensical for a consumer to expend more resources trying to locate a product than the potential savings available from its use. If, for example, a consumer has discovered three adequate lawnmowers of equal price, the best of which would save him one dollar in convenience and quality, there is no reason to spend more than one dollar to discover which of the three is truly best. Accordingly, a rational consumer will purchase product information only to the point at which the marginal cost of obtaining that information is likely to exceed any marginal gain in the total value of the product.⁷⁷ Thus, the "best" purchasing decision is not best in absolute terms, but only relative to the cost of the diagnosis, product testing, and communication necessary

⁷⁶ A slightly different typology has been used by Nelson, who distinguishes between "search qualities"—qualities of a product that the consumer can determine prior to purchase—and "experience qualities"—qualities that the consumer cannot determine prior to purchase. Nelson, *Advertising as Information*, 82 J. POL. ECON. 729, 730 (1974); Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311, 312 (1970). Darby and Karni use the term "credence qualities" to describe qualities that cannot be evaluated through normal use of a product, but can be assessed only by gaining additional costly information. Darby & Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 68-69 (1973).

⁷⁷ This model of course simplifies both the economics and the psychology of consumer search. The marginal-value/marginal-cost calculation is not strictly applicable to non-searchers. Given the presence of at least some consumer searchers, non-searchers can secure the benefits of product information without sustaining any costs, as producers are likely to compete for the searchers' business while offering the same terms to non-searchers. See Salop & Stiglitz, *Bargains and Ripoffs: A Model of Monopolistically Competitive Price Dispersion*, 44 REV. ECON. STUD. 493, 493-95, 501 (1977); see also Rothschild, *Models of Market Organization With Imperfect Information: A Survey*, 81 J. POL. ECON. 1283 (1973). But the notion that producers will compete for searchers' business may not extend fully to those markets in which hidden costs are excluded from the purchase decisions of all but the most scrupulous searchers. In these instances, producers may compete only as to price, with poor quality or substandard performance prevalent throughout the market. See text accompanying notes 81-86 *infra*.

For a recent study of the economics of information, see Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979). See also Katona & Mueller, *A Study of Purchase Decisions in CONSUMER BEHAVIOR: THE DYNAMICS OF CONSUMER REACTION* 30, 49, 52, 79-80 (L. Clark ed. 1954); Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

to make it. That some consumers may accept high total costs, in the form of dangerous, inadequate, or high energy-consuming products, does not necessarily indicate that the market is functioning inefficiently, for such a choice may reflect a rational trade-off against even higher information costs.

It follows that a range of less costly products, with "cost" again including potential hidden costs, will require less costly attempts to ensure that the purchasing decision is a proper one. If the price of the product is low, and the possible adverse consequences of a bad choice are minimal, the consumer's own diagnosis may be completely adequate, ("I know what kind of food agrees with me"); as well as his own search ("Let's see if there's a restaurant in the neighborhood"); and his own testing ("It looks like a dive, but I'll try it once"). Alternatively, consumers might rely on the judgment of trusted friends, who are aware of their particular needs ("You'll love the ambiance, but don't eat the goulash"). If the product proves worthy, then the cost of diagnosing, testing, and locating it in the future can be greatly reduced by merely repurchasing it. Indeed, the business value of the "goodwill" derived from an established trade name or marketing technique is that consumers are willing to pay a premium for what they save by avoiding costly diagnosing, product testing, and searching.⁷⁸

Occasionally, of course, it is more reasonable to look elsewhere for reliable information. When an incorrect purchasing decision could pose high risks to health or property, or could result in substantial economic loss, self-diagnosis or self-testing is unwise. Prudence would dictate, for example, that one seek expert advice about the need for maintenance or repair of complex machinery such as an automobile, home plumbing, or one's own body. Similarly, it is advisable to refrain from ingesting unidentified pills or investing a small fortune in an untested machine "just to see if it works," and to rely instead on tests performed by others. Indeed, it is often necessary for sellers to offer new products at a discount or to guarantee "complete satisfaction or your money back" in order to offset consumers' understandable reluctance to sail such uncharted seas. By the same token, if the sources of diagnostic or product-testing information are scattered, but the group of consumers who want the

⁷⁸To be sure, advertising may be used to establish goodwill. Although the product image created by advertising may substitute for product quality, "informative advertising" may serve a useful purpose when employed by new entrants to identify an established producer who has chosen to "rest on his laurels" rather than maintain consistent quality. Boyer, *Informative and Goodwill Advertising*, 56 *REV. ECON. & STAT.* 541 (1974).

information are identifiable and can be reached through some common medium, it may be more efficient for the sources to communicate their information than for the consumers to spend their own time and resources trying to locate the sources. For example, a shipper specializing in Caribbean cruises could locate prospective purchasers by advertising in the *New Yorker* far more efficiently than prospective purchasers could locate him by writing to shipping companies.

Some sources of diagnostic and testing information sell nothing but such information, with the consumer paying primarily for reliability and good judgment. Consumer guides, independent testing laboratories, newspaper reviewers, and various types of appraisers fit within this category, as do, on a slightly more general level, training manuals, adult-education courses, and how-to-do-it books. Because property rights in such information are limited, however, and difficult to enforce against a recipient who is apt to share the information freely with others,⁷⁹ often only those sources who also have a pecuniary interest in the products under scrutiny can bear the direct cost of developing and communicating diagnostic and testing information. Some of these information sources function in effect as agents, and select products on behalf of consumers. In exchange, they charge consumers a premium for the quality of their selection. Travel agents, stock brokers, realtors, and department stores all bear most of the direct costs of developing product information and then pass these costs on to the consumers who find it more efficient to rely upon such intermediaries than to carry on their own diagnoses, tests, and searches. Alternatively, reliable information about product risks or inadequacies can sometimes be derived from competitors, for whom the cost of developing such information may be less than the expected revenues generated from sales of their own product.

Because they have direct access and control, sellers often can generate test information about their products more efficiently than any other source. They can run tests as a routine step in the production or marketing process, and they are aware of the particular product characteristics that require most careful attention. Similarly, sellers of maintenance or repair services often can generate diagnostic information more efficiently than other sources because they can both diagnose and respond to a particular need in a single transaction.

⁷⁹ See generally, *THE ECONOMICS OF PROPERTY RIGHTS* (E. Furubotn and S. Pejovich eds. 1974).

B. *Minimizing Consumer Misestimation of Hidden Costs*

With this understanding of the role of product information in purchasing decisions, it becomes apparent that rational consumers will select the source of information that is both least expensive and most reliable, relative to the total product cost at stake. The sources of such information likewise can be expected to bear the direct cost of producing it only insofar as consumer demand yields adequate revenues. In this way, the information market should generate approximately the "right" amount of reliable information to enable consumers to make adequately informed purchasing decisions.

Under perfect marketing conditions, then, government intervention to protect consumers would be unnecessary. One could assume that consumers get just the amount of product information they need, and that they make rational trade-offs between product information, product quality, and purchase price. But consumers may, for a variety of reasons, underestimate the risk of economic loss or personal injury attendant upon their purchasing decisions. Sufficient product information may be unavailable or, if available; may be misconstrued. Or consumers may overestimate the reliability of the diagnosis or product-testing information received. Either way, they will miscalculate how much additional information they need—how much care they should exercise—before purchasing.

The problem then lies not in a particular product or service which appears to be inadequate, defective, unhealthy, inefficient, or unsafe. All these adjectives convey relative concepts which lack meaning outside the particular set of expectations which frames the transactions. Manufacturers and sellers make countless decisions to substitute lower cost for a higher-quality product or product information, and there is nothing inherently wrong about these decisions. Rather, problems arise when consumers, unaware of such substitutions, are unpleasantly surprised by poorer quality (higher hidden costs) than they bargained for. Skateboards, kitchen knives, waterbeds, "gas-guzzlers," and hang-gliders all can have disastrous consequences, but they present little justification for government intervention because consumers are apt to know of their risks and costs at the time of purchase.⁸⁰ On the other hand, life-insurance policies,

⁸⁰ With regard to some products, consumers know only of the existence of risks. They remain uncertain as to their distribution and unable to assess these risks accurately because all relevant information is possessed by the seller. The ways in which "imperfect information" may lead to market failures are discussed in Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. Econ. 488 (1970).

home insulation, drugs and food additives are more obvious targets for government intervention because consumers are likely to underestimate the riskiness and costliness of these products.

To be sure, the magnitude of the potential risk and the gravity of the harm are important considerations in deciding the appropriateness of intervention. A relatively small chance that consumers will underestimate these measures may nevertheless require intervention if risk and harm are substantial. The point is that it is the ignorance of consumers, rather than the product's intrinsic risk, which triggers the inquiry into the need for government action.

Misestimations of reliability of information or risk of loss could be reduced, if consumers or sellers, or both, were required to exercise more care in their transactions; but how much care, and who should exercise it, are complex issues. The ultimate question is not whether *caveat emptor* or *caveat venditor* is the correct principle, but under what circumstances and to what extent one principle is to be preferred to the other. If consumers and sellers could bargain with each other over the allocation of this responsibility, free from the costs of transacting those bargains, presumably they would allocate the responsibility to the party in the best position to minimize the likelihood of misestimations. In fact, buyers and sellers in large-scale commercial transactions do bargain over such responsibilities and risks. In the real world of unequal bargaining power and lack of coordination among consumers, however, liability rules may be necessary to allocate responsibility between the parties. Common law causes of action sounding in contract or tort in effect require the seller to bear the cost of fulfilling consumer expectations that his product is fit for ordinary use and not unreasonably dangerous, unless the seller gives warning that the product is being sold "as is" or presents unusual risks. But in other circumstances, the costs of private litigation are likely to be prohibitive, and more direct forms of government regulation may be desirable.

Viewed in this light, the purpose of government intervention should not be to protect consumers from purchasing "bad" products. Rather, the goal of consumer protection should be to minimize the likelihood that consumers will misestimate product risks and hidden costs, by placing the responsibility for avoiding such misestimations on sellers and manufacturers when they are better able to do so than consumers. This principle stands in sharp contrast to the "purchasing agent" model, which allows the government to intervene whenever it decides that the costs of a given product, including hidden costs, outweigh its benefits. Here, intervention is appro-

priate only when it cannot be presumed that sellers will voluntarily seek to prevent consumer misestimations.

IV. WHEN IS INTERVENTION APPROPRIATE?

A proper allocation of responsibility between sellers and consumers to prevent misestimations of product risk is likely to occur automatically in markets where sellers are concerned about developing and maintaining goodwill, and where consumers can easily discover hidden costs after they have purchased the product. Under those circumstances it is simply unnecessary for government to intervene to protect consumers. By contrast, intervention may be appropriate when sellers are unconcerned about goodwill or when hidden costs can be passed on to an unsuspecting public with no detrimental effect on goodwill.

Consumers are often willing to pay a premium for trustworthiness and the chance to avoid costly diagnosis, testing, and searching among unknown products.⁸¹ For the seller who capitalizes on it, this willingness to pay more for a trusted product can ensure a stable or growing market. To preserve his market, however, the seller will have to incur costs of maintaining product quality and consumer satisfaction. At the least, he must inform consumers of potential hidden costs, when it is more efficient for him than for the consumer to discover and draw attention to them, so that consumers can make informed trade-offs between quality and price.

Such a private ordering of responsibility cannot be presumed, however, when sellers have no particular stake in maintaining goodwill. Indeed, under these circumstances, it may be in their interests to mislead consumers, to fail to disclose hidden costs, or generally to sell products that fail to meet consumer expectations. And it is here that government intervention *may* be appropriate.

Sellers are apt to be unconcerned about goodwill when consumers' surprise and disappointment at the product's hidden costs have no bearing upon future sales. This is likely to occur if 1) consumers do not know of the existence of these costs; 2) consumers know of their existence, but are unable to attribute their cause to the particular product or seller; 3) the seller is not dependent on repeat purchases or "word of mouth" reputation; or 4) the seller, because of market power or collusion with other sellers, knows that the consumer has no real choice as to source of supply.

⁸¹ See text following note 78 *supra*.

A. *Difficulty in Detecting Hidden Costs*

There are some products whose hidden costs may easily go undiscovered. High energy costs due to faulty installation of home insulation, or poor-quality insulation, are difficult for the average consumer to detect, since the monthly utility bill provides no easy method of calculation. Manufacturers and sellers of insulation therefore have little incentive to test their product's energy-saving potential or to provide consumers with truthful information. Similarly, poor nursing-home services may be difficult for the purchaser to discern, because the purchaser is often not the elderly beneficiary. Moreover, the patient is often too enfeebled to judge or complain about the quality of care. Accordingly, nursing-home operators may have little incentive to maintain adequate quality control, or truthfully to inform prospective purchasers and patients of the level of service provided.

Ignorance of hidden costs also underlies consumer dissatisfaction with what is suspected to be unnecessary work performed by auto mechanics or doctors. If diagnostic or testing information is sold in conjunction with the service, the consumer may be unable to judge the accuracy of the diagnosis or the necessity of the operation or repair work. But, because it is normally more efficient to bundle diagnosis and treatment together rather than require that the mechanic or doctor put the subject back together between diagnosis and treatment, the consumer often is reluctant to undertake the extra expense of separating them and getting a "second opinion." The consumer can assess whether such unbundling is worthwhile only if he is aware of the risk and cost of the bundled as against the unbundled diagnosis and treatment—risks and costs which the seller often has no interest in disclosing.⁸²

B. *Difficulty in Attributing the Cause of Hidden Costs*

Many products have hidden costs which are not readily traceable because the costs appear at such time or in such form that their magnitude or cause cannot be discerned. For example, carcinogenic

⁸² One particularly tragic example of risky and costly bundling recently came to light in Japan, where physicians are permitted to sell drugs directly to patients on their own prescriptions. The drug Clioquinol, used throughout the world since 1899 in antidiarrhea medicines, has been found to cause a severe and crippling nervous disorder when ingested in large quantities. Only in Japan has the drug had these widespread harmful effects, because Japanese doctors have prescribed larger daily doses for longer periods than physicians in any other country. This might be explained by the bundling of diagnosis, prescription, and retail sales, which gives Japanese physicians a strong financial incentive to over-prescribe. See Wash. Post, Mar. 18, 1979, § A, at 1, col. 5.

properties of certain food additives, drugs, or cosmetics may not become apparent for years after use, and even then it may be difficult to attribute the problem to particular products. Hence, manufacturers and retailers will have little incentive, notwithstanding their interest in maintaining goodwill, to test for carcinogenicity. Indeed, if consumers cannot know of a product's carcinogenicity, manufacturers and sellers may have little incentive to develop safer products. The cost of research and development is not likely to be offset by increased sales, since skeptical consumers will probably discount advertisements of non-carcinogenicity, knowing they will never be able to verify them.

Sometimes hidden costs can be traced to particular products, but the products themselves cannot be attributed to particular manufacturers or sellers. The identification of a defective product with its manufacturer becomes difficult if the manufacturer frequently changes models or promotes a new image, as is often the case with automobiles and household products, respectively. And, even if identification is possible, the past disappointment of consumers may be overborne by promises of new and improved products. Alternatively, if the manufacturer fears that consumer dissatisfaction with one of its brands will jeopardize others, the manufacturer may attempt to conceal its corporate identity and induce the consumer to believe that there is no connection between brands. For example, corporate sellers frequently hide their identity when they sell "seconds" at lower quality and lower price than their name-brand goods.

When consumers are unaware of hidden costs or cannot attribute their cause to a particular product or seller, they are unable to act on their dissatisfactions. They cannot alter their own buying behavior or that of their friends and neighbors, because they do not know what needs to be altered. As a result, seller goodwill is not in jeopardy and sellers have no incentive to remedy the problems. This suggests that government intervention may be appropriate. It also suggests that consumer complaints are poor indicia of which markets are most in need of government intervention; the complaints themselves are evidence that consumers are able to discover the causes of their dissatisfaction, an important first step in eliciting a market response.

C. Non-repeat Sales

If the seller is not particularly concerned about repeat purchases by the same consumer or other consumers within the same

geographic area, then he has no goodwill incentive to discover and communicate hidden costs. So-called "fly-by-night" sellers, moving rapidly from city to city; mail-order houses, telephone solicitors, and door-to-door sales networks that rely upon ever-new geographic markets; and sellers of "once in a lifetime" products, such as exotic vacations or tracts of land, often do not depend on repeat purchases.⁸³ Because consumers and their neighbors rarely have prior experience with these sellers, the latter reap no particular benefit from a reputation for trustworthiness. Rather than invest in building such a reputation by ensuring that consumers get the value of their bargain, it is often more profitable for such sellers to invest in ways of overcoming the reluctance of consumers to contract with the unknown. For example, the seller may offer a discount. Or, frequently, the seller will provide large commissions to its sales force, a guarantee of aggressive, if not ruthless sales practices.

D. *Low Level of Competition*

The value to the seller of goodwill is intimately related to the competitive structure of the market. Sellers may have an incentive to warn consumers of hidden costs in their competitors' products if their own hidden costs are lower, and thereby to build up their own goodwill. But the cost of developing and communicating such information may be greater than revenues expected from increased sales. This may be particularly true if the seller's product has similar defects and the warning merely induces consumers to shift to other product lines, or if the product is so similar to others that any newly won sales will be widely shared. But, even if it were profitable in the short run to communicate such information, competitors might be unwilling to do so for fear of triggering competition in an oligopolistic market, or of creating opportunities for entry or expansion of sales by new entrants.⁸⁴

More fundamentally, if there is tacit or explicit collusion among sellers, or excessive concentration, goodwill may cease to be an important factor, since patronage can often be guaranteed without it. Under these circumstances, the seller has no particular reason to worry when consumers underestimate the hidden costs of his products. Nor will he have any particular incentive to reduce

⁸³ Mail order companies continue to generate a high number of consumer complaints. Over 15% of the complaints received by offices of the Better Business Bureau in 1978 involved mail-order purchases; door-to-door sales followed closely behind. See STATISTICAL SUMMARY OF BETTER BUSINESS BUREAU ACTIVITY (1978).

⁸⁴ See Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 664-66 (1977).

these costs. He can reap the fruits of his monopoly either by raising prices or reducing quality control, and is free to choose the latter out of sheer laziness. The owner of a so-called "company store" or ghetto supermarket, often a local monopoly, is apt to be less concerned about fulfilling his customers' expectations than he would be in a more competitive situation. Lack of competition may also explain the frustration consumers experience at the hands of indifferent government bureaucrats and unhelpful employees of public utilities. To be sure, in some cartels, non-price competition may substitute for more readily policed price competition, and sellers may invest in means of enhancing their goodwill at the expense of their cartel compatriots. But, the mutual interests of cartel members will not be served if these campaigns degenerate into "octane wars" or "tar and nicotine derbies."⁸⁵ There are therefore strong disincentives for investment in goodwill in markets with low levels of competition.

These four factors—detectability, traceability, reliance on repetitive sales, and level of market competition—often interact. Thus, the likelihood that purchasers of new automobiles will underestimate the frequency and cost of repairs resulting from "piston scuffing" and will not be warned by sellers of this potential "defect" is high because 1) it may be difficult for consumers to detect this problem; 2) it is often difficult to attribute subsequent breakdowns to this factor rather than poor servicing; 3) most consumers are relatively inexperienced in purchasing automobiles, and dealers and manufacturers, although eager for repeat purchases, nevertheless have steady streams of first-time customers and of new lines and models for which they can claim superiority over all former ones; and 4) the industry is highly concentrated, offering consumers a relatively narrow range of real options, all of which are apt to have repair problems of one sort or another.⁸⁶

This is not to say that government intervention is necessarily appropriate whenever one or more factors are present. It may be less costly for consumers to discover and repair a "defect" when it occurs than it is for manufacturers or dealers to warn all purchasers of its likelihood, to repair it free of charge, or to improve the manufacturing process so that such "defects" do not occur. The point is that the proper allocation of responsibility for consumer misestimations is less likely to occur automatically through market forces

⁸⁵ *Id.* 665.

⁸⁶ See note 49 *supra*.

when there are greater difficulties in cost detection and attribution, less dependence on repeat purchases, or higher levels of monopoly power and collusion. Where such impediments exist, one cannot presume a proper allocation of responsibility to avoid misestimations of risk. Government policymakers may therefore justifiably attempt to balance the costs of intervention against the benefits to consumers of more fully informed purchasing decisions.

The lesson for consumer-protection policy is clear. Whether one is considering a legislative or regulatory solution to a perceived consumer problem, the first step is to ascertain whether and to what extent any one of the four impediments outlined above is present in the product or service market under scrutiny. If the impediments are nominal or non-existent, it can be presumed (absent special instances of consumer incompetence or vulnerability, for which government paternalism may be widely accepted, such as addicts, young children, or cancer victims) that the market is efficiently allocating between consumers and sellers the responsibility for avoiding misestimations. If, however, a substantial impediment blocks the market's natural allocation, it *may* be appropriate for the government to intervene. Whether intervention is, in fact, appropriate, and if so, what form it should take, are questions which can then be answered only by weighing the costs and benefits of government action.

V. HOW SHOULD GOVERNMENT INTERVENE?

Consumers need protection not because unsafe or defective products are being sold, but because the market may sometimes shield the seller from responsibility for the consumer's misestimation of product risks. This suggests a general approach to intervention that avoids taking direct control over product quality or seller conduct. Since the problem lies in the ability of sellers in certain markets to dispense with goodwill, the solution will usually be to increase the importance of goodwill to those sellers. Such a strategy would begin by overcoming whichever market factors have made goodwill irrelevant.

This general approach to the method of government intervention is borne out by a cost-benefit analysis that aims for the least costly remedy. The cost of a particular intervention has two components: the cost to the government of enforcement, and the cost to the seller of compliance, some or all of which may be passed on to the consumer in the form of higher prices. Exerting direct control over the quality of products or seller conduct typically entails high enforcement costs. New products and models, new advertising

campaigns, and new ingredients, are all introduced into the economy at an overwhelming pace. It is simply not feasible for the government to police any but a small fraction of these initiatives. By contrast, a consumer-protection strategy aimed at creating goodwill incentives would involve smaller enforcement costs because it focuses directly on the market and only indirectly on the product.

Similarly, compliance costs are higher for regulatory measures that directly control product quality and seller conduct than they would be for a strategy of enhancing market incentives. In addition to the cost of filing compliance reports with the government, a program of direct controls inevitably raises the quality, and the price, of some products higher than consumers are willing to pay. The alternative approach outlined here, by contrast, would preserve the efficiency of the market: sellers would invest in goodwill only to the extent that consumers were willing to pay a premium for trustworthiness.

To be sure, there may be some products with substantial hidden costs which society simply does not wish to entrust to the market, regardless of the sellers' concern to maintain goodwill. The likelihood of consumer harm from the sale of certain dangerous drugs, unsafe toys, or virtually worthless real estate may be so great relative to benefits that, notwithstanding proper motives on the part of sellers, a total ban is justified. Such instances will be rare. By and large, government strategy designed to protect consumers should aim first to foster sellers' stake in goodwill.

How can this stake be enhanced? Possible strategies follow directly from the four impediments to goodwill described in part IV. Consumers' difficulties in discerning the hidden costs of the product, attributing their cause to the product or seller, or discovering the nature of such hidden costs on the basis of previous purchases or local gossip, all correspond to a set of strategies designed to overcome such information impediments. The impediment resulting from low competition levels requires a different set of strategies which bear a curious relationship to the first.

A. Overcoming Information Impediments

When manufacturers and dealers are shielded from responsibility because of the difficulty of discerning or attributing to them subsequent hidden costs, consumer-protection strategy should aim to establish causal connections between the product and the subsequent cost. If, for example, the efficacy of a particular home insulation is hard to discern, mandatory disclosures, such as average

yearly energy savings, might be appropriate. By the same token, if it is difficult for consumers to attribute unsatisfactory purchases to a large manufacturer or conglomerate whose identity is obscured by a multiplicity of products and subsidiaries, then perhaps the conglomerate should be required to disclose its identity on all its products. And if subsequent health problems cannot readily be traced back to certain drugs, mandatory disclosure of the risks of ingesting the drugs might provide a solution.⁸⁷

Because such cause-and-effect information is apt to be complex, however, consumers often will have difficulty using it effectively. Thus, an appropriate strategy might aim to facilitate independent "information brokers," who can process and simplify the information according to the needs of consumers. For example, manufacturers or sellers of home insulation might be required to offer the services of, or warn consumers of the need for, an energy "auditor" who could independently appraise the home's insulation needs and calculate potential energy savings from various kinds of insulation. Similarly, when diagnosis and treatment are bundled, as with auto mechanics and doctors, an appropriate strategy would be to develop a market of independent diagnosticians who would offer only diagnoses. These individuals would have an incentive to warn consumers of the risk and cost of unnecessary treatment. They might also refer consumers to specialists they knew to be reliable, a role perhaps played in simpler times by family doctors and local garage mechanics. The government may need to subsidize such diagnosticians, however; property rights in the information disbursed by these individuals would be quite limited, rendering their services susceptible to use by "free riders."⁸⁸

When sellers are shielded from responsibility because they are not dependent on repeat purchases by the same consumer or by others within the same locale, methods should be devised to make them accountable for their improprieties. For example, companies that sell by mail-order or from door to door might be required to maintain up-to-date files of consumer complaints and to inform prospective purchasers about the incidence and subjects of consumer dissatisfaction.⁸⁹ Alternatively, these companies might be required to maintain broad warranty and insurance coverage. Finally, responsibility might be placed upon a third party who, because it deals repeatedly with the seller, is better able than individual con-

⁸⁷ See Pitofsky, *Beyond Nader*, *supra* note 84, at 673-75.

⁸⁸ See text accompanying note 79 *supra*.

⁸⁹ For an alternative remedy, see FTC Mail Order Rule, 16 C.F.R. § 435 (1979).

sumers to hold the seller accountable for defective products or poor service. If, for example, consumers were legally entitled to invoke against a creditor who financed their purchase of shoddy merchandise the same claims and defenses they have against the seller, the creditor surely would have a strong incentive to monitor the performance of the sellers with whom it deals. So long as this rule is limited to creditors who have regular business dealings with the seller, it may be a way of maintaining seller accountability far more efficient than setting minimum standards for the purchased goods.⁹⁰ A similar remedy would require sellers of products with particularly high hidden costs to sell only through fixed location dealerships or department stores, where reputational stake is likely to be higher than in mail-order or door-to-door sales operations.⁹¹

These strategies for overcoming impediments to goodwill may be inadequate or overly cumbersome. Ensuring that particular disclosures are provided, that offers are made of auditors and warranties, or that third parties are adequately policing the transaction can pose a substantial enforcement burden. In seeking to make sellers accountable for the consequences of their sales, it may therefore be more efficient for the government to create and enforce what might be termed "property rights in trustworthiness." Such property rights, which could take the form of licenses or certification, trademarks, or exclusive-sales agreements, would allow higher-quality sellers to differentiate themselves from poorer ones more efficiently than the market would otherwise permit.

Government licensing or certifying can function as an efficient method of quality control when mere reputation cannot. Certain products that have risks difficult for consumers to assess, such as prescription drugs or firearms, are sold only through licensed screeners who can help the consumer to understand the delicate trade-offs involved. Such licensed screeners are well-situated to test products for risks that would elude individual consumers, and can put their knowledge of past consumer product complaints to good advantage in advising on subsequent purchases. Moreover, the licensing or certifying authority can establish minimum professional standards, and can review consumer complaints against licensees in a single revocation hearing. A preferred means of ensuring con-

⁹⁰ This theory has been embodied recently on a more general level in the FTC's Rule 433. See FTC Preservation of Consumers' Claims and Defenses Rule, 16 C.F.R. § 433 (1979).

⁹¹ It is interesting to note in this connection that Montgomery Ward complained to Firestone about the poor quality of its radial tires as early as 1976, two years before the National Highway Transportation Safety Administration ordered a recall. *Product Safety: Tired Out*, NEWSWEEK, Aug. 21, 1978, at 61.

sumer protection and business investment in the past, licensing today is being considered by several state legislatures for nursing-home operators and other occupations.⁹²

Certification also may foster competition in product quality. If the high cost of credibly communicating distinctions of product quality makes sellers reluctant to inform consumers that the hidden costs of their own are lower than those of their competitors' products, the government can encourage comparisons by developing standardized comparative measures. For example, once the Federal Trade Commission developed a uniform standard for measuring the tar and nicotine content of cigarettes, manufacturers of cigarettes with lower tar and nicotine had an efficient means of communicating their comparative advantage. As a result, manufacturers began to compete vigorously to produce and advertise cigarettes of even lower tar and nicotine content.⁹³

Trademarks and brand names can provide sellers an important incentive to establish goodwill and provide an easy means of identifying trustworthiness. Sellers obviously would have little incentive to invest in quality control and promotion if any other seller could capitalize on the investment, and consumers would be unwilling to pay a premium for the quality control and promotional information if they had no way of knowing which product embodied it. Trademark protection makes it profitable for sellers to invest in quality control and promotion to the extent that consumers are willing to pay a premium for them. Consumers profit too, provided that the premium they pay still allows them to save on the total cost of the product, including hidden costs, as well as the costs of diagnosing, searching, and testing it.⁹⁴

Occasionally sellers will contract to transfer their property rights in goodwill to other sellers or several sellers will pool their collective goodwill. These sales agreements can be profitable if the

⁹² See, e.g., S. 680, Pa. Gen. Assemb., 163d Sess. (1979), an act providing for licensing of nursing homes.

⁹³ In 1967, when FTC testing of tar and nicotine content was begun, only 5.5% of the advertising and promotional expenditures of cigarette companies were devoted to cigarettes yielding 15 milligrams or less of tar. 32 Fed. Reg. 11,178 (1967). Ten years later that percentage had jumped to 49.4%. FEDERAL TRADE COMMISSION, ANNUAL REPORT TO CONGRESS ON CIGARETTE ADVERTISING, Table 11 (1978). The extent to which public demand for low-tar cigarettes over this period was itself influenced by the ready availability of an easy comparative measure, and how that demand affected advertising and promotion decisions remains undetermined.

The potential to foster competition in product quality may similarly exist for other markets affected by Commission certification efforts. E.g., 16 C.F.R. §§ 259.1-259.2 (1979) (automobile mileage-per-gallon ratings); 16 C.F.R. § 409.1 (1979) (durability and power-consumption ratings for lightbulbs).

⁹⁴ See text accompanying notes 75-78 *supra*.

cost to the sellers of maintaining overall quality control, which presumably rises with the number of outlets, is less than the premium that consumers are willing to pay.⁹⁵ The Quality Inn trademark, for example, has become for consumers a valuable assurance of quality for which they are willing to pay a premium. So long as that premium exceeds the cost to each independent proprietor of his share of system-wide-promotion and inspection responsibilities, the pooling arrangement will be profitable.⁹⁶

Other forms of exclusive dealing arrangements may also serve to ensure manufacturers or sellers that their goodwill remains unimpaired and quality consistently high. Agreements by which dealers provide certain customer services in return for a manufacturer's grant of an exclusive-sales territory can serve as a device for efficient quality control. By this means, manufacturers can prevent injury to their goodwill from careless or shoddy retail servicing, and dealers can capture the benefits flowing from their investment in promoting and servicing a manufacturer's product.⁹⁷ Similarly, manufacturers or sellers may limit those permitted either to service their products, or to provide spare or component parts. Such a restriction may ensure that the product will be maintained in good working order and that faulty components will not jeopardize it. Inadequate servicing or faulty components might otherwise undermine a seller's goodwill, particularly if difficulties in attributing the cause of subsequent problems were to lead consumers to lay the blame at the seller's door.⁹⁸

B. *Overcoming Market Concentration and Collusion*

If sellers have little stake in maintaining goodwill because of market concentration or collusion, the obvious consumer-protection strategy would be to foster competition. Such a plan may necessitate a reversal of the strategy of increasing sellers' stake in goodwill by promoting property rights in trustworthiness. Government licensing, trademark and brand-name protection, exclusive-sales agreements, and product tie-ins of servicing or component parts

⁹⁵ The premium may rise with the number of outlets since opportunities for consumers to save on the costs of diagnosis, search, and test are increased.

⁹⁶ As more hotels qualify for membership, the consumer's premium is likely to grow since the trademark becomes more widely recognized and opportunities for consumers to take advantage of it increase; but the total costs of inspection and promotion also are likely to rise. Theoretically, system-wide expansion should cease when the costs of inspection and promotion reach the highest premium that consumers are willing to spend in return for potential savings.

⁹⁷ See text accompanying notes 51-58 *supra*.

⁹⁸ See text accompanying notes 59-60 *supra*.

restrain competition by erecting barriers to market entry. All have been the focus of antitrust enforcement.⁹⁹ In a market characterized by low levels of competition, therefore, enforcing property rights in trustworthiness may backfire, and reduce sellers' stake in goodwill rather than increase it. On the other hand, if in more competitive markets promotion of property rights in trustworthiness enhances the importance of goodwill, then singleminded pursuit of an anti-trust strategy, without regard to its effects on information impediments, will likewise exert a negative effect on consumer interests.

How then is the choice to be made between those strategies designed to overcome information impediments and those designed to correct competitive impediments? The preceding analysis suggests several rules of thumb.

1. *If products entail substantial hidden costs, attribution and reputation problems make it unlikely that consumers can rely upon seller goodwill, and the market is not particularly concentrated,* the balance may tip toward the creation and enforcement of property rights in trustworthiness. Under these circumstances, trade-name promotion, government licensing, exclusive-sales agreements and tying arrangements may be motivated primarily by the desire of sellers and consumers to trade in trustworthiness rather than by sellers' desire to collude. Accordingly, a sensible consumer-protection and competition strategy would foster these property rights. For example, territorial restrictions which encourage dealers to hire well-trained salespersons would be permissible for distribution of complex audio or camera equipment; prospective consumers of these products are likely to want to purchase this extra help in assessing potential hidden costs, and competition in these markets appears to be quite vigorous.¹⁰⁰ By the same token, government licensing of insurance agents, doctors, or auto mechanics is apt to facilitate these sellers' stake in goodwill by overcoming information impediments to a greater extent than it creates competitive impediments. And vigorous promotion of trademarks by hoteliers will probably encourage responsible service in a relatively competitive industry, thereby providing consumers with protection from flea-ridden, sleepless nights.

2. *On the other hand, when a product has substantial hidden costs, but discovery and attribution of these costs after purchase are relatively easy for consumers, and sellers are dependent on repeat*

⁹⁹ See text accompanying notes 51-73 *supra*.

¹⁰⁰ See Pitofsky, *The Sylvania Case*, *supra* note 54.

sales, there is less justification for territorial restrictions, licensing, trademarks, and tying arrangements. Sellers of home appliances, osteopathy, or haircuts, will in all likelihood disappear from the market with relative dispatch if they fail to satisfy their customers. And this self-corrective feature of the marketplace will be particularly efficient if there are no barriers to entry by potential competitors.

3. *When it is less clear which impediments—information or competition—are paramount*, an intermediate strategy of required disclosures would alert consumers to the quality-control issue, but leave to them the decision whether to invest in trustworthiness. To avoid the anticompetitive effect of a servicing or component tie-in under these circumstances, the seller could be required to disclose to prospective purchasers the existence of the tie-in and the likely future cost, discounted to present value, of the servicing or components. Consumers could then decide if they wished to pay a premium for this guarantee of continued product quality. Similarly, to avoid the anti-competitive effects of government licensing, unlicensed sellers nevertheless might be permitted to sell their products on condition that they disclose the lack of government approval and any pertinent risks that the licensing was designed to address. Consumers could then choose the unapproved, and presumably less expensive product if they wished. Rather than undertake exclusive-sales agreements, manufacturers could allow certain sellers to indicate that they had been inspected and approved by the manufacturer; other sellers would have to disclose that they had not been so approved. Once again, consumers could decide which they preferred.

4. *Finally, when there are little or no hidden costs and products are relatively simple and fungible*, as with laundry detergents, paper napkins, aspirin, liquid bleach, and long grain rice, goodwill is unnecessary to ensure that consumers get what they expect.¹⁰¹ Under these circumstances the cost of adequate diagnosis, testing, and search is so low that consumers have no need to invest in trustworthiness. Here, vigorous promotion of a trade name may actually cause consumers to overestimate the consequences of their purchasing decision, and to pay a premium for the promoted product upon

¹⁰¹ Porter refers to “[g]oods with relatively low unit price, purchased repeatedly, for which the consumer desires an easily accessible outlet”—and for which research costs outweigh the probable gains from asking price and quality comparisons—as “convenience goods.” M. PORTER, *INTERBRAND CHOICE STRATEGY AND BILATERAL MARKET POWER* 24 (1975).

the mistaken assumption that real differences exist among brands. Because trademark or brand-name promotion that artificially differentiates such a product is likely to serve little purpose but to create barriers to competition,¹⁰² an appropriate consumer-protection strategy would be to require the trademark owner to license the trade name to competitors, or to disclose the product's standard "generic" ingredients. Similarly, under these circumstances, government licensing, exclusive-sales agreements, and tying arrangements are unnecessary to prevent consumer misestimation of hidden costs; they are more apt to protect sellers from potential entrants whose competition might well reduce prices. The best consumer protection strategy would therefore aim at rescinding these property rights. Viewed in this light, the administrative law judge's decision to order trademark licensing in the FTC's *ReaLemon* case seems entirely defensible.

CONCLUSION

This Article proposes a nonpaternalistic rationale for consumer-protection regulation, a rationale superior to that which allows government to intervene whenever it appears to regulators that the benefits of intervention exceed the costs. The critical issue for policymaking turns not on the merits of particular products, but on the characteristics of particular markets. Do sellers have sufficient stake in goodwill to ensure that they will bear the cost of avoiding consumer mistakes, when it is more efficient for sellers than for consumers to do so? When market conditions do not facilitate sellers' stake in goodwill and a substantial likelihood of consumer misestimation exists, government intervention may be appropriate.

This analysis of when government should intervene also suggests how intervention should proceed. Consumer-protection regulation should aim at improving market performance by enhancing sellers' stake in goodwill, rather than improving the quality of particular products or product information. This calls for a strategy combining, in differing proportions according to market characteristics, elements of disclosure, property rights in trustworthiness, and competition. Such a market-centered approach to consumer protec-

¹⁰² Studies have shown a strong positive relationship between consumers' perception that unfamiliar brands are risky and the strength of consumers' expressed brand preferences. Other experimental studies have shown that subjects are willing to pay a price premium for brands of bread and beer with which they have experience, even though other brands they could have chosen at less cost were identical in all respects but the labels. For a summary of these and related studies, see Schmalensee, *supra* note 68, at 1036-39.

tion would require careful analyses of particular industries and sectors, not unlike those that should underlie policy planning for antitrust enforcement. Indeed, data on industry concentration, consumer purchasing patterns, and advertising and marketing should inform decisions to intervene both to protect consumers and to maintain competition. When the two goals conflict, several rules of thumb may help government regulators choose an appropriate strategy to maximize both.

In sum, regulators engaged in protecting consumers should not act as purchasing agents, substituting their judgments for those of informed consumers. They should instead design ways to encourage the market to provide the quantity and quality of product and information that consumers want. A policy which thus seeks to make the market more responsive to consumer desires need not run afoul of the basic principles of competition policy. Both have at their core the same fundamental purpose: the enhancement of consumer welfare.