

# Chapter 10

## Consumer Law and Paternalism: a Framework for Policy Decision-making

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### 10.1 Introduction

One of the most difficult challenges for New Zealand consumer policy-makers is deciding when it is permissible to intervene in the marketplace in order to protect consumers from themselves. These interventions are commonly labelled as a form of paternalism. The word “paternalism” is often avoided by policy-makers for fear of critical feedback about a policy initiative being an “infringement of liberty” or an example of the “nanny state”. Yet many of New Zealand’s current consumer laws are paternalistic in nature and generally supported by the community. For example, age restrictions on the sale of tobacco and alcohol, and prohibitions on the sale of heroin and automobile safety regulations are paternalistic measures that are not overly controversial.

In general terms, a consumer law will be categorised as “paternalistic” in this chapter if it intervenes in the market with the objective of changing consumer behaviour in order to lessen consumer detriment.<sup>1</sup> Consumer behaviour such as eating unhealthy foods, gambling, smoking tobacco, not saving for retirement, taking on high levels of debt<sup>2</sup> and engaging in dangerous adventure sports are all areas of behaviour which require policy-makers to consider the appropriateness of paternalistic consumer regulation designed to

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<sup>1</sup> This is a general definition. Part 3 examines the difficulties in giving a precise definition of legal paternalism.

<sup>2</sup> See Graeme Austin “The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions” in this volume (ch 11).

assist consumers to make better choices. Is this kind of regulation ever justifiable? Under what particular circumstances might paternalistic consumer regulation be legitimate? What limits should there be on paternalistic intervention, and how should policy-makers decide what kind of intervention is going to be most effective in any given situation? This project examines the issues that policy-makers must consider when attempting to answer these questions.

The overall objective of the project is to establish a framework to guide the policy-making process and inform the debate about the appropriateness of paternalism in New Zealand consumer law.<sup>3</sup> This chapter represents stage one of the project. It identifies the relevant issues and provides necessary background information. The chapter is divided into the following parts: Part 2 examines how the concept of “consumer law” is used in this project. Part 3 examines the question of how to determine whether a legal intervention is paternalistic. It uses current New Zealand consumer laws as examples and discusses the concepts of soft and hard paternalism. Part 4 identifies areas where paternalism might feature in the future of New Zealand consumer law. In Part 5 the chapter turns to a consideration of the various legal and philosophical theories on the legitimacy of legal paternalism. Part 6 examines the extent to which a cost-benefit analysis can inform the debate about paternalism. Finally, Part 7 of the chapter concludes with a summary of the anticipated goals for the next stage of the project.

## 10.2 What is consumer law?

The precise boundaries of consumer law are not easily defined. This project, however, is not concerned with any common law principles that offer protection to consumers. It uses the term consumer law broadly as being any regulatory measure, excluding competition regulation,<sup>4</sup> which has the prime objective of protecting consumers of goods or services. This raises the question of when someone should be considered a consumer.

There is no generally agreed definition of the term “consumer” in New Zealand law. Different statutes give varying definitions of the term, although all the definitions focus on whether the product is purchased for personal use rather than business use. The Credit Contracts and Consumer

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<sup>3</sup> The OECD (Organisation for Economic Co-operation and Development) has produced several publications that examine the issue of regulatory reform in general terms. See for example Organisation for Economic Co-operation and Development *Report on Regulatory Reform: Synthesis Report* (Organisation for Economic Co-operation and Development, Paris, 1997); and Organisation for Economic Co-operation and Development *The Consumer Policy Toolkit* (Organisation for Economic Co-operation and Development, Paris, 2010). These papers do not specifically address the issue of paternalism in policy-making.

<sup>4</sup> For a discussion of this topic see Paul Scott “Competition Law and Policy” in this volume (ch 3).

Finance Act 2003 defines “consumer” by reference to the *actual* purpose for which the credit is purchased, whereas the Consumer Guarantees Act 1993 refers to the uses for which the product is *ordinarily* purchased.<sup>5</sup> The Fair Trading Act 1986, on the other hand, while primarily designed to protect consumers, does not contain a “consumer” limitation and commercial entities therefore benefit from its protections.

It is unnecessary for this project to provide a precise definition of “consumer”. The important point is that the project is concerned with examining the legitimacy of paternalistic intervention in consumer sale contracts. It does not examine legal paternalism in areas that do not involve buying and selling. For example, laws that allow medical treatment to be given without consent, prevent homosexual marriage, or that make it illegal for cousins to marry each other, could all be seen as paternalistic laws, but are not the subject of this project.

The most significant pieces of New Zealand consumer protection legislation are the Fair Trading Act 1986, the Consumer Guarantees Act 1993 and the Credit Contracts and Consumer Finance Act 2003.<sup>6</sup> A wide variety of other regulatory measures can also be viewed as types of consumer protection regulation. For example, the prohibition of surrogacy contracts, the ban on the sale of human organs, the imposition of tobacco taxes, the regulation of the sale of medicines and the regulation of various professional service occupations can all be seen as consumer protection measures.<sup>7</sup> A

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<sup>5</sup> See the Credit Contracts and Consumer Finance Act 2003, s 11(1)(a)–(b), where a “consumer credit contract” is limited to credit contracts where the debtor must be a natural person who enters the contract primarily for personal, domestic or household purposes. The Act is largely aimed at protecting consumers; however, the provisions dealing with oppressive credit contracts extend to all credit contracts (see s 117). The Consumer Guarantees Act 1993 is also principally aimed at protecting consumers. It does, however, protect those businesses that are purchasing goods or services of a kind ordinarily supplied for personal use when the guarantees under the Act have not been contracted out of under s 43 and the business is not using the goods or services for one of the excluded purposes (see s 2 definition of consumer). The excluded purposes are resupply in trade, consumption in the course of manufacture and, in the case of goods, repairing or treating in trade other goods or fixtures on land.

<sup>6</sup> See discussion in Graeme Austin “The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions” in this volume (ch 11).

<sup>7</sup> Other consumer statutes include the Door to Door Sales Act 1967; the Layby Sales Act 1971; and the Unsolicited Goods and Services Act 1975. The sales of medicines are regulated by the Medicines Act 1981. There are also various industry-specific Ombudsman schemes and Codes of Practice. For example, “Electricity and Gas Complaints Commissioner” (2011) Electricity and Gas Complaints Commission [www.egcomplaints.co.nz](http://www.egcomplaints.co.nz) (last accessed 8 August 2011); “Advertising Standards Authority Codes of Practice” (2011) Advertising Standards Authority [www.asa.co.nz/pdfs/ASA\\_Codes.pdf](http://www.asa.co.nz/pdfs/ASA_Codes.pdf) (last accessed 8 August 2011); “NZMA Code of Ethics” (2008) New Zealand Medical Association [www.nzma.org.nz/sites/all/files/CodeOfEthics.pdf](http://www.nzma.org.nz/sites/all/files/CodeOfEthics.pdf) (last accessed 8 August 2011); “Banking Ombudsman Scheme” (2011) The Office of the Banking Ombudsman [www.bankomb.org.nz](http://www.bankomb.org.nz) (last accessed 8 August 2011); “Insurance and Savings

broad definition of “consumer law” recognises that New Zealand consumer laws are not developed solely by the Ministry of Consumer Affairs.

## 10.3 What is paternalism?

In order to embark on a discussion about paternalism and consumer law it is necessary to define what is meant by the term “paternalism”. There is no universal agreement as to what the essential characteristics of paternalism are.<sup>8</sup> For the purposes of this project, paternalism will be viewed in broad terms as any law that has the goal of re-shaping consumer behaviour in order to increase consumer welfare. A paternalistic intervention either encourages or coerces the consumer to make choices that will promote some benefit or avert some harm to the consumer. The intervention does this by limiting the consumer’s liberty or by making it more costly for the consumer to engage in the behaviour that is seen as detrimental.

The restriction of liberty can range from extreme to minor. It is important for policy-makers to recognise where on this spectrum a proposed paternalistic policy lies. This is because the various factors which might justify a minor form of paternalism are different from those needed to support a more severe restriction of liberty. An example of an intervention at the extreme end of the scale is a complete ban on the sale of a product. Unless the consumer is prepared to take on the costs of making the product themselves or sourcing the product on the black-market, he or she is effectively prevented from obtaining that product. This form of paternalism, where a consumer’s liberty is severely restricted, is sometimes called hard paternalism or strong paternalism.<sup>9</sup> The New York City ban on trans-fats in restaurants and bakeries is an example of hard paternalism.<sup>10</sup> Prohibiting the sale of recreational drugs is also an example of hard paternalism. These measures prevent consumers

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Ombudsman” (2011) Insurance and Savings Ombudsman [www.iombudsman.org.nz/iso-scheme](http://www.iombudsman.org.nz/iso-scheme) (last accessed 8 August 2011). In addition, mechanisms such as the Disputes Tribunals have been introduced in order to increase access to justice: see “Disputes Tribunal” (2011) Ministry of Justice [www.justice.govt.nz/tribunals/disputes-tribunal](http://www.justice.govt.nz/tribunals/disputes-tribunal) (last accessed 8 August 2011); and Disputes Tribunals Act 1988.

<sup>8</sup> Several scholars have grappled with the question of how to define paternalism and have arrived at different conclusions. See, for example, Thaddeus Pope “Counting the Dragon’s Teeth and Claws: The Definition of Hard Paternalism” (2004) 20 Ga St U L Rev 659; Gerald Dworkin “Paternalism” in Robert Audi (ed) *The Cambridge Dictionary of Philosophy* (2nd ed, Cambridge University Press, New York, 1995); Peter Suber “Paternalism” in Christopher B Gray (ed) *Philosophy of Law: An Encyclopedia* (Garland Publishing Co, London, 1999).

<sup>9</sup> Some scholars also use the term “hard paternalism” to refer to interventions that override voluntary decisions and “soft paternalism” to mean interventions that restrict behaviour that is not substantially voluntary. See, for example, Thaddeus Pope “Is Public Health Paternalism Really Never Justified? A response to Joel Feinberg” (2005) 30 Okla City U L Rev 121–207 at 122. This is not how the terms are used in this article.

<sup>10</sup> § 81.01 New York City Health Code.

from making decisions that potentially give short-term benefits because the government considers these benefits to be outweighed by a longer-term decrease in consumer welfare.

Other examples of hard paternalism include product safety bans under the Fair Trading Act 1986, such as the ban on flammable nightwear and the ban on the sale of toys containing excess levels of lead.<sup>11</sup> The prohibition of the sale of medicines that have not passed strict safety standards under the Medicines Act 1981 is also a form of hard paternalism.<sup>12</sup> Examples of hard paternalism that have not yet been adopted by New Zealand include the capping of interest rates for loans and prohibiting unfair terms in consumer standard form contracts.<sup>13</sup> All of these examples might seem unobjectionable from a consumer's point of view. The consumer is, after all, being protected from unsafe nightwear, unsafe medicines, high interest rates and unfair terms. However, the interventions are hard paternalism because they remove or severely restrict the consumer's freedom of choice. The consumer cannot agree to buy potentially unsafe nightwear at a cheaper price. He or she cannot try out a potentially life-saving drug until it has passed strict safety standards. It is not possible for the consumer to negotiate a cheaper price by accepting terms that are considered by the government to be "unfair". In the case of capped interest rates the intervention might mean that consumers who are high-risk debtors no longer have the option of obtaining credit because there are no creditors willing to lend them money if they are unable to charge high interest rates.

Two more examples of interventions that arguably have an element of strong paternalism are the Consumer Guarantees Act 1993 and the cooling-off period offered under the Door to Door Sales Act 1967.<sup>14</sup> A cooling-off period can be viewed as paternalistic because it aims to prevent consumers from making a contractually binding irrational choice in the heat of the moment. The consumer is coerced into making an agreement that includes a cooling-off period during which the consumer can change his or her mind about the purchase. There is no scope for the consumer to opt-out of the cooling-off period in exchange for a lower price. The Consumer Guarantees Act 1993 can

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<sup>11</sup> Product Safety Standard (Children's Nightwear and Limited Daywear Having Reduced Fire Hazard) Regulations 2008. These regulations are issued under the Fair Trading Act 1986, s 29. Unsafe Goods (Lead in Children's Toys) Indefinite Prohibition Notice 2009 issued under the Fair Trading Act 1986, s31.

<sup>12</sup> See discussion in John Yeabsley and Chris Nixon "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans Tasman Integration" in this volume (ch 17).

<sup>13</sup> For a detailed discussion of this issue see Graeme Austin "The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions" in this volume (ch 11).

<sup>14</sup> The Door to Door Sales Act 1967, s 7 allows consumers a seven-day period within which to cancel the door to door sales contract. Section 12 of the Act prohibits contracting out. Note that this will change if the Consumer Law Reform Bill is enacted – the provision will then be incorporated into the Fair Trading Act: Consumer Law Reform Bill 2011 (287-1).

also be viewed as incorporating elements of hard paternalism as it forces consumers to agree to rights of redress for faulty products.<sup>15</sup> Unless the consumer is purchasing for business purposes, he or she does not have the option of negotiating a lower price for a contract with no statutory guarantees as to quality.<sup>16</sup> The limitations on behaviour in these two examples are unlikely to be objected to by most consumers and are therefore easier to justify than interventions that more directly negate consumers' preferences at the time of purchase. Nevertheless, the consumer has no ability to opt out of the agreement that the government stipulates will be best for them. The fact that most consumers will want to be protected in this way might make the paternalism more easily justifiable, but it does not necessarily take it out of the category of hard paternalism. The other reason that these examples of paternalism might be relatively easy to justify is that they can also be rationalised by non-paternalistic goals, such as preventing suppliers from harming consumers by preying on their vulnerability.

The preceding paragraphs have given examples of hard paternalism. These forms of paternalism severely restrict consumers' liberty. At the other end of the spectrum are interventions which encourage, rather than coerce, the consumer to make "better" choices. These interventions operate by imposing more minor costs on consumers who engage in the behaviour that the policy-maker has identified as being detrimental. Such interventions are sometimes called "soft paternalism" or "weak paternalism". They "nudge" consumers rather than force them into making "better" choices.<sup>17</sup> The KiwiSaver scheme is an example of soft paternalism. Joining the scheme is voluntary, but workers are automatically enrolled when they start a new job and then have six weeks to opt out.<sup>18</sup> The Gambling Act 2003 also establishes a soft form of paternalism by allowing individuals who identify themselves as problem gamblers to ban themselves from a casino.<sup>19</sup> Other New Zealand examples of soft forms of paternalism include interventions that prohibit supermarkets from selling spirits, prohibit tobacco advertising, or impose a tax on cigarettes.<sup>20</sup> Removing

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<sup>15</sup> Part 1 of the Consumer Guarantees Act 1993 provides a set of statutory guarantees to consumers who buy goods or services that are ordinarily bought for personal use. The guarantees cover such matters as acceptable quality, fitness for purpose and compliance with description.

<sup>16</sup> Consumer Guarantees Act 1993, s 43. Contracting out of the Act is prohibited except where the consumer purchases the goods or services for business purposes.

<sup>17</sup> Richard Thaler and Cass Sunstein *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Penguin Books, New York, 2009). Thaler and Sunstein argue that soft paternalism is a legitimate form of government intervention. Their theories are discussed below at [10.5].

<sup>18</sup> KiwiSaver Act 2006, ss 9 and 16. See also [www.kiwisaver.govt.nz/new](http://www.kiwisaver.govt.nz/new) (last accessed 8 August 2011).

<sup>19</sup> Gambling Act 2003, s 310.

<sup>20</sup> New Zealand Supermarkets are only allowed to sell beer, wine or mead: Sale of Liquor Act 1989, s 37(3). The ban on tobacco advertising is provided for in the Smoke-free

the GST from the sale of fruit and vegetables would also be a form of soft paternalism. In all these examples consumers are encouraged to make a “better” decision, but still largely retain the freedom to make their own choices.

Although advocates of soft paternalism argue that such policies completely preserve freedom of choice, this is not entirely accurate.<sup>21</sup> Soft paternalistic interventions work by deliberately imposing an obstacle, albeit a minor one, to the consumer choosing the “detrimental behaviour”. They can cause a product to have a higher price or be less easily available, or they might make it harder to receive information about the product or require the consumer to take the time and effort to opt out of the government’s preferred option. Unlike hard paternalism, however, these interventions do not attempt to completely remove consumers’ ability to choose. There is a continuum between soft paternalism and hard paternalism. It is not a case of two separate categories of paternalism but rather a case of the “nudge” becoming gradually harder until it becomes more of a “shove”. The prohibition on the sale of tobacco to under 18-year-olds in s 30 of the Smoke-free Environments Act 1990 is an example of an intervention that lies somewhere in the middle of the continuum. On the one hand the intervention has elements of hard paternalism because it involves a ban. On the other hand the intervention is soft because it does not make it illegal for an 18-year-old to smoke cigarettes.

Some consumer laws do not have the goal of re-shaping consumer behaviour in order to protect consumers from themselves. These laws are not paternalistic. For example, laws that aim to ensure consumers make voluntary and fully informed purchasing decisions should not be categorised as paternalistic. The prohibitions on misleading conduct and misrepresentations under the Fair Trading Act 1986, and the disclosure requirements under the Credit Contracts and Consumer Finance Act 2003, are both examples of non-paternalistic consumer laws. The goal of these interventions is to improve consumer information in order to allow consumers to more effectively choose in line with their own preferences. The disclosure requirements for credit contracts also aim to make it easier for consumers to compare alternative credit options so they can effectively choose which one they prefer. In neither case is the intention to guide or force consumers to make choices that the government perceives as being in the consumers’ best interests.

In assessing whether a particular intervention is paternalistic, it is crucial to assess the goal of the intervention. This point is not always fully appreciated in the academic debate about whether paternalism should encompass laws that improve consumer information. Some scholars include ignorance or lack of

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Environments Act 1990, s 2. See [www.moh.govt.nz/moh.nsf/indexmh/tobacco-excise](http://www.moh.govt.nz/moh.nsf/indexmh/tobacco-excise) (last accessed 8 August 2011) for details of current tobacco tax rates.

<sup>21</sup> Richard Thaler and Cass Sunstein *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Penguin Books, New York, 2009) at 5: “we strive to design policies that maintain or increase freedom of choice”.

adequate information as a justification for paternalism.<sup>22</sup> Others suggest that paternalism does not include interventions that correct imperfect or insufficient information.<sup>23</sup> A more theoretically sound approach, however, recognises that whether a particular regulation concerning consumer information can be characterised as paternalistic will depend on the goal of that regulation. The above discussion concluded that the consumer information requirements of the Fair Trading Act are not paternalistic because they do not aim to steer consumers towards behaviour that the government considers is in consumers' best interests. On the other hand, if a policy-maker decides to require shocking pictures of disease on cigarette packets this information requirement could be classified as paternalistic. The aim is not simply to make sure that consumers are fully informed about the dangers of smoking so that they can make up their own minds about whether the benefits of smoking outweigh the potential hazards. The aim of graphic photographs is to encourage consumers to make the decision that the policy-maker views as in the consumers' best interests. The success of the regulation will be judged by the size of the reduction in tobacco consumption.

The issue of assessing whether a particular law is paternalistic can be complicated by the fact that some laws have both paternalistic and non-paternalistic goals. For example, the law that bans the sale of cigarettes to under 18-year-olds has the paternalistic goal of discouraging under 18-year-old consumers from harming themselves. It might also have the non-paternalistic goal of reducing the costs imposed on the health system by smoking-related illnesses. This secondary goal is non-paternalistic because it aims to prevent consumers from harming other people (taxpayers) rather than preventing the consumers from harming themselves. The two goals run in tandem. It might be tempting to avoid the charge of paternalism by claiming that the non-paternalistic goal is the only goal of such regulation. However, this claim is hard to sustain given that policy-makers would probably still impose the restriction if tobacco consumption always caused a quick death and therefore imposed no costs on the health system. It is preferable in cases such as this to acknowledge that the regulation has an element of paternalism. The existence of the additional non-paternalistic goal might strengthen the justifications for the regulation; it should not, however, mask the reality of the paternalistic component of the regulation.

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<sup>22</sup> See, for example, John Kleinig *Paternalism* (Manchester University Press, Manchester, 1983) at 48; Joel Feinberg *Harm to Self* (Oxford University Press, Oxford, 1986) at 12.

<sup>23</sup> See, for example, Bill New "Paternalism and Public Policy" (1999) 15 *Economics and Philosophy* 63 at 68–71. New gives the example of people swimming in an area of the coast which they do not realise is subject to dangerous tides. He argues that statutory warnings about tides would not be paternalistic because they simply remedy an information deficiency. He puts nutritional food information in the same category.



## 10.4 How might paternalism feature in the future of New Zealand consumer law?

New Zealand's consumer protection laws contain a mixture of both paternalistic measures, designed to protect consumers from themselves, and non-paternalistic measures, designed to enhance market efficiency or punish supplier misconduct. Policy-makers in the future will face the challenge of deciding the degree to which consumers need any further protection in order to shield them from making poor decisions, despite the fact that they are fully informed and are acting voluntarily.

The current New Zealand government has recently conducted a review of most current consumer statutes.<sup>24</sup> The review has culminated in the Consumer Law Reform Bill 2011. The Bill is not focussed on issues of paternalism. It deals largely with reorganising and modernising existing laws. It incorporates four narrowly focused statutes within the Fair Trading Act 1986.<sup>25</sup> In addition, it introduces some substantive and non-paternalistic updates such as extending the Disputes Tribunal jurisdiction to cover complaints about misleading conduct and requiring auctioneers to be registered.<sup>26</sup>

The Bill does, however, include three measures that are to some extent paternalistic. First, the Bill, if enacted, will extend the Consumer Guarantees Act 1993 to cover new goods sold by traders in traditional and online auctions.<sup>27</sup> This change arguably involves a degree of strong paternalism, because it forces the consumer to purchase the auctioned goods with statutory guarantees rather than take their chances and obtain the product at a possibly cheaper price with no guarantees as to quality. The update makes sense, however, because it is difficult to rationalise providing a lower level of consumer protection simply because the sale occurs in an online auction or traditional auction rather than in a shop.

The second paternalistic provision included in the Consumer Law Reform Bill is the requirement for a five-day cooling-off period for consumers who

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<sup>24</sup> *Consumer Law Reform: A Discussion Paper* (Ministry of Consumer Affairs, 2010) at [2]. The review covers the Fair Trading Act 1986, the Consumer Guarantees Act 1993, the Weights and Measures Act 1987, the Carriage of Goods Act 1979, the Sale of Goods Act 1908, the Secondhand Dealers and Pawnbrokers Act 2004, the Auctioneers Act 1928, the Door to Door Sales Act 1967, the Layby Sales Act 1971, and the Unsolicited Goods and Services Act 1975.

<sup>25</sup> The four statutes that will be repealed and incorporated into the amended Fair Trading Act 1986 are the Auctioneers Act 1928, the Door to Door Sales Act 1967, the Layby Sales Act 1971 and the Unsolicited Goods and Services Act 1975.

<sup>26</sup> Consumer Law Reform Bill 2011 (287-1). Clause 21 extends the jurisdiction of the Disputes Tribunal to cover claims for misleading conduct under s 9 of the Fair Trading Act 1986. Clause 66 requires auctioneers to be registered and cl 67 disqualifies certain people from registration.

<sup>27</sup> Consumer Law Reform Bill 2011 (287-1), cls 39 and 40.

purchase extended warranties.<sup>28</sup> Selling extended warranties is now commonplace in New Zealand. The value of some of these warranties is questionable given that the consumer already has statutory guarantees under the Consumer Guarantees Act 1993. Implementing a cooling-off period for the purchase of these warranties is a form of paternalism because it forces consumers to accept a cooling-off period for their own good. The consumer is unable to negotiate a less expensive extended warranty with no cooling-off period.

The third paternalistic provision that forms part of the Consumer Law Reform Bill is an amendment to the Fair Trading Act 1986 which would allow the Minister of Consumer Affairs to declare goods to be unsafe if the Minister considers that a reasonably foreseeable use or misuse of the goods will, or may, cause injury to any person.<sup>29</sup> The Minister may then prohibit the supply of these goods. The new provision is an extension of the current rule which allows only a consideration of the “ordinary use” of the goods rather than a “reasonably foreseeable use or misuse” of the goods.<sup>30</sup> The provision covers goods that are considered to have the potential to injure “any person”, not just people other than the consumer. It therefore covers situations where there is a potential for the good to injure the consumer who has acquired the good. Consequently the provision has an element of paternalism because it allows the government to severely restrict consumers’ choice by banning a product in order to protect consumers from themselves. Consumers would not be able to choose to buy the potentially unsafe product and use it in a safe manner or assume the risks of using it in an unsafe manner.

The consumer law review included one further substantive paternalistic proposal that has not been included in the Bill. This is the proposal to follow the United Kingdom and Australia by introducing a prohibition on unfair terms in standard form consumer contracts.<sup>31</sup> The proposal can be characterised as paternalistic because it has the goal of protecting consumers from agreeing to contractual terms that are determined by a third party (either a judge or government body) to be unfair. The government subsequently chose not to proceed with the unfair terms prohibition at this time but is planning to monitor the Australian experience over the next few years.<sup>32</sup>

As markets and cultures change and technology advances, new consumer problems will arise that will require policy-makers to grapple with the issue of the legitimacy of paternalistic regulation. In addition, further developments in

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<sup>28</sup> Consumer Law Reform Bill 2011 (287-1), cl 36U. The United Kingdom also provide for a cooling-off period for extended warranties. See The Supply of Extended Warranties on Domestic Goods Order 2005 (UK) under the Fair Trading Act 1973 (UK).

<sup>29</sup> Consumer Law Reform Bill 2011 (287-1), cl 14.

<sup>30</sup> Fair Trading Act 1986, s 31(3).

<sup>31</sup> *Consumer Law Reform: A Discussion Paper* (Ministry of Consumer Affairs, 2010) at [6.2.1].

<sup>32</sup> Ministry of Consumer Affairs *Office of the Minister to Cabinet Economic Growth and Infrastructure Committee* (MED 1119797, Ministry of Consumer Affairs, 2010).

behavioural economics are likely to continue to provide insights into consumer behaviour that may prompt policy-makers to consider areas where paternalistic intervention to improve consumer welfare might be justifiable.<sup>33</sup> Below is a list of some emerging issues for New Zealand consumers that may present such challenges for future policy-makers:

- New Zealand is the third most obese country in the developed world after the United States and Mexico.<sup>34</sup> Policy-makers are likely to need to consider the legitimacy of developing paternalistic interventions to protect New Zealand consumers from the negative health effects of obesity.<sup>35</sup>
- The current government is committed to making New Zealand smoke-free by 2025.<sup>36</sup> Attempting to achieve this goal will inevitably raise questions as to the degree to which paternalistic intervention is justifiable. A recent government inquiry into the tobacco industry has recommended paternalistic interventions such as banning cigarette vending machines, prohibiting shop displays of tobacco, implementing plain packaging and reducing duty-free allowances.<sup>37</sup>
- New Zealand insurance law has been described as “singularly bereft of legislative protection for consumers”.<sup>38</sup> The sale by insurance companies of “inappropriate” annuities to senior citizens is one area where a paternalistic policy might be considered appropriate. New York State introduced regulations in 2011 that prohibit insurance companies from issuing an annuity until they have reviewed the consumer’s financial situation and determined that there is a reasonable basis to believe the annuity is suitable and beneficial to the consumer.<sup>39</sup>

<sup>33</sup> Paragraph [10.5] discusses the findings of behavioural economics and their impact on paternalistic policy decision-making.

<sup>34</sup> “Health Care Data” (2010) Organisation for Economic Cooperation and Development stats.oecd.org/Index.aspx (last accessed 8 August 2011).

<sup>35</sup> For the latest statistics see *Obesity in New Zealand* (Ministry of Health 2011). See also Boyd Swinburn “Obesity Prevention: the role of Policies, Laws and Regulations” (2008) 5 *Australia and New Zealand Health Policy* 12; Richard Epstein “What (not) to Do about Obesity: A Moderate Aristotelian Answer” (2005) 93 *Geo LJ* 1361 at 1386.

<sup>36</sup> See the government response to the report of the Māori Affairs Committee on its *Inquiry into the tobacco industry in Aotearoa and the consequences of tobacco use for Māori (Final Response)* (2011) New Zealand Parliament www.parliament.nz/NR/rdonlyres/3AAA09C2-AD68-4253-85AE-BCE90128C1A0/188520/DBHOH\_PAP\_21175\_GovernmentFinalResponsetoReportoft.pdf (last accessed 8 August 2011).

<sup>37</sup> Māori Affairs Committee *Inquiry into the tobacco industry in Aotearoa and the consequences of tobacco use for Māori* (l.10A Māori Affairs Committee 2010). The Smoke-free Environments (Controls and Enforcement) Amendment Bill 2010 (267-2), if enacted, would remove all tobacco displays in shops.

<sup>38</sup> Virginia Grainer, Bob Dugan and Bill Bevan *Consumer Law* (LexisNexis, Wellington, 2010) at 266.

<sup>39</sup> “A Consumer Guide for Annuity Products in New York” (2011) New York State Insurance Department www.ins.state.ny.us/consumer/life/cli\_annu\_guide.pdf (last accessed 8 August 2011). Copies of the regulations are available at: Insurance Department of the

- The sequencing of the human genome has resulted in private labs in the United States offering consumers a genetic test to determine their predisposition to minor and serious medical conditions. These services are marketed, usually via the internet, direct to consumers without the mediation of a doctor or geneticist. In the future, New Zealand consumers might also face the direct marketing of genetic information. This could prompt future policy-makers to consider whether paternalistic laws are needed to protect consumers from the potential detriment caused by unrestricted ability to purchase this information. For example, consumers could be required to receive genetic counselling or medical advice as a condition of purchase.
- The regulation of natural health products is an area where the level of paternalistic consumer protection is one of the core issues.<sup>40</sup> The law in this area is currently under review.<sup>41</sup>
- Decisions about the legitimacy of paternalism are also relevant to developing appropriate safety regulation for the provision of various consumer services which are inherently risky. For example, the regulation of the adventure tourism industry inevitably requires policy-makers to balance freedom with paternalism.<sup>42</sup> Paternalistic measures in respect of safety regulation might be more justifiable in New Zealand than in other countries because our accident compensation scheme means that consumers are in the unique position of being unable to sue for personal injury by accident.<sup>43</sup> This arguably reduces the incentive for service providers to ensure safety standards are set at a high level.
- Research has shown that many New Zealand consumers make seemingly poor choices about how much to borrow and on what terms.<sup>44</sup> Policy-makers might consider the legitimacy and likely effectiveness of paternalistic interventions such as interest rate caps, cooling-off periods and placing responsible lending requirements on suppliers of credit.<sup>45</sup>

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State of New York "Suitability in Annuity Transactions" 11 NYCRR 224 at reg 187 and 299. See [www.ins.state.ny.us/r\\_emergency/pdf/re187t.pdf](http://www.ins.state.ny.us/r_emergency/pdf/re187t.pdf) (last accessed 8 August 2011).

<sup>40</sup> See Chris Nixon and John Yeabsley "Australia New Zealand Therapeutic Products Authority: Lessons from the Deep End of Trans Tasman Integration" in this volume (ch 17).

<sup>41</sup> Ministry of Health *Consultation Paper: The Development of a Natural Health Products Bill* (Ministry of Health 2010).

<sup>42</sup> Regulation of the adventure tourism industry is currently under review. See Department of Labour *Review of risk management and safety in the adventure and outdoor commercial sectors in New Zealand 2009/10 – Final Report* (Department of Labour 2010). The report is available online at: [www.dol.govt.nz/consultation/adventure-tourism/final-report/](http://www.dol.govt.nz/consultation/adventure-tourism/final-report/) (last accessed 8 August 2011).

<sup>43</sup> Accident Compensation Act 2001.

<sup>44</sup> Jaime Legge and Anne Heynes *Beyond Reasonable Debt: A Background Report on the Indebtedness of New Zealand Families* (RR 8/08, prepared jointly by the Families Commission and Retirement Commission 2008); Ministry of Consumer Affairs *Review of the Operation of the Credit Contracts and Consumer Finance Act 2003* (2009).

<sup>45</sup> Australia has introduced responsible lending provisions which prohibit the lender from providing credit products and services that are unsuitable for the consumer's needs and

- There are other diverse areas involving issues of paternalism that are either currently being debated or might be the subject of future consumer policy debate. These include the reform of alcohol laws,<sup>46</sup> the regulation of contracts for the sale of products such as herbal recreational drugs, tooth whitening products, genetically modified foods, and human organs, the regulation of surrogacy contracts and improvements or alternatives to the KiwiSaver scheme.

## 10.5 The legitimacy of paternalistic consumer laws

This project does not attempt to give a definitive answer to the legitimacy of paternalism either generally or in respect of consumer law. The aim of the final stage of the project is to present a framework for decision-making so that policy-makers consider all the relevant issues and questions when deciding whether and why a particular paternalistic policy might be justifiable. This section of the chapter provides the necessary foundation for the development of this decision-making framework by examining the academic theories behind the different approaches to legal paternalism.

Views on paternalism are divergent and wide-ranging. It is essential for policy-makers of all political persuasions to understand these theories in order to improve their ability to provide clear and comprehensive justifications for enacting a paternalistic consumer law. Academic literature provides four main strands of thought on paternalism. There is traditional paternalism, anti-paternalism, libertarian paternalism and asymmetric paternalism. These theories will be explained in terms of how they are relevant to New Zealand consumer law.

### 10.5.1 *Traditional paternalism*

Traditional or “old” paternalists are happy to assume that there are times when governments know better than consumers what is in consumers’ best interests. They accept that in certain circumstances it is legitimate to coerce people for their own good. Until relatively recently, paternalism was not only widely accepted by society, it was also approved of by most philosophers. Plato, Aristotle and Thomas Aquinas all accepted that people should be

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that the consumer does not have the capacity to repay. See the National Consumer Credit Protection Act 2009 (Cth), ch 3. See also the discussion in Graeme Austin “The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions” in this volume (ch 11).

<sup>46</sup> See the Alcohol Reform Bill 2010. The Bill seeks to implement the Government’s response to the Law Commission’s 2010 report, *Alcohol in Our Lives: Curbing the Harm*.

protected, not only from others, but also from themselves.<sup>47</sup> More recent philosophers such as John Locke, and later, John Rawls, viewed some degree of paternalism as acceptable due to the social contract, in which human beings hand over some of their rights to the state in order to attain social order and receive protection.<sup>48</sup>

## 10.5.2 *Anti-paternalism*

In contrast to traditional paternalists, anti-paternalists believe that consumer behaviour is the best indicator of consumer preference and consumer welfare. They disapprove of the government intervening on the basis that it knows better than consumers what is in their best interests.<sup>49</sup> An anti-paternalist would argue, for example, that consumers of investment products should be left to make their own choices about whether and what to invest in without government influence. Similarly consumers should be left to make their own choices about what to eat, whether to smoke, what contractual terms to accept and what trade-offs between safety and price they are willing to accept. Anti-paternalism rests on the principle that infringing individual liberty should be avoided and that individuals are the best judge of what is in their own interests. It is closely aligned with classical contract theory which is based on principles of freedom of contract and sanctity of contract.<sup>50</sup> The free market is underpinned by the notion that people should be free to enter any bargain that suits them.<sup>51</sup> Once the bargain is struck our economic system is founded on the certainty that the deal will be binding and must be performed. Legal paternalism interferes with these principles. It attempts to influence the types of contract that consumers enter into, allows consumers to escape contractual obligations or imposes obligations on suppliers beyond those included in the contract.

As far back as the mid-1800s, John Stuart Mill argued against legal paternalism. He claimed that “[t]he only purpose for which power can

<sup>47</sup> Alan Ebenstein and William Ebenstein *Introduction to Political Thinkers* (Wadsworth Group, Belmont (CA), 2002).

<sup>48</sup> Pete Laslett "Introduction" in John Locke *Two Treatises of Government: a Critical Edition with an Introduction and Apparatus Criticus* (Cambridge University Press, Cambridge, 1960); John Rawls *A Theory of Justice* (Belknap Press of Harvard University Press, Cambridge, 1971).

<sup>49</sup> See, for example, Mario Rizzo and Douglas Whitman "The Knowledge Problem of New Paternalism" (2009) 4 BYU L Rev 905. See also Robert Nozick *Anarchy, State and Utopia* (Blackwell, Oxford, 1974). Nozick argues in favour of minimal State intervention and considers paternalistic laws to illegitimately restrict individual liberty.

<sup>50</sup> See *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462 at 465. See also Patrick S Atiyah *The Rise and Fall of Freedom of Contract* (Oxford University Press, Oxford, 1979); Jack Beatson and Daniel Friedmann, "From Classical to Modern Contract Law" in Jack Beatson and Daniel Friedmann (eds) *Good Faith and Fault in Contract Law* (Oxford University Press, Oxford, 1995).

<sup>51</sup> See Paul Scott "Competition Law and Policy" in this volume (ch 3).

rightfully be exercised over any member of a civilised community against his will is to prevent harm to others”<sup>52</sup> and that “[h]is own good either physical or moral is not a sufficient warrant. He cannot be rightfully compelled to do or forbear because it will be better for him to do so, because it will make him happier, because in the opinion of others, to do so would be wise or even right.”<sup>53</sup> Paternalistic consumer laws do just this; they prevent or discourage certain consumer behaviour for the consumers’ own good.

The anti-paternalist “harm principle” advocated by John Stuart Mill forms part of the Regulatory Standards Bill 2011.<sup>54</sup> The Bill aims to improve the quality of New Zealand regulation. It sets out constitutional “principles of responsible regulation”. Incompatibility with these principles is deemed acceptable only if it can be justified in a free and democratic society.<sup>55</sup> Clause 7(1)(b) declares that legislation should not diminish a person’s liberty or freedom of choice unless to do so is necessary in order to protect the liberty of others.<sup>56</sup> If the Bill is enacted, a paternalistic consumer regulation will be against the principles of good law-making.<sup>57</sup>

Neoclassical economic theorists firmly reject paternalism as a goal of consumer regulation. Their theory is rooted in the view that in most situations a free market will produce a better result than government regulation. It is based on the assumption that consumers and suppliers in a free market will make rational choices that are in line with their preferences.<sup>58</sup> Therefore, if a

<sup>52</sup> John Stuart Mill *On Liberty* (JW Parker, London, 1859) at ch 1.

<sup>53</sup> John Stuart Mill *On Liberty* (JW Parker, London, 1859) at ch 1.

<sup>54</sup> The Bill was previously called the Regulatory Responsibility Bill 2006 (71-1). It was recommended by the Regulatory Responsibility Task Force in 2009: see Regulatory Responsibility Taskforce *Report of the Regulatory Responsibility Taskforce* (Treasury 2009).

<sup>55</sup> Regulatory Standards Bill 2011 (277-1), cl 7(2). The Bill establishes three mechanisms to ensure that regulation adheres to these principles: certification of new laws, judicial declarations of incompatibility and a requirement that judicial interpretation prefers meanings that are compatible with the principles.

<sup>56</sup> See Petra Butler “Rights and Regulation”; and Dean Knight and Rayner Thwaites “Review and Appeal of Regulatory Decisions: The Tension between Supervision and Performance”, both in this volume (chs 9 and 8, respectively).

<sup>57</sup> The Bill has been condemned by academic commentators as imposing unduly restrictive and pro-market limitations on future Parliaments. See, for example, Richard Elkins “The Regulatory Responsibility Bill and the Constitution” (2010) 6(2) *Policy Quarterly* 9; Jane Kelsey “Regulatory Responsibility: Embedded Neoliberalism and its Contradictions” (2010) 6(2) *Policy Quarterly* 36; Geoff Bertram “Deregulatory Irresponsibility: Takings, Transfers and Transcendental Institutionalism” (2010) 6(2) *Policy Quarterly* 48.

<sup>58</sup> Richard Posner *Economic Analysis of Law* (7th ed, Aspen Publishers, Austin (Texas), 2007) at 17. He states that “rationality means little more to an economist than a disposition to choose, consciously or unconsciously an apt means to whatever ends the chooser happens to have”. In his most recent book Posner analyses the global financial crises. He argues that although people make decisions that are individually rational they can make collectively irrational financial decisions and this is what led to the collapse of the entire economy. See Richard Posner *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (Harvard University Press, Cambridge, 2009).

consumer is acting voluntarily and has sufficient information, the result of the exchange will increase the welfare of both the consumer and the supplier.<sup>59</sup> Consumers will purchase products that increase their well-being and suppliers will have an incentive to offer such products on the market.<sup>60</sup> This is the polar opposite of the assumption behind paternalistic intervention. Paternalism is based on the idea that there are times when consumers make choices that decrease their welfare.

The neoclassical economic approach accepts only two categories of circumstances which might justify legal intervention. These are situations where there is a consumer information deficit and situations where there is consumer involuntariness.<sup>61</sup> An imperfectly informed consumer is less able to make purchasing choices that are in line with maximising his or her welfare. Information defects therefore reduce the ability of the market to produce optimal results for consumers and the law can legitimately remedy these defects.<sup>62</sup> The provisions of the Fair Trading Act 1986 which prohibit misleading conduct and misrepresentations can be justified on this basis. The second category for which standard economic theory supports regulation is where the exchange is for one reason or another not voluntary. If a consumer is not acting voluntarily then it cannot be assumed that the transaction will be in his or her best interests. For example, in a private monopoly of essential services, consumers may have no real choices and thus government intervention might be justified.<sup>63</sup>

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<sup>59</sup> See Richard Epstein “The Neoclassical Economics of Consumer Contracts” (2007–2008) 92 *Minn L Rev* 803; Richard Posner *Economic Analysis of Law* (7th ed, Aspen Publishers, Austin (Texas), 2007). See also Ministry of Consumer Affairs *The Economic Context of the Ministry of Consumer Affairs* (1999). This Policy Paper emphasises the role of the law in removing impediments to voluntary and informed exchanges, especially by reducing transaction costs. Transactional costs include, for example, the costs to consumers of obtaining relevant information and the compliance costs to businesses of labelling laws.

<sup>60</sup> See Paul Scott “Competition Law and Policy” and Graeme Austin “The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions”, both in this volume (chs 3 and 11, respectively).

<sup>61</sup> Some neoclassical economists, such as Richard Epstein, argue for intervention on the very limited grounds of either gross information deficit or obvious involuntariness resulting from fraud or duress. See Richard Epstein “Unconscionability: A Critical Reappraisal” (1975) 18 *J L & Econ* 293. A broader neoclassical approach would accept consumer regulation may be needed in any case of imperfect information or impairment to voluntary decision-making. In respect of this latter category Richard Craswell refers to “imperfect consent” rather than “involuntariness”. Richard Craswell “Property Rules and Liability Rules in Unconscionability and Related Doctrines” (1993) 60 *U Chi L Rev* 1.

<sup>62</sup> See, for example, Alan Schwartz and Louis Wilde “Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis” (1979) 127 *U Pa L Rev* 630 at 682. See also Howard Beales, Richard Craswell and Steven Salop “The Efficient Regulation of Consumer Information” (1981) 24 *Journal of Law and Economics* 491.

<sup>63</sup> Richard Posner *Economic Analysis of Law* (7th ed, Aspen Publishers, Austin (Texas), 2007) at 369.



Neoclassical economic theory is based on the assumption of consumer rationality. Recent developments in the social sciences have challenged this assumption. Behavioural economics has shown that consumers in a free market do not always act rationally and enter transactions that will maximise their self-interests. They make mistakes because they suffer from irrational thinking, information processing limitations, self-control problems, status quo bias, susceptibility to framing effects and misperceptions about the costs and benefits of certain products.<sup>64</sup> For, example, studies have shown that consumers with a higher default risk may irrationally choose a credit card with a lower interest rate and a higher late payment fee than one with a higher interest rate and a lower late payment fee.<sup>65</sup> The findings of behavioural economics raise important questions for consumer regulators.

### 10.5.3 *The new paternalism – libertarian paternalism and asymmetric paternalism*

The “new” paternalists argue that the findings of behavioural economics justify a re-think of the traditional economic theory. Thaler and Sunstein argue for what they call “libertarian paternalism”.<sup>66</sup> They believe that the new insights into consumer behaviour justify soft paternalism, where a consumer is nudged rather than coerced into making better choices. They advocate that it is permissible for the government to intervene in ways that retain freedom of choice, but help consumers to act according to their “real”, “deep”

<sup>64</sup> Peter Diamond and Hannu Vartiainen (eds) *Behavioural Economics and its Applications* (Princeton University Press, Princeton and Woodstock, 2007); Melvin Aron Eisenberg “The Limits of Cognition and the Limits of Contract” (1995) 47 *Stan L Rev* 211 (describing how limits of cognition provide a rationale for the non-enforcement of certain kinds of contract); Christine Jolls, Cass Sunstein and Richard Thaler “A Behavioural Approach to Law and Economics” (1998) 50 *Stan L Rev* 1471, 1545; Russell B Korobkin and Thomas S Ulen “Law and Behavioural Science: Removing the Rationality Assumption from Law and Economics” (2000) 88 *Cal L Rev* 1051; William Samuelson & Richard Zeckhauser “Status Quo Bias in Decision Making” (1988) 1 *Journal of Risk and Uncertainty* 7. See also Ministry of Economic Development *Behavioural Analysis for Policy: New lessons from economics, philosophy, psychology, cognitive science and sociology* (2006).

<sup>65</sup> Oren Bar-Gill “Seduction by Plastic” (2004) 98 *Nw U L Rev* 1373; Oren Bar-Gill “The Behavioral Economics of Consumer Contracts” (2008) 92 *Minn L Rev* 749. See also Richard Epstein “Behavioral Economics: Human Errors and Market Correction” (2006) 73 *U Chi L Rev* 111. Epstein argues that the findings of behavioural economics do not warrant legal intervention. Oren Bar-Gill responds to Epstein’s arguments by arguing that the findings of behavioural economics show that consumers make systemic mistakes in certain markets, and that sellers’ strategic responses to take advantage of these mistakes can reduce welfare and potentially justify legal intervention.

<sup>66</sup> Richard H Thaler and Cass R Sunstein “Libertarian Paternalism” (2003) 93 *Am Econ Rev* 175; Richard Thaler and Cass Sunstein *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Penguin Books, New York, 2009).

preferences.<sup>67</sup> So, because consumers want to save for their future, but find it difficult, a libertarian paternalist would approve of the KiwiSaver scheme which is voluntary but uses automatic enrolment with an opt-out option. Similarly, a libertarian paternalist might advocate that because people want to eat more healthily or stop smoking but find this challenging, it would be legitimate for the government to consider implementing a tax on unhealthy food or requiring cigarettes to be sold in plain packaging. Libertarian paternalism also uses insights from behavioural economics to manipulate more effectively consumer behaviour. For example, the KiwiSaver opt-out scheme relies on the fact that consumers are too apathetic to change from a default option (status quo bias).

Another branch of paternalism that has developed in response to the findings of behavioural economics is asymmetric paternalism.<sup>68</sup> Under this theory a paternalistic regulation is legitimate if it creates larger benefits for those who make errors while inflicting little or no harm on those who are fully rational.<sup>69</sup> The cooling-off period provided by the Door to Door Sales Act 1967 is an example of asymmetric paternalism. It allows consumers seven days after making the agreement in which to cancel the contract.<sup>70</sup> This cooling-off period creates benefits for those consumers who make poor decisions in the heat of the moment. The only cost to consumers who are fully rational is that they are unable to negotiate a cheaper price for a contract with no cooling-off period.

### **10.5.4 Criticisms of the new paternalism**

Many anti-paternalist scholars have not been persuaded that the research in behavioural economics justifies paternalistic intervention. Although the research might show that consumers sometimes act in ways that seem irrational this does not automatically indicate that the government should step in and manipulate or coerce consumers into choosing differently. There is apprehension that government decision-makers themselves have cognitive limitations and are prone to error.<sup>71</sup> Moreover, in an unregulated market

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<sup>67</sup> See, for example, Richard H Thaler and Cass R Sunstein "Libertarian Paternalism" (2003) 93 *Am Econ Rev* 175; Cass R Sunstein and Richard H Thaler "Libertarian Paternalism is not an Oxymoron" (2003) 70 *U Chi L Rev* 1159; Richard Thaler and Cass Sunstein *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Penguin Books, New York, 2009); Daniel Ariely *Predictably Irrational: The hidden forces that shape our decisions* (Harper Collins, Oxford, 2010).

<sup>68</sup> See Colin Camerer and others "Regulation for Conservatives: Behavioral Economics and the Case for Asymmetric Paternalism" (2002–2003) 151 *U Pa L Rev* 1211.

<sup>69</sup> Colin Camerer and others "Regulation for Conservatives: Behavioral Economics and the Case for 'Asymmetric Paternalism'" (2002–2003) 151 *U Pa L Rev* 1211.

<sup>70</sup> Door to Door Sales Act 1967, s 7.

<sup>71</sup> Edward Glaeser "Paternalism and Psychology" (2006) 73 *U Chi L Rev* 133.

consumers have the opportunity to learn from their mistakes or to pay for professional consumer advice.<sup>72</sup>

There is also concern that it is dangerous for governments to assume that they can deduce consumers' true preferences by assessing what the consumer would have done if he or she had the ability to process all information, no self-control problems and no cognitive biases.<sup>73</sup> Consumers have to choose between sets of conflicting preferences. Their short-term preference might be to eat unhealthily, save little, extend their credit or smoke cigarettes, whereas if asked what their long term preferences are, they may say that they want to lose weight, save more, have less debt and stop smoking. Scholars such as Rizzo and Whitman argue that the new paternalists believe that they are implementing policies that improve consumer welfare according to consumers' "true" preferences but are in fact implementing policies based on what the new paternalists think are the "right" preferences.<sup>74</sup> Robert Sugden argues that in situations where consumer preferences are unstable there is inherent value in consumers having the opportunity to make their own choices even if these choices sometimes appear irrational.<sup>75</sup> Finally, there is concern that allowing soft paternalism is the start of a slippery slope toward more intrusive forms of paternalism.<sup>76</sup>

## 10.6 To what extent can a cost-benefit analysis be useful in the paternalism debate?

An important part of developing any regulatory reform is to conduct a cost-benefit analysis.<sup>77</sup> New Zealand policy-makers are currently required to

<sup>72</sup> Richard Epstein "Behavioral Economics: Human Errors and Market Correction" (2006) 73 U Chi L Rev 111; Jonathan Klick and Gregory Mitchell "Government Regulation of Irrationality: Moral and Cognitive Hazards" (2006) 90 Minn L Rev 1620.

<sup>73</sup> See Graeme Austin "The Regulation of Consumer Credit Products: An Examination of Baseline Assumptions" in this volume (ch 11).

<sup>74</sup> Mario J Rizzo and Douglas G Whitman "The Knowledge Problem of New Paternalism" (2009) BYU L Rev 905.

<sup>75</sup> See Robert Sugden "The Value of Opportunities over Time when Preferences are Unstable" (2007) 29(4) Soc Choice Welfare 665.

<sup>76</sup> Mario J Rizzo and Douglas G Whitman "Little Brother Is Watching You: New Paternalism on the Slippery Slopes" (2009) 51 Ariz L Rev 685.

<sup>77</sup> See Derek Gill "Regulatory Management in New Zealand: What, Why and How?" in this volume (ch 7), which discusses the Regulatory Impact Statement process. See also Anthony E Boardman and others *Cost-Benefit Analysis: Concepts and Practice*, (3rd ed, Pearson/Prentice Hall, Upper Saddle River (New Jersey), 2006); Christopher Breidert, Michael Hahsler and Thomas Reutterer "A Review of Methods for Measuring Willingness-to-pay" (2006) 2(4) Innovative Marketing 8. See also Ministry of Consumer Affairs Policy Paper *Assessing Costs and Benefits in Consumer Policy Development* (October 1996).

provide Regulatory Impact Statements (RIS) for submission with their Cabinet papers when policy decisions are sought from Cabinet. The RIS ought to list the feasible options (including the status quo) and explain how the preferred option was decided. It should include a cost-benefit analysis.<sup>78</sup> The Regulatory Standards Bill 2011 also places a significant emphasis on cost-benefit analysis. One of its “principles of responsible regulation” is that legislation should produce benefits that outweigh its costs.<sup>79</sup>

Requiring benefits to outweigh costs might sound unobjectionable and even obvious. However, while a cost-benefit analysis can be important for determining whether a paternalistic intervention is likely to achieve its goals or have unintended consequences, it is ill-equipped to answer the more philosophical question of whether a particular paternalistic policy is legitimate. The methodology of an economic cost-benefit analysis may appear scientific, but it is difficult to give a precise and objective measurement to all possible costs and benefits. Value judgements can alter how benefits and costs are measured or whether it is even considered relevant to conduct a cost-benefit analysis.<sup>80</sup> An anti-paternalist, for example, will rate freedom of choice, sanctity of contract and autonomy more highly than would a traditional paternalist, who would assign more weight to factors such as saving human lives or protecting human health and well-being. In fact, if an anti-paternalist holds the view that the government should only restrict individual liberty when that liberty is causing harm to another individual then they may see no relevance in attempting a utilitarian cost-benefit calculation of a policy that restricts liberty where there is no apparent harm to others.<sup>81</sup>

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<sup>78</sup> Research has shown that there is patchy and inadequate compliance with these requirements. See New Zealand Institute of Economic Research *Compliance with Regulatory Impact Analysis* (prepared for the Ministry of Economic Development 2008). The paper is also available online at: [www.med.govt.nz/templates/MultipageDocumentTOC\\_\\_\\_35268.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC___35268.aspx) (last accessed 8 August 2011).

<sup>79</sup> Regulatory Standards Bill 2011 (277-1), cl 7(1)(j).

<sup>80</sup> For discussion of the difficulties involved in using a cost-benefit approach to regulatory decision-making see Steven Kelman “Cost-Benefit Analysis: An Ethical Critique” (1981) 5 AEI Journal on Government and Society Regulation 33; Cass Sunstein “Congress, Constitutional Moments and the Cost-Benefit State” (1996) 48 Stan L Rev 247; Alan Strudler “Incommensurable Goods, Rightful Lies and the Wrongness of Fraud” (1998) 146 U Pa L Rev 1529; Robert H Frank “Why is Cost-Benefit Analysis so Controversial?” (2000) JLS 913; Eyal Zamir and Barak Medina “Law, Morality, and Economics: Integrating moral constraints with economic analysis of law” (2008) 96 CALR 323.

<sup>81</sup> In some circumstances an empirical study on the existence and degree of harm to others might be relevant but any other measurement of costs would be irrelevant to Mills theory on paternalism. For a discussion of both consequentialist and deontological theories of law see Eyal Zamir and Barak Medina “Law, Morality, and Economics: Integrating moral constraints with economic analysis of law” (2008) 96 CLR 323. See, for example, Brian Bix “Epstein, Craswell, Economics, Unconscionability, and Morality.” (2000) 19 QLR 715 at 725. Bix cast doubt on the idea that wealth maximisation should be a key concept in determining the legitimacy of legal intervention.

Value judgments about the potential benefits of any form of government regulation are also likely to shape how costs and benefits are measured. The current New Zealand Government released a Statement on Regulation entitled: *Better Regulation, Less Regulation* in 2009.<sup>82</sup> The wording of the statement indicates that the government has a preference for minimal legal intervention in the marketplace. This set-point is likely to inform the cost-benefit analysis of any proposed paternalistic regulation.

A further problem with using traditional cost-benefit analysis to assess the merits of a proposed paternalistic regulation is the difficulty in measuring unstable or inconsistent consumer preferences over time. The anticipated benefit of a paternalistic regulation is an increase in consumer well-being. An important part of a cost-benefit analysis would therefore measure the well-being of consumers in an unregulated market and compare it with a measure of consumer well-being in a regulated market. In traditional economic theory well-being is understood in terms of consumer preferences. Preferences are determined by observing market behaviour. However, this approach will only show the preferences consumers have at the time of purchase. It does not always reveal consumers' future preferences for longer-term benefits. For example, the willingness of a smoker to purchase cigarettes at a certain price reflects the value that the consumer gives to smoking cigarettes at the time of purchase. It does not necessarily measure the guilt or regret that the consumer may feel some time after making the purchase. Neither does it necessarily give an accurate measure of the costs that the consumer might experience in the future in respect of addiction or ill health.

Economists and social scientists have now developed new methods for attempting to measure consumer well-being in situations where consumers are making trade-offs between costs and benefits occurring at different times.<sup>83</sup> Consumer surveys can prove helpful and economists can make calculations based on formulas that take into account factors such as consumers' systemic tendency to underestimate future costs and benefits. Nevertheless, estimating plausible and unbiased costs and benefits of a paternalistic policy is a difficult task. The task is further complicated by the fact that individual consumers are not a homogenous group with identical preferences. Consumers may differ in the degree to which they accurately

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<sup>82</sup> Hon Bill English and Hon Rodney Hide "Government Statement on Regulation: Better Regulation, Less Regulation" (17 August 2009) available at [www.treasury.govt.nz/economy/regulation/statement](http://www.treasury.govt.nz/economy/regulation/statement) (last accessed 14 September 2011). Jane Kelsey argues that the "better regulation, less regulation" slogan essentially advocates a light-handed pro-market approach which she contends "can no longer claim to be uncontested orthodoxy" in New Zealand. See Jane Kelsey "Regulatory Responsibility: Embedded Neoliberalism and its Contradictions" (2010) 6(2) *Policy Quarterly* 36 at 39.

<sup>83</sup> For discussion on this type of economic analysis see Shane Frederick, George Loewenstein and Ted O'Donoghue "Time Discounting and Time Preference: A Critical Review" (2002) *XL Journal of Economic Literature* 351; Ingebjorg Kristoffersen "The Metrics of Subjective Wellbeing: Cardinality, Neutrality and Additivity" (2010) 86(272) *The Economic Record* 98.

predict their future suffering, the degree to which they experience short-term pleasure or the degree to which they experience well-being from delaying gratification in favour of long term goals.

Those who are opposed to paternalistic intervention argue that assessing whether intervention will maximise well-being requires the policy-maker to make a judgment call about which of the temporally inconsistent consumer preferences to give the most weight.<sup>84</sup> For example, in relation to tobacco regulation it is arguably difficult to determine how heavily the value of future health should be weighted against the value of the hedonistic pleasure of smoking. In addition, the policy-maker needs to make a value judgment as to whether maximising consumer preferences is in fact the goal of the legislation or whether it is a situation where the regulator is claiming to know better than the consumer what is in his or her best interests.

Where cost-benefit analysis is likely to be of most value is in drawing attention to the likelihood of the paternalistic intervention achieving its goals or of it having costly side effects or unintended consequences. These are pragmatic considerations rather than philosophical ones. Once policy-makers have judged that the goal of a paternalistic policy is legitimate, then a cost-benefit analysis can assist in identifying efficient and effective ways to implement this policy. The costs that need to be taken into account include the costs to government of creating and implementing the legislation. These costs might be reduced if New Zealand simply copies a relevant overseas regulatory model already in place.<sup>85</sup> Other costs include enforcing the legislation and the compliance costs to suppliers. Policy-makers will need to consider whether compliance costs are so high that it will become unprofitable for some suppliers to sell their products, resulting in an undesirable decrease in consumer choice and reduction in consumer welfare. Research in the United States has indicated, for example, that heavy-handed regulation relating to the efficacy of new medicines could cause more harm than it prevents.<sup>86</sup> Consumers may suffer ill health or die in the time that it takes for effective and safe medicines to go through the regulatory process. The small scale of the New Zealand economy might mean that excessive regulation in some industries could significantly stifle innovation.

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<sup>84</sup> See, for example, Shane Frederick, George Loewenstein and Ted O'Donoghue "Time Discounting and Time Preference: A Critical Review" (2002) *XL Journal of Economic Literature* 351; Mario J Rizzo and Douglas G Whitman "The Knowledge Problem of New Paternalism" (2009) *BYU L Rev* 905.

<sup>85</sup> The issue of whether and why some overseas models might be less relevant or adaptable to New Zealand will be discussed in the next stage of this project.

<sup>86</sup> Sam Peltzman "An Evaluation of Consumer Protection Legislation: The 1962 Drug Amendments" (1973) *81 J Pol Econ* 1049.

Sometimes people adjust their behaviour to a paternalistic consumer regulation in ways that counter-act the intended effect of the regulation.<sup>87</sup> For example, putting severe warnings on cigarette packets might just make the addict feel guilty and reduce pleasure from smoking but not actually change behaviour.<sup>88</sup> Research in the United States has shown that regulation to make motor vehicles safer increases the incidence of risky driving behaviour which leads to higher rates of injury and death to cyclists and pedestrians.<sup>89</sup> It is difficult to predict all possible unintended consequences that might result from a proposed regulation. It is important for New Zealand regulators to examine any relevant research into the effects of similar regulation in other parts of the world. It is also essential for regulators to conduct regular cost-benefit reviews after a paternalistic consumer regulation is in place to determine whether the regulation is achieving its objectives and whether there is any evidence of unintended consequences.

Although a formal cost-benefit analysis can be a useful and important exercise for policy-makers, it should be recognised that it is not always possible or practicable to carry out extensive quantitative calculations. This type of analysis can impose expensive and time-consuming data collection requirements on regulators and can sometimes force them to make seemingly scientific measurements for judgments about ethical values.

## 10.7 Conclusion: towards a multi-factorial approach

Much of the existing legal scholarship on paternalism is based on the search for a unifying theory for justifiable intervention. Each theory is based on a single premise; paternalism is seen as either a good idea or a bad idea, or justifiable only if it retains some consumer choice or only if the benefits to the irrational consumers outweigh the costs to the rational consumers. The final stage of this project is likely to conclude that outright anti-paternalism is undesirable and that uncritical paternalism is unsustainable. The challenge is to develop a decision-making framework to inform the debate as to where the middle ground should lie. It is likely that the project will recommend a multi-factorial approach where competing values and factors are weighed up

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<sup>87</sup> See Sam Peltzman "The Effects of Automobile Safety Regulation" (1975) 83 J Pol Econ 677; Sam Peltzman "Regulation and the Wealth of Nations" (2007) 3 New Perspectives on Political Economy 185. See also Alex Kozinski "The Dark Lessons of Utopia" (1991) 58 U Chi L. Rev 575. Kozinski states at 592–593 that "[O]ur ability to predict the full effects of governmental actions – much less the synergetic effects of hundreds of thousands of simultaneous government actions – is very limited. Far too often there are unanticipated results and costs, despite the most careful efforts of government officials."

<sup>88</sup> George Loewenstein and Ted O'Donoghue "We Can Do this the Easy Way or the Hard Way: Negative Emotions, Self-Regulation, and the Law" (2006) 73 U Chi L Rev 186.

<sup>89</sup> Sam Peltzman "The Effects of Automobile Safety Regulation" (1975) 83 J Pol Econ 677.

in order to determine if a paternalistic measure to protect consumers might be legitimate and, if so, whether it should be soft or hard paternalism.

The analysis is likely to include an examination of the extent to which the existing theories on the middle ground (libertarian paternalism and asymmetric paternalism) can adequately assist the policy-maker. For example, libertarian paternalism advocates nudges and not coercion. It cannot therefore adequately account for hard paternalistic measures such as cooling-off periods or banning products such as flammable nightwear. Yet the proponents of the concept of libertarian paternalism admit in the penultimate chapter of their book *Nudge* that bans and cooling-off periods might be justified in some circumstances.<sup>90</sup> Libertarian paternalism also appears to allow nudges in all areas where consumers can be shown to make “poor” decisions. There is no mechanism in the theory for excluding government intervention to correct consumer errors such as buying the wrong size jumper or buying an elaborate kitchen renovation that does not bring an anticipated increase in well-being.

Asymmetric paternalism also has limitations in its ability to assist the policy-maker. Unlike libertarian paternalism, it provides a rationale for some instances of hard paternalism by arguing that an intervention is justifiable where benefits to the irrational consumer are large and there is little cost to the rational consumer. This approach can provide a rationale for cooling-off periods in door-to-door sales. The approach could prove problematic, however, if used to allow coercive measures such as a complete ban on the sale of cigarettes on the basis that this would benefit the health of smokers and cause little harm to non-smokers. Asymmetric paternalists might argue that such a ban would not work because of the likelihood of the creation of a black-market. This, however, is a pragmatic argument about the effectiveness of the policy rather than a philosophical objection based on the importance of liberty or personal responsibility. Theoretically, the concept of asymmetric paternalism could also be used to justify the unsatisfactory suggestion of a cooling-off period for all consumer purchases. Such a policy would benefit irrational consumers acting in the heat of the moment at a small cost to rational consumers. Asymmetric paternalism does not account for the fairness of imposing extra burdens onto suppliers or the value of sanctity of contract.

The aim of the next stage of this project is not to advocate an exact point at which to draw the line between individual liberty and paternalistic legal intervention. People of different political persuasions will draw the line at different points. This project is likely to lead to the development of a framework for decision-making so that New Zealand policy-makers consider all the relevant issues and questions when deciding whether and why a particular paternalistic regulation might be justifiable. The approach is likely to be one

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Richard Thaler and Cass Sunstein *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Penguin Books, New York, 2009) at 250–252. Thaler and Sunstein refer to asymmetric paternalism as an appropriate strategy for cautiously proceeding down the slippery slope away from nudges to coercion.



that assists policy-makers by recommending the consideration of multiple factors on the basis of sliding scales. The factors to be considered might include: the degree to which consumers want to be protected; the reason for consumers' seemingly irrational behaviour; the magnitude, probability and irreversibility of potential consumer harm; the relevance of addiction; whether there are additional non-paternalistic reasons for enacting the law; and the likelihood of the market eventually providing solutions to the problem. This multi-factorial approach to issues of paternalism acknowledges the complexity of the problem and requires a balancing of various competing factors. It is an approach that could be built into the formal assessment process for New Zealand regulatory policy.

The recommended approach is also likely to include the suggestion that in cases where an assessment of these sliding scales points to a proposed paternalistic intervention being justifiable, policy-makers should then consider the possibility of unintended consequences and the likelihood of the regulation being effective. This stage of the decision-making framework will likely require New Zealand regulators to study the success or otherwise of any similar regulation that has been adopted by overseas jurisdictions. The project will consider whether there are factors unique to New Zealand, such as our small size and isolation, which might have an effect on the relevance and adaptability of overseas regulatory models.

The discussion in the next stage of this project is also likely to consider the issue of the slippery slope from nudges to coercion. It will attempt to identify the different combinations of factors that might make a more coercive intervention justifiable.

