

Regulatory Techniques in
Consumer Protection
Lecture 5:
Private Regulation

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How to protect consumers buying food at food trucks?



- ① Set license and sanitation rules in statutes and regulation (Ex Ante)
- ② Tort law: courts determine wrongdoing (Ex Post)
- ③ No Regulation
 - Chaos?

Private “Substitutes” to Regulation

1. Self-protection and Exit
2. Ratings (reputation)
3. Regulation by Intermediaries
4. Private certification
5. Insurance

1. Self Protection and Exit

In the absence of regulation or liability, consumers will be more apprehensive and cautious

- Self precaution
- Require proof of safety
- “try out” before entering a large transaction
- Carve transactions into smaller commitments
- Demand for exit rights
 - “No Contract”

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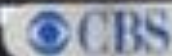
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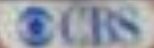
Judgment Day is coming
May 21, 2011



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S.W. Radio 1
7 to 8 PM & 9 P

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Self Protection and Exit

No Contract = No Termination Penalty

Another type of exit right: right to withdraw

- Exit rights come at a cost

Consumer demand for exit rights induces competition on this dimension

- Lawmaker do not have to mandate these protections
- Exit rights come at a cost

2. Ratings

ebay Shop by category

All Categories Search

Back to search results | Listed as Apple iPhone 5 Latest Model - 16GB - White & Silver (AT&T) Smartphone

Apple iPhone 5 Latest Model- 16GB - White & Silver (AT&T) Smartphone

3,888,800 33 product reviews



Item: Used
condition:

Time left: 6d 21h (Jul 22, 2013 06:26:47 PM)

Price: **US \$499.99** Buy It Now

Add to cart

11 SquareTrade 1 yr warranty \$68.88
400 to 10000000

Later Speed \$99 and get 6 months to pay
Subject to credit approval. See terms

Shipping: **FREE** Expedited Shipping (see details)
from location: **Fort Wayne, Indiana, United States**
Ship to: **United States**

Delivery: On or before **Thu, Jul 18** to 60015
Estimated by eBay (FAST 'N FREE)

Payments: **PayPal**, **Bill Me Later** | see more

Returns: **No returns or exchanges**, but item is covered by eBay Buyer Protection

100% Positive feedback

Save this seller
See other items

Artillery 11

More view image (2 items)



Seller information

babysshadow2013 (1225 )

100% Positive feedback

Ratings

Can market ratings succeed where mandated disclosure failed?

- Mandated scores deliver a breakdown of quality
 - Firms focus on the scored aspects, not others
 - Breakdown is too complex
- Study of Health Networks ratings (N=40 million)
 - Report cards help consumers make better choices
 - Effect is due to satisfaction ratings, NOT to quality scores (Dafny & Dranove, Rand J. Econ 2008)

3. Regulation by Intermediaries

ebay Shop by category All Categories Search

[Back to search results](#) | [Listed as Apple iPhone 5 Latest Model - 16GB - White & Silver \(AT&T\) Smartphone](#) | [Category: Cell Phones & Accessories](#) | [Cell Phones & Smartphones](#)

Apple iPhone 5 Latest Model- 16GB - White & Silver(AT&T)Smartphone

USED 33 product reviews



Item: Used
Condition:
Time left: 6d 21h (Jul 22, 2011 06:26:47 PM)
Price: US \$499.99 **Buy It Now**
Add to cart
Save with SquareTrade 1 yr warranty \$68.88
400 to watch list

Seller Information
babyshadow213 (122)
100% Positive feedback
[Save this seller](#)
[See other items](#)

Free Later Speed \$99 and get 6 months to pay
Subject to credit approval. See terms

Shipping: **FREE** Expedited Shipping (see details)
from location: **Fort Wayne, Indiana, United States**
Ship to: **United States**

Delivery: On or before **Thu, Jul 18** to 60015
Estimated by eBay **FAST 'N FREE**

Payments: **PayPal**, **Bill Me Later** | see terms

Returns: No returns or exchanges, but item is covered by eBay Buyer Protection.

[Add to Watch List](#)

Photo over image (2 items)



Payments: **PayPal**, Bill Me Later | [See details](#)

Returns: No returns or exchanges, but item is covered by **eBay Buyer Protection**.

Regulation by Intermediaries

1. eBay Buyer Protection

- Insurance for buyers
- Sanctions against sellers
 - Rules how to treat buyers
 - Dispute resolution
 - Procedures for mediation and arbitration
 - remedies
 - Sanctions against sellers
 - Enforcement: hold seller's funds

➔ eBay as regulator

SquareTrade 1 yr warranty **\$68.99**

Add to Watch list

Regulation by Intermediaries

2. Square Trade

- Extended warranty to buyers
- Covers product failure
 - Option to purchase coverage for drops and spills
 - Does not cover items lost by consumers
- Does it regulate sellers?
 - Premium depends on reliability of seller

Regulation by Intermediaries

- Retailers
 - Regulate conduct of suppliers
 - Example: regulation of labor conditions in Bangladesh
 - Regulate quality of food
- Payment Networks: Visa, PayPal
- Hospitals
 - Regulate behavior of doctors
- American Bar Association
 - Regulate law schools
- Trade Associations
 - Trade rules, licensing, dispute arbitration

Regulation by Intermediaries

- “Gatekeepers”
 - Lawyers, accountants
 - Bouncers
 - Academic Journals
 - Parents

4. Private Certification

Auto safety: TOP SAFETY PICK
(Insurance Institute for Highway Safety)



2013

C I V I D

SEDAN

2013 IIHS TOP SAFETY PICK+

AUTO SPIES

LEARN MORE

[3] Awards and ratings do not apply to the 2012 Civic Natural Gas.

A silver Honda Civic sedan is shown from a rear three-quarter view. The background is dark with various award logos and text. The "2013 IIHS TOP SAFETY PICK+" logo is prominent, along with the "CIVIC" branding and "SEDAN" text. A "LEARN MORE" link is visible at the bottom.

Private Certification

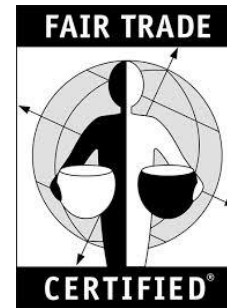
Environmental-friendly home construction:

- LEED (US Green Building Council)



Private Certification

- “Fair Trade”
 - Certify fair treatment of coffee growers
- “TRUSTe”
 - Certify privacy practices of websites
- ISO 14001 Standard
 - Certify that a company environmental standards



5. Insurance

Insurance companies as regulators of safety

- Standard Theory: Insurance causes Moral Hazard
 - Policyholders have LESS incentive to invest in safety
 - Insurance UNDERMINES regulations of safety
- Ben-Shahar & Logue (2012): Insurance reduces Moral Hazard
 - Through ex ante and ex post “private regulation”, insurance creates MORE incentive to invest in safety
 - Insurance can be a SUPERIOR regulator of safety

Insurance-as-Regulation

Ex Ante Regulation:

- Discounts for installing safety measures (“Feature Rating”)
 - House alarms, car anti-theft devices
 - Telematics: monitor drivers’ behavior
 - Environmental safety
- Discounts for safety record (“Experience Rating”)

Insurance-as-Regulation

Ex Ante Regulation (cont.):

- Develop standards of safety
 - Auto safety ratings
 - Construction codes
 - Fire sprinklers, roof anchors
- Coach policy holders on safety
 - Workers Compensation Insurance: workplace safety
 - Environmental Liability Insurance
 - Born & Chen (2013): “Insurance coverage for environmental liability should provide incentives for firms to reduce pollution . . . Efforts to control potential losses should be reflected in premium discounts, and insurers can assist firms in determine the types of mitigation efforts that are most cost effective.”

Insurance-as-Regulation

Ex Post Regulation:

- Adjudicate
 - Determine whose fault
 - Measure the loss
- Deny coverage for intentional harm
- “Moral Hazard Exclusion”
 - No coverage for wrongful acts
- Ex-post Underwriting

Insurance-as-Regulation: New Applications

1. Regulation of Food Safety

- Strict Liability on food manufacturers/suppliers
- Mandatory liability insurance
- Regulation of safety by insurers

2. Regulation of Financial Statements

- Strict Liability on firm for misstatements
- Mandatory “Financial Statements Insurance”
- Insurers will audit the statements
- Insurance premiums, policy limits, have to be revealed to market

Insurance-as-Regulation: New Applications

3. Insurance versus Occupational Licensing

- Licensing is a type of ex ante regulation
 - 30% of workers affected by licensing requirements
- Thornton & Timmons (JLE 2013): Study of Massage Therapists Licensing laws
 - 36 U.S. States have licensing requirements
 - Licensing limits entry
 - Earnings rise as much as 15%
- Can Tort law + mandatory insurance replace licensing?

Conclusion

- Private substitutes to protective regulation exist
- In many settings, private “regulators” have better information, better enforcement tools
- Lawmakers should cultivate, supplement, and mimic these templates

The End