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## Consumer policy and market processes

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Is there a need for consumer policy? To answer the question I looked at consumer policy and market processes.

### Consumer policy

In the early days, policies to strengthen the market did help the consumer indirectly, or, if directly, on an *ad hoc*, temporary basis. Think of rationing in extreme scarcity or quality standards for dangerous products. From the 1960s onward, however, consumer policy has aimed at a systematic and direct improvement of the position of the consumer.

What are the reasons for the change? First, in today's world consumer sovereignty should not operate. The wish of the consumer is no longer fundamental. Why? Full sovereignty of the consumer implies a complete servitude of the producer to the consumer. But the consumer king is capricious. To secure his capital investments the producer plans production and distribution. Through all kinds of sales tactics he plays upon the consumer. Consumer sovereignty becomes an empty word; the consumer feels impotent. Second, consumers face a rich, but by its magnitude and variation, nontransparent market. Information is mainly given by the producer (Imkamp, 1986, p. 235). The consumer feels discomforted.

Consumer policy answers the feelings of impotence and discomfort. The first reason—lack of consumer sovereignty—leads to a top-bottom motivation. From basic values or needs, policymakers deduce aims (Kuhlmann, 1990, p. 60). Consumer policy protects the individual rights in the economic context. Taken after President Kennedy's presidential address of 1962, the rights are (1) the right to safety, (2) the right to be informed, (3) the right to choose, and (4) the right to be heard. Consumer policy tries "to insure that all consumers obtain what they really want (were they fully informed), subject to the limitation of their income" (Maynes,

1979, p. 97). The second reason—consumer feelings of discomfort—leads to a bottom-top motivation. Inductive methods show consumer complaints, in aggregated form they give the aims of consumer policy. Consumer policy restores the equality in the producer-consumer relation.

Of the tools used, some change the behavior of the producer, others that of the consumer. All try to protect or inform the consumer: to secure that no unreasonable physical and economic risks befall him. For physical safety, it means bans on dangerous products, for less dangerous products, specifying technical standards. For economic safety, it means regulation of the information content of advertising and of producer written contracts, as well as subsidies for comparative testing, mandatory informative labelling, and quality certification (Thorelli and Thorelli, 1974, p. 2).

The essence of consumer policy is (1) to increase the efficiency of the consumer's ends-means relation, and (2) if there is a conflict between ends from an individual or social perspective, to influence the ends of the consumer (Kuhlmann, 1990, p. 5-6). Consumer policy implies that the policy-maker knows the consumers' ends-means relation. He knows the products that are dangerous and ought to be banned and the minimal safety standards. He also knows the standard price, quality, and contract, as well as the relevant characteristics of the product labels and those in comparative tests.

### Market processes

The neoclassical market model gives the theoretical motivation of consumer policy. The consumer is a maximizer: action follows from an optimal choice in a given and known ends-means relation. The relation includes uncertainty that search can reduce. Because the consumer faces a gap in as well as an overload of information, consumer policy directs and restricts his choices. Prices per standard quantity and comparative tests increase the market transparency and direct choices. Laws limiting interest rates or prescribing standard contracts restrict choices. In other words,

consumer policy fosters—for both producer and consumer—the conditions for perfect competition: full knowledge and homogeneity of goods. To restore competition among consumers however, isn't an explicit goal. It's implicit, as it fosters the conditions for it. As far as consumer policy goes, consumers should be better protected and informed, and competition among producers restored.

Next to this well-known market model there is the far less-known Austrian model. In the Austrian model the consumer and producer have to find out the ends-means relations, first. They are more than mere calculators: they are venturing, innovating, exploring, and searching for new means and ends. The essential difference between the neoclassical and Austrian model is the idea of error and the role of error. Contrary to the neoclassical model, errors aren't always calculation mistakes caused by inadequate resources or a faulty institutional structure. There's also the possibility of entrepreneurial error: opportunities costlessly available are overlooked. In disequilibrium would-be buyers who have returned home empty-handed should learn that it is necessary to outbid other buyers. Buyers who have paid high prices should discover that they could have obtained the same goods at lower prices (Kirzner, 1973, p. 14). The problem is to describe an equilibrium as the result of "*the systematic way in which plan revisions are made as a consequence of the disappointment of earlier plans*" (Kirzner, 1962, p. 381).

The neoclassical equilibrium model can't describe endogenous plan revisions; the maximization model isn't fit for the task to generate systematic changes. It suffers from a discontinuity in the succession of decisions. Only an exogenous change in the data, e.g., in preferences, in technology, or in information, can generate a new decision. A decision the original model can't explain. Without exogenous change there is no choice-theoretic explanation why yesterday's plans are replaced by today's.

Endogenous change is possible with the—what Israel Kirzner, the leading Austrian theorist of competition, calls—entrepreneurial element in each man: alertness. Alertness is the propensity of knowing where to look for information: "the propensity ... toward fresh goals and the discovery of hitherto unknown resources" (Kirzner, 1973, p. 34). Disequilibrium points to market ignorance (error). From the ignorance emerge profitable

opportunities entrepreneurial alertness exploits (Kirzner, 1979, p. 30). Alertness broadens the image of human action; it makes possible the description of the market as a unified discovery process. Austrians are interested in competition as a process, not in the competitive state that results from it. Not the destination, but the journey is important.

For Austrians the reasons given for consumer policy have no value. The first one, consumer sovereignty, is irrelevant. The point is, do consumers err, and do they try to correct them? Which of course they do. The second, empirical reason is valid in equilibrium not in the Austrian world of constant change.

### **Market processes and consumer policy**

How does the Austrian model of the market relate to consumer policy? In other words: What is the impact of consumer policy upon the perception of consumers and producers of the available array of opportunities? Consumer policy "may effect what it is that decision makers *discover* to be the situation in which they act" (Kirzner, 1985, p. 94). These are the costs that must be taken account of. I give four ways in which consumer policy may hamper discovery (cf. Kirzner, 1985, p. 137-45).

### **The undiscovered discovery process**

A consumer problem doesn't necessarily point to regulation. The market is a discovery process; genuine inefficiencies generate their own correction. But the systematic tendency for imperfect knowledge to be spontaneously improved upon takes time. In Austrian economics time is part of the solution.

What are, for example, the market answers to the information asymmetry between producers and consumers? Of course sellers, as specialized producers, know more than non-specialized buyers possibly can; sellers are able to manipulate consumers. This led Gorge Akerlof to his claim that in equilibrium on the market for used cars only lemons will be offered by sale (Akerlof, 1970, p. 490). The government's answer is occupational license or certification. But there are many free market answers to

the alleged market failure. producer given guarantees and quality screening services, private information services, and all forms of non-governmental certification. There are also many information surrogates that keep consumers informed: repeated purchase, experience of friends, relatives, and neighbors, or inferences drawn from the firm's length of life. "[I]f consumers are able to check the veracity of suppliers *in any manner*, laissez-faire market equilibrium can support [contrary to Akerlof's claim] high quality" (Young, 1987, p. 18). Besides, consumers who prefer lower-priced, lower-quality service will be worse off with licensing, because such suppliers will not be permitted to practice. The poor subsidize the lower information costs of the rich (Young, 1987, pp. 21).

Even in an—almost legally forced—nontransparent market as the illegal drugs market, to give another example, transaction costs are lowered. A drugs supplier faces high selling costs. It isn't easy for him to make selling efforts; there's certainly no room for direct advertising. And, if caught, he has the costs of imprisonment and income forgone. For the consumer, too, there are high buyer costs. He faces high search costs, uncertainty over quality, and if defrauded there's no law to protect him.

In this disequilibrium situation coordination between buyers and sellers, and transaction volume are low. Entrepreneurs will try to make a profit as middleman creating an information market. The middleman offers information the consumer needs and the supplier likes publicized. The supplier separates the market of drugs supply from that of selling. For a fee, he creates an information market which lowers the selling costs. Because he is no supplier, the middleman himself doesn't face the high costs of imprisonment. At the same time, he lowers the search costs for the consumer. Both supplier and consumer value the middleman; he reduces the transaction costs for both of them (cf. Kunz, 1985, pp. 93-103).

Self-interest ensures that such a market continues to exist. The middleman will not share his information about where to buy drugs with too many people. Otherwise the supplier can be sold out as a buyer arrives. The information will be exclusive. If the middleman wants to stay in the market he must be reliable not only in the information on where to buy but also on quality. The more

reliable the middleman is, the more he can charge. The supplier has to be reliable about quantity and quality of the drugs to the middleman, otherwise he will lose business, too. Better quality commands a higher price for the supplier and a higher fee for the middleman. The result is (1) the market will be more coordinated and the transaction volume higher than otherwise would be the case (2) an experience good becomes a search good; and (3) quality doesn't deteriorate; there's even a stimulus to increase it.

### The unsimulated discovery process

How do policymakers know what prices and qualities to set? In the absence of the profit incentive, market opportunities which present themselves in the form of potential profit are unlikely to be discovered by them. "It is doubtful in the extreme if ideal such as benevolence or patriotism can be relied upon, in general, to enable a potential discoverer to identify his own personal interest with that of the discovery of an opportunity for a reallocation of resources desirable for society" (Kirzner, 1985, p. 33). The discovery process of the market can't be simulated by regulatory activity.

Because the consumer always gets the profit (the gain in utility) himself, it looks as if his alertness is stimulated however the form of the market. Yet things are more complicated. A consumer in a regulated market focuses on the efficiency of a given and known ends-means relation. A consumer in an unregulated market is, next to the efficiency of the relation, alert to the discovery of entrepreneurial errors: to expect the unexpected. His alertness is switched on because there may be something lurking around the corner. Something he is hopeful or something he is fearful of. But government regulation of producer decisions takes possible surprises out of his open-ended universe. A consumer in a regulated market (the government-takes-care-of-me) is less alert to new ends and means than is the one in an unregulated market.

Regulation, e.g., a price ceiling, tends to bar entry by potential new competitors. But it doesn't merely block the upper reaches of a given supply and demand curve. It also holds back the discovery of as yet unknown sources and substitutes of supply and demand (Kirzner, 1985, p. 143). To stick to the illegal drugs market. Think of such 'undiscovered' uses of marijuana as paper, fuel, building materials, clothing, animal food, and a protein source for humans.

The chance that regulation may discourage, hamper, or even completely stifle the discovery process of the unregulated market counts for producers as well as consumers. The consumer, too, discovers new unexpected ends and means. The role of the producer doesn't always "consist[] in *relieving the consumer of the necessity to be his own entrepreneur*" (Kirzner, 1973, p. 136). Advertising, for instance, alerts the consumer of the availability and even desirability of a good. But it can also be the other way around. The producer hires a trendwatcher. Someone who looks out for what a trendy consumer discovers. The market in a compatible economy is a two-sided process. When producers don't compete it is like a planned economy, e.g., communism in the former Soviet Union. When consumers don't compete, it is a bit like the old caste society in India where free entry among different groups of consumers was absent. When one side of the market process fails the economy becomes rigid and less competitive. James Steuart, a predecessor of Adam Smith, described this back in 1767 as double competition. "Double competition is what is understood to take place in almost every operation of trade; it is this which prevents the excessive rise of prices; it is this which prevents their excessive fall. While double competition prevails, the balance is perfect, trade and industry flourish" (Steuart, 1767, p. 264).

### The wholly superfluous discovery process

Regulation is likely to open up new roads for entrepreneurial gain. It introduces a new situation: a new discovery process with its wholly unexpected and even undesired outcomes,

e.g., enterprising bribery and corruption of the regulators. And doesn't the poor man's drug, crack, fall under this heading too? But here again, since the peak of the crack epidemic in 1989, the market returned to stability. The market regulated itself setting rules and transmitting knowledge about the effects and dangers.

### Conclusion

The Austrian model of the market gives a novel angle for critique of the regulated consumer. Regulation interferes with the spontaneous discovery process that the unregulated market generates. Comparative tests, informative labels, and so on, are wrong. It's regulation that makes them wrong. They ought to follow from the entrepreneurial-competitive process of discovery. Consumer policy ends up with about the opposite of what it intends. Isn't the ultimate aim to better the possibilities to satisfy needs by means of consumption?

When the French mercantilist minister, Colbert, once asked a group of businessmen what he could do for them, one of them, Legendre, replied, *laissez nous faire*. As is clear by now, it isn't only Legendre who had to say no. For when Ralph Nader asked the government to help him, it would have been equally wise for her just-to-say-no. What the capitalistic market process depends on is nothing but entrepreneurship. Less consumer policy means more entrepreneurship for producer—and consumer alike.

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