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# Why Regulate Consumer Product Safety?

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**M**y former employer, the Consumer Product Safety Commission (CPSC), has the authority to regulate the safety of all consumer products that are not explicitly regulated elsewhere. Since the most dangerous products are regulated elsewhere, the CPSC has the awkward responsibility to regulate the safety of the broad range of relatively safe products.

We achieve safety goals in this country through two basic mechanisms in addition to the market. The tort system is aimed both at increasing safety and at compensating victims. The regulatory system, including the CPSC, aims only at increasing safety. Although I shall consider some aspects of the tort system, I limit my analysis to its preventive function. The academic literature generally concludes that it is preferable to separate prevention and compensation. Compensation is best achieved through first-party insurance. The amount of replacement income needed by a bereaved family, for example, is not affected by how the breadwinner died. Therefore, first-party insurance is in all respects preferable to third-party insurance, such as by compensation through the tort system.

Neither the regulatory system nor the current tort system works very well. The harms caused by tort law are greater than the harms caused by

undesirable regulation, however. This is so since the CPSC, at least, is a relatively benign agency. Most of its actions are what have been called "zip-zip" regulations, rules with zero costs and zero benefits. Modern tort law, on the other hand, does impose real and substantial costs on the economy.

Because comprehensive descriptions of the tort system are available elsewhere, I shall first describe the workings of the product regulatory system. Then I shall discuss some changes that would improve the functioning of that system. Finally, I shall propose ways to improve the interaction between the tort system and the regulatory system.

## The Current Regulatory System of the CPSC

The CPSC has several regulatory tools. For example, it can undertake rulemakings. But information and administrative costs of this procedure are so high as to be almost prohibitive, and few rulemakings have actually been concluded in recent years. It is, however, more common for the agency to begin a rulemaking procedure that is later terminated when a voluntary standard is achieved. For those rulemakings that do occur, the agency is required to compare costs and benefits. It is not, however, necessary to determine that benefits are greater than costs, but only that benefits bear a "reasonable relationship" to costs.

In addition to rulemakings the CPSC can in general interact with voluntary standards associa-

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tions and make recommendations regarding safety. That is a major area of CPSC involvement. Indeed, since 1981 the agency has been instructed by Congress to use that method wherever possible. Finally, the agency engages in recalls of “defective” products. It is important to note that the CPSC has no prior approval authority. No one need consult with CPSC before introducing a new product.

In assessing consumer product safety regulation consider that *there is no reliable public evidence that any of the CPSC’s policies has saved any lives*. That applies both to the CPSC overall and to particular regulations, such as those aimed at reducing crib strangulations, fires, and ingestion deaths. Indeed, there is some evidence that certain CPSC regulations, including those on aspirin caps, may have *increased* the number of deaths by “lulling” consumers into thinking that products provided more safety than was in fact true. We should bear in mind, however, that the CPSC is a cheap agency to fund—about \$37 million direct cost per year. Given that typical “willingness to pay” values for prolonging a life are at least \$1 million and often significantly more, the agency could be justified if it saved a number of lives too small to appear in any possible statistical analysis.

A second point to note is that, for its economically most significant activities, *CPSC makes no effort to perform any cost-benefit or other quantitative analysis of its policies*. Indeed, for a time such analyses were *forbidden* by Congress for recalls, and even now statutory language states explicitly that cost-benefit analysis is not required. Cost-benefit analysis is required for rulemakings, but these are rare events. The agency sometimes performs such analyses for recommendations regarding voluntary standards, but there is no requirement for such analyses, and they are not always performed. As indicated below, recalls probably have the largest impact of any agency activity, and for these there are no cost-benefit analyses.

It is also worth noting, however, that CPSC policies are not inordinately costly in terms of keeping useful products on the market because, unlike the Food and Drug Administration, the CPSC lacks this power. Generally, redesigns of products mandated by the CPSC are not excessively costly either. Although costs are not explicitly considered, most actions (both recalls and product redesigns as parts of voluntary standards) are “voluntarily” agreed to by firms. Voluntary agreement may be coerced by the threat of litigation. If the costs of these voluntary measures were excessive, however, litigation would

always be an option for target firms. Indeed, the CPSC has not fared well when it has gone to court. Thus, there are implicit caps on the costs that the CPSC can inflict, and for the most part, those costs are relatively minor. Although one study alleges that CPSC standards benefit large firms at the expense of smaller rivals, it offers no evidence to that effect. While that result is plausible, the magnitude is probably relatively small. Another study finds that the major loser from CPSC recalls was Sears, not a small firm.

The most significant costs imposed by the CPSC are through its recall program. Recalls cause significant losses in stock prices that probably reflect in

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part the reputation lost by firms having their products branded as “unsafe.” Estimates are that between 5.4 and 6.9 percent of the net worth of companies with recalled products is lost. Given that most recalls are relatively minor and that direct costs are small, it is surprising that the level of capital market effects is as large as it appears. That result is consistent with other evidence about surprisingly large stock effects of regulatory actions. Several studies have found that FTC advertising cases had large effects on capital markets; another study found large effects for drug recalls. Nonetheless, the conclusion of the literature is that regulatory actions with small direct costs often have significant and surprisingly large effects on capital markets.

If recalls indicated that firms were behaving irresponsibly, then large reputation losses would be justified. In this context a firm may be said to be “irresponsible” if it behaved “negligently,” as negligence was defined under the “Hand formula” by not undertaking cost-justified safety spending. Since there is no cost-benefit test for recalls, however, we cannot determine whether firms are behaving irresponsibly. The CPSC may be (and probably is) randomly imposing costs on firms.

It may be that part of the stock market effect is

fear of product liability litigation following recalls. If so, then this apparent cost of the CPSC is actually a cost of the tort system. Plaintiffs' lawyers are major users of the CPSC accident reporting system by means of Freedom of Information Act requests, and it is likely that they also respond to recalls.

### **Possibilities for Reform of the CPSC**

Three basic reforms should be considered. They include increasing the use of information rather than regulation, changing the recall process, and increasing the use of cost-benefit analysis in general.

**Use of Information.** One reform would be to emphasize the informational function of the agency at the expense of its regulatory function. Markets for information might work only imperfectly. Thus, there may be situations in which providing product information could benefit consumers. For example, one study showed that three-wheeled all-terrain vehicles (ATVs) are more dangerous than four-wheeled ATVs. That analysis was of actual injuries, so that behavioral responses would have been taken into account. When consumers learned that four-wheeled ATVs were safer, probably as a result of information put out by the agency and others, they ceased buying the three-wheeled models. The CPSC negotiated a virtual ban on three-wheeled ATVs with the industry, but this ban had little, if any, effect. By the time of the ban, consumers had virtually ceased buying the three-wheeled variety.

If regulatory standards were replaced by information standards, there would be several benefits. First, consumer choice would be preserved. Second, if it were made clear that there were no government safety regulation of products, then consumers would not be lulled into believing that they need not take responsibility for their own safety. Thus, safety in the marketplace might actually increase. Third, it should be easier to correct errors in information provision than in banning products. If a product is erroneously banned, there is no possibility of later learning that it is actually less dangerous than was initially thought. If the agency disseminates false information, the result will be costly for the relevant firm, but it will still be possible to correct the information later.

**The Recall Program.** There are substantial possibilities for reforming the recall program. The entire recall program should be greatly cut back or even scrapped. Evidence indicates that all products

recalled would cause no more than fifty deaths per year (of the 25,000 deaths associated with CPSC regulated products), and recalls are unlikely to save more than twenty lives per year on the basis of observed return rates. Moreover, that is an upper bound estimate, so that the actual number of lives saved by recalls is almost surely significantly smaller. That estimate was based on a detailed examination of all recalled "defective" products from 1984 to 1986. Although deaths from product defects subject to recalls are only two-tenths of 1 percent of deaths associated with CPSC regulated products, the CPSC spends over one-third of its resources on that program.

Moreover, recalls eliminate products that have already been produced, while other CPSC programs,

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**To increase its effectiveness, the CPSC should increase the use of information rather than regulation, change the recall process, and increase the use of benefit-cost analysis.**

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such as voluntary standards interventions, generally involve changes in products before production. Scrapping or retrofitting a product that has already been produced is generally more expensive than redesigning it for future production. For example, redesigning the all-terrain vehicles to add a fourth wheel would cost \$190 per new vehicle, while eliminating the existing three-wheeled vehicles would cost perhaps \$1,000 per vehicle; there is no feasible way of adding a fourth wheel to existing three-wheeled vehicles. Thus, recalls probably impose higher costs per life saved or injury prevented than do other CPSC programs.

While a cost-benefit analysis of recalls has not been undertaken, it is likely that the program costs in total more than it is worth, although particular recalls may be justified. It is politically unlikely that recalls will be eliminated, however. A second-order reform would be to use cost-benefit analysis for recalls and mandate only those recalls that will provide net benefits to consumers. It has not been politically possible in today's climate even to impose a requirement for cost-benefit analysis on the recall program, but this might be a feasible reform under certain circumstances.

**Cost-Benefit Analysis in General.** Cost-benefit analysis and other quantitative methods of analysis should be used for all agency functions. It would

be useful to require cost-benefit analysis for CPSC recommendations to voluntary standards organizations. If the agency used formal decisionmaking procedures for allocating its own resources, then it might realign its resources in a way to reduce the spending on the recall program so as to prevent more accidents with its limited budget. Thomas showed that even from its origin, the CPSC has systematically misallocated resources.

There would be other benefits from rational internal resource allocation. In addition to recalls, there are other misallocations of resources by CPSC. To target more significant hazards the agency has a staff of epidemiologists and formally tracks accidents. This procedure is flawed in various ways. First, there is not an adequate exposure data base so that the agency measures only total accidents associated with a product. The economics staff does attempt to estimate accidents per product in use. There is, however, no good measure of intensity of product use unless a survey is undertaken, as was the case with all-terrain vehicles. Second, the data base measures accidents "associated with" a product, not accidents caused by a product. Nonetheless, internal analysis by staff epidemiologists and economists is able to partially correct these biases in planning projects, and there is some relationship between agency projects and true harms.

The agency is particularly susceptible to outside publicity, however. Often some product that may actually represent a relatively minor risk will be involved in a newsworthy accident. At that point the agency will allocate resources intensively to that product. One agency economist refers to those as "headline hazards." Often the agency's behavior results from congressional pressure. While such misallocations generally do not result in large social

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costs (a typical result is the recent ban on "lawn darts"), we would achieve more safety per dollar if the agency were able to control its own projects more closely.



"It's one of those days. Now Pritchard's pants have been recalled."

Reform or even abolition of the CPSC would be desirable. Nonetheless, the level of costs imposed by the CPSC is sufficiently low that major efforts aimed at reducing those costs probably would not be a worthwhile expenditure of scarce political resources by parties with an interest in efficient regulation. There may, however, be reasons for attempting to change the CPSC.

### The CPSC and Tort Reform

While the CPSC imposes relatively few costs, the same is not true of the tort system. This system imposes substantial direct and indirect costs. The direct costs are of two sorts. First, there are the costs of the system itself, including litigation costs. The total amount spent on litigation may approximate two-thirds of the amount at stake in a litigated case. Even if we view damage payments as transfers, the litigation costs are clearly deadweight losses.

Moreover, damage payments are not merely transfer payments. They also impose real costs on society. Many aspects of the tort system act to transfer wealth from states of the world where consumers value it more to states where they value it less. Injured (or, in the limit, dead) consumers place lower value on wealth than do healthy consumers. The tort system forces consumers to purchase unwanted insurance bundled with products.

This leads to substantial price distortions and can impose substantial deadweight costs. It is even possible that, under plausible circumstances, well-informed, risk-averse consumers might be deterred from buying a product that offers unambiguous safety improvements because of the cost of the unwanted insurance bundled with the product.

Additionally, the indirect costs of the tort system may be greater than the direct costs. These indirect costs include costs borne by producers attempting

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to avoid tort liability. They would include, for example, the costs of pharmaceuticals and other products not invented or sold because of a fear of tort liability.

Given the set of relative costs, it would be more desirable to reform the tort system than the product safety regulatory system if costs "per unit" of reform were equal. Costs may not be equal, however. It may be significantly cheaper to reform the regulatory system. Although cost-benefit analysis has not become a routine part of CPSC decisionmaking, efforts to achieve this goal have come close to being successful. The CPSC has been closer to instituting widespread cost-benefit analysis than anyone has been to achieving a comparable goal in the tort system. Moreover, there have been some meaningful improvements in the functioning of the CPSC when the commissioners want such reform.

There may be a much larger benefit to CPSC reform than is immediately obvious. If the CPSC can begin to use formal quantitative tools such as cost-benefit analysis for risk analysis and risk reduction, it may be possible for these tools to spread into the tort litigation system.

An analogy with the Department of Justice's *Merger Guidelines* may be appropriate. These are formal, quantitative guidelines adopted by the DOJ (and, essentially, the FTC) for analyzing mergers under the Hart-Scott-Rodino Premerger Notification Act. These guidelines are binding only on the agencies that have adopted them and perhaps not

even on those agencies. The guidelines have no legal force in litigation under the various antitrust statutes. This is true whether plaintiffs are the antitrust agencies or private parties. Nonetheless, courts are increasingly relying on the guidelines.

The guidelines are used in litigation regarding virtually all antitrust matters, not merely mergers. In particular, the principles of market definition used in the guidelines are becoming the legal standard for much antitrust litigation involving many aspects of behavior in addition to mergers. Even those who are hostile to antitrust laws in general would probably admit that, if we are to have such law, it has been improved by the use of the guidelines, if only because it is now more difficult to allege an antitrust injury in a market where there is no market power.

If it were possible to achieve significant reform of the CPSC, we might hope for a similar pattern. If the CPSC formally adopted a set of principles for cost-benefit analysis of product safety, such principles might spread into the litigation system. If so, then reform of the CPSC would pay much larger dividends than are apparent from the size and impact of the CPSC itself.

Currently, if a product has passed some CPSC-approved standard, the manufacturer may nonetheless be found liable in a civil action. Many have made the sensible recommendation that approval of a product by a regulatory agency be a defense to a private action. Such approval is not a defense, although violation of a standard makes a finding of liability more likely. That may indicate that the courts would be unlikely to adopt any CPSC guidelines for product safety.

The *Merger Guidelines* analogy may be instructive here as well. If the relevant antitrust agency (the FTC or the DOJ) approves a particular merger, that does not insulate the merger from private challenge in the courts. But if there is such a private challenge, the courts may still rely on the guidelines in evaluating the merger. If the CPSC were to adopt specific, quantitative guidelines for cost-benefit analysis of product safety, there might be a similar result. One recommendation would be for a comparison of the costs of fixing a product with the expected costs of accidents per unit of the product over its lifetime.

## Conclusion

The Consumer Product Safety Commission is a relatively benign agency. While there is little evidence that it improves safety, the costs that it imposes are

relatively small. (The major cost is the loss of a firm's value caused by recalls of its products.) The tort system imposes much larger costs on society.

There are reforms that would improve the CPSC. It would be an improvement if the agency acted to provide information to consumers rather than to regulate the products they could buy. Another improvement would be for the agency to rely more on cost-benefit or other quantitative analysis. This last reform would be particularly useful if the methods of the CPSC could spread into the litigation system and become a standard for product liability litigation in general. The model of the Department of Justice's *Merger Guidelines*, which have become a de facto standard for litigation as well as regulation, may provide some hope that such a change might occur. If so, then it might be worth investing some political capital in trying to improve the CPSC. If not, it is more efficient to concentrate on reforming the tort system than on reforming the CPSC.

### Selected Readings

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