What You Didn't Learn in Ec 101[1]

Talk by Neva Goodwin
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You learn a lot of surprising things in Ec 101. Who would have thought that the world can be adequately described as a place where corporations have relatively little power to affect what consumers do, or the regulatory environment in which they operate – where the only important economic goal for policy-makers is to maximize consumption possibilities – where the only rational behavior for individuals is a continuous effort to get what you want.

Naïve students might think that the large parts of our lives when we are at work is of comparable importance to our non-work time, and that consumption of marketed goods and services is not our only goal, even when we are at leisure. They might believe that, while people are interested in getting what they want, there are other motives that affect much of our behavior, even in economic settings. They might think that economics should be concerned with all the ways that people's needs can be met, including non-marketed assistance given by family, friends, governments, and non-profit organizations.

It's probably obvious that I believe there has been an excessively wide divergence between common sense and economic theory. Economists have been characterized as suffering from "physics envy," and they do seem to have adopted the stance of modern physics, that there is no need to try to match up their theories with what people can see and feel. But physics is a physical science, and economics is about people. We, as the human topics of economic science, not only have insights into the subject matter – ourselves; we also affect the patterns of economic behavior that the theory tries to describe. A culture that believes that only selfishness is rational, and that limitless greed is a universal human characteristic, will define success in strictly material terms and ask few questions as to how it is achieved. As this plays out, the culture will accept as normal energy scams and cooked books, tax fraud and tax havens, dirty politics and the exploitation of child labor. We have seen this happen over the last few decades. Enron and WorldCom, with their tragedies for workers and retirees, investors and customers, are symptoms of such a culture.

I don't blame all of this on economic theory, but I believe it has played a significant role in shaping our economic culture – which spills over into our broader social culture. Today I'm just going to talk about a few of the areas where we need a new look at economic realities – a new way of talking about what is economically important – based on a clearer understanding of economic behaviors and human well-being. I'll start with the topic of competition, where corporate reality seems to have been changing dramatically, first in one direction, then in another, over the past hundred and fifty years or so, but where the theory has, with just a few nods to reality, overall become increasingly refined and narrow. I'll use Wal-Mart as a surprising example of how nature

[1] With some additions and corrections as suggested by helpful discussions from the excellent audience at that talk.

has followed art – in this case, how a firm has turned a lot of ideas upside-down by behaving the way the theory says it should. Then I'll discuss externalities – a topic which has the potential for creating common, realistic, ground for a wide range of positions, including economists on the left and right, environmentalists, and people with concerns for social justice. There have been misunderstandings about this term which have prevented it from being as useful as it might be. Finally, I'll talk about a possible extension of the idea of externalities, and will then apply these ideas to what we have seen in the Wal-Mart .

One of the major lessons learned in economics 101 is that competition is a good thing. It's good because it increases efficiency. Efficiency is normally just considered good in itself, but if you insist on knowing what it's good for, you will be told that it increases consumption opportunities by making it possible to obtain more output from a given level of inputs. Other things being equal, that sounds like an excellent idea. From an environmental point of view, less materials and energy are used for a given output. From the workers' point of view, efficiency gains usually result in increased output per worker, which could result in higher wages, or shorter working hours, or both. Of course, that doesn't always happen; in the boom years of the '90s labor productivity increased dramatically, but almost all of the benefits went to shareholders, in the form of profits, or to managers, in the form of soaring salaries at the top, and to consumers, enjoying lower prices. From the consumers' point of view this is what is good about efficiency – that it lowers prices.

Another way economists talk about efficiency is to say that it is about using society's resources to maximize production of the **most valued outputs**, while using less of the **more valued** inputs, and more of those on which society places a **lower value**.

So how are we to decide what society values most highly? Some people might think society's most valuable products include good nutrition, good education, good health, and good neighborhoods. But the market values for these things doesn't equate very well with what we might call human value. A piece of jewelry or a macmansion can cost a lot more than a year's food, care, education, and housing for a child, or for many children. You can explain this by the basic lesson from Economics 101 – that prices are determined at the intersection of what suppliers can supply, under existing market circumstances, and what consumers want that they are willing and able to pay for.

Beneath the 101 story there is, in fact, a lot of circularity; the market circumstances that affect supply are a result of prices, as well as being a partial determinant of prices. The most independent variable in this picture is on the demand side: what consumers want that they are willing **and able** to pay for. The price system is ultimately a system of "one-dollar, one-vote."

So, in fact, efficiency is about producing more of the outputs that people want and can afford to buy – rich consumers get many more votes than poor people do. An efficient system, to put this in the crudest terms, is one that is highly responsive to the desires of the rich. If, along the way, a process uses a great deal of an input that is highly valued by many people who have few dollar-votes – for example, if it uses a lot of land that has great importance to people who lived on it before the Europeans came to this continent – that doesn't make the process inefficient, in economic terms. Standard economic theory has no way of formally recognizing the validity of needs and wants that cannot achieve market expression through purchasing power.

It's curious, by the way, that the concept of efficiency is not applied, in the standard approach, to either consumption or distribution: might there not be important ways that well-being could be enhanced by consuming things that actually make us happy, rather than things that are designed only to make us want more? There is a growing body of literature that shows that there are dramatically different classes of consumption goods: more status goods in a society do not make the whole society better off, while an increase of certain other types do contribute consistently to happiness.

I hope this has made you a little skeptical about the values that are implicit in standard economics. I said, a moment ago, that competition is considered good because it increases efficiency. Having indicated some doubt about the value of efficiency, as it is understood in economic terms, I'm now going to express my doubts about competition.

At the heart of the standard economic theory that is taught in American universities – and, increasingly, in universities around the world – there is a model of perfect competition. For a long time I was very skeptical of the reality of that model. It seemed pretty obvious that the world is not supplying the conditions that are necessary for perfect competition to exist. For one thing, competition is usually assumed to occur between rival firms, but in fact an enormous proportion of the economic transactions that take place today are within-firm transactions where there is no market to enforce competition – when the Hong Kong arm of IBM sells parts to the US company, the transaction can be priced by mutual agreement, or by a company manager, with reference to such things as tax rates, and where they want profits to show up, rather than based on competitive market forces. Ignoring the huge area for cooperative, within-firm economic transactions, standard theory describes perfect competition as a result of a series of formal requirements. For example:

- You can't have perfect competition in a market in which products are differentiated – you can't have brand names!
- There must be no barriers that would make it hard for small firms to enter a market and compete with large ones that are already there.
- All economic actors must have, if not perfect information, at least fully adequate and equal information. For example, consumers must know as much about what they're getting into as the sellers do, so that there is no power inequality.
- Technology must not create ongoing economies of scale that would allow firms to grow big enough to have market power – that means the ability to set the prices at which they buy and sell.
- And there must be no externalities. (I'll return to this one later.)

When all of the conditions for perfect competition are met, the idea is that every firm is forced to be a cost-minimizer, because any firm that tries to sell above the lowest possible price will lose all its customers. And this is a good thing because consumers can make their money go farther, to get more stuff.

For most of the 20th century most large firm behavior didn't even come close to this model. Wal-Mart is the outstanding counter-example to my skepticism. Wal-Mart really does behave as if it existed in the text-book world of perfect competition. It has, to a remarkable extent, created the cost-minimizing competitors that it projected to start with. In doing so, Wal-Mart has significantly affected the efficiency of its economic environment. A report from McKinsey has estimated that some 15-25% of the productivity gains in the late '90s came from Wal-Mart's drive for efficiency, and further credited it with some responsibility for the low inflation rate of the decade.

This decision to act as if the real world was the maximally competitive world of the neoclassical economic model was adopted voluntarily, as far as I can tell, by Sam Walton. The result was in many ways just what the textbooks would have predicted. Other companies have been forced to behave like competitive cost-minimizers because they were losing customers to a company that was phenomenally successful at minimizing its own costs. The result has been – again, just as predicted – to burn the fat out of the system. Every unnecessary cost is under scrutiny in the numerous spheres where Wal-Mart has become a major player – from household goods to apparel, from music and magazines to computers. **Every unnecessary cost**…

The result that might not have been fully anticipated by the most ardent proponents of competition is that the costs first identified as "unnecessary" have included many of the aspects of economic life that had previously been hailed as progress.

In this country, and in much of Europe, our notions have progress have included the idea that wages should be sufficient to support workers and their families at a fairly high standard of living – very high, in fact, compared to the rest of the world. Progress meant that there was a social agreement about hours of work: people with pretty exciting jobs, in the top echelons, are welcome to work as much as they want, but for less exciting jobs the 35-40 hour week became standard, and it was agreed that extra work should be paid in overtime. There were strict laws banning child labor. Conditions of work, especially indoor work, were expected to be safe, sanitary, and not too uncomfortable. And there was a general agreement that all but the smallest companies should contribute to programs to assist their employees with health care and retirement benefits.

All of this progress comes into question when real competition is unleashed on the world.

The competitive pressure is felt, to begin with, by the Wal-Mart employees who work as sales-persons, cashiers, or janitors. You have probably read the stories of night-time lock-ins, unpaid overtime, and massive resistance against unions. Some of the hottest competition has been between Wal-Mart and unionized supermarkets, where the latter were, on average, providing wage-and-benefit packages worth about $10 an hour more than that received by comparable workers at Wal-Mart. Stores that paid these "unnecessary" costs couldn't compete with Wal-Mart's low, low prices. The result has been the bankruptcy of the Grand Union supermarket, along with two dozen other regional supermarket chains around the nation, eliminating, it is estimated, some 12,000 mostly union jobs. In Oklahoma City alone, 30 supermarkets closed their doors when Wal-Mart moved in.

The average wage for Wal-Mart's sales clerks in the U.S. is well below the federal poverty line for a family of three. Some Wal-Mart employment centers have hot-lines to the state welfare offices to help their workers get access to food stamps, public health services and other services for which they qualify because of their poverty status. In this respect, Wal-Mart is subsidized by the public, which makes it possible for them to provide what are, in the U.S. context, below-subsistence wages.

In spite of all this, it wasn't Sam Walton who let the globalization genie out of the box, and he himself didn't initially want to play that game. He wrote a memoir in 1992 titled "Made in America," and was proud of the company's record of job-creation in the United States. But his overriding focus on low prices for consumers speeded up the requirement for Wal-Mart's competitors to push down labor costs by producing in countries with the lowest wages. In 1995 Wal-Mart was still claiming that only 6 per cent of the products they sold were imported. They no longer publish that figure, but last year the consulting firm, Retail Forward, estimated that it was 50-60%.

If U.S. wages have been depressed by the kind of competition that Wal-Mart excels at – and there is considerable evidence that they have been – the situation in poorer countries is even worse. The stories out of Honduras, Bangladesh, China, and Vietnam include unsafe, unsanitary and inhumane working conditions, child labor, egregiously long hours, and pitifully low pay. In any of the countries I have just mentioned – and many others – suppliers and government officials are aware that Wal-Mart could buy from somewhere else if they don't go along with the demands that every year every product should be produced more cheaply, or show demonstrably higher quality. Either requirement – cut costs or raise quality – means longer hours for the workers, without more pay. Over and over again that seems to be the bottom line. And it's the same bottom line that has emerged from the Wal-Mart effect in the U.S.

There is, of course, another side to the Wal-Mart effect. Aside from its impact on wages, Wal-Mart has pioneered innovative efficiencies in management and in merchandise handling that have contributed to lowering costs. A lot of people are able to buy more things than they could have bought without this super-low-cost retailer. According to a 2002 study by UBS Warburg, on average, a Wal-Mart supercenter offers prices 14% below its rivals.

Wal-Mart also provides a lot of jobs. In fact, it is the world's largest non-government employer. When you add the jobs in places that are supplying inputs to Wal-Mart, it is even more significant. As of 2003 Wal-Mart was a direct employer of 15,000 people in its Chinese retail outlets. Wal-Mart also purchases 10% of what China exports to the U.S.; that provides a huge number of jobs in more than 3,000 supplier factories in China, where one of the leading problems is the hundreds of millions of people who are looking for off-farm work. And not all of the jobs are bad. There are opportunities for advancement, in a corporation that promotes two-thirds of its managers from the sales floor. But the overall effect has been to roll back the standards for compensation and working conditions. The turnover rate in the U.S. is the strongest evidence of this: every year Wal-Mart has to replace 44% of its hourly workers.

The major take-away message is that competition, when it really takes place according to the standard economic prescription, pits the welfare of workers against the welfare of consumers. As consumers, we find it irresistible: 82% of American households made a Wal-Mart purchase in 2002, and 2 out of every 5 American women make a weekly visit to a Wal-Mart store. Chinese consumers treat a Wal-Mart outing like a party, and are thrilled with the quality and variety – not only of Western goods, but also of Chinese specialties that were previously available only in isolated parts of the country. But as workers we're hurting.

Robert Reich put the matter neatly when he said "We have split brains. Most of the time, the half of our brain that wants the best deal prevails… Wal-Mart's prices may be lower, but that's small consolation to a lot of people who end up with less money to spend." According to a Los Angeles Times article [i], Reich said that the consumers' addiction to low prices is accelerating a shift toward a two-tiered U.S. economy, with a shrinking middle class and a growing pool of low-wage workers. The same article quoted Roxana Kahn, a former factory manager in Dhaka, Bangladesh, who has joined Verite, the firm that conducts factory audits for Levi Strauss, Tommy Hilfinger, and other U.S. companies that are taking seriously the need to ensure that their overseas suppliers provide decent working conditions. Kahn summarized: "It's the workers who suffer when entrepreneurs have to survive by cutting corners."

In 2001 Wal-Mart was removed from the Domini Social Index for its failure to uphold labor rights and its "unresponsiveness to calls for change." Nike is the only other firm that Domini had invested in and then booted out for its negative social impact.

The picture I have drawn so far is of a case where the market seems to have worked just as it should, at least in the sense of approaching the ideal of perfect competition. There is an ideology that George Soros calls "economic fundamentalism," according to which there is nothing of economic importance that is not best achieved through markets. Adherents to this view contend that any problem you find in our economy is probably caused by some entity, usually the government, monkeying with the market; and if we could just get the market un-monkeyed – free it up from regulatory or do-gooder interference – we would attain the best of all possible worlds. This simple-minded, economistic approach is, unfortunately, promoted in most economics departments in this country. But if you want to make an economist think again, try using the word: Externalites.

You are probably all familiar with this term. Externalities are *impacts generated by some economic actor, which are felt by others, but the market doesn't bring these impact back to affect the actor that originated them*. What I want to note, first, about this term is that the concepts it embraces are shared among a wide range of economists, on the right and on the left, as well as with environmentalists and proponents of social justice.

Unfortunately, mutual suspicion among these groups sometimes prevents them from realizing the power of the convergence of their ideas. I often hear enviros – or economists whose hearts are green – say things like, "economists marginalize most of the important things in life by putting them down as 'just externalities.'" On the contrary, this concept is one of the strongest cards that socially conscious economists can play against the dogmatic, but influential position of market fundamentalism. In fact, I've never heard an economist of any stripe saying "oh, that's not important, it's just an externality". They all take externalities very seriously, because even the most economistic model cannot escape its own proofs that externalities are signs of market failures. When there are serious market failures, the prescription that markets should be able to solve all human requirements for production, consumption and distribution is open to challenge.

It is very a positive development that the discipline of economics is wrestling with efforts to "internalize" the costs of economic activity that have been "externalized" to the natural world. In order to assess the likelihood that externalities will in future be internalized to a much greater extent than hitherto, we must ask, first, why have they been allowed to remain external up to now? and, second, what has changed so that we can expect the future to be different in this respect?

The principal answer to the first questions is power. The economic actor, X, who can avoid the costs of his/her economic activities by leaving them to be borne by A, B and C, generally has some or all of the following characteristics:

-- X is either a single actor or else a small group, and is able to organize in pursuit of clearly perceived goals.

-- X possesses knowledge, in particular of what is in his/her interest; s/he also knows what s/he is doing (and may deliberately conceal certain actions from A, B and C).

-- X possesses economic power.

-- X possesses political power.

By contrast, A, B and C are apt to be relatively small actors, diffuse, unorganized, ignorant of how they are being affected by X, possessing fewer financial resources, and (largely because of these characteristics) lacking in political power.

This sounds like the way the world has always worked; you might be wondering whether anything has happened that might change this dynamic. I can suggest a few reasons for hope. The environmental movement has taken the lead, first by increasing the knowledge possessed by A, B and C – informing those affected by negative externalities about the ways in which economic actors, such as firms, may be off-loading some costs of their activity in the form of environmental degradation or threats to the health and safety of workers, neighbors, consumers and other stakeholders. Environmental groups and movements, as they work to inform A, B and C, are also taking advantage of the communications revolution to overcome the disadvantages of diffuseness, and are assisting the organization of those adversely affected by economic externalities. The Global Reporting Initiative is a prime example of how environmentalists, working with labor and other socially concerned groups, as well as with investors like yourselves, can change the balance of power with respect to knowledge and information.

However, now that we've got onto the subject of power, we should note that the environmental movement, even allied with labor and investor groups, has to face the countervailing force of globalized corporations, whose power and scope continues to grow, and to reach ever deeper into the levers of political power. However, the convergence of the environmental and social movements with economic ideology on the topic of externalities is so unusual that it gives me some hope. Maybe we are moving toward a global culture that will really believe that each economic actor should pay all costs for which it is responsible.

I'd like to emphasize that this possibility represents a potentially enormous change. If you think back through the history of colonialism and the industrial revolution, about the freedom with which industrialists have polluted, disrupted communities, and absorbed and destroyed resources – even more, if you think back to the plundering of the colonies by the nineteenth and twentieth century colonial empires – you will recognize what a radical proposal is "internalizing externalities". If there is a movement in this direction, we are still at its beginning stages – and, as an economist, I have to warn you that this is not an idea that can be applied in an obvious and simple way in the majority of situations. Still, it is encouraging that so many different groups are converging on the basic idea that it is wrong to make other people pay the costs of actions from which you have benefited.

Now I want to apply the concept of externalities to what I've been saying about Wal-Mart, asking which of its effects can be said to operate directly through markets, and which can be seen as externalities, indicating market failure.

Consider the consumer who needs to drive farther to buy groceries and other things because her local stores have gone out of business. The demise of the local stores is a market effect – the result of price competition. But the extra distance driven is a cost to the consumer that has resulted from Wal-Mart's market dominance – a cost, however, that Wal-Mart doesn't have to pay. Another example, in a developing world context, would be the effects on workers who have started work at a young age and have health problems due to repetitive motions, long hours, poor ventilation, inadequate lighting, and so on. They and their families face on-going medical costs – if they can afford them – as well as the loss of future income. In the U.S. context, think back to the "unnecessary costs" that Wal-Mart has shed, and has forced its competitors to shed, if they want to stay in business. Counties and states consider basic nutrition and health requirements to be sufficiently necessary so that, when Wal-Mart's wages put families below the poverty line, public funds fill in some of the gaps. If Wal-Mart's wages were too low to allow its sales clerks – or even its CEO – to purchase a yacht, no one would feel that yacht-deprivation was an externalized cost. But it's a clear indication of the presence of an externality when tax-payers' money has to be used to the difference between what a firm allows its workers and what the society has agreed on as a minimum standard of living.

Economists are often not very good at including the loss of quality of life in their calculations of externalities; it's harder to calculate the costs that have been externalized when workers at a Chinese or Bangladeshi supplier to Wal-Mart are deprived, every week, of all but a few hours of living, aside from work and sleep. Nevertheless, economists do take the whole notion seriously. If a firm benefits from hiring someone, and then causes health or other costs that it doesn't have to pay – and someone else does – the market is not working properly. Other people than economists, hearing about such externalities would talk about it in the more common terms of fairness. The result, in any case, is that here is a rare and precious case where we are all in agreement.

The next question is, what should be done about it? The economist's answer is: Internalize the externalities – that is, find some way to ensure that the economic actor that creates costs has to pay them all. The environmentalists have a more appealing term for this: the Polluter Pays Principle. Economists would like it if little changes could be made at the edges of the market so that internalization of externalities would become automatic, with minimum extra-market interference. Self-regulation and self-policing is popular, for this reason, among economists as well as in corporations.

I don't want to knock self-regulation; regulation by entities outside of the corporation can only go part way to prevent it from externalizing its costs. But self-regulation works better in a culture that honors integrity and concern for others at least as much as it respects success in making money. Unfortunately, our culture has drifted away from that position, making outside regulation more necessary.

This brings me to a related topic, with the less familiar term, meta-externalities. Meta-externalities are *unwanted side-effects of the whole economic system on its physical and social contexts* – externalities in which the economic culture fouls its own nest, if the "nest" is understood broadly as all the contexts in which we humans live. Critical meta-externalities show up in the impact of the economic system on the social context. Productive enterprises need a workforce that has been socialized to be able to defer gratification, to think independently and sometimes creatively, and to be honest and responsible. Citizens and politicians need to care about the long run, and to be able and willing to address intelligently the myriad highly complex issues that face modern societies. But the sales efforts within modern enterprises are focused on a different set of requirements. From the sales point of view, the self-interest of business is served by a consumer-oriented culture of instant gratification and simplified thinking that urges material purchase as the answer to any discomfort. The strongest influence from the economy to the culture is motivated by corporations' desire to increase short-term profits and sales, achieved through advertising, ownership of news media, and purchase of political influence. Selfishness, short-term thinking, cynicism, and impatience with complexity are cultivated in the populace at large – even though these are not the characteristics that will best contribute to a healthy society or a healthy economy.

So now we have three headings under which to examine Wal-Mart's impact on the economies and societies of the world: pure market effects, simple externalities, and meta-externalities.

The pure market effects come out of a company that has done just what it was supposed to do. Wal-Mart can demonstrate an impressive history of reduced waste, streamlined delivery, and other contributions to efficiency, with all the good, resource-saving and price-reducing effects the textbooks expect. In some areas – or from some points of view – the benefits seem to outweigh the costs. For the purpose of this discussion, however, I'm focusing on what goes wrong when competition is too unregulated.

Wherever Wal-Mart's effects come from their pricing policy, that's probably a market effect. The popularity of their stores, the fact that other stores can't compete with their prices – on the face of it, that is nothing but the market working as it should. Some people would say that unions ask for too much – going beyond basic needs in the direction of saying everyone has a right to a yacht. They might say it's okay that so many unions, and unionized grocery stores, have been swept away by the march of Wal-Mart. But there's a fine line between just being so much smarter and more efficient that you cause the bankruptcy of competing chains, like Kmart, Ames and Bradlees, and going beyond the pale – creating situations that forces your competitors to drive wages below the poverty line, so that the public sector has to step in to make the difference.

When firms that don't offer a living wage have a justifiable claim, "the market made me do it," or "I was forced to it by competition," then the time has come to reinforce the regulations that were put in place in the early 20th century, when it was believed that a reasonable portion of the benefits of increasing efficiency and productivity should go to workers. We have been led astray by an implicit assumption, supported by economic theory, that all that matters is the benefits that go to the consumers and the investors. Low prices and good stock returns are only two parts of the story: the part that has been missing is the workers' well-being. Some of us are stockholders; all of us are consumers; and most of us, for some significant part of our lives, are workers. The theory of competition, and Wal-Mart, the corporation that has acted out that theory in the real world, have missed the third piece of human experience.

Now I'll take a last look at some of the meta-externalities generated by Wal-Mart, and by our corporate culture in general.

Standard economic theory, and common business practice, have exclusively focused on maximizing two things: profits and consumer purchases. I can't tell you how many articles I've read that started off stating that the author was going to show how some activity can be proven to maximize utility – that's the economistic term for well-being – and then went on, "*since utility is not measurable, consumption will be used as a proxy for utility. This paper will show that such-and-such a policy maximizes consumption.*" Consumption and profits are very closely allied: the more consumer purchase you have, the greater the opportunities for profits. For this reason it's hard to imagine corporations starting a campaign to reduce consumption of anything. On the contrary, all of the corporate impact on the society is aimed at encouraging people to spend more money on more marketed goods and services.

However, at the same time there is a whole area of research that is showing with increasing force and persuasiveness that this is not making people happier or healthier. In fact, a major meta-externality shows up in the fact that increasing materialism and worse eating habits are resulting in growing mental and physical health disorders. The resources this country possesses could be used to bring about a far happier society.

Much of this discussion has implicitly raised the question: what is the purpose of an economic system? Ec 101, as well as upper-level economics courses, have an implicit answer to that question: The purpose of an economic system is to maximize the possibilities for consumption in a society. More precisely, it should maximize what can be consumed that has been produced and distributed **through market mechanisms**. With that assumption for the **system**, then it can be assumed that the purpose of economic **theory** is to teach how to achieve maximum productive efficiency, so as to maximize output and therefore consumption.

I have been working with others to develop a different system of economic theory, which we call contextual economics. We begin our textbook, *Microeconomics in Context*,[ii] with an overt, rather than an implicit, inquiry into the goals of both the economic system and the theory that supports it. We propose that, in fact, economic systems should be designed to maximize sustainable human well-being. In the situations where more consumption contributes to that final goal, then that is a valid and important intermediate goal. But our society has enough material goods and productive capacity to provide a high level of security, health, education, self-actualization, comfort, and stimulation to all of its people. We do not need to create a culture that makes people believe – against the evidence of their senses as well as the results of good research – that happiness is usually or best achieved by more stuff. The great challenge before us is how to glide off of our present path, in which our whole society is organized around the need of business to sell more things, onto a different path where business success is tied to achieving the social goal of sustainable well-being for all.

Some of this can be achieved by a stringent insistence on internalizing negative externalities. Some of it can be achieved by returning to more equitable systems of taxes, along with appropriate laws and regulations on work conditions and environmental impacts. But in addition we must pay more attention to the meta-externalities that emanate from the whole system.

The hardest question is how corporations can be viable without being destructive to their cultural surround. This question directs us to look at what firms produce – is the product useful, usually harmless, or usually harmful? Over recent decades our society has succeeded in creating, in relation to tobacco products, a very helpful model which I call “legal but hassled.” This is a model that might be applied to other especially questionable products, such as small arms.

In particular, the "legal but hassled" tobacco model might be a good place to start on the especially knotty issue of advertising. It has been accepted that tobacco products are a serious health hazard, and their advertising is now circumscribed by the international convention on tobacco, as well as by a variety of local regulations. There have been more or less successful efforts to do the same with liquor advertising, as also with firearms. We're a long way from grappling with Barbie Dolls and Twinkies, but careful experimentation along these lines should be continued. Scientific evidence doesn't seem always very meaningful these days, when contrary conclusions can be bought. However, we can anticipate a slowly growing consensus around clear evidence from the biological and social sciences on the connections between certain kinds of advertising and anorexia, obesity, teenage and adult anxiety, depression, and suicide, and some of the other ills of our society. The Supreme Court's decision that commercial speech is protected under the first amendment to the Constitution dates only back to the 1960's, and I haven't given up hope that it may some day be reversed.

Another useful input to discussion on the cultural impact of corporations is a growing understanding in the social sciences regarding the ways that a switch of emphasis, away from status and status goods, could produce a happier, healthier society.[iii]

None of this resolves a core problem. Our economy is predicated on growth; we fall into recession or depression, with the traumas of unemployment and bankruptcy, when the economy stops growing. Yet we know that the planet cannot accommodate an indefinitely growing population – especially one that consumes at the U.S. level. And it seems likely that we can actually be happier, healthier, and better protect our environment by producing and consuming less stuff. There appears an inherent conflict between a fairly clear vision of a better world, where people enjoy life and preserve and heal our natural environment, and the requirements of our economy. Yet perhaps in that last sentence lies the solution to the conundrum; there is so much work to do in cleaning up and healing our environment – perhaps that could be the growth industry that would allow us to go on raising GDP through healthy activities. This does not explain how those environmental workers would be paid for – but that is what I'll be working on in my next book, *Macroeconomics in Context*.

Most of the very large issues touched on in this talk are not raised in economics classes. Yet I believe they are where any useful study of economics should begin.

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[i] Los Angeles Times, November 23, 2003 Sunday Home Edition Part A; Pg. 1

[ii] To learn more about this work, go to www.gdae.org – click on "Educational Materials" on the nav. bar, than click on "textbooks."

[iii] See Robert Frank, *Luxury Fever*, and Kahneman, Diener and Schwarz, eds., *Well-Being: The Foundations of Hedonic Psychology*.