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“Summary of article by David B. Hamilton: Institutional Economics and Consumption”

This article reviews the treatment of consumption in classical and neoclassical economics, and presents an institutionalist alternative based on Thorstein Veblen's analysis.

JEREMY BENTHAM AND HIS GHOST

Classical economics focused on the problem of increasing production, and paid little explicit attention to consumption. Both classical and neoclassical economics sought to demonstrate that prices are based on values – derived from embodied labor in the former case or from subjective feeling in the latter. For the neoclassical school, psychological egoism, in the form of the hedonism championed by Jeremy Bentham, provided an alternative approach to value. For the classical school, work was viewed as painful and the products of work were valuable in proportion to the amount of work that went into their construction.

The problem with the classical economists' labor theory of value was that it led directly to Marxism. "If labor is the ultimate author of all things, then it seems only reasonable that the author should also be vested with ownership. This proposition suggests itself even to sluggish minds; those with more nimble minds can do all sorts of things with it." (1535) Neoclassical economics and its treatment of value and consumption were largely a response to Marx and his elaboration of the labor theory of value. By the 1870s, when Stanley Jevons, Carl Menger, and Leon Walras published their works on marginal utility theory, the first volume of Karl Marx's *Capital* was widely available and becoming influential in the socialist movement.

"The psychology that snatched victory from the Red Baron was itself flawed, however. Hedonism was not acceptable in any other area of social inquiry except economics. Rather than rise to the defense of Bentham, an impossible task, some economists began to deny that psychology was relevant to the theory." (1537) This approach, epitomized in Lionel Robbins' much-quoted phrase, "We take wants as given," was later formalized by Paul Samuelson in the mathematics of revealed preference. Although Galbraith and others have made it clear that wants are not "given," but are shaped by social influences, conventional economics views consumption as the final, external end to economic activity, largely outside the realm of analysis by definition.

GOODS AS SYMBOLS OF STATUS AND AS INSTRUMENTS TO ACHIEVE ENDS

One of the classic works in institutional economics, Thorstein Veblen's *The Theory of the Leisure Class,* was written as a theory of consumption. Although frequently misinterpreted as solely a satirical social commentary or a description of exceptional behavior, Veblen's work in fact presents an alternative to the hedonistic model of behavior underlying conventional theory.

While neoclassical theory assumes that individuals are always striving to reach (and then, presumably, passively remain at) a static, optimal equilibrium, Veblen viewed human beings as active and evolving. Production and consumption are interrelated, ongoing activities, neither of which is simply a means to an end.

Conventional hedonistic theory treats people as isolated individuals with minimal, narrowly defined influences on each other. Economists are fond of alluding to the story of Robinson Crusoe and his isolated plans and calculations as an illustration of economic behavior. However, all behavior is simultaneously individual and social, and assumes culturally conditioned forms. Viewing consumption from this standpoint, Veblen noted that all actions have two dimensions: one ceremonial and the other technological or instrumental. We use consumer goods both as symbols of status and as instruments to achieve some end.

Veblen's treatment of consumption and status is frequently misrepresented as "keeping up with the Joneses," a nonstop race to outspend each other. In fact, he maintained that everyone is expected to spend on a level commensurate with his or her status. Conspicuous consumption demands "adequate" expenditure but also places limits on that expenditure. To exceed what is called for will attract unwanted attention as surely as will inattention to status-defined expectations.

Style and fashion are tangential to this phenomenon. Veblen contended that the leisure class set styles which were then emulated by others. Items of fashion, losing touch with function, could go out of style quite quickly. Emulation by lower-status groups makes yesterday's fashions no longer stylish for the upper strata.

The ceremonial value of any good depends on its authenticity or appropriateness for particular circumstances. A tuxedo or wedding gown would be out of place at a tennis match. Conformity to social standards begets a certain self-satisfaction, seemingly giving credence to a hedonistic interpretation of behavior: but, conspicuous consumption should not be interpreted to mean simply that socially approved spending patterns make individuals happy. Such an interpretation of Veblen and the institutional theory of consumption would be faulty for two reasons.

First, individual feelings are prone to change far more often than social norms of consumption and therefore provide an unstable basis for valuation. Conventional economics has responded to this dilemma by moving even farther away from social analysis, adopting an extreme relativism and refusing to express any judgment on anyone's feelings or preferences. This nihilism resembles the cultural relativism of sociologists and anthropologists, although economists go even farther in making truth dependent on the individual rather than on culture.

Second, the utilitarian interpretation of Veblen ignores his understanding of the dual function of consumer goods. If goods were used solely as symbols of status, then conspicuous consumption could be viewed as socially induced irrational behavior, as is sometimes suggested. However, Veblen distinguished between the use of goods to satisfy conspicuous consumption and the use of goods to achieve some instrumental objective. Cars, for example, are simultaneously symbols of status and instruments of transportation. A simple problem (e.g., physical deterioration of the car) may interfere with both its ceremonial and its technological roles.

Veblen's standard of value was ultimately an instrumental one. Society does care about the instrumental efficacy of goods, as shown for example by the existence of consumer testing organizations. But since status considerations also affect consumer decisions, an institutional theory of consumption cannot link price to instrumental value alone.

AGGREGATE CONSUMPTION EXPENDITURE DOES MATTER

In conventional macroeconomics, savings is a dynamic force that allows for investment and growth, while consumption is a deterrent to savings. In the institutional view, consumption and savings are interdependent, and tend to increase together. Indeed, it is sometimes hard to distinguish one from the other; only in the second half of the twentieth century has economics realized that a consumption expenditure such as education can be treated as investment in human capital. The same is true for expenditures on health and nutrition (food), as well as on other necessities of personal and family life. Since consumption is so closely tied to production, investment cannot be expanded in the long-run without a concomitant increase in consumption.