Consumption, globalization and theory: why there is a need for radical reform

by Frances Stewart

The entire edifice of normative or welfare economics rests on consumers' sovereignty, i.e. the assumption that individuals know what is best for them; that they make unconstrained decisions in the market; and that this will lead to maximum welfare not just for the individuals but also for society. Maximising consumer welfare thus provides the ultimate basis of *every* normative prescription in economics, including those about optimum trade policies, cost/benefit analysis, price regulation and so on. This is the foundation stone for the justification of the market model, with consumption as the driving force of the economic system.[1]

Yet this edifice is astoundingly fragile. Neither psychology, nor logic, nor morality provide firm support for a consumer sovereignty approach to welfare; indeed in many respects they challenge it. Common sense suggests this is so, as evidenced by the fact that consumer sovereignty is consistent with famine in the midst of plenty, high and rising levels of criminality, psychological depression and suicides, overwork for some and unemployment for others, boring, repetitive and exhausting work, unacceptable levels of inequality within and between countries, and high levels of poverty. Moreover, there is a built in 'dissatisfaction trigger' in the way modern economies are organised, so that levels of welfare frequently do not rise *even among those whose incomes are rising* because the content of what constitutes a satisfactory level of consumption is continuously changing, requiring more and more resources for its realisation. However fast world economic growth is, the tide of expectations and desires moves even faster: this is not just a temporary phase, but built into the way that the global capitalist economy operates.

This note explores some of the weaknesses underlying the equation of 'consumers sovereignty' with welfare optimisation and the consumption driven market system which it supports. The first part explores some problems in a static setting. The second part considers the role consumption plays in the dynamic global economy. The arguments in

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[1] This has been elaborated in many places: see e.g. Little, 1957.

the first section point to some of the weaknesses in the basis of modern welfare theory; the second section shows the damaging implications, at a global level, of adopting a consumer sovereignty approach to the organisation of the world economy. Section III attempts to identify alternatives.

I. Deficiencies of the consumer sovereignty model

The model of consumer sovereignty assumes that the only economic objective is to maximise utility (or achieve the maximum fulfilment of preferences); that this can best be done by consumers choosing freely among alternative bundles of goods; that if any individual acquires more income and consumes more they will be better off; that society is better off if some are able to consume more and no-one is constrained to consume less, but one cannot say whether society is better or worse off if there is redistribution and some consume more at the expense of others consuming less.

There are numerous problems with the consumer sovereignty model. Important among them are:

- 1. the way distribution among households is treated;
- 2. the blurring of individuals and households;
- 3. the neglect of externalities;
- 4. the naive view of human psychology; the fact that other people's wellbeing enters into individuals' objective function; that people do not only maximise their *own* satisfaction; that people and societies have other goals besides maximising consumer welfare;
- 5. the fact that only micro decisions can be made by consumers, yet the more important ones are macro over which individual consumers have no control.

1. *Distribution of income/consumption.*

The consumer sovereignty approach to welfare is based on utilitarian philosophy, derived from the work of Bentham, James and John Stuart Mill, the basic idea being that the ultimate goal of mankind is to maximise the sum of human happiness. The utilitarian objective could be consistent with highly egalitarian conclusions. Assume that there is diminishing marginal utility to consumption, a common assumption applied to the consumption of individual goods, then if this extends not only to individual goods but to consumption as a whole, diminishing marginal utility of money, income or consumption follows. If everyone has the *same* utility function, utility maximisation will be achieved with equal distribution of income. This broadly was the conclusion of Pigou. The view of identical utility functions is simplistic and somewhat naive: clearly people have different needs, so that a handicapped person may need more to achieve the same utility as someone who is able bodied; people in cold climates may need more resources than those in hot climates; the old or very young can have different needs from each other and middle generations. These are differences which in principle one could identify and measure, assuming that the same utility was achieved by people if and only if their objective circumstances (their capabilities or functionings in Sen's terminology) were the same. But in the 1930s Robbins made a much more radical and damaging claim: he argued that in principle it was impossible to compare people's utilities because some people might be much more sensitive than others, so that their marginal utility from additional income could be greater than others, even when their total income was much higher. It followed that interpersonal comparisons of utility became impossible. While one could state the conditions for the maximisation of individual utility, one could say nothing about the desirability of redistribution of income among individuals.

The implications of this denial of interpersonal comparisons of utility are clearly far reaching: maximisation of consumer welfare becomes consistent with highly unequal income distribution, about which economists can say nothing. Yet the basis for the assumption of non-comparability across individuals is flimsy; it would seem as reasonable to assume - as Pigou implicitly did - the identity of utility functions among individuals except where their conditions vary in relevant respects. This is the assumption made in medical practice, for example, where people with similar conditions are assumed to have similar needs.

Alternative approaches to wellbeing - relating it to objective circumstances (e.g. capabilities, basic needs or some external psychologists' assessment of wellbeing) rather than to the essentially subjective metric of 'utility' - permit interpersonal comparisons and hence conclusions about better and worse distributions among individuals.

2. *Individuals versus households*. The agent of decision-making in welfare theory is the individual who, by making unconstrained choices, reveals her preferences and therefore her utility ranking.[2] Yet we know that many decisions are made by one person on behalf of others within the household. These decisions may be made by a farseeing and benign household 'dictator' whose only concern is the wellbeing of members of the household; or they may be made by a less benign more self-concerned person who takes decisions about the nature of consumption and its distribution within the household in the light of their own interests. In the second case - where household relations depend on power and bargaining within the household - actual consumption decisions made may not reflect the preferences of some household members, so 'consumer sovereignty' does not reveal each individual's preferences and therefore fails even to maximise *individual* welfare. Evidence about consumption behaviour in developing countries increasingly supports the second view of household decision making (the power/bargaining model), with male discrimination against women and against basic needs type expenditures compared with female decisions [see e.g. Behrman, 1995; Hoddinott and Haddad, 1991; Strauss and Thomas, 1996].

3. *Neglect of externalities*.

Consumption externalities are very large. They not only include the obvious negatives of neighbours' noise, or positives of their beautiful gardens, but the whole realm of (a) status and positional goods; and (b)aspirations to 'keep up with the Jones'. Hence the value of any particular good to any individual is in part *socially determined*. It follows from this that much additional consumption does not confer any (or proportionate) additional satisfaction.

Status and positional goods. Veblen pointed to the importance of 'status' goods demonstrating individuals' ranking. Hirsch analysed 'positional' goods (which would encompass status goods). Positional goods are goods whose value depends on the person being the only (or among the few) to enjoy them. For both these categories, more means better for particular individuals. But by its nature satisfaction from improved ranking is

[2] 'The individual guinea pig by his market behaviour reveals his preference pattern' (Samuelson, 1938).

offset by dissatisfaction from worsening ranking for society as a whole. The whole tends to form a zero sum game. Hence a general rise in consumption will leave satisfaction from positional and status goods unchanged.

Keeping up with the Jones. People wish to function in ways they regard as socially appropriate. Thus social standards as well as personal preferences determine their choice of foods, clothes, transport, entertainment etc.[3] It follows that with a general rise in incomes, and new goods or habits that emerge reflecting this rise, there may be very little *additional* satisfaction from following the new styles yet considerable unhappiness caused by failing to do so. For example, in the US women are expected to wear different clothes each day of the week (possibly for a longer period) while in much of the rest of the world it is fine to wear the same clothes everyday so long as they are clean. In poorer countries, high standards of cleanliness may not be expected. Since people suffer unhappiness from not obeying the social norms, the utility gained from having seven sets of clothes in the US may be little or no greater than from having two sets in the UK. It follows that a good deal of extra consumption associated with general increases in income does not confer additional satisfaction, but, in the context of generally increasing consumption, it is needed to avoid rising dissatisfaction associated with a fall in relative standards.

Consumption externalities are important because they challenge two basic notions of the consumer sovereignty model: first, they undermine the view that individual choice maximises utility because individuals fail to take into account the benefits or costs for others of their consumption; secondly, given the importance of positional goods and socially determined consumption standards, general increases in consumption will not increase welfare proportionately and may sometimes not increase it at all.

4. *Human motivation, goals and satisfaction.*

There are a variety of problems with the assumptions about motivation, goals and satisfaction that underlie the consumer sovereignty model.

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[3] This aspect has been explored by Layard..

The consumer sovereignty approach assumes that society's overriding aim is to maximise the total utility of individuals in society and this is best achieved by individuals making unconstrained choices which maximise their own utility. But people are social beings and the wellbeing of others affects their own utility, through what Sen has termed *sympathy* and *commitment*.[4] The 'philosophy of the revealed preference approach essentially underestimates the fact that man is social animal and his choices are not rigidly bound by his own preferences only.' (Sen, 1982) 'The purely economic man is close to being a social moron'. (Sen, 1973).

Once non-personal goals are allowed for in the individual utility function - sympathy and *agency* goals (i.e. actions taken because of some general principles, not for the utility conferred by a particular good) - then unconstrained individual consumer choice may *not produce an optimum*.

Further, psychologists and others have observed that choice itself - especially if very large - may cause unhappiness.[5]

A much more important question is whether utility maximisation is accepted as the overriding goal of human activity. Is human 'happiness' (or 'utility') all we should aim for? Does morality have no place, except as a contributor to happiness? Are other goals such as environmental sustainability, protection of animals, scholarship, only to be justified in so far as they contribute to human happiness?

This is a fundamental issue, with enormously important implications for our views of consumption and of the economic system more generally. The consumer sovereignty/utility maximisation views underlie the growth/GNP maximisation approach to development. The UNDP's Human Development approach is based on a rejection of

[4] *Sympathy* describes the utility conferred on individual A by consumption of someone close to them (B). *Commitment* is where a person values consumption of B, even though it gives them no utility, because their moral position is that other people matter too (Sen, 1982).

[5] See also Scitovsky, 1976.

this. The goal is 'human development' interpreted broadly as the enhancement of capabilities, and associated specifically with particular basic capabilities, including the capability of being well nourished, healthy and educated. When interpreted as achievements (or *functionings* in Sen's terminology) these are objective measurable phenomena (in contrast to 'utility'). They can be compared among people. Basic capabilities should be achieved by all - with strong distributive implications, especially in poor societies. According to this view, consumption of goods and services is a *means* to the achievement of functionings. Some types of consumption are more efficient in this respect than others. The HD approach can then assess whether a particular pattern of consumption will contribute to the objective or not. This is not possible with the utility approach, since the act of consuming (or purchasing) is defined as utility conferring: people have revealed their preferences by making unconstrained consumption decisions and that is the end of the matter.[6]

5. *The macro/micro issue*

When individuals make consumption choices, they are faced with certain givens - the range of goods and infrastructure available, the consumption behaviour of others. In this context, they have a huge range of choice in most countries, *if* they have the money. (If they do not then they have very little choice, especially since so little attention has been devoted to developing poor people's products[7]). These choices are micro-choices. People cannot make macro-choices through their individual consumption decisions. Macro choices are those determining the context of micro-choices: e.g. whether imported goods are available; the transport system; enviromental standards; the availability of guns etc. Macro choices are probably more important for wellbeing than micro-choices. But these are taken elsewhere - through laws and regulations determined by the political system, as a result of international treaties, or the unintended effect of a myriad of micro-decisions. Macro-decisions are affected by votes and by lobbies. Individual consumers are powerless to influence them. Collectively, they may, however, through campaigns. The

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[6] Strong externalities might cause some amendment to this position, but only in a preference-based context.

[7] See James and Stewart, 1981.

outcome of the political process that leads to macro decisions is the result of numerous influences, with financial power typically being of substantial importance.

All the talk of maximising consumer welfare relates to the micro-decisions. Yet the macro decisions can affect welfare much more. The macro choices are rarely explicitly on the agenda, except as advanced by specific pressure groups (e.g. anti-smoking).

A *Human Development Report* on consumption should identify the macro-agenda, as it relates to human development, as well as exploring the implications of micro-decisions for HD. Some relevant macro-issues are:
- Research and development related to poor people's products (appropriate products);
- Regulations of HD-destroying products - e.g. guns; smoking.
- Local culture and imported products;
- Appropriate safety (and other) regulations for poor societies;
- Appropriate policies towards advertising and consumer information;
- The regulation of informal sector products;
- Information technology and HD.

This section of the paper has shown the flimsy basis for the welfare conclusions based on consumer sovereignty. The model is not appropriate for an HD approach; it assumes a much narrower set of goals than the HD approach; it rejects the possibility of normative assessments of distributional aspects; it ignores intra-household issues; it does not deal with the macro-issues which are of fundamental importance to human wellbeing, and provides no basis for assessing them. An HD approach, in contrast, which assesses changes in consumption from the perspective of the impact on HD, and in particular basic capabilities, can contribute to each of these issues. The next section will consider the implications of a consumption driven approach to the global economy for sustainable human development and wellbeing.

II. **Globalization, capitalism and consumption**

Consumption is the driving force of development in modern capitalist economies. All production is undertaken either directly for consumption or indirectly via investment goods which are themselves wanted for the consumption goods they will produce. Hence sustained growth of output rests on growth in consumption demand. It is essential, therefore, that consumption grows if growth of output and employment is to be sustained.

In the high-income economies, there is, in principle, a possibility of satiation as consumption grows. If tastes remained unchanged, and there were no new products and no advertising, growth in consumption might slow down. The richest groups would consume as much as they want, and still be able to save a great deal; poorer groups would catch up with the life-styles of the rich and then they too could stabilise their consumption levels. But this slowdown would be highly damaging to a capitalist system, as it would lead to a slowdown in output and employment growth unless offset by growth in demands elsewhere. With growing labour productivity, growth in sales is essential just to maintain employment levels.

The need for output and consumption growth is felt not only at an economy-wide level but also at a firm level. Firm success depends on output growth, with growth of profits dependent on growth of sales, especially in the presence of economies of scale. Hence there are strong motives at both firm and economy level to seek to expand markets, either by expansion of sales domestically or abroad.

A firm's competitive success in expanding sales depends either on successful product innovation or on undercutting rivals by competitive pricing (or some combination). Hence the imperative of output expansion also leads firms to undertake research and development to produce new/improved products and cost-cutting technologies. In developed countries, the prime emphasis tends to be on product development - in fact research shows that at least three-quarters of R. and D. is devoted to product development [See e.g. Mansfield, 1962; Schmookler, 1966; Gustafson, 1962]. Hence in developed countries, the need to increase/maintain market share leads to continuous product innovation. This means that consumers face never- ending changes in products.

The new/improved products generally find a ready market. This is partly because they are 'better' products - i.e. fulfill needs more efficiently or satisfactorily - e.g. fuel saving cars; time-saving faxes; more comfortable air-filled trainers. But they also find a market because of the social determination of consumption demand discussed above. Socially determined standards of dressing, entertaining, travelling etc. require the consumption of the new products, while 'demonstration' and 'positional' effects lead all those on lower incomes to emulate the consumption standards of those above them on the income ladder.

The net effect is to prevent satiation - indeed to replace it by ever present unsatisfied demand for most people, because as soon as people have attained given consumption objectives, new ones come along, with the successive waves of product developments. Moreover, new products render old ones obsolete; the old cars no long obey the clean air restrictions; film is no longer available for the old cameras; the old washing machines can't be repaired...

In this dynamic process, developing countries are mainly the recipients of technological innovation rather than the innovators. They tend to enter the product cycle as consumers of Northern-designed products and as cost-cutting producers of products designed in the North, acquiring technology and often machinery from the North. A limited amount of innovation occurs in developing countries mainly devoted to improving the efficiency of production in different locations, but there is extremely little product innovation [Lall, Katz].

The South, of course, receives not only machinery, but also consumption styles from the North. The successive waves of consumption which ripple down the income ladder of developed countries, move almost as fast into the consumption markets of the South. Globalization - especially the communication revolution and the spread of international travel, world-wide television and advertising - has speeded up the process. The consumption patterns of the elite in the South are very similar to that of the elite anywhere else. The middle and working classes aspire to the same consumption standards (of course, with some local differences) as middle and working classes in the North. For the elite and middle classes, their actual consumption patterns may be very similar to those found in developed countries. For the working classes and the poor, consumption aspirations remain unavoidably unfulfilled, given their low incomes.

Like consumers in the developed countries, the model leads to some objective improvements in conditions, but less increase in satisfaction, since the moving target of a satisfactory consumption pattern can never be achieved. In both developed and developing countries, neither the increase in consumer satisfaction nor improvement in objective conditions (capabilities) is proportionate to the additional consumption defined in terms of extra incomes or resource use. The reason is that so much of the extra consumption is related to the maintenance of socially determined standards rather than genuine improvements in the quality of life, while so much of a consumers own psychic satisfaction depends on the person's relative position on the consumption ladder - which does not change so long as consumption inequality remains unchanged - rather than absolute levels of consumption.

In developing countries - especially among the poor - there is a further problem. The new products are designed to suit the income levels of the middle and working class in the developed countries, and not for the poor of developing countries. This means that the consumption needs of the poor are not met, while the new products cater to middle and upper-income groups. Hence distribution of well-being defined in terms of needs fulfilment may worsen, *even without any change in measured income distribution,* as the middle classes can spend their incomes on better products and the poor cannot. Indeed to the extent that the new 'high-income' products displace the low-income products, then the position of the poor becomes absolutely and not just relatively worse. This can best be illustrated by examples. Suppose development in airplanes leads to a more comfortable flight and lower costs; the wellbeing of those who do or might travel by air will improve; that of the rest of the world will remain unchanged; the distribution of wellbeing will become more unequal. Now suppose the improvements in air travel lead to the abandonment of buses, to which the poor had access. In this case, the absolute as well as the relative position of the poor will worsen. Usually, such changes will not affect the distribution of income. They would only be captured with very sophisticated measures that include different price indices for rich and poor which capture not only price but also product quality/availability. Some attempts have been made to develop such indices to measure change in welfare over time for society as whole (but rarely). I have never seen any attempt to differentiate by class within a society in such measures.

The diagram illustrates the impact of new products on welfare in rich and poor countries (or among rich and poor consumers), showing different sets of indifference curves for rich and poor. Product development from P to P_N improves the position of the rich consumer. The position of the poor consumer is unchanged in absolute terms while worsening relatively so long as the old product remains in production. But if the old product disappears, then the absolute position of the poor consumer worsens (to a lower indifference curve) with the development of the new product.

In practice, the evidence suggests that many old products are withdrawn as new products are developed, partly because as consumption switches away from them, there is loss of economies of scale, and partly because they become obsolete (as they use old materials and parts).

To summarise: this section of the paper has argued that the dynamics of the world economy depend on a sustained and everlasting expansion in consumption, which is based on the continuous development and sale of new and improved products. The extra consumption does confer some additional consumer satisfaction, but not proportionate to the extra incomes/resources embodied. This view is supported by empirical research into happiness in different societies and across time. Using measures like suicides, mental breakdown, crimes and questionnaires all such work points to the conclusion that more consumption does not raise happiness (certainly not proportionately). The consumption driven model of the world economy thus leads to a position in which: (a) neither satisfaction nor objective conditions of consumers increase proportionately with incomes; (b)the needs of the poor are left out in product development and their position tends to worsen relatively and absolutely. Moreover, the first part of this note showed that one cannot appeal to economic theory to justify the system in terms of 'welfare maximisation' since the links between consumption and welfare are as fragile and full of holes as a cobweb.

Not only is it impossible to justify the model in terms of human development or satisfaction it also has some critical negative effects in terms of environmental sustainability. The endless rise in consumption leads to ever increasing use of world resources, with well-known implications for energy shortages/ excess carbon dioxide, global warming etc.

III. Can one devise alternatives?

The first two sections of this note have pointed to serious problems with the organisation of the world economic system: its basic engine - the continuous expansion of consumption - is not viable in the long run because of its resource using implications; nor is it justified in the short term in terms of its effects in improving people's satisfaction or capabilities. While it does make a contribution to both these objectives, the contribution is not proportionate to the resources used, especially as people become richer. Hence it is important to search for alternatives. But before doing so, it is necessary to point to some substantial virtues of the present global model.

The consumption led economy has resulted in continuous technical change, with huge improvements in the efficiency of resource use (e.g. as measured by labour/output or energy/output ratios). Higher productivity and new products have produced greatly improved nutrition and large medical advances; life expectation has more than doubled in many countries. For many life is much more comfortable and interesting than it was a century ago. Improved standards have not been confined to developed countries, but have been shared by the majority of mankind. Moreover, the sharply diminished returns to extra consumption appear most notably among elite consumption standards and the middle classes in developed countries. The poor in both rich and poor societies could still enjoy considerable improvements in their lives if they had access to more goods and services.

The problem with the system arises because it depends on ever growing consumption levels among high income groups - the people for whom extra consumption is not particularly desirable; and the higher consumption among these groups creates new demands among everyone else. The key question then is whether it is possible to slowdown the system at the upper-income level (for shorthand at the level of 'elite consumption') without causing the whole system to seize up. This could be achieved without a slackening of world output growth, though a redirection of output away from the elite towards the poor in developed and developing countries and towards the fulfilment of other important objectives, such as environmental, social and educational ones. There would be enough demand to generate rising output and employment from these areas and from raising the standards of the poor for a considerable time-span (say the next fifty years). Eventually, there might be a general satiation and the need to reorganise the world economy towards a stationary, replacement, production and consumption equilibrium. This would require huge changes in the organisation of the world economy and society - although in historical terms it would amount to no more than a return the centuries of experience before the industrial revolution. But this is a problem for the late 21st century, not one we need face today. The immediate problem today is to redirect resources away from additional elite consumption, which would include that of the elite throughout the world and the upper middle classes in developed countries towards the poor in developed and developing countries and towards social goods.

The problem is to identify technical mechanisms and political conditions which would bring about the required redirection. While the problem is partly technical, much the greater element is political. Technically, what is required is similar to the 'Redistribution with growth' strategy developed in the 1970s, but applied to the *whole world* and not just developing countries.[8] Somehow the extra resources gained by the elite through growth need to be redistributed to the poor and to a set of environmental, social and educational objectives (for shorthand 'good society' objectives). The redistribution could be achieved, technically, by swingeing taxation on the rich, but this might act as such a disincentive that it reduced the growth of the system as a whole. (This was always a difficulty with the original 'RWG' strategy). Other alternatives would be very heavy consumption or expenditure taxes, or restrictions on earnings at the upper end. Finally, a voluntary solution might be sought, with the elite persuaded to 'downsize', to work less long hours etc.

Politically, it is obvious that none of these 'solutions' are plausible at the present conjuncture, when the trend is towards higher inequality, more and more grossly high

[8] See Chenery et al., 1974.

salary levels in high income economies and reduced income tax rates, on the 'grounds' of incentives and efficiency. Moreover, there is also a trend towards privatisation and against state activity, yet for the 'good society' goals, state or community expenditures may be essential. The trend in fact is precisely the opposite of that needed which is scarcely surprising because there would not be such a clear problem were this not so.

Hence while we can point to plausible 'macro' solutions to the problem, we cannot realistically have any expectations of their realisation. Moreover, any solution needs to start in the richest economy, where new consumption standards are set - which today means the US. And the US appears less likely than almost any other society to accept that there is a problem or that any of the possible solutions are acceptable.

Hence more 'micro' solutions have to be sought in the short run, with the hope that this will pave the way eventually for more macro solutions as the unsatisfactory nature of the present pattern of growth becomes increasingly apparent.

Elements of the 'micro' approach include:
- documenting and publicising what is wrong with the present system; generating indicators of people's level of satisfaction/happiness and of their changing objective circumstances over time and among different segments of society.
- exploring, documenting and publicising experiments in alternative life-styles, and assessing levels of happiness and changing capabilities associated with these alternatives. Alternatives to be investigated include: people who have 'down-sized'; communities who are seeking alternative patterns of living; different life styles in traditional communities.
- identifying the environmental implications of the existing system and of alternatives;
- reforming the system of indirect taxation to increase taxation on elite products and pursue green objectives.

The doable micro-agenda may appear weak when confronted with the magnitude of the issue. But it itself represents a major task, and a necessary beginning to tackling the macro-issue.

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