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A Bean-Brick Parable: "Consumer Sovereignty" Yet Again

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All the grosser mistakes in economic policy arise from focussing upon the interests of people as producers rather than upon their interests as consumers, that is, from acting on behalf of producer minorities rather than on behalf of the whole community as sellers of services and buyers of products. One gets the right answers usually by regarding the interests of consumers, since we are all consumers.—Henry Simons

Lord Finchley tried to fix the electric light
Himself. It struck him dead, and served him right.
It is the duty of the wealthy man
To give employment to the artisan.
Hilaire Belloc

Two unrelated circumstances prompt this re-examination of a threadbare problem. A personal circumstance is the reprinting of a generation-old essay of mine,[1] with which I no longer agree completely and which I should like to amend. The other circumstance is the current disorder in international trade and in trade theory. I refer particularly to the popular charge that the United States, supposedly basing its industrial policy (or lack of one) on the consumer interest, has lost out in international economic competition to other countries, notably Japan, who have based their own industrial policies on producer interests.

In such arguments, it is interesting to note, gains and losses are measured by balances of commodity trade—or on current account, if "invisible items" are included.[2] A surplus of sales over purchases indicates "winning" without regard to consumer satisfaction, and a surplus of purchases over sales indicates "losing" with the same disregard of the domestic consumer. (Good 17th-century mercantilism, including its disregard of the consumer, all dressed up in 20th century statistics.)

I

The pro-consumer head-note to the present essay is from Henry Simons (1899–1946) rather than from Frederic Bastiat (1801–1850), Simons' predecessor by almost precisely a century. This choice is made less in deference to my former teacher (Simons) than to Simons' having advanced the argument in an important particular. He sees the consumer as simultaneously a buyer of goods and a seller of services; Bastiat sees him only as a buyer of goods, leaving his sale of services out of account. Simons' consumer is a full participant in the economic process; Bastiat's consumer may be a parasite pure and simple. One can wish that Simons had developed his incremental insight further than he apparently did in his short life, since a number of highly derogatory connotations of the consumer as parasite, or as free rider, underlie so much of the argumentation on the other side. One can, for example, see these notions both in my anti-consumer head-note quatrain from Hilaire Belloc and in the current attacks on American trade and industrial policies as pandering to consumer interests—whether or not they actually do so.

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The Fabian Socialists Sidney and Beatrice Webb, I still believe as I did in 1954, provided in *Industrial Democracy* (1899) the classical statement of the anti-consumer (and anti-market) position. The Webbs' argument, in condensed form, is that at every stage of production and distribution, from the hiring of labor to the retailing of a final product to a final consumer, the need of the seller to sell exceeds the need of the buyer to purchase. The buyer can hire someone else instead, or purchase something else instead, or simply save (hoard) his money. But if the seller does not sell his services or his goods for any extended period, he starves. And the burden of the pyramid of market distortions springing from consumer sovereignty is pressed down eventually upon the worker and the family farmer, who are exploited in the sense that their wages and incomes are lowered below what they might have been had equal urgency prevailed on both sides of all markets.

Allowing for exaggeration and hyperbole, the analytical residue of the Webbs' case against "the higgling of the market" can even be diagrammed: Elasticities of supply on representative capitalist markets are lower than they would be under ideal conditions (equal urgency to buy and sell, springing presumably from greater initial equality of income and wealth), and the supply functions themselves are accordingly shifted further to the right at low prices. Equilibrium prices are lower, equilibrium quantities higher. Sellers' incomes are lower also, if buyers' demand is both price-inelastic and not significantly increased by departure from ideal conditions. (I believe both these conditions are assumed implicitly by the Webbs.)

Figure 1 illustrates the situation through the Webbs' eyes. OP, OQ, and the product (OP × OQ) are the market price, quantity, and sellers' gross income under actual conditions (consumers' sovereignty). OP', OQ' and (OP' × OQ') are their notional values under ideal conditions.

Passing from Fabian Socialism to neo-mercantilism represents no particular advance—possibly even

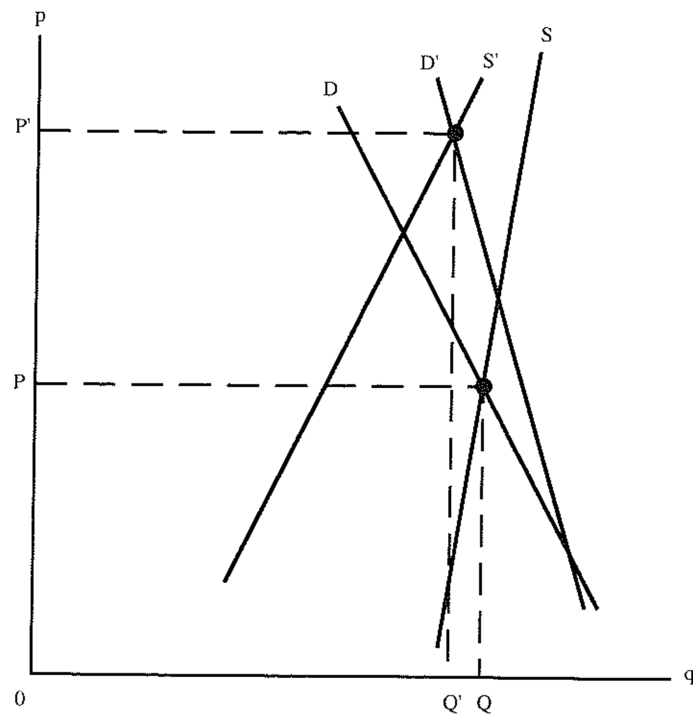

Figure 1. The Fabian Perspective

the reverse. It does, however, lend itself more readily to macro-economic treatment, which neo-Austrians consider a great leap backward.

We have the following identities, in familiar notation:

$$(I - S) + (G - T) + (X - Im) = 0$$

$$\left(\frac{dI}{dt} - \frac{dS}{dt}\right) + \left(\frac{dG}{dt} - \frac{dT}{dt}\right) + \left(\frac{dX}{dt} - \frac{d(Im)}{dt}\right) = 0$$

Of course, some neo-mercantilists refuse to acknowledge these identities, and indeed propose to violate them. I interpret the neomercantilist position on consumer sovereignty more leniently, however.

Suppose the existing situation to be unsatisfactory from their point of view, in that imports *Im* exceed exports *X*, and that the situation is getting steadily worse, with the increase rate of imports d(Im)/dt likewise exceeding that of exports dX/dt. Something known as "industrial policy" is called for.

Industrial policy in the consumer interest, if such a thing can be imagined in this context, is a do-nothing policy. If producers and their political spokespersons think the current-account balance[2]XX-Im is too low, they will be told to cut prices, improve quality, or otherwise make their products more attractive both on the world market (raising *X*, dX/dt positive) and the domestic market (lowering *Im*, d(Im)/dt negative. The resulting rise in domestic income *Y* will be found to have raised both savings and government receipts (dS/dt, dT/dt both positive). The identities will hold throughout the adjustment process, except for "statistical discrepancies."

Industrial policy is far more commonly advocated in the producer interest, with the consumer again treated as a parasite or free rider. Such industrial policy may be frankly protectionist, in which case, it is macroeconomically identical with the consumer-interest variant of our last paragraph. Its instrument, however, is a set of protectionist devices to reduce Im (and sometimes also to raise *X*) directly, without requiring lower prices or improved quality in either export or import-competing industries.

Many other producer-oriented industrial-policy proposals seem macro-economically flawed, at least in the short term. These proposals would raise I, raise G, and lower T usually in combination. These changes would require (X-Im) to fall, not to rise as desired.

One can of course imagine a pro-producer industrial policy in which the required rise in I would be more than offset by a fall in G and rises in T and S.[3] A simple example might combine "economy" in social and-or defense expenditures which would also lower interest rates and "crowd in" the increased I) and a net increase in taxes with a shift of the tax burden from income and wealth to consumption expenditures. A "special added attraction" might be a tightening of consumer credit and-or capital export.) But such a combination forms no part of the better-known industrial-policy proposals, although the fall in G is often demanded by itself—in insufficient magnitude to offset the desired rise in I.

It is difficult to avoid classifying neo-mercantilism, including industrial-policy proposals in the producer interest, as being either purely protectionist or macro-economically confused. They represent no particular advance over the Webbs at the turn of the century (who did not treat macroeconomics explicitly at all), except in emergence from the shadow of the great deflation of 1870–1900. (It is easy to interpret the Webbs' "higgling of the market" chapter as an explanation of deflation, as well as an attack on consumer sovereignty.) Let us therefore return to the Webbs' case against "the higgling of the market" as leading inexorably to the exploitation of people as producers by people as consumers. Without assuming either imperfect competition or long-term deflation, I shall try to construct a counter-factual economy "such as never was, on land or sea," in which the Webbs are always right and "the consumer is always wrong." This counter-factual or thought-experiment economy is essentially a one-commodity one, whose single commodity is produced in a wide variety of shape-size-color configurations; their differences are so important to consumers that a single consumer buys only one, and the elasticity of substitution between varieties is zero.[4] The single commodity is the end product of a number of intermediate production

processes, but all intermediate products disappear in these processes and cannot be bought, sold, or stored separately.

Following a suggestion of Herbert Simon, I shall call this mysterious single product the bean-brick, consumable directly as a non-durable consumption good (beans) or as a durable one (bricks). It is also storable costlessly for an indefinite period.

Workers and other factor suppliers (if any) to the bean-brick industry have not read Adam Smith on the benefits of specialization and division of labor. Or alternatively, they are universal geniuses who have taken all technology to be their province. In addition, they have the blood of nomads, gypsies, and airport economists. They move effortlessly between jobs, between firms, and between localities, developing neither loyalty nor communality of interest with any craft, firm, or home town. They are thus immune and impervious to any form of special-interest producer organization, whether economic or geographic.

In this topsy-turvy economy, a strong consumer interest would naturally concentrate exclusively up increasing the supply and lowering the price of bean-bricks. The producer interests, on the other hand, would be dispersed and diffused between the hundreds of thousands of different crafts, firms, and localities of which the bean-brick industry is composed within the nation or possibly all over the world—like Ford Motors' "world car" writ large, plus the controversial Japanese *tanshin-funin* institution.[5]

People-as-consumers could organize readily in the bean-brick economy, to fend off restrictions of output, and increases of price, in any of the bean-brick variants. Technological progress in bean-brick production would be reflected in a downward movement of bean-brick prices—deflation, if you will.[6] "Rotating" workers and farmers, people-as-producers, could not organize at all, and would depend on impersonal market forces to keep their wages and incomes up. People's interests as consumers would be protected against market imperfections other than those which they might themselves foster as monopsonistic cartels. People's interests as laborers, farmers, or factor suppliers in general would be protected only by the market. Monopsony, including monopsonistic cartelization, would leave them defenseless against exploitation in the conventional Pigovian sense of the term.[7] The bean-brick economy might well degenerate into just such an economy as the Webbs saw emerging from Victorian era capitalism plus the 1870–1900 deflation—prices low and falling, wages near subsistence. But should "underconsumption" develop, the bean-brick government could more easily supplement bean-brick incomes with its own bean-brick purchases. Or it could institute bean-brick "social dividends, as per the "bread and circuses" of Imperial Rome or the "market socialism" schemes of the 1930s and 1940s.

Our "bean-brick economy" argument amounts to this: If it is fallacious to raise producers' incomes at the expense of total output for consumers, it is equally fallacious to raise total output at the expense of producer exploitation. The pro-consumer half of this argument is familiarly known—and familiarly disregarded precisely because it is familiarly known. The pro-producer half, less familiarly known, we have sought to elucidate by raising consumer sovereignty to ridiculous heights in an imaginary "bean-brick economy."

II

An important attribute of intelligent policy discussion in economics is precisely its emancipation from the fallacy of composition—the confusion of the part with the whole (or vice versa). In simplest terms: What is good for me, and for my interest group, is transmitted by my and our economic linkages—backward by our purchases, forward through our production—to other members of the economy and eventually to the economy. Whoever argues this way about concessions to himself, herself, or to his or her pressure group, is that extent guilty of the fallacy of composition and advocate of a sub-optimal policy.[8] It makes no difference whether the pressure group is composed of buyers or of sellers, of producers or consumers.

People as consumers want abundance and low prices; people as producers fear "over-production"[9] and want high prices. To the consumer's dread of scarcity corresponds the producer's dread of exploitation. When these preferences conflict, as they usually do, the competitive market supplies a feasible solution, which we may assume also to be stable. But are market solutions optimal? Are suggestions for their supercession tainted with fallacies of composition, and if so in which direction? Bastiat, and to a lesser extent also Simons, argue that the (informed) consumer is always right, and producer-inspired departures from free competition always wrong. Belloc argues in verse, from the fate of Lord Finchley as amateur electrician, that the (wealthy, parasitic) consumer is always wrong, and his social function limited to the provision of employment (at going wage rates and mark-ups). My little parable seeks to broaden the argument by presenting a different kind of world, where consumers are organized and producers not.

III

It is now time for a conclusion, but what can we conclude? Is the consumer always right? Is the producer always right? What of the parasite and the free rider? Are such pro-producer interventions as trade protection and industrial policy more likely or less likely to improve on the competitive market than are pro-consumer interventions?

My suggested answer to these mutually-related questions are more than a little abstract and academic, although I trust not entirely pedantic. Rather the avoidance of scarcity on the one had or of exploitation on the other—rather than "economics for output" on the one hand or "economics for (working) people" on the other, I propose to focus on limiting the prevalence and persuasiveness of fallacies of composition as applied to economic policy issues!

Issue-dodging in the extreme? Kindly consider a moment. Whichever elements in society are best situated, singly or in combination, to employ that fallacy to gain advantage for themselves in economic policy—and to persuade themselves and each other that they are acting in the public interest—are most likely to be wrong from the viewpoint of the average person or the average citizen. And whichever elements are least well situated for such fallacy-of-composition argumentation are most likely to be correct.

In our present industrial or even post-industrial society, by this criterion, producer interests are indeed most likely to be wrong, and consumer interests to be right. At the same time, validity is inherent neither in "the consumer interest" nor in the various interests of people as consumers. In our imaginary bean-brick economy the exact opposite is the case, with generalist producer interests more likely to be possessed of the better reason than the single-minded, particularist, and possibly monopsonistically-inclined consumers, each concerned with a (lower) price and (higher) quality for the bean-brick variety which he favors.

The foregoing paragraphs are presented as an answer to my respected teacher, Henry Simons, for whom the consumer was always right. They may not have met the counter-claims of Hilaire Belloc, of the Webbs, or of the neo-mercantilists, who regard the producer as always right and might either deny infection with the "fallacy-of-composition" virus or deny its significance. We had best consider their positions additionally.

"The buyer need not buy, but the seller must sell." This differential or urgency is more a matter of relative incomes from whatever source derived than a matter of individuals' side of the market. The poverty-stricken consumer cannot save and must buy to keep alive—if not one commodity, then another; if not from one store, than another. The wealthy seller need not sell, but can withhold his goods or services until "the price is right." The leading practicioners of the so-called "free professions," with law and medicine perhaps foremost, are cases in point.

As for the Lord Finchleys of this world, who are by no means limited to the landed aristocracy of Britain—where did their income and wealth come from? In general, from the services of their property, in titles to capital or to land, which are productive even when Lord Finchley himself is not. If indeed the noble lord is a parasitic consumer, a parasite on the consumption side of the markets, he is equally parasitic as a rentier or as a coupon-clipper on the production side as well (*pace* the abstinence and "waiting" theories of interest).

NOTES

1. M. Bronfenbrenner, "Monopsony and the Consumer Interest," *Indian Economic Review* (February 1954) reprinted in Bronfenbrenner, *Keizaigaku Tokoro-Dokoro* (*Here and There in Economics*) (1988). I have also referred to the earlier study in *Income Distribution Theory* (1971), ch. 8, paras. 15–17.

2. The (X-Im) item of conventional social accounting is actually intermediate between the balance on commodity trade and the balance on current account. It is closer to the latter, in that it includes services. However, it excludes transfer payments, both public and private, which enter the current-account balance.
3. Plant and equipment investment could conceivably rise at the expense of residential housing and inventory accumulation, with no over-all rise in *I*. But who wants to gut the real-estate and construction industries?

   Similarly, within the plant and equipment category, the industrial-policy planning agency could allocate investment credits and materials to favored sectors of the economy. This is done as a matter of course in the centrally-planned economies, and allegedly by the Japanese MITI (Ministry of International Trade and industry) in the 1950s and 1960s. But such "picking winners and losers" by a public agency is decidedly *not* supposed to play any part in Western industrial policy.
4. The differences are thus as substantial as those between commodities in competitive price theory, and more substantial than those between the offerings of rivals in either oligopoly or monopolistic-competition analyses of a single "industry."
5. In firms making use of this system, workers—mainly white-collar workers and middle managers—are shuttled about from place to place as trouble-shooters, while their families remain in one locality, where housing is relatively cheap, children's education relatively painless, and-or moving costs entirely absent.
6. I assume a variant of monetary neutrality, in which MV per capita remains essentially constant, with M itself a money-of-account like the Special Drawing Rights of the International Monetary Fund or the Ecus of the European Community.
7. On the meanings of "exploitation," see M. Bronfenbrenner, *Income Distribution Theory* (1971), ch. 8.
8. And again, vice versa. If free international trade in steel, for instance, is assumed good for the country as an entity, it does not follow that free trade in steel is good for the Pittsburgh or Gary steelworker. It is even impossible to prove—and may well be false—that the steelworker as consumer would gain more from free trade all round than he would lose from free trade in steel. (As an extreme example, consider a country whose entire structure of trade protection is concentrated in the steel industry.)
9. Or, in Japan, "excessive competition." Compare M. Bronfenbrenner, "'Excessive Competition in Japanese Business," *Monumenta Nipponica* (1966), also reprinted in *Keizaigaku Tokoro-Dokoro.*