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Litigating Consumer Interests: An Economic Perspective on Ralph Nader

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ABSTRACT

Ralph Nader is a leading advocate of governmental consumer protection activities. A distinguishing characteristic of Nader's advocacy actions is his use of court litigation and other legal instruments on behalf of unorganized groups of consumers who would benefit from increased collective consumer protection activities. An economic analysis of the market for consumer information reveals possible causes of allocative efficiency and distributional equity failures in the private sector that may justify collective consumer protection actions. Organizing costs and free-rider problems that discourage collective action may also inhibit the communication of demands for consumer protection to governmental units, causing governments to fail to undertake actions that would correct inefficiencies and inequities associated with the operation of private markets. A potential role for Nader's activities is the correction of existing governmental and private sector failures by representing underorganized consumer interests through the use of legal instruments. A case study of Nader v. Allegheny Airlines, Inc. suggests that law-oriented representational activities can play this role. Their impact may not always be dramatic, but they draw attention to potential governmental and private sector failures and in conjunction with other non-litigation activity can stimulate the search for collective action that recognizes previously neglected interests.

LITIGATING CONSUMER INTERESTS: AN ECONOMIC PERSPECTIVE ON RALPH NADER

Since the 1965 publication of Unsafe at Any Speed, Ralph Nader has emerged as the nation's leading advocate of consumer protection legislation. His stated objective is to provide consumers with greater protection against fraud and against the exercise of monopoly power than is forthcoming from the unfettered private market. This objective is at least as old as the Pure Food and Drug Act of 1906 and has been pursued by many individuals and nongovernmental organizations throughout this century.[1] What particularly distinguishes Nader's activities from earlier ones are the instruments he employs. Like his predecessors he uses organizing tactics and informational and lobbying techniques, but he also uses instruments of a legal sort: court litigation (and the threat of litigation) and participation in administrative agency rule making and adjudicative proceedings.

In section I of this paper we argue that Nader's law-oriented activities on behalf of consumer interests can be usefully analyzed and evaluated by applying elements of the economic theory of private market failures, first to the private market for consumer information and second to the decision processes of the public sector. We also identify the possible causes of efficiency and equity failures in the private market for consumer information. The usual economic prescription for correcting market failures relies on

governmental intervention through taxes and subsidies or direct public provision. We argue that there are reasons to expect that governments will sometimes fail to take such corrective actions even though it would be socially efficient to do so. Nader's activities may then be conceptualized as efforts to correct these governmental failures by using legal instruments to represent underorganized consumer interests. In section II we present a case study of one Nader law suit that illustrates these ideas and provides some insights regarding the effectiveness of this type of legal advocacy. Section III offers concluding observations on the use of litigation and related legal instruments for correcting market failures.

1. CAUSES OF PRIVATE MARKET AND GOVERNMENTAL FAILURES

Consumer protection is usually thought of in terms of governmental intervention in private markets--intervention that is designed to "protect" consumers from "unfair" selling practices or "unsafe," "ineffective," or "unreliable" products.[2] Consumers frequently do protect themselves, however, by using information on products and product prices that is generated

in private markets. With the appropriate information, consumers can avoid falling victim to "bait and switch" selling tactics and other "unfair" practices, and can buy those products that offer as much safety, effectiveness, or reliability as they are willing to pay for. It follows that the overall degree to which consumers are actually protected is determined, in the first instance, by the extent to which consumers are informed through private markets about the products they buy and the retailers they buy from.

The private sector, in short, quite apart from any governmental influences, makes available to consumers a great deal of information (and some misinformation) through advertising, labeling and sales personnel, and also by adhering to voluntary, industry-wide product safety, dimension, and labeling standards. Consumers supplement this with information gained from their own experience and from the experience of others. Thus, private markets are continuously producing some consumer protection through those informational routes, at least to the extent that consumers are willing to acquire and to use the information available and producers are willing to respond to consumer demands for information. The need for governmental consumer-protection activities therefore depends on the adequacy of the performance of private markets. When private markets fail to provide "enough" protection relative to specific criteria, governmental intervention is warranted. The criteria we shall use to determine how much protection is "enough" are those of allocative

efficiency and distributional equity.

Private Market Failures: Allocative Efficiency.

There would be no need for governmental consumer protection activities, at least on allocative efficiency grounds, if the following conditions existed in private markets: (1) if consumers were fully informed about all products, meaning that they not only possessed but readily understood (i.e., processed), all relevant information about all available products; (2) if the use of goods and services by one person did not impose external costs or bestow external benefits on another (or, alternatively, if costs of internalizing external effects were negligible); (3) if firms were seeking to maximize profits; and (4) if firms possessed no monopoly power. Under these conditions consumers would be protecting themselves by making informed purchases.

Consumers are never fully informed, of course, if only because the production of information is costly. Thus condition (1) does not hold. Still, if conditions (2), (3), and (4) above were to hold, and (1a) if persons could readily process any relevant information and (1b) if each consumer paid for each bit of information he used then the private market's provision of information--as well as of other goods and services--would be allocatively efficient. Consumers would not be fully protected; they would be efficiently protected.

It is certain that even under these conditions everyone

would be less than fully informed, simply because the cost of making any consumer fully informed would exceed the benefits of doing so. However, there would be no need for governmental consumer protection activities to improve the allocation of resources generated by the private sector. (There might be justification for consumer protection activities to improve distributional equity, but for the moment we are concerned only with allocative efficiency.)

If any of the above conditions are not satisfied, there exists a potential private market failure, in the efficiency sense, and collective efforts to alter the provision of consumer protection may be justified; they are justified on efficiency grounds if the benefits of correcting the failure exceed the costs of doing so. Clearly the above conditions are quite restrictive. Condition (3), that firms seek to maximize profits, is probably satisfied reasonably well in most circumstances.[4] We shall therefore discuss only the remaining conditions: (1a) that consumers are able to process all relevant information, (1b) that all information used be paid for, (2) that there be no Pareto-relevant external effects in consumption, and (4) that firms possess no monopoly power.

Processing information. The cost of information to an individual includes both the payments made to others to cover production and supply costs, and the cost in time and effort

required to interpret the information.

Precisely because processing information is not costless individuals demand less information, learn less from their market experience, and use less information when making their buying decisions than they would if there were no cost involved in processing information.

The implications for economic efficiency that follow from the existence of processing costs depend on the ways in which consumer information contributes to consumer welfare. Information contributes directly to consumer welfare by reducing the risk of incurring "regret" costs--the costs of learning after the fact that a better decision could have been made. The processing of information is a way in effect of buying insurance against such an event, and as less information is processed, less of this insurance is purchased. Thus, relative to an "ideal" world, the presence of processing costs causes fewer resources to be devoted to the production of insurance against regret costs.

Information also contributes indirectly to consumer welfare. As an input to decision-making it is used to identify and compare alternative products. On the basis of this exercise a consumer selects that set of products which appears best to suit his wants. Because information processing is not costless, an individual will devote a limited amount of time

and income to identifying and comparing alternatives; for this reason his actual selection may not be his "best" selection--that is, the one he would make in the absence of these information-processing costs. The implication for allocative efficiency in the provision of consumer protection will depend on the difference between actual purchases and "best" purchases.

Even though underinformed relative to an "ideal" situation, consumers may nevertheless buy products that offer the same amount of safety, reliability, and other attributes as they would buy if fully informed.[5] Further, even if these products are different, underinformed consumers could end up buying commodities that have more or less of some desirable attribute than they would buy if they were fully informed. There is no presumption that imperfect information will lead to any particular deviation from a full-information equilibrium. Merely recognizing the existence of information-processing costs does not indicate whether there is an over- or underproduction of such commodity attributes as safety, reliability, or effectiveness.

Though no direct evidence exists to suggest whether underinformed consumers tend to over- or underestimate product safety, reliability, and so on, it is plausible that consumers generally overestimate the degree to which products possess these attributes because they believe that government agencies are doing more to protect consumers than

they are in fact doing. Many individuals may believe, for instance, that because there is a Food and Drug Administration all drugs available on the market are safe and effective, or that the Federal Trade Commission actually does prevent all deceptive advertising. Neither is true, but individuals who know of these agencies may not know of their precise functions or methods of operation, and may thus be less wary, less informed, and thus more likely to overestimate product reliability than otherwise.

If there were no costs to organizing and no incentives for individuals to behave as free-riders, consumers might pool their resources and pay for the collection and processing of information each would like to use. Rather than each consumer acting alone and facing the same problem, consumers as a group would need to face the problem only once, and by doing so would reduce the average cost to each of collecting and processing information. Thus, because of information-processing costs, the potential exists for some form of collective action to improve the allocative efficiency of private markets.

Insofar as the costs of processing information are the cause of a market failure in the production of consumer protection, efforts aimed at increasing the supply of information or reducing the cost of acquiring information may not be effective in generating that protection if the costs of information-processing are sufficiently high. If any

consumer protection action is capable of producing net benefits for consumers and correcting the private market failure in such a situation, it will probably involve the imposition of some general product standard--for example, a fully-enforced ban on flammable pajamas--that has the effect of restricting choice and providing consumers with information that does not require a significant processing effort.

Paying for information. To some extent, a piece of information is a collective-consumption good; once it has been made available to one consumer, it can be made available to many consumers at little or no marginal cost. Since information circulates by word of mouth and through newspapers, magazines, and other media, it may not even be possible for a firm trying to sell information to restrict the availability of its product in such a way that all those who use it must pay for it. The more expensive it is to prevent non-paying consumers from gaining access to a bit of information, the less likely it is that a private, for-profit firm will produce it, even if aggregate willingness to pay exceeds the cost of production.

This collective consumption characteristic of information may explain why much of the consumer information produced in the private sector is not directly sold to its users. Through informational advertising, a firm can reach many potential customers with information about its product, though it may

get revenue from only the few who actually use the information. Indeed, consumers spend no money for such information until they buy one of the firm's products.

This characteristic of information, combined with the effects of information-processing costs discussed above, may also explain, at least in part, why deceptive and misleading advertising can occur. The more costly it is for consumers (and rival firms) to detect a deceptively advertised product, and the more difficult it is to collect payment for the use of information exposing the deception, the more profitable deceptive advertising is likely to be. Aggregate willingness to pay for additional information could exceed the cost of supply and yet the private market could still fail to provide consumers the information they want.

"Third party" effects. The third source of potential private market failure relevant to the production of consumer information and consumer protection is the existence of external effects in consumption. The automobile provides an example. One person's decision to buy a car that has a high risk of performance failure may result in an accident causing damage to a third party. Another example is smoking, which causes discomfort and creates health hazards for persons other than the smoker. To the extent that the injured parties in these examples would have been willing to pay the offending consumer

enough to persuade him to make a different decision--e.g., regarding the type of auto he buys or the amount he smokes--there is a potential loss in allocative efficiency.

Another instance where external effects can occur is in the use of consumer information.[8] The "conscientious consumer," the person who seeks out information and complains to retailers when he doesn't find what he wants or when he finds deception, conveys information to producers on consumer demands for both information and other goods and also helps to keep producers honest. These activities provide benefits to other consumers, though the conscientious consumer may only be concerned about his own interests. If he were paid by the beneficiaries of his action, he would be likely to do more.

Monopoly power. The final requirement for efficiency in private markets is the absence of monopoly. It is a well-known economic proposition that a firm with monopoly power will tend to produce less output and charge higher prices than would a firm faced with competition from existing rivals and potential entrants to the industry.

The need for collective intervention to promote the public interest in an efficient allocation of resources by regulating firms that have monopoly power has long been recognized . This type of governmental consumer protection

legislation dates from the 19th century, and earlier in the common law. With regard to consumer information and the need for consumer protection, the problems discussed above will exist whether or not firms have monopoly power. They may be exacerbated, however, by monopolistic and oligopolistic market structures to the extent that firms in such markets cooperate rather than compete and can, to their advantage, restrict the supply or type of consumer information. Nonetheless, it is still the presence of processing costs, organizing costs, and the collective-consumption characteristics of information that prevent a profit-oriented firm other than the monopolist from frustrating the monopoly by acquiring and producing the information that consumers are willing to pay for.

Private Market Failures: Income Distributional Equity

As noted earlier, even in the absence of private market failures of the allocative efficiency type, there may be justification for consumer protection activities to enhance social equity. Even though an allocation of resources may be efficient, some people may feel it is "unfair" that some consumers (those with lower incomes) can afford less protection than others. In such a case collective intervention to change the distribution of protection may be consistent with the "public interest" in equity.

Private market failures of the efficiency type also have income distributional consequences that may be sufficiently

adverse to justify governmental consumer protection activities on equity grounds alone. For example, since individuals differ in their ability to process information, the same bit of information is more costly for some consumers to process than for others. For the aged and for those with less education, for example, processing costs may be so high that they demand and use comparatively little information, and hence provide themselves with less protection than other consumers. Though the desire to make in-kind transfers of consumer protection to these people may be shared by many, the existence of transactions costs and free-rider problems may prevent individuals from making these transfers and may justify governmental or other subsidized, collective intervention.

The exercise of monopoly power is another potential source of inequity that may warrant intervention in private markets. As stated above, monopolistic firms will tend to restrict output below competitive levels and charge higher prices and earn greater profits than firms faced with active or potential competition. If it is deemed unfair for consumers to pay higher than competitive prices and for monopolistic firms to earn greater than competitive profits at the expense of their customers, then a potential private market failure in the equity sense would exist and governmental intervention may be justified. Indeed, measures that protect consumers from the inefficiency caused by the exercise of monopoly power will also have income distributional consequences favorable to

consumers, though unfavorable to the regulated firms, their owners and, perhaps, their employees.

Governmental Failures

Thus far we have identified a number of reasons why collective intervention to alter the private market's provision of consumer protection may improve either allocative efficiency or distributional equity. Such intervention has come from the public sector in a variety of forms, some supplementing the activities of the private sector, some regulating those activities. But there are reasons to expect that, in some instances, the public sector will fail also.

The underlying reason for private market failure, as we have noted, is the existence of organizing costs and free-rider problems that prevent individuals from taking collective actions that are in their own interests. These same factors may prevent individuals from fully transmitting to governments their demands for consumer protection. This applies not only to the enactment of consumer legislation but also to the enforcement of regulations, particularly when effective enforcement relies on the filing of complaints by individual consumers.

Producers, on the other hand, are well situated, and often strongly motivated to transmit their demands to the public sector. While each consumer may have some interest in many of the more than 200 government agencies whose actions

affect virtually all products, firms, and types of information,[10] a producer's interest tends to be considerably more concentrated, extending over comparatively few products and agencies. While many consumers may have some interest in a particular government action, in general, a comparatively small number of producers will have a significant interest in the same action. The smaller number of producers and the larger interest of each in a relatively limited set of areas reduce the significance of organization costs and free-rider problems as impediments to group action. For these reasons, producers are more likely than consumers to find it advantageous to organize and to represent their interests to the public sector--e.g., through lobbying activities.

As a government agency matures, producer organizations are usually on hand to influence the development and enforcement of the agency's regulations. When an agency institutes an administrative enforcement action, a firm, as a defendant, can usually devote substantial resources to delay and defense.[11] Consumers, in contrast, are seldom directly represented either in the formulation of an agency's rules and policies or in the prosecution of an alleged violation of an agency's regulations. Yet once an agency is formed, believing that their interests are now being protected, consumers may become less cautious and conscientious in their buying, and may need even more vigilant representation in the continuing implementation activities that follow Congressional legislation.[12] Although an agency is, itself, presumably concerned with the interests of

consumers, the potential for a representational imbalance exists where producers are present to influence the agency bureaucracies but consumers' input is minimal. The public sector, as a result of such an imbalance, may fail to provide either the amount of consumer protection that individuals would be willing to pay for, or a distribution of consumer protection that society would deem equitable.

2. RALPH NADER AND THE REPRESENTATION OF UNORGANIZED INTERESTS: A CASE STUDY

The analysis presented above raises at least the possibility that the operation of both the private and public sectors will produce inefficient amounts and types, or an inequitable distribution , of consumer information and hence consumer protection. Organizing costs and the incentive to free-ride inhibit collective action and leave some interests under-organized and underrepresented relative to competing interests. This suggests a positive role for activities of the Ralph Nader type. By advocating the adoption and/or stricter enforcement of consumer protection laws he may be representing interests that are neglected in both private market and governmental processes.

It is impossible to determine from a theoretical analysis whether Nader's activities, and in particular his use of legal instruments such as litigation, are actually performing this function. Further, there is no market test that Nader's activities might pass or fail that

would tend to support or reject the hypothesis that he is representing interests that would otherwise be underrepresented. For the very reasons that private markets and governments can fail, the collective good involved in Nader's type of legal representation cannot be expected to pass such a market test. Only an analysis of specific actions can provide evidence on the question. Thus, we turn now to a case study --Nader v. Allegheny Airlines, Inc.

Nader's well-publicized suit against Allegheny Airlines is an example of the kind of law-oriented activity Nader has undertaken on behalf of consumer interests. We first present the relevant facts.[13] We then analyze three distinct aspects of the case: the objectives of the action, the remedies proposed for achieving the objectives, and the outcomes actually realized.

On April 28, 1972, Nader, holding a confirmed reservation, was denied boarding on an Allegheny flight from Washington, D.C., to Hartford, Connecticut. He was denied boarding because the flight had been overbooked and was already filled to capacity when he arrived at the Allegheny terminal. Nader sued Allegheny for compensatory and punitive damages. In October 1973,a district court found in Nader's favor, stating that overbooking as practiced by Allegheny was both deceptive, since the public was not told of the practice, and excessive, since Allegheny had bumped 945 customers during the same month Nader was bumped.[14] The court awarded Nader compensatory damages of $61 and punitive damages of $50,000. Allegheny appealed the decision, and in 1975 an appeals panel sent the case back to the district court

with instructions to stay further proceedings pending a decision by the Civil Aeronautics Board (CAB) on whether Allegheny had engaged in an unfair and deceptive practice by not disclosing publicly its overbooking practices.[15] Nader had appealed to the U.S. Supreme Court which ruled in June 1976 that the case should not be stayed.[16] The case has not yet reached a final judicial outcome.

Subsequent to the initial court ruling, Nader stated that, while the immediate objective of the case was to exact a penalty from Allegheny, the ultimate objective was to create enough pressure on the CAB and the industry to force the promulgation of a rule that would prohibit the practice of overbooking--the practice of selling more reservations for a flight than the flight can carry.[17] If this objective could not be achieved, Nader hoped that the case would at least pressure the airlines to restrict voluntarily the amount of overbooking they do.

Case Objectives: Efficiency Dimensions

It will be useful to describe in a qualitative way how overbooking can contribute to economic efficiency. The amount of overbooking practiced has a direct effect on the use of existing airline capacity. An efficient use of capacity would require that all individuals willing to purchase a reservation be able to do so as long as there are seats available. However, this cannot always be accomplished, particularly under the

existing CAB rules, primarily because some persons reserve seats but either fail to show up at boarding time or cancel immediately prior to departure.[18] As a result of these "no-shows," a flight booked to capacity can leave the terminal with empty seats, denying the use of available capacity to individuals otherwise willing to purchase a ticket even at the ordinary fare (let alone at the far lower fare that would cover short-run marginal cost).

In this way, the no-show imposes costs on third parties by creating the possibility that other customers will be denied reservations when, in fact, there is space available. Since overbooking adjusts for no-shows, it reduces the "denied-reservation" costs and thus benefits some airline customers. At the same time, since the number of no-shows is uncertain in advance of departure time, overbooking creates the possibility that some passengers will have to be bumped, i.e., denied boarding even though they hold confirmed reservations. Therefore, the social cost that no-shows impose on other customers is the sum of "denied-reservation" costs plus "bumped-passenger" costs, and, for a given "expected" number of no-shows, this total depends on the amount of overbooking. Unfortunately--for it would be desirable to minimize each type of cost--actions that reduce either type of cost have the effect of increasing the other. Hence, it is the sum of the two that should be minimized.[19] Thus, if the expected number of no-shows cannot or will not be reduced, an efficient use of capacity would require

that airlines engage in an amount of overbooking that minimizes this total cost, and this could call for a positive amount of overbooking and, as a result, a positive amount of bumping.

In any event, the costs that no-shows impose on others, though minimized by an appropriate amount of overbooking, will not be reduced to zero. These costs will be lower, however, the lower the number of no-shows. Except for "unintentional" no-shows, that is, persons who fail to show for a flight despite making a reasonable effort to arrive on time, the number of no-shows depends on the amount that individuals benefit by making and holding reservations that they do not, in the end, use. Individuals may, for instance, hold multiple reservations to provide themselves with flexible travel plans or with some insurance against bumping. These "intentional" no-shows, while using a service for which they benefit, will not take account of the costs they impose on others unless charged a price reflecting those externality costs. The higher the price, or penalty, levied against no-shows, the lower the expected number of no-shows will be. But since some consumers may be willing to pay a price commensurate with the externality costs of a no-show, a positive number of "intentional" no-shows would,in general, be consistent with economic efficiency.

In short, an efficient use of airline capacity would be achieved by charging a price for being a no-show and using overbooking to minimize the impact of no-shows on other airline

customers. It follows that some positive amount of overbooking, and bumping, will in general be economically efficient, although depending on the quantitative magnitudes involved, the possibility that efficiency requires no overbooking cannot be ruled out on a priori theoretic grounds.

The question remains whether airlines actually use efficient rates or, indeed, whether the mechanism through which the level of overbooking is determined is likely to generate a socially efficient level of overbooking. If it were the case that individuals were fully informed about overbooking--that is, if they knew the probability of being bumped from a particular flight and could process the information--airlines operating on the same route (when such competition exists) could compete for customers by offering lower probabilities of being bumped. At the same time, airlines would recognize that overbooking tends to compensate them for the revenue lost because of no-shows. Thus, airlines would have incentives both to reduce the number of no-shows and to minimize the impact of no-shows on other potential airline customers. Under these circumstances the private sector's practice of overbooking would be economically efficient. Airlines that overbook more would be able to offer lower fares, and would be forced by competition to do so; consumers might then be confronted with a wider variety of choices than they have now, being able to purchase tickets at various fares and associated probabilities of being bumped. Indeed,

an individual airline might offer such "conditional" fares.

There are two reasons to expect, however, that under current conditions (as of the Nader suit) airlines actually engage in an excessive amount of overbooking relative to the efficiency benchmark. First, since the processing of information on bumping probabilities--which are normally very low--is likely to be more costly for consumers than the processing of other information relevant to the choice of an airline, consumers are unlikely to demand and use information on bumping probabilities, and instead are likely to consider, and thus force airlines to compete on, other aspects of air travel. Second, because entry into the industry and the selection of travel routes by airlines are restricted by government regulations while alternative modes of transportation are relatively poor substitutes for air travel, the strength of market forces promoting allocative efficiency is less than it would be in a freely competitive market. Hence, airlines can compensate for no-shows and the concomitant loss in revenue by overbooking without being forced by competition to reduce fares, to restrict the practice of overbooking to levels that minimize the external costs no-shows impose on other customers, or to attempt to reduce the number of no-shows to optimal levels.

Apparently being more attentive to the interests of airlines than of airline passengers, the CAB has never directly regulated the overbooking practice.[20] A CAB regulation,

promulgated in 1967 and in effect to the present, does require that an airline offer a bumped passenger either alternative transportation to his destination at no additional expense or compensation in the form of a refund.[21] However, the impact of this regulation is probably minimal. Since airlines probably expect to lose some of the future patronage of a bumped passenger in any case, the only penalty for overbooking implicit in the regulation is the (expected) additional cost of making alternative transportation arrangements. This added cost is probably so small as to have an insignificant effect on overbooking practices.

Thus, it appears likely that at the time of Nader's law suit there were private market and governmental "failures" that left airline customers bearing more of the costs associated with no-shows and overbooking than would be economically efficient. That is, some reduction in the rate of overbooking would yield aggregate net benefits. As we shall see, however, Nader's specific target, the total elimination of overbooking, was probably an inefficient goal.

Case Objectives: Equity Dimensions

The objective of reducing overbooking has distributional implications for both the airlines and the airlines' passengers. To the extent that a reduction in overbooking would increase the number of unoccupied seats on flights leaving the terminal, it would reduce the average number of passengers per flight

increasing the average cost of transporting a passenger and reducing profit per passenger. If some customers denied reservations decide not to fly at all, then the total profit earned by air carriers would decline. Any such reduction is likely to be borne in part by airline stockholders and in part by airline passengers as carriers try to raise fares to offset the loss in earnings.

A reduction in overbooking, on the other hand, is likely to reduce the number of passengers bumped, and thus to benefit an individual to the extent of his willingness to pay for a reduction in the probability of being bumped. Yet, because of a reduction in overbooking, some customers would probably be denied reservations on flights fully booked but under-utilized because of no-shows. Hence, an individual will bear costs to the extent of his willingness to pay to avoid an increase in the probability of being denied a desired reservation.

For some individuals, the costs of a reduction in overbooking--a possible fare increase and an increase in the likelihood of being denied a reservation--may exceed the benefits of a lower bumping probability. Thus, while Nader intended to represent the interests of all air travelers, it is not clear that he did, since a reduction in overbooking would quite likely impose net costs on some customers.

While the CAB has never directly regulated overbooking, it has tried to insure that bumped passengers are reasonably

compensated. As described earlier, CAB regulations require that some compensation be offered. Bumping is clearly unfair, imposing costs on persons not initially responsible for the overall problem and not aware of the degree to which they are subject to the risk of being bumped.[22] The present CAB rule does appeal to notions of fairness by providing the bumped passenger with at least some compensation for the unexpected disruption of his travel plans, but that rule does nothing to discourage "excessive" overbooking or to see that a price is charged for the convenience of acting as a no-show.

These distributional considerations suggest that the objective of reducing the amount of overbooking is not necessarily desirable on equity grounds, though it may be. While the private sector has failed to produce an equitable distribution of the costs and benefits of overbooking, the public sector has intervened partially to correct that failure. A more equitable solution would require that a reduction in overbooking be accompanied by some effort to make individuals pay for the convenience of not showing up for a flight.

Case Remedies

The remedy proposed by Nader was for the CAB to prohibit all overbooking. Though this remedy was not at issue in the litigation, Nader has stated that it was the remedy he intended.[23]

From the data available on overbooking it is not clear whether a fully enforced rule banning the practice would be an efficient response to the problem. Although no information is available on consumers' willingness to pay for the elimination of virtually all probability of being bumped, some indirect evidence suggests that consumers, in the aggregate, might be better off if the practice of at least some overbooking is maintained.

In an average year there are 160 million passenger boardings and about 80,000 cases of passenger bumping.[24] Typically, close to half of those denied boarding accept alternate transportation arranged by the airline and scheduled to arrive within two hours of the original flight.[25] Virtually all of the remaining persons bumped accept denied boarding compensation from the airlines in amounts ranging from $25 to $200.[26]

If the practice of overbooking were eliminated, the number of persons denied reservations on fully booked but not fully utilized flights could total several million or more per year.[27] There is an extreme paucity of data on the number of persons denied reservations because of no-shows, and thus any figure must be a very rough estimate. But assuming that 1 million reflects the right order of magnitude, it seems likely that the total cost to consumers of eliminating overbooking would exceed the total of consumer benefits. While a

customer denied a reservation can attempt to make alternate travel arrangements, the cost of such an inconvenience might be comparable to the cost incurred by a bumped passenger, particularly one who accepts alternate transportation. Since nearly half of all bumped passengers accept such alternate transportation, there is some reason to doubt that aggregate consumer losses from overbooking are any greater, at least for this half of the bumped group, than the aggregate consumer losses that would accompany its elimination. In any event, no firm conclusion can be drawn from the available data regarding the efficiency impact of the remedy proposed by Nader. However, the possibility of an adverse efficiency impact resulting from the elimination of overbooking certainly cannot be dismissed.

With respect to the distributional consequences to be expected from an elimination of overbooking, it would appear that for each consumer who benefitted by not being bumped many other consumers would be harmed by being denied a reservation. Further, simply eliminating overbooking, without charging the no-shows, would only maintain the inequity of allowing some to enjoy the convenience of being a no-show without bearing the associated costs, and it would simultaneously reduce airline revenues and passengers carried. Further, to the extent that any change in overbooking practices yields either net benefits or net costs for air travelers, the

effect will not be distributed equally across the population but will have an impact only on air travellers, a subgroup of the population composed mostly of whites and those with higher incomes.[28]

Case Outcomes

As noted earlier, Nader's victory in district court was reversed and remanded at the appellate level and still awaits a final ruling. But because Nader won in district court and stood to receive over $50,000 in damages, the case received a substantial amount of publicity.[29] Even before the district court ruling, the threat of such publicity and the possibility that Nader might take further action to expose the problem apparently persuaded the CAB and the airline industry that some form of action was needed.

On the basis of facts revealed in Nader, the CAB initiated a separate proceeding against Allegheny charging that the airline had engaged in "excessive" overbooking during the years 1969 to 1972.[30] In 1974, Allegheny agreed to pay a $12,600 civil penalty. The penalty should provide at least some incentive for Allegheny, and other airlines as well, to do less overbooking, and presumably less bumping.

Within two months of the initial verdict in Nader, both the CAB and the industry advanced proposals to deal with the overbooking problem. The industry's proposal called for a reduced-fare schedule to apply to reservations that would be subject to the risk of bumping.[31] While this approach would

enhance free choice, it suffers from two problems. First, unless the airlines can find a way to make the disclosure of their bumping rates a positive selling point, and to present the information in a form that makes it relatively easy for consumers to process, consumers may either not receive or not utilize such information in their buying decision. More important, the proposal does not effectively deal with the primary market failure problem--the externality effects caused by the no-show--since it does not attempt to shift any of the costs incurred by bumped passengers onto the no-show customers.

The CAB has rejected this approach. The CAB's alternative proposal is to retain the existing regulation regarding the payment of denied boarding compensation and to add a regulation requiring that tickets be purchased well in advance of flight departures and allowing the airlines to deny full refunds to customers who fail to show without first cancelling their reservations.[32] By forcing the no-show to take into account added costs that are representative of the losses his actions impose on others, this proposal is clearly aimed at correcting the externality problem, and also represents a reasonably fair assessment of costs. By attempting to reduce the number of no-shows, it has the potential to remove the primary incentive--and the justification--for overbooking, and at the same time recognizes the efficiency role that overbooking plays and the fairness of compensating parties injured by the practice.

Although not an attempt to regulate overbooking per se, this approach could nevertheless have a positive impact. For six months during 1962 a similar rule was in effect, and during that brief period there was apparently some decline in the number of no-shows.[33] At the same time, revenues from denied refunds were sufficient to cover the airlines' costs of operating the program.

The 1962 program "expired automatically by its own terms...for failure to obtain the unanimous agreement among the carriers necessary for the plan's continuation."[34] Given this experience, it seems likely that the CAB's failure to take any steps to deal with the no-show problem since 1962 can be attributed to influential pressure from the airlines. Any policy that discourages reservations clearly represents a threat to the industry, while given the small expected losses involved for an individual consumer, it is not surprising that consumer demands for action have not been effectively transmitted to the CAB.

Though there is no simple solution to the problem,[35] and we cannot conclude that the CAB's proposal is the best solution or even that the CAB will eventually take any action at all, it does appear that Nader was, in fact, an attempt to correct an existing market failure. Without Nader, the CAB would probably still be far from even considering the need to take corrective action, and the interests of many consumers would probably still be unexpressed. By representing those

interests, Nader, though possibly in pursuit of an inappropriate remedy, appears to have acted as a catalyst, prompting governmental action consistent with the correction of an existing market failure.

3. CONCLUSIONS

Many of Ralph Nader's activities involve the use of legal instruments, such as litigation, on behalf of unorganized groups of consumers. We have argued that when these activities are analyzed from an economic perspective they can be evaluated in terms of whether they actually and effectively represent consumer interests that might otherwise go underrepresented in the private market and governmental processes that determine resource allocation and the distribution of output.

We have identified the causes of underrepresented consumer interests with possible private market and governmental failures in the production and distribution of consumer information and consumer protection. Where organizing costs and free-rider problems inhibit collective action, demands for consumer protection activities will be underrepresented relative to competing demands in both the private and public sectors.

Our case study of Nader v. Allegheny suggests that law-oriented representational activities can play a role in correcting market and governmental failures. Their impact may not always be dramatic, but they can draw attention to problem areas and

stimulate and help direct the search for a collective action that recognizes previously neglected interests.

It is noteworthy that judicial decisions played only a secondary role in determining the impact of the Nader case. It was primarily the litigation effort itself and especially the publicity it threatened and eventually produced that led the CAB and the airlines to move in the direction of Nader's objective. A victory in court or before an administrative agency is neither necessary nor sufficient for bringing about the changes in behavior needed to correct market and governmental failures. Publicity and other non-litigation activity (including organizing, informational, and lobbying activity) all interact with the litigative action to determine what impact, if any, it will ultimately have on behavior. Thus, the Nader type of legal representation of underorganized interests must be considered as part of a complex of political, social, and economic mechanisms that affect efficiency and distributional issues. Nader's legal activities can assist, if only in a sometimes marginal way, the collective effort to identify market failure problems and find efficient and equitable remedial action.

NOTES

[1]For information on the historical development of consumer protection activities and the role of voluntary consumer organizations see: Ralph M. Gaedeke, "The Movement of Consumer Protection: A Century of Mixed Accomplishments," University of Washington Business Review, XXIX (Spring 1970) pp. 31-40; E. Scott Maynes,"Consumerism: Origin and Research Implications," in Eleanor B. Sheldon, ed., Family Economic Behavior (Philadelphia: J.B. Lippincott Co., 1971); and Helen L. Sorenson, The Consumer Movement (New York: Harper & Bros., 1941).

[2]For a discussion of various consumer protection activities see: David A. Aaker and George S. Day, eds., Consumerism (New York: The Free Press, 1971); Ralph M. Gaedeke and Warren W. Etcheson, Consumerism (San Francisco: Canfield Press, 1972); National Institute for Consumer Justice, Redress of Consumer Grievances (Washington, D.C.: National Institute for Consumer Justice, 1973); and U.S. Senate, Initiatives in Corporate Responsibility, Committee Print of the Committee on Commerce, October 2, 1972.

[3]For a discussion of the benefits to consumers of using product information see E. Scott Maynes, "The Payoff for Intelligent Consumer Decision-Making," Journal of Home Economics, LXI (February 1969), pp. 87-103.

No one has ever attempted to quantify the amount of information provided by private firms. However, the following annual expenditure data have been reported: $20 billion for

advertising, $0.5 billion for labeling changes, $7 billion for sales promotion, $36 billion for personal selling, and $3 billion for public relations. See Advertising Age, April 24, 1972, p. 2; E. Scott Maynes, "Consumerism: Origin and Research Implications," p. 293, n. 14; and F.M. Scherer, Industrial Market Structure and Economic Performance (Chicago: Rand McNally & Co., 1971), pp. 326 and 406.

[4]The question whether firms actually seek to maximize profits and the implications of alternative behavior for economic efficiency have been the subject of much debate. For an introductory review of the issues, see Joseph McGuire, Theories of Business Behavior (Englewood Cliffs, N.J.: Prentice-Hall, 1964), and also see Richard H. Day, "Profits, Learning and the Convergence of Satisficing to Marginalism," Quarterly Journal of Economics, LXXXI (May 1967), pp. 302-311.

[5]Of course, consumers would not be buying the same "bundle" of goods and services, since they would be buying less information and more of other commodities. What we are suggesting is that consumers might demand the same mix of quality attributes, though they will purchase different amounts of some products. This does not imply that the additional information that would be produced in a "processing-costless" world is redundant. Rather, a consumer is foregoing the benefit of knowing that his decision was based on more information rather than less--that is, he is bearing a greater risk of incurring "regret" costs. The assertion that information is underproduced since

information-processing is costly is then an assertion that the welfare gain of consuming more in other goods and services is less than the welfare loss associated with the greater risk of "regret" costs.

[6]For additional analysis of the use of standards vis à vis information, taxes, and subsidies see Russell E. Settle and Burton A. Weisbrod, "Governmentally-Imposed Product Standards: Some Normative and Positive Aspects," (U.S. Department of Labor, 1976), and forthcoming in Ronald Ehrenberg, ed., Research in Labor Economics, Vol. II (JAI Press, 1978).

[7]The existence of incentives which lead a manufacturer or retailer to misrepresent his product or to withhold information for which consumers would be willing to pay is a source of potential private market failure, and hence is a source of inefficiency and inequity. See George A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," Quarterly Journal of Economics, LXXXIV (August 1970), pp. 488-500, for a discussion of asymmetrical information holdings as a source of inefficiency. If firms or individuals responsible for external, third-party effects were motivated by social responsibility or honesty, the market failure might be avoided. However, too much social responsibility or too much honesty might create problems of their own. It might be inefficient and it might be deemed inequitable for one man to impose his version of responsibility or honesty on another. See Kenneth J. Arrow, "Gifts and Exchanges," in Edmund S. Phelps, ed., Altruism, Morality and Economic Theory (New York: Russell

Sage Foundation, 1975), p. 22. See also Richard Titmuss, The Gift Relationship (London: George Allyn & Urwin, 1971).

[8]Sarah V. Thorelli, "The Informed and the Informers: The Grants Economics of Consumer Information," paper presented at the Midwest Economics Association meetings, March 14, 1975, describes the externality effects associated with a consumer's use of information, at pp. 2-3.

[9]See Tibor Scitovsky, "Ignorance as a Source of Oligopoly Power," American Economic Review XL (May 1950), pp. 48-53; and John R. Ferguson, et al., "Consumer Ignorance as a Source of Monopoly Power: FTC Staff Report on Self-Regulation, Standardization and Product Differentiation," Antitrust Law and Economics Review, V (Winter 1971-2), pp. 79-102 and V (Spring 1972), pp. 55-74.

[10]For a source list of government agencies and activities related to consumer products see the Office of Consumer Affairs, Executive Office of the President, Guide to Federal Consumer Services, 1971, and State Consumer Action Summary, 1971.

[11]C.f., e.g., Note, "Corrective Advertising Orders of the FTC," Harvard Law Review, LXXXV (1971), pp. 477-506.

[12]For discussion of problems in implementing one program of the Economic Development Administration, see Aaron B. Wildavsky and Jeffrey L. Pressman, Implementation (Berkeley: University of California Press, 1973).

[13]The facts and legal aspects of the case are discussed in Administrative Law: Nader v. Allegheny Airlines, Inc., "Court Usurpation of CAB Function: The Problem of the 'Bumped' Passenger," UMKC Law Review, XLIII (Fall 1974), pp. 112-120, and in Notes, "Discriminatory Bumping," Journal of Air Law and Commerce, XL (Summer 1974), pp. 533-549.

[14]Nader v. Allegheny Airlines, Inc. 365 F. Supp. 128.

[15]See 512 F.2d 527 (D.C. Cir. 1975); Emergency Reservations Practices Investigation, CAB Docket 26253, Order 75-7-54 (July 11, 1975); and Wall Street Journal, May 5, 1975, p. 19.

[16]CCH Consumerism, IV (June 9, 1976), p. 131 reporting on U.S. Supreme Court No. 73-455, June 7, 1976.

[17]New York Times, October 21, 1973, Section IV, p. 12.

[18]Notes, "Discriminatory Bumping," pp. 533 ff. There are other factors in the no-show and overbooking problem that may contribute to "excessive" overbooking, such as "overzealous travel agents who report that reservations are confirmed when they are not." p. 534, n. 5, and Emergency Reservations Practices Investigation, CAB Docket 26253, Initial Decision (June 10, 1974), pp. 8-10.

[19]A more complete specification of objectives would also recognize the interests of the no-shows, for whom the opportunity to make a last-minute decision has some value.

[20]The CAB has never regulated overbooking. For a discussion of what the CAB has done with respect to no-shows and bumped passengers, see Administrative Law, "Court Usurpation of CAB Function," p. 113, and Emergency Reservations Practices Investigation, CAB Docket 26253, Order 73-12-95/EDR-260 (December 21, 1973), p. 5, and the text below. For a discussion of the relationship between the CAB and the airline industry, see K.G.J. Pillai, "Consumer Protection in Aviation Rate Regulation," Journal of Air Law and Commerce, XXXVIII (1972), pp. 215-27, and K.G.J. Pillai, "Government Regulation in the Private Interest," Journal of Air Law and Commerce, XL (1974), pp. 29-50.

[21]The refund is limited by a $25 minimum and $200 maximum. Administrative Law, "Court Ursupation of CAB Function," p. 113, n. 11 and accompanying text.

[22]Airlines do not publicize their overbooking practices but do notify the CAB of their use of overbooking. See references at note 15 above, and Notes, "Discriminatory Bumping," p. 543.

[23]See New York Times, October 21, 1973, Section IV, p. 12.

[24]The number of domestic boardings for fiscal year 1973 (FY 73) was 160 million, and for FY 72 was 147 million. The numbers for FY 70 and FY 71 were 139 and 137 million, respectively. Emergency Reservations Practices Investigation, CAB Docket 26253, Brief of the Bureau of Operating Rights (March 18, 1974), Appendix F. The number of international boardings was 6 million

in both FY 72 and FY 73. Airline Statistics Annual (Washington, D.C.: Aviation Daily) 1973 and 1974, Table 8.2b. The amount of overbooking itself is not reported. However, during peak travel periods, eight bookings are sometimes alleged to be needed to produce one real passenger. Aviation Week, XCVIII (April 30, 1973), p. 43.

The number of denied boardings was 99,005 in FY 70, 73, 578 in FY 71, 80, 824 in FY 72 and 75,925 in FY 73 according to data in Emergency Reservations Practices Investigation, CAB Docket 26253, Brief of the Bureau of Operating Rights (March 18, 1974), Appendix F.

[25]In FY 73, 49% of those denied boarding apparently accepted alternate transportation. In FY 72, the same statistic was 50%, in FY 71 49% and in FY 70 61%. From data in Emergency Reservations Practices Investigation, CAB Docket 26253, Brief of the Bureau of Operating Rights (March 18, 1974), Appendix F.

[26]The payment represents 100% of the value of the first remaining flight coupon, with a minimum of $25 and a maximum of $200. Administrative Law, "Court Usurpation of CAB Function," p. 113. The number of passengers denied boarding who, like Nader, have sought other relief apparently totals no more than 10 since 1956, at least to the time of Nader. Notes, "Discriminatory Bumping," p. 533, n. 1 and accompanying text. But see note 29, below.

[27]The number of denied reservations is the number of persons denied the use of an unoccupied seat because a no-show has reserved the seat but not used it. If overbooking were eliminated, the number of denied reservations would increase from present levels, but would not be equal to the number of overbookings currently made since some overbooked persons are themselves no-shows and some are denied boarding or bumped. Thus, the increase in the number of denied reservations resulting from the elimination of overbooking would equal the number of overbookings adjusted for no-shows minus the number of bumpings.

The CAB does not collect and the airlines do not report data on the amount of overbooking. However, United Airlines has stated that during fiscal year 1976 the airline overbooked more than 1 million passengers. New York Times, September 8, 1976, p. 52. Using 1 million and assuming that United is an average airline with respect to its use of overbooking, the estimated total number of overbookings per year for the industry is 5.37 million, since United has 18.6% of all passenger boardings according to data in Aviation Week CII (February 17, 1975), p. 33, and in Airline Statistics Annual (Washington, D.C.: Aviation Daily) 1973 and 1974, Tables 8.1 and 8.2b.

The number of overbookings multiplied by a factor of one minus the average no-show rate provides an estimate of

the number of overbooked persons who actually show up at the terminal. The average no-show rate is the number of no-shows divided by the total number of bookings, and the total number of bookings equals the number of passenger boardings plus the number of no-shows plus the number of persons bumped. In 1973 there were 19.41 million no-shows, 160.15 million passenger boardings and 0.08 million persons bumped according to Emergency Reservations Practices Investigation, CAB Docket 26253, Brief of the Bureau of Operating Rights (March 18, 1974), Appendix B, p. 1, and Appendix F. This yields a no-show rate of 0.108. Multiplying the estimated number of overbookings by (1-0.108) and subtracting the number of persons bumped gives 4.71 million as an estimate of the number of denied reservations per year that would result if overbooking were eliminated.

[28]See U.S. Bureau of the Census, 1972 Census of Transportation, National Travel Survey, Travel During 1972, TC72-N3 (September 1973), Table 6.

[29]The story was covered in at least two articles in the New York Times: October 19, 1973, p. 12, and October 21, 1973, Section IV, p. 12. Since Nader, similar bumping cases have been brought because of the publicity earned by Nader. Decisions in all are apparently awaiting the outcome in Nader. See, Emergency Reservations Practices Investigation, CAB Docket 26253, "Comments of Aviation Consumer Action Project (ACAP) and Certain Victims of Airline Overbooking," submitted to CAB Docket 26253 pursuant to Order 75-7-54 (July 11, 1975).

[30]Wall Street Journal, May 5, 1975, p. 19.

[31]Aviation Week, C (January 7, 1974), pp. 20-2. These proposals were stimulated by the CAB's investigation of overbooking, Emergency Reservations Practices Investigation, CAB Docket 26253, begun December 21, 1973, according to the CAB, because of emergency fuel allocations to be instituted as a result of the energy crisis of that fall. See CAB Docket 26253, Order 73-12-93/EDR-260, (December 21, 1973), pp. 1-4. It seems likely that the publicity surrounding Nader was at least a contributing factor.

[32]There are, of course, exceptions to those who will be so penalized under the plan. The proposal is aimed at curtailing intentional no-shows. The amount of the proposed penalty is 50% of the ticket value with a minimum of $25 and a maximum of $100. Aviation Week C (January 7, 1974), pp. 20-2.

[33]Aviation Week LXXVII (October 1, 1962), p. 30. During 1957-58 a similar program was in effect and reduced the incidence of no-shows to passengers enplaned from a high of 14% to a low of 5%. Emergency Reservations Practices Investigation, CAB Docket 26253, Order 73-12-93/EDR-260 (December 21, 1973), p. 5.

[34]Emergency Reservations Practices Investigation, CAB Docket 26253, Order 73-12-93/EDR-260 (December 21, 1973), p.5.

[35]For another solution to the overbooking/bumping problem, see Harold Bierman, Jr., and L. Joseph Thomas, "Airline Overbooking Strategies and Bumping Procedures," Public Policy, XXI (Fall 1973), pp. 601-606.