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Explaining The Concept Of Consumer Surplus

Michel Kelly-Gagnon

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A large majority of people do not smoke, or no longer smoke, and tend to accept certain bits of conventional wisdom without question. Smoking tobacco being harmful to one's health, smokers therefore need to be protected--even those who would choose to, say, patronize their own smoking restaurants and bars. And we can count on government to enforce regulations and bans to this effect.

But what if smokers get something from their "vice," and that this can be explained in economic terms? The answer could be found in the concept of consumer surplus.

I found in the current issue of *Regulation* an article by Pierre Lemieux that is particularly useful in understanding and analyzing this issue. Pierre Lemieux is an economist affiliated with the Department of Management Sciences at the University of Québec in Outaouais, and a Senior Fellow at the Montreal Economic Institute. *Regulation* is a quarterly magazine published by the Cato Institute in Washington, DC.

Professor Lemieux starts by noting that plain packaging of tobacco products is the new frontier of anti-smoking activism. The Canadian government intends to impose plain packaging of tobacco products as the Australian government and a few others have already done. (Incidentally, my MEI colleague Youri Chassin recently published a research paper on this topic.)

Some years ago, I wrote an article about the tendency of the Nanny State to control us for our own good. "My point," I wrote, "is not to say that public health officials in Canada are communists or fascists. As a matter of fact, one of my closest neighbours works for Health

Canada in the anti-tobacco field and she's the nicest person you can imagine. She has all the best intentions in the world."

But good intentions aren't enough. The important question, which Lemieux asks, is: Shouldn't we assume that consumers can weigh for themselves the costs and benefits of more or less risky products, and make their own individual choices? And shouldn't this apply to tobacco too?

Economic analysis proceeds from the principle that each individual makes his choices given his preferences and the costs--including the risks--of satisfying them. As Lemieux explains, "[E]conomists traditionally have used individual preferences as the ultimate criterion" of what is good. These preferences constitute the foundation of the method of cost-benefit analysis.

Economists call the net benefit that an individual gets from a good he decides to consume or an activity he chooses to pursue his "consumer surplus." Lemieux quotes a well-known economist who was a pioneer of cost-benefit analysis, Ezra J. Mishan, who wrote: "The consumer's surplus is the most crucial concept in the measurement of social benefits in any social cost-benefit calculation."

In 2014, a group of nine self-described "prominent economists" argued that only a small part of smokers' consumer surplus should be regarded as real. Following in their footsteps, the Australian government decided to simply ignore consumer surplus when evaluating the social costs and benefits of plain packaging, which was contrary to their own official guidelines for cost-benefit analysis.

The two arguments typically made for neglecting the consumer surplus in the case of smokers are that they are either addicted to tobacco or uninformed about its consequences. Regarding the first charge, from a simple statistical perspective, there are now more ex-smokers than current smokers. As for the second argument, smokers, far from underestimating the health risks of smoking, *overestimate* them, according to research by Professor W. "Kip" Viscusi, an expert in the economics of risk.

The public health movement's approach is very different. For many decades, it simply ignored economic analysis. But maybe people who choose to smoke simply judge that for them, the benefits outweigh the costs, and they will continue to enjoy their "vice" for as long as this remains true.