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Government Regulation of Advertising:
Good or Bad?
*A Comment on the Paper by Kassarian and
Kassarian in JCP, Volume 11,
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ABSTRACT. Kassarian and Kassarian (1988) present some interesting results on the impact of regulation on advertising. They state three hypotheses that are partly confirmed by the facts. The theory behind the three hypotheses is not explicitly stated. In this paper I will first try to reconstruct the implicit theory. Secondly I will give a completely opposing theory and show that it can explain the same facts. The resulting evaluation of the government regulatory programme is negative as opposed to Kassarian and Kassarian's evaluation.

In an interesting article "The Impact of Regulation on Advertising: A Content Analysis" Harold Kassarian and Waltraud Kassarian (1988) present "the results of a formal content analysis of claims made in advertisements . . . before (1970), during (1976), and after (1984) the spurt of regulatory activity in the US." In the midst of the 1970's the Federal Trade Commission (FTC) pursued an advertising substantiation programme. Advertisers had to have available all documentation, proof, and substantiation for claims that purported to be based on objective evidence. Under the programme, false or deceptive claims might lead to a law suit. The results of the content analysis are presented as tests of three hypotheses on how advertising claims change as a result of government regulation. The hypotheses are partly confirmed by the facts. Kassarian and Kassarian's conclusion is that "the advertising substantiation programme was moderately successful." "In 1976 consumers were provided less information, but it was of better quality than in 1970. However by 1984 the various trends seem to suggest that advertisers are returning to their pre-regulation ways."

In this comment I will try to make explicit the theory that is behind Kassarian and Kassarian's hypotheses. If the character of

the goods is taken into consideration, I can show that from a diametrically opposed theory, alternative hypotheses can be deduced that are confirmed by the facts too.

THEORIES BEHIND THE FACTS

The implicit theory of Kassarian and Kassarian is as follows. Advertising is partly deceptive and partly manipulative. Without government regulation this situation will continue. With government intervention (the FTC substantiation programme) producers will change, based on a cost-benefit analysis, the content of their ads. “[I]ndustry [can] avoid the expense and adverse publicity of a governmental investigation and trial.” In some cases the content will change from claims that could have been scientifically verified (sounds verifiable but no evidence is presented) to more inherently verifiable claims (the evidence itself is presented). In some other cases the content will change to vague but safe puffery (literal verification is not possible). These three claims (sounds verifiable, evidence presented, and puffery) constitute the types of advertising claims analyzed in Kassarian and Kassarian’s paper.

To put it bluntly, consumers are implicitly assumed blithely to consume goods of questionable quality. Consumers ignore or underestimate risks; producers use advertising partly as a means to mislead the consumers. Advertising can manipulate consumers into taking action they otherwise would not have taken: Consumers need government protection.

I contrast this view with the theories of, e.g., Stigler (1961), Nelson (1970, 1974), and Kirzner (1973) (for a general overview of the alternative theories, see Ekelund and Saurman, 1988). The authors claim advertising is a good like any other good. It is supplied by the producer at a level of quality demanded by the consumer. Advertising lowers the search costs of the consumer for all three types of advertising claims analyzed in Kassarian and Kassarian’s paper. On the whole the consumer gets the type and quality of advertising he wants and is willing to pay for.

To put it bluntly, again, consumers are assumed to make choices in such a way as to yield them the largest expected benefit. Consumers can manage the risks of their personal environments, they know what is best for them and cannot be fooled all the time. Con-

sumers assess the kind of advertising they get from a cost-benefit point of view. It lowers the full prices, which includes the search costs, of the products they buy. Advertising is an essential part of the competition process: It makes the product known to the consumers. Consumers are not passive actors but by-and-large act in their own self-interest.

FRAUD

What does the alternative theory imply about the occurrence of fraud, i.e., the deceptiveness in claims in which the attribute sounds verifiable and which government regulation is supposed to mitigate?

One would expect the amount of fraud for the products investigated by Kassarian and Kassarian to be not very high. The targeted products for substantiation under the FTC programme are antiperspirants and pet foods. A control group consists of the comparable products skin lotion and prepared foods. The goods can be characterized as low priced mass-products. I deduce the following three points.

Firstly, the amount of information requested by consumers will be rather low (Laband, 1986). For the products the learning-by-doing effect is great; losses are not substantial. For both producer and consumer an extensive use of ads is not worth the cost. Through repetitive sale, the amount of fraud will soon be brought to a minimum.

Secondly, claims that could have been scientifically verified but for which no evidence is presented will not be very numerous. The goods are so-called "experience" goods for which quality claims are not as essential as for "search" goods. For experience goods quality can be experienced only after the product has been bought. For search goods quality can be discovered and tested before the good is actually bought.

Thirdly, most of the claims will be inherently verifiable or a sheer hyperbole. To reach the consumers nation-wide, the lowest common denominator will be necessary. Advertising will be rather simple and universal. It is to be expected that the number of potentially deceptive claims (claims that sound verifiable in laboratory or survey) will be low.

Consequently the decline in number of claims in which the

attribute sounds verifiable, as it happened under the FTC substantiation programme, will probably be a real loss in valuable informative claims. This given the fact that it will not be fraud that declines. The hard-core of claims in which the attribute sounds verifiable is reduced.

HYPOTHESES AND FACTS

I state Kassarian and Kassarian's hypotheses followed by my own hypotheses as I deduce them from the alternative theory.

Hypothesis 1: Number of Attribute Claims Made

Kassarian and Kassarian's first hypothesis is that "the number of claims made in 1976 advertisements would be less than those made in 1970, and would once more increase in 1984. The effect would be more pronounced in those industries that were required to provide substantiation than in similar, but non-targeted industries" (pp. 271–272). Kassarian and Kassarian come to the hypothesis on the basis of the increasing costs for producers to substantiate a certain claim, e.g., as the result of the negative news in cases of an investigation by the FTC. The relevant cost-benefit ratio changes.

The hypothesized U-shaped curve for the number of claims, however, did not emerge. Except for pet foods, the number of claims did not decrease between 1970 and 1976. However, the long run effects of regulatory activity was that advertisers made fewer claims.

What hypothesis follows from the alternative theory? I distinguish between the short and long term. Since advertising is a necessary part of competition and cannot be dispensed of, producers will in the short term, for the same cost-benefit reason as given by Kassarian and Kassarian, substitute less for more effective claims of advertising (Ehrlich & Fisher, 1982). Less effective should be interpreted as less demanded by consumers, e.g., less eye-catching for the consumers and therefore less attractive for the producers. In the short term the total number of claims will therefore be about the same.

In the long term, producers will resort to other means of conveying this type of claim, e.g., sales talks or product demonstrations in shops. Consumers might revert to a form of mouth-to-mouth adver-

tising, given the fact that the sort of information lost by the reduction in claims in which the attribute sounds verifiable is still demanded by consumers. In the end the total number of claims will go down.

The long term negative trend in the number of claims is reinforced by the following circumstances. Firstly, if the number of claims drops, competition will slow down. Consequently, in the long term, fewer new product improvements and corresponding claims will be made.

Secondly, because research has to be done, "scientific" advertising is costly. As there is always the possibility that regulation will come back, research investments become more risky. The length of time a producer can profit from them will become shorter. Even if regulation stops, the entry barrier for "scientific" advertising will be greater.

The second circumstance also contains a reason why, in the short term, the number of scientific claims will stay the same, even rise modestly in the non-targeted industries. There are still gains to be made. Research costs are already made, they are sunk costs (Kessides, 1986). It is to be expected that the marginal returns for "scientific" advertising in the non-monitored goods increase. Some consumers are not aware which goods are monitored and which are not. We could call this the "bandwagon-effect" for the non-monitored goods. Consequently the amount of (effective) fraud may remain the same or even rise. For producers who want to deceive, though the costs are higher, also the gains at stake do rise; consumers, who will believe that there is no fraud any more, now that the government has taken care of it, will be less alert of existing fraud.

The alternative hypothesis is: The number of claims made in 1976 advertisements will be more or less the same as those made in 1970, and would *decline* in 1984. For the non-targeted industries even a slight *rise* in the number of claims made in 1976 can be expected.

Except for pet foods (the only good that confirmed Kassarjian and Kassarjian's hypothesis), my hypothesis is better confirmed by the facts. Maybe for pet foods the costs of substitution of "scientific" information by the other two types of claims were too high (the returns too low).

Hypothesis 2: Verification of Claims

The second hypothesis of the Kassarjian and Kassarjian paper,

presented by them as a three way split is as follows: “Industries from which substantiation was demanded would have handled verification of claims in one of two extreme ways: either by providing inherent verifiability and verifying evidence, or, at the other extreme, by making non-verifiable vague claims or puffery. It was assumed that by 1984 after the cessation of regulatory activity, the trends would reverse” (p. 272).

As described in the foregoing section such results are to be expected and are not different for my opposing theory: a U-shaped curve for claims that sound verifiable and inverse U-shaped curves for the inherently verifiable claims and puffery.

What differs, however, is the interpretation of the hypothesis. What in Kassarian and Kassarian’s theory is a favourable development, the decline in “claims that sound verifiable but in which the evidence [is] not presented and undoubtedly not available” (p. 281), is in the opposing theory a real loss in valuable information claims.

The facts confirm the hypothesis better than Kassarian and Kassarian assume. Most of the exceptions can be explained by a peculiarity of Kassarian and Kassarian’s presentation of the facts.

Because the number of claims are given as a percentage, as opposed to what Kassarian and Kassarian assert (pp. 277 and 282–283), no straightforward conclusions about causality can be made. For instance, if in the case of two types of claim, which sum up to one hundred percent, one of the claims goes up in absolute number while the other remains the same, then as a percentage, the second claim will go down. But this last phenomenon has nothing to do with causality. Two exceptions to the hypothesis can be explained as having its source in the arithmetic “trap.”

1. Contrary to the percentage rise, antiperspirants claims in which evidence is presented in ad or which are inherently verifiable go down in absolute number — a fact that confirms the hypothesis. The effect happens because the total number of claims, on the basis of which the higher percentage is calculated, sharply declines between 1976 and 1984.

2. Contrary to what was expected the percentages of puffery claims of skin lotions and prepared foods rose between 1976 and 1984. In absolute number, however, they went down. This can be explained, again, by the overall decline in number of claims.

The contradictions between the hypotheses and the facts are not

real. The hypotheses are even better corroborated by the facts than the authors imagined.

Hypothesis 3: Number of Informational Cues

Kassarjian and Kassarjian's third hypothesis is "Advertising within industries from which substantiation was requested would provide a lower level of informational cues in 1976 than they had in 1970. By 1984 the number of information cues would again rise. Further, in 1976 these ads would be less informative than advertisements from industries without substantiation orders" (p. 273).

The facts confirm part of the hypothesis. By 1976 "the targeted industries were giving less information to consumers . . . while the non-targeted industries were providing significantly more information." By 1984 "[a]ntiperspirants and skin lotions had significantly fewer informational claims than in 1976, while pet and people food remained more or less the same . . ." (p. 282).

Following the total reduction in claims (Hypothesis 1) the number of informational cues will decline, too. A cue, however, is not the same as a claim; it stands to a claim as a genus to a species. In an earlier paper, Healey and Kassarjian (1983) found less claims than cues. A claim is a statement or assertion about an attribute describing what the advertised product is or does. For instance, for anti-perspirants the product attributes mentioned are wetness control, odour control, comfort (ease of use), ingredients, etc. A cue, on the other hand, says something about the level of informativeness of the advertisement. The cues, i.e., the evaluative criteria, are the factors that could potentially be used in intelligent decision making. We can think of price, value, quality, and performance.

There is, however, a difference between a cue and a claim that is of importance to the interpretation of the decline in the number of informational cues in the alternative theory. From the perspective of competition an essential informative characteristic of advertising is to let people know that the product is there. The consumer has to see that there is a product before the product in a certain sense even exists. This informational claim, however, is not counted as an informational cue by Kassarjian and Kassarjian. So, when through regulation "scientific" claims are substituted by inherently verifiable claims or vague claims, the change often will be from an informa-

tional cue to a claim which just states that there is a product and which is not counted as an informational cue. Consequently the decline in level of informativeness will be more nominal than real.

The alternative hypothesis is: The number of informational cues will decline between 1970 and 1976, a trend which will be sustained in the long run. The facts given by Kassarian and Kassarian confirm the hypothesis.

TWO FINAL REMARKS

To conclude:

In the alternative theory, the effect of government regulation is the opposite of what Kassarian and Kassarian assert. The situation without government intervention is optimal. Consumers are getting and producers are supplying the quality of advertising that is demanded. Advertising has nothing to do with fraud or deceptiveness but is a matter of attractiveness. Attractiveness is essential for the competitive market process.

To say the least, the whole issue is tricky. Every set of facts can be explained, especially after they are known to us, by different, even opposing, theories. On the other hand, facts can never prove a theory, they can only falsify it. What remains are two opposing theories that both explain the same facts.

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ZUSAMMENFASSUNG

Staatliche Regulierung der Werbung: gut oder schlecht? Ein Kommentar zum Beitrag von Kassarian und Kassarian in JCP, Band 11, September 1988. Kassarian und Kassarian untersuchen in ihrem Beitrag die Wirkung von staatlicher Regulierung auf die Qualität von Werbeaussagen, insbesondere was das Ausmaß an Irreführung betrifft. Die Autoren stellen drei Hypothesen auf, die durch die präsentierten Daten teilweise bestätigt werden. Insgesamt ziehen die Autoren die Schlußfolgerung, daß staatliche Regulierung ziemlich erfolgreich war. Der Autor dieses Kommentars bewertet nun dieselben Daten anders und präsentiert für sie eine alternative Erklärung. Der Unterschied zwischen den beiden Erklärungen ergibt sich daraus, daß seine Erklärung sich aus einer Theorie ableitet, die der implizierten Theorie von Kassarian und Kassarian genau entgegengesetzt ist. Nach seiner Theorie ist die Situation ohne staatliche Eingriffsmöglichkeiten optimal. Konsumenten bekommen und Anbieter liefern diejenige Qualität der Werbung, die nachgefragt wird. Werbung ist eine Sache der Attraktivität und Gegenstand eines wettbewerblichen Marktprozesses. Nach dieser Theorie können die Erfolge staatlicher Interventionen ausschließlich negativ, d.h. ineffizient, sein und nicht, wie Kassarian und Kassarian geltend machen, negativ oder positiv oder irgendwo dazwischen.

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Reply

The authors of the original article, Harold H. Kassarian and Waltraud M. Kassarian, have sent the following reply:

“As much as we would like to present a rejoinder, we simply feel that there is nothing much to add. Every set of facts can be explained by different, even opposing, theories. Our data stand as they were presented. We have one interpretation, the author proffers another. It is up to the reader to decide which one of us is correct.”