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What I would like economics majors to know

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Introduction

I have been teaching microeconomics for more than four decades, and over the past months I have been seriously thinking about this question: "What are some of the most important things I would like economics majors to know before they graduate?" At first I was leaning to such important and well-known ideas as opportunity cost, marginal analysis, moral hazard, externalities, and the prisoners' dilemma game. Now I am leaning to important ideas that are not well-covered in economic textbooks, and indeed are often omitted entirely. Five of the ideas that I would recommend are:

1. people are not solitary creatures but social animals;
2. tastes are malleable and particularly so among children and adolescents;
3. there are lots of children and adolescents in the world (though few in economic textbooks);
4. retail purchasers rarely have detailed information about the products they buy:
5. large corporations (and other economic institutions) often have a substantial social and political power.

I am not claiming that economists do not occasionally write about these ideas, for economists write about virtually everything, but that these important ideas have not sufficiently made it into most economic textbooks. I will first discuss these ideas generally, and then with respect to an important market—the market for cigarettes.

Unlike most other social sciences, economics has a single basic model that is taught to all budding economists. Like all models, the microeconomic model abstracts from reality. The model has proven to be very powerful and useful, providing important insights and policy guidance, and raising economics to the "queen of the social sciences"—the only social science with a "Nobel Prize". The assumptions of the model are its strengths—and also its limitations

Two of the basic assumptions of microeconomics are that (a) people are rational, and (b) tastes or preferences are exogenous—they are well-defined and stable, essentially God-given at birth. The advent of behavioral economics has been a breadth of fresh air for microeconomics and much of the focus has been on the rationality assumption, particularly the rationality of individuals (rather than of institutions). However, aside from a growing literature on the desire for social position, there has been less emphasis on the fact that people are social animals and the effect that society and culture have on how tastes are formed and how tastes change.

In the economic model, people are largely solitary creatures, with fixed tastes. We are basically Robinson Crusoe's, each living on our own little island. Our major interaction with

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other humans is when we trade (including trading labor for goods). In other words, we are connected to each other primarily through markets. Economic theory in effect has, with mere punctuation changes, converted John Donne's famous saying into "No! Man Is an Island."

However, in the real world, humans are not like bears. Bears are solitary animals. An adult male spends almost all of his life away from other bears, living and dying by himself. By contrast, wolves, dolphins, and primates like ourselves, are social animals. We live in societies, and we are dependent on others of our species for most of our health and happiness. Humans "are social not just in the trivial sense that we like company, and not just in the obvious sense that we each depend on others. We are social in a more elemental way: simply to exist as a normal human being requires interaction with other people." (Gawande 2009).

It is now commonly accepted that human children require nurturing from others, not just for food and protection but also for the normal functioning of their brains. Caregivers teach children how to be human. Child neglect typically has worse long term consequences than child abuse. Even for adults, one of the most severe forms of punishment is solitary confinement, where one is denied contact with other humans. Indeed, it could be considered psychological torture.

As biologists, sociologists and psychologists know, people do extremely little individually or independently. Human nature is about grouping, flocking and herding. We are natural imitators of each other, literally "monkey see monkey do." Indeed that is how children learn.

Raising children involves not only helping them learn the natural laws of the planet they live on (e.g., how long a day is; that clouds can bring rain) but also the customs or rules of the specific society in which they live. Children must largely adapt to these customs if they are to survive and thrive. What to wear, what to eat, what to say, how to play. Each child is somewhat different, but they almost all go through similar stages at various ages, and quickly learn and mimic most of the conventions of their society.

Thus tastes are very predictable. For a boy growing up in Chicago in the 1950s, one could predict pretty accurately that his favorite sport might be baseball, football or basketball, and that his favorite sports team would be a Chicago team. By contrast, at the same time, soccer would probably be the favorite sport of a boy growing up in Caracas, Venezuela.

Parents are key influences on the tastes children will have as adults. For example, we know that a major risk factor for adult smoking is whether your parents smoke, and that the best single predictor of adult gun ownership is if you grew up in a home with a gun. We also know that children and adolescents brains are still in the process of developing and that they are more likely than adults not only to make poor long run decisions but to have malleable tastes.

Tastes are affected not only by parents, but also by peers. Adolescence is probably the most peer-driven of ages. Teens tend to move, play, and even commit crimes in packs. The importance of peer approval on the behavior of adolescents cannot be overstated. How else to explain that so many US teens are currently getting tattoos?

The desire for many products depends on the purchases of others. Teens "need" cell phones because their friends have cell phones, and they will be an outsider without one. Kids want baseball gloves if their friends have gloves and are playing baseball. A generation of children wanted to read Harry Potter and go to the Harry Potter movies in large part so that they could be part of the group and talk about the stories.

Adults often want what other adults have for many similar reasons. If everyone else is watching the Superbowl, it is fun to watch it with others; you are an outsider if you missed it and everyone else is talking about it. Even adults are tied together in networks of individuals. We now know that even obesity can spread through social networks, just as fads and fashions spread. What you give as gifts and when you desire to retire is dependent in large part on what others are giving and when others are retiring.

The fourth, and perhaps the most controversial idea, is that most consumers have little real knowledge about what they are buying, instead relying (sometimes correctly) on the good faith of the seller, government protection, or perhaps the invisible hand of a perfect market. My belief in the lack of knowledge of retail purchasers was formed by my experiences working for consumer advocate Ralph Nader in the 1960s, writing my doctoral dissertation on standards and product specifications (Hemenway 1975), and my work in public health. With Nader, we used to document how buyers were mislead and/or incapable of knowing what they were buying—e.g., how a sizable amount of distilled water sold in supermarkets was actually tap water, how college educated consumers could not determine the low cost item among identical products, and how buyers had no idea how many rodent hairs were being sold in hot dogs.

Specifications, and standard specifications, I discovered were used almost exclusively by large buyers (e.g., corporations) who were buying in bulk and had the ability and financial incentive to know exactly what they were buying. By contrast, since learning about the quality of a product is largely a fixed cost that can be spread over the amount of the product that is being purchased, retail consumers are largely rationally ignorant. If you or I need paint, we simply go to the store. If General Motors wants paint, it writes or uses detailed purchase specifications.

Working in the health arena has also made me skeptical of the knowledge of consumers. For example, the public spends tens of billions of dollars each year on quack remedies. I am in the public health field, yet I personally know extremely little about the health and safety aspects of what I buy, and what little I know often comes from government reporting requirements. Test yourself. How flammable are the clothes you are wearing? How carcinogenic are the items in your bathroom? When you buy beef or poultry, do you know what the steers and chickens were fed?

The fifth idea, that corporations have social and political power, is well known, though rarely studied by economists. It is, after all, more in the domain of sociologists and political scientists. It is nonetheless important for economists to remember that policies affecting corporations typically affect not only their economic but also social and political activities. Politically, for example, corporations have the power to influence who gets elected, what laws are passed, what regulations are set, and how they are implemented and enforced. Indeed, unlike unions, churches, unincorporated businesses or even local governments, U.S. corporations have been given human rights, including the right to free speech, and presumably the right to privacy.

The cigarette story

A few years ago I read a fascinating history of the cigarette industry in the 20th century (Brandt 2007), written from a public health perspective. Because litigation against the industry forced it to reveal internal documents, there is probably more and better information about the behavior of cigarette companies than any other industry in the United States. The cigarette story can be used to illustrate these five ideas.

From a public health standpoint, tobacco-related diseases are the largest preventable burden of mortality in the United States, and will soon hold that unenviable position for the entire world. Were they a new product, it is doubtful that cigarettes would be allowed on the U.S. market. They not only cause a multitude of diseases to the smoker (over 400,000 deaths per year in the United States), but secondhand smoke significantly increases the risk of disease to others.

At the turn of the 20th century, cigarette smoking was widely considered a dirty habit, practiced by disreputable men and boys. Smoking was seen as a profound moral failing, and Henry Ford among others, vowed never to hire a cigarette smoker. A number of states even prohibited the sale of this noxious weed. All that would change in the next fifty years; by the mid-1950s half of American adults smoked cigarettes, and smoking was an integral part of the American lifestyle.

People are social animals with malleable tastes

The social aspects of smoking were crucial to its popularity in 20th century America. The first cigarette was rarely a pleasant experience, but smokers soon grow accustomed. Still, when asked, smokers overwhelmingly cited sociability as the essential attraction of a cigarette. Only a tiny percentage cited taste as one of a cigarette's pleasures.

While almost everyone smoked their own particular brand, in repeated experiments, although blindfolded smokers believed they were able to identify their regular brand, they typically failed. Still, brand loyalty was fierce for this largely undifferentiated product, whose identity was fashioned not through intrinsic qualities but by cultural meaning.

Cigarettes were promoted, not only through enormous amounts of advertising, but through many other means including parades, planted magazine articles and product placement. Cigarette advertisers, armed with evidence from psychology, were sure that the public didn't really know what it wanted. It had to be given ideas about what it should like. Individuals, they believed were in a constant struggle to conform and yet be different. The industry could thrive, they believed, if it did not focus on selling the product, but on selling a way of life, with cigarettes a mechanism of self-identity.

In the 20th century, the large majority of smokers began as adolescents, and cigarettes played an important role in the rituals of adolescent identity. To smoke had meaning—for example to refrain from smoking could be considered the same as joining the sissy group of boys. Many girls in the early 20th century began smoking to break with Victorian conventions about females, to show that they were modern and up-to-date.

For women, smoking became associated with physical beauty, sexual attractiveness, social and political equality. For men, it provided connotations of virility and strength. Movies were filled with the cigarette smoke of the leading stars.

The importance of promotion was highlighted when the Marlboro brand was successfully transformed from a luxury cigarette for women into a macho smoke for men, solely through mass marketing. Marlboro ads had little copy and instead conveyed the message almost exclusively through image.

Unfortunately for the cigarette companies, by the end of the 20th century in America, the image of smoking had changed dramatically. Anti-cigarette ads, shown on TV because of the fairness doctrine, smartly focused not only on the health aspects but the social aspects of smoking (e.g., "nobody wants to kiss an ashtray") and significantly reduced the level of smoking. In the late 20th century an RJR memo would correctly report that "the general public and its leaders are of the opinion that smoking is messy, indulgent, down-scale, non-family oriented, non-fashionable habit—one that is increasingly a smaller part of contemporary lifestyles". The companies saw that they were losing the cultural battle.

Smokers reported a declining pleasure from smoking. What was fragrant had become foul, what was attractive had become repulsive. Social conventions moved to stigmatize smokers as irrational, dirty and self-destructive. Yet while the cigarette was losing its connotation of glamour, sophistication and sexual allure in the United States, the industry was able to construe meanings of social status, cosmopolitanism and affluence in developing nations, turning Western cigarettes into status symbols among teenagers. Worldwide, each DAY, some 80,000-100,000 individuals become new smokers (mostly children and young people).

Youth and children

Adolescents play a crucial role in this industry. In the United States, over 80% of smokers begin regular use before the age of 18. The first brand one smokes is likely to be the one that is kept for life, and the younger one starts smoking, the less likely one is able to quit smoking. By the 1970s, with smokers dying off or quitting, the companies clearly understood the need for "replacement smokers"—that their future rested on the illegal buying decision of teenagers. Not surprisingly, cigarette companies promoted their cigarettes to youth and children. A 1991 study found that for children aged 3-6, the recognition rate of a tobacco company cartoon character "Joe Camel" approached that of Mickey Mouse. Internal company documents made it clear to whom the appeal of Joe Camel was focused.

Consumer misinformation

Cigarettes have been called a delivery system for nicotine. Nicotine is addictive, in the same way that heroin or cocaine is, leading to dependence, tolerance and withdrawal when ingestion is halted. In a typical year, more than 2/3 of American smokers express a desire to quit, but fewer than 10% who try are able to quit. To keep people smoking, the companies sometimes added nicotine. For example, they knew that "light" cigarettes required increased nicotine to help sustain the addiction.

As is true for many goods, retail consumers had little detailed information about the product they were consuming. For example, cigarette companies not only secretly varied the levels of nicotine in their cigarettes, but often included additives--at least 13 of which were substances banned in food products. At mid-century, most consumers and even some researchers believed that smoking could not be very harmful, relying largely on the fact that so many people smoked. Surely everyone would know if it were deadly.

After research linked smoking to cancer and other diseases, the companies introduced filter cigarettes, with the clear implication that these would reduce the risk of disease (e.g., Kent's micronite filter, "just what the doctor ordered"), which they did not do. Most filter cigarette smokers believed the claims. Similarly, the introduction of low tar and light cigarettes did not reduce the risk of smoking, but as the companies understood, many smokers were convinced, switched to low tar and light cigarette brands, and kept smoking.

When the science began overwhelmingly to show that cigarettes caused many diseases, the industry undertook the PR strategy to produce and sustain scientific skepticism and controversy. Although there was virtual consensus even among industry researchers—who were not permitted to publish their findings—for decades the companies were able to create the impression of strong controversy and scientific debate about the relationship between cigarette smoking and disease. The press, responding to industry urgings for fairness and balance, dealt with the issue as it would a political debate and willingly provided "both sides" of the science.

As a judge concluded in 2006 in a suit against the industry, "over the course of 50 years, defendants lied, misrepresented, and deceived the American public--including smokers and the young people they avidly sought as replacement smokers--about the devastating health effect of smoking and environmental tobacco smoke." Recognizing the role they inadvertently played in fanning the so-called controversy, many universities have banned the acceptance of tobacco money, historically used to gain status and legitimacy while influencing the scientific process.

Corporate power

Crucial to the rise of cigarettes in 20th century America was its promotion and use among soldiers during wartime (e.g., World Wars I, II, and Korea). The industry often provided the cigarettes, which were included as part of supply rations.

The tobacco lobby for decades was considered the most powerful lobby in Washington D.C. It was able to avoid the regulation of its product by the Federal Trade Commission (FTC), by the Consumer Product Safety Commission, and even by the Food and Drug Administration (FDA). In the 1980s, for example, the FDA approved Nicorette chewing tobacco which was intended to help smokers quit. The FDA was in the strange position of regulating products to help individuals quit smoking, but having no jurisdiction over the cigarette itself.

The tobacco industry had more political power at the federal and state than at the local level. They thus wanted and were able to have most states pass "preemption laws" which forbade local authorities from passing more restrictive tobacco legislation than passed by the state.

Even when the industry appeared to lose legislative battles, it typically was able to promote its own interests. For example, a year after the 1964 Surgeon General's report concluding that smoking was hazardous to health, the Federal Cigarette Labeling and Advertising Act mandated warning labels on cigarette packages. But the law, in effect, rebuked the FTC for considering cigarette regulation. The label themselves deterred few smokers but provided cover for the companies to defeat lawsuits brought against it. The *New York Times* called the warning label requirements “a shocking piece of special interest legislation.”

Similarly, in 1969, the industry acceded to the Federal Communication Commission and agreed to a ban on TV advertisements for cigarettes. But the ban meant that the effective anti-tobacco ads, which had been required by the FCC fairness doctrine, also disappeared. It also made it harder for new firms to enter the industry.

After industry duplicity was disclosed through internal documents, it appeared that the industry would be sued successfully by the Attorneys-General in each state for contributing to state medical costs. But the “Master Settlement” effectively imposed only a long term excise tax on the industry which made the state coffers dependent on the firms’ survival. This meant the states were against lawsuits that might threaten the financial viability of the industry and the Attorneys-General sought to protect the companies’ cash flow from other litigants.

In more recent years, the industry has sought and received support from the U.S. government to help open markets, especially in developing nations. U.S. tobacco companies have successfully made major inroads, particularly in those nations where health regulations have yet to be firmly established. Public health observers compare U.S. international tobacco policy with the opium wars of the 19th century. While we are pleading with foreign governments to stop the export of their cocaine, we are pushing for the export of our tobacco. Former Surgeon General Koop asserted “I think the most shameful thing this country did was to export disease, disability and death by selling our cigarettes to the world.” It is now estimated that the 21st century worldwide death toll from tobacco will be 1 billion people.

Allan Brandt, who wrote the history, calls cigarettes a “rogue industry.” Economists, I believe, would largely see the companies in this industry as simply acting to maximize their profits, as companies tend to do in all industries. For example, I would suspect that if all the internal documents were available for the soft drink industry, we would see many of the same sort of activities. The companies successfully sell flavored sugar water to youth, in large part by promoting lifestyle choices, and for many years managed to promote and sell their product in public schools. It is not an industry focused on improving the public’s health.

Conclusion

I am sure that other economists will have very different opinions, but I would like economic majors to know that markets often work well, and sometimes have major problems. I would like them to realize that the simple model they have learned leaves out, or de-emphasizes, important aspects of the world. Five ideas that I personally would like them to recognize is that, at least at the level of economic texts, there is an under-emphasis on that fact that (a) people are social animals; (b) their tastes are malleable and particularly so for children and adolescents, (c) there are lots of children and adolescents in the world (d) consumers are rarely knowledgeable about the products they buy, and (e) large corporations (and other institutions) often have a great deal of social and political power

If they understand these ideas, along with all the others they have learned as economic majors, I believe they will be better economists and better citizens.

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