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WHO SHOULD REGULATE ADVERTISING, AND WHY?

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It is indeed a great privilege for me to deliver the third Advertising Association's President's Lecture.

In the Inaugural President's Lecture, Lord Briggs spoke of the need to examine advertising within the larger economic, social, and cultural perspective -- a perspective that identifies advertising as an integral part of communication, one of man's natural rights. In the second lecture, Dr. Frits Hondius discussed how the communication revolution has rendered obsolete parochial national restrictions on advertising and has shown the need for uniform inter-European standards.

I regard my address today as an appropriate sequel in this series. My topic is "Who should regulate advertising, and why?" It seems almost a rhetorical question, coming from the Chairman of the regulatory agency in the United States charged with enforcing federal prohibitions against unfair and deceptive advertising. Rest assured, I am not about to deliver my autobiography.

We Americans are especially qualified to identify who should regulate advertising, because just about everyone over on our side of the ocean has tried his hand at it. Federal authorities, state governments, cities, associations, and consumer groups have all joined the fray. I will discuss the evolution of American thinking on advertising, and the lessons that have come out of our regulatory experiments.

As the celebrated Anglo-American economist Ronald Coase has noted, both the United States and the United Kingdom historically have made a sharp distinction between the ordinary market for goods and services, and the activities of speech, writing, and the exercise of religious belief. Coase used a fitting name for this latter category of activities: "the market for ideas." In the market for goods, intensive government regulation has generally been regarded as acceptable. Regulation abounds - from standards for weights and measures to warranties of safety and performance. In the market for ideas, however, the position is very different. The conventional wisdom, with which I agree, holds that government regulation in the market for ideas, at best, is inefficient and, more likely, is pernicious.

The glaring inconsistency of the two regulatory approaches left commercial advertising in a nether world embraced by neither sphere. Yet it has characteristics of both categories. Advertising is speech, but it concerns the market for goods. The tendency, until recently, was to squeeze it into the latter category. Writing in 1974, Coase noted:

> It is an odd feature of this attitude that commercial advertising, which is often merely an expression of opinion and might, therefore, be thought to be protected by the First Amendment, is considered to be part of the market for goods. The result is that government action is regarded as desirable to regulate (or even suppress) the expression of an opinion in an advertisement which, if expressed in a book or article, would be completely beyond the reach of government regulation.[1]

Public policy ascribed little value to the protection of commercial speech because of a generally-held fear that advertising exercises a tyranny over the individual. A generally accepted notion emerged that advertising is manipulative, forcing people to do things they would not ordinarily do. Thirty years ago, Vance Packard epitomized this curious phenomenon in his book "The Hidden Persuaders." In it he decried:

> the large-scale efforts being made, often with impressive success, to channel our unthinking habits, our purchasing decisions, and our thought processes by the use of insights gleaned from psychiatry and the social sciences. Typically these efforts take place beneath our level of awareness; so that the appeals which move us are often, in a sense, "hidden." The result is that many of us are being influenced and manipulated, far more than we realize, in the patterns of our everyday lives.[2]

This view of Mr. Packard's -- and he was not alone -- held that advertising had a powerful, almost sinister, effect on people. If the advertisements were cleverly enough executed the consumer would buy the advertised product. Manufacturers distorted consumer needs and made consumers want whatever the manufacturers wanted to sell. Consumers required government protection.

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[1] Coase, R., The Market for Goods and the Market for Ideas, 64 American Economic Review 384, 385 (1974).

[2] Vance Packard, The Hidden Persuaders, 3 (1957).

Until recently, economists generally shared this view. A typical comment was made by John Kenneth Galbraith -- America's tallest social scientist -- who stated:

> It is true that the consumer may still imagine that his actions respond to his own views of satisfactions. But this is superficial and proximate, the result of illusions created in connection with the management of his wants. Only those wishing to evade the reality will be satisfied with such a simplistic explanation. All others will notice that if an individual's satisfaction is less from an additional expenditure on automobiles than from one on housing, this can as well be corrected by a change in the selling strategy of General Motors as by an increased expenditure on his house.[3]

If this view sounds naive today, it is because only in recent years has advertising been studied in the light of economics. Economists largely ignored advertising until the 1930's.[4] Economic models based on perfect competition assumed that, in a world of perfect information, advertising would not exist. That advertising _did_ exist was taken to indicate, not that the assumption of perfect information needed to be relaxed, but that the extent of competition was not what it should be.[5] The fallacy is obvious now; the earlier views assumed away the real phenomenon of consumer ignorance - which is what explains advertising's very existence. Nonetheless, as late as the 1960's and even the 1970's, the typical economic view of advertising was that it was anti-competitive and socially wasteful.[6]

Slowly, this view of commercial advertising has been exposed as the fallacy that it is.

There were a few lonely voices against the earlier view, those of economists George Stigler and Lester Telser at the University of Chicago. They maintained that advertising was a

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3 Galbraith, _New Industrial State_, 214-15 (1967).

4 _See_, _e.g._, Chamberlin, E., _The Theory of Monopolistic Competition_ (1933).

5 _See_, _e.g._, Kirzner, I., _Competition and Entrepreneurship_ (1973).

6 _See_, _e.g._, Galbraith, J., _The Affluent Society_ (1958).

useful, pro-competitive way to convey information to consumers.[7] But not many people were listening in the 1960's.

The real breakthrough, I believe, came with empirical studies showing the effects of bans on advertising. In the professions in particular, a number of "natural experiments" were under way in the United States. Some jurisdictions banned advertising and others allowed it.

Advertising by the professions has an odd historical background on both sides of the Atlantic. Two years ago, Dr. Hondius discussed how in late Nineteenth Century Europe, there was an extraordinary outpouring of posters legally advertising, among other things, professional services, and that these posters were the work of respected painters one of whom was Toulouse Lautrec. Against this backdrop, he noted with some irony that, as late as 1978, a Hamburg veterinary surgeon was prosecuted for unfair competition -- merely for appearing in a newspaper interview after he had saved a cat's life. Given the current litigiousness in my country, if the animal had been an American cat, I would suspect it also would have found a reason to sue the vet.

A similar Dark Age descended on the United States for most of the Twentieth Century. Before then, lawyers and other professionals were allowed to advertise. For example, in 1853 a young attorney named Abraham Lincoln advertised his availability to practice in Illinois courts. Then states began to outlaw advertising, and by 1908 the American Bar Association had adopted codes of ethics that prohibited most forms of solicitation throughout the country. Other self-regulating professions also adopted advertising restrictions that varied in scope from state to state: medicine, dentistry, veterinary medicine, architecture, accounting, engineering, optometry, and pharmacy.

The lessons that have come out of our federalist experience may be instructive as you struggle with the transnational advertising issues central to European media development. As early as 1972, evidence began to mount in the United States that advertising lowers prices, a point in fundamental conflict with the claims that it somehow undermines competition. In the earliest empirical study of advertising and prices, Lee Benham compared prices in states that banned optometric advertising with

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[7] Stigler, "The Economics of Information" in The Organization of Industry (1968); Telser, Advertising and Competition, 72 Journal of Political Economy 537 (1964).

prices in states that allowed it.[8] He found that advertising restrictions increased the prices paid for eyeglasses from 25 to over 100 percent.

A similar methodology was used by John Cady to compare the states that did and did not restrict advertising of prescription drug prices.[9] Cady found that in 1970 American consumers paid approximately $150 million more for drugs in states that banned advertising.

This early empirical work was plainly influential in spurring a series of important Supreme Court decisions. In the 1970's the Court held, for the first time, that commercial speech, like other forms of speech, deserves Constitutional protection.

In 1976, (in Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748 (1976)) the Supreme Court first made clear the First Amendment interest in advertising:

> Advertising, however tasteless and excessive it sometimes may seem, [I note, parenthetically, the obligatory sneer from the intelligentsia] is nonetheless dissemination of information as to who is producing and selling what products, for what reason and for what price. So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that these decisions . . . be intelligent and well informed. To this end, the free flow of commercial information is indispensable.

In case after case, the Supreme Court struck down state government bans on advertising of drug prices, professional

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[8] Benham, Advertising, Competition and the Price of Eyeglasses, 15 Journal of Law and Economics 337 (1972).

[9] Cady, An Estimate of the Price Effect of Restrictions on Drug Price Advertising, 14 Economic Inquiry 493 (1976).

services, contraceptives, as well as electricity.[10] At the same time, the Federal Trade Commission was active in challenging private restrictions on professional advertising and solicitation.[11] As the barriers to advertising began to fall, the evidence of advertising's beneficial effects continued to mount.[12]

Our experience with advertising for professional and other industries demonstrates that advertising is necessary for product development and innovation. If a firm cannot inform consumers about the characteristics of its products, it has little incentive to adapt its products to suit consumer preferences better.[13] Moreover, as I noted earlier, study after study has continued to confirm that advertising increases new entry and price competition. Advertising facilitates entry by lowering the information barrier that exists because consumers have more experience with established brands than with new ones. And advertising increases price competition by making it easier for

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[10] Prophylactic prohibitions on the advertising of drug prices, Virginia Board of Pharmacy, 425 U.S. 748 (1976); professional services, Bates v. Bar of Arizona, 433 U.S. 678 (1977); contraceptives, Carey v. Population Services International, 431 U.S. 678 (1977); houses -- through the use of "For Sale" signs, Linmark Associates v. Township of Wellingboro, 431 U.S. 85 (1977); and electricity consumption, Central Hudson Gas and Electric Commission v. Public Service Commission, 447 U.S. 85 (1977); all were invalidated despite their asserted purpose of protecting the public health, safety and welfare.

[11] See, e.g., American Medical Association v. Federal Trade Commission, 638 F.2d 443 (2d Cir. 1980), aff'd mem., 452 U.S. 960 (1982).

[12] See e.g. Jacobs, W., et al., Staff Report on Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (1984) (Federal Trade Commission).

[13] Ackoff, R., Advertising Research at Anheuser-Busch, Inc. 1963-1968, 16 Sloan Management Review 1-15 (1975); Lambin, J., Advertising, Competition and Market Conduct in Oligopoly Over Time, in Contributions to Economic Analysis (1976).

firms to communicate that they are offering lower prices or new products.[14]

Along with the growing recognition of the economic value of advertising, the view that advertising has a manipulative effect on consumer purchasing behavior also began to fade. We came to recognize that consumers actually remember their myriad experiences and beliefs. They evaluate commercial messages, not in a vacuum, but in the context of their lives.[15]

From a regulatory perspective, how do we distinguish commercial advertising from other forms of speech? Granted, the purpose of commercial speech is persuasion, and its motivation is the self-interest of the speaker. But these characteristics are commonly found in many other communications, from the most private billet-doux to the political harangue.

Is it, then, that commercial speech is in greater need of regulation because it serves the market for goods, while other forms of speech serve some nobler ideal of democracy or freedom? This distinction also strikes me as unsatisfactory. As the noted Chicago Economist, Aaron Director, once stated:

> ...the bulk of mankind will for the foreseeable future have to devote a considerable fraction of their active lives to economic activity. For these people

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14 Some industries where there is empirical support for this argument are eyeglasses, toys, prescription drugs, and legal services. In all cases, advertising restrictions were associated with higher prices. See, Benham, L., The Effects of Advertising on the Price of Eyeglasses, 4 J.L. & Econ. (1972); Bond, R., et al., Staff Report on Effects of Restrictions on Advertising and Commercial Practice in the Professions (1980)(Federal Trade Commission); Steiner, R., Does Advertising Lower Consumer Prices?, 37 J. of Marketing 19 1973); Cady, J., Drugs on the Market: The Impact of Public Policy on the Retail Market For Prescription Drugs (1975); Jacobs, W., et al., Staff Report on Consumer Access to Legal Services: The Case For Removing Restrictions on Truthful Advertising (1984)(Federal Trade Commission); Kessides, I., Advertising, Sunk Costs and Barrier To Entry (1983)(Federal Trade Commission).

15 See, e.g., Bauer, R., The Initiative of the Audience, J. of Advertising Research, vol. 3, no. 2 (1963); Ray, M., "Marketing Communication and the Hierarchy of Effects," in New Models for Mass Communication Research (Clark, P., ed. 1973); and McGuier, W., "An Information Processing Model of Advertising Effectiveness," in Behavioral and Management Sciences in Marketing (Davis, H. & Slik, A., eds. 1978).

> **freedom of choice as owners of resources in choosing within available and continually changing opportunities, areas of employment, investment, and consumption is fully as important as freedom of discussion and participation in government.[16]**

Any communication, commercial or not, carries with it a potential for deception. Indeed, in the context of political speech and the news media, we have long recognized that the price we pay for truthful speech is that confusion and probably some deception is inevitable. Even the most honest speaker cannot control the inferences his audience will make from his statements. Indeed, recent studies suggest that over one-quarter of the relevant content of television communications, and over one-fifth of the meanings of print communications, are misunderstood.[17]

Writers and reporters might be embarrassed to learn that the level of miscomprehension does not vary substantially between commercial and non-commercial communications.[18] People in the studies misunderstood the news as often as they were confused by the commercials.

Even in the age of the "Communications Revolution," imperfect understanding remains a fact of life. The only way to avoid all deception and misunderstanding is to cease communicating. Seldom is such a ludicrous policy proposed in order to protect people from confusing news. But this approach is embraced with some frequency by regulators of commercial speech. The respect for the competition of ideas often evaporates when those ideas come from the realm of commerce. Given the competitive nature of commerce in our countries, the widely disparate treatment is puzzling.

No chronology of advertising regulation would be complete without a discussion of "tar wars," the saga involving the advertising efforts of cigarette manufacturers to confess to shortcomings. One might assume that cigarette manufacturers would be the last group voluntarily to publicize tar and nicotine levels, because such information continually reinforces consumer awareness of the unhealthy consequences of smoking. The

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[16] Director, A., The Parity of the Economic Marketplace, 7 Journal of Law and Economics 1,6 (1964).

[17] Jacoby, J., The Miscomprehension of Television Communications (1980); Jacoby, J., The Comprehension and Miscomprehension of Print Communications (1987).

[18] Id.

assumption is wrong. In the 1950's, cigarette firms advertised this information even though the net effect was to reduce overall sales. Producers of cigarettes with lower tar and nicotine discovered they gained sales by proclaiming reductions of these feared substances. The amount of tar and nicotine dropped by 30 to 40 percent as the competitive pursuit for sales overwhelmed firms' sense of loyalty to the industry. This caused other firms to reduce the tar and nicotine content of their brands and to advertise that fact.

In 1960, concerned that the rash of competing tar and nicotine claims might confuse consumers, the Federal Trade Commission obtained an industry-wide agreement to ban all tar and nicotine claims. Because the consumer no longer received information on tar and nicotine content, cigarette firms no longer had the same incentive to compete to reduce those substances. Subsequently, many public service organizations decried the ban, the Commission changed its policy, and firms began again to compete vigorously with regard to tar and nicotine content -- and began again to advertise that content. Tar and nicotine levels once again fell substantially. The epilogue to this adventure is written in recent epidemiological studies that have linked the lower tar cigarettes of the 1950's and 1960's to approximately a 20 percent decrease in lung cancer.[19] One has to wonder how many lives may have been lost as a results of the Commission's well-intentioned effort to limit advertising.

Whether it is in the sphere of ideas or of goods, I am convinced the government cannot, in most cases, regulate as well as the marketplace regulates. Businesses, far more painfully than politicians, pay the price for empty promises. Businesses, like individuals, have strong incentives to safeguard their reputations. In both the commercial and social world, your word is only as good as your name. For this reason, in the United States --and, no doubt, the United Kingdom also -- challenges against advertising are resolved satisfactorily and voluntarily outside of government far more often than within official channels. In the United States, the Better Business Bureau's National Advertising Division and National Advertising Review Board have played an indispensable role in ensuring that advertising campaigns adhere to demanding standards of truthfulness.

Regulators, like politicians generally, are shall we say, "frequently" subject to the influences of special interests -- and even when they are not, they lack the omniscience to make

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19 See e.g., Lee, P., and L. Garfinkel (1981), "Mortality and Type of Cigarette Smoked," Journal of Epidemiology and Community Health 35, pp. 16-22.

improvements. The market doesn't have to work perfectly to work better than government.

All of this is not to say that there should be no role for government in the regulation of commercial speech, or that deceptive speech is something to be encouraged. But it is to say that government restraints on commercial speech must be carefully circumscribed and extremely limited in order to prevent the suppression of truthful information. Now, there clearly are occasions when government can prevent injury faster than market forces can. Newspapers in our country can be held liable -- at least in theory -- for publishing maliciously false information, and businesses can be liable for frauds they perpetrate on consumers. Commercial con artists, like common criminals, operate outside the constraints of reputation, debate, and evaluation that check behavior. They are in fact parasites on the good reputation of the general business community.

Of course I can identify other situations, not necessarily involving fraud, where I will acknowledge a proper role for government regulation of commercial speech. In some cases, consumers cannot easily evaluate the veracity of important claims made for a product. If an advertiser misrepresents the amount of pollution its air filter will remove, or the amount of energy its insulation will conserve, or the amount of protection its motor oil will provide, the injury it inflicts on consumers can be substantial before the market exposes the deception. Nonetheless, the powerful incentives that favor truth and punish deception in free markets -- if they are allowed to work -- will keep such examples to a minimum.

I think the great danger in government regulation of any market -- the market for ideas or for goods -- is that power invites abuse. This is nowhere more evident than in the politics of consumer protection. The temptation to abuse power is often abetted by the efforts of consumer advocacy groups that refuse to believe -- or accept -- that consumers' values and tastes may differ from their own. In the United States these groups have often demanded that the government restrict the flow of information in order to alter the attitudes, behavior, and purchasing decisions of the consumers. This strikes me as a dangerous assault on our freedom, and on our economic welfare.

Consumer groups have advocated bans on the advertising of tobacco products and alcoholic beverages --proposals justified to promote public health. The question arises whether something about cigarettes or alcohol, or any product that may pose health risks, transforms normally beneficial competitive forces into something insidious, so that an advertising ban would for once be a good thing.

I am reminded of a conversation we recently had in Washington with a consumer reporter from Poland. We asked her whether her country allowed advertising of cigarettes. No, she answered, the Polish do not need cigarette advertising -- because everybody there smokes already. Meanwhile, U.S. consumers are quitting cigarettes faster than ever, despite the industry's expenditures of two billion dollars annually to advertise the product. We must always remember, as I said earlier, that the market does not have to work perfectly to work better than government. Before acting, I think government regulators must weigh the performance of the market against the promise of regulation.

Proposals to ban truthful advertising rest on an alien notion that no consumer would voluntarily choose to smoke absent some hidden persuader, which is presumed to be advertising. This notion, of course, requires government, acting as Big Brother, to shield consumers from commercial appeals that it believes they will not have the good sense or ability to resist. Totalitarian regimes may treat their people in this fashion. Free societies should not.

Once we embark on such an approach with particular products, are there are any principled limits? I fear the pathway to censorship may be a slippery slope from cigarettes and alcohol to calories and cholesterol. The government is continually urged to burden the truthful advertising of an array of products in an effort to alter the purchasing decisions of Americans. Last month in the New York Times, an editorial decried a U.S. Food and Drug Administration proposal to permit truthful substantiated health claims on the labels of food products. The Times instead wants all health claims for food products pre-screened by the government, in order to ensure that consumers are not confused, and to ensure that claims focus only on what the government determines are "major problems."[20]

Once again, we see the disparate treatment accorded commercial speech. Imagine, if you can, the Times' reaction to a proposal that its news and editorials be cleared by the government before being printed -- in order to avoid confusing readers, of course. But if American consumers are incapable of processing truthful information about the foods they eat, how can the Times trust them to think through the bewildering array of information presented each day on the pages of newspapers? I would note that the Times is subject to a far more lenient standard of truth and accuracy.

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[20] "The Snake Oil Diet," New York Times, p. A-18, August 10, 1987.

I can see by glancing at the Advertising Association's annual report that regulators in this country too are not free from the inexorable pressures to regulate any and all aspects of commercial speech for an array of coercive purposes. The choice between keeping information freely available to consumers and suppressing information "for the public good" is the choice between consumer sovereignty and censorship.

This returns us to the original question, "Who should regulate advertising?" My answer is that in a free society, the primary regulator must always be the consumer, through his participation in the marketplace. Beyond being the most efficient method, only this approach is consistent with our shared heritage of political freedom and economic liberty. Government's role should be to preserve the powerful economic mechanisms that compel business to satisfy consumer choice by providing information. Government should rid the marketplace of misleading claims that injure consumers but only when it can do so more quickly than the market. Government should also work to end unfair and anticompetitive restrictions on the ability of firms to advertise their products truthfully.

I was accused once of having too skeptical a view of the value of government regulators. But my judgment is that only those who constantly question the role and the performance of regulators should be regulators. Only those who have decent respect for the disciplining effect of the free market should be given the power to interfere with that market. I believe the invisible hand of free competition is, in the end, the consumer's surest protection in the market place. And I will say again in closing -- and this is the third time I've made the point -- that the market doesn't have to work perfectly to work better than government.