

TITLE: Hidden 'costs' with every choice we take

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Economists are often accused of knowing the price of everything and the value of nothing. Consumers, on the other hand, are assumed to have good knowledge of both. Indeed free-market economics rests more heavily on the assumption that individuals know what's best for them than on any other assumption.

While it is relatively clear that individuals are best placed to decide what they want for lunch or what colour car they would like to drive, it's not always the case with all decisions they face. When it comes to deciding on which pharmaceuticals we need, which investment products suit us best or even which mobile phone plan to choose, most people are happy to take the recommendation of someone they believe has more expertise than themselves.

While economists and policymakers typically assume away the kinds of "imperfect information" and "asymmetric knowledge" that dominate our decisions about where to invest and who to buy a phone from, in the back of the textbooks we do make mention of so-called "principal-agent" problems. Put simply, while economists understand the need for consumers to pay for expert advice, the fact is the person paying for the advice is never certain that the expert is putting their customer's interests ahead of their own. That's why we have so much regulation in the financial advice sector.

Sometimes the agent that we use to do our shopping around for us is the government. Governments procure a wide range of services on our behalf, such as roads and hospitals, and then make them available to us. Often for free. Obviously we want governments to obtain such services at the lowest possible cost, but at the same time we don't want them to scrimp on quality. That's where the difference between price and value comes in.

Goods and services often have intangible benefits which might be hard for economists to quantify but consumers readily identify. The latest vintage of Grange Hermitage, for

example, was widely considered exceptionally good wine at an exceptionally high price. The label alone, it was argued, played a major role in setting the price.

Another form of intangible attribute is convenience. Despite the price war between Coles and Woolworths on milk in supermarkets, the same retailers sell their milk for twice the price if you buy it in their petrol stations. Why? Because if you want convenient milk you pay a premium.

Regulators and even the Australian Bureau of Statistics sometimes struggle with intangible costs and benefits. For example, what is the “cost” of watching free-to-air television? While the price may be zero, the cost is the amount of time spent watching the advertisements that interrupt the programs. What then is the impact on the “cost of living” when television stations substitute bookmakers for commentators? The price may remain stable at zero, but most people would accept the price of viewing has gone up.

What about privacy? If a government could reduce the cost of processing and storing data by reducing the amount of privacy a citizen could expect would that be an “efficient cost saving” or a “breach of a citizen’s rights”? According to the NSW Department of Education at least, price seems to trump privacy. In a successful attempt to save money, the former NSW government decided to move 1.3 million student email accounts to Google’s Gmail. While there are potential advantages associated with the use of cloud-based services, there are also potential disadvantages. For example there is nothing to stop Google from analysing the content of student Gmail accounts to help them build a profile of student interests and concerns to better target advertisements at them when using other Google products such as YouTube or Google Search.

It is understandable that governments want to save money when providing services to citizens, but it is also understandable that parents might be worried about the privacy of students replying to official education department emails. It might be hard for economists to put a price on intangibles like privacy, but it is very risky of politicians to assume such intangibles are worthless.

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