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"Foundations of Economic Theories of Consumption" by Frank Ackerman

The standard economic theory of consumer behavior is a relatively recent creation in historical terms, no older than consumer society itself. That theory, in brief, assumes that consumers come to the market with well-defined, insatiable desires for private goods and services; those desires are not affected by social interactions, economic institutions, or the consumption choices or well-being of others. Only prices, incomes, and personal tastes affect consumption - and since tastes are "exogenous" (that is, determined outside the realm of economics), there is little point in talking about anything but prices and incomes.

The relationship of this theory to the visible facts of economic life is tenuous at best. No other social science accepts this theory, nor holds a similarly narrowed view of the process of consumption. Yet in economics the neoclassical theory, as it is called, has dominated professional discourse throughout the twentieth century. Its abrupt appearance in the last third of the nineteenth century is a central event in the history of economic thought. Parts V and VI examine the foundations of the neoclassical theory of consumption, and the critiques and alternatives that have been proposed. This part focuses on work done before 1960, while Part VI addresses the period since then.

The economics that we know today did not triumph for lack of well-articulated criticisms and alternatives. Indeed, one great mystery of the field is how rapidly and totally its dissenters have vanished. One step beyond the mainstream in economics, evidently, there lies an intellectual Bermuda Triangle where voyages of thought disappear without a trace. Some of the missing have turned up on other shores, leading new lives as influential voices in sociology, history, political debate, and cultural criticism. But word of their survival rarely makes it back to their native discipline.

The goal of this part is two-fold: to explore the origins of neoclassical theory, and to rediscover some of the lost dissenters of economics, whose criticisms may yet point the way toward a new frontier in economic thought. Of the nine articles presented here, the first four span the period from the beginnings of economics through the nineteenth century. The remaining five include a unique look at the views of John Maynard Keynes and four seminal contributions from the generation of economists who followed him in the 1940s and 1950s.

MATERIALISM, HUMANISM, AND CLASSICAL ECONOMICS

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Modern economics often traces its origins back to Adam Smith. The core ideas go back even farther, to an innovation in philosophical tradition at the dawn of the capitalist era. In the beginning economics was seen as a branch of moral philosophy. However, the lead actor in the standard economic model, the "rational economic man," is an insatiably acquisitive individualist - which is not a personality type that is endorsed by traditional moral philosophies. In the first summary in this section, Joel Kassiola examines the history and meaning of materialism, both as a philosophical doctrine and in the more colloquial sense, as a synonym for acquisitiveness.

Kassiola begins his discussion of modern materialism, in the latter sense, with the thought of Thomas Hobbes. Writing in the seventeenth century in the midst of the English Civil War, Hobbes expounded a competitive individualism: Everyone always wants more power and material goods to protect what they already have, and to satisfy the desires for social recognition, honor, and vanity. "Felicity is a continual progress of the desire from one object to another, the attaining of the former being still but the way to the latter," said Hobbes. "I put for a general inclination of all mankind a perpetual and restless desire of power after power that ceases only in death."[1]

At the time this was as novel and controversial as Hobbes' better-known innovations in political theory. Rousseau was a prominent early critic, arguing that relentless competition and acquisitiveness were not innate in human nature, but rather were created by a particular social system and could be changed by a different system. Kassiola's sympathies are clearly with Rousseau in this disagreement; he traces the criticism of unlimited acquisitiveness back to the ancient Greek philosophers, and forward through a number of the authors whose work is summarized in this volume. But economic theory has taken Hobbes' side of the debate. As competition and acquisitiveness came to play a more important role in the theories of the day, economics detached itself from moral philosophy and became known as "political economy."

A little more than a century separates Hobbes' *Leviathan* from Adam Smith's *Wealth of Nations*. In that interval, as English capitalism advanced from the Civil War toward the Industrial Revolution, economic theory moved toward acceptance of the merits of consumption as an end in itself - as described in the article by McKendrick in Part IV. The prevailing school of economic thought in the seventeenth century was mercantilism, which viewed foreign trade as the key to national prosperity, and saw domestic consumption as an impediment to trade and growth. Moreover, the religious beliefs of the day tended to stigmatize luxury consumption as immoral. But these skeptical views of consumption dissolved in the warm bath of eighteenth-century economic growth. In 1714 Bernard de Mandeville caused a furor with the publication of his satirical *Fable of the Bees*, extolling the virtues of wasteful luxury consumption as a means to create work for the poor. By 1776, however, Smith's classic work could argue confidently that increasing individual consumption was the goal of all economic activity; since his time that goal has often been simply assumed without comment.

The rise of economic theory was not a smooth crescendo from Adam Smith's day to the present. Discordant notes were heard almost at once, as described in the article by Mark Lutz and Kenneth Lux. They explore the history of humanism in economics, by which they mean the explicit concern for the well-being and opportunities for self-development for all individuals. Lutz and Lux quote Smith's cheerful assertion that laissez-faire economics would be good for

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everyone, leading to almost the same results as equal division of all resources. Smith's successors, in contrast, were less sanguine. Classical economics was often a rather grim affair, weighed down by population pressure, declining wages and crop yields, and the like. Nor, as it turned out, was it a very long-lived school of thought. In the second half of the nineteenth century, according to Lutz and Lux, classical economics split into three branches: humanistic economics, Marxism, and neoclassical economics.

Humanistic economics may be the first of the dissenting traditions to disappear without a trace. In their day, Simonde de Sismondi, John Ruskin, and John Hobson were well-known, influential figures.[2] Their critiques of the social effects of industrialization and mass production, their advocacy of creative work and production for human use, their concern for the aspects of human welfare that transcend material needs and private consumption, all made an impression on their contemporaries. Sismondi's descriptions of early industrialization were quoted extensively by Marx in *Capital*; Ruskin had a significant impact on Gandhi's thinking; Hobson received an uncharacteristically friendly treatment from Lenin, who relied heavily on Hobson's analysis of imperialism. Yet virtually nothing was heard of them in academic economics.

The next branch off the tree of classical economics was not exactly forgotten. In the hands of Karl Marx, the labor theory of value and other elements of classical economics were combined with ideas from history and philosophy to form a sweeping indictment of capitalism. Production, specifically the labor process, was the focus of Marx's economics, and received far more attention than consumption. However, as Martyn Lee explains, a subtle understanding of commodities and consumption played an important role in Marx's analysis. At the beginning of *Capital*, his magnum opus, Marx introduced the idea of commodity fetishism: in a capitalist society commodities acquire meanings and values unrelated to their actual use, and relations between people as producers are concealed in the "fantastic form" of relations between commodities. This idea has a surprisingly modern ring to it, and has been put to creative use, as Lee demonstrates, in a number of contemporary Marxian interpretations of consumer society. But the modern writers discussed by Lee, examining issues such as the cultural definition of the meanings of goods, the role of advertising, and systems of social control, speak a language that is not often heard or understood within the discipline of economics.

THE RISE OF NEOCLASSICAL THEORY

By the late nineteenth century, a specter was haunting classical economics. Most economists were not inclined to identify with proletarian revolutionaries who had nothing to lose but their chains. However, Marxism appeared to be an uncomfortably logical consequence of the theoretical apparatus of Smith, Ricardo, and Malthus. The desire to answer or avoid Marxism contributed to the rise of neoclassical economics, as David Hamilton wryly observes (with the concurrence of Lutz and Lux). Political economy was now replaced by economics pure and simple. Any explicit mention of the labor process was banished, replaced by a vision of production as merely a combination of inputs to yield the maximum profit, rather like assembling a jigsaw puzzle. Consumption was interpreted in a precisely analogous manner, as an assemblage of purchases selected to yield the maximum utility. Since production is only profitable if someone buys the output, producers were described as responding to the commands of "sovereign" consumers. Thus the consumer, not the capitalist, was ultimately in control of the market system.

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Although neoclassical theory operates at a high level of abstraction, its origins were undoubtedly influenced by the economic conditions of the time. By the late nineteenth century the development of consumer society, as seen in Part IV, was well advanced. The activity of the consumer choosing among a myriad of options in the marketplace was becoming more important in reality, making it more plausible for economic theory to focus on consumption. A century earlier, when consumer society was less firmly established, an economic theory of consumption would have seemed beside the point.

The scientific developments of the nineteenth century also played a part in shaping neoclassical economics. Rapid progress in physics, expressed in elegant and powerful mathematical formulations, defined the image of a successful science; the pioneers of neoclassical theory borrowed heavily from the physics of their day.[3] Adam Smith's metaphor of the invisible hand fit comfortably into an analogy with thermodynamics, where individual producers and consumers are seen as particles moving toward equilibrium.

In one crucial area, however, neoclassical theory fell well behind the state of the art. In their understanding of human behavior and motivation, the inner forces driving the economic particles, the early neoclassicals looked back even earlier to the utilitarianism of Jeremy Bentham. Utilitarianism was a hedonistic philosophy that assumed that the goal of society was to make individuals as happy as possible; Bentham asserted that the level of satisfaction, or "utility," of each individual could be added to yield a measure of social welfare. Reliance on utilitarianism had its advantages: The notion that all motives can be reduced to the pursuit of individual pleasure (or "maximization of utility") provides a theory of behavior which is easy to formalize in a mathematical model; the assumption that each individual is the sole judge of his/her own satisfaction leads to a subjective theory of value which is above any suspicions of Marxist implications. However, utilitarianism was incompatible with the understanding of human motivations and behavior developed in the emerging fields of psychology and sociology.

Modern critiques of neoclassical economics are presented in Part VI. For now it is enough to note, as Lutz and Lux do, that some of the founders of neoclassical economics held more complex views of human nature and desires. Alfred Marshall, the creator of the familiar graph of intersecting supply and demand curves and many other fundamentals of modern microeconomics, was a former theology student who was deeply concerned about the ethical implications of economic theory. Marshall believed that it was possible to make a distinction between higher and lower desires; indeed, a hierarchy of more and less urgent wants is one possible basis for the declining marginal utility of consumption. Unfortunately, Marshall concluded that such subtleties could not be incorporated into economics, writing that

> Such a discussion of demand, as is possible at this stage of our work, must be confined to an elementary analysis of an almost purely formal kind. The higher study of consumption must come after, and not before, the main body of economic analysis; and, though, it may have its beginning within the proper domain of economics, it cannot find its conclusion there, but must extend far beyond.[4]

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Ironically, Marshall is remembered today for what he referred to as elementary and almost purely formal analysis.

MORE THAN SOCIOLOGY

The behavioral assumptions of neoclassical theory received somewhat harsher treatment from one of Marshall's contemporaries:

> In all the received formulations of economic theory... the human material with which the inquiry is concerned is conceived in hedonistic terms; that is to say, in terms of a passive and substantially inert and immutably given human nature. The psychological and anthropological preconceptions of the economists have been those which were accepted by the psychological and social sciences some generations ago. The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact.[5]

For Thorstein Veblen, the neoclassical view of the consumer was already "some generations" out of date in 1898. Veblen argued that "it is the characteristic of man to do something, not simply to suffer pleasures and pains... [Human nature is] a coherent structure of propensities and habits which seeks realization and expression in an unfolding activity."[6]

Veblen is of course famous for the idea of conspicuous consumption, which he introduced in *The Theory of the Leisure Class* (although an earlier economist, John Rae, had presented a similar perspective on luxury consumption[7]). Hamilton reminds us that Veblen was developing a theory of consumption, not just presenting social commentary or satire. For Veblen, goods were both ceremonial and instrumental, yielding both status and use-value to their consumers. Over time the ceremonial aspect of consumption could expand indefinitely without producing any net increase in satisfaction, as Veblen so effectively and satirically demonstrated; but at any point in time, there was an appropriate level of status-oriented consumption for each group in society.

Conspicuous consumption was not Veblen's only innovation. He created an evolutionary, institutional theory of economics that differed from mainstream views in countless ways. He offered a feminist interpretation of anthropology and the origins of private property; a critique of absentee ownership, bureaucracy, and militarism; and an admiration of the "instinct of workmanship" and the potential of technology. These and other elements combine to create a strikingly original and thought-provoking theory.[8]

Despite his renown in other fields, Veblen is another casualty of the Bermuda Triangle of economics. All that remained floating on the surface after his disappearance was the comparatively small school of institutional economics (of which Hamilton is a member); this school draws much of its inspiration from Veblen and is almost entirely ignored by the mainstream of the economics profession. From the vantage point of other disciplines, few economists are as important as Veblen in discussions of consumption; more than one recent writer has simply declared him a sociologist, a reasonable inference from the company he (posthumously) keeps. For the record, Veblen was offered the presidency of the American

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Economic Association in 1925. Bitter at his lifelong rejection by the profession -- he was then 68, in his last year of work - he declined the offer.[9]

KEYNES AND HIS SUCCESSORS

A different analysis of consumption was central to the leading twentieth-century innovation in economic theory. Reflecting on the nature and causes of mass unemployment in the depression of the 1930s, John Maynard Keynes created a new approach to macroeconomics which legitimized government intervention to boost employment. His *General Theory of Employment, Interest, and Money* focused attention on the aggregate propensity to consume, devoting a chapter each to the objective and subjective factors influencing consumption. His principal macroeconomic conclusion in this area, the existence of a stable relationship between changes in national income and aggregate consumption, has prompted extensive theoretical and empirical debate. That debate is not reviewed here since it raises complex technical questions but adds little to the analysis of consumer behavior and motivation.

Keynes had little patience with theoretical deduction that ignored common sense, writing that "extraordinary achievement of the classical theory was to overcome the beliefs of the 'natural man' and, at the same time, to be wrong."[10] He based his work on fresh and perceptive observation of the real world rather than on neoclassical theory; a novel understanding of consumer behavior often seems implicit in Keynes' work, but is never quite spelled out. Since his time, economists have produced numerous more or less tortured attempts at reconciliation of Keynesian macroeconomics with neoclassical models of individual behavior, resulting in a thicket of mathematics at which Keynes himself surely would have been horrified.

According to S.A. Drakopoulos, generations of graduate students may have suffered through this mathematical thicket in vain. Carefully examining some of Keynes' less well-known writings, Drakopoulos demonstrates that Keynes quite emphatically rejected the neoclassical model of behavior and its utilitarian foundations. Unfortunately Keynes offered only scattered comments about his preferred alternative; Drakopoulos argues that those comments are consistent with belief in a hierarchy of wants of differing urgency and importance. A formal model based on such a hierarchy provides a neat explanation of one of Keynes' more puzzling observations, the "stickiness" of prices and wages. Thus an alternative model of consumer behavior may be lurking behind the scenes of Keynesian macroeconomics.

The tumultuous events of the depression and World War II, and the success of Keynesian theory, may have created an opening for new approaches to the economics of consumption in the 1940s and 1950s. The last four articles summarized in this section are leading contributions from that era. While older than other selections included in this volume, these mid-twentieth century works still represent new frontiers where many economists have not yet dared to go.

James Duesenberry is mentioned by Drakopoulos as the later economist who was closest to Keynes' approach to consumption. Duesenberry began with an empirical puzzle: the decline over time in the amount of savings by households at any constant level of real income. Rejecting much of the neoclassical theoretical apparatus, he took it as self-evident that individual preferences are interdependent, in part socially determined, and subject to learning and habit formation. The result of social interdependence was the "demonstration effect": contact with

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superior consumption goods and higher standards of living leads to a desire to increase one's own consumption. Although Duesenberry mentioned in passing that the demonstration effect need not depend on conspicuous consumption, most readers will find echoes of Veblen as well as Keynes in his analysis.[11]

The solution to the empirical puzzle was the "relative income hypothesis": Consumption depends not only on an individual household's income, but on its income relative to others. Duesenberry demonstrated that unconventional hypotheses could be modeled in formal mathematical terms (see the original article rather than the summary). Today, however, he is cited primarily by those who are looking for alternative theoretical perspectives; mainstream economics, with only a few exceptions, was quick to critique and then forget him.[12]

Another approach to formal modeling of alternative theories can be seen in the summary of the paper by Harvey Leibenstein. His "bandwagon, snob, and Veblen effects" are simplified models, depicted graphically in the illustrations, of three different ways in which social interaction can alter consumer demand for a good. (All three would have made sense to Veblen, despite the fact that his name appears on only one of them.) Each of Leibenstein's models implies a relationship between price and demand that differs from the standard neoclassical model, for in the latter social interactions do not affect demand curves. Taking Leibenstein's models seriously would require complex, far-reaching changes in the neoclassical theory of consumption; instead, they are more often exhibited as classroom curiosities than used for serious analytical work.[13]

Ragnar Nurkse's *Problems of Capital Formation* was an early classic in the new field of development economics. His chapter on consumption, summarized here, is the place where Duesenberry's demonstration effect had the greatest impact on economic theory. Just as Duesenberry had argued that a household consumes more when it comes into contact with higher-income households, Nurkse concluded that the same should be true of nations. Like Duesenberry, Nurkse was concerned about the aggregate rate of savings; inadequate savings and investment were crucial impediments to development. The demonstration effect of American consumption patterns, in particular, seemed to promote consumption and discourage savings in lower-income nations. Thus international inequality was inherently bad for development: The greater the inequality, the greater the force of the demonstration effect. In the postwar era of expanded international travel and communications, Nurkse feared that the demonstration effect would make it impossible for other nations to accumulate enough capital to industrialize. Nurkse's ideas are discussed further in Part IX, in connection with the global aspects of consumer society.

Finally, there is the economist who needs no introduction (in fact, we asked him to introduce us, as seen at the front of this book). *The Affluent Society* is one of the best-known books by John Kenneth Galbraith; its chapters on the nature of private consumption are summarized here. The book as a whole is a remarkably readable treatment of the history of economics and the problems of the American economy. Galbraith argues that it is no longer appropriate for affluent societies to place a priority on economic growth and maximization of output. Overemphasis on production for private consumption leads to too little spending on public goods and services, and too little leisure and economic security, among other undesirable consequences.

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Galbraith believes it is obvious that increasing affluence makes the growth of private consumption less urgent. Something unnatural had to happen, therefore, to keep people spending. The villain is the all too visible hand of advertising, creating the demand for new products as part of the process of production. Advertising, Galbraith suggests, is too large to ignore in an analysis of business behavior. And it cannot be considered of great social importance to satisfy desires for products if the desires were created solely by their producers' advertising.

Galbraith studied economics with members of the institutional school, and has always focused on the behavior of corporations and other major institutions. His history of economic thought, in the early chapters of *The Affluent Society*, highlights Veblen as perhaps the most important American economist to date. The chapters on consumption cite Keynes' comments on differing types of wants, and Duesenberry's analysis of the demonstration effect. Galbraith's prose style is lively enough that the publisher felt compelled to warn readers, on the book jacket for the first edition, that "while the author uses criticism, irony, ridicule - and humor - to make his case," nonetheless "it is a carefully reasoned economic treatise." The end result has been one more victim of the Bermuda Triangle: like Veblen before him, Galbraith is a central figure in discussions of consumption outside economics, and all but ignored within the profession from which he came.

The story of the debate about the neoclassical theory of consumption continues with more recent contributions in Part VI.

Notes

1. Thomas Hobbes, *Leviathan* (1651), quoted in Kassiola, 125.
2. For a related discussion of the same economists, see the article by Gerald Alonzo Smith summarized in Krishnan, Goodwin, and Harris, editors, *A Survey of Ecological Economics*.
3. For a thorough but dense presentation of the influence of physics on economics, see Philip Mirowski, *More Heat Than Light* (New York: Cambridge University Press, 1989).
4. Alfred Marshall, *Principles of Economics* (eighth edition, 1920), quoted in Lutz and Lux, 47. See also Neva Goodwin, *Social Economics: an Alternative Theory. Volume 1: Building Anew on Marshall's Principles* (New York: St. Martin's Press, 1991), and A.M. Endres, "Marshall's analysis of economizing behavior with particular reference to the consumer", *European Economic Review* ***35*** (1991), 333-341.
5. Thorstein Veblen, *The Place of Science in Modern Civilization*, excerpted in Max Lerner, editor, *The Portable Veblen* (New York: Viking Press, 1948), 232.
6. Ibid., 233.
7. Stephen Edgell and Rick Tilman, "John Rae and Thorstein Veblen on conspicuous consumption: a neglected intellectual relationship", *History of Political Economy* ***23*** (1991), 731-743.
8. For a concise exposition of Veblen's economic system, see E.K. Hunt, *History of Economic Thought: A Critical Perspective* (Belmont, California: Wadsworth Publishing, 1979), 299-327.
9. Lerner, editor, op.cit., 19.
10. Keynes, *The General Theory of Employment, Interest, and Money (*1936), Chapter 23.
11. See Ken McCormick, "Duesenberry and Veblen: The Demonstration Effect Revisited", *Journal of Economic Issues* ***17*** (1983), 1125-1129.
12. The high point of later mathematical modeling based on Duesenberry's work may have been the series of papers by Robert Pollak in the 1970s, including "Interdependent preferences", *American Economic Review* ***66*** (June 1976), 309-320, and "Habit formation and dynamic demand functions", *Journal of Political Economy* ***78*** (1970), 745-763. See also the more recent empirical work of George Kosicki, "Income redistribution and aggregate consumption: implications of the relative income model", *The American Economist* ***34*** (1990), 40-44.

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13. Early papers by Robert Pollak are the most prominent applications of Leibenstein's approach, just as with Duesenberry. See Pollak's "Endogenous tastes in demand and welfare analysis", *American Economic Review* ***68*** (May 1978), 374-379, "Price dependent preferences", *American Economic Review* ***67*** (March 1977), 64-75, and other articles cited there.

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