The Demand for and Supply of Assurance

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The book chapter

YouTube video of lecture:
https://youtu.be/fETVRVqGCPU
The Division of Knowledge

Hayek:

“This 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.”
You demand:

1. Cheeseburger—of a promised quality and safety

That demand carries an associated demand:

2. Assurance of cheeseburger quality and safety
Should you trust the promiser?

Figure 1

Truster decides whether to trust Promiser.
Sequence

1. Promiser communicates the content of the promise.
2. Truster heeds assurances of Promiser’s trustworthiness.
3. Truster forms a level of confidence in Promiser’s trustworthiness.
4. They make the decisions in the figure.
The demand for X creates opportunities for entrepreneurs to profit by supplying X.

-- in broad senses of:

“demand”, “opportunities”, “entrepreneurs”,
“profit”, “supply”
X can be tangibles
X can be intangibles

- entertainment
- friendship
- sympathy, love
- assurance of quality and safety

... though you cannot draw it into a supply & demand diagram.
Three approaches to assurance

1.

2.

3.— our focus here
1. Government restrictions on voluntary exchange

- Food and Drug Administration (FDA)
- Consumer Product Safety Commission
- Occupational Safety and Health Administration (OSHA)
- Federal Trade Commission
- National Highway Traffic Safety Commission
- Occupational licensing (state policy)
- Housing and building codes (state and local policy)
2. The courts, product liability law
3. Voluntary practices including abstention and reputation

The supply of assurance:
many methods
many forms
Informal Channels of Information Sharing

- Ask a friend
- Gossip
- Local community newsletters, websites, Facebook, Yelp!, Angie’s List…

Average Customer Review: ⭐⭐⭐⭐⭐ 47 customer reviews
Amazon Best Sellers Rank: #370,805 in Books (See Top 100 in Books)
Gossip

Anthropologist Sally Merry: "gossip can be viewed as a means of storing and retrieving information." "It forms dossiers on each member of one's community: who is a good curer, who can be approached for loans, ... who is a good worker, and who is a thief." In consequence, "the individual seeks to manage and control the information spread about him or her through gossip"
Extended Dealings

• Continuance, repetition, or information sharing → Reputation.

• Our power to damage a promiser's reputation or to withdraw from dealings serves as a hostage that we hold against his promises.
Trustworthy Promisers Cultivate Extended Dealings

Alfred Marshall referred to “that highest form of advertisement, which comes from the recommendations of one customer to another; and from the inducements which dealings with one department offer to dealings with another.”
The Umbrella of the Brand Name

“To ease the minds of customers about problems of quality, reliability, and safety, manufacturers and advertisers appealed to consumers to buy according to brand names. National Biscuit, Heinz Soup, Armour Meat, Standard Oil, and other companies placed one banner on many different products. The consumer who found one product of a brand to be satisfactory, those companies suggested, could assume that all other products also would be suitable.”
Dealers Make for Extended Dealings

S = Seller

D = Dealer

B = Buyer
Reputational Nexus and the Middleman

The middleman creates a bridge of trust between two traders
The Middleman Also Acts as Knower

The retailer specializes in knowing good products from bad, by:

– recognizing brand names and seals of approval
– studying the information on labels and packaging
– keeping track of customer complaints and returns
– conducting his own tests and investigations
– hiring testing services
– following trade or consumer literature
– observing whether other retailers carry the product
– chatting with industry colleagues.
Knower Services

• “Knower”—one with valuable knowledge about the trustworthiness of the promiser.

• Trusters pay for knowledge:
  – Gossip
  – Consumer Reports
  – Credit reports
  – Doctors prescription
  – Hired inspector
Seals of Approval and Self-Disclosure by Promisers

Independent knowers evaluate quality or safety. If the word is favorable, the promiser broadcasts it.

• Computer and automotive advertisements tout "editor's choice" accolades
• Household products display the *Good Housekeeping* seal of approval
• Movie ads reproduce favorable excerpts from the critics
• Restaurants display favorable dining reviews.
• Stores show credit-card services as seal of approval.

VISA  ZAGAT  FILM FESTIVAL LAURELS  Starring Samuel L. Jackson  BlueCross BlueShield
When a knower generates basic quality information on a standardized product of interest to a wide class of trusters, reconveying the information might be easy, and he may go broke trying to sell information to trusters.
• In that case he goes to work for the promisers.
• If a lack of parking spaces would prevent customers from coming to buy, and an independent parking entrepreneur could not exclude nonpayers, then the retailer would himself provide parking, at no charge.
Promisers hire knowers

- Underwriters' Laboratories
- Moody's
- Accounting audits
- Professional schools, technical schools, institutes, and training programs grant degrees and certificates.
- These credentials are prominently displayed.
Franchises as a System of Seals of Approval

• When a motorist pulls off the highway and into Joe's Garage for sudden repairs, she will have isolated dealings with Joe and feel vulnerable.

• The motorist would do better to pull into Shell, because if the local Shell franchisee cheats her, it faces the prospect of punishment.
How franchises police quality

• "mystery shoppers“
• unannounced inspections
• audits
• complaint investigation
Knower is remunerated by

<table>
<thead>
<tr>
<th>TRUSTERS</th>
<th>PROMISERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hired inspectors (for buildings, automobiles)</td>
<td>Credential givers (universities, institutes, training programs)</td>
</tr>
<tr>
<td>Letters of recommendation</td>
<td>Underwriters= Laboratories</td>
</tr>
<tr>
<td>Doctors</td>
<td>American Dental Association</td>
</tr>
<tr>
<td>Financial advisors</td>
<td>US Pharmacopoeia</td>
</tr>
<tr>
<td>Hired investigators</td>
<td>Good Housekeeping</td>
</tr>
<tr>
<td>American Automobile Association</td>
<td>Security ratings (Moody=s, Standard &amp; Poor=s)</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Securities underwriters</td>
</tr>
<tr>
<td>American Automobile Association</td>
<td>Financial and accounting audits</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Notary public</td>
</tr>
<tr>
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<td>Letters of recommendation</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Orthodox Union (kosher foods)</td>
</tr>
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<td>Credential givers (universities, institutes, training programs)</td>
<td>Internet seals of approval (TrustE, Cyber Patrol, Safesurf, Verisign, BBB Online)</td>
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<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Consumer Reports</td>
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<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Dun &amp; Bradstreet</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Industry newsletters</td>
</tr>
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<td>Credential givers (universities, institutes, training programs)</td>
<td>Hobby, product, and news publications</td>
</tr>
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<td>Credential givers (universities, institutes, training programs)</td>
<td>Restaurant and movie reviews</td>
</tr>
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<td>Credential givers (universities, institutes, training programs)</td>
<td>Employment agencies</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Brokers</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Internet chat groups (eBay)</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Referral services</td>
</tr>
<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Advertising firms</td>
</tr>
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<td>Credential givers (universities, institutes, training programs)</td>
<td>Signs, labels, packaging, displays, sales help</td>
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<tr>
<td>Credential givers (universities, institutes, training programs)</td>
<td>Web pages</td>
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**Figure 4**

Classification of knower services
Yet Other Paths to Assurance

• Tryout periods, warranties, guarantees, sureties

• Rival exposé: The failings of promisers are exposed by rival promisers in advertising, product comparisons, and contests.

• Signaling: By making visible expenditures that would be profitable only for a high-quality product, promisers signal quality by advertising, obtaining accreditations, and making long-term investments in design, product line, and facilities.
The Internet

is expanding information exchange and assurance.

When critics find some fault in e-commerce, such as doubts about privacy, security, or trustworthiness, entrepreneurs invent an e-solution, usually taking the form of a middleman service or a knower service.
2008 Crisis:
Governmentalized finance

1. Money borrowed often becomes money loaned or invested: Systemic risk, contagion.

2. Government bailouts, moral hazard.
Governmentalized finance

3. Huge government agencies as irresponsible trusters, irresponsible demanders of assurance.

4. Governmentally privileged knowers, certifiers.

5. Many assets (real estate, stocks, mbs) are not promises of future returns.
Who is fighting the cheater?

– the truster
– the trustworthy promisers
– middlemen
– knowers (certifiers, seals of approval)

By foiling the cheater, they gain from achieving trusting, honest exchange.
The intricacy of consciousness
Conclusion

• There is a demand for and supply of assurance.

• The supply takes many forms.

• The processes tend to be *self-correcting*.
Conclusion:
Costs unredeemed?

- Food and Drug Administration (FDA)
- Consumer Product Safety Commission
- Occupational Safety and Health Administration (OSHA)
- Federal Trade Commission
- National Highway Traffic Safety Commission
- Occupational licensing (state policy)
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