9.4 CONCLUSION

The neoclassical approach to understanding consumption decisions appears to make a lot of sense, given the specific (perhaps peculiar) way the question is posed. Why do people buy what they buy? Because they prefer these things over others. Of course! But how well does this approach answer the truly interesting questions of modern consumption decisions? Why, for instance, do some people buy sports cars only to park them with everyone else in rush hour traffic? Why is it that, when we go to buy clothes, we spend so little time comparing the warmth and durability of the materials, and so much time on the finer details of 'how it looks'? *De gustibus non est disputandum* leads the neoclassical analysis to conclude simply that these are the elements which provide the most utility, leaving the critical thinker to ask: well, why are these the major elements of utility? (Naturally, to argue that we prefer the things that give us utility, and the things that give us utility are the things we prefer, is little more than an exercise in circular reasoning after all.)

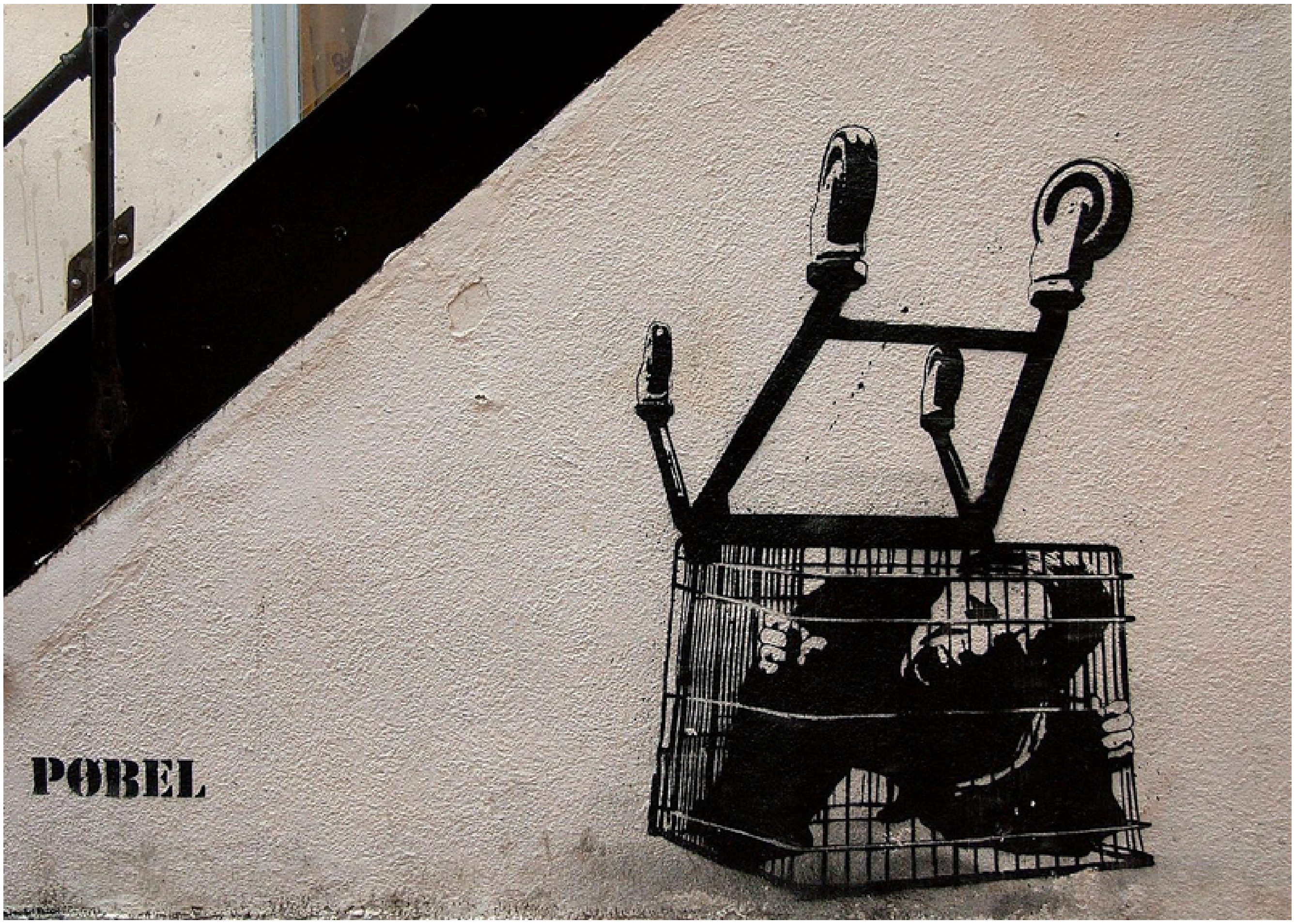
Jettisoning the overly constricting assumption of *de gustibus non est disputandum* allows us to move on to an institutional analysis; and with that analysis we can begin to answer the really interesting questions. Once we accept that humans are naturally, inherently social creatures, and that a society's institutions evolve over time, we can begin to understand how consumption patterns reflect partly the needs and desire of individuals, but also in part the received 'habits of thought' of the societies these individuals were born into. We can develop plausible explanations, like conspicuous consumption, for why consumers appear to be purchasing things for their *dis*utility or their wastefulness.

These theories, in turn, bring to light new questions. For instance, what is the relationship between the producers of consumer goods and the desires of consumers if not simply for the former to cater to the latter? What is the nature of the Self, how is that constrained by a culture of consumerism, and how might it break free of those constraints? These may be difficult questions to answer within the standard framework of neoclassical economics. Because of this, heterodox economics often turn to an institutional analysis instead.

WHO ARE WE AND WHAT DO WE WANT?

Certainly, the basic purpose of this textbook is to introduce the student to how economists explain the way our economy works. But it's worth pausing for a moment to reflect on the following question: are you, the student, being trained in something more than theories that explain the consumption, production, and distribution of goods and services? Does it go deeper than that?

In a recent interview, linguist Noam Chomsky was asked if he agreed with the view that "bedrock human nature" indicated that we, as people, are "selfish and really seeking material comfort…that we can never get away from that–that's what we are." Chomsky's response was that such a view was a product of the last century of advertising, rather than any scientific study of actual human nature. "The natural thing for humans," Chomsky argued, "is to want to be independent, creative.…



Anti-consumerism graffiti in Oslo, Norway. (Wikimedia user Anne-Sofie Ofrim. CC BY-SA 3.0)

People, I think, want dignity and a sense of self-worth, and a sense of creating and doing something that's important; that's what we are. I think it's taken huge efforts, enormous efforts–a huge part of the economy is devoted to trying to drive these things out of people's heads, to make you think that all you want is more commodities…"

It is worth considering where an introductory economics class (and textbook) fits into the broader culture in which we live. While economists surely strive to be objective social scientists, it is impossible for us to completely divorce ourselves from the societies in which we were brought up. Is it possible, therefore, that the stories we tell about, for instance, consumer choices have embedded in them certain assumptions about what it is to be human? And, furthermore, is it possible that those assumptions are in part a reflection of the very societies we're trying to understand? As this chapter has demonstrated, regardless of your personal beliefs about human nature, asking these questions is important if we're to properly understand our economy as it evolves through time.

CHAPTER 10. COST AND INDUSTRY STRUCTURE

INTRODUCTION TO COST AND INDUSTRY STRUCTURE

Figure 1. Amazon is an American international electronic commerce company that sells books, among many other things, shipping them directly to the consumer. There is no brick-and-mortar Amazon store. (Credit: modification of work by William Christiansen/Flickr Creative Commons)

AMAZON

In less than two decades, Amazon.com has transformed the way books are sold, bought, and even read. Prior to Amazon, books were primarily sold through independent bookstores with limited inventories in small retail locations. There were exceptions, of course; Borders and Barnes & Noble offered larger stores in urban areas. In the last decade, however, independent bookstores have become few and far between, Borders has gone out of business, and Barnes & Noble is struggling. Online delivery and purchase of books has indeed overtaken the more traditional business models. How has Amazon changed the book selling industry? How has it managed to crush its competition?

A major reason for the giant retailer's success is its production model and cost structure, which has enabled Amazon to undercut the prices of its competitors even when factoring in the cost of shipping. Read on to see how firms great (like Amazon) and small (like your corner deli) determine what to sell, at what output and price.

CHAPTER OBJECTIVES

Introduction to Cost and Industry Structure

In this chapter, you will learn about:

- Explicit and Implicit Costs, and Accounting and Economic Profit
- The Structure of Costs in the Short Run
- The Structure of Costs in the Long Run

This chapter is the first of four chapters that explore the *theory of the firm*. This theory explains that firms behave in much the same way as consumers behave. What does that mean? Let's define what is meant by the firm. A **firm** (or business) combines inputs of labor, capital, land, and raw or finished component materials to produce outputs. If the firm is successful, the outputs are more valuable than the inputs. This activity of **production** goes beyond manufacturing (i.e., making things). It includes any process or service that creates value, including transportation, distribution, wholesale and retail sales. Production involves a number of important decisions that define the behavior of firms. These decisions include, but are not limited to:

- What product or products should the firm produce?
- How should the products be produced (i.e., what production process should be used)?
- How much output should the firm produce?
- What price should the firm charge for its products?
- How much labor should the firm employ?

The answers to these questions depend on the production and cost conditions facing each firm. The answers also depend on the structure of the market for the product(s) in question. Market structure is a multidimensional concept that involves how competitive the industry is. It is defined by questions such as these:

- How much market power does each firm in the industry possess?
- How similar is each firm's product to the products of other firms in the industry?
- How difficult is it for new firms to enter the industry?
- Do firms compete on the basis of price, advertising, or other product differences?

Figure 2 illustrates the range of different market structures, which we will explore in Perfect Competition, Monopoly, and Monopolistic Competition and Oligopoly.

First let's take a look at how firms determine their costs and desired profit levels. Then we will discuss costs in the short run and long run and the factors that can influence each.

Figure 2. The Spectrum of Competition. Firms face different competitive situations. At one extreme—perfect competition—many firms are all trying to sell identical products. At the other extreme—monopoly—only one firm is selling the product, and this firm faces no competition. Monopolistic competition and oligopoly fall between the extremes of perfect competition and monopoly. Monopolistic competition is a situation with many firms selling similar, but not identical, products. Oligopoly is a situation with few firms that sell identical or similar products.