

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:

“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.”



Cheeseburger

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?

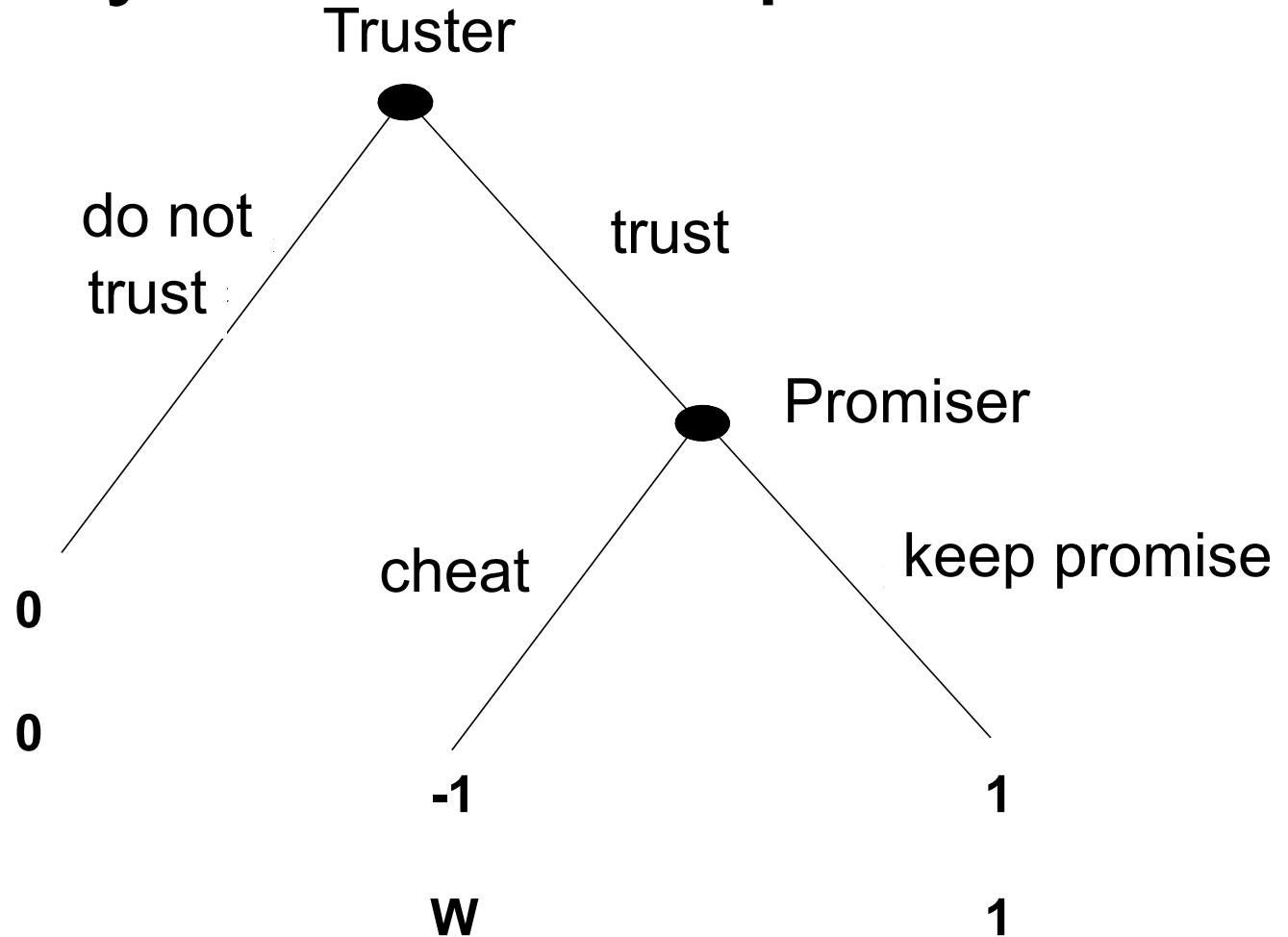


Figure 1

Truster decides whether to trust Promiser.

Sequence

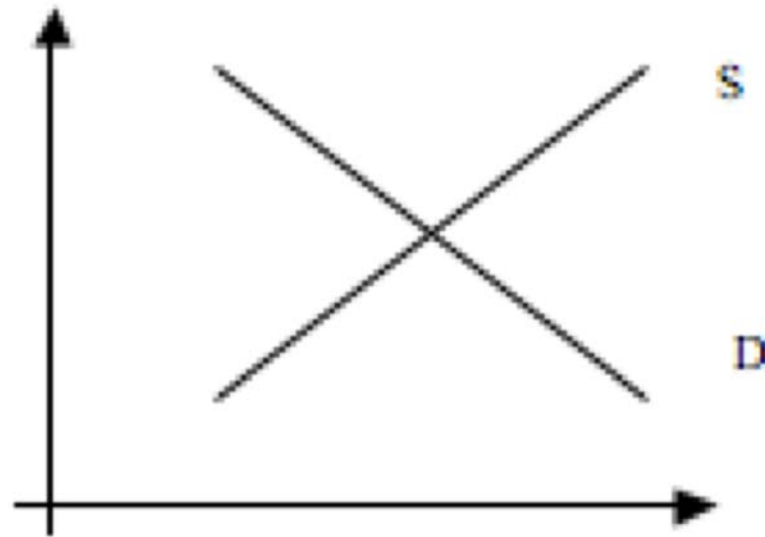
1. Promiser communicates the content of the promise.
2. Truster heeds *assurances* of Promiser' s trustworthiness.
3. Truster forms a level of *confidence* in Promiser' s trustworthiness.
4. They make the decisions in the figure.

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



cheeseburgers



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

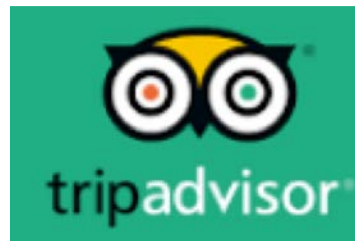
The supply of assurance:

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

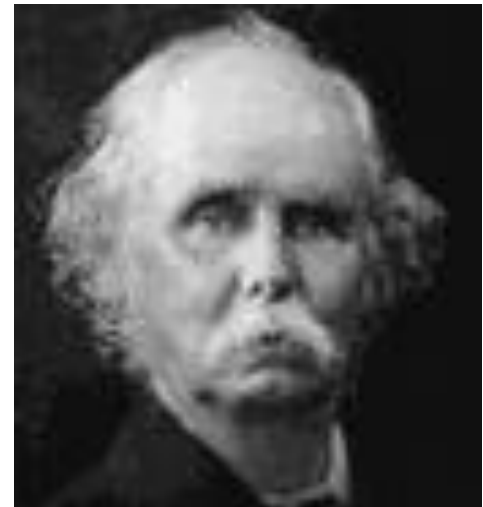
Anthropologist Sally Merry: "gossip can be viewed as a means of storing and retrieving information." "It forms dossiers on each member of one's community: who is a good curer, who can be approached for loans, ... who is a good worker, and who is a thief." In consequence, "the individual seeks to manage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



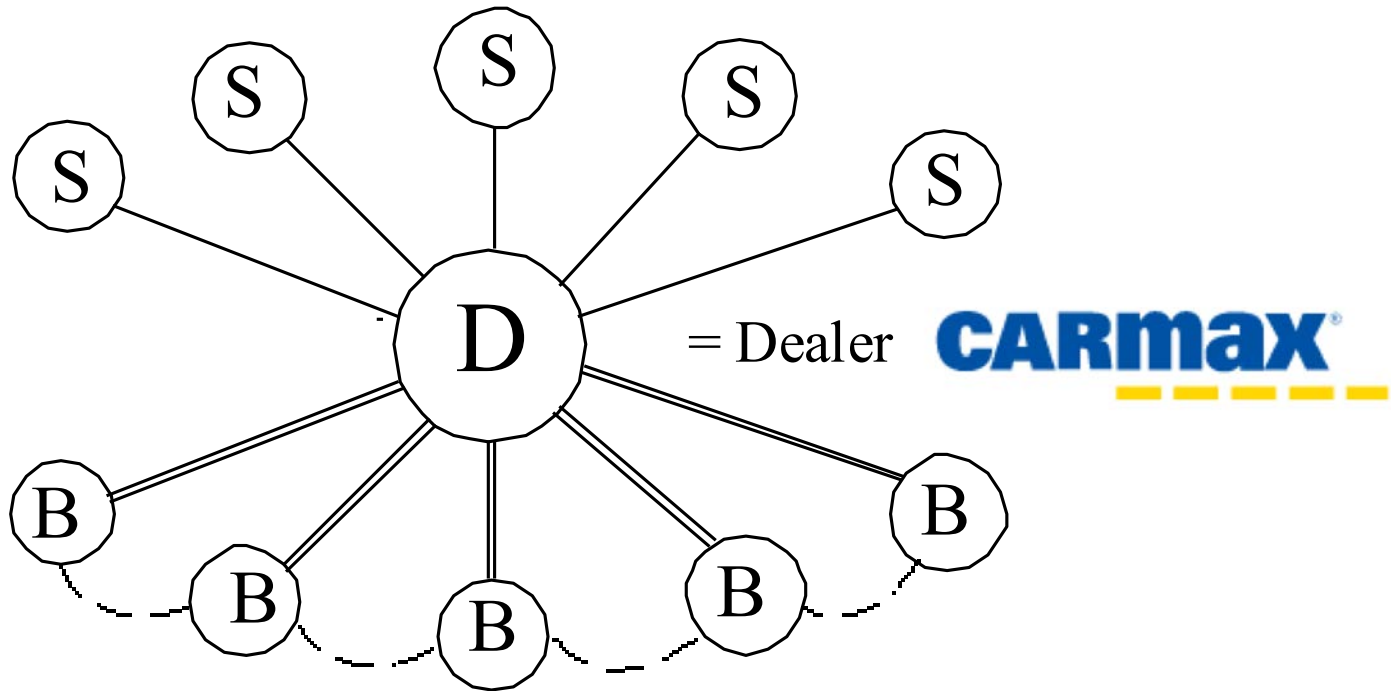
The Umbrella of the Brand Name

“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

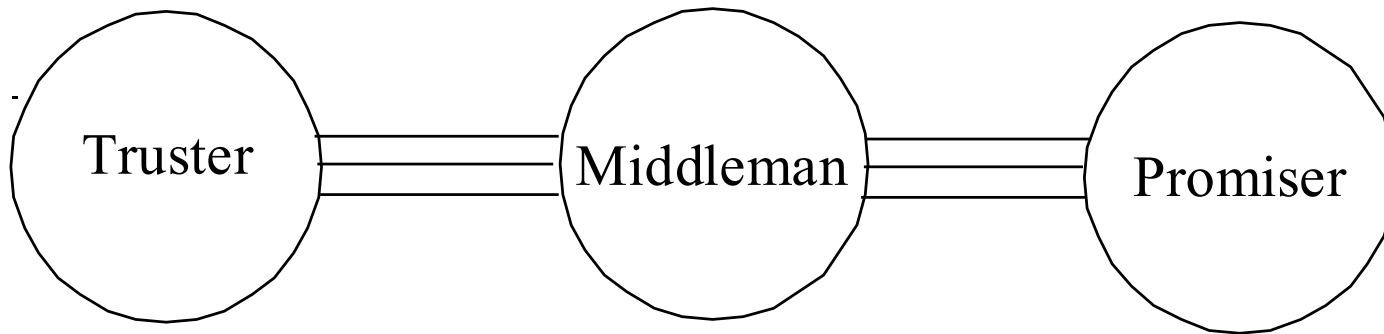
S = Seller



B = Buyer

Reputational Nexus and the Middleman

CVS/pharmacy®



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.



Starring Samuel L. Jackson

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

		TRUSTERS	PROMISERS
Knower engages in information	GENERATION	Hired inspectors (for buildings, automobiles) Letters of recommendation Doctors Financial advisors Hired investigators American Automobile Association	Credential givers (universities, institutes, training programs) Underwriters= Laboratories American Dental Association <i>US Pharmacopoeia</i> Good Housekeeping Security ratings (Moody=s, Standard & Poor=s) Securities underwriters Financial and accounting audits Notary public Letters of recommendation Orthodox Union (kosher foods) Internet seals of approval (TrustE, Cyber Patrol, Safesurf, Verisign, BBB Online)
	GENERATION AND CONVEYANCE	<i>Consumer Reports</i> Dun & Bradstreet Industry newsletters Hobby, product, and news publications Restaurant and movie reviews Employment agencies Brokers Internet chat groups (eBay)	Franchises Better Business Bureau Medical data banks Employment agencies Brokers (securities, real estate, produce, art, collectables)
	CONVEYANCE	Gossip, e-mail Consumer credit bureaus	Referral services Advertising firms Signs, labels, packaging, displays, sales help Web pages

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



**DIAL M
FOR MURDER**



*Honesty is
the best policy*

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)
- Housing and building codes (state and local policy)