

Regulatory Techniques in Consumer Protection

Lecture 1:

Ex-Post v. Ex-Ante Rule-Making

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How to protect consumers buying food at food trucks?



- ① Set rules in statutes and regulation
 - Requirements for licensing
 - Regulate food truck locations
 - Periodic inspections by regulatory agency
 - Administrative sanctions
- ② Set principles of safety and compliance and enforce through courts only when harm occurs

Our Basic Question:

When Should Legal Commands be Set?

- ① Ex Ante Regulation (= “IN ADVANCE”)
 - Determined before actions are taken
 - Enacted by legislators and regulators
 - Applied to all actors uniformly
 - Presented to actors in the form of bright-line rules
 - Enforcement does not require “harm”
- ② Ex Post Regulation (= “AFTER THE FACT”)
 - Determined after actions are taken
 - Usually, only when harm occurs
 - Tailored individually to each case
 - by courts, based on general guidelines

Ex-Ante Regulation: examples

- Drug Regulation: pre-approval by FDA
- Food Safety: Restaurants and food trucks, slaughterhouses, distribution of GMO foods
- Consumer Product Safety: helmets, baby products
- Building Codes: materials, electric safety
- Air Travel : airplane safety; airline licensing
- Disclosure Laws: Mandated warnings, pre-drafted disclosure form

Ex-Post Regulation: examples

- Products Liability and Tort Law
 - Strict Liability: Injurers “self regulate”
 - Negligence: courts set the safety rules
- Disclosure regulation:
 - Failure to warn tort suits
 - Fraud and deception suits
 - Informed consent

Hybrid Regimes

- Highway safety
 - Ex Ante Regulation: Speed limit, drivers' license, rollover ratings
 - Ex Post Regulation: tort liability for reckless driving
- Medical treatments
 - Ex Ante Regulation: hospital accreditation, doctor licensing, mandated guidelines
 - Ex Post Regulation: medical malpractice law, informed consent law

Rules versus Standards

- Rules = Ex ante regulation
(Example: municipal building codes, banking regs)
- Standards = ex post regulation; legislation provides general principles, but the specific commands are set in the course of dispute resolution by courts
 - negligence law (“reasonableness”)
 - competition law (“restraint of trade”)
 - deception law (“unfair or deceptive”)
 - Criminal justice (“cruel and unusual punishment”)

A separate question:

How precise should rules be?

Precision = fine tuning; complexity;

How many circumstances should bear on the legal command

Example: damage rules

- “make the victim whole” → precise, complex
- “each victim gets \$2000” → imprecise, simple

Example: definition of “market power”

- x% of the market → imprecise, simple
- “power to control price and exclude competition” → precise, complex

The Fundamental question:

When should legal rules and commands be set ex ante, and when ex post?

- Information needed to set optimal rules
- Costs of enforcement
- Efficacy of enforcement
 - The Judgment Proof problem
 - The Detection problem

(1) Cost of Information

Who has cheaper access to information?

- Regulators → use EX ANTE regulation
 - Example: safety of mass-distributed drug
 - Large investment in information necessary
 - Regulated activity is frequent and homogenous
 - Compare with: rare-use drug
 - Example: sanitation of restaurant or food truck
 - Difficult to prove after the fact in court
 - Regulated activity affects many consumers in the same way
 - Compare with: private catering
 - Example: Building safety codes
 - situation repeats frequently and uniformly
 - parties are “small” and need bright line command

(1) Cost of Information (... cont.)

Who Has cheaper access to information?

- Actors, courts → use EX POST regulation
 - Example: deceptive advertising
 - Firms know best if they are accurate or deceptive
 - Use Strict Liability
 - Example: Harm caused to patients by medical malpractice
 - Courts have better access to information
 - Use negligence rule
 - Example: Anti-competitive behavior by firms
 - Situations are heterogeneous and idiosyncratic
 - Need information about outcomes and effects

(2) Cost of Enforcement

What is the incidence of enforcement?

- Ex-Ante Regulation: administrative enforcement costs incurred for every act
 - Ex-Post Liability: only when harm occurs
- ➔ Ex Post liability is generally cheaper!

Examples:

- Regulation of Human Subject Research, medical treatments

What about food trucks?

- Enforce only when there is poisoning
- But enforcement is more complicated (detection . . .)

(3) The Judgment Proof Problem

For ex post regulation, actors have to be able to pay for harm done

- Actors are Judgment proof → EX ANTE regulation
 - Example: shipping of explosives, weight of trucks, fire safety of hotel, caregiving for children
- Is there another way to solve the judgment proof problem?
 - Liability insurance
 - It has to be mandatory (a “mild” form of ex ante regulation)
 - Examples: environmental insurance, auto insurance, workers compensation
 - Insurers become de facto private ex ante regulators

(4) The Detection Problem

Low probability of liability → EX ANTE regulation

- Unobservable harm-causing actions (weight of trucks)
- Difficulty of establishing causation (regulation food safety)
- Dispersed small harms (clean air regulation)
- Latent harms (regulation of building materials; genetically modified foods)

Summary: Food Trucks

- Ex Ante Regulation:
 - Government Inspections and licensing of trucks
 - Standards of food care
 - Regulation of locations, hours
- Ex Post Regulation:
 - Tort suits by victims for negligently harmful food
 - Nuisance suits by residents

Summary: Food Trucks (. . . cont.)

- Reasons Ex Ante regulation is better:
 - Homogeneous standards fit most circumstances (e.g., age of food served, permissible locations)
 - Regulator may know better what the risks are
 - Imperfect enforcement under tort liability
 - Dispersed harm, hard to prove causation
 - Judgment proof defendants
- Reasons Ex Post liability is better:
 - Cost of enforcement: impossible to inspect all food
 - Mandatory insurance solves judgment proof problem

Application: Health Claims on Food

- Ex Ante Regulation:
 - Food manufacturers have to prove that claim is valid
 - Similar to drug regulation
- Ex Post Regulation:
 - Suits by consumers or by government agency for deception

The End