

## Telling Other People How to Run Their Businesses

From time to time I think of a better way that other people should do what they are doing. If I am wrong, that raises the puzzle of why the arguably wrong way people are doing things is right.

And there is always the chance that I might be right ...

### How to Run a Restaurant

When I eat in a restaurant I am consuming two different things, both of which cost the restaurant money, the food produced and the use of the part of the restaurant I occupy. I can order a bowl of soup and linger over it for an hour. I can choose to eat lots of expensive food fast and leave. Since the restaurant charges only for the food, I have no pecuniary incentive to economize on my consumption of space. Since the price of the food has to cover the cost of both food and space, I have too strong an incentive to economize on my consumption of food. If desert costs the restaurant four dollars to produce, is priced at eight dollars and worth six dollars to me, I don't buy it, costing me and the restaurant two dollars of potential surplus. Similarly if sitting in the restaurant another half hour talking to a friend is worth four dollars to me and costs the restaurant six dollars in lost custom.

The solution is to price food and space separately. When I sit down, a clock at the table starts running. When I leave, my bill includes a price per minute for the time plus the cost of what I ordered. If I want to spend two hours chatting with a friend over tea and scones I can do it and pay for it without worrying about angry looks from the waiter. My bill should average out about the same, since the combined bill still has to cover the same costs, but now the costs of sitting and of eating are being billed separately, giving me the right incentive with regard to each.

No restaurant, so far as I know, is run that way. Some have crude approximations, such as a cover charge, but why not simply price food and space separately, just as rental cars price car and gas separately?

When I raised the puzzle on my blog, some of the answers I got hinged on psychological factors, customers who would be bothered by the pressure of a running clock or find that such a restaurant felt less hospitable or that charging for time “is so culturally revolting that restauranteurs know customers won't put up with it.” Such explanations might explain why some restaurants choose not to do things my way but not why all restaurants do, since each would apply to some customers and restaurants and cultures but not to all.

Other commenters reported that there were institutions, although not restaurants and not in the U.S., that did something along the lines I suggested, karaoke places in Japan and Hong Kong and manga cafes in Japan. “You pay by time and room size. Some basic beverages are usually included. Food is extra.” Another referred me to [Ziferblat](#), a Russian chain with branches in other countries that charges only for time. The food and drinks — coffee, cookies, and the like — are free. “It blurs the lines between a pub, your front room and a coffee shop.”

Not a restaurant.

## Why Tie Showing to Selling?

To shop for a car I visit multiple dealers, each for a different brand, test drive a car at each. Why don't I have the option of going to one location that lets me try and compare different brands of cars, provides access to a few well informed and unbiased advisors and suitable literature to help me decide which to buy. Why not a firm that sells service rather than automobiles, charges me, say, fifty dollars an hour for helping me choose a car?

The advantages of such a firm have declined as auto malls become more common, reducing the time and inconvenience of visiting multiple dealers, but not to zero. If I buy a car from a dealer that also provides a showroom and test drives, I am paying for both in the car's price if I buy it, nothing if I don't. Separating the two products would have the efficiency advantage I described in the restaurant context. It would also make it easier for me to compare and choose.

Another reason to sell cars that way, and one becoming more important with the spread of online commerce, is to prevent car buyers from free riding on the services dealers provide. With the present system a buyer can get sales services for free from the dealer then buy a car online. The more common that becomes, the harder it will be for dealers to charge enough over the cost of the car to pay for the showroom and salesmen.

## Boarding Southwest: The Sound of One Hand Clapping

It long ago occurred to me that one way of making the process of getting on an airplane easier would be to line up the passengers in advance in the inverse order of their seat numbers then march them aboard. That way the passenger in seat 25 would not have to wait while the passenger in seat six put his bag up. For a fancier version, do it by number and letter — first line up everyone with a window seat, march them in, then everyone with a middle seat, then aisle seats.

Some year back I was pleasantly surprised, preparing to board a Southwest flight, to find that they were indeed lining passengers up in order — in three successive groups: A, B, C. I assumed that someone else had finally gotten the same idea I had and implemented it.

Until I realized that the number on the boarding pass had nothing to do with where you sat, since the flight was open seating.

According to a 2006 article in *Wired*, America West organized an academic study of the question of how best to organize passenger boarding and, after applying both theory and simulation, came up with essentially my solution: “a boarding approach called the reverse pyramid that calls for simultaneously loading an aircraft from back to front and outside in. Window and middle passengers near the back of the plane board first; those with aisle seats near the front are called last.” According to the article America West implemented it. Other airlines came up with other solutions; AirTran “first seats the back five rows of the plane, then the front five, and continues rotating back-front-back until boarding is complete.” United Airlines “boards all window passengers first, followed by those with middle seats and, finally, those seated in the aisle.”

Since that article was written, additional research has been done on the issue of boarding strategies.<sup>1</sup> At present airlines routinely board by groups, with strategies such as grouping all

---

<sup>1</sup> For an example published in 2017 and references to others, see “[Comparative Study of Aircraft Boarding Strategies Using Cellular Discrete Event Simulation](#)” by Shafagh Jafer and Wei Mi.

passengers near the back of the airline or all window seat passengers and sending them in first. No airline I have observed implements its boarding strategy by lining passengers up as I have suggested.

Southwest's experience demonstrates that it could be done. But nobody appears to be doing it.

### **How to Buy and Sell Houses**

When you are looking for a house, one of the first questions the real estate agent is likely to ask is how much you can afford to spend. The prudent customer will think twice before giving an honest answer. Realtors are paid a commission based on the price of the house; if you tell her you can afford a four hundred thousand dollar house she may, if she is competent, find you the best four hundred thousand dollar house in the city but has little reason to look for a house almost as good and a hundred thousand less.

What you want is not the best house you can afford but the house that gives you the maximum surplus, the largest possible difference between what it is worth to you and what it costs. Perhaps you ought to reward the realtor on the basis of how good a job she does of finding it. To do so, each time the customer looks at a house he tells the realtor the highest price he would pay for it. When the customer finally buys, the realtor's commission is a percentage of the difference between the highest price the customer said he would pay and the actual price paid.

This system gives the realtor an incentive to find the right house, the house that maximizes the net benefit from buying it. It also gives her a direct financial incentive to do as good a job as possible of helping the buyer bargain the seller down — the opposite of her incentive under the present system.

It is an imperfect solution for at least two reasons, putting aside the difficulty of getting the profession to adopt it. The first is that the customer has an incentive to lie, to understate the value to him of each house in order to reduce the commission he will have to pay if he buys that house. But he knows that doing so has a risk; he may end up with the wrong house either because the right one is above his claimed limit or because his lie results in the realtor finding him a different house instead.

The second problem, shared with the present system, is that it ignores the cost of search. As long as a dollar's worth of extra search produces more than a dollar's increase in net benefit, it is in the joint interest of realtor and customer to continue searching. Both benefit and cost are shared between the realtor and her customer, but there is no reason to expect that the fraction of search costs born by the realtor will be the same as the fraction of benefit received. If she bears most of the cost but receives only a fraction of the benefit, it will be in her interest to stop search too soon.

One possible explanation for the present system is that people regard a house as a good investment; the interest is tax deductible and everyone knows, or used to, that house prices always go up. If it is a good investment it may make sense to buy the most expensive house you can finance, even if the benefits of living in the house do not justify the price.

That argument looks less convincing now than it used to.

### **Pricing Rooms**

If the agent's first question is how much you can spend, her second is likely to be what sort of house you are looking for: how large, how many rooms of what sort, in what location. Put that

way, it is the wrong question; with houses as with other things, what you want to buy depends on what it costs. You would like to have a house with a bedroom for you and your wife, a bedroom for each child and an extra bedroom for a home office but if that costs too much, you could put your desk at one end of your bedroom or persuade two children to share a room. Whether you want to do so depends on how much one more bedroom adds to the price of a house. What you need is a price list, a description of how much more you can expect to pay for a house with more rooms, a larger lot, in a better location.

So far as I know, no such price lists are currently available, but one could be. Realtors have access to extensive information on the characteristics of houses that have sold and what price they sold at. In an area with a sufficiently lively real estate market it should be possible to calculate how much more, on average, a house costs with one more bedroom, an additional hundred square feet of area, a larger yard or in a better school district. All it takes is running a multiple regression on the data.

Somebody, perhaps the multi-lister service that currently provides data to the realtors, should do it. If they are not willing someone else, using the information provided by Zillow, could do the calculations and sell the information to realtors. The realtor provides his customer with a price list, the customer decides about what sort of house he is looking for, and the realtor finds and shows him houses accordingly.

### **Drugs for Africa: A Modest Proposal**

How can one make medical drugs available in countries too poor to pay American prices? The obvious solution is discriminatory pricing, selling in poor countries at prices lower than charged in rich countries but higher than the actual cost of production. That provides more money to the producer than trying to charge a price people cannot pay, and it provides their customers with drugs.

The problem is resale. How can the drug company be sure that the drugs it sells at a cheap price in Zambia do not get resold in France or the U.S., undercutting them there? One possible solution is to control distribution; once the drug is in the patient it cannot be resold. But that may be difficult to do in poor countries lacking the infrastructure to monitor what happens to drugs once they get there.

I have another solution. Let charitable donors in rich countries buy out the patent on the second best AIDS drug and public domain it, letting anyone who wants make it. The patent should not be that expensive, since it is probably not making much money any more. Even if the same company owns the first best drug it should not lose too many sales, since most customers who can afford the best drug will keep taking it.

This proposal has one large advantage over the alternative of forcing drug companies to make their drugs available at a low price in poor countries, with the threat that if they do not the countries in question will refuse to enforce their patents. That proposal makes the development of new drugs less profitable and so buys a short run gain in availability at the long run cost of slowing the development of new drugs. It could be a very large long run cost if the practice spreads from very poor countries up to less poor countries. My proposal, on the other hand, makes the development of drugs not less profitable but more. You can make money on your drug until a competitor brings out something better then get a little more by selling it to the Gates Foundation.

I have a second suggestion, this one intended to make drugs more available for both rich people and poor people. FDA rules on testing should allow drug companies to make not yet approved drugs available abroad in order to use the information so generated to meet the requirements for approval in the U.S. That would bring down the cost of finding out safe and effective new drugs are. At the same time it would provide low cost — albeit somewhat risky — drugs for people in poor countries.

Critics will argue that it is unjust for rich people to get the best drugs and poor people the second best, even if the realistic alternative is poor people not getting any drugs at all. They will make good demagogic use of the idea that it is wicked to use human beings as guinea pigs for potentially dangerous drugs, despite the fact that using humans as guinea pigs is the only way we have of finding out whether or not drugs are safe for humans.

### **An Entrepreneurial Proposal**

Many museums, such as the Metropolitan Museum in New York or the Royal Ontario Museum, sell replicas of some of the historical jewelry in their collection. Typically the quality is significantly lower than the quality of the original, cast when the original was constructed, often using glass instead of gemstones. Despite which the replicas are expensive.

For quite a long time, I have been seeing imported jewelry, usually in silver, coming from places such as Bali and India. The quality of execution is comparable to that in historical pieces: precise filigree, some of it probably using the technique developed in antiquity to do fine filigree and granulation without having the details blurred by solder.<sup>2</sup> It is better than the museum replicas and much less expensive.

This suggests a possibility for an entrepreneur with an interest in historical jewelry and contacts somewhere in the third world. Put together a collection of pictures of pieces of historical jewelry. Locate craftsmen willing and able to make copies of those pieces. Web your pictures as a catalog and offer to make any piece in it. For a somewhat higher price, guarantee never to make another copy of the same piece.

This particular idea occurred to me because I happen to be interested in historical jewelry, but there must be many other market niches of the same sort, categories of goods for which the combination of online marketing and hand-craft technology would make it possible for customers to get unique items of special interest to them while providing profitable work for craftsmen in poorer parts of the world. Some of this already happens, organized by entrepreneurs in the Third World. How much was happening in 2009 when I first made the suggestion on my blog I do not know.

One of my hobbies is historical recreation in the Society for Creative Anachronism. The persona I represent is a North African Muslim from about 1100. I happen to own a small and very lovely Damascus steel knife, a Kard, the sort of utility knife my persona might carry to cut meat, or rope, perhaps to whittle down a piece of wood. I was not willing to carry it and use it that way at SCA events for risk of losing or damaging a valuable antique.

I noticed sellers of Damascus steel knives on EBay, with prices that seemed absurdly low compared to knives made in the U.S. by enthusiasts. I bought one and found that it was indeed as advertised, so I sent the seller in India pictures of my kard and a query as to whether he would be

---

<sup>2</sup> Sometimes referred to as colloidal hard soldering. A [description](#).

willing to reproduce it. He was and did, producing a close and very attractive copy. The price was unreasonably low, so I bought several more for gifts.



My original



The copy

### **An Economist Who Was Right**

One might expect restaurant owners, airline executives and realtors to know more than I do about their business, so if my suggestions were good ones they should already be being done. If so, my proposals are really puzzles: Given the arguments for what I propose, why doesn't it work?

I have one example, however, of an economist doing what I have been doing and succeeding; his proposal was implemented, and still is, by most or all of the industry. The economist was Julian Simon, best known as the leading critic of the population scares of the sixties and seventies but active as an energetic critic of other orthodoxies as well. The industry was the airlines. The issue was overbooking.

Since airlines do not want to fly empty seats, they sell a few more seats than the plane has in the expectation that a few passengers will cancel. Occasionally not enough do and the airline ends up with more passengers than seats. They used to solve the problem by bouncing the passenger who showed up last, compensating him with a refund of the ticket price plus a free seat on the next flight. I remember at the time seeing the suggestion that one could sometimes get a free flight by deliberately showing up just before boarding closed.

This was a very inefficient solution; the last person to show up might be a busy executive with a tight schedule for whom the cost of the delay was much more than the price of a ticket. There might be other passengers for whom the cost of being switched to the next flight was little or nothing, perhaps because the next flight would still make their connection. What the airline ought to have done was find the passengers most willing to switch flights and offer to pay them to do so.

To an economist, the solution is obvious: An auction. If the flight is overbooked, offer passengers the opportunity to switch to a later flight in exchange for a suitable payment. If nobody volunteers, raise the offer. Julian Simon demonstrated the workability of the approach by holding mock auctions in airport departure lounges, that being well before 9/11, a time when anyone who wanted

could walk into the lounge where passengers were waiting for their flights. Eventually, with the help of Alfred Kahn, the economist in charge of deregulating the airlines under Carter, he persuaded the airlines to try his idea. They are still doing it. James Heins, who was a colleague of Simon at the University of Illinois, [estimates](#) the total savings since then, mainly by allowing airlines to run fuller flights, at \$100 billion.

Sometimes, when an economist thinks people are doing things wrong, it is worth saying so.