

CHAPTER 8

Consumer, Industrial, and Government Demand

(draft)

The Post Keynesian approach identifies at least four types of demand: demand for consumer goods, for investment goods, for intermediate inputs, and for non-market goods such as government goods and services. There is also a demand for labour power, but Post Keynesians consider that quite different from demand for goods and services. The factors which influence the demand for the four categories of demand above are quite distinct and therefore will be considered separately. In particular we shall first consider consumer demand and then consider the demand for intermediate inputs. The other types of demand will be considered later.

Consumer Demand

As discussed in chapter two, markets for consumer goods are distinguished by their specific use value and by their income class. We also know that consumers directly purchase a wide range of goods which fall into a variety of markets. Thus what we are interested in is the process by which the consumer decides on the goods to purchase and the quantity of the purchase. We shall do all of this in the following manner:

1. In our approach, it will be assumed that purchasing decisions are made by the household as a social organization rather than by a asocial person. Consequently, the choice of goods purchased by the household is conditioned by the society in which it is located, by the social upbringing of

the heads of the household, and by the current social demands made upon the household. Therefore the actual choices of the household are both socially conditioned and limited. The socially conditioned choices also has another impact besides choice--it also determines the appropriate quantities for consumption by specifying recipe-like consumption or socially acceptable limits--more below. But this does not mean that the purchase of consumption goods and services necessarily only takes place within the household. Individual members of the household do circulate among other non-household members and within an array of non-household functional physical environments. But their purchases are made within the context of household spending decisions. So the household is the basis of spending decisions while the actually purchases and consumption of the goods and services obtained can take place outside the household.

Within the household, the consumption activity is viewed principally as a process of social relations; that social relations in consumption activity involve the active pursuit and maintenance of cooperative non-monetary relations or personal encounters with other identifiable persons face to face; that in such relations the joint activity of mutual word-of-mouth interpersonal communication and mutual transfer of certain types of non-market services occurs; and that physical market goods are used as a means of facilitating such functional social relationships.

In an advanced society the basic material needs of the individual/household are easily satisfied, at least for the great majority of persons living in those societies, that the choice among consumption goods reflects idiosyncratic preferences rather than just objective needs. Thus individuals consume goods which have both an use-value (instrumental) dimension and a social (ceremonial) dimension.¹ These preferences, however, are not innate or inherited. They are the result of a social conditioning or learning process that begins with the acquisition of language and continues throughout the individual's lifetime. First parents and relatives, then friends and acquaintances will instruct the neophyte consumer as to what items are the proper ones to use under varying circumstances. When two adults join together to form a household, they become the more immediate influence on each other's behaviour, with any conflicting views necessarily having to be reconciled through some interpersonal or proto-political process. The norms developed through continuous interaction with other human beings are then modified, though only in part, by other social mechanisms such as the formal educational system and the mass media. Of course, the choice among different consumption goods never depends solely on a person's prior social conditioning or on current social

¹It should be noted that the social dimension of making choices means the households may care about their relative position to other households in terms of consumption--more on this.

mores. There is usually some room for individual discretion. Nonetheless, once both the objective and social constraints on the choice among consumption goods have been taken into account, the room for individual discretion may be quite limited. The scope for deliberate, conscious choice is even further narrowed by the need to reduce as much as possible the burden which the multiplicity of available consumption goods places on the household's decision-making capability.²

2. The material needs (preferences) of the household are lexicographically ordered based on the separability and hierarchy of the needs.³ The material needs of household members are discrete, variegated, and quantities socially limited. This means that each household, viewed as a social organization, requires a large number of different items which are not substitutable for one another as well as given amounts. What is not possible is that the household has unlimited desire for any particular good or for goods in general: household have satiable needs--more below.⁴ The

²The choice of goods to buy also can not be fully understood independent of the system of economic activity which provides it. In other words, enterprises can affect choice and mould social perception, as they are members of the society itself. This process will not be discussed now, but later on.

³What this means is that while household purchase goods for consumption, the goods themselves may also be bought for other reasons. In addition, consumption goods/consumer goods differ significantly which means that generalities across consumer goods is not possible. That is the outcome of having a hierarchy of needs.

⁴Goods which households choose to meet their material needs are social defined not individually defined--more on this.

food that must be consumed in order to provide the minimum daily intake of calories will not provide protection against the vagaries of the climate. And among the different types of food consumed, meat does not provide the same nutrients as fruits and vegetables--just as, among the different means of sheltering the individual from the elements, clothes do not offer the same protection as a dwelling. In other words, the material needs of households are qualitatively distinct, or separable. It is for this reason that, in specifying the material needs of a household, one must speak in terms of a consumption basket.

The different goods represented by this consumption bundle can be grouped together into discrete categories, with the items that are included within any one category more nearly alike in the need they serve than the items excluded. Fourteen major categories of household consumption can be delineated: housing, fuel and power, food and non-alcoholic drinks, alcoholic, tobacco, clothing and footwear, household goods, household services, personal goods and services, motoring, fares and other travel costs, leisure goods, leisure services, and miscellaneous. Within each major category, various subcategories can be further delineated on the basis of the same rule--namely that the items included are more nearly alike in the need they serve than the items excluded.

An individual household must be able to make a large number of decisions on a continuous basis. Even if one

ignores all the other aspects of daily living and focuses only on the question of how any income is to be spent, the number of choices is quite large. This is not to suggest that human beings, organized into households or other types of social groups, are incapable of making a rational choice. The point rather is that it is not easy for them to do so. Even if all the necessary information is at hand--something that cannot always be counted on--it requires time and mental effort to weigh the options and make a choice that everyone within the group will find tolerable. The larger the number of decisions that must be made, the greater the strain on the group's decision-making capability. The difficulty is compounded with a large number of persons in the household. It is for this reason that, faced with the task of having to make a large number of decisions on a continuous basis, the representative, or typical household can be expected to adopt a two-part behavioral rule, at least insofar as the purchase of consumption goods is concerned.⁵

a. The household will continue to maintain whatever pattern of consumption it has already been established, especially in the case of food, clothing and other non-durable goods. Only in response to some new information--information that indicates a change either in the household's own circumstances or in the availability of

⁵In adopting this two-step rule, we are saying that the households are procedurally rational.

consumption goods, will the household consider altering that pattern. In this way the household is able to minimize the number of conscious, deliberate decisions it needs to make.

b. When new circumstances require that it consider a possible change in its pattern of consumption, the household will transform whatever multiple options it has into a series of discrete, preferably dichotomous, choices. The household can then use whatever power of discrimination it has to rule out a succession of alternatives until only one good, the item that best meets its need, remains to be chosen. In this way, the household is able to follow a relatively simple algorithm, one that does not place too great a strain on its ability to make decisions.

The representative household is able to transform its multiple options into a series of discrete choices through the three-step sequential decision-making process it usually follows in selecting any particular basket of goods for purchase at the store. The first step in the process is for the household to determine the maximum amount of income it wishes to spend under each major category of consumption-- usually as part of the exercise it goes through in drawing up a household budget. The minimal number of consumption goods that need to be purchased will be determined by the adult members of the household at the time they establish a separate household. At the very least they must decide how much to spend on food, clothing and shelter while still leaving themselves enough income to cover any incidental

expenses. Indeed, it is only if there is enough income to meet those minimal needs that a separate household will be established. Thus an initial budget can be assumed to have been determined at the time a separate household is formed, with that budget then revised with every significant change in either the composition of the household or its real income. As long as the budget previously worked out remains in effect, the household need make no further decisions as to how its income should be apportioned among the major types of consumption goods. All it has to do is limit its purchases within any one category to the amount allowed for in the budget.

The second step in the sequential process by which the household decides which items to purchase is for the household to draw up a shopping list prior to visiting the store. Once established, a household will try to keep a certain stock, or inventory, of the goods it needs, replacing those items through periodic visits to the store only as they are used up. In this way, the household can compile a separate shopping list for each of the major types of consumption goods it needs simply by noting what items have been consumed since the last visit to the store that sells those items, with the frequency of any visit to the store depending on how quickly those types of goods are normally used up. Thus the shopping list for food and other household items is likely to be compiled daily or weekly, the shopping list for clothes seasonally and the other

shopping lists as items need to be replaced. The compiling of a shopping list is likely, however, be the occasion for taking into account any new information and, on the basis of that information, revising the list of items normally purchased. Adding a new item to the shopping list may mean that the household will not be able to stay within its budget. In that case the household will find itself back at the first step in the sequential decision-making process--having to decide whether to revise its budget. More typically, however, the household will simply purchase the new item instead of some other good, one that, with the inclusion of the new item, need not be purchased as frequently or indeed even at all. It may be that the good dropped from the regular shopping list is a more expensive one. In that case, the household will have found a way to reduce the cost of satisfying whatever are the present set of needs allow for within the budget.

The third step in the sequential process by which the household decides which items to purchase is for some member of the household actually to visit the store and then based on the shopping list previously compiled, select specific items. This third step in the process provides one last opportunity for the household's buying plans to be revised.

While visiting the store, the member of the household with the responsibility for doing the shopping can take cognizance of any significant change in prices or in the items available for sale. A change in price may cause a

revision in buying plans for either of two reasons. If there should be a decline in the price of some good--one that is normally kept in stock by the household but is not on the current shopping list because it does not yet need to be replaced--the person doing the shopping may decide to take advantage of the bargain and add the item to the basket of goods being purchased. Alternatively, if the good was already on the shopping list, there will be money left over either to spend on other items or to be added to the household's unspent cash balances, thereby augmenting its discretionary funds or savings. Conversely, if the price of some good on the list has increased, the person doing the shopping will need to reconsider the tentative choices represented by the shopping list. The individual can decide that the higher price is only a temporary deviation from the price which normally prevails and, in anticipation of the price subsequently falling, may simply avoid making a purchase at the present time. To this extent, the person will necessarily be speculating as to what is the normal price of the good. However the individual may instead decide that the higher price is a permanent rather than a temporary one, in which case he or she will need to make some allowance for the loss of real income involved. This can range from going all the way back to the first step in the sequential decision-making and deciding whether to revise the household budget to merely cutting back on the purchase of some other good so as to stay within the present

budgetary limits.⁶

3. Purchases by household consists of two kinds--one which is routine or continuous and the second which is non-routine. As a result, the household income is divided into two categories--that which is claimed for the routine purchases and that which is claimed for discretionary (non-routine) purchases. To obtain these latter goods, the household must accumulate sufficient funds in the form of liquid assets and/or after the necessary financing has been arranged. While most of the latter items are durable goods of one sort or another, such as a home, a car or various household furnishings and appliances, they may also include outlays on non-durable goods and services which go beyond the amounts normally budgeted for, such as university tuition or special holidays.
4. Purchases are primarily affected by money income while price variation has no independent role. Each household can be assumed to have an order of priority in which it will select any one of the items in its consumption basket as its income increases. This order of priority will reflect both the household's objective material needs and the types of social conditioning to which the members of the household have been subject. It will therefore depend on: (1) the current stage in the life cycle of the household, as proxied by the

⁶Need to note that what is desired are the characteristics, experiences, services, etc. of the goods not the goods per se themselves. This permits substitutability in some ways--see below.

number of persons constituting the household and their respective ages; (2) the household's social class, as proxied by the educational background and occupation of its adult members; and (3) the larger culture to which the household belongs, as proxied by nationality, language, religion and other ethnic characteristics. These three sets of factors suffice to define the household's socioeconomic profile, with the distinguishing features of that profile serving as the parameters of the household's consumption behaviour.

Each household with a similar socioeconomic profile can be expected to add a particular item to its normal inventory of consumption goods, and thus to its regular shopping list, once its income in real terms reaches a certain threshold limit--that is, once all the items with a higher priority are already being purchased on a regular basis. According to this way of conceptualizing the household's decision process, the choice is never whether to purchase more of the same good. Rather the choice is whether to purchase some additional item for the first time or whether to purchase some variant of an item already on the household's regular shopping list. By allowing for the additional possibility that the increment of income will not be spent on any item of consumption but will instead simply be used to increase the household's discretionary funds or savings, it is possible to encompass all the different purposes for which an increment in household income can be used. There is no

reason to assume that, for all households with the same socioeconomic profile, the threshold level of income at which a particular item of consumption will be added to the shopping list is the same. On the contrary, it seems more reasonable to assume that the threshold level will vary.

a. For a given product and price, increasing money incomes could have a positive or negative impact on the demand for the product. If the increase in income for households means that more households can enter the market for the good (due to its income class characteristic) then demand for the product increases; but if at the same time, households already buying the good start to buy a different good because of their increase in income then the demand for the product could decline.

b. Whether the demand for a product increases or decreases as income increases depends on how that increase in income is distributed and what households get the increase in income.

c. It is normal within a capitalist economy for the demand for a good to increase/decrease as income increases; it is also normal that product development co-exist with changes in income. Therefore the distinction of normal/inferior good is not appropriate; and nor is necessity/luxury good. Since all consumption is socially conditioned, the appropriate distinction is between routine-discretionary goods. Thus for example conspicuous consumption is not extraordinary consumption but perhaps routine consumption

designed to fulfil a particular social (ceremonial) function (say desired by the rich). Of course, when value judgments are used for evaluating the capitalist economy, then routine goods for the rich can be effectively evaluated.

d. Issues of income elasticity of demand are problematical because income, price, and product variation/development are interdependently linked with income-aggregate investment and the distribution of income. Thus increases in income cannot be considered independently but must be related to all the other factors--MORE.

5. The question of substitution can only take place within a narrow range of sub-categories. That is in determining the degree of substitutability between any two consumption goods, it is not enough just to identify the items in broad terms, such as food or clothing. At that level, the replacing of one consumption good with another is simply not feasible. For substitution to be a real possibility, the various items of consumption need to be specified in sufficient detail. In addition, substitution is only feasible between closely aligned goods on the lexicographic continuum--only the items listed immediately before or after one another are likely to be close substitutes. The greater the number of other goods separating any two items, the less likely it is that one good can be used in place of the other to satisfy the same need. Thus only chicken and not a necktie can be considered a substitute for beef--and even then, if the recipe for making stew calls for beef, using

chicken may not, as a practical matter, be an option. Indeed, the material requirements needs of the household may be governed by recipes. Still it is not just objective, technical relationships that will determine the substitutability among the different items of consumption. Habits, based on social mores, also play a role.

6. The instrumental and ceremonial values of a good is not linked to its price--more on this point.

Demand for Intermediate Material Inputs

[needs to be done]

Demand for Investment Goods

[needs to be done]

Government and Other Demand

[needs to be done]

Terms

household
social dimension
use-value dimension
lexicographic ordering
routine purchases
discretionary purchases
degree of substitutability

Exercises and Questions

1. How do households make choices when purchasing consumer goods?
2. What role does the household income play in the purchasing of consumer goods?
3. What role do prices play in the purchasing of consumer goods by households?

Readings

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