

CONSUMER ECONOMICS

A Practical Overview



Steven D. Soderlind

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STEVEN D. SODERLIND

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PREFACE

This textbook presents principles of economics pertinent to consumers. It covers the fundamentals of consumer choice, market mechanics, financial assessment, risk taking, bargaining, public policy, and more, to anchor introductory courses in consumer economics. Given its focus and scope, the book will also support a topical introductory course in economics, answering the need on many campuses for relevant service offerings.

Designed for one-semester courses, this book responds to the widespread concern among economists that texts in the field of consumer economics tend to underplay economic analysis while focusing excessively on minutiae from personal finance. Many economists would prefer a more applied approach with less time devoted to the quirks and idiosyncrasies of particular markets. The complaint is not that elements of personal finance or market details are out of place in consumer economics, but that they have come to dominate. Answering that concern, this text emphasizes economic reasoning as the basis for introductory courses in consumer economics.

The book contains twenty-five chapters organized into five parts. Each chapter involves from one to two hours of reading (15–20 pages), starting with a preview of key points and ending with a summary, study questions, important terms, and items for further reading. The body of each chapter includes—in addition to key economic points—amplifying vignettes on relevant cases, famous economists, or issues of the day. Terms and study questions follow the text, mainly as a guide to help students review and digest the principles at hand. The suggestions for further reading at the end of each chapter generally include seminal materials in the economics

literature. Instructors are encouraged to add other sources (from the Web, public documents, and consumer research publications) and projects (oral presentations, case studies, and group discussions) to round out the text. Such added activities both customize a course to the teacher's strengths and enhance learning. For example, in the area of health care (chapter 20) students might be encouraged to search the Web for terms like "activity pyramid" and "exercise pyramid"; they will find thousands of related sites on physical activity, nutrition, and personal health.

Taken as a whole, this text surveys the vast terrain of consumer economics. Part I begins by introducing the notions of consumer sovereignty, market mechanics, demography, negotiation, and household accounting. Part II then lays a foundation of economic reasoning based on rational consumer choice (utility maximization), emphasizing the role of personal preferences and circumstances in explaining consumer behavior. Its chapters explore product assessment, product preferences, time preferences, risk-return preferences, gains from trade, and so on. Part III of the book, three chapters, is devoted to matters of consumer protection, covering its history, contemporary structure, and economic justifications. Part IV, eight chapters under the title "Momentous Decisions," draws attention to such consequential choices as buying houses, cars, college educations, and the like. These discussions apply the principles developed earlier to important decisions that lie ahead for most students. Finally part V turns to macroeconomic issues, especially the study of consumption, both private and public, in relation to national prosperity. This connection is of special interest to the modern consumer-citizen.

It is hoped that this book will establish a new and enduring blend of topics for introductory courses in consumer economics, a field of specialization that should be a lively and relevant component of undergraduate education. Universal, complex, and practically a metaphor for life in this era, consuming is an appropriate subject for college studies, though consumer economics is widely absent on campuses across the nation. The market for texts in the field is notoriously small. Seen in that light, perhaps the greatest service this book can render would be to nudge the study of consumer economics out of its doldrum and into the mainstream of undergraduate economic education in America.

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CONSUMER ECONOMICS

PART I

GETTING STARTED

This section of five chapters sets the stage for our study of consumer economics. Chapter 1 focuses on the economic role of consumers, emphasizing their considerable authority over world resources. Chapter 2 discusses consumers themselves, presenting three characterizations and a demographic survey. The characterizations are of the so-called rational consumer, pilgrim consumer, and role-playing consumer, while survey results show how American consumers stratify according to income, age, sex, race, and settlement. Chapter 3 highlights the operation of free markets, emphasizing the concepts of supply and demand. Next, chapter 4 covers the topic of negotiation, appreciating that buyers often find themselves bargaining with sellers over price, quantity, or terms of purchase. Finally, chapter 5 surveys the topics of household accounts and budgeting.

Part I: Getting Started

Chapter 1 Introduction

Chapter 2 Consumers

Chapter 3 The Marketplace

Chapter 4 Negotiation

Chapter 5 Household Accounts

These chapters develop many key points for departure: (1) consumers are increasingly empowered to lead national economies, (2) consumers operate with varying motives in a wide array of circumstances, (3) consumers often find themselves making purchases in relatively free and well-ordered markets, (4) consumers can often influence the price or terms of purchases, and (5) consuming can be measured and shaped relative to household priorities. Building on these points, subsequent sections turn attention to issues of sound decision making and sensible public policy.

1

INTRODUCTION

The central point of this chapter is that consumers exert increasing control over the world's resources. This state of affairs, commonly called "consumer sovereignty," began to emerge in the eighteenth century, and has progressed rather dramatically—versus the countervailing powers of kings, dictators, and central planners.

Consumers guide modern economies in several ways: (1) by their purchases in markets, (2) by their votes in elections, and (3) by their tendency to congregate in like-minded communities or neighborhoods. Voting with dollars, ballots, and their feet, consumers try to meet their individual and collective needs.

The notion of a "free and sovereign consumer" anchors the study of consumer economics and motivates several questions: Are consumer-led economies likely to be more prosperous than economies dominated by other interests? Should consumers be trusted to make excellent decisions? Should there be governmental policies to protect consumers or assist them with decision making? Such questions frame this introduction to consumer economics.

CONSUMER SOVEREIGNTY

Adam Smith, founder of modern economics, argued that the essential task of coordinating national economies should fall to consumers. Not kings, not parliaments, not priests, not even chief executive officers (CEOs)—but consumers—should lead nations in deciding how resources will be used. Pressing this key point, Smith almost single-handedly carved economics from the larger body of social philosophy.

To support his proposal Smith blasted away at what he called the “mercantile system” (or “mercantilism”), which was the economic order of his day. According to Smith, the mercantile system featured a strong central government with a tendency to favor the interests of merchants and manufacturers over the interests of consumers. Such a system, he argued, was outmoded, monopolistic, and incompatible with the national interest. Summarizing his views in *The Wealth of Nations*, published in 1776, Smith wrote:

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. This maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer.¹

Casting his lot with consumers, Smith opposed monopoly licenses for merchants; he objected to public favors for large investors; and he proposed that consumers be allowed to make purchases from competing suppliers. These stands made him something of a rebel, promoting the interests of a disorganized public against those of well-connected aristocrats, merchants, and corporations.

Today’s buzz phrase for Smith’s idea is “consumer sovereignty,” a banner term for those who see society’s interest meshing with that of free, self-seeking consumers. The argument for consumer sovereignty remains quite simple: Because consumers routinely seek high-quality products to meet genuine needs at reasonable prices, they naturally do an excellent job of guiding economic development. Steering resources to meet discernible human needs, consumers—not kings—should rule. What is more, when suppliers compete for the consumer’s favor, their tendency is to improve products, increase output, and charge lower prices. Therefore, it is best to promote competition among suppliers and let consumers make their purchases freely.

But even as Adam Smith was launching the movement for consumer sovereignty, he harbored reservations. He was, after all, professor of moral philosophy at the University of Glasgow, Scotland, and he was well aware of the human potentials for irresponsibility and weakness. He knew that consumers could be flighty just as surely as they could be conscientious and tight-fisted. In particular, he wrote of several potential pitfalls: temptation and manipulation could result in lousy decisions; unreliable information might cause resources to be pulled off course; and there were larceny, robbery, and scams galore—from which free consumers might need protection.