

Testing Deregulation Can Help Fight COVID-19

The road to hell is paved with good intentions, says an old adage. Unfortunately, the saying has come to haunt India's fight against the COVID virus. The Indian Council of Medical Research (ICMR) stringently regulates which private labs can and cannot test for the virus. The ICMR licensing rules are intended to help consumers by protecting them against fraudulent labs. These regulations have however had quite the opposite effect. The ICMR regulations trampled private initiatives to test for the virus in the early stages of the pandemic, and they continue to limit our ability to detect, treat, and quarantine patients. The fight against COVID-19 would benefit from a comprehensive deregulation of the market for testing.

The ICMR regulations are based on the belief that the market for medical testing would fail in the absence of the quality standards set by the agency. After all, most consumers know little about medical science. They are unlikely to be able to tell good tests from impostors. With the possibility of fooling consumers in sight, phony private labs would mushroom. These labs would generate greater profits than genuine labs, as dummy tests cost pennies. Without government regulation, the story goes, the supply of dummy tests would far outnumber that of true tests. Given the low likelihood of getting a true test, rational consumers would see no point in paying for tests. They would no longer demand tests, and as a consequence labs would no longer sell them. This is the usual story of how markets, riddled with asymmetric information, would fail in the absence of government regulation, first told by George Akerlof in "The Market for Lemons: Quality Uncertainty and the Market Mechanism."

Most regulators are aware of the market failure story in one form or another. What is less known, however, is the penultimate section of the Akerlof's paper, in which he discusses markets institutions that can counteract the problems created by information asymmetry. This is critical, because the problem of information asymmetry between producers and consumers is not limited to the market for medical testing. It is rampant in markets for all goods and services. The root cause of information asymmetry is the division of labor. There is no information asymmetry in a Robinson Crusoe economy, where a single man produces all of what he consumes. In an economy with division of labor and exchange, most individuals do not produce the goods they consume. In fact, one of the causes of the increases in productivity that come with division of labor is that individuals develop specialized knowledge about the goods they produce. The flip side of the coin is that individuals know less and less about the

goods they consume. Most people cannot repair the automobiles they drive or program the computers they use, let alone build these goods from scratch.

So how do markets work despite asymmetric information everywhere? It depends on what we mean by markets. If we think of markets as places where people trade goods, one struggles to see why markets wouldn't fail in the absence of government regulation. But if we think of markets as places where people come together to solve problems associated with production and exchange, a wide variety of solutions opens up, not the least of which is branding and reputation. Some private players realize that there are greater profits to be made by being truthful to consumers in the long term rather than cheating them a few times. After all, consumers cannot be cheated forever. Those who come to know the poor quality of the car they bought or of the imitation medical tests they paid for are unlikely to patronize the seller in the future. Nor are they likely to recommend the seller to others. Reputation matters for profits. And suppliers are often more than willing to expose the poor quality of the products sold by competitors. Not long ago, detergent manufacturers in India would hold free washes to illustrate the performance of their product relative to that of competitors. Wine festivals and Formula One races are but more organized versions of competition to ascertain quality. What matters is not that consumers know a great deal about the goods they purchase, but that competing sellers are willing to expose each other's quality.

Rivalry between firms is only one of the many ways in which markets resolve the problem of asymmetric information. In some markets, specialized firms emerge which rate the quality of products sold by other firms. In financial markets they are known as rating agencies. In some markets, the certification takes the form of franchising. McDonald's, for instance, ensures the prescribed quality standards in all its stores through frequent inspections, coupled with a high cost for violation. Hospital chains impose quality standards on affiliated physicians. And finally, there are web portals which maintain and sell customers reviews. Each of these methods of ascertaining quality differs in its enforcement mechanism, but they all point to the reality that markets are as much about quality and long-term relationships as they are about prices and quantities.

Not only is the market for medical testing likely to work without ICMR regulations, it is likely to work better. The COVID case is unfortunately illustrative. In the early phases of the COVID pandemic, the Indian Council of Medical Research effectively prohibited labs from testing for the disease. In the absence of these regulations, entrepreneurs would have seized the opportunity to make profits by expanding testing facilities in the wake of the pandemic. More

recently, the ICMR has allowed a limited number of private players to test for the virus. Regulations, however, require that the labs use testing kits approved by the US Food and Drug Administration, the European Union, or one of its own centers. This raises the costs of testing and thereby limits access. Without the ICMR testing kit regulation, competition among kit makers is likely to drive down costs, much the way the competition between automobile manufactures drove down car prices in the post-Ambassador era. Regulations keep potential low-cost solutions out of the market for far too long. Mass testing requires a system capable of mass-producing kits at sufficiently low costs.

Germany's success in testing for the virus is illustrative of some of these mechanisms at work. Germany has been testing more than one hundred thousand people per week since late February. By April 20, it had tested more than twenty-five persons per thousand. Compare this to India, where the testing rate is less than one person per thousand. One reason for Germany's success is a relatively freer market for medical testing compared to India. Private companies in Germany were able to mass-produce the test kits early on, as they were less burdened by a central regulatory body like the Indian Council of Medical Research. The government of India has struggled with the paucity of testing kits and equipment. But the number of testing kits—not unlike the number of ventilators and hospital beds—is not an immutable given. Rather testing kits are resources created by people under different institutional arrangements. Some institutional arrangements incentivize us to strive to serve our fellow human beings, while others generate sloppy and lethargic behaviour. Germany's experience tells us that, in contrast to conventional wisdom, decentralized systems are likely to respond more effectively to pandemics than systems that depend on central directives.

The COVID pandemic illustrates an often underappreciated cost of government regulation: the impeding of rapid market responses to new social needs. Government regulations often have more to do with the present than the future. They are not written to tailor our responses to unforeseen pathogens. Profit-motivated entrepreneurs, unlike government bureaucrats, have an incentive to predict possible pandemics, much the way hedge funds forecast stock prices and automobile producers forecast the demand for cars. Such forward-looking behavior is the key to predicting and acting within a reasonable time frame to contain new pathogens. Regulatory reforms are in order if we are to maximize our chances of successfully fighting pandemics; the next one might not give us as much time as the present one has.