

**Ministry of Consumer Affairs Seminar on  
Consumer Policy**

**Deregulation and Consumer Policy**

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## DEREGULATION AND CONSUMER POLICY<sup>1</sup>

Consumption is the sole end and purpose of all production, and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer... But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

*Adam Smith  
The Wealth of Nations, 1776*

### **The Primacy of Consumer Interests**

Adam Smith had it right. Consumption is the end purpose of economic activity. Economics is about using scarce resources to best meet consumers' needs. The interests of producers are only relevant insofar as they create benefits for consumers. Consumers are the ultimate employers of the suppliers of both capital and labour. Economic policy should be directed to creating an environment in which firms are forced by competition to be efficient and to give consumers wider choice, higher quality and lower prices.

For the long period of fortress New Zealand, economic policies in this country conformed with what Smith labeled the mercantile system. Producer interests were paramount. Over the last decade, New Zealand has belatedly joined the worldwide trend towards trade liberalisation, deregulation, privatisation and greater reliance on the private sector and competitive markets to better serve consumer interests. However, we are still much further away from being a genuinely open and competitive economy than is popularly imagined, and the unbalanced and partial nature of the liberalisation programme is the source of many of the persisting economic difficulties.

### **Consumer Benefits from Deregulation and Public Sector Reform**

Looking back over the moves towards more consumer-oriented policies in the last 10-15 years, one is struck by the fact that few of the major reforms owed much to the advocacy of those nominally responsible for advancing consumer interests. As a first example, it is plain that consumers have benefited enormously from the dismantling of import licensing through access to a greater variety of better and cheaper

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<sup>1</sup> Views expressed in this paper are my own and do not necessarily reflect those of the New Zealand Business Roundtable.

products, including from domestic firms responding to the stimulus of competition. Yet the Department of Trade and Industry, the official agency with responsibility for consumer affairs in that period, fought tooth and nail for many years against efforts to relax licensing. Similarly I recall from first hand experience that efforts to interest the Consumers Institute in import licensing issues or the programme of industry studies were largely unsuccessful.<sup>2</sup>

Much the same could be said about the area of competition policy. The same department was responsible for the arsenal of price controls which stifled competition and led to pervasive cost-plus pricing behaviour. As recently as the early 1980s it resisted the abolition of national pricing. For many years it was hostile towards the franchising arrangements for whitegoods operated by Fisher and Paykel. Not until last year's decision of the High Court overturned the majority decision of the Commerce Commission was an arrangement with clear-cut consumer benefits recognised and sanctioned. The costs to the company of this fiasco were enormous.

Nor were consumer interests instrumental in the moves to corporatise and more recently privatise government trading departments. There were few more obvious examples of organisations, often with legislated monopoly positions, that exploited consumers through inflated prices and poor quality services. Yet consumer interests such as the Major Energy Users Group criticised corporatisation, arguing that electricity prices would jump by around 40 percent. In fact the Electricity Corporation has reduced its total real unit costs by 29 percent over the last 4 years and average wholesale prices are down by 16 percent in real terms. Service standards in organisations like Telecom and New Zealand Post have improved out of sight. The extent of waste and inefficiency that has been revealed in state-owned enterprises is mind-boggling. Yet many of those who denied the scope for gains from corporatisation are now arguing against the subsequent moves to privatisation which have the potential to offer further gains to consumers.

Consumer voices were barely heard in the debate over financial market deregulation. I do not recall consumer pressure for airline deregulation, perhaps the most striking example of the benefits of competition in the eyes of the New Zealand public. The two stages of liberalisation of shop trading hours over the past ten years were promoted much more strongly by producer interests (such as the retail industry) than by consumers. To my knowledge the current moves to deregulate the labour market have received no support from consumer representatives, even though their contribution to productivity and hence consumer welfare is likely to be massive.

Indeed, far from being reliable allies of advocates of market competition, consumer organisations have on occasions been quick to invoke the use of controls and regulations. A recent case in point was the threat to oil supplies posed by the Gulf crisis which prompted calls from the Consumers Institute and the Automobile Association for government intervention despite New Zealand's costly experiences

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<sup>2</sup> The Porter study on New Zealand's international competitiveness has drawn attention to the role of domestic demand conditions in forcing firms to upgrade their performance. It finds that decades of protectionism reduced consumer choice. Consumer demand is relatively unsophisticated and has provided little stimulus to New Zealand industry to achieve competitive advantages.

with such policies in the past. Thankfully both ministers of energy in office over the period resisted such pressure and markets efficiently handled the adjustment: prices rose as supply risks grew and are now falling as they recede.

There are exceptions to the pattern that I have been describing. One such is port reform, which has been driven in substantial measure by pressure from user interests. Farming and business groups will continue to press for privatisation of port companies and further improvements in employment arrangements which will yield benefits over and above those already realised. But whereas consumer lobbies in Europe are active campaigners against agricultural protectionism, New Zealand consumer representatives, in contrast to groups such as the Importers Institute and the Merchants Association, have had no significant role in moves to reduce high tariffs or indeed in trade issues generally.

So there is a paradox to explain: public and private sector organisations ostensibly dedicated to consumer interests have seldom been effective supporters of freedom fighters attacking the mercantilist system. Economics has long provided part of the explanation for this paradox, which is that consumer interests are typically dispersed, difficult to organise and benefit only in small measure from successful lobbying (and as a result consumer movements are easily captured by crusaders), whereas producer interests are concentrated and organised and have much at stake. There are other institutional explanations. Consumer interests were formerly stuck with a department 'charged' (in its mind) with 'helping' industry. In the laudable interests of not duplicating the responsibilities of other departments, the present Ministry of Consumer Affairs has deliberately limited its focus to the narrow (and less economically significant) range of issues that fall within the rubric of 'consumer policy'. But a puzzle remains: Why is it that consumer spokespersons often seem to end up missing the larger picture and hissing the wrong guys?

### **The Ideology of Consumer Protectionism**

A clue to this puzzle is given in an analysis of what Parish has called the 'ideology of consumer protectionists'. As he puts it:

"Hostility to the market economy is a strong element in consumer protectionism - as it is of protectionist thought in general. This is directed not merely against monopoly and other market imperfections long-recognised and analyzed by economists, but at the central proposition of the economic theory of markets, namely, that voluntary exchange is mutually beneficial. Scepticism about the performance of markets contrasts with an unquestioning faith in the ability of governments to intervene in the consumer interest." (p. 233)<sup>3</sup>

This stance can be detected in the thinking of both the Ministry of Consumer Affairs and the International Organisation of Consumer Unions (IOCU). In its briefing for the new government, the Ministry wrote:

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<sup>3</sup> Parish, Ross, 'Consumer Protection and the Ideology of Consumer Protectionists,' in *Consumer Protection Law and Theory*, Duggan A.J. and Darvall, L.W. (eds) Sydney, The Law Book Company Ltd, 1980.

"The orientation of the Ministry of Commerce, in line with its business perspectives, is very much away from direct intervention in markets unless demonstrated market breakdown is occurring. The activities of the Ministry of Consumer Affairs are more interventionist by nature. This is required to correct bargaining and legal imbalances between traders and consumers... Interventionist consumer policy would no longer be necessary if conditions of equity in markets and perfect competition were achieved." (p. 6)<sup>4</sup>

Similarly, IOCU has stated:

"The concept of a 'free' market is often touted as the magic solution to solve huge economic problems, presumably because in a free market perfect competition exists and therefore protects consumers from market domination and control. This trend towards freeing the market is very strong and might become a main issue of the nineties. But does a free market really exist? Many do not think so, at least not in the true sense of the word. If a free market cannot exist, then there is a need to protect consumers in the market-place." (p. 1)<sup>5</sup>

The IOCU's discussion of 'free' markets and its equation with the textbook model of perfect competition is primitive and has no counterpart in the economic analysis that has driven regulatory reform in New Zealand in recent years. This has paid a good deal of attention to issues such as transactions costs (defined broadly as the costs of information, negotiation and enforcement), asset specificity, limitations on rationality and opportunism, all of which have no part in the naive perfect competition model. It is ironic that those employing this more sophisticated analysis of market competition are often accused of using and ignoring the limitations of the simple model whereas their critics, for example those who are hostile towards arrangements of the Fisher and Paykel type, in fact base their judgments on the standards of perfect competition. By those standards, an exclusive dealership contract appears to be anti-competitive.

There are other problems with the foundations of consumer policy as outlined by the Ministry. Considerable weight is placed on the assumed lack of equity in markets which is defined as the imbalance of bargaining power between traders and consumers. This is analogous to the notion of the alleged imbalance of bargaining power between employers and workers which has underpinned 100 years of industrial law in New Zealand and which the government has rightly rejected in framing the Employment Contracts Bill. The fallacy is apparent in the employment context when it is recognised that Fletcher Challenge has no more ability to hire workers on inferior terms than the smallest firm in the land: if it offers work at \$9 an hour when the market rate is \$10, other things equal it will get few takers. The

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<sup>4</sup> Ministry of Consumer Affairs, Briefing for Incoming Government, October 1990. The Ministry nevertheless affirms that the end result it desires is market efficiency.

<sup>5</sup> IOCU, Congress Prospectus, 13th World Congress, Hongkong, July 1991.

essence of bargaining power is the existence of alternatives.<sup>6</sup> This is not to say that in both factor and product markets there are not times of scarce or plentiful supplies which favour sellers or buyers, but the point about properly functioning markets is that they adjust under competition to remove such imbalances.

Parish discusses this issue in the consumer protection context as follows:

"Most consumer protectionists seem to see economic life as a series of great struggles between different groups, especially between employers and employees, and between producers and consumers. Producers are said to 'exploit' consumers – and landlords tenants – because of their superior 'bargaining power'...

"I and many other economists share a quite different view. We see producers and consumers, or landlords and tenants, as being in a complementary relationship: each needs the other and each gains from a transaction with the other... The great competitive struggle is not between producers and consumers, but between consumers and consumers, on the one hand, and between producers and producers on the other. That is, consumers compete with one another for the supplies provided by producers, with producers competing with one another for the custom of consumers." (p. 5)<sup>7</sup>

The vision of the economic process which underlies theories of bargaining power bears little relation to current realities. Consumer bargaining power was constrained to a much greater degree in the era of import licensing and widespread controls over domestic markets. Deregulation has greatly enhanced consumer choice and hence bargaining power.

For this reason, a further theme of the Ministry of Consumer Affairs, and of the Ministry of Commerce in relation to competition policy, has it exactly backwards. This is that in a less regulated economy there is a need to strengthen consumer policy and antitrust enforcement to prevent "private regulation", whatever that means, and the abuse of market power. The reality is that the scope for abuses of market power is now vastly reduced compared with the fortress New Zealand era. The number of

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<sup>6</sup> The issue of bargaining power is often confused with the problem of monopoly. As Posner notes:

"Under monopoly, by definition, the buyer has no good alternatives to dealing with the seller, who is therefore in a position, within limits, to compel the buyer to agree to terms that in a competitive market would be bettered by another seller. But there is no reason to expect the terms (such as sellers' warranties or the consequences of the buyer's default) to be different under monopoly from what they would be under competition; the only difference that is likely is that the monopolist's price will be higher. The problem is monopoly, not bargaining power - unless, unhelpfully, these are treated as synonyms."

(Posner, R.A. *Economic Analysis of Law*, Boston, Little, Brown and Company, 1986.)

<sup>7</sup> Parish, Ross, 'Economic Effects of Residential Tenancies Legislation', mimeo.

situations in which monopoly may be a concern has shrunk essentially to those supported by legislation and to some parts of the non-traded goods sector. Yet in the same period the bureaucracies responsible for competition policy and for the newer forms of consumer policy have expanded considerably.

### **Consumer Incompetence, Imperative Values and Distributional Issues**

Some further arguments of doubtful validity in the consumer protection debate are worth a brief comment.

One of these is based on a view of consumer incompetence. Thus the minister of consumer affairs, justifying plans to introduce pre- and post-sale legislation, has argued that:

"As the marketplace is becoming increasingly sophisticated... consumers are less able to assess a (sic) product characteristics and quality without specialist knowledge."<sup>8</sup>

One response to this claim is to ask: "Have you ever bought a horse?" But even if it were true, it is hard to see how consumers are disadvantaged by an increasing variety of things among which to choose. This increase in choice has also been accompanied by a vast range of industries and institutions supplying information to consumers. Thus, as Sieper notes:

"...specialist organisations and publications test and review products of all kinds, brand names signal commitment to performance, large retail stores search out products and certify their suitability by money back guarantee, franchises reduce search costs through product standardisation etc. while dealers in information such as general practitioner doctors, travel agents, insurance brokers, architects etc. evaluate consumer requirements and recommend consumption plans. Even consumer organisations sometimes play an informational role." (footnote 8)<sup>9</sup>

Similar tendencies to use official policy or the law not to protect every member of society from the injustice or oppression of every other member of it but to protect individuals from themselves arise in the field of product safety. In the United States, courts have imposed strict producer liability to the extent of finding in favour of complainants who have come to grief cutting a hedge with a power mower. The Ministry of Consumer Affairs has noted that New Zealand's no-fault Accident Compensation Scheme has had the effect of reducing the incentives for traders to meet strict standards of safety.<sup>10</sup> In turn this leads to pressures to restrict or ban activities deemed dangerous or unhealthy. As one writer has put it:

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<sup>8</sup> Hon Katherine O'Regan, minister of consumer affairs, addressing Major and Multiple Stores Conference, 21 February 1991.

<sup>9</sup> Sieper, E. 'Consumer Protection - Boon or Bane?', Centre for Independent Studies, Sydney, 1978, mimeo.

<sup>10</sup> Op. cit. p. 11.

"We are heading towards a society where dangerous sports will not be permitted, pedestrians will be required to have a licence, obesity will be illegal and what we are allowed to eat will be determined by the National Dieting Board!" (p. 6)<sup>11</sup>

Martino went on to say that if you think that this is ridiculous or exaggerated, consider the European Community toy regulations. As pointed out by Digby Anderson:

"The contemporary obsession with safety, especially safety for children, has found its true bureaucratic home in the EEC... Committees have now recommended the statutory minimum dimensions of marbles based on the average width of toddlers' throats so that the Community shall protect its young from swallowing them. Or perhaps it is so that they *will* be able to swallow them rather than get them stuck: it's not clear... The pea in a whistle may be governed by regulations as to its toxicity lest someone tread on a whistle, the pea escape, be picked up and chewed by a child desperately looking for a pre-EEC-ban-style marble."

"I'm unsure," Anderson concludes, "about whether such peas will have to be the size of tennis balls (for marble-ish reasons) and how huge post-1990 whistles will have to be to incorporate them."<sup>12</sup>

Safety is a valid social objective, but not an imperative value that can normally be allowed to take precedence over all others. The costs and benefits, and the frequently perverse side effects, of safety regulations, in particular the undermining of incentives for personal responsibility and care, need to be carefully weighed. To date, New Zealand has not travelled far down this particular regulatory road, though there are pressures to go further.

An argument for consumer policy invoked by the Ministry of Consumer Affairs is to "empower groups of consumers who have been identified as particularly vulnerable and disadvantaged in the marketplace, for example Maori, Pacific Island people, women, the elderly, low income and rural consumers.<sup>13</sup> (The non-disadvantaged are presumably non-retired, wealthy European men living in cities.) There may be a case for targeting the consumer education function in this way, if targeting is accepted for public education in general. However, it is far from clear that we are making the least well off better off with the sorts of regulatory interventions under discussion. A recurring finding in regulatory studies is that regulations tend to operate in the interests of better-off groups and against the interests of the less privileged. In the

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<sup>11</sup> Martino, A. 'Liberalism in the Coming Decade,' The Mont Pelerin Society General Meeting, Munich 1990, mimeo.

<sup>12</sup> Anderson, Digby, 'Games that Eurocrats Play...' Sunday Telegraph, 2 October 1988.

<sup>13</sup> Ministry of Consumer Affairs, op. cit. p. 4.

consumer field, as the Ministry notes, the organised consumer groups comprise "people who are principally educated, articulate and have the resources and time necessary to pursue vigorously the interests of their members."<sup>14</sup>

Consumer protection, like all forms of protection, typically involves higher prices in return for reductions in risk. The trade-off between risk and price involved in such protection may be more in line with middle class tastes than those of the poor, who are likely to value low prices more. For those who are relatively poor, which includes most of us at some stage of our lives, the preferences about these trade-offs are different from when we are better off or have greater responsibilities to others. One illustration of this effect was experience with the Safety of Children's Nightclothes Act 1977, which aimed to protect children from burns. According to a former minister of consumer affairs, this resulted in the near-disappearance of children's nightclothes from the market as a result of vastly reduced demand due to high costs. Instead, parents made their own children's nightwear out of highly flammable but cheap material, and children were put at even more risk. There are many other similar examples.

In the consumer protection field there is frequently too little recognition of the links between the price and other conditions of the contract. Many consumer protection advocates appear to believe in a 'free lunch', i.e. the absence of a risk-price trade-off. The reality is that if the risk in the terms of sale is altered in favour of the consumer, the price is likely to adjust to compensate the seller for the cost of bearing extra risk. Thus the additions to tenants' rights in the Residential Tenancies Act 1986 have in all probability come at the cost of higher rents. Better-off people may well find such altered risk-price trade-offs desirable. But because most protection involves higher prices, and because the poorest members of society will tend to put the most value on low prices relative to risks, we may actually be especially penalising the poorest people.

## **Conclusion**

It is not difficult to identify further initiatives for consumer protection legislation which seem ill-conceived. The current proposals to introduce mandatory labelling requirements for country of origin, care and fibre content seem to fit into that category. The government is proceeding with country of origin labelling despite a consultant's report to the Ministry which found against it, and would have done so more strongly if some important issues had not been overlooked. (To its credit, the Ministry of Consumer Affairs has advised against country of origin labelling regulations.) The Auckland Chamber of Commerce has called for the regulation of education services for foreign students on the basis of a couple of unfortunate experiences. There have been calls for curbs on imports of used cars from Japan on grounds that have little to do with consumer interests. Last year a visiting consumer affairs expert, Jeremy Mitchell, recommended that New Zealand should establish a deposit insurance scheme to protect bank customers against the risk of collapses, despite the widespread recognition that the incentives for unwise lending created by deposit insurance have been at the root of the savings and loans fiasco in the United

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<sup>14</sup> Ministry of Consumer Affairs, op. cit. p. 11-12.

States.<sup>15</sup> Those who think New Zealand is immune from such folly would do well to note the creeping re-regulation of financial markets being promoted by the Reserve Bank.

I have argued that consumers in New Zealand have benefited immeasurably from policies to open markets to competition, even though these are, as yet, far from complete. We still maintain, for example, an extraordinary form of commercial regulation of pharmacies which restricts supermarket pharmacy and the ownership of multiple outlets. Many other occupational regulations impose restrictions which are in the interests of producers rather than consumers, and the Ministry of Consumer Affairs has rightly identified these as a reform target. There is no effective competition in the market for accident insurance. The electricity industry remains partially regulated at the distribution level and is still publicly-owned. Producer board monopoly controls remain largely intact. We still have significant tariff barriers. Education, particularly at the tertiary level, is largely a state monopoly. In the education sector in general, consumer interests are now asserting themselves more forcefully and are demanding greater choice and competition. The same can be said of health. The potential of market reform in serving consumer interests better is still enormous.

Consumers have not captured all the benefits of regulatory reform, nor should they necessarily do so in the short run. In cases such as the SOEs and port companies, taxpayer and ratepayer shareholders have also benefited from higher returns on their investments. But as returns rise to normal competitive levels and are constrained by competition and other influences, consumer benefits will dominate. Similarly efficiency gains in our export industries arising from deregulation have benefited owners and workers in export firms - as well as consumers abroad.

I noted that, with some honourable exceptions, organised consumer interests in the past have not played a large role in many of the changes which have benefited consumers. Often they seem to have missed the bigger picture and concentrated their efforts on finding the rotten apple in the bottom of the barrel. Economic theory provides an explanation as to why the political influence of consumers is often weak, and the ideology of consumer protectionism also sheds light on why some initiatives promoted by the consumer movement have not been in the interests of consumers overall.

Given the shaky foundations on which parts of official consumer policy have been seen to rest - particularly erroneous notions of imbalance in bargaining power and the effects of deregulation - together with the risks of perverse distributional outcomes from consumer protection, there seems a good case for a general review of consumer policy. I suggest this is likely to find that a number of current policies meet the tests of sound economic analysis. For example, the maintenance of a system which guarantees the value of ordinary weights and measures in the interests of facilitating contracts would be widely accepted as a core government function. (As an anti-inflation discipline, the same standard might appropriately be applied to maintaining the value of the monetary unit of account.) Laws to prohibit knowingly misleading or deceptive conduct, false representations, fraud and duress and to

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<sup>15</sup> Federal expenditure flowing from this episode is estimated to exceed the total amount of aid provided to Western Europe after World War II under the Marshall Plan.

protect against incapacity are reasonably non-controversial. There is a place for consumer education, at least as part of the public education role. Legislation such as the old Sale of Goods Act is among the best on the statute books, and proposals to modify it should be approached with particular care. On the other hand, it seems likely that some of the principles underlying statutes such as the Hire Purchase Act (e.g. the ban on add-on security clauses), the Residential Tenancies Act and the Fair Trading Act will not stand up well to scrutiny. Reform efforts in this direction could well prove fruitful.