Quality-and-Safety Assurance

How Voluntary Social Processes Remedy Their Own Shortcomings

DANIEL B. KLEIN

In the United States, governments at every level impose many restrictions on voluntary interaction in the name of protecting consumers from poor-quality or unsafe products and services. Examples of government quality-and-safety agencies and restrictions include the Food and Drug Administration, the Consumer Product Safety Commission, the Occupational Safety and Health Administration, the Environmental Protection Agency, the Federal Trade Commission, the Securities and Exchange Commission, the National Highway Traffic Safety Administration, state and local occupational licensing laws, and local housing codes.

Many economists are critical of such restrictions. For instance, economists argue that FDA restrictions on drug production are politicized, tend toward rejection of new drugs, discourage the development of new drugs, delay the availability of drugs, and make drugs more expensive to the consumer (for overviews, see Temin 1980; Grabowski and Vernon 1983; Higgs 1995). On occupational licensing, economic researchers find that the restrictions increase practitioner fees and incomes, reduce the quantity supplied, stunt innovation, delay treatment, discourage preventative care, and induce consumers to turn to unlawful, do-it-yourself, and often unsafe remedies. Also, there is very little evidence that licensing achieves its primary goal of raising the quality of lawful practice (for overviews see Rottenberg 1980; Shimberg 1982; Carroll and Gaston 1983; Young 1987; Feldstein 1993, chap. 14; Svorny forthcoming).

The arguments in support of quality-and-safety restrictions are of two kinds: knowledge-externality arguments (e.g., lemons models) and paternalistic arguments. I at-

Daniel B. Klein is an associate professor of economics at Santa Clara University, in Santa Clara, California.

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tempt to place these issues within a larger vision, developed by Adam Smith and F. A. Hayek, of the economy as a division of knowledge. I argue that quality-and-safety restrictions on voluntary exchange cannot be justified by the knowledge-externality arguments, which leaves only paternalism as a possible justification. Paternalism, however, runs contrary to the broad liberalism typically favored by economists and to the cognate values of human dignity.

Distinguishing Quality-and-Safety Restrictions from Paternalism

By "quality-and-safety restrictions," I mean restrictions that purport either to protect consumers from getting less than they bargained for or to elicit higher-quality products or services. Quality-and-safety restrictions ostensibly serve as a safeguard against quacks, charlatans, and frauds and against degenerative "lemons" markets. Drug prohibition, in contrast, is not rationalized as helping drug users avoid being cheated by drug dealers (the effect of drug prohibition in this regard is, of course, to increase the likelihood of rip-offs). Prohibitionists do not seek to advance promise keeping or foster sound quality in the cocaine trade. Drug policy is rationalized on the grounds that the promises themselves are unworthy, that using cocaine, exactly as bargained for, should not be permitted. Drug prohibition is a form of paternalism. It may not be pure paternalism, insofar as the prohibitionist maintains that drug users impose on others external losses greater than the external losses of drug prohibition. In any event, a policy such as drug prohibition is distinct from quality-and-safety restrictions.

Complex Systems Rely on the Division of Knowledge

In the first chapter of his *Wealth of Nations* ([1776] 1936), called "Of the Division of Labour," Adam Smith marvels at the complex array of activities, some occurring at "the remotest corners of the world!" (11), involved in making a woolen coat. The description of the workmen and their activities occupies an entire page of text. By virtue of the proper coordination of activities within a complex system, Smith argues, England is much richer than less complex economies. (The term "coordination" is used here in the Hayekian sense, not the Schelling sense; on the distinction, see Klein 1997d.)

Complex systems require a division of knowledge. Smith notes that no single mind could have the knowledge utilized in the economy (423, 651). The principle of the division of knowledge applies also to other complex systems. Marvin Minsky, MIT computer scientist and author of *The Society of Mind* (1986), applies the principle *inward,* writing of the division of knowledge *within* the human mind:

> Achieving a goal by exploiting the abilities of other agencies might seem a shabby substitute for knowing how to do the work oneself. Yet this is the

> very source of power of societies. No higher-level agency could ever achieve a complex goal if it had to be concerned with every small detail of what each nerve and muscle does. Unless most of its work were done by other agencies, no part of society could do anything significant. (169)

Within the human mind, Minsky explains, the activities of subagents with divided knowledge are coordinated chiefly by organizational structures. In the economy, the activities of those with divided knowledge are coordinated, as Ronald Coase (1937) has explained, sometimes by relations within organizations and sometimes by market exchange. The division of knowledge is limited by the extent of voluntary interaction.

The economy can be seen as a complex system of chains of promises. Any single exchange is but one link in long chains of promises that finally result in things such as woolen coats. An entire chain is sustained ultimately by consumers willing to pay for woolen coats, who thereby create opportunities for entrepreneurs to profit by providing what is demanded. At each link in a chain, transactors pay heed to current prices and other conditions to discern profit opportunities in dealing with adjoining links. Knowledge of these local opportunities resides locally: "in their local situation [the people] must generally be able to judge better of [their own interest] than the legislator can do" (Smith [1776] 1936, 497; see also 651). This condition I call the *canon of local knowledge*. When what is beneficial for the chain as a whole is advantageous at each individual link, the canon of local knowledge points directly to a conclusion of freedom. As Smith puts it, "the law ought always to trust people with care of their own interest" (497).

In some cases, as Smith recognized (651), what is beneficial for the chain as a whole is not advantageous to the individual link. In these cases the necessary basis for exchange (namely, private property rights) is weak or absent, so the activities of those with divided knowledge do not come into beneficial coordination. But these cases do not present violations of the canon of local knowledge: individuals are still presumed to know best where their own interest lies.

Divided Knowledge Implies an Expanded Role of Trust

Since Smith's time, economists have explained how the price system guides people to make the promises that bring about a beneficial coordination of activities. Economists have devoted much less attention, however, to a problem that would seem to grow as an economy becomes more complex. As Hayek (1960) pointed out, "The more civilized we become, the more relatively ignorant must each individual be of the facts on which the working of his civilization depends. The very division of knowledge increases the necessary ignorance of the individual" (26; see also Benson 1997, 171). Ignorance makes one vulnerable to deception and cheating. In a complex economy, we stand, as Smith ([1776] 1936) put it, "at all times in need of the co-operation and assistance of great multitudes" whom we cannot know (14). Increases in the division of knowledge imply an expansion of our dependence on things unknown to us and an expansion of the role of trust in economic affairs.

Economists have explained how people come to *make the correct* promises, but they have not studied very much why people *keep* their promises. In other words, economists have explained the *coordination* of promises but have done much less to explain the *integrity* of promises. For the most part, economists take for granted that people will keep their promises, perhaps assuming implicitly the existence of efficacious tort remedy. If we consider seriously why people keep their promises, we can better understand how quality and safety are governed by the canon of local knowledge. In the light of this understanding, we shall be more inclined to support the liberal prescription.

Promises Made to Assure that Other Promises Will Be Kept

In telling blackboard stories of markets, economists usually assume away transaction costs. With positive transaction costs, however, the market may not establish a single price. Transaction costs also lie at the heart of other stories of "market failure," such as those involving externalities, public goods, and even natural monopoly. If the market is imperfect, perhaps government can improve the situation.

Consider consumers who want to shop downtown where parking is scarce. By virtue of their demand for the goods in the stores, consumers have an associated demand for parking, which creates profit opportunities for entrepreneurs. When a shopper pays $5 for parking, that $5 may be viewed as part of the transaction costs of shopping downtown. But with reference to the parking-space transaction, it is not a transaction cost; it is the price paid for the thing purchased—parking space. The transaction costs of one market may become payments for services rendered in other markets.

Is the cost a transaction cost? The question has no definitive answer; it is a matter of interpretation. Consider another illustration, again involving parking. One way to deal with parking is for the stores to provide parking space at no additional charge to customers. Their costs of providing parking space may be viewed as part of their overall costs. Alternatively, the costs of providing parking space may be separated from other costs and viewed as costs incurred by the stores to complete their transactions with customers—that is, as transaction costs. In this fashion, even the cost of ball bearings used in the wheels of skateboards may be viewed as a transaction cost incurred by the manufacturer in the process of supplying all *other* assembled components of skateboards.

Now consider trust. Consumers wish to obtain goods that are safe and of sound quality. They want advance *assurance* of quality and safety. They want grounds for trust. This demand creates opportunities for entrepreneurs to profit by providing what is demanded. An auxiliary realm of assurance, reputation, and trust develops. Institutions and practices arise, including the following:

(a) investigating and demonstrating the characteristics of goods and services (displays, sales assistance, labeling and packaging information, try-out periods, consumer inquiry, word-of-mouth advice)

(b) reserving for the truster an advantage held until the end of the relationship (warranties, guarantees, return policies, security deposits, collateral, future dealings, judgments expressed to others)

(c) fostering repeat or extended dealings (brand names, advertising, product lines, contracting, affiliations, agents, middlemen, dealers, brokers, retailers, insurance companies)

(d) knower services remunerated by trusters (hired inspectors, second opinions, *Consumer Reports,* Dun & Bradstreet, consumer credit bureaus, industry newsletters, restaurant and movie reviews, employment agencies, doctors, lawyers, e-mail chat groups, market mavens, hotel concierges, friends, neighbors, coworkers)

(e) knower services remunerated by promisers (Underwriters Laboratories, universities, medical schools, other credential givers, Moody's Investors Service, securities underwriters, account auditors, the Better Business Bureau, medical data banks, employment agencies, referral services, e-mail chat groups arranged by promisers, letters of recommendation, friends, coworkers, neighbors)

(f) signaling quality by making visible investments that would be profitable only for a high-quality product (advertising, voluntary accreditation and certification, brand-name promotion, long-term investments in equipment, facilities, and design)

Elsewhere I have presented a guide to such voluntary practices and institutions (Klein 1997c; see the Schematic Bibliography of the volume for copious references).

The issue of supplying assurance takes us back to the question of what explains promise *integrity*. The answer turns out to be—in addition to the tort-remedy explanation—a special instance of the answer to the question of what explains promise *coordination:* People truck, barter, and exchange, utilizing their local knowledge. To assure that promises will be kept, people make other promises.

Hayek (1948) recognized that the canon of local knowledge transcends the mere knowledge of one's own preferences and the array of market prices:

> In actual life the fact that our inadequate knowledge of the available commodities or services is made up for by our experience with the persons or firms supplying them—that competition is in a large measure competition for reputation or good will—is one of the most important facts which enables us to solve our daily problems. The function of competition is here

> precisely to teach us *who* will serve us well: which grocer or travel agency, which department store or hotel, which doctor or solicitor, we can expect to provide the most satisfactory solution for whatever particular personal problem we may have to face. (97)

In response to the proposal to provide trust by extending the division of knowledge, one might ask: But don't these extensions themselves generate new trust problems? For example, a manufacturer wants to get retailers and consumers to trust his electric heater, so he contracts with Underwriters Laboratories (UL) for seal-of-approval services. How do we know we can trust UL? The answer is that UL has repeated dealings, and it would injure *its* reputation if it were to compromise the integrity of its practices.

To suppose that the division of knowledge implies a constant degree of vulnerability to untrustworthiness is a mistake. No such conservation principle applies, because in the competitive processes of voluntary affairs, built on local knowledge, trust problems come to rest where they are dealt with most effectively. As Hayek (1948) says, "We have developed these practices and institutions by building upon habits and institutions *which have proved successful in their own sphere* and which have in turn become the foundation of the civilization we have built up" (88; my emphasis).

Externalities in Knowledge: Curse or Blessing?

Some analysts say consumers have "imperfect information" when choosing a doctor or a drug therapy. If consumers value more information, won't entrepreneurs supply it? Economists respond that it may not be profitable to supply information. Information, they claim, involves exceptional problems—externalities, lack of appropriability, high transaction costs. Consider the following statements by economists:

- As is well known, information on quality has many of the aspects of a public good. . . . Under such circumstances, inadequate resources will be channeled to providing information. (Leland 1980, 268)

- In the absence of special legal protection, the owner [of information] cannot, however, simply sell information in the open market. Any one purchaser can destroy the monopoly, since he can reproduce the information at little or no cost. (Arrow 1971, 151)

- Trust and similar values, loyalty or truthtelling, are examples of what the economist would call "externalities." . . . They are not commodities for which trade on the open market is technically possible or even meaningful. (Arrow 1974, 23)

- Perceptibly safer versions of a commodity, or commodities that can protect users against predictable hazards, will be profitable and hence likely to be produced

> through competitive pressures. Even some forms of precautionary information—for example, safety ratings on consumer goods—will be generated by the market. But these will be inadequate where product performance is hard to monitor by users, where hazards are not widely or accurately perceived, or where people do not realize that they are uninformed. . . . The market's myriad decentralized actions do not themselves ensure adequate safety. Centralized controls of various sorts are needed. These have been instituted in the form of regulations, constraints, information programs, licensing and certification. (Rothenberg 1993, 166, 172)

Smith ([1776] 1936) said that government should act (beyond guaranteeing the security of voluntary agreement) when undertakings beneficial to society at large fail to remunerate private undertakers. Even if we were to concede that voluntary processes inadequately ensure quality and safety and that government action (aside from the tort remedy) is called for, that action should take the form Smith indicated: providing what is lacking. It should not take the form of restricting people's freedom of contract.

Before pursuing that line of argument, however, I devote the remainder of this section to a series of nine numbered paragraphs disputing the claim that the quality-and-safety assurance provided by voluntary processes (and the tort system) will be inadequate.

1. Kenneth Arrow (1971) claims a problem will arise "in the absence of special legal protection" (151). Where such protection exists, then, no problem will arise. A good example is *Consumer Reports,* whose property rights in its ratings have been successfully defended in court. Its publisher, Consumers Union, has made a business (albeit "not-for-profit") of selling information on standardized products.

2. Even where information is not proprietary, are the activities involved really nonrivalrous and nonexcludable? Information must be not only generated but organized, formatted, stored, retrieved, and transmitted. The pessimists tend to neglect the costliness of these activities. The generation of information may be nonrivalrous and nonexcludable in principle, but one may nonetheless be able to appropriate an adequate portion of its value at the stages in which it is conveyed. (There is a clear parallel here to Terence Kealey's theory of laissez-faire R&D and scientific research; see Kealey 1996, 228–32.) Equifax and Dun & Bradstreet process massive amounts of information and release needed bits of it to millions of specific customers every month. It does not follow that those now in the know of tiny bits of information can expropriate the value of the service provided by credit bureaus. Technical limitations impede reselling the information, and legal limitations prevent contracted agencies from using the information in ways not agreed upon in advance. The credit bureaus are not only providing information

but doing so profitably. The institutions that have evolved have done so precisely because they remedy the problems identified by the pessimists.

3. The pessimists suggest that the lowness of the cost of reconveying information causes markets to "fail." But usually we regard low cost as a blessing. (Indeed, the 1971 Arrow passage indicates that it can undercut monopoly.) If a knower service cannot make profits selling to trusters, instead it sells to promisers. Promisers pay UL to generate knowledge, and then they convey the symbol of judgment, or seal of approval, far and wide. George Stigler (1951) explained that when an activity conducted within a firm is separable from the firm's other activities and exhibits increasing returns to scale in the effective range of the firm's production, that activity tends to be taken over by specialized firms (or not-for-profit organizations), which then sell the service to many firms downstream. UL is an example. The low cost of reprinting the UL mark is not a curse but a blessing—a blessing, that is, to trustworthy promisers, not to untrustworthy promisers. UL and hundreds of like organizations make profits doing exactly what the pessimists suggest cannot be done. Do UL and similar seal-of-approval organizations function perfectly? The answer depends on what one means by "perfect." A more pertinent question is whether the current voluntary system works better than would a system in which all products had to be approved by a government agency before being manufactured and sold. Most economists would oppose the imposition of such a regime for electrical appliances. Yet many of those same economists favor such a regime for pharmaceuticals. Sometimes people rejoin, "But drugs have larger effects on physical well-being," overlooking that the point cuts both ways. (For a nice discussion of voluntary possibilities in a liberalized drug market, see Weimer 1982, 263–76.)

4. The seal-of-approval market—and the blessing of information externalities—is apparent for services such as those of UL, Moody's, account auditors, universities, certificate-granting academies, and so on. Less apparent is that the same kind of service attends every decision by a retailer to carry a product, by an agent to take on a client, by a medical group or hospital or clinic to include a physician, by the American Automobile Association to contract with a towing company or motel, by a pharmaceutical company to market a new drug, by a doctor to prescribe a drug, by a law firm to employ a new attorney, by a movie star to take a part in a movie project, by a franchisor to take on a new franchisee, by an economics department to accept a new graduate student. In all of these cases, a knower gives a seal of approval. That this seal of approval can be reconveyed at low cost is a blessing, not a curse.

5. Voluntary practices and institutions evolve, based upon local knowledge and working from the bottom up, to transform the externality aspects of quality-and-safety assurance into the very substance of gains from trade and interpersonal

relationships. Just as moments of chatting are, according to O. Henry, the raisins in the tasteless dough of existence, information sharing more generally suffuses and, indeed, *constitutes* social relations. Sometimes information is the consideration owed to us. Sometimes it is a lagniappe, or free add-on, such as free parking or pleasant surroundings, that people provide to make themselves more attractive (i.e., more competitive) as merchants, associates, or friends. Sometimes knowledge is jointly produced and used, as in e-mail chat groups (Hagel and Armstrong 1997) or kibitizing with “market mavens” (Gladwell 1996). When money does not change hands, as in barter transactions, open-ended employment relations, or friendships, the roles of “consumer” and “producer” have no relevance. But even then, the concept of mutual gains from exchange remains paramount. A friend or associate can counsel us on selecting a promiser or recommend us to trusters. Our friends hope for similar benefits from us. Two friends cooperate as teammates, but they also compete (as individuals and as a team) for positions on other teams. We compete for the friendship and favor of others, and others compete for our friendship and favor (Shearmur and Klein 1997). In this dynamic competition, the offering of pointed and opportune knowledge and seals of approval is one of the staple considerations. These principles operate in the “friendships” consumers have with pharmaceutical companies, pharmacies, hospitals, doctors, and health organizations, and in the “friendships” these organizations and practitioners have with each other. *Quality-and-safety assurance is achieved by creative extensions of the division of knowledge.*[1]

6. Promisers who are trustworthy have an incentive to broadcast not only evidence of their trustworthiness but also evidence of their competitors’ lack of trustworthiness. They do so by making rival claims or insinuations in their advertising, promotions, marketing, and so on. They challenge each other’s claims. Of the 65 advertising challenges resolved by the Better Business Bureau’s National Advertising Division in 1992, almost all of which dealt with the truth or accuracy of advertising claims, 47 were brought by competitors (BBB 1992 Annual Report, 2). Again, the “public goods” aspects of information appear not as a curse but as a blessing.

7. The above quotations from Jerome Rothenberg are from his 1993 critique of Aaron Wildavsky’s highly libertarian book *Searching for Safety* (1988). Rothenberg, who told me in a telephone conversation that he has never done research on quality-and-safety issues, describes himself in the article as “considerably less optimistic” than Wildavsky (180) and expresses clear judgments in support of restrictions. Although Rothenberg notes that some services such as *Consumer Reports*

1. For a major exploration of the themes of this paragraph, focused on fame and greatness rather than quality-and-safety assurance, see Cowen 1997.

or *The Medical Letter* exist, he adds: "But such instances are in fact rare. The more likely sources of such precautionary information are governmental product safety programs, scientific studies, and journalistic exposés" (172). Rothenberg does not note that the development of voluntary remedies, which, of course, include scientific studies and journalistic exposés, will be hampered by the subsidization of government agencies performing competing services and especially by the requirement that everyone must have government approval to practice or trade.

8. Shirley Svorny (1992, 33; forthcoming) constructs (I would not say endorses) an argument in favor of licensing as follows: Licensing can deter malfeasance because malfeasance may result in revocation of the license, and revocation results in much lower incomes. This suggests that policy makers make the practice of medicine especially remunerative for the few by withholding the right to practice from the many. Svorny is borrowing the idea of quality-ensuring premiums from the literature of labor economics, where they are called "efficiency wages." In the context of occupational licensing, they might be called "efficiency privileges." Svorny (1992, 33) notes that the same mechanism conceivably could function equally well with certification. Indeed, brand names, credentials, impressive affiliations, and reputation in general make for premiums that depend on keeping up quality (Klein and Leffler 1981). The idea of efficiency privileges depends, furthermore, on a degree of policing and revocation that may not be feasible. And, of course, whether efficiency privileges will increase quality depends also on whether hamstringing competition will weaken incentives for quality improvement and innovation and induce resort to black-market and do-it-yourself remedies.

9. What about government failure? Is the government really a more knowing assessor of relevant trade-offs involving hazards, a better steward of knowledge, a speedier, more pointed, and more opportune messenger? The pessimists appear to be optimists when it comes to processes steered by politicians and government bureaucrats.

At the core of the foregoing points lies the canon of local knowledge. Wildavsky (1988) put it this way: "Safety results from a process of discovery. Attempting to short-circuit this competitive, evolutionary, trial and error process by wishing the end—safety—without providing the means—decentralized search—is bound to be self-defeating" (228; see also Kirzner 1985). Wildavsky is referring to voluntary processes in which entrepreneurs see profit opportunities in what some economists call "market failures" and, by acting on those opportunities, remedy those "failures."

Externalities in Knowledge: No Grounds for Restriction

I think the judgments made or hinted at by the pessimists are wrong. Even if they are right about the inadequacies of voluntary processes, however, it does not follow that quality-and-safety restrictions are justified. Within formal models such as Akerlof's lemons model (1970), restrictions can make things better, maybe even Pareto superior. But a model by itself does not warrant belief. If you change a model's assumptions, its result also changes. After Akerlof's paper had appeared, Geoffrey Heal (1976) published an article with a model showing that with repeated interaction, Akerlof's result does not hold; Kip Viscusi (1978) published an article with a model showing that with voluntary certification, Akerlof's result does not hold; and Sanford Grossman (1981) published an article with a model showing that with warranties, Akerlof's result does not hold. In fact, Akerlof's original paper noted that lemons problems are resolved by guarantees, brand names, chain stores, degrees, and credentials.

More relevant than models are discussions steeped in knowledge of institutions and the law. Consider an article in the *Journal of Law and Economics* by Howard Beales, Richard Craswell, and Steven Salop (1981), all working at the time at the Federal Trade Commission (see also Beales and Salop 1980; Ippolito 1986; Viscusi and Magat 1987; Magat and Viscusi 1992). The authors point out that product bans and restrictions "can be viewed as attempts to correct, by direct regulation, market performances that may well be due to deficiencies in buyers' information" (513). They suggest a different approach:

> The focus on information remedies in this paper reflects the belief that, where inefficient outcomes are the result of inadequate consumer information, information remedies will usually be the preferable solution. Remedies which simply adjust the information available to consumers still leave consumers free to make their own choices, thus introducing less rigidity into the market. Such remedies leave the market free to respond as consumer preferences and production technologies change over time. For the same reason, information remedies pose less risk of serious harm if the regulator turns out to have been mistaken. . . . Similarly, information remedies allow different consumers to strike different balances between price and product quality, while direct quality regulation almost necessarily imposes a single choice on all consumers. . . . Consumers are constantly monitoring quality in the course of their market search, thus relieving regulators of this task. Firms then self-enforce their own compliance out of competition-induced profit motives rather than from the fear of government compliance actions. (513–14)

One of the central strategies for enhancing consumer information, the authors suggest, is government rating of products, or "scorings" for particular dimensions of product quality. Utilizing the scorings on labeling or in advertising may or may not be required: "if firms have their own incentives to disclose whenever disclosure would be useful, required disclosure is unnecessary" (527). Firms that do not disclose might, of course, increase the wariness with which retailers and purchasing agents regard their products.

There have been many proposals along these lines. For drugs, people have proposed that the FDA continue to certify claims of safety and efficacy but not require its approval for marketing (Grabowski and Vernon 1983, 71; Statman 1983, 62; Krauss 1996). If hospitals, doctors, health organizations, pharmacies, and consumers valued the FDA certification, they would look for it. For medical devices, economists have likewise proposed that FDA approval be changed to mere certification (Higgs 1995, 99–100) or that certification be carried out by independent organizations (Campbell 1997). People have proposed similar liberalizations in the control of drug information. The "split-label" proposal would allow pharmaceutical companies to list claims for the drug—claims now forbidden—on a distinct portion of the label for "Not-FDA-Approved Claims" (Pearson and Shaw 1993, 7). Had aspirin makers been permitted to use such labeling, tens (perhaps hundreds) of thousands of people who died of myocardial occlusion and stroke after 1988 probably would have been saved (Rubin 1995, 33; Pearson and Shaw 1993, 15; Keith 1995).

For occupational licensing, eliminating coercion might permit a system proposed long ago by Milton Friedman (1962, 149) and espoused by many others (e.g., see Gross 1977), in which the government offers certification but does not require practitioners to have it. Again, hospitals, firms, insurance plans, and consumers could demand certification if they wished. These proposals allow quality-and-safety assurance and problem solving to evolve according to the decisions of those with local knowledge. (One possible argument against this reform has to do with efficiency privileges, as explained in Svorny 1992.)

One way for a government to police trustworthiness is by using undercover operatives. Private companies make extensive use of "mystery shoppers"—to make sure that franchisees do not cheat customers, for example. In California the state's Bureau of Automotive Repair uses undercover operatives to police auto mechanics. But this method of ferreting out frauds and quacks and inducing good behavior, though very direct and so inexpensive that the private sector employs it, is not extensively used by governments except in prostitution control (Pearl 1987).

A voluntary system with government product scorings would be preferable to a coercive system, but it is unclear whether anyone would pay attention to voluntary government scorings. I suspect that such a system, despite being financed by tax dollars (hence not fully voluntary after all), could not compete successfully. Like the U.S. Postal Service, government enterprise in this matter might depend on forbidding competition or mandating use of the government scoring. It is unclear to me what the pessimistic economists and self-styled consumer advocates would say about a plan of voluntary government scorings. If they were to say that people are uninformed, why isn't it enough for government to inform them? And if, in an unrestricted field, people were to gravitate to private forms of quality-and-safety assurance, saying "No, thank you" to the government service, wouldn't that action demonstrate the adequacy of private institutions and practices?

The pessimists might argue that product standards and ratings exemplify path dependence. There is probably much truth in that argument, but the chance of an inferior set of standards becoming locked in would be greater, I suspect, if the process were monopolized and dictated by government than if it were left to the voluntary, decentralized choices of people utilizing their local knowledge and their own discovery of ways to better their condition. Indeed, the hazard of an inferior, inflexible system's becoming locked in provides a strong argument against government information programs, even voluntary ones.

The Concept of Divided Knowledge Extended Inward: Paternalism as Insult to Human Dignity

The proponents of quality-and-safety restrictions might concede that *if* consumers demand assurances, assurances will be supplied. But, they might insist, product variation and risk analysis are too complicated for consumers to understand; consumers do not know the hazards to which they would expose themselves.

> The growth of scientific knowledge of mental and physical health and disease is working a revolution in this matter, undermining the idea that each individual is the best judge of his own desires. (Clark 1936, 99)

> To argue that people ought to be able to choose their own risks, that government should not intervene, even in the face of inadequate information, is to impose an unrealistic burden on people when they are most vulnerable to manufacturers' assertions. (David A. Kessler, quoted in Associated Press 1992, A3)

After all, how much do I know about, say, therapies for ulcers? Perhaps very little. One thing I do know, however, is that I know little about therapies for ulcers. In fact, I am the world's foremost expert on the topic of my knowledge of ulcer therapies.

It is not our random ignorance that governs our fate, but our pointed, purposive knowledge. If I have stomach pains, I seek help. If I get opinions, I seek assurances. When in doubt, I ask another question. Sufferers tend to become experts in the local opportunities for treatment of their illness and in local assurances of those treatments. A Yiddish proverb says: "Don't ask the doctor; ask the patient." Having always been ourselves makes *us* the experts on our existence at this moment.

Individuals do err and suffer, of course, sometimes fatally, from their ignorance or, more likely, their ignorance of their ignorance. We all know error and self-reproach.

But self-reproach tells us to check for error in our behavior. Within the mind we engage agents to watch and reflect on what our other agents are doing. In *The Society of Mind* (1986), Marvin Minsky puts it this way:

> Divide the brain into two parts, A and B. Connect the A-brain's inputs and outputs to the real world—so it can sense what happens there. But don't connect the B-brain to the outer world at all; instead, connect it so that the A-brain is the B-brain's world! . . . Now A can see and act upon what happens in the outside world—while B can "see" and influence what happens inside A. (59)

Knowledge of our being ignorant is often almost as valuable as not being ignorant, because knowledge of ignorance directs us, when needful (and only when needful), to overcome ignorance. Not having much information about ulcer therapies matters less than our *judgment* of whether we are well informed. Indeed, wiser is the person who is ignorant and knows it than the person who has some information and thinks he is fully informed. The first person is less informed but has better judgment about his situation.

Judgment involves more than sensing whether we should gather more information; it also involves sensing whether we should reconsider our *interpretation* of the information. Although economists sometimes foolishly speak as though knowledge were merely information, knowledge is the triad of information, interpretation, and judgment (Klein 1997a). Sensing that we are lacking information or neglecting a better interpretation, a mental "watcher" directs us to look further, to search for assurances, to double-check. These deeper dimensions of knowledge, cascading always beyond our comprehension, are the neglected part of local knowledge that Polanyi (1966) termed *tacit* knowledge. Knowing our ignorance, he says, "we can have a tacit foreknowledge of yet undiscovered things" (23).

People's leading, ever-present impulse is the avoidance of physical suffering. Most consumers know very little about drugs in general, but they know not to ingest drugs at random. You may have known very little about the ingredients and activities that went into making the lunch you ate yesterday, but you knew to look for assurances. Watchful agents within your mind have taught you not to pick a hamburger up from the gutter or out of the garbage bin, even if the same hamburger would look appetizing if served in a restaurant.

Again, people do err. But if medical experts and public-health officials feel strongly that people are not aware of certain major hazards, they should also feel confident of their ability to make the people aware of those hazards. Let them submit their special knowledge to the public and its chosen knowers. Consumers, retailers, manufacturers, and so on would have strong incentives, including those of the tort system, to heed such warnings (unless, of course, the warnings came from experts who had destroyed their reputations by crying wolf too often; see Viscusi and Magat 1987, 18–21; Wildavsky 1988, 199).

The belief that it is inadequate for the government to offer information and warnings to the interested parties amounts to a lack of faith in people's capability to look out for themselves, to claiming that people cannot learn, that the dividing of knowledge within the human mind is breaking down or reaching an insurmountable barrier. The regulators conclude that providing information about hazards and trying to persuade people to be more alert to new information about hazards is not enough. The people are defective, their judgments unworthy. They must be coerced, for their own good.

The presumptuousness of coercing people "for their own good" is paternalistic. No one denies that in exceptional circumstances, such as when a friend gets behind the wheel drunk, coercion might be justified. And even liberals accept restrictions on the "freedom of choice" of children and of adults with serious mental deficiencies, such as the senile. But as government policy for the general population, paternalism asserts that people are hopelessly defective and that government must protect them from themselves. It denies the hope of learning the errors (if errors they be) of our ways. It asserts that we cannot come to see the profit in what government experts know to be profitable to us. It assaults the image we have of ourselves as capable of taking possession of ourselves and transcending our current troubles. It rejects the canon of local knowledge extended inward to include knowledge of our ignorance and the capacity to transcend our current foolishness.

Assaulting people's dignity has many bad consequences—spiritual, moral, and political (Klein 1997b). Isaiah Berlin (1969) comments on the moral consequences of policies that deny the hope of personal responsibility:

> Paternalism is despotic, not because it is more oppressive than naked, brutal, unenlightened tyranny, nor merely because it ignores the transcendental reason embodied in me, but because it is an insult to my conception of myself as a human being, determined to make my own life in accordance with my own (not necessarily rational or benevolent) purposes, and above all, entitled to be recognized as such by others. For if I am not so recognized, then I may fail to recognize, I may doubt, my own claim to be a fully independent human being. For what I am is, in large part, determined by what I feel and think; and what I feel and think is determined by the feeling and thought prevailing in the society to which I belong. (157)

The advocates of quality-and-safety restrictions cannot deny that such restrictions tread on people's liberty, albeit "for their own good." If liberalism entails respect for individuals in their choosing of personal goals and their caring for themselves, then good liberals will oppose paternalistic restrictions on such choosing and caring.

Conclusion

The arguments for quality-and-safety restrictions fall into two broad categories. The first pertains to externalities in knowledge. I have argued that voluntary processes can deal with quality-and-safety assurance more successfully than is generally recognized. The principle of division of knowledge applies more broadly than economists have realized; it applies even to remedying its own problems. Economists have not paid adequate attention to the trade in esteem and seals of approval that pervades voluntary affairs and elicits promise keeping. Furthermore, even if voluntary processes were inadequate, the appropriate governmental response would be provision of information, not restrictions; in this solution the government would be essentially extending the division of knowledge rather than restricting it. These conclusions are built on the economic canon of local knowledge. The second argument for quality-and-safety restrictions is paternalism. This argument assaults human dignity and is therefore illiberal. The assault on human dignity derives from a neglect of the moral canon of local knowledge. In sum, support for quality-and-safety restrictions rests on bad economics or illiberal politics, both of which stem from a failure to appreciate the depths of local knowledge.

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