A Bean-Brick Parable: “Consumer Sovereignty” Yet Again

Martin Bleaney

All the greater mistakes in economic policy arise from focusing 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 Finlay 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 threnody problem. A personal circumstance is the reprinting of a generation-old essay of mine,¹ with which I so long ago 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 having 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 industrial 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.)

1

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 passive 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 argument on the other side. One can, for example, see these notions both in my anti-consumer head-note gristmill 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.

¹School of International Politics, Economics, and Business, Aoyama Gakuin University (Tokyo, Japan).

265
The Fabian Socialists Sidney and Beatrice Webb, I believe as I did in 1954, provided in *Industrial Democracy* (1899) the classical statement of the anti-consumer (and anti-market) position. The Webb's argument, in condensed form, is that at every stage of production and distribution, from the hiring of labor to the reselling of a final product to the 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 (heard) 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 same 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 Webb's case against "the haggling 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-elastic 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 Webb's eyes: OP, OQ, and the product (OP x OQ) are the market price, quantity, and the market value under actual conditions (consumers' sovereignty). OP', OQ' and (OP' x OQ') are their notional values under ideal conditions.

Posting from Fabian Socialism to neo-mercantilism represents no particular advance—possibly even the reverse. It does, however, lend itself more readily to macro-economic treatment, which neo-Austrians consider a great leap forward.

We have the following identities, in familiar notation:

\[
(1 - S) + (G - T) + (X - IM) = 0
\]

\[
\frac{dI}{dt} + \frac{dG}{dt} - \frac{dT}{dt} + \frac{dX}{dt} - \frac{dIM}{dt} = 0
\]

Of course, some neo-mercantilists refuse to acknowledge these identities, and indeed propose to violate them. I interpret the neo-mercantilist position on consumer sovereignty more leniently, however. Suppose the existing situation to be unsatisfactory from their point of view, in that imports 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.

Indusial 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 spokespeople think the current-account balance 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) and the domestic market (lowering IM, d(Im)/dt). 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 macroeconomically 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. 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 not increase 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—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 protectionistic or macro-economically confusied. 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' "haggling of the market" chapter as an exposition of deflation, as well as an attack on consumer sovereignty.) Let us therefore return to the Webbs' case against "the haggling 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, no 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. The single commodity is the end product of a number of intermediate production processes.
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, carrying, directly or as a consequence, a consumption good (beans) or as a durable one (bricks). It is also storable uselessly for an indefinite period.

Workers and other factor suppliers (if any) in 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 nomsacs, gypsies, and airport economists. They move effortlessly between jobs, between firms, and between localities, developing neither loyalty nor community 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 tepidtery economy, a strong consumer interest would naturally concentrate exclusively on 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" will large, plus the controversial Japanese sawn-off shotgun institution.

People-as-consumers could organize readily in the bean-brick economy, in fact, all 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? "Rotating" workers and farmers, people-as-producers, could not organize as at all, and would depend on the impersonal market forces to keep their wages and incomes up. People's interests as consumers would be protected against market imperfections other than those to which they might themselves foster as monopolistic cartels. People's interests as laborers, farmers, or factor suppliers in general would be protected only by the market. Monopoly, including monopolistic cartelsization, would leave them defenseless against exploitation in the conventional Pigovian sense of the term. The bean-brick economy might well degenerate into just such an economy as the Webbs suppose to have existed in 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 "argues" amounts to this: If it is efficacious to raise producers' incomes at the expense of total output for consumers, it is equally efficacious to raise total output at the expense—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 inestimable heights in an imaginary "bean-brick economy."

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 simple 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 condescensions to himself, herself, or to his or her pressure group, is that exact guilty of the fallacy of composition and advocate of a sub-optimal policy. It makes no difference whether the pressure group is composed of buyers or of sellers, of producers or consumers.

People as consumers want abundances and low prices; people as producers fear "over-production" and want high prices. To the consumer's dearth of scarcity corresponds the producer's dearth 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 arguments 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. Bello argues in verse, from the fate of Lord Finsbury 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 market-ops). My little pamphlet 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 producer always right? What of the parasitic 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 hand 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 beset 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 monopolistically-inclined consumers, each concerned with a (lower) price and (higher) quality for the bean-brick variety which 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-charges of Hilari Bello, of the Western World or the neo-monopolists, 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 differentially or uniquely 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 practitioners of the so-called "free professions," with law and medicine perhaps foremost, are cases in point.

As for the Lord Finsbury 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 Finsbury himself is not. 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 aristocracy and "waiting" theorists of interest).

NOTES

3. The (X, Y,t) 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 excludes service revenues, transfers between public and private sectors, and the current account balance.

4. Plant and equipment investment could conceivably rise at the expense of residential housing and inventory accumulation, with no overall rise in Q. But who wants to put the real-estate and construction industries in?

5. 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 analogously 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.

6. The differences are also as substantial as those between commodities in competitive price theory, and more substantial than those between the offerings of rival either oligopolistic or monopolistic competition analyses of a single "industry.

7. "And again, nice versa. If four international trade is bad 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 true—that the steelworker in question would gain more from free trade all around 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.)


Book Reviews


In this timely book Bergsten draws on research done at the Institute for International Economics to propose "a comprehensive economic strategy for the United States to respond to the unprecedented challenges it will face in the world economy of the 1990s." He argues that despite the recent recovery, all is not well with the US economy: productivity growth is slow, saving rates low, real wages probably falling, and income distribution more uneven.

The villains are the twin deficits: the US current account deficit, and the fiscal deficit. The fiscal imbalance tends to raise interest rates, drain private savings away from productive use in the private sector, and reduce productivity, growth and living standards over the long run; it also leaves a substantial burden on future generations. Inflationary pressures due to the excess demand in the goods market and pressures raising interest rates have been mitigated by the trade deficit. The maintenance of this deficit will require the indefinite inflow of foreign capital, but

[If foreign investors and central banks finally stop lending such quantities to the United States, recognizing the unsustainability of the situation, the dollar will plunge and interest rates will soar. (pp. 4)]

The result: stagnation. This loss of confidence could be prevented by keeping interest rates high to attract foreign funds, but this would only postpone the inevitable crisis, and would meanwhile reduce the growth rate by discouraging investment and productivity growth.

Bergsten's solution is a three-pronged program of policies.

The first prong involves macroeconomic policy. The federal government's structural budget deficit must be eliminated by cuts in government programs and tax increases. This would reduce consumption and government spending, increase private investment which was crowded out by the deficit, and improve the trade balance. The country would have higher rates of saving, investment and productivity growth. The dollar should be depreciated, which would also reduce the trade deficit. These measures would have to be complemented by pressures on the surplus economies—such as Japan, Germany and the Asian NICs—to grow faster and reduce their surpluses, which would be in accord with their pressing domestic needs.

The second prong involves the promotion exports with an aggressive trade policy which would, among other things, curb presence on foreign countries to open up markets to US exports, provide investment tax credit and permanent status to research and development credits, and refurbish the entire educational system. Powerful pressures for import protection should be countered, since such protection would only result in foreign retaliation and the shattering of the world trading system.

The final prong involves effective strategies for resolving the Third World debt crisis which would restore Third World growth, expand its exports and lessen the US deficit. This would be accomplished mainly by inducing international financial institutions—especially the World Bank—to increase lending to the Third World on the condition that the borrowers pursue "the right" policies. Increases in such lending would have miniscule budget costs for the US. Efforts should also be made to increase the flow of direct investment to the Third World.

The book clearly has much to recommend it. First, the author clearly appreciates that economics cannot be divorced from politics, international relations and psychology. He argues convincingly why it is to the advantage of the new administration to take quick, decisive action, given the internal political structure of the US. It explores the problems of foreign policy, showing a shrewd understanding of how the US can use its political leverage to achieve its economic goals. It stresses throughout the importance