

## ABSTRACT

Title of Document: SHOULD ADVERTISING REMAIN A TAX-DEDUCTIBLE BUSINESS EXPENSE?

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Advertising expenses have been deductible ever since the income tax was enacted in 1913. Over the years, however, a number of analysts have questioned advertising's tax status. According to some, advertising creates intangible capital and should, therefore, be capitalized and amortized like other capital assets. According to other analysts, advertising does more to reduce welfare than to augment it; therefore, the deduction should be completely denied. Advertisers and their supporters, on the other hand, maintain that the deduction is entirely reasonable.

This dissertation addresses some of the legal controversies involving the deduction and examines some of advertising's economic psychological, sociological and ecological effects. In Part I, Chapter 1 introduces the research question and debates the welfare implications of ad-induced economic growth. Chapter 2 considers whether advertising is, in fact, an "ordinary and necessary business expense" that is entitled to a tax deduction. Although advocates for the deduction

claim that it is both ordinary and necessary, some critics argue that the deduction is, in fact, a subsidy that shifts more of the tax burden to individual taxpayers.

Part II is devoted to the economic effects of advertising. Chapter 3 discusses advertising's impact on demand for the output of an individual firm, a particular industry, and all industries combined. Chapter 4 examines the effect of advertising on the competitive model; Chapter 5 evaluates advertising's influence on innovation, employment, and savings; and Chapter 6 considers the economic impact of advertising on the media.

The focus in Part III is on advertising's influence on well-being. Chapter 7 examines ways that advertising affects the well-being of individuals and society. Chapter 8 surveys the impact of ad-induced materialistic values on the environment. Chapter 9 looks at a number of costs and benefits that are associated with advertising, discusses potential obstacles to changing advertising's tax status, and offers recommendations for policymakers.

SHOULD ADVERTISING REMAIN A DEDUCTIBLE BUSINESS EXPENSE?

By

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## Dedication

To the memory of my sister, Dr. Sidney Wengrover Emas, who inspires still . . .

## Acknowledgements

As I wrote this dissertation, so many people helped me, in so many ways; I hardly know where to begin. Diving in, I'll start with my advisor, Professor Herman Daly. Exposure to some of his ideas, a quarter-century ago, altered my worldview and, ultimately, motivated my return to school. Any expression of my gratitude to him for being my dissertation advisor would be greatly understated. Throughout the writing process, his kindness, guidance, and patience kept me moving steadily forward. I am also grateful to the other professors who have served on my dissertation committee: William Galston, Carol Graham, Robert Nelson, and Eric Zanol. Their questions and suggestions about my dissertation proposal, along with those of professors David Crocker and Steve Fetter, directed much of my subsequent research. In addition, I want to thank Professors Peter Balint, Mac Destler, and Robert Sprinkle for their kindness and support at various critical times.

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## List of Frequently Used Abbreviations

qtd.: quoted  
n.p.: no page (i.e., in an unpaginated work)  
n.d.: no date  
ed.: edited by  
no.: number

## PART I: THE ADVERTISING DEDUCTION

### *Introduction*

Ever since 1913, when the Sixteenth Amendment gave Congress the “power to lay and collect taxes on incomes,” businesses have deducted advertising expenses (Faber 1994; Teinowitz 2000). Today, the relevant section of the Internal Revenue Code (i.e., § 1.162-1 Business Expenses) reads, in part:

Business expenses deductible from gross income include the *ordinary and necessary expenditures* directly connected with or pertaining to the taxpayer’s trade or business. . . . Among the items included in business expenses are management expenses, commissions . . . , labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business . . . , *advertising* and other selling expenses, together with insurance premiums . . . , and rental for the use of business property. (italics added)

Clearly, the Code states that advertising *is* deductible. Advertising is assumed to be an ordinary-and-necessary business expenditure. But is the expense truly

*ordinary and necessary*, or is it, in fact, optional? And if it is optional, should it be deductible?

A logical argument in support of the deduction, based on the assumptions of mainstream economics, might follow a line similar to the following:

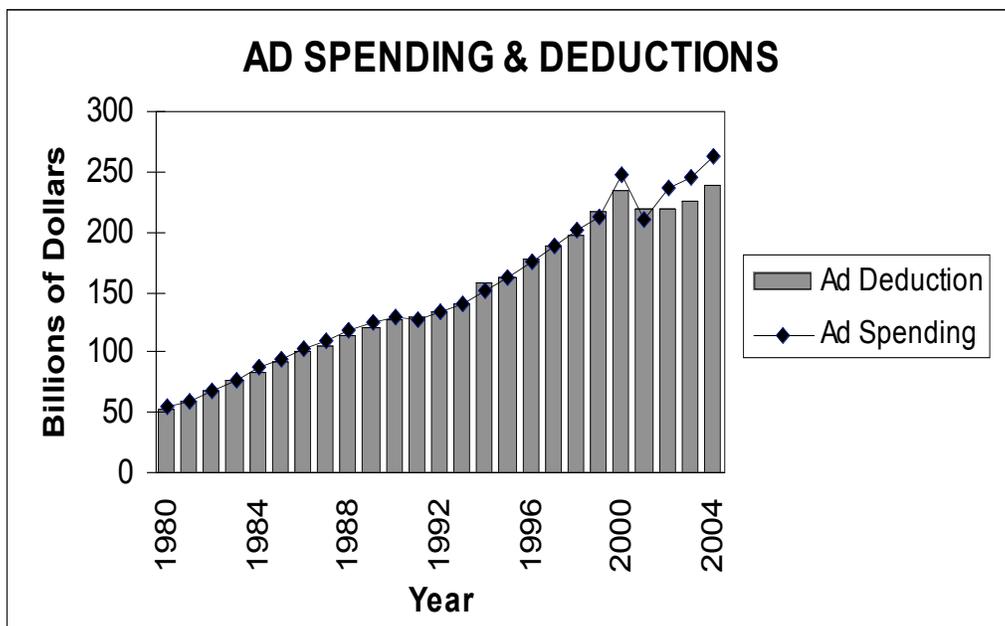
- *Governments should promote policies that enhance citizens' welfare.*
- *Economic growth enhances citizens' welfare.*
- *Therefore, governments should promote policies that fuel economic growth.*
  
- *Advertising fuels economic growth.*
- *Governments should enact policies that fuel economic growth.*
- *Therefore, governments should enact policies that encourage advertising.*

At the end of that line of logic, one arrives at the following question: What can governments do to encourage advertising? One likely answer: Make advertising tax deductible.

## Chapter 1: Advertising and Growth

In the United States, the federal government allows businesses to deduct 100 percent of their advertising expenses from their gross income, before calculating their tax liability. How much do businesses deduct annually? Hundreds of billions of dollars. (See Figure 1.1.)

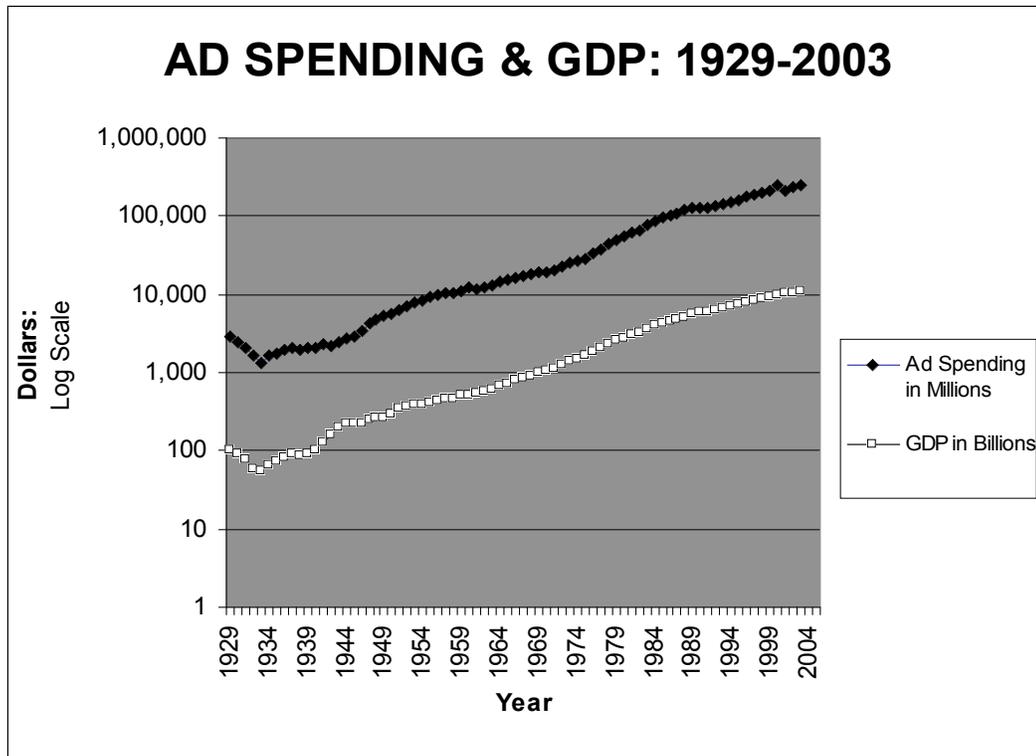
Figure 1.1



Source: U.S. Internal Revenue Service, *Statistics of Income, Corporation Income Tax Returns, Annual* (ad-deduction data) and Coen 2006 (ad-spending data). Data for 1981-1984 ad deductions have been interpolated.

Taken together, U.S. businesses spent well over a *trillion dollars* on advertising between 2000 and 2004. Although correlation does not prove causation, it is interesting to note that GDP and advertising expenditures have followed nearly identical growth paths ( $r = 0.997$ ), as Figure 1.2 indicates.

Figure 1.2



Source: (GDP data) Bureau of Economic Analysis and (ad-spending data) *Advertising Age Special Issue*: “The Advertising Century,” prepared by Robert J. Coen. Data is given in millions of 1999 U.S. dollars.

Throughout the twentieth century, and particularly since World War II, U.S. gross domestic product, personal consumption, advertising expenditures, and advertising deductions have climbed together in lockstep.

The advertising industry claims to have helped push the standard of living in the United States perpetually higher. Judging by the tax deduction afforded to advertising and countenanced by the Congress, courts, and Internal Revenue Service, the government concurs with the industry. Indeed, policymakers seem to consider advertising to be a public good.

### ***A Public Good?***

*See, I understand: If you can create the demand for goods . . . , the economy grows.*

*That's what you got to understand.*

—George W. Bush at a campaign rally, October 26, 2004

*Instead of us lurching back and forth, what I want to do is to create a climate for sustained economic growth.*

—Barack Obama interview, March 27, 2008

Implicit in the statements of Bush and Obama is the assumption that economic growth is good—irrefutably good. Identifying growth as the *summum bonum* of economic policy is nearly universal, not only among policymakers but also among the public at large.

Borrowing some of the points noted above, a logical argument for allowing the deduction could include the following premises:

- *Governments should promote policies that enhance citizens' welfare.*
- *Economic growth enhances citizens' welfare.*
- *Advertising fuels economic growth.*
- *Allowing businesses to deduct advertising expenses encourages them to advertise.*

Assuming that all of those premises are true, one might logically conclude:

- *Governments should, therefore, allow businesses to deduct advertising expenses.*

But what if the unqualified premise, “economic growth enhances citizens’ welfare,” is false? Clearly, false premises prove nothing; thus, the argument falls apart. For the conclusion to be proven, each link in the chain of premises must be true (Kelley 1994, 119). If, beyond some limit, growth tends to undermine citizens’ welfare and advertising fuels growth, then policies that encourage businesses to advertise—without reference to that limit—would seem to be unwarranted and unwise.

### ***More and More Without End?***

*The avarice of mankind is insatiable; . . . men always want more and more without end; for it is of the nature of desire not to be satisfied, and most men live only for the gratification of it.*

—Aristotle

According to Galbraith (1998), the proposition “that the urgency of wants does not diminish appreciably as more of them are satisfied” is “extremely important for the present value system of economists” (117). Economics-textbook author Kuenne (2000) certainly ascribes to that value system. He writes: “Within the consumer’s field of choice he or she is never *satiated* in goods. . . . More of any one or more goods is always welcome” (9). Another popular microeconomics textbook puts it this way: “For all feasible quantities of [two particular] commodities, the consumer is never satiated. A bundle with more of either commodity is always preferred to a bundle with less. . . . If some is good, more is better” (Katz and Rosen 1998, 24). It stands to reason, therefore, that if more is better, more must be produced, and the economy must grow.

Thus, for the neoclassical economist, “welfare is increased through the ever-greater provision of goods and services, as measured by their market value” (Daly and Farley 2004, 4). But, one might wonder, how is increasing welfare through the ever-greater provision of goods and services possible? If human desires are insatiable, then consuming more goods and services brings one no closer to satiety than consuming no more, just as pouring a ton of sand into a pit with no bottom gets one no closer to filling it than pouring in no sand at all.

On the other hand, could the assumption that more is always better actually be false? Consider the following example. Suppose there are four citizens—ready, willing, and able to sit—in an economy that can produce only one chair. Knowing that all four citizens will eventually want to sit down at the same time, one can safely

make two assumptions: (1) that the four citizens will be better off in an economy that grows enough to produce three additional chairs and (2) that once ensconced in his or her chair, each person's desire to sit will be satisfied. In cases of finite needs such as this one, more seems to be better, and growing from a one-chair to a four-chair economy would seem to enhance citizens' welfare.

What about growing from a four-chair to an eight-chair economy? Would doubling the number of chairs enhance citizens' welfare? With only one posterior per citizen to put in each chair, any number of chairs beyond four might be superfluous. On the other hand, with two chairs a citizen could put his or her feet up while sitting. Would more be better in this case? The answer here is less clear. Let's suppose our nation has only eight trees and it takes one tree to make one chair. To make eight chairs would require cutting down all eight trees. Would eight chairs increase welfare? Not if citizens would rather sit in the shade with their feet on the ground than sit in the sun with their feet on the chairs. What about an intermediate economy, one that produces six chairs and leaves two shade trees standing? Would two trees provide enough shade? Who would get the foot-rest chairs if only two were produced? What if the foot-rested individuals became corpulent, sedentary, and indolent, while the single-chaired folk became envious, conniving, and felonious? Would a six-chair be better than a four-chair economy in that case? If the production and consumption of the additional chairs leads to individual misbehavior, social unrest, and environmental destruction, would the benefit associated with economic growth be worth the cost?

In general, whether or not economic expansion adds to welfare depends on a number of factors that we need not dwell on here. (Chapters 8 and 9 will discuss the impact of growth on welfare.) The point, for now, is simply that once the economy has produced a sufficient number of chairs to satisfy each citizen's basic need to sit, expanding the economy may do nothing to enhance citizens' welfare; rather, further growth could prove to be detrimental.

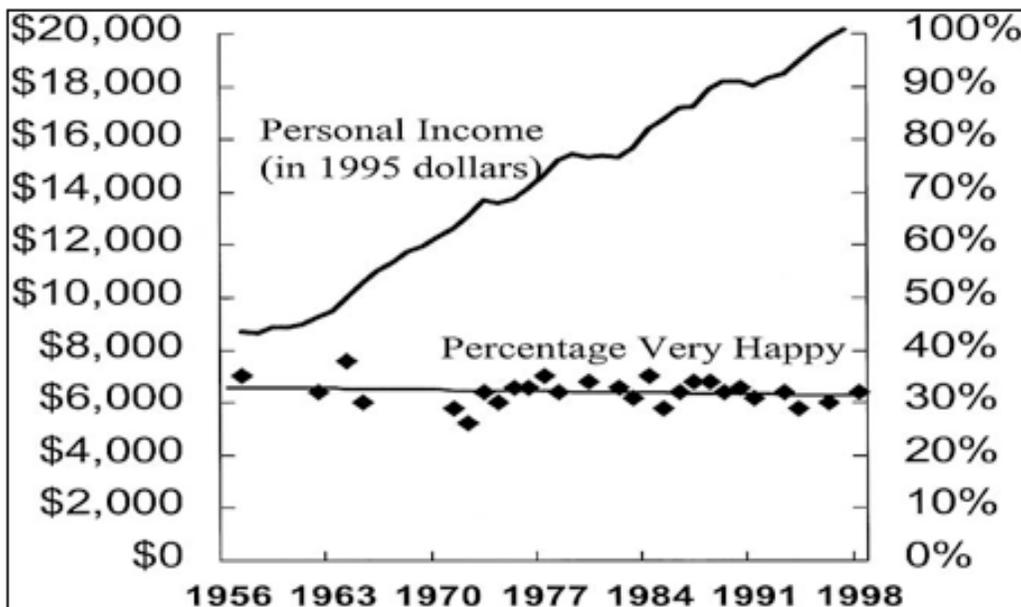
### **A Counterargument**

I suspect that many neoclassical economists (among others) would call my four-person, eight-tree economy an absurd abstraction. In the real world, they would say, resources are far less limited, and enterprising individuals develop innovative technologies that stretch existing resources and (essentially) create new ones. Furthermore, a chair is only one of an uncountable number of goods. In the real world, if a one-chaired woman desires a foot-rest chair, she can trade something she has (her labor, for instance) in order to get it. Better yet, rather than trade for a foot-rest chair, she can buy an ottoman. According to neoclassical economists, people are always better off with more goods because with more they have the option of trading away something they have for something they would rather have. Since economic growth enables people to obtain more goods and services—which they can keep or trade according to their preferences—economic growth is categorically good. Hence, governments should enact policies that help the economy grow; and, if advertising fuels economic growth, governments should encourage businesses to advertise.

## A Rebuttal

Some growth-skeptics might respond that what is missing from the neoclassical-economists' argument is the recognition that economic growth is an unreliable proxy for welfare. In making their case, the skeptics would likely point to a number of recent empirical studies in which researchers find no direct relationship between economic growth and levels of self-reported "happiness," "subjective well-being," or "satisfaction with life" (terms that, according to Graham and Felton (2005), economists often use interchangeably.) Myers (2000) finds, for example, that while average personal income more than doubled between 1956 and 1998, the percentage of Americans who reported being "very happy" fell slightly, as Figure 1.3 shows, from about thirty-five to about thirty-one percent.

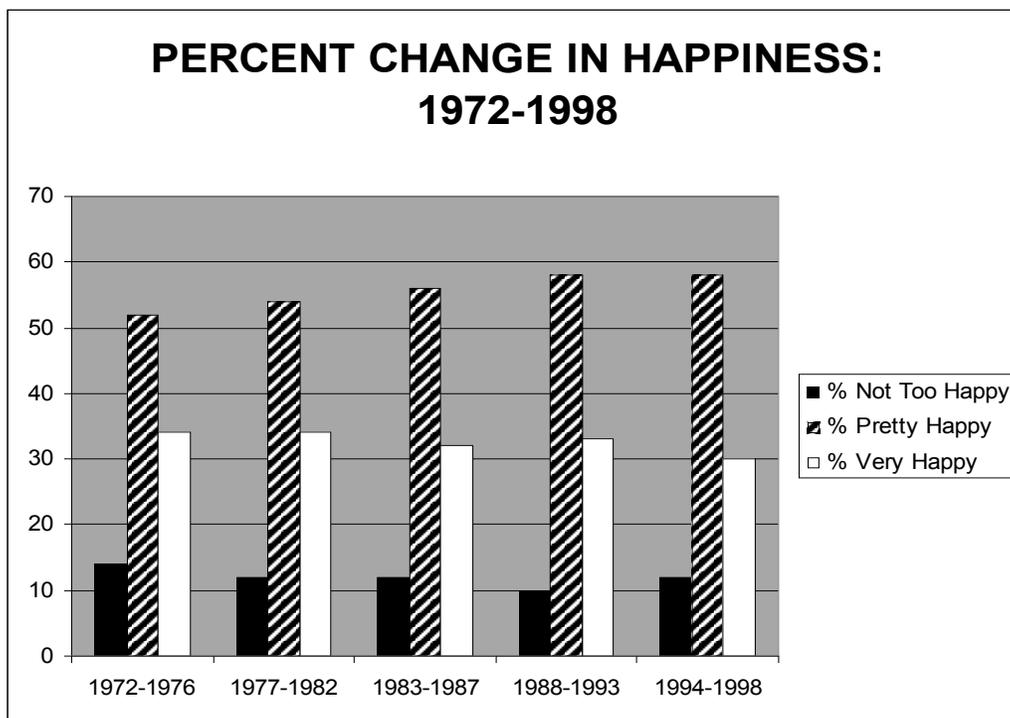
**Figure 1.3**  
**THE RELATIONSHIP BETWEEN INCOME AND HAPPINESS**



Source: Myers (2000).

In a similar study (see Figure 1.4), Blanchflower and Oswald (2004) found that the percentage of Americans who reported being “very happy” dropped from thirty-four to thirty percent between 1972 and 1998. Over the same time-span, the number who reported being “pretty happy” climbed, from fifty-two to fifty-eight percent, while the number who reported being “not too happy” exhibited no trend. Apparently, Americans were less happy in 1998 than in 1972, but they were not more miserable.

Figure 1.4



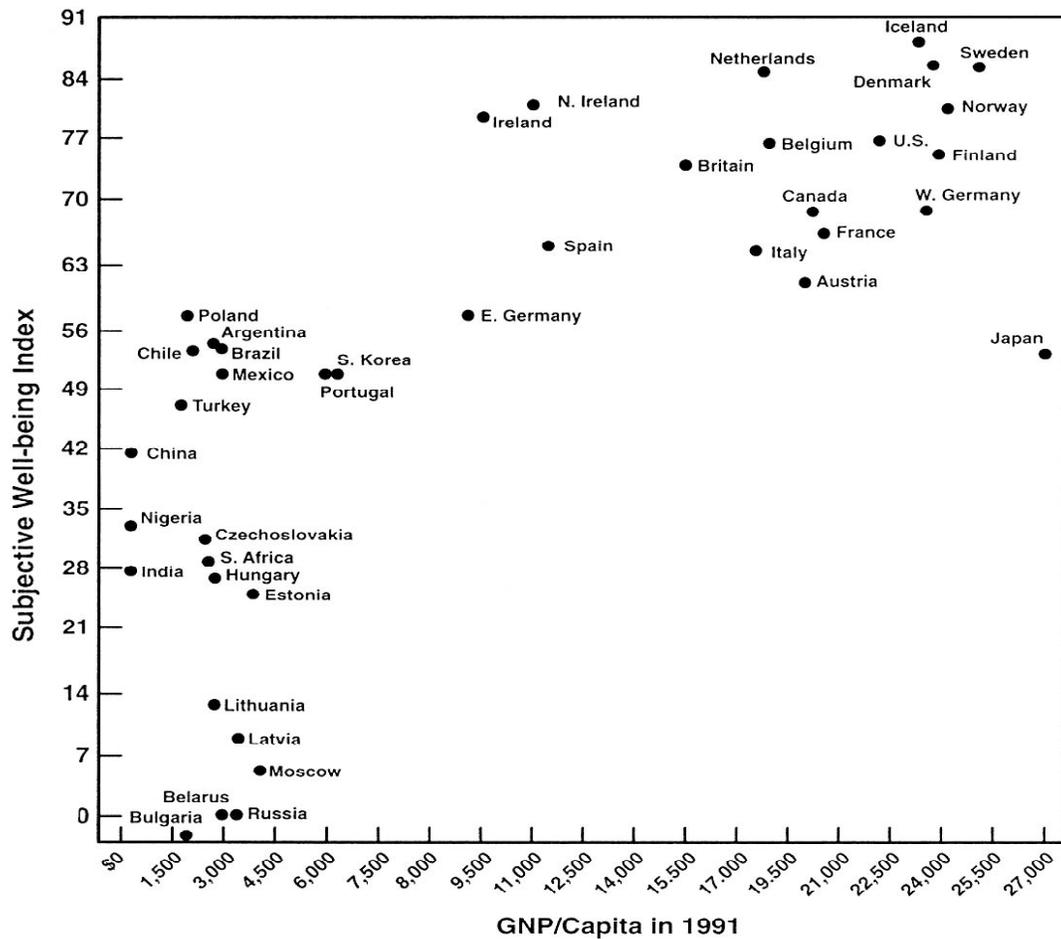
Source: Data in Blanchflower and Oswald (2004).

## A Weak Surrogate

A number of studies consider the relationship between income and happiness across nations or subcultures within nations. The 1990-1991 World Values Survey, for example, examines the relationship between per-capita gross national product (GNP) and subjective well-being for 50,000 people from forty different countries (Inglehart in Myers 2000). Among its findings, the survey reveals that the residents of Argentina, Chile, Brazil, East Germany, Japan, Mexico, Poland, Portugal, and South Korea reported nearly the same average level of subjective well-being— notwithstanding variances in per-capita GNP that ranged from approximately \$2,000 in Poland and Chile to about \$27,000 in Japan.

In the scatter-plot of Figure 1.5, dots representing countries appear to form two clouds: one cloud below and the other cloud above an imaginary dividing line of about \$8,000 per capita. (The results of more recent surveys of subjective well-being in various nations reveal similar patterns.) As the scatter-plot shows, the group of countries on the right side of the \$8,000 line exhibits higher levels of subjective well-being in comparison to the group of countries on the left, but within those two groups—right and left—no relationship exists between well-being and per-capita GNP. Using the U.S. poverty line for individuals in 1990, which was \$6,280 (U. S. Department of Health and Human Services 2004), as a *rough* guide, we might fairly conclude that \$8,000 was enough to cover basic needs and satisfy some extraneous, but not extravagant, desires. Thus, Figure 1.5 apparently indicates that increases in per-capita GNP fail to improve well-being in countries where people have more than enough to satisfy their basic needs, on average.

Figure 1.5 : The Impact of Income on Subjective Well-Being



Source: The data is from the World Bank and the 1990-1991 World Values Survey. The scatter plot was originally published in *Culture Shift in Advanced Industrial Society* (p. 62) by Richard Inglehart and was later reprinted in Myers (2000).

In another study with similar results, Diener and Seligman (2004) found that members of the Forbes list of the 400 richest Americans, the Pennsylvania Amish, and the Inuit of northern Greenland tied for first place in self-reported life satisfaction (as indicated in Table 1.1).

Table 1.1: Life Satisfaction for Various Groups

| <i><b>Group</b></i>                                       | <i><b>Rating</b></i> |
|---|----------------------|
| Forbes magazine's "richest Americans"                     | 5.8                  |
| Pennsylvania Amish  | 5.8                  |
| Inughuit (Inuit people in northern Greenland)             | 5.8                  |
| African Maasai  | 5.7                  |
| Swedish probability sample                                | 5.6                  |
| International college-student sample (47 nations in 2000) | 4.9                  |
| Illinois Amish  | 4.9                  |
| Calcutta slum dwellers                                    | 4.6                  |
| Fresno, California homeless                               | 2.9                  |
| Calcutta pavement dwellers (homeless)                     | 2.9                  |

Source: Diener and Seligman (2004). Authors' note: "Respondents indicated their agreement with the statement 'You are satisfied with your life.' Using a scale from 1 (complete disagreement) to 7 (complete agreement); 4 is a neutral rating."

Imagine for a moment the multi-million-dollar mansions of the Forbes-list rich; now, think of the Inuit's igloos and huts, which generally lack even the basic

amenities of electricity and running water. From a material standpoint, a greater contrast is barely imaginable. Nevertheless, the Inuit reported the same high level of life satisfaction as the richest Americans. As Diener and Seligman conclude, “If the well-being findings simply mirrored those for income and money—with richer people invariably being much happier than poorer people—one would hardly need to measure well-being, or make policy to enhance it directly. But income, a good surrogate historically when basic needs were unmet, is now a weak surrogate for well-being in wealthy nations.”

Consideration of similar findings led Easterlin (1974) to note an apparent paradox concerning the relationship between wealth and happiness. Graham (2005) describes that paradox as follows: “While most happiness studies find that *within* countries wealthier people are, on average, happier than poor ones, studies across countries and over time find very little, if any, relationship between increases in per capita income and average happiness levels” (45).

Although the Easterlin paradox is widely cited, Stevenson and Wolfers (2008) challenge its validity. They find “a clear positive link between average levels of subjective well-being and GDP per capita across countries, and find no evidence of a satiation point beyond which wealthier countries have no further increases in subjective well-being.” Nevertheless, they note that “many researchers have examined the trend in US happiness . . . and all have come to the same conclusion: the US has not gotten any happier over this time period [1972 through 2006] and has even experienced a mild decline in happiness.” (See Figure 1.6.) Their own analysis, they write, “turns up similar findings” (24). In the view of the authors, “the U.S. time

series is thus a data point supporting the Easterlin paradox, [but] it should be regarded as an interesting exception warranting further scrutiny” (24).

Figure 1.6: Average Happiness in the U.S.



Source: Stevenson and Wolfers (2008)

Given that consumption in the U.S. has risen substantially for decades (see Figure 1.7, below), while subjective well-being has stagnated and even declined, why do many people—including many policymakers—assume that increasing consumption *will* increase well-being?

The answers are, no doubt, numerous. Here are a few that seem plausible:

- The notion that consuming more fails to increase welfare is counterintuitive.

Consumption produces pleasure, or, if not pleasure, at least satisfaction.

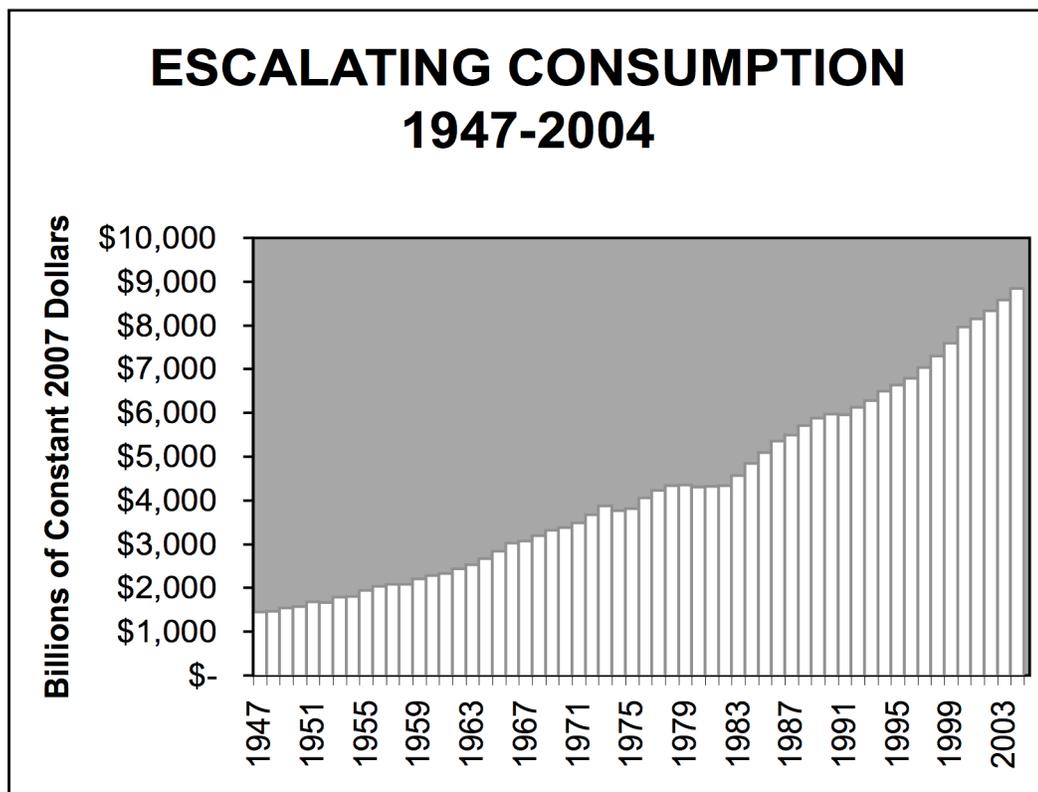
Although the pleasant sensation is fleeting in most instances, the initial utility is more salient than the long-run disutility.

- Amassing goods for future use may be an instinctual strategy that increases the probability of survival.
- Many people evaluate their self-worth based on their ability to “keep up with the Joneses.” They assume that their lives would be better if they could achieve or surpass the consumption of their peers.
- Compared to the mind’s response to the intensity of hunger pangs and the pleasure of eating, its recognition of *satiety* is subtle, which may be why so many people overeat. Tight clothing, a number on a scale, and an image in a mirror provide feedback; but that feedback is temporally, physiologically, and psychologically removed from the initial experience of pleasure.
- Environmental signals of over-consumption by individuals are particularly subtle. For example, when consumers become aware that the possessions they have accumulated are crowding their living space, many expand their living space rather than reduce their consumption. Thus, they cope with the disutility of consuming too much by consuming more.
- What is being lost as people devote more time, attention, and resources to the acquisition and consumption of more goods and services generally goes unnoticed. Changes in the way people live tend to be slow and incremental. Those who draw attention to the downside of the changes are often called nostalgic or pessimistic; they are marginalized, and their views are dismissed.
- A rising GDP is hailed widely by the media and trumpeted loudly by incumbent politicians as a reason for reelection and a cause for celebration. The general public accepts the assumption of economic experts and

government officials that growth—and particularly consumption-induced growth—is good.

- Finally, and most directly relevant to this dissertation, advertisers spend billions of dollars annually attempting to convince people to consume more. Thus, people may want more because advertisers tell them to want more—incessantly.

Figure 1.7



Source of data: Bureau of Economic Analysis (2007). The chart presents constant-dollar estimates. It shows a sextupling of consumption between 1947 and 2004, although the population merely doubled (U.S. Census Bureau).

## ***Basic Human Needs***

Clearly, human well-being depends on the satisfaction of needs. But what defines a need? According to Kasser (2002), a “need is not just something a person desires or wants, but is something that is necessary to his or her survival, growth and optimal functioning” (24). Human needs extend beyond the strictly biological. As Schudson (1984) explains, “the creditable human being must have not only the things needed for a decent life, but something extra, something superfluous or sentimental or luxurious” (133). Even in primitive and impoverished societies, he writes, “human needs and desires are culturally constituted and socially defined” (132).

If, as Schudson (1984, 134) maintains, human “desires and pleasures spring from society” and are measured “by society and not by the objects which serve for their satisfaction,” then perhaps one reason that Inuits (as noted above) are as satisfied with their lives as Forbes magazine’s richest Americans—despite the stark difference in the monetary wealth and consumption levels of the two groups—is that the Inuit and the richest Americans both manage to satisfy their *social* as well as their survival needs.

Advertising attempts to redefine human needs by implying that people need advertised products in order to be truly creditable human beings. In the process, advertising inculcates materialistic values.

## ***The Parallel Growth of Advertising and Materialism***

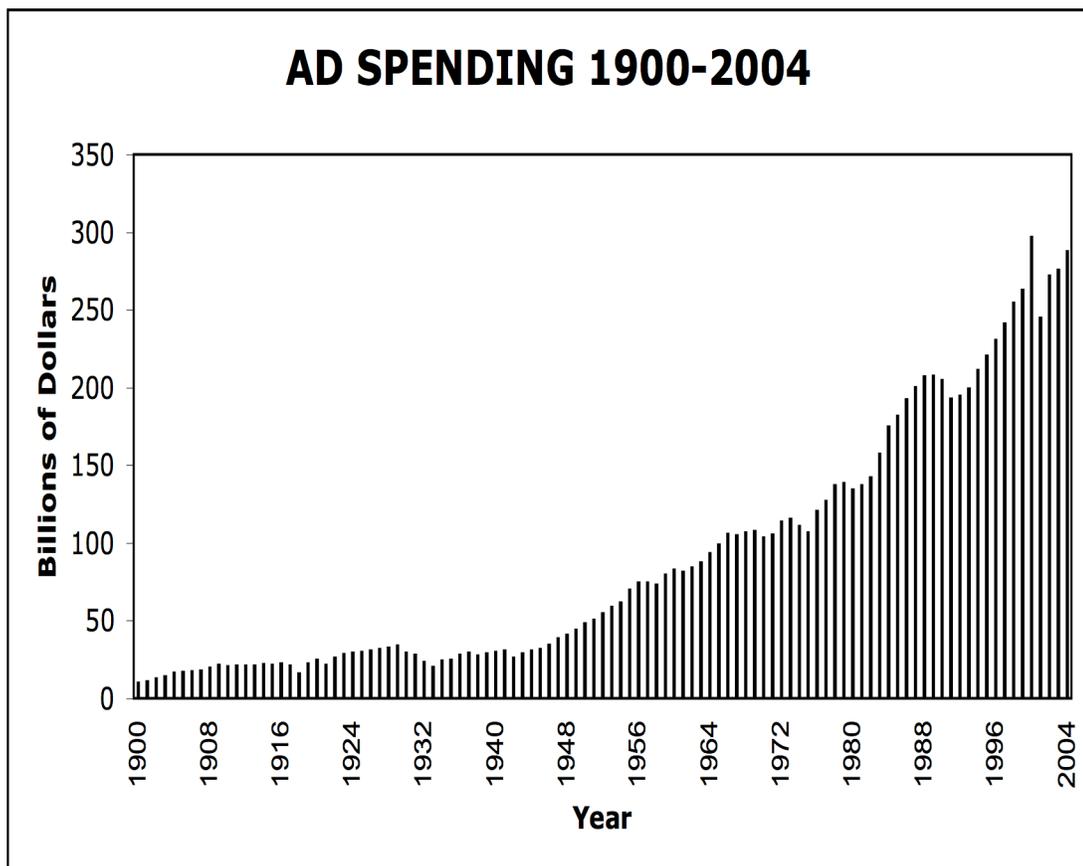
As Figure 1.8 illustrates, between 1900 and 2004, while population less than quadrupled, annual spending on advertising in the United States increased 26 times, going from \$11 billion to \$288 billion in constant 2007 dollars (Oregon State University 2007) or from \$450 million to \$263 billion (Coen 1999; 2006) in current dollars.

While Figure 1.8 illustrates the growth of advertising in constant-dollar terms, it fails to indicate the impact of that growth on individuals and society. In human terms, the increased exposure to commercial messages has transformed the tenor of daily life profoundly. At the beginning of the twentieth century, 11 percent of Americans were illiterate (U.S. Department of Education n.d.) and more than 60 percent of all Americans lived in rural areas (U. S. Census Bureau “Population” n.d.); thus, as Twitchell (1996) notes, for many people, weeks would often pass between ad sightings. In contrast (see Chapter 2, below), the average American in the new millennium is exposed to several thousand ads every day, or about a million ads per individual per year (Twitchell 1996; Union of Concerned Scientists n.d.). Once a novelty, ads have become ubiquitous.

According to a growing number of social scientists, the omnipresence of commercial messages is having a number of sociological and psychological effects (see Chapter 7). Advertising, psychologists say, plays a major role in the formation of materialistic attitudes. As Kanner and Soule (2004) put it, “one meta-message that cuts across most, if not all, commercials is the idea that happiness is to be found

primarily in material goods and services.” The effect of commercial messages, the authors explain, is cumulative. When people live in an environment awash with ads, regardless of content, “the sheer volume of commercial messages promotes materialism” (57).

Figure 1.8



Source of ad-spending figures: Robert J. Coen (1999, 2006). Converted to constant 2007 dollars using “Consumer Price Index (CPI) Conversion Factors 1774 to estimated 2018 to Convert to Dollars of 2007.”

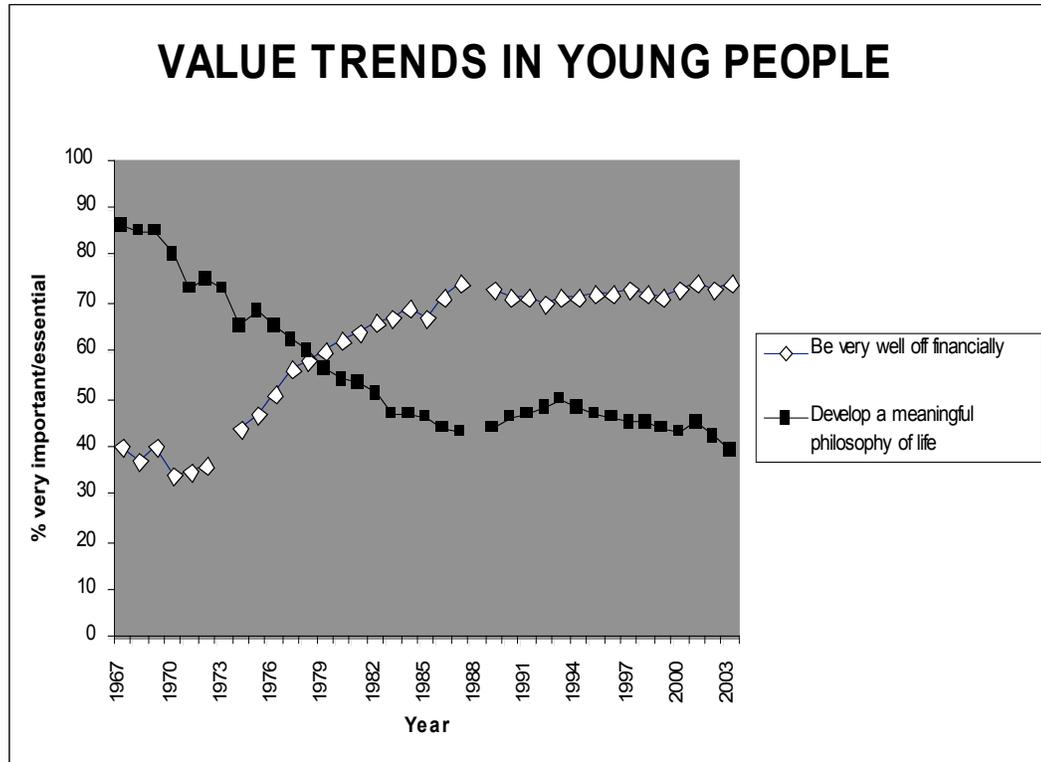
Like most values, materialism becomes most deeply rooted when it is instilled early in life. The deregulation of broadcasting in the 1980s and the media mergers in

the 1990s have transformed children's programming and have allowed advertisers to make children a central focus of their attention. According to Steyer (2002), "the past decade's wave of media mergers has produced a complex web of business relationships that now defines America's mass media and popular culture. These relationships offer a huge opportunity for cross-promotion and the selling of products among different companies owned by the same powerful parent corporations." In Steyer's view, these "all-purpose media corporations . . . look at kids as targets in this vast commercial empire they are conquering in the name of profit . . ." (13).

Has this targeting of children been effective? If the numerous psychological studies (to be discussed in Chapter 7) that link exposure to advertising to the development of materialistic values are valid, then perhaps the targeting has been effective—given that several surveys indicate that successive cohorts of young people hold increasingly materialistic values.

To take one example, a study conducted by the Higher Education Research Institute (HERI) at UCLA asked more than 275,000 college freshmen questions about their values. Between the 1967 and 2003, the number of entering college students who said that being very well off financially was "very important or essential" climbed dramatically. As Figure 1.9 indicates, in 1970, when materialism among college freshmen was apparently at its nadir, only about 34 percent indicated that being very well off financially was essential. By 2003, however, that number had climbed to 74 percent (UCLA 2004).

Figure 1.9



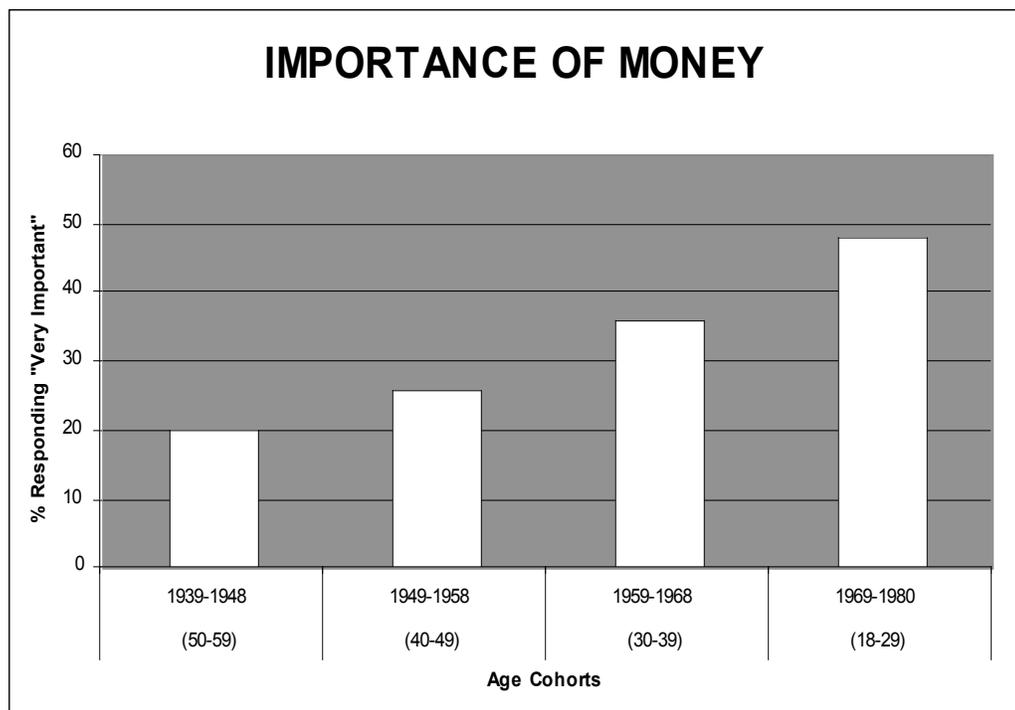
Source: UCLA Graduate School of Education and Information Studies: Higher Education Research Institute (2004) survey data.

A 1998 poll by NBC News and the Wall Street Journal seems to indicate greater materialism in young people, as well. In response to a series of questions about their personal values, younger cohorts were more likely than older cohorts to say that money was very important (Roper Center 1999). As Figure 1.10 shows, the younger the group, the more its members said they valued money. In fact, compared to the oldest group, the youngest group was almost two-and-a-half times more likely to think that having a lot of money was very important.

Figure 1.10 seems to suggest a negative relationship between age and materialistic values. Comparing Figure 1.10 to Figure 1.9, one might reasonably

conclude, in addition, that the older a cohort is today the less its members cared about being wealthy when they were young. But if, in fact, each generation is more materialistic (on average) than were previous generations, why is that the case? Certainly, more than one variable is at play. Nonetheless, psychological studies (as subsequent chapters will show) find that advertising inculcates materialistic values. Since each generation is being exposed to a greater number of ads, each generation is being exposed to a greater number of messages that impart materialistic values than the generation that came before.

Figure 1.10



Source of data: 1998 NBC News/Wall Street Journal poll.

Apparently, materialistic values, like most values, tend to be formed early in life and remain relatively stable. That is not to say, however, that people who are middle-aged are no more materialistic now than they were when they were young. Statistics on consumption (see Figure 1.7) indicate that Americans have increased their consumption almost every year since 1947. One might argue, of course, that increased consumption might merely reflect higher per capita incomes over time. It should be noted, however, that instead of increasing their spending, Americans could have held their consumption constant—or even decreased their spending as their incomes grew—and saved more of their income.

### ***Confronting over-consumption***

Until quite recently, over-consumption generally affected only the individual who over-consumed and, perhaps, his or her community to some degree. Today, however, the consumption of goods and services by Americans comes increasingly at the expense of the rest of life on the planet—human and otherwise. According to the environmental organization Redefining Progress (Creslog and Graeser 2001; Hoppe and Creslog 2002), more than five Earths would be required to allow the rest of humanity to match the American rate of consumption.

For the most part, public policy has failed to grapple with over-consumption by individuals. The problem is seemingly intractable: regulating private consumption is politically infeasible, and calling for voluntary restraint is generally ineffective. Policymakers add complexity to an already thorny problem by being so fixated on

economic growth that they tend to panic when personal consumption falls.

Nevertheless, consumption must fall, because the associated costs, from global warming and species extinction to obesity and diabetes, are rapidly mounting and must be confronted. Public policies that encourage people to over-consume, even if that encouragement is indirect, are counterproductive and should be re-evaluated.

Consider the tax deduction for advertising. Advertising encourages people to consume. In fact, the very purpose of advertising—its *raison d'être*—is to motivate the consumption of products and services. Since deductibility promotes advertising, and advertising engenders materialism, and materialism fuels over-consumption, and over-consumption (*ex hypothesi*) leads to disutilities (see Chapters 7 and 8), perhaps it is time to eliminate the advertising deduction.

But that is, of course, just one side of the argument. As we shall see, supporters of the advertising deduction offer a number of justifications for their position.

### ***Looking forward***

*Should advertising remain a tax-deductible business expense?* Subsequent chapters of this dissertation attempt to answer that question by examining some of the legal, economic, psychological, sociological, and ecological effects of advertising. Chapter 2 (in Part I) considers whether advertising is, in fact, an “ordinary and necessary business expense” that is entitled to a tax deduction.

In Part II—The Economics of Advertising—Chapter 3 discusses advertising’s impact on demand; Chapter 4 examines the effect of advertising on the competitive model; Chapter 5 evaluates advertising’s influence on innovation, employment, and savings; and Chapter 6 considers the economic impact of advertising on the media.

The focus in Part III is on advertising’s influence on well-being. Chapter 7 examines ways that advertising affects the well-being of individuals and society. Chapter 8 surveys the environmental impact inhering to ad-induced materialistic values and economic growth. Chapter 9 looks at the costs and benefits associated with advertising, discusses potential obstacles to changing advertising’s tax status, and offers recommendations for policymakers.

## Chapter 2: An Ordinary and Necessary Business Expense?

Advertising is currently deductible as an “ordinary and necessary business expense.” According to Section 1.162-1(a) of the Internal Revenue Code, “Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer’s trade or business. . . . Among the items included in business expenses are . . . advertising and other selling expenses . . .” (Internal Revenue Code § 1.162). Nevertheless, advertising’s inclusion as a deductible business expense has sparked controversies ever since 1913, when the Sixteenth Amendment to the Constitution enabled Congress “to lay and collect taxes on incomes, from whatever source derived.” In the view of some observers, for example, the tax deduction for advertising expenditures amounts to a subsidy by the taxpayers. As the Chairman of the House Ways and Means Committee of the 105<sup>th</sup> Congress, Bill Archer, once remarked: “We have seen a Cato Institute report where they say they’re defining corporate welfare. And one of the items that they claim is corporate welfare is the business expense of advertising. . . . I mean, what is a legitimate business expense? Obviously it’s like beauty. It’s in the eye of the beholder” (House of Representatives 1997).

Advertising’s advocates maintain that the deduction for ad expenditures, like the deductions for other business expenses, “merely reflects the true cost of producing taxable income” (Neuborne 1992). This seems to be an inadequate justification for the deduction, however, since the Internal Revenue Service, backed by the courts, disallows deductions for a number of income-producing expenditures. Furthermore,

some business expenses that were once deductible are no longer. Three-martini lunches, for example, are nondeductible now, even though somewhat inebriated, less inhibited prospects undoubtedly make better customers. In some instances, expenditures for sales' motivators have never been deductible. Take skimpy clothing, for example. As every marketer knows, sex sells. For that reason, at the Sweet Spot Café, the Natte Latte, and the Bikini Espresso in the suburbs of Seattle, baristas wear bikinis. "It's not against the law," said a spokesman for the Sheriff's Department. "And the truth is, [they] are doing a land-office business" (qtd. in Verhovek 2007). It's unlikely that the baristas or their employers are allowed a bikini deduction, however. The IRS disallows deductions for articles of clothing that are suitable for ordinary wear—whether or not that clothing attracts paying customers (Cook 2004).

### ***Equivalent to salespeople?***

Advertising is salesmanship-on-paper.

John E. Kennedy

### **Historical perspective**

According to *Advertising Age* editorials, advertising is a "legitimate and fully deductible business expense," equivalent to expenditures for "sales calls" (1995a), "sales staff salaries" (1993a), or a "company's sales force" (1986). Over the years, a number of observers have equated advertising with salesmanship. Rosser Reeves (1986) writes: "Advertising is, actually, a simple phenomenon in terms of economics. It is merely a substitute for a personal sales force—an extension, if you will, of the

merchant who cries aloud his wares” (145). Similarly, Daniel Starch (1923) notes: “The simplest definition of advertising, and one that will probably meet the test of critical examination, is that advertising is selling in print” (5). Indeed, the tax code itself equates advertising with selling expenses, as noted above.

Businesses have deducted advertising expenses for as long as the federal government has collected taxes on income. Much has changed, however, since 1913, when the income tax was enacted. At that time, advertisements truly did function a lot like salesmen. In fact, creating ads that functioned like salesmen was the aim of most ad agencies. Influential, turn-of-the-century ad-man John E. Kennedy believed that “an ad should say in print precisely what a good salesman would say face-to-face to a customer” (Fox 1997, 50). According to Kennedy, an advertisement should provide “a good, strong, clearly expressed Reason-why” to buy the advertised product (Kennedy c. 1910, 7). As other ad men followed Kennedy’s lead, “Reason-Why” became the vogue in advertising. Thus, the widespread use of an advertising style that emulated straightforward salesmanship coincided with the enactment of the income tax.

In that pre-World-War-I era, ads seemed analogous to salesmen not only because ad men designed them to function like “salesmen on paper” but also because many Americans encountered advertisements only about as often as they encountered salesmen. As Twitchell (1996) notes, “In 1915 a person could go entire weeks without observing an ad” (2). Newspaper and magazine subscribers certainly encountered ads more often, but ad exposure for a significant proportion of the

population was limited to seeing outdoor signs and, on occasion, receiving a handbill or a circular.

Prior to the 20<sup>th</sup> century, advertising was anything *but* an ordinary and necessary expense for most businesses. According to Fox (1997), as recently as the late 1800s, advertising had been “considered an embarrassment. . . . A firm risked its credit rating by advertising; banks might take it as a confession of financial weakness” (15). But the stigma associated with advertising was about to lift.

Beginning in the 1880s, a few innovative manufacturers began to use continuous-process machinery, which allowed them to manufacture packaged consumer goods cheaply and to sell those goods at low prices. As Schudson (1984) notes: “The massive increase in output made possible by the new machinery led manufacturers to build large marketing and purchasing networks and to engage in widespread advertising” (164). With the massive expansion in capacity made possible by the new machinery, these manufacturers used advertising to generate demand to match their newly achievable output. “For firms where technology had solved production problems, advertising arose as part of a marketing effort to sell goods whose supply could be increased easily at little additional production cost” (167-168).

Thus, when the income tax was enacted, a few manufacturers of packaged consumer goods had begun to advertise heavily, but most businesses advertised little or not at all. In the aftermath of World War I, however, many businesses confronted an excess-profits tax and sought to spend those profits “in a manner that could be justified as a business expense. So they invested lavishly in advertising: full pages in

newspapers, double pages in magazines, with more illustrations and wider borders to fill the space. In only two years, the total annual volume of advertising *doubled*, from \$1.5 billion worth in 1918 to just under \$3 billion in 1920” (Fox 1997, 77; italics in original). The excess-profits tax thus provided an incentive for businesses to spend vast sums on advertising.

Because businesses had money to burn in order to avoid taxes and media had pages to fill, a new theory of advertising soon supplanted Kennedy’s Spartan, “Reason-Why” style. Known as “impressionistic copy” or “atmosphere advertising,” the new ad-style aimed to project an image of high quality and status, by featuring “opulent art and striking layouts,” as well as “dignified, elegant writing as a complement to its high visual tone” (Fox 1997, 70). Commenting on the transformation, Inger Stole (1998) writes: “In the space of a relatively few years, as advertising veered from mere price and product information to an emphasis on appeals that were image-based, emotional, even deceptive, it became both a powerful and controversial business practice” (21).

A case can be made, therefore, that the post-war transformation of advertising left it bearing little resemblance to ordinary salesmanship. Businesses, nevertheless, continued to claim the deduction just as they had before the change in ad style.

The growth-spurt in advertising expenditures following World War I—an unintended consequence of the excess-profits tax—has since settled into a pattern of steady ad growth. In 1913, the year the income tax was enacted, American businesses spent just over one billion dollars (approximately 22 billion in 2007 dollars) on advertising (Coen 1999). In 2007, ad spending exceeded \$290 billion.

Not only are today's ad expenditures not comparable to those of 1913, the technologies employed to research, produce, and transmit ads have stretched the analogy between face-to-face selling and advertising past the breaking point.

*Using technology to find the "buy button"*

Today's market researchers employ ever more sophisticated scientific and medical instruments in a relentless quest for a sure-fire consumption trigger—what some marketers call a "buy button." To monitor the lengths of time that test subjects focus on various sections of an ad, for example, market researchers fit subjects with eye-tracking instruments; to quantify an ad's ability to evoke emotions, neuroscientists measure subjects' galvanic skin responses. Nor do researchers limit their research to overt physical responses in their attempts to determine an ad's effect. Current technologies allow researchers to probe deep within a subject's brain. By hooking-up subjects to electroencephalographs, for instance, neuroscientists have been able to identify cognitive functions in twelve separate parts of ad-viewers' brains (Wells 2003). By noting which parts of the brain "light up," that is, where in the brain electrical activity spikes, researchers can determine when and how an ad attracts or repels a subject and "which parts of commercial messages, if any, are encoded in the experimental subjects' long-term memories." Such encoding is of great interest to advertisers because, according to neuroscientist Richard Silberstein, "people who are more likely to purchase a product show significantly higher memory encoding than those who are less likely" (qtd. in Wells, n.p.).

Over the past few years, a number of corporations, including Coca-Cola, Johnson & Johnson, DaimlerChrysler, and Hallmark, have employed magnetic

resonance imaging in the search for brain activities that signal the decision to consume. According to one psychiatrist/neurologist who has conducted brain-imaging for DaimlerChrysler, using an MRI is “a little like mind reading” (Wells, n.p.). A professor of organizational behavior has predicted that “in the not-too-distant future, firms will be able to tell precisely if an advertising campaign or product redesign triggers the brain activity and neurochemical release associated with memory and action” (Wells, n.p.). Finding the means to trigger the neurochemical release associated with action would be a crucial advance in the ad industry’s ability to motivate consumption, because a potential consumer will not buy—no matter how well he or she remembers an advertised product—without an internal impulse to act. When advertisers can both encode into memory and spur to action, they will, perhaps, have found the long-sought “buy button.”

In the meantime, advertisers use information about individuals’ behavior to inform the content of custom-tailored commercial messages. Today’s interactive computer technology allows advertisers to collect personal information and target individuals with personalized ads. Such “behavioral-targeting” systems employ computer algorithms to process personal information gleaned from information stored in numerous databases. Increasingly, as consumers go onto the Internet or turn on their cell phones, they receive custom-tailored ads (Story 2007c). Google, for example, electronically scans its e-mail subscribers’ inboxes and subsequently displays ads, on the subscribers’ computer screens, that seem relevant to the content of the users’ e-mail messages (Story 2007b). Similarly, Pudding Media uses voice-recognition software to eavesdrop on its users’ phone calls; then it uses content-

analysis software to figure out which ads might be relevant to the user; and then it delivers custom-tailored ads to the users' computer screens, based on the content of their conversations (Story 2007b). Internet social-networking companies, such as MySpace and Facebook, mine the information (or the "digital gold," as one company executive put it) that users display on their personal profile pages. "We are blessed with a phenomenal amount of information about the likes, dislikes and life's passions of our users," said the president of Fox Interactive Media, owner of MySpace (qtd in Stone 2007b, n.p.). With grocery scanners compiling information about individuals' purchases, Internet search engines collecting users' web-surfing histories, online advertisers tracking and storing individuals' visits to websites, and telephone and e-mail providers eavesdropping on personal communications, advertisers have access to more than enough information about most Americans to create highly effective, personalized ads. Until researchers locate the sure-fire buy-button within the human brain (if they ever do), "behavioral targeting" may be the best method in the advertiser's arsenal for motivating consumption.

### **Ad ubiquity**

Even the best method to motivate consumption is only effective if it can first engage consumers' attention. Because people spend their time engaged in many different activities, advertisers try to put their ads wherever human beings might go. "We never know where the consumer is going to be at any point in time, so we have to find a way to be everywhere," an ad executive told a reporter for the *New York Times* (Story 2007a). If nothing else, advertisers are successful at being omnipresent.

According to Yankelovich, a market research firm, people who live in cities encounter approximately 5,000 ad messages per day (Story 2007a). Estimates of all Americans' daily ad exposure vary, by source, from several hundred (*Consumer Reports Website* 2002) to several thousand (Advertising Media Internet Center 2002). Whatever the precise number, advertising's current ubiquity further differentiates it from the salesmanship-on-paper advertising of 1913.

When the income tax first took effect, advertisers lacked the means to broadcast their messages to millions of people simultaneously. In 1913, a few inventors had built experimental radios, but a decade would pass before American consumers brought radio receivers into their homes. With the radios came spoken messages exhorting listeners to buy advertised goods. Those messages multiplied the average Americans' ad exposure by many times. Several decades later, when consumers added televisions to their households, they further increased their ad exposure.

Over the years, as technologies have offered new means to reach potential customers, advertisers have employed those means to carry their commercial messages to virtually any place a human being might go. Consequently, as time has passed, more and more ads have appeared in more and more places. But, as Comanor and Wilson (1974) note, because "the advertising of others creates 'noise' in the market, one must 'shout' louder to be heard . . ." (47). Today, according to one marketing executive, "what all marketers are dealing with is an absolute sensory overload" (Story 2007a).

Attempting to transcend that overload, many advertisers put ads in unexpected places. In some cases, everyday objects—adorned by ads—can be eye-catching.

Table 2.1 lists some examples of mundane objects that some advertisers have used to carry their messages.

**Table 2.1: Mundane Objects as Guerilla Ad Media**

| AD MEDIA   | PRODUCT   |
|--|---|
| Airport security-station trays<br>Paper liners covering pediatricians' exam tables<br>Chinese food cartons<br>Subway turnstiles<br>Tray tables on US Airways<br>Dry-cleaners' hanging bags<br>Pizza boxes<br>Women's room stall interiors<br>Men's room wall, next to urinal attached near ceiling<br>Ice (full-size, melting car sculptures)<br>Laser-etched eggs (with ads for programs)<br>Sides of abandoned, inner-city buildings (as graffiti)<br>Clothing (caps, coats, shirts, etc.)<br>Telephone, "on-hold" messages<br>Backs of grocery receipts<br>Ticket stubs<br>Back of neck permanent tattoo<br>Pregnant belly temporary tattoo | Rolodex <sup>(1)</sup><br>Little Einstein DVDs <sup>(1)</sup><br>Continental Airways <sup>(1)</sup><br>Geico auto insurance <sup>(1)</sup><br>Microsoft <sup>(1)</sup><br>Perry Ellis <sup>(1)</sup><br>Verizon <sup>(1)</sup> ; Continental Airlines <sup>(1)</sup><br>Crest Night Effects whitening gel <sup>(4)</sup><br>Spiderman 2 movie <sup>(3)</sup><br>Volkswagen <sup>(3)</sup><br>CBS <sup>(4)</sup><br>Sony PlayStations <sup>(2)</sup><br>Various<br>Various<br>Various<br>Various<br>Globat web-hosting <sup>(4)</sup><br>Globat web-hosting <sup>(4)</sup> |

Sources: (1) Story (2007a); (2) *NewsfromRussia.com* (2005); (3) Jana (2001); (4) Petrecca (2006).

The tactic, called "guerilla" advertising, often works—for a while, at least. As time passes, however, the public becomes inured. Thereafter, the once exotic, eye-catching location seems banal. Thus, ad agencies perpetually hunt for new ways to deliver commercial messages. The ad agency representing Nissan, for example, once dropped car keys in 20,000 public places, from stadiums to bars to concert halls.

Attached to each key ring was a tag that read: “If found, please do not return. My generation Nissan Altima has Intelligent Key with push-button ignition, and I no longer need these” (Gilbert 2007).

Beyond keys, entire cars sometimes carry commercial messages. Procter & Gamble, PepsiCo, Coca-Cola, and Verizon are among the companies that have advertised on privately owned cars, vans, trucks, SUVs, and buses (Newman 2007). Imprinted on adhesive vinyl, their ads are wrapped tightly around the vehicles, giving the appearance of permanent paint. According to FreeCar Media, a Los Angeles ad agency, over a million people have volunteered to drive the rolling billboards. When Procter & Gamble or some other company wants to target a particular demographic group, the ad agency searches its database for a driver with the correct demographic profile. A soccer mom might be matched to a car with an ad for new-and-improved Tide, for example. In return for participating, drivers receive either stipends of up to \$800 per month for allowing their vehicles to be ad wrapped or new, pre-wrapped vehicles. Because Americans spend much of their time commuting, ads on vehicles can be effective. According to one study, tens of thousands of motorists and pedestrians can be exposed to one ad-wrapped-vehicle’s message per day (Newman 2007).

Subway commuters make good ad targets, as well. Recently, subway systems in a number of cities (e.g., Beijing, Shanghai, Tokyo, London, Washington, New York, and San Francisco) have installed ads on subway-tunnel walls. Using the same persistence-of-vision phenomenon that television and movies employ, the ad’s still-frame images appear to move when the train’s speed exceeds twenty-five miles per

hour. “The user experience is so cool and so innovative that [it] actually excites people,” the CEO of one subway-ad company said. Even after the novelty wears off, commuters will probably tend to watch the ads because, as the same CEO explained, “people are looking out the window anyway to avoid eye contact” (Terdiman 2007).

Although many San Franciscans may have enjoyed the novelty of ads in subway tunnels, they complained when the California Milk Processing Board put “Got Milk?” ads at some area bus stops. Why? Because the billboards emitted the aroma of chocolate-chip cookies. Ultimately, citizen outrage forced removal of the aromatic ads (Story 2007a).

The reaction to the cookie-aroma ads in San Francisco was mild, however, compared to the brouhaha that occurred when a television cartoon, “Aqua Teen Hunger Force,” debuted an outdoor ad campaign in Boston. As part of the campaign, marketers surreptitiously installed circuit boards, with light-emitting diodes arranged to depict one of the cartoon’s characters on the front, in highly trafficked locations. The strange, illuminated devices panicked some area residents. Concerned that terrorists might have planted the devices, city officials sprang into action. Calling on the F.B.I., Coast Guard, and Department of Homeland Security for assistance, they closed subway stations, bridges, the northbound lane of an interstate highway, and even a section of the Charles River, while explosive experts examined and removed the “hoax” devices hanging nearby. “It is outrageous, in a post-9/11 world, that a company would use this type of marketing scheme,” said Boston’s mayor, Thomas Menino (qtd. in Belluck 2007).

Advertisers have diverted their expenditures toward non-traditional ad media as consumers have become desensitized and less vulnerable to the influence of television advertising. While TV is still a powerful ad medium, its ability to motivate consumption has waned somewhat, due, in part, to the increased sophistication of today's viewers and to the proliferation of communication technologies that compete for viewers' time. Devices that allow viewers to eliminate the audio portion of an ad or to skip a commercial entirely have further degraded television as an ad medium. Thus, TV advertisers have begun to divert some of their expenditures away from thirty-second commercials that are segregated from the program content and, instead, pay networks to exhibit their products as props or background elements within the TV program, itself. Beyond mere placement, advertisers and their surrogates collaborate with writers, producers, and network ad departments to work mentions of their products into the scripts of television programs. According to Nielsen Media Research, advertisers paid for more than 100,000 products placements in the 2004-2005 TV season (Manly 2005).

Meanwhile, television networks have begun to place ads for their own programs *not* on television but on the surfaces of mundane, unexpected objects, to draw public attention and generate word-of-mouth publicity. In addition to putting ads on eggs and postage stamps, CBS put ads for its programs on the insides of elevator doors, to engage a short-term, captive audience that invariably faces the door. The network even plowed the name of one program, *Jericho*, into a Kansas cornfield, to enable flyover exposure (Petrecca 2006).

KFC took ad viewing beyond the stratosphere and into outer space when it assembled an 87,500 square-foot image of Colonel Sanders, its founder, in the Nevada desert in order to gain publicity for its new logo. Although the outer-space audience has been limited (as far as we know) to a handful of astronauts and cosmonauts, the expenditure was not wasted. After GeoEye's IKONOS satellite captured the Colonel's image and beamed it back to Earth, news media gave the new KFC logo free publicity, by broadcasting the satellite photo along with a story about the gigantic logo's creation (Business Wire 2006).

While some people undoubtedly thought that blanketing a vast expanse of private property with a KFC logo was a clever idea, probably the only ones who thought stretching a giant logo across the sky would be similarly appreciated were the members of a Georgia marketing firm who proposed the idea. In the early 1990s, the firm had plans to offer ad space on mile-long sheets of mylar, which would have been carried into space by rocket and released into low-Earth orbit. Dismayed at the prospect, Congressman Edward Markey introduced the Space Advertising Prohibition Act of 1993, to prevent orbiting billboards from “beam[ing] down the logo of Coke or G.M. or the Marlboro man, [and] turning our morning and evening skies, often a source of inspiration and comfort, into the moral equivalent of the side of a bus” (Congressional Record 1993, E1732).

The 106<sup>th</sup> Congress enacted a modified version of Markey's bill. Given the popular agreement that some places (the skies, for example) are unsuitable for ads, one might expect that other places—public schools, for example—might be declared off limits to advertising, as well. Such is not the case, however. Throughout the

U.S., advertisements are becoming quite prevalent in schools, as desperate school districts accept ad placements in exchange for cash and equipment.

As James Steyer (2002) notes, marketers realize that “they can get more bang for their advertising buck,” in schools. “Relatively few marketing messages [compete] for the youngsters’ attention, [thus] consumer messages can be much more potent and effective” (114-115). In addition to being excellent showcases for ads, schools contain captive audiences, for about seven hours per day and five days per week. “Companies desperately want to get into high schools,” said one sports-marketing representative, “because they know they are getting a captive audience with disposable income that is about to make decisions of lifelong preference, like Coke versus Pepsi” (Pennington 2004).

With advertisers eager to supply cash and equipment, chronically underfunded school boards are cutting deals. Many schools now show Channel One’s programs and advertising, and receive computers and video equipment in exchange for class time. As schools sell flat surfaces throughout school buildings and grounds to companies to be used for ad space, “more and more children are seeing their schools turned into massive ads and billboards for snacks, soft drinks, and consumer products” (Steyer, 115). Advertisements appear on the sides of school buses, tickets to school sporting events, end-zone billboards, gymnasiums’ inner and outer walls, scoreboards, and locker-room walls, among other places. One school board president told a reporter: “I’m looking into selling advertising on the children’s basketball uniforms,” (Pennington 2004).

Off the schoolyard, marketers recruit children to act as product consultants and peer-to-peer marketers. “Companies enlist children to market to each other at school, in chat rooms, on playgrounds, even inside their homes,” Juliet Schor writes (2004, 22). Many children are eager to be recruited, because they receive product samples and gain status among their peers in exchange for providing information about youth trends and promoting the advertisers’ brands.

The Internet is a particularly powerful means for children to promote products to their friends. According to Alissa Quart (2003), “intense peer-to-peer promotion has emerged and flowered online . . .” (39). Why do children forward advertisements (or links to ads) to their friends via e-mail? Generally, like adults, they send ads to their e-mail contacts because they think the ads are funny, creative, beautiful, or clever, and they think that their friends and relatives will enjoy seeing the ads.

In the trade, this Internet-assisted, word-of-mouth method of promotion is called “viral advertising.” Because it is inexpensive and effective, viral advertising has become an important marketing method in a short stretch of time. “Viral marketing appeals because it’s so cheap,” one marketing director explained. “Instead of buying ad space, the distribution is done for you by customers who communicate your messages by word of mouth on the Internet” (*Financial Times* 2001).

In a twist on the viral-ad theme, a number of major advertisers (e.g., Heinz Ketchup, Sprint, Jeep, Dove, and Pepsi) have invited the public to create ads for their brands, offering prizes to the creators of the best entries. As ad-industry observer Louise Story (2007e) notes, the approach “combines the populist appeal of reality

television with the old-fashioned gimmick of a sweepstakes to select a new advertising jingle.”

Beyond facilitating Internet advertising, computers have been a boon to the creation of innovative commercials in a number of ways. The ease with which computers manipulate digital photography, for example, enables ad creators to make babies, birds, cats, dogs—anything—speak. Not only does the technology allow gorillas to promote Bud Light and lions to endorse Taco Bell, it also enables performers who have been dead for decades, such as Louis Armstrong, Humphrey Bogart, and James Cagney, to appear in new ads.

Table 2.2 lists some examples of ads that digital information technology has made possible.

**Table 2.2: Ads Exploiting Digital Video Technology**

| AD MEDIA   | PRODUCT PROMOTED  |
|--|---|
| Digital video projected onto sides of buildings<br>Interactive animation projected onto walls<br>Digital video projected onto sidewalks<br>Interactive floors (burgers bounce with footsteps)<br>Interactive sign (sneakers fly when people walk by)<br>Video games (featuring Big Macs, etc.)<br>Video games (featuring vehicles)<br>Video games (featuring Army and Marines)<br>Flat screens in taxis, buses, airports, subways, elevators<br>Animated digital billboards along highways<br>Digital billboards in stores, gyms, gas stations, etc.<br>Small-screens on iPods, cell phones, and laptops | Unilever (Axe cologne) and Toyota <sup>(1)</sup><br>Adobe <sup>(6)</sup><br>Chase Bank and Commerce Bank <sup>(1)</sup><br>McDonald's <sup>(1)</sup><br>Adidas <sup>(1)</sup><br>McDonald's <sup>(2)</sup><br>MiniCooper <sup>(3)</sup> and Chrysler (Jeep) <sup>(5)</sup><br>U.S. Department of Defense <sup>(4)</sup><br>Various<br>Various<br>Various<br>Various |

Sources: (1) Story (2007a); (2) Ashdown (2003); (3) O'Dwyer's PR Services Report (2004); (4) Edwards (2004); (5) Bond (2004); (6) Aspan (2007).

And if all the means for displaying and distributing ads already mentioned were not enough, ever-alert advertisers have found another ready means in cellular phones. Not long ago a novelty, the now ubiquitous cell is on the brink of becoming a major advertising medium. Many cell-phone service providers already send banner and display ads to their subscribers' picture phones. Soon, some will show Honda ads along with four-to-six-minute "minisodes" of old television programs, such as "Charlie's Angels" and "Fantasy Island" (Elliott 2007). Because cell-phone use generates data that can be helpful in targeting commercials to specific users, many advertisers are eager to subsidize cell phone use; and because cell-phone companies want more customers in order to generate greater revenues, cell-phone companies are eager to accept advertising and to reward customers for viewing ads. Thus, some phone companies offer additional services to ad viewers at no additional cost; others reduce phone-service rates. One company plans to give college students free cell phones and a forty percent discount on their calling plans—if the students agree to watch at least four ads per day (Story 2007d).

In sum, ads today confront us at every turn. From a refrigerator shelf where a dozen eggshells sport the CBS Eye to the Nevada desert where 65,000 one-foot-by-one-foot tiles are hooked together to form a fried-chicken-franchise logo, ads are everywhere. According to the editor-in-chief of *Advertising Age*, Rance Crain, "Advertisers will not be satisfied until they put their mark on every blade of grass" (qtd. in Petrecca 2006).

## *Interest Group Influence on Corporate Tax Rates*

Although advertising was quite similar to face-to-face salesmanship in 1913 when the income tax was enacted, equating one with the other today seems far-fetched. All the same, advertising remains fully deductible. Why? In part because, as Jonathan Rauch explains, “adopting government measures to help industry has always been easy, getting rid of them next to impossible” (Rauch 1994, 56). Once an interest group (in this case advertisers, media, and the advertising industry) receives a tax benefit, the group’s members will fight hard to retain it. Given that the cost of the group’s benefit is dispersed across the multitude of taxpayers, any individual’s share of the cost is too small for it to be in his or her interest to fight for repeal; nor will taxpayers organize a group to fight the benefit, because, as Mancur Olson (1965) explains, each potential group member recognizes that the cost of organizing the group will be greater than the benefit of membership.

John Wright (1996) explains the persistence of tax benefits for particularistic groups this way:

There will be little or no interest group opposition to policies that disperse the costs of particularistic benefits across the entire population without regard to group membership. Any group that opposes another group’s particularistic benefit can at best hope only to reduce the tax bill for all individuals in the population. However, since a lower tax bill for the population as a whole is itself a collective, or universalistic good, no group will be expected to lobby for such an

outcome, or equivalently, against another group's particularistic benefit. (177)

When the income tax was established, rather than the creation of a system that would allow groups to claim particularistic benefits, the motive was the establishment of a more equitable tax system. The Populists, who had championed the income tax, wanted a system that would determine how much a person owed the government by how much he could afford, and, as they saw it, income provided the best indication of a person's ability to pay. "From the start, however, Congress made exceptions to that basic principle, allowing special treatment for income that was used for certain purposes or that came from certain sources" (Birnbaum and Murray 1987, 6-7). Advertising was one such exception.

As a general proposition, tax breaks distort economic decision-making, by providing investors an incentive to direct funds to tax-favored expenditures. According to Robert Shapiro (1993) of the Progressive Policy Institute, "Industries that don't receive special treatment have to compete at a disadvantage, because those that do enjoy an artificially elevated rate of return that attracts private investment away from those left to operate on their own" (31). In addition, those who receive tax breaks "claim scarce resources that otherwise could go to public investment, deficit reduction, or tax relief" (32).

If it were not for the tax breaks they receive, corporations would pay a much larger share of government revenues. In 2006, the tax rate for corporations with earnings under \$335,000 was between 15 percent and 34 percent of their taxable income. The rate for those with earnings over that amount but under \$18,333,333

was between 34 and 35 percent. The tax rate for corporations with higher earnings and for all “qualified personal service corporations” was 35 percent (Internal Revenue Service 2006). Ultimately, however, most corporations pay a much lower rate than the statutory maximum (Friedman 2003). As Lawrence Summers (2007) notes: “The United States currently has . . . one of the highest corporate tax rates in the OECD [the Organization for Economic Co-Operation and Development], but nonetheless manages, despite a record level of corporate profitability, in having the fourth lowest corporate tax revenues as a share of GDP in the OECD” (8).

According to a report by the Government Accountability Office, between 1996 and 2000, 94 percent of all U.S. corporations paid less than five percent of their income in taxes, and more than 60 percent paid no tax at all (MSN 2007). Between 1998 and 2005, the proportion of corporations paying no income tax escalated to two out of every three (Browning 2008). A study of 275 profitable *Fortune 500* corporations by Citizens for Tax Justice finds that “eighty-two of America’s largest and most profitable corporations paid no federal income tax in at least one year during the first three years of the George W. Bush administration,” and “twenty-eight corporations enjoyed negative federal income tax rates over the entire 2001-03 period” (Citizens for Tax Justice 2004). The average effective tax rate, averaged across the entire group of 275, fell from 21.4 percent in 2001 to 17.2 percent in 2002 and 2003. With revenues from corporate taxes being so low, more of the tax burden necessarily falls on individuals. According to IRS data, in 2003 corporations paid only 7.4 percent of total tax receipts; whereas, individuals paid 45 percent (MSN 2007).

The list of eighty-two corporations that paid “zero tax or less in at least one year, 2001-2003,” compiled by the Citizens for Tax Justice (McIntyre and Nguyen 2004), and the list of the top fifty advertisers, compiled by *Advertising Age* (2006) for 2004 and 2005, share a number of common elements. As Table 2.3 shows, a number of America’s largest ad spenders paid no federal income tax.

Table 2.3: Major Advertisers Who Pay No Tax

| CORPORATION<br>PAYING NO TAX | ADVERTISER’S RANK |      |
|------------------------------|-------------------|------|
|                              | 2004              | 2005 |
| Time Warner                  | 3                 | 3    |
| AT&T                         | 4                 | 5    |
| Walt Disney                  | 6                 | 7    |
| Verizon Communications       | 8                 | 4    |
| Pfizer                       | 10                | 11   |
| General Electric             | 11                | 12   |
| Cendant Corp.                | 44                | 43   |
| American Express             | 48                | 33   |

Source for tax info: McIntyre, Robert S., and T. D. Co Nguyen. 2004. “Corporate Income Taxes in the Bush Years.” *Citizens for Tax Justice & the Institute on Taxation and Economic Policy*. Source for advertising information: *Advertising Age* (2006).

Furthermore, a comparison of top corporate tax-break recipients with top advertisers reveals a number of entries that are common to both lists, as Table 2.4 indicates.

Table 2.4: Top Tax-Break Recipients

| TOP CORPORATE TAX-BREAK RECIPIENTS | Advertiser's Rank |      |
|------------------------------------|-------------------|------|
|                                    | 2004              | 2005 |
| AT&T                               | 4                 | 5    |
| Verizon Communications             | 8                 | 4    |
| Pfizer                             | 10                | 11   |
| General Electric                   | 11                | 12   |
| Altria (Philip Morris)             | 21                | 20   |
| Citigroup                          | 33                | 35   |
| Microsoft                          | 37                | 37   |
| American Express                   | 48                | 33   |

Source for tax info: McIntyre, Robert S., and T. D. Co Nguyen. 2004. Source for advertising information: *Advertising Age* (2006).

While advertising is just one of a number of different tax breaks that corporations can exploit, it is worth noting, nevertheless, that some of the nation's largest advertisers pay no federal income tax whatsoever.

A similar revelation motivated tax-reform legislation in the mid-1980s. At that time, Robert McIntyre (who co-authored the 2004 Citizens for Tax Justice study) had reviewed the annual reports of 250 of the nation's largest corporations. Publication of his discovery that 128 of them had paid no income tax ignited a national furor. Throughout the country, newspapers carried his findings on their front pages. Politicians cited his report during television appearances. At a rally in New Jersey, a labor leader told the crowd that the package of General Electric light bulbs he had in his hands cost more than GE had contributed to the cost of running the government. "It's a scandal when members of the Fortune 500 pay less in taxes than the people who wax their floors or type their letters," McIntyre said (Birnbaum and Murray 1987, 12).

The furor surrounding the release of McIntyre's study ultimately led to the elimination of many corporate tax deductions, with the passage of the Tax Reform Act of 1986. Nearly twenty years later, when McIntyre's organization, Citizens for Tax Justice, released its 2004 report, corporate interests and their supporters attempted to discredit it. The Heritage Foundation's Norbert Michel, for example, criticized the study's methodology: "The report fails to disclose that corporations' tax return data are not publicly available, a fact that makes CTJ's analysis imprecise at best. Because of this shortcoming and other errors, CTJ's conclusion that 'loophole seeking-corporations' aren't paying their fair share of taxes falls flat" (Michel 2004). In response, McIntyre pointed out that CTJ had gotten "the tax data straight out of corporate annual reports," and added that "Congress's Joint Committee on Taxation used the same approach in a number of corporate tax studies" (McIntyre 2005).

Although McIntyre's 1984 report had also drawn intense criticism from corporations, that criticism had come too late to influence public opinion. As Birnbaum and Murray explain in their book about the Tax Reform Act of 1986, "Bob McIntyre's one-man report would turn out to be more influential than all the firepower the corporate lobbyists could muster" (13).

As it happened, when McIntyre's report was published, the Reagan administration was facing intense criticism over a ballooning budget deficit and, consequently, searching for ways to boost revenues. The administration's fiscal ideology limited the available options, because its principles restricted the government to finding ways to augment its coffers *without* raising taxes. Disallowing unreasonable (and unpopular) deductions seemed to promise a solution to that dilemma. Thus, the White House began to examine the legitimacy of various corporate tax breaks. As a result, the Treasury Department sent a proposal (see Chapter 9 concerning the proposal's disputed authorship) to the Senate Finance Committee to reduce the deductibility of advertising expenditures.

Although the Senate ultimately omitted that proposal from the Tax Reform Act of 1986, it has entertained discussions about limiting the deduction from time to time since then. Senator John McCain, for example, included a proposal to reduce the advertising deduction, as part of a 43-point program aimed at eliminating "loopholes, subsidies and set-asides" (Teinowitz 2000). Targeting only the pharmaceutical industry, Senator Stabenow proposed a restriction on the amount drug makers would be allowed to deduct for advertising. "American taxpayers should not have to subsidize excessive advertising that only leads to higher prices at the

pharmacy counter,” she argued (Elliott 2002). Senator Bradley introduced legislation to eliminate the deduction tobacco companies can take for advertising, claiming that “there is no constitutional right to receive a federal subsidy” (Colford 1993b). Similarly, Senator Byrd maintained that disallowing the deductibility of alcohol ads “would simply end the American taxpayers’ subsidization of alcohol advertising” (Hymel 2000).

Working behind the scenes, the Congressional Budget Office has discussed the merits of reducing the ad-expense deduction as a strategy for reducing the deficit in several of its annual reports, and the Congressional Joint Committee on Taxation has included the proposal in a list of revenue-raising options.

Executive branch officials have weighed in, as well. Richard Darman (budget director for President George H. W. Bush) and Robert Reich (Labor Secretary for President Clinton) each proposed limiting the deduction as a deficit-reduction measure or, as Reich put it, as a means of cutting “corporate welfare,” and “Aid to Dependent Corporations” (Teinowitz 1995).

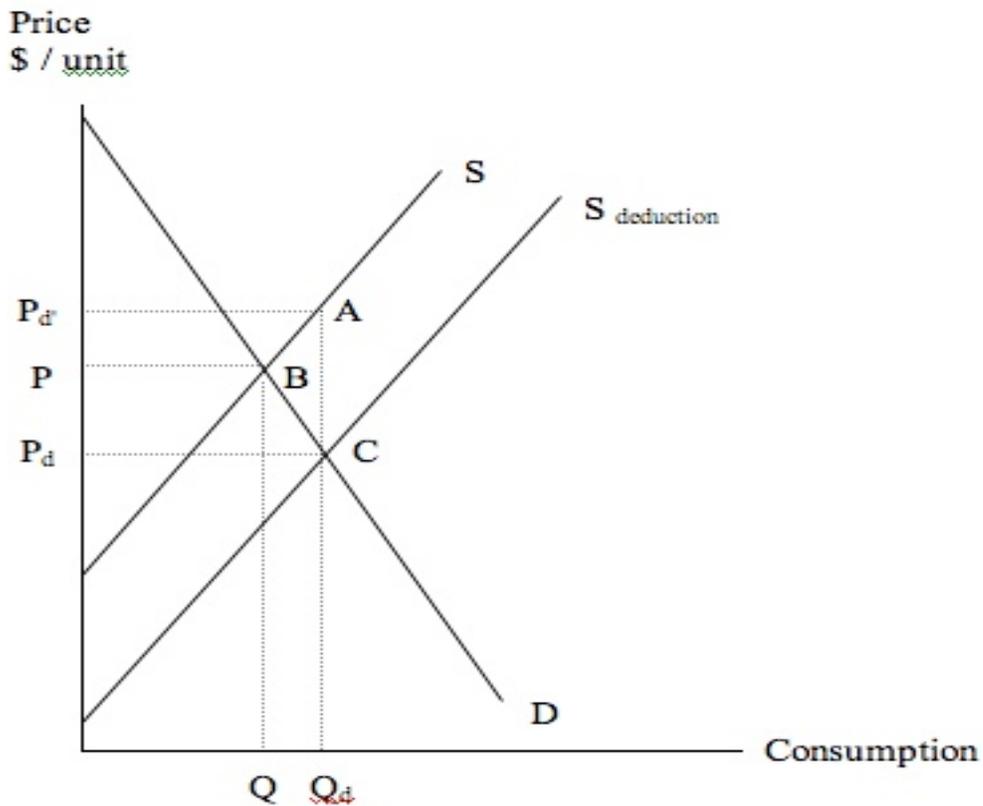
In addition to executive- and legislative-branch proposals, at least one think tank, the Progressive Policy Institute, and one non-profit organization, the Center for the Study of Commercialism, have proposed reducing or eliminating the deduction. Thus, even though the Treasury Department’s proposal was unsuccessful in 1986, its core notion, that advertising’s deductibility should be reconsidered, captured the imagination of some participants in the policymaking process. The enduring interest in such proposals seems to indicate that although the deduction is allowed, more than a few policymakers question whether it should be.

### *A subsidy for advertisers?*

For many of those who question its legitimacy, the deduction is the equivalent of a subsidy, and from an economic standpoint, the deduction does seem to act like a subsidy, as Figure 2.1 illustrates.

Figure 2.1

The Impact of the Deduction on the Price and Quantity of Advertising



In the graph above,  $P$  represents the equilibrium price and  $Q$  represents the equilibrium quantity for advertising.  $P_d$  represents the effective price that advertisers pay to media for space or time to showcase their advertisements, given that advertisers are allowed to claim a tax deduction for advertising.  $P_d'$  represents the actual price advertisers pay to the media. In other words, the media can charge  $P_d'$ , because advertisers are able to claim a deduction equal to the difference between  $P_d'$  and  $P_d$ . Given the deduction,  $Q_d$  is the quantity of media space/time that advertisers demand.

As the graph shows, the deduction increases the quantity of advertising demanded by media consumers (i.e., advertisers), lowers their costs, and raises producers' (i.e., media suppliers') revenues. Although the deduction increases consumers' surplus (area  $PBCP_d$ ) and producers' surplus ( $PBAP_d'$ ), the government's cost, represented by the rectangle  $P_d'ACP_d$ , is greater than the combined surplus gains. The excess cost, or deadweight loss, is represented by triangle  $ABC$ .

### ***An equitable deduction?***

Regardless of views to the contrary, the ad lobby insists that advertising is not a subsidy but rather an ordinary and necessary business expense, clearly eligible for a full deduction. Bristling at the notion that the deduction constitutes corporate welfare, an *Advertising Age* editorial derides, as a “goofy idea,” the “assumption that anything the government can't tax is a subsidy. . . . Advertising is a legitimate

business expense, pure and simple; every bit as legitimate as the cost of raw materials, rent, payroll, shipping, etc.” (*Advertising Age* 1993b).

In response to a request from the president of the Association of National Advertisers, New York University School of Law Professor Burt Neuborne wrote a letter supporting the ad-lobby’s argument that a tax deduction is not a subsidy. “The legislation [to eliminate the deduction for tobacco advertising] appears to assume that the federal government is morally entitled to tax any and all of the property of its citizens,” Neuborne writes. “However, Americans start not with an assumption that everything potentially belongs to the tax collector (with decisions not to tax treated like discretionary subsidies), but with the opposite assumption that government must justify its decision to tax” (Neuborne 1992). When government allows firms to deduct advertising expenditures, it does so in recognition of “the fact [that] an income tax cannot be legitimately imposed on anything other than net economic gain.” Thus, Neuborne concludes, “an income tax deduction, like the deduction for advertising, that merely reflects the true cost of producing taxable income is not the equivalent of a government subsidy.”

Despite the forcefulness of Neuborne’s argument, a number of academics, policymakers, jurists, and other observers disagree with his conclusion. More than a few economists, for example, have looked at the deduction for ad expenses as a subsidy. And while some have merely provided ammunition for the proponents of a change in the tax status of advertising, other economists have labeled the deduction a subsidy outright. Juliet Schor, for example, notes that advertising “expenditures are fully subsidized by taxpayers: advertising costs are deductible from corporate profits”

(1998, 165). Comanor and Wilson (1974) maintain that the “current income-tax provisions that permit advertising expenditures to be expensed rather than depreciated” subsidize advertisers. In the authors’ view, the deduction has “served to augment the heavy volume of advertising . . . and “need[s] to be reconsidered in the light of the major findings of [their] study. Furthermore,” they continue, “public actions may be needed that move in the opposite direction” (252-253).

Corden (1961) concurs. He writes: “It can be argued with considerable conviction that by treating advertising as a current cost rather than as an investment, [the tax code] is providing an interest-free loan to the advertisers. The result is a distortion of business endeavour [*sic*] in a socially disadvantageous way” (32).

Corden seems to consider advertising expenditures to be investments in the creation of intangible capital and the deduction to be a subsidy to advertisers.

As detailed in Chapter 4, the literature reveals a number of other economists who conclude that advertising creates intangible capital. Among them are: Braithwaite (1928), Borden (1942), Stigler (1958), Corden (1961), Nerlove and Arrow (1962), Telser (1962), Palda (1964), Doyle (1968), Peles (1971), Bloch (1974), Lambin (1976), Dhalla (1978), Telser (1978), Hirschey (1982), Ayanian (1983), Hirschey and Weygandt (1985), Summers (1987), Baye, Jansen, and Lee (1992), Shapiro (1993), Congressional Budget Office (1997), Kamber (2002), Bagwell (2003), and Corrado, Hulten, and Sichel (2006). On the other hand, some economists, including Clarke (1976), Ashley, Granger, and Schmalensee (1980), Bublitz and Ettredge (1989), Seldon and Doroodian (1989), Boyd and Seldon (1990),

and Leone (1995), maintain that advertising generally loses its ability to influence sales within one year.

If advertising tends to create intangible capital, but, for tax purposes, advertising is considered to be a current expense, then advertising expenditures receive favorable tax treatment in comparison to tangible-capital expenditures, which must be amortized or depreciated over a number of years.

A number of tax experts maintain that the current law does give advertising and some other intangible assets an advantage over tangible assets. According to Mundstock (1987a), in almost all cases, “immediate deduction (100% first year depreciation) provides earlier, and, therefore, more valuable in present value terms, tax deductions, resulting in a larger present value after-tax cash flow” (1194). The Congressional Budget Office (1997) apparently agrees. In a review of options for increasing federal revenues, the CBO notes:

The sooner the deductions, the lower the effective tax rate at which income earned from using the asset is taxed. . . . Currently, businesses may deduct advertising expenses in the year they are incurred. The benefits of advertising, however, may extend beyond the current year because advertising can create brand recognition or otherwise increase the demand for a business’s products or services in later years. If advertising creates a durable asset, the immediate deduction allowed by current law favors such investments over investments in other durable assets. (Congressional Budget Office 1997, under Section 20, Chapter 6, “Intangible Capital,” n.p.)

For the sake of government revenues, the difference between deduction and amortization of ad expenditures can be considerable. The Joint Committee on Taxation calculated that the government would receive an additional \$28 billion in revenues, over five years, if advertisers were required to amortize 20 percent of their ad expenses (for 1998 through 2002) and allowed an immediate deduction for the remaining 80 percent (Congressional Budget Office, 1997). According to a 1988 proposal, amortizing 40 percent of annual ad expenses over four years could raise government revenues \$40 billion per year (Bernstein 1988).

Given that government analysts predict tax revenues would be higher if advertising expenditures were capitalized and amortized and that many economists have determined that advertising does create intangible capital, why does the tax code mandate deduction rather than capitalization and amortization of ad expenditures?

The answer is that advertising's tax status was determined early on by what was, in essence, a historical accident. In the beginning, the tax code was ambiguous in regard to the deduction or capitalization of advertising expenses. Adams (1918) described taxpayers' behavior during the first few years of income tax collection this way:

Some corporations have so handled advertising and similar costs that they stand on the books as capital assets, designated 'good will,' 'trade-marks,' and the like. Many other corporations, having brands or similar intangible assets of great value, have written off as current expense the advertising and similar expenditures made to develop or create these intangible assets. Some corporations have bought good

will for a very large sum and within the next few years have written it entirely off their books. Other corporations carry the original expenditure as a capital asset (157).

One year after Adams' description of early taxpayer behavior, Thulin (1919) wrote: "The subject of intangible property under the federal tax laws is somewhat misunderstood" (294). The problem, in Thulin's view, was the existence of two types of intangible property. One "on which *no depreciation* or depletion can be taken in computing the income subject to taxation." Advertising generally belonged in that category. For the other type, "*depreciation* or depletion can be taken in computing income subject to taxation" (294; italics in the original). When advertising is classified as a goodwill expenditure, the character of that expenditure "from the point of view of federal tax laws is dual; when made [such expenditures] are charges to income if so desired, or charges which may be capitalized, if so desired" (301).

Under current law, taxpayers rarely, if ever, have the ability to choose between deducting and capitalizing ad expenses. George Mundstock, a University of Miami professor of law, describes "two historical flukes [that] contributed to the development of current law." One involves a 1919 regulation that strictly limited the depreciation of intangible capital. Under its provisions, capitalizing intangible expenditures would lead "to the harsh result of effectively no deduction" (Mundstock, 1987a, 1233). According to Mundstock, that potential result "certainly influenced the courts to allow an immediate deduction" (1233). The other historical accident involves an excess-profits tax, levied in the wake of World War I. As Mundstock explains, in response to the levy, some taxpayers attempted to reduce their obligations

by either capitalizing their pre-war ad expenditures and depreciating them at the excess-profit tax-rate or by “treating advertising as ‘invested capital’ so as to reduce the amount of excess profits subject to high rates of tax” (1232).

To counter these tax-avoidance tactics, “the I.R.S. developed an anti-capitalization bias,” which “pushed the courts in an anti-capitalization, anti-investment direction” (Mundstock 1987a, 1233). In the appeal of *Northwestern Yeast Co. v. Commissioner* (1926) for example, the U.S. Board of Tax Appeals acknowledged that “some part of the cost of a campaign or system of promotion may be of permanent significance and may be regarded as a capital investment rather than a deductible expense.” Nevertheless, the court held that “the disallowance of the entire expenditure and of any portion thereof as invested capital is proper.” In doing so, the Court accepted the Commissioner’s contention “that there can be no allocation to capital except to the extent actually proven, and since it is clear from the evidence that some uncertain part of the amount, however slight, is not capital, no allowance can be made. *Falsus in uno, falsus in omnibus*” (United States Board of Tax Appeals 1926). In *Colonial Ice Cream Co. v. Commissioner* (1927) and *C. Howard Hunt Pen Co. v. Commissioner* (1928), the U.S. Board of Tax Appeals reached similar judgments.

Although the I.R.S. argued successfully against capitalization of ad expenses before the courts on the ground that differentiating between current and capital expenditures was infeasible, it eventually came to regret its position. As Mundstock (1987a) explains, once the excess-profits tax was no longer a factor, “the I.R.S. was faced with bad judicial precedent that it had helped create” (1233).

In *RJR Nabisco Inc. v. Commissioner* (1998) for example, the I.R.S. argued that advertising expenditures for graphic and package designs, which RJR deducted, should have been capitalized, because they were intended to provide long-term benefits. In finding for RJR, the Tax Court noted that advertising expenditures generally provide short- and long-term benefits and that no court had ever distinguished between long-term, campaign expenditures and short-term, execution expenditures.

The underlying, statutory authority for advertising-expense deductions is found in Section 162(a) of the Internal Revenue Code. According to the Supreme Court, “to qualify as an allowable deduction under §162(a) of the Internal Revenue Code of 1954, 26 U.S.C.S. § 162(a), an item must (1) be paid or incurred during the taxable year, (2) be for carrying on any trade or business, (3) be an expense, (4) be a necessary expense, and (5) be an ordinary expense” (*Commissioner v. Lincoln* 1971). Thus, advertising expenditures must conform to those five requirements in order to qualify for a deduction. But while determining whether an advertising expenditure conforms to the first three requirements is reasonably straightforward, making that determination about the final two is more difficult.

For that reason, the Supreme Court has attempted to clarify the terms “ordinary” and “necessary.” In *Commissioner v. Tellier* (1965), for example, Justice Stewart noted that the primary function of the term “ordinary” in Section 162(a) of the tax code “is to clarify the distinction between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset.” The term

“necessary,” according to the Court in *Welch v. Helvering* (1933) implies that the expense is “appropriate and helpful” to the taxpayer’s business. Citing *Welch*, Mattingly (1993) notes that the term “necessary” requires that the expense be a normal means for ensuring the “effective and efficient operation of the taxpayer’s business.”

Even with the Court’s clarification, however, advertising’s status as an ordinary and necessary business expense remains controversial. Professor Neuborne maintains, for example, that “allowing taxpayers to deduct advertising expenses in calculating taxable income is not an act of legislative grace; rather it is an obligation inherent in our conception of limited government and equitable income taxation” (Neuborne 1992). However, in *New Colonial Ice Co. v. Helvering* (1934), *White v. United States* (1938), *Deputy v. Du Pont* (1940), *Interstate Transit Lines v. Commissioner* (1943), *City Ice Delivery Co. v. United States* (1949), *Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Co.* (1974), and *INDOPCO, Inc. v. Commissioner of Internal Revenue* (1992), the Supreme Court expressly states that a deduction *is* an act of legislative grace and maintains that capitalization is the rule, and deduction is the exception.

Some would argue that advertising is literally *unnecessary*. While it might be “appropriate and helpful,” advertising hardly ensures the “effective and efficient operation of the taxpayer’s business.” Consider a restaurant, for example. Normal expenses to ensure its operation include expenditures for food, tables, chairs, silverware, ovens, refrigerators, utilities, and wait staff. Although advertising might increase the restaurant’s sales, unlike food et al., advertising is clearly *inessential*,

because many restaurants do quite well by mere word of mouth. In addition, as noted at the top of the chapter, increasing sales is an insufficient justification for a deduction. A restaurant would probably increase sales if its attractive, young waitresses wore bikinis; all the same, it is unlikely that the I.R.S. would allow a bikini deduction.

More often debated than the argument that advertising is a “necessary” expense, however, is the claim that it is an “ordinary” expense. As noted above, an ordinary expenditure, by the Court’s definition, must *not* be a capital outlay. According to many economists, academics, jurists, and other tax observers, however, advertising creates goodwill, and goodwill is an intangible capital asset. Thus, expenditures for advertising are not “ordinary”; they are expenditures devoted to the creation of intangible capital.

Intangible assets have been defined as “the value of a firm in excess of the value of tangible assets” (Gravelle and Taylor 1991; qtd. in Bokinsky 1994). From the beginning, most intangibles have been allowed a depreciation allowance. A 1927 Treasury regulation, however, singled out goodwill as ineligible for depreciation of any such expenses. At the same time, however, the regulation reaffirmed the legitimacy of amortizing intangible assets. That 1927 regulation, according to Bokinsky, “set the stage for sixty-six years of litigation in which taxpayers struggled to attribute purchase price to intangible assets other than goodwill” (217). With goodwill nondeductible, the incentive to maintain advertising’s ordinary-and-necessary status increased.

In *Commissioner v. Lincoln Savings and Loan* (1971), the Supreme Court reiterated earlier rulings in which it found that expenses must be “ordinary,” and not “in the nature of capital expenditures,” to be deductible. In particular, the Supreme Court ruled in *Lincoln* that expenditures must be capitalized if they create or enhance “a separate and distinct additional asset” (354). Mundstock (1987a) notes that the transactional approach adopted by the Court in *Lincoln* allows businesses to deduct many intangible-capital expenditures due to “the difficulty in linking a given expenditure” to the intangible asset (1231). Advertising, for example, enhances the goodwill associated with a trademark. Even though the trademark is a separate and distinct asset, the advertising that enhances the asset is deductible, because tying the ad expenditure to the efficacy of the trademark is problematical.

The Court attempted to clarify the capitalization rule it issued in *Lincoln* with its decision in *INDOPCO, Inc. v. Commissioner* (1992). Whereas *Lincoln* held that an expenditure must be capitalized if it creates or enhances a separate and distinct asset, the Court ruled in *INDOPCO* that the creation of a separate and distinct asset is sufficient but not necessary for capitalization to be required. The only necessary requirement for capitalization is that the expenditure provides more than incidental future benefits. According to Mattingly (1993), the *INDOPCO* decision created “uncertainty in the characterization of what were traditionally deductible business expenditures” (815).

A number of observers soon noted that the *INDOPCO* ruling jeopardized advertising’s tax status. Writing in *Tax Lawyer*, Faber (1994) remarks: “If one were writing on a clean slate and using *Indopco* as the only guide to decision, one might

conclude that advertising expenses should be capitalized. They clearly are intended to produce a future benefit, especially when introducing a new product” (n.p.). In the *Journal of Accountancy*, Maples (1999) notes confusion among accountants: “Tax and accounting authorities acknowledge that it is difficult for CPAs to establish criteria about when a company should capitalize advertising costs. . . . Some advertising undoubtedly creates for a company significant benefits that extend beyond the current tax year, so the crucial issue CPAs face is not whether long-term benefits exist but how to measure them” (n.p.).

In the wake of *INDOPCO*, the Internal Revenue Service (1992) attempted to alleviate the confusion that the Court’s decision had created, by issuing Revenue Ruling 92-80. The ruling, in part, reads:

The *Indopco* decision does not affect the treatment of advertising costs under section 162(a) of the Code. These costs are generally deductible under that section even though advertising may have some future effect on business activities. . . . Only in the unusual circumstance where advertising is directed towards obtaining future benefits significantly beyond those traditionally associated with ordinary product advertising or with institutional or goodwill advertising, must the costs of that advertising be capitalized (Internal Revenue Service 1992; under “Law and Analysis,” n.p.).

An “unusual circumstance” cited by the ruling, in which the taxpayer was required to capitalize advertising, was the case of *Cleveland Electric Illuminating Co. v. United States* (1985). In that case, the Court held that expenses associated with an

advertising campaign that sought to deter public opposition to a proposed nuclear power plant must be capitalized. Noting that the benefits of that campaign were entirely directed at reaping future benefits, the Court ruled that the utility erred in claiming a current deduction.

A year after the I.R.S. issued Revenue Ruling 92-80, Congress enacted Section 197 of the tax code to reduce confusion about the tax status of intangible assets. Prior to enactment of the section, the code discriminated among intangibles, disallowing the amortization of some and allowing the amortization of others. As Bokinsky (1994) notes, regulations that the Treasury Department promulgated in 1927, which disallowed amortization of goodwill, had led to decades of litigation. Section 197, which includes goodwill, standardizes the amortization of intangibles over a fifteen-year period. Nevertheless, the section excludes self-created intangibles, such as advertising, from the amortization requirement.

Section 197 gives more favorable tax treatment to goodwill created by advertising than to “purchased” goodwill, because ad expenses remain deductible while purchased goodwill must be capitalized and amortized over fifteen years. It is worth noting, however, that a corporation can compound its tax savings by selling the goodwill it has created through advertising (which the corporation has already been allowed to deduct) to a subsidiary corporation (which is sometimes called a “blocker” corporation, because it is created in order to block taxes). The subsidiary corporation can, in turn, amortize the “purchased” goodwill over fifteen years. By following this practice, the corporation can, in some instances, greatly reduce its overall tax liability (Johnston 2007).

Clearly, self-created intangible capital receives preferential treatment in comparison to tangible capital. As Mundstock (1987a) explains, expenditures for tangible capital—machines, for example—must be depreciated, while advertising expenses can be deducted immediately. “The effect,” he writes, “is an implicit preference for the intangible capital created by deductible expenditures . . .” (1199).

As Bokinsky (1994) explains, “most practitioners and academics agree that ‘the tax treatment of these internally developed intangible assets is bewildering’” (246). Nevertheless, Congressional records, detailing the legislative history of Section 197, indicate that both the House and Senate “believed that there [was] no need at [that] time to change the Federal income tax treatment of self-created intangible assets, such as goodwill that is created through advertising and other similar expenditures” (House of Representatives 1993).

Congress also passed up an opportunity in 1986 to make advertising expenditures better conform to the consensus tax-criteria of simplicity, equity, and neutrality. At that time, Congress reevaluated a wide range of deductions claimed by businesses, questioning whether the expenditures deducted were truly ordinary and necessary. That reevaluation culminated in passage of Section 263A of the tax code, which mandated capitalization of many previously deductible expenditures. “Section 263A of the Internal Revenue Code provides that producers of real or tangible personal property must capitalize the direct costs and a proper share of the indirect costs of such property” (Internal Revenue Code § 263A 1988).

The Senate Finance Committee had recommended subjecting advertising to Section 263A requirements, but the final version of the bill omitted that

recommendation. And even though the Treasury Department prepared an estimate of the increased revenues that would likely accompany partial capitalization of advertising expenses, Section 263A specifically excluded advertising (Hymel 2000).

Remarking that “Congress could have included advertising in both of these tax provisions [Section 197 and 263A], but did not,” Hymel speculates that the exclusion of advertising “illustrates a political process dominated by special interests. The advertising industry,” she argues, “is well organized and has successfully lobbied their way out of inclusion” (436-437).

### ***An ordinary and necessary expense?***

After the Supreme Court issued a decision in *INDOPCO* that put the deduction for advertising expenditures in doubt, the I.R.S. quickly issued a “comfort ruling” (i.e., Revenue Ruling 92-80) to maintain the status quo. As Faber (1994) notes, “the Ruling does not indicate why advertising expenses should be deductible, other than that they always have been” (n.p.).

Fundamentally, advertising expenditures have been deductible because they have been thought to be ordinary-and-necessary business expenses. Upon reflection, however, advertising seems unlike the ordinary-and-necessary expense that it was when the income tax was enacted in 1913. The dollars expended, technologies employed, and quantities displayed differentiate advertising today from face-to-face selling to such an extent that advertising’s inclusion, with selling, as an ordinary-and-necessary business expense seems ripe for reevaluation.

In addition, advertising is not literally necessary (except, perhaps for mail-order businesses) and is often not ordinary—not, at least, as the Supreme Court defines the term. By that definition, advertising cannot be classified as an ordinary expense if it creates a capital asset; and, according to many economists (see Chapter 4), academics, policymakers, and jurists, advertising often does just that. Capitalization and amortization of ad expenditures would remove the favorable treatment that the tax code currently bestows upon advertising and improve the code's correspondence to the tax-policy goals of simplicity, equity, and neutrality.

But would requiring the capitalization and amortization of advertising expenses be the optimal policy? If advertising reduces welfare, should the tax code go beyond mere neutrality and completely disallow the deduction? In consideration of those questions, Part III addresses some of the utilities and disutilities associated with advertising. First, however, Part II examines the economics of advertising in some detail.

## PART II: THE ECONOMICS OF ADVERTISING

### *Introduction*

On several occasions since the mid-1980s, legislators and executive-branch officials, both Democrats and Republicans, have suggested revising the income-tax code to reduce or eliminate the deductibility of advertising expenses. The advertising industry, in response, has maintained that firms would advertise less if the deduction were reduced; and, if businesses advertised less, the economy would be harmed. The following are typical comments made by ad-industry advocates, printed in the trade journal *Advertising Age*, over a span of nearly two decades.

- A March 24, 2003, editorial suggested that “advertising is about jobs and economic growth as well as selling product” (26).
- On January 17, 2000, Jeff Perlman, senior vice president for the American Advertising Federation, called advertising “the economic engine that pushes the economy” (6).

- A February 10, 1997, editorial referred to “the critical role advertising plays in stimulating sales and economic growth” (20).
- A May 22, 1995, editorial argued, “business considers advertising essential. With profits to reinvest, seasoned business managers are putting dollars earned from the current strong economy back into more and more advertising to keep up sales momentum” (18).
- On September 27, 1993, Charles D. Peebler, Jr., president and CEO of the advertising giant Bozell, Jacobs, Kenyon & Eckhardt asserted that advertising is “one of the strongest economic stimuli known. . . . It is, in fundamental terms, a fuel that is essential to power our continuing advance as an industrialized nation and prosperous society.” Advertising provides an informational service that is “intrinsic to this nation’s very way of doing business.” According to Peebler, advertising expands consumers’ range of choices, intensifies competition between firms, and drives prices lower. In addition, advertising is “one of the nation’s most valuable exportable commodities,” and it “is endlessly renewable” (21).
- Professor of Management John Calfee (formerly of the Federal Trade Commission, where he worked on advertising regulation) maintained, in a March 15, 1993 editorial, that “advertising is an integral part of that astonishingly productive and self-correcting mechanism known as the competitive market, or more simply, capitalism.” Advertising, Calfee explained, matches consumers to the product they desire. American expertise at advertising “translates into efficiencies and lower prices at

home, and market leadership around the world.” In addition, advertising “is one of our greatest comparative advantages” (24).

- A July 9, 1990, editorial asserted that advertising is “American industry’s most *efficient* selling tool.” It is “critical to the competitive marketplace that benefits all consumers,” and is, therefore, “an *essential* business expense” (22; italics in the original).
- As reported on November 21, 1988, the Council for Commercial Freedom (representing approximately twenty ad-related trade associations) argued that a nationwide reduction in advertising (caused by the loss of full deductibility) would probably have many adverse effects, including: higher prices for consumer goods, unemployment in major media centers (e.g., New York, Chicago, and Los Angeles), reduced outlets in media for diverse viewpoints, hardship for small and minority media, and diminished competitiveness for American companies in the global marketplace.
- According to Wally Snyder, senior vice-president of the American Advertising Federation, many “things go into the mix of why a consumer purchase is made, but a big part of it is advertising” (March 3, 1986, 17).

Clearly, from the perspective of the ad lobby, advertising provides unalloyed economic benefits. But what do *economists* say? Does advertising improve the economy, as its apologists claim? Is it a boon to the economic welfare of the nation or something less?

Over the years, a number of economists have considered advertising's impact on economic welfare, and a few, such as Kaldor, Corden, Doyle, Simon, and Bagwell, have surveyed and summarized that literature. Table II lists some of the authors' findings.

Stripped of redundancy, the pro/con summaries offer a variety of arguments concerning advertising's impact on economic welfare. According to its proponents, advertising: enables economies of scale in production and distribution; reduces business-cycle fluctuations; provides important market information (and thereby lowers search costs); improves product quality; is entertaining; improves labor relations; makes consumers' shopping decisions easier; subsidizes media (and thereby promotes media freedom); stimulates innovation and progress; lowers prices; disperses economic power; fuels consumption and economic growth; increases consumers' wants and enjoyments; enables social cohesion; facilitates the market entry of new firms; promotes competition; and confers a prestigious image to purchasers of certain products. According to advertising's critics, on the other hand, advertising: exacerbates business-cycle fluctuations; raises prices; raises costs; raises prices in comparison to costs (and thereby inflates profits); slows economic growth; facilitates market power; encourages wasteful spending; promotes consumer dissatisfaction; imperils the autonomy of the media; misleads and misinforms consumers; concentrates industry unnecessarily; discourages competition; raises barriers to entry; differentiates products artificially; offends public sensibilities; warps values; and corrupts character.

**Table II.1: Authors' Summaries of Claims in the Literature Concerning Advertiser's Impact on Welfare**

| <b>Economist</b>   | <b>Welfare-Enhancing Arguments</b>   | <b>Welfare-Reducing Arguments</b>   |
|--------------------|--|---|
| Kaldor (1950-1951) | Advertising enables firms to attain economies of scale; it stabilizes the economic system by reducing fluctuations in the business cycle; it improves labor relations; it enhances consumer satisfaction by providing entertaining ads and making shopping choices simpler; and it subsidizes the media and thereby promotes media freedom and independence. | Advertising engenders market power and strengthens monopolies; it slows economic growth by increasing prices in comparison to costs; it encourages wasteful spending; it destabilizes the economy by exacerbating business-cycle fluctuations; it engenders distorted values and results in perpetual dissatisfaction as the experience of consumption falls short of ad-induced expectations; it influences consumers to distribute their expenditures inefficiently; and it imperils the public's right to a free and independent press by providing a large portion of the income of the communications media. |
| Corden (1961)      | Advertising provides an information service for consumers, improves product quality, facilitates economies of scale, stimulates progress, and subsidizes communications media.   | Advertising supplies inadequate information, concentrates industry unnecessarily, and wastes energy and resources—human and otherwise.  |
| Doyle (1968)       | Advertising enables firms to achieve economies of mass production and distribution; it subsidizes communications media and thereby lowers their price; and it improves product quality by stimulating innovations and improvements.  | Most advertising is misleading, uninformative, or both; it is anti-competitive; and it unnecessarily increases both costs and prices.   |
| Simon (1970)       | Advertising lowers prices; supplies efficiency-increasing information to consumers and businesses; subsidizes communication media; disperses economic power; boosts consumption and economic growth; increases consumer's wants and thus their enjoyment of life; and supports pluralism by enabling social cohesion without resort to coercion.             | Advertising raises prices, misinforms consumers; discourages competition and thus concentrates economic power; wastes economic resources; exacerbates the business cycle; persuades consumers to make silly or harmful purchases; offends public sensibilities; warps values and corrupts character; and lies and cheats.   |
| Bagwell (2003)     | Advertising provides valuable market information, lowers search costs, facilitates entry, promotes competition, and contributes toward a prestigious image that reflects well on the consumer.   | Advertising is anti-competitive, provides biased information, differentiates products artificially, concentrates markets, raises prices, and inflates profits.  |

## Chapter 3: Advertising and Consumption

As a central justification for full deductibility, ad proponents argue that advertising fuels economic growth. In the relevant literature, studies of advertising's impact on demand generally fall within three categories: (1) demand for a particular advertiser's output, (2) demand for the output of all firms within a particular industry, and (3) demand for aggregate output across all industries.

### *Demand for a particular advertiser's output*

Early twentieth-century retailer John Wanamaker is widely quoted as having said: "I know half the money I spend on advertising is wasted, but I can never find out which half" (University of Texas, n.d.). Wanamaker is not alone in his confusion about the effectiveness of advertising. According to a 2005 survey conducted by the Association of National Advertisers, nearly three-quarters of the respondents said they were uncertain to what extent advertising campaigns affect their sales (Elliott 2005). Nevertheless, if firms that advertise are profit-seekers, they must assume that advertising enhances revenue. Solow (1968) puts it this way: "No one who believes, as I do, that profit is an important business motive could argue that advertising has no influence on the willingness of consumers to buy a given product at a given price. After all, how could I then account for the fact that profit-seeking corporations regularly spend billions of dollars on advertising?" (48)

The confusion concerning advertising's impact on demand is exacerbated by the common practice among advertisers of using a percentage of past sales to

determine future ad budgets. Thus, (as we shall see) some studies indicate that consumption leads to advertising, others find that advertising leads to consumption, and still others conclude that each leads to the other.

Early students of the economics of advertising seem to take as given the notion that advertising increases consumers' demand for a particular advertiser's output. Their theories concerning the mechanism by which advertising affects demand vary somewhat, however. Noting that the "demand curve is raised by advertisement," Braithwaite (1928) argues that the effective mechanism is persuasion (23). Chamberlin (1933) differs slightly, suggesting that advertising shifts the demand curve for the advertised product to the right by informing potential customers of the product's existence, its quality, and its potential utility. According to Chamberlin, firms advertise in order to make their brand name familiar to the public, with the expectation that consumers will ask for the brand by name, rather than purchase an unfamiliar, unadvertised product. Chamberlin suggests that advertising generates demand by altering tastes and preferences through persuasion, but he acknowledges advertising's informational role, as well. "Advertising," he writes, "increases a seller's market by spreading information (or misinformation) on the basis of which buyers' choices as to the means of satisfying their wants are altered. This is equivalent, of course, to a change either in the shape or in the location of the demand curves for their products" (118).

While Borden (1942) agrees with Chamberlin and Braithwaite that advertising increases demand for the output of individual firms, he argues that the extent of advertising's impact "varies widely and depends upon the circumstances under which

an enterprise operates” (844). According to Borden, a firm’s advertising is more likely to be effective when:

- sales in the industry to which the advertiser belongs are expanding;
- the advertiser’s products are easily differentiated from those of its rivals;
- the product has hidden qualities that advertisers can exploit to indicate quality (as opposed to explicit qualities that consumers can easily observe and appreciate);
- the advertiser can appeal to powerful emotions to motivate consumers to purchase its product; or
- the firm has the means to spend substantial sums on advertising.

A number of theoretical and empirical studies reveal a positive association between firms’ expenditures on advertising and consumers’ demand for the advertised products. Kaldor (1950-1951), for example, finds that, as a general rule, advertising shifts the demand curve for advertised products up and out. Adding that advertising may induce consumers to try a product for the first time, Nerlove and Arrow (1962) agree with Kaldor that advertising tends to produce an upward-and-outward shift of the product’s demand curve. Becker and Murphy (1993) describe advertising’s impact on demand curves in similar terms.

In a study of twenty-five product markets across seventy-eight countries, Lambin (1976) finds that advertising has a “positive and statistically significant effect” on brands’ sales (90). “Firms do succeed in creating, by means of advertising, a preferential demand for their brands,” he writes (94). The author observes that the “nonnegligible effect” of advertising “is by no means a discovery” (94). To make his

case, he cites sixty published studies and discusses, in particular, research by Nerlove and Waugh (1961), Telser (1962), Palda (1964), Hoofnagle (1965), Bass (1969), and Schultz (1971) as representative examples. Similarly, Taylor and Weiserbs (1972) explain that economists generally agree that advertising has the capacity to shift out the demand curves of individual, advertised products.

In a study conducted for the Association of National Advertisers, the New England Consulting Group (Levin 1993) finds “a strong, positive relationship between advertising and incremental sales” for six of eleven tested brands, from companies such as General Motors, AT&T, and Procter & Gamble. The researchers observe a similar relationship between advertising and cumulative sales for nine of the eleven brands. In a separate study of thirty-three brands, the same researchers report that the market leaders are generally the firms that spend the most on advertising.

In a more recent study, using “advanced statistical techniques,” Kamber (2002) finds that firms’ sales tended to grow at stronger rates, in the years following the recession of 1990-1991, if they maintained or increased their advertising expenditures during the recession than if they did not. According to Kamber, sales-growth rates among companies that did so were substantially higher than those that cut back their ad expenditures, independent of variables such as total sales, previous sales-growth rates, firm size, stock valuation and price volatility, and total sales. His results, he notes, confirm the results of earlier, less-sophisticated studies of the impact of ad expenditures during previous recessions on subsequent sales growth.

While most studies, as Lambin reports, suggest that a brand's advertising correlates positively with its sales, in some cases, the strength of the correlation proves to be unimpressive. Aaker, Carman, and Jacobson (1982) find a "very weak" feedback relationship between advertising and sales in a time-series analysis of demand for six cereal brands, for example. Tellis (1988a) also finds that advertising's influence on brand choice can be weak. In a study of demand for toilet tissue (involving 251 households in a test city, scanner data for purchases of ten different brands over a one-year period, and television-meter records of household exposure to brand advertising), Tellis finds that either a product's price or a consumer's previous experience with a product is a better predictor of demand for a particular brand than is advertising.

Observing a somewhat ambiguous relationship between advertising and demand, some analysts question the assumption that increased advertising leads to increased sales, suggesting the possibility that the direction of causality could be the converse, with increased sales leading to increased advertising. As Schmalensee (1972) explains, numerous empirical studies find that sales typically influence advertising expenditures because most firms set their current advertising expenditures as a percentage of their past sales. For that reason, he argues, "it is almost always impossible to estimate the impact of advertising on sales volume" (43). Nevertheless, he concludes that the advertising expenditures of individual firms *probably* influence their own sales.

Like Schmalensee, Amadi (2004) offers ambiguous results that do little to quell advertisers' confusion. Although his study reveals a long-term, causal

relationship between growth rates in advertising and consumption expenditures, the relationship seems to vary significantly across individual firms. For example, Granger causality tests reveal that sales strongly explain advertising expenditures for six firms, advertising expenditures appear to cause sales growth for five firms, and causation runs both ways—from advertising to sales and from sales to advertising—for four firms.

Jung and Seldon (1995) also address the ambiguity. While noting that a number of studies conducted during the preceding decades conclude that consumption leads to advertising, Jung and Seldon begin with the intuition that profit-maximizing firms advertise because they assume that advertising will increase their sales and profits. Ultimately, however, the researchers observe *two-way* causality; that is, they find that advertising influences demand *and* demand influences advertising.

At least one study explains the impact of advertising on demand for the output of individual firms with reference to the firm's size. According to Yang (1964), the advertising expenditures of small- and medium-sized companies tend to fluctuate more in response to business cycles than do the expenditures of large firms. This result implies that demand informs the ad spending of small- and medium-sized firms more than it does the ad expenditures of large firms. In another twist, Dean (1951) argues that the extent to which individual firms' advertising expenditures vary with the business cycle depends on the income elasticity of the particular product.

According to Bagwell (2003), difficulties in determining the direction of causality between advertising levels and product sales arise in some cases because researchers fail to address problems of endogeneity. Echoing Schmalensee and

others, Bagwell explains that the positive relationship between demand and advertising expenditures may be due to increased advertising expenditures by firms in response to increased sales, rather than—or in addition to—increased commodity sales in response to increased advertising. To produce valid results, therefore, empirical studies must control for the endogeneity of advertising and sales, Bagwell maintains.

So, all things considered, does advertising affect demand for a particular advertiser's output? Since most firms set their current advertising expenditures as a percentage of their past sales, untangling the precise impact of advertising on sales volume is "almost always impossible" (Schmalensee 1972, 43). Nevertheless, on balance, the literature does seem to indicate that advertising increases demand for at least some advertisers' services or products.

### ***Demand for the output of all firms within a particular industry***

According to Marshall (1919), advertising can play either a constructive or a combative economic role. When it plays a constructive role it is economically useful, because it helps consumers learn about the existence of commodities, where to find them, what the commodities do, and how well they do what they do. When advertising plays a combative role it is economically wasteful, because it merely serves to redistribute customers away from low-intensity advertisers (or non-advertisers) toward high-intensity advertisers.

Differing from Marshall, a number of economists describe advertising as playing one role predominantly. Some conclude that—rather than increasing the

aggregate sales of an entire industry—advertising often tends to create a combative, zero-sum game among firms, with some firms winning by taking sales away from their competitors. Pigou (1932), for example, suggests that advertising can play such a role. He writes:

It may happen that the expenditures on advertisement made by competing monopolists simply neutralize one another, and leave the industrial position exactly as it would have been if neither had expended anything. For clearly, if each of two rivals makes equal efforts to attract the favour [*sic*] of the public away from the other, the total result is the same as it would have been if neither had made any effort at all. (pgEW: Part II, Chapter 9 in paragraph II.IX.22)

Similarly, a 1967 report by the Economists Advisory Group concludes that advertising may fail to influence market demand even when it affects the profits and sales of individual companies.

Reviewing the literature, Schmalensee (1972) notes that many of advertising's critics maintain that advertising is essentially an economically wasteful competition for market shares. Taken to an extreme, Schmalensee explains, this criticism implies that oligopolistic industries should slash their ad expenditures, because, if they did, sales would be unaffected, "and society would be better off" (6).

Studies by Borden (1942), Kaldor (1950-1951), Simon (1970), Metwally (1975, 1976), Lambin (1976), and Metwally and Tamaschke (1981) among others, find that advertising tends to be combative. Lambin, summing up his extensive statistical investigation of the issue, writes: "*The order of magnitude and the opposite*

*sign of own and competitive advertising coefficients indicate a tendency toward reciprocal cancellation of effects in the market as a whole*” (109; italics in the original). Similarly, Baye, Jansen, and Lee (1992) find that advertising at the firm level fails to increase industry demand. To illustrate their point, the authors quote the words of a spokesman for Kellogg’s cereals who once remarked: “For the past several years, our individual company growth has come out of the other fellows [*sic*] hide” (1093).

Corden (1961) also suggests that the sales of one firm within an industry may increase with advertising at the expense of the sales of another firm within that same industry. If both firms advertise, then sales of both may increase, but, potentially, at the expense of the sales of firms that manufacture substitute products. In Corden’s words, “It is quite possible, for example, that, in some industries or sections of the market, the advertising of competing firms or products just offset each other, so that finally the pattern of sales is just the same as if there had been no advertising—the only difference being that a lot of money is spent on advertising” (15-16). Although Comanor and Wilson (1974), in an extensive study, find that advertising is not completely self-canceling, they note that Marris and Solow agree that when the advertising messages of competing firms directly offset each other “the economic effect of these messages is nil . . .” (250-251). Indeed, Solow (1968) concludes that while specific firms generally benefit by advertising, their gain comes at the expense of their market rivals. Baye et al. (1992) agree.

Bagwell (2003) refers to the combative, self-canceling role of advertising as a “business-stealing externality.” As he sees it, “when there are multiple firms,

excessive advertising may occur, since a firm privately benefits from the sale that an additional ad may generate, even when this sale is ‘stolen’ from another firm and offers no or modest social benefit” (83). Dixit and Norman (1978) emphasize the combative role of advertising and go further than Bagwell, concluding that advertising may be excessive—even if it reduces prices—due to this business-stealing externality.

Empirical studies of specific industries offer conflicting results concerning advertising’s combativeness. In a study of low-tar-cigarette advertising, Roberts and Samuelson (1988) find that since advertising expands the size of the market, it is not combative. Gasmi, Laffont, and Vuong (1992), however, report that in the cola market, advertising is primarily combative, and Slade (1995) finds that although advertising has a positive impact on the size of the saltine-cracker market, its role is largely combative.

Some studies cite a difference in the impact of advertising that depends on the size and reputation of the specific market under investigation. According to Reekie and Allen (1983), for example, “only at the level of the large, well-established aggregated market (e.g., automobiles, liquor, cigarettes) does advertising appear to have consistently little impact on overall market size” (106). Put another way, Reekie and Allen’s results indicate that advertising’s impact is more than zero-sum in many industries.

Nerlove and Arrow (1962) reach a similar conclusion. Their results indicate that advertising may induce consumers to try an industry’s product for the first time, and subsequently cause the industry’s demand function to shift upward and outward.

Borden (1942) also finds that the impact of advertising can be more than zero-sum. His results suggest that advertising accelerates expansion in the demand for an industry's product when economic conditions are favorable and retards contraction when conditions are poor.

In a study of the tobacco industry, Bardsley and Olekahns (1999) find that advertising has a minor, positive influence on consumption. Leeflang and Reuijl (1985), in a separate study of the industry, conclude that advertising has a positive influence on tobacco sales, which wanes over time. Examining the auto industry, Thomas, Shane and Weigelt (1998) report finding a positive relationship between current advertising expenditures and future sales.

Analyzing the sales and advertising data for eleven different brands, the New England Consulting Group (Levin 1993) finds that a firm's advertising does more to fuel its sales than to steal market-share from its competitors. Studies by a number of other economists (e.g., Bagwell 2005) find that advertising's impact on primary demand defies simple categorization because the impact tends to vary from one industry to another.

Thus, the literature fails to reveal a consensus concerning the impact of advertising on demand for the output of all firms within an industry. While many studies find that advertising tends to create a zero-sum game among competing firms, other studies indicate that advertising increases industry-wide demand, and others find that advertising's impact on market size depends upon the industry under investigation.

## ***Demand for output across all industries***

Much of the economic literature concerning advertising's macroeconomic effects examines how ad expenditures relate to business-cycle fluctuations and aggregate consumption. Early studies seem to assume that advertising is an independent variable and examine its influence on dependent macro-variables. More recent studies generally drop that assumption and treat advertising as a dependent or an endogenous variable.

### **Advertising and the business cycle**

In one early study, Borden (1942) concludes that advertising encourages investment and affects "real national income." While he finds that advertising tends to accelerate demand expansion and offers the promise of demand- and profit-stability, he notes that, in practice, advertising expenditures tend to vary directly with the business cycle. "As a stimulant of demand for products and services advertising has been most extensively used in boom times and most lightly used in depressions. When thus employed it has tended to accentuate the swings of demand" (865). Still, it "cannot be classed as an important causal factor in cyclical fluctuations. . . . None of the students of cyclical fluctuations have named advertising as an important causal factor," Borden writes (865).

More than two decades later, Simon (1970) joins that group, expressing his doubt that advertising influences business cycles to any great extent. Yang (1964),

however, does find a tight relationship between fluctuations in sales and fluctuations in advertising expenditures during swings of the business cycle.

Investigating the relationship between advertising and business cycles using annual data, Blank (1962) finds little cyclic variability. When he examines the relationship using quarterly data, however, he notes a significant response in advertising to fluctuations in general business activity. He finds, in fact, that advertising's expansions and contractions exceed those of the gross national product.

In examining the impact of advertising on the business cycle, a number of economists, including Corden (1961), seem eager to discover that decreasing the quantity of ads during periods of inflation and increasing their number in periods of high unemployment helps to stabilize the economy. Corden finds, however, that advertising actually tends to intensify business-cycle fluctuations. He attributes this tendency to the way advertisers set their budgets. Rather than adjust advertising expenditures to reduce market fluctuations, a high proportion of advertisers merely base the level of their future advertising expenditures on sales data from the recent past.

In a study of the Dutch economy, Deleersnyder (2003) finds that aggregate-level changes in demand for advertising fail to predict business-cycle volatility. Rather, the converse appears to be true: fluctuations in the aggregate economy predict changes in the demand for advertising. According to Deleersnyder, contractions and expansions in aggregate demand for advertising, during the decades under study, were more than double the cyclic fluctuations in the gross domestic product.

Over all, the literature seems to indicate that since many advertisers base their future expenditures on past sales, business-cycle swings probably cause more fluctuations in ad levels than fluctuations in ad levels cause business-cycle swings.

### **Advertising and aggregate consumption**

A great deal of the economic literature examines the relationship between advertising and aggregate consumption. Numerous studies, in effect, ask the question: Does advertising lead to consumption or does consumption lead to advertising?

Simon (1970) attempts to answer that question by evaluating quasi-experimental and time-series studies, as well as historical consumption-function evidence, but he finds the studies flawed or unpersuasive. According to Simon, establishing the relationship between advertising and consumption is fraught with difficulties due to: “the repetition of purchases of many commodities; the intertwining of the effect of promotion with the effects of education, the mass media, and other cultural forces; the existence of the group values we call ‘the standard of living’; the possibility of moonlighting as a response to [advertising]; and temporary saving to buy durables” (205). Simon reports, however, that his case study of a January white-sale provides an example in which advertising does seem to induce consumption. He notes, as well, that “business men and economists have few doubts that advertising increases consumption for the economy as a whole. In fact,” Simon continues, “the opinion of our profession seems almost unanimous” (193). As an example of the economic consensus, Simon quotes noted economist Lawrence Klein, who writes:

“The advertising industry has certainly had a bad influence on many aspects of our lives . . . but it has also served to maintain consumption at a higher level than it otherwise would have been. Advertising is not the best way to get a high-consumption, low-savings economy, but it is *a way*” (qtd. in Simon, 193).

Taylor and Weiserbs (1972) report that while economists generally agree that advertising shifts the demand curve for individual goods upward and outward, they disagree when the discussion turns to advertising’s impact on the aggregate consumption function. Addressing this controversy with their own study, Taylor and Weiserbs find that advertising does, in fact, affect aggregate consumption: As advertising goes up, consumption also goes up, and saving goes down. The authors acknowledge, however, that the extent of advertising’s affect on aggregate consumption remains unresolved, despite their results. It is possible, they note, that a bidirectional relationship exists between advertising and consumption or that advertising serves as a proxy for some other variable.

Reflecting on the advertising-consumption controversy, Solow (1968) wonders how anyone, who believes that profit is a major motivator of business activity, can be aware of the expenditure of billions of dollars on advertising by profit-seeking firms and yet be unwilling to acknowledge advertising’s influence on consumers’ propensity to spend. Nevertheless, he remains unconvinced that advertising affects consumer demand in the aggregate, since, in his view, advertising tends to be a zero-sum game.

Comanor and Wilson (1974) posit that advertising’s influence on spending decisions by consumers is strong. In a series of multiple regressions, the authors find

“virtually no instance” of a negative impact on consumption from advertising. In fact, their results indicate that relative price is less frequently significant than advertising in predicting consumption levels. The evidence, they say, calls into question the argument that advertising’s influence on consumption tends to cancel out at the national level.

In their examination of the relationship between advertising and personal-consumption expenditures, Jacobson and Nicosia (1981) find that the extent of the relationship between advertising and aggregate consumption is determined, in part, by the period under analysis. Instantaneous causality, they report, is the most significant relationship. Also statistically significant, though weaker in effect, is evidence of feedback between advertising and consumption for periods of one year or more. In addition, the authors find that a within-one-year relationship between the variables might exist, but are unable to determine the direction of the interaction. They note, however, that the level of consumption in one year seems to affect advertising in the next year. This is due, they suppose, to advertisers basing their future advertising expenditures on past sales. One surprising result, which they find in a few cases, is a *negative* relationship between advertising in one year and consumption in the next. In the authors’ view, that relationship might be due to “some kind of budget effect” (37). Noting that evidence of instantaneous causality is strong, the authors suspect that consumers make purchases in the initial year and thus have less to spend on the advertised product in the following year.

Reekie and Allen (1983) utilize a cross-sectional analysis of twenty-four nations to test the hypothesis that advertising affects aggregate demand. As a result

of that analysis, they conclude that advertising can stimulate switching between brands and, at the same time, increase aggregate demand. In addition, they observe that the results of studies concerning the impact of advertising on demand seem to depend on the level of aggregation that researchers choose to study.

Didow and Franke (1984) report evidence for a “positive contemporaneous relationship between advertising and consumption” that other economists report (e.g., Jacobson and Nicosia 1981; Ashley, Granger, and Schmalensee 1980; Parsons, Schultz, and Pilon 1979; Taylor and Weiserbs 1972). However, contrary to the findings of several of those earlier studies (e.g., Ashley et al. 1980; Jacobson and Nicosia 1981; Parsons, Schultz, and Pilon 1979; Schmalensee 1972), Didow and Franke observe no changes in current consumption that induce changes in the future demand for advertising.

Taking a different approach to the question of the relationship between advertising and aggregate demand, Godshaw and Pancoast (1987) estimate the influence on consumption of a reduction in advertising. Their results indicate that the demand for goods and services would be sharply reduced if advertising were curtailed.

Two more recent studies indicate that increasing advertising leads to higher aggregate demand. Hamada (1999), for one, emphasizes the power of advertising to stimulate consumption; and, in an ad-industry sponsored study, Raimondi and Klein report a strong positive relationship between advertising and economic growth (O’Malley 2004).

For Corden (1961), assessing “the effects which advertising has on the efficient functioning of our economy is an extremely difficult matter. We can make use of all the available facts and figures, but basically we enter the realm of hypothesis,” he writes (9). Acknowledging that advertising probably leads to increases in spending on intensively advertised, nonessential goods, the question for Corden (1961) is whether aggregate consumer-spending increases as a result of advertising. Ultimately, Corden concludes, “advertising cannot be justified on the grounds that it increases total spending” (13).

Approximately two decades later, Ashley, Granger, and Schmalensee (1980) report their inability to reject the null hypothesis that aggregate advertising does not cause aggregate consumption. They say that their results suggest the possibility, in fact, that consumption may cause advertising. In addition, the authors note that although they are unable to determine the direction of causation, “an instantaneous or very short-term” relationship between the two variables, advertising and consumption, may exist.

Two decades after Ashley et al. (in a study of the determinants of advertising expenditures in New Zealand), O’Donovan, Rae, and Grimes (2000) find that while consumption does cause changes in advertising expenditures, advertising does not cause changes in aggregate consumption, over the long run. In an even more recent study, Chang and Chan-Olmsted (2005) report finding only one variable (in seven regression models) that predicts advertising expenditures with any statistical significance: Gross Domestic Product.

Jung and Seldon (1995) observe a bi-directional relationship between advertising and consumption. Noting that their results differ from those of Ashley, Granger, and Schmalensee (1980) and Schmalensee (1972), who report evidence to show that consumption may cause advertising, or Verdon, McConnell, and Roesler (1968), Ekelund and Gramm (1969), and Chowdhury (1994), who fail to find any clear relationship between the two variables, or Taylor and Weiserbs (1972), who find that advertising does, in fact, influence the aggregate consumption function, Jung and Seldon (1995) conclude that the relationship is bi-directional: Advertising causes consumption, and consumption causes advertising.

Setting aside the question of the direction of causation, Seldon and Jung (1995) find that the size of advertising's impact on aggregate demand is uncertain. Also investigating the size of advertising's impact, Picard (2001) finds that the relationship between advertising expenditures and gross domestic product varies from one country to another and from one medium to another.

Metwally and Tamaschke (1981) find a bi-directional relationship between the propensity to consume and the intensity of advertising. While their "statistical results suggest that the intensity of aggregate advertising is an important determinant of the propensity to consume and vice versa," the authors maintain that a substantial proportion of advertising has no influence on consumption; it merely reallocates firms' market shares (283). In addition, the authors offer a couple of explanations for the finding that increases in consumption lead to increases in advertising expenditures. New firms, the authors say, may be attracted to the market by reports of increasing consumption, and these firms may announce their entrance and secure a

place in the market through advertising. Another possible explanation, according to the authors, is that increasing consumption spurs existing firms to advertise in order to maintain or expand their share of the market.

In sum, the body of studies seems to be fraught with problems involving endogenous and intervening variables. Quarles and Jeffres (1983), for example, apparently miss an intervening variable when they maintain that rising income leads to consumption and consumption leads to advertising and then end their analysis there—if Braithwaite (1928), Brack and Cowling (1983), Reekie and Allen (1983), Fraser and Paton (2003), and Courard-Hauri (2005) are correct. In the view of the latter group, advertising leads to the desire to consume more, which leads to the desire to increase income, which leads to more hours worked; more hours worked leads to increased income, and increased income enables greater consumption. If, on the other hand, firms base their future advertising expenditures on past sales, which is apparently a common practice, Braithwaite, Brack and Cowling, and the rest apparently fail to notice that consumption also leads to advertising, as Quarles and Jeffres maintain. Causation, in other words, seems not to be unidirectional—or even bidirectional—but tends to be circular, when all relevant variables are included.

### ***Advertising's influence at firm, industry, and aggregate levels***

Needless to say, the influence of advertising on demand is controversial and unresolved. Since many firms base their future ad expenditures on past sales, estimating advertising's impact on consumption, at any level of aggregation, is

problematic. As Michael Schudson (1984), sociologist and professor of communications, writes:

The advertising agencies and the media can argue the point either way. If they are trying to convince an advertiser to increase the media budget, they can cite examples of devastatingly successful advertising campaigns. But if they are defending themselves before the Federal Trade Commission (FTC) or a civic organization decrying television advertising to children, they trot out the data that demonstrate that advertising has slight or no effect on product sales. (15-16)

Still, businesses expend billions of dollars on advertising annually, because they believe that ads increase demand. In the words of Andy Tarshis, of the A.C. Nielsen Company: “We find that advertising works the way the grass grows. You can never see it, but every week you have to mow the lawn” (qtd. in Mayer 1991, 179-180).

## Chapter 4: Advertising and the Competitive Model

### ***Three explanations for advertising's impact on consumer behavior***

According to Simon (1970), the great economists of the nineteenth century “paid little or no attention to advertising. And for good reason, because mass advertising clearly had little economic or social importance before the twentieth century” (xi). Bagwell (2003), however, explains the matter somewhat differently. As he sees it, economists showed little or no interest in advertising until the twentieth century because, for the most part, the economic research of the nineteenth century focused on developing the theory of perfect competition, “and this theory does not immediately suggest a role for advertising” (2). Pigou (1932) puts the matter this way: “Competitive advertisement [is] directed to the sole purpose of transferring the demand for a given commodity from one source of supply to another.” In a footnote he continues: “Under simple competition, there is no purpose in this advertisement, because, *ex hypothesi*, the market will take, at the market price, as much as any one small seller wants to sell” (n.p.). Since the theory of simple competition also assumes that consumers have perfect information about the attributes and prices of market products and fixed preferences, advertising would seem to be incapable of influencing consumer spending.

Experience has shown, however, that advertising does influence consumer spending. Over the years, economists have suggested a variety of reasons why this might be so. Reviewing that literature, Bagwell (2003) specifies three perspectives

that have emerged among economists to explain advertising's impact on consumer behavior. One perspective, which dominates the literature of the first half of the twentieth century and retains some influence today, posits that advertising affects behavior via persuasion. According to some economists (Braithwaite 1928; Robinson 1933; Bain 1956; and Comanor and Wilson 1974, for example), advertising changes tastes and creates brand loyalty by artificially differentiating products. It also tends to erect barriers to entry, concentrates markets, raises prices, and inflates profits. In sum, according to proponents of this perspective, advertising has a substantial, anti-competitive impact on the economy, and its value to consumers is questionable.

With the rise of the Chicago School of economic thought in the middle of the twentieth century, the view that advertising works through persuasion began to fade, however, and a second perspective came to dominate the economics-of-advertising literature. According to the proponents of this view (e.g., Ozga 1960; Stigler 1961; Telser 1964; and P. Nelson 1974), advertising influences consumers by providing information about available commodities. It thus corrects a discrepancy in the assumption of perfect market information (i.e., the real-world fact of uninformed or under-informed consumers) by supplying information about the availability, price, and quality of certain market products. Because advertising is expensive, it “can in effect offer a financial ‘hostage’ that provides an effective assurance of future product quality”; and, for that reason, “even advertising that is altogether empty of content . . . may still ‘signal’ important information” (R. Nelson 2001, 214). Thus, the advocates of this view argue that advertising informs consumers about the market, both directly

and indirectly, and the information advertising provides lowers consumers' search costs.

In contrast to the economists who focus on advertising's persuasive effects, proponents of the informative perspective maintain that advertising tends to lower, rather than erect, barriers to entry. Advertising, they argue, supplies aspiring market entrants with a way to announce their existence and describe the attributes of their products. By increasing price competition, advertising tends to reduce product prices, as well. In sum, from the perspective of those who see advertising's economic role as primarily informative, advertising tends to promote—not restrict—competition.

According to a third perspective offered by Stigler and Becker (1977), Nichols (1985), and Becker and Murphy (1993), for example, advertising influences consumer behavior by acting as a complement to the advertised commodity. In contrast to proponents of the persuasive perspective, economists who share this third view accept the conventional assumption that consumers' preferences are fixed—not altered by persuasive advertising. Furthermore, they reject the view of the proponents of the informative perspective, who maintain that advertising always supplies useful information—either directly or indirectly. As this third group sees it, advertising may be informative, but then again, it need not be. In their view, advertising should enter consumers' utility functions as a good or a bad. Either way, it enters directly as a complement to the advertised good.

## ***Competition facilitated or impaired?***

Throughout the economics-of-advertising literature, the impact of advertising on competition is a common subject of inquiry. Opinions concerning that impact vary. As previously noted, many of the economists who wrote about the issue in the first half of the twentieth century considered advertising to be deleterious to the operation of a perfectly competitive market. According to Braithwaite (1928), for example, the basis of advertising's success lies in its ability to *limit* competition. She explains that producers would have nothing to gain by advertising in a perfectly competitive market, since, *ex hypothesi*: (1) the demand curve is fixed, and (2) firms are selling everything they can produce at the market price. Although she acknowledges that the assumptions concerning perfect competition are never completely realized, in Braithwaite's view, "where advertisement is largely used, they cease to correspond, even remotely, to the facts" (28). For one thing, she explains, non-advertisers face resistance from potential buyers and difficulty finding outlets for their commodities due to the effectiveness of their rivals' advertising. For another, advertisements can alter the marginal utility of goods and shift the demand curve outward.

## **Advertising homogeneous goods**

According to Braithwaite, firms use advertising to create a reputation and thereby differentiate their products. "Reputation restricts competition between goods which may be dissimilar only in name, by attracting the attention of the consumer to

the advertised commodity to such an extent that he ignores the prices and merits of other similar commodities,” she writes. Successful advertisers secure a partial monopoly, which would be impossible to secure if they sold their goods in bulk, since retailers and wholesalers buy bulk goods in the least expensive market. Overall, Braithwaite concludes, advertising establishes “reputation monopolies” for the products it promotes and thereby substitutes competition that is harmful to consumers (i.e., competition through advertising) for competition that is beneficial to consumers (i.e., competition through price or quality).

In accord with Braithwaite, Robinson (1933) finds advertising inconsistent with perfect competition. She writes: “If a very small reduction in price by one competitor would secure an indefinitely large increase in sales, it would be folly to spend money on advertisement” (167).

Similarly, Chamberlin (1933) notes that assumptions concerning the nature of pure competition deny an economic role for advertising. Under pure competition, products are homogeneous, there are many competing firms, and no single supplier has the ability to control market supply or price. In fact, that no firm has any measure of control over the supply of a particular commodity—and thus its price—is a prerequisite for pure competition, Chamberlin explains. Advertising is incompatible with perfect competition since a producer will not advertise if he is unable to distinguish his goods from the goods supplied by rival firms. He will not advertise, Chamberlin explains, because, if he did, “he would be forced to increase or diminish their sales *pari passu* with his own,” and any return to the advertiser “would be a negligibly small fraction” of the overall return (127).

Put another way, placing an ad for a homogeneous good presents a collective-action problem, because such an ad is a public good (i.e., one that cannot feasibly be denied to any member of a group if any other member benefits from it). Unless producers of homogeneous products receive a special benefit or are forced to pay for an ad campaign, they will refrain from advertising. If, on the other hand, they overcome the collective action problem somehow and do advertise, their ads will distort the competitive market.

Consider, as an example, ads for surplus agricultural products. In keeping with Chamberlin's prediction, individual family farmers rarely advertise their homogeneous agricultural products. Given the ostensible public interest in generating demand for such goods, however, the U.S. government sometimes requires farmers to pay for ad campaigns to promote their common products. Under the Beef Promotion Research Act of 1985, for instance, the Department of Agriculture collected \$1 per head of cattle from ranchers to support the "Beef: It's What's for Dinner" campaign. The Department also forced farmers and ranchers to contribute to ad campaigns for pork ("The Other White Meat"), milk ("Got Milk?"), cotton ("The Fabric of Our Lives"), and California peaches ("Remember the Taste"), among other products (Cooper 2004).

The Supreme Court has generally upheld the government's right to force cooperation in such ad campaigns, rejecting (in one case) the argument that the mandatory ads violate constitutional protections regarding coerced speech (Richey 2005). Nevertheless, the government provides an advantage to the particular industries that it forces to advertise, by mandating a solution to the collective action

problem. More to the point of the current discussion, however, the government-mandated ad campaigns undermine the competitive market for homogeneous goods.

### **Chamberlin and the theory of monopolistic competition**

According to Chamberlin (1933), when producers of homogeneous goods band together to advertise their common product, their cooperation creates “conditions of monopolistic competition,” with “the whole body of sellers acting as one in competing for their market with sellers of other goods” (127-128). Such was the case with beef, peach, and cotton ads, as mentioned above. Similarly, when a single supplier of a homogeneous good uses advertising to differentiate that good from identical substitutes (e.g., Morton Salt from generic salt), that supplier’s ads can create conditions of monopolistic competition, as well.

As Chamberlin explains, the central goal of advertising is to persuade consumers to prefer the advertiser’s product to those of his rivals by means of differentiation. He writes: “Anything which makes buyers prefer one seller to another . . . differentiates the thing purchased to that degree, for what is bought is really a bundle of utilities, of which these things are a part” (8). When advertising differentiates goods, they are, by definition, no longer homogeneous. The difference between similar products, Chamberlin writes, “may be real or fancied, so long as it is of any importance whatever to buyers, and leads to a preference for one variety of the product over another” (56). By advertising his products, a seller differentiates them from those of his rivals, and “where there is any degree of differentiation whatever, each seller has an absolute monopoly of his own product.” The seller’s monopoly is

tempered, however, since it is “subject to the competition of more or less imperfect substitutes, [and] we may speak . . . of the forces at work as those of ‘monopolistic competition’” (9).

Bagwell (2003) explains that in developing the theory of monopolistic competition, Chamberlin was attempting to formally integrate advertising into economic theory. According to Bagwell, Chamberlin had a “conviction that advertising was a *necessary* part of [his] hybrid theory” (7; italics in the original).

As Chamberlin explains it, “advertising would be without purpose under conditions of pure competition, where any producer can sell as much as he pleases without it” (73). Under conditions of monopolistic competition, however, buyers and sellers are paired, “not by chance and at random (as under pure competition), but according to their preferences” (56).

### **Is advertising pro- or anti-competitive?**

Corden (1961) concludes that advertising is anticompetitive. Adding authority to his argument, he notes that the U.S. Supreme Court once “recognized that advertising may be, not an aspect of competition, but an instrument of monopoly—‘a powerful offensive and defensive weapon against new competition’” (19).

According to the Economists Advisory Group (1967), perfect competition and monopoly are concepts that incorporate “a number of simplifying assumptions which [are] obviously unrealistic in a descriptive sense” (27). In line with Braithwaite, Chamberlin, Robinson, Bain, and others, the Group explains that the perfect-competition model assumes that consumers are accurately and completely informed

and that consumers' preferences are given. In reality, however, consumers' knowledge of the market—and even of their own preferences—is faulty and incomplete. In addition, contrary to the traditional assumption of homogeneous commodities, many firms differentiate their goods from the similar goods of their rivals with trademarks or distinctive packaging and publicize that differentiation through advertising. Although the theory of perfect competition assumes that competition takes place on the basis of price alone, in actual practice, competition via advertising is common. Since advertising has no place in the model of perfect competition, the Economists Advisory Group concludes that monopolistic competition appears, in general, to be a more realistic economic model.

Telser (1964) observes that many early students of the economics of advertising conclude that advertising is anti-competitive. Although he takes an opposing view, himself (see below), Telser quotes Henry Simons, noted economist of the early twentieth century, who writes: “A major barrier to really competitive enterprise and efficient service to consumers is to be found in advertising” (537).

Bain (1956) finds empirical support for the hypothesis that advertising tends to be anti-competitive, in an analysis of cross-sectional data. Advertising propagates product differentiation, he explains, by persuading the consumer that the advertised product is more desirable, prestigious, or higher in quality than similar (or virtually identical) goods offered by rivals. By differentiating the commodity in this way, advertising enables the firm to set its price—at least to some extent—independently from its competitors.

In more recent empirical studies, Gallet and Euzent (1998) find that advertising in the brewing industry is anti-competitive, and Tremblay and Martins-Filho (2001), utilizing a game-theoretic model, find that firms create “real and perceived distance between products,” through vertical differentiation and persuasive advertising (3). According to the authors, once firms have distanced their product from other similar products, they are able to dampen competition.

While the view that advertising restricts competition is prevalent, it is far from universal. Telser (1964) may have been one of the first economists to suggest that advertising may, in fact, promote competition. Stigler and Becker (1977) agree with Telser and dispute the view, common to a number of earlier economists (as noted above), that advertising is incompatible with perfect competition.

Several more recent empirical studies also suggest that advertising is pro-competitive. In a cross-sectional marketing study of 1,100 businesses, for example, Carpenter (1987) finds that intense promotional expenditures are related to small profit margins. According to Carpenter, this result “implies that intense promotion does not reduce the intensity of competition by building brand loyalty and barriers to the entry of new brands, which would lead to high margins” (218). Rather, his finding suggests to Carpenter that intense promotion is associated with intense competition.

Arrow, Stigler, Landes, and Rosenfeld (1990) maintain that the hostility prevalent in the early literature devoted to the economics of advertising is due to the belief that advertising impedes competition, but that more recent studies, such as those by Lynk (1981), Hirschey (1981), Gomes (1986), Kessides (1986), and Eckard

(1988) indicate that advertising is actually pro-competitive. According to Arrow et al., the belief common to early economists—that advertising is an instrument for the suppression of competition—“was based (at least implicitly) upon a view of markets that assumed everyone knew everything from birth” about the availability, prices, and qualities of goods. “But we do not live in such a world” (3). In the world in which we do live, advertising helps keep the economy functioning smoothly by providing market information to consumers in a cost-effective manner. It reduces the prices of goods, and it lowers barriers to entry for new products and firms. “In short,” Arrow et al. write, “advertising is a powerful tool of competition” (3).

Standing in between the advocates of anti- and pro-competitive positions are those, like Borden (1942) who contend that the impact is neither one; rather, the impact of advertising on competition is ambiguous. According to the Economists Advisory Group (1967), advertising is “as much a weapon of competition as of restriction” (2). And Comanor and Wilson (1974), in an early recognition of advertising’s heterogeneous effects, conclude that advertising’s impact on competition varies by industry.

### ***Consumers’ preferences affected?***

As Bagwell (2003) explains, according to the conventional assumptions of the theory of perfect competition, consumers have fixed preferences and, thus, no reason

to respond to advertisements. Noticing that consumers do respond to ads, however, a number of economists consider the impact of advertising on those preferences.

As Bagwell (2003) explains, during the first half of the 20<sup>th</sup> century, the view that “advertising alters consumers’ tastes and creates spurious product differentiation and brand loyalty” dominated the economic literature (3). According to Braithwaite (1928), for example, advertising shifts the demand curve for advertised goods outward. In the process, it distorts consumers’ actual preferences, which the pre-advertising demand curve accurately reflects. Consumers’ post-advertising evaluations of goods can be “less correct than those which would otherwise have obtained,” Braithwaite writes (26). When this occurs, the goods and services that are produced fail to satisfy the public’s actual needs; thus, economic resources are wasted and social welfare declines.

Robinson (1933) also suggests that advertising alters consumers’ preferences. Kaldor (1950-1951), however, maintains that sweeping statements cannot be made about the impact of advertising on the structure of consumers’ preferences among different commodities (i.e., on general demand). Citing Chamberlin, Bain (1956) notes that advertising differentiates products and affects “buyers’ preferences for one or some of a variety of very similar substitute products” (114). Galbraith (1967, 1998) and Packard (1957) go further, arguing that advertising not only changes consumers’ tastes for particular goods; it actually alters the manner by which consumers’ tastes are formed.

According to Nerlove and Arrow (1962), advertising expenditures may “alter the tastes and preferences of consumers and thereby change the shape of the demand

function as well as shift it” (129). The authors note, however, that ad-induced changes in tastes and preferences are unlikely to be permanent; rather, consumers’ preferences have a tendency to return, over time, to their earlier patterns. Still, Nerlove and Arrow conclude that the impact of an advertising campaign does “tend to persist for a considerable period following the campaign” (130).

Although Yang (1964) finds that advertising is largely responsible for changing consumers’ tastes and shifting the consumption function upward year-after-year, Solow (1967) and Simon (1970) are skeptical about the claim that advertising alters tastes and preferences. Comanor and Wilson (1974) stand with Yang, declaring: “That advertising has an impact on the underlying structure of tastes is difficult to deny” (249).

Schmalensee (1972) agrees. As he sees it, one major reason why traditional economic tools fail in the case of advertising is that—by its very nature—advertising “tends to induce changes in tastes, making the issue then whether or not such taste changes add to welfare” (6).

Stigler and Becker (1977) maintain that the issue Schmalensee raises is off the mark, however. “On the traditional view,” they write, “an explanation of economic phenomena that reaches a difference in tastes between people or times is the terminus of the argument” (76). As Stigler and Becker see it, economists need never encounter such an impasse if they look for changes in incomes or prices to explain changes in behavior. The influence of advertising can be explained, in their view, “by a generalized calculus of utility-maximizing behavior, without introducing the

qualification ‘tastes remaining the same’” (76). Advertising, they conclude, changes behavior by influencing prices and incomes, not preferences.

Similarly, Telser (1978) argues that preferences are unaltered by advertising. “Preferences are not given; they depend on the stock of knowledge,” he writes. Due to the high costs associated with acquiring knowledge, consumers generally repeat favorable experiences and avoid unfavorable ones. Inertia tends to characterize their buying habits. Although advertising can help a firm overcome consumer inertia and increase the propensity of a first-time purchase, it cannot change consumers’ preferences or induce consumers to make subsequent purchases of products that they find unacceptable.

Becker and Murphy (1993) tend to agree. While they acknowledge that persuasive advertising creates wants, they maintain that ads do not change tastes. As they see it, “there is no reason to claim that advertisements change tastes just because they affect the demand for other goods” (942). Rather, advertisements are simply “one of the goods that enter the fixed preferences of consumers” (941).

Subsequent research offers some different perspectives concerning advertising’s influence on preferences. In a marketing study, for example, Van Osselaer and Alba (2000) find that when consumers learn about a product’s “quality” from an ad before they actually try the product, “brand cues may ‘block’ the learning of quality-determining attribute cues” (14). As a result, consumers’ preferences may be influenced more by advertising for a product than by actual experience with the product itself.

Looking beyond consumers' preferences among products, Fraser and Paton (2003) find support for the hypothesis (offered by Braithwaite, among others) that advertising is shifting workers' preferences toward consumption and away from leisure. Striking a similar chord, Courard-Hauri (2005) finds that consumers have imperfect access to their own utility functions. Although their "choices may approximate utility maximization . . . the correspondence is unlikely to be exact," he writes (1). Advertising may exploit this ignorance of internal preferences, such that people "overengage in income-producing work and underengage in other activities" (12).

Daly and Farley (2004) also maintain that advertising tends to alter preferences in favor of consumption over nonmarket activities. "While many economists argue that preferences are innate," they write, "businesses are betting [billions every year] that preferences are heavily influenced by advertising" (412). Since advertising that is designed to induce a preference for nonmarket goods is virtually nonexistent, "to the extent that advertising alters preferences, it systematically does so in favor of market goods over nonmarket goods" (413).

The extent to which advertising alters preferences is critical, since the concept of preferences is central to economic theory. As Daly and Farley explain, according to neo-classical economics, individuals are "best able to determine what provides utility." Since measuring utility directly has been problematic, "economists have taken to using revealed preferences as a proxy. Preferences are revealed by people's objectively measurable choices in the market. In the market economy, preferences are revealed through market decisions, and market decisions can only be made with

money,” they write (241). By altering our preferences toward advertised products, without providing the financial means to satisfy those wants, the authors conclude, “advertising directly diminishes our welfare,” and tends to constitute a “public bad” (413).

Summing up, the bulk of the literature seems to indicate that advertising changes tastes and preferences by differentiating products with words and images that tend to engender brand loyalty. In the words of legendary adman David Ogilvy: “Give people a taste of Old Crow, and *tell* them it’s Old Crow. Then give them another taste of Old Crow, *but tell them it’s Jack Daniel’s*. Ask them which they prefer. They’ll think the two drinks are quite different. *They are tasting images*” (Ogilvy 1985, 15; italics in the original). Advertising generates the images that alter—and perhaps even dictate—preferences.

### ***Advertising as a complementary commodity***

According to some economists, advertising is a complementary commodity that is supplied jointly with the product it promotes. Some contend that the complementary nature of advertising promotes consumer welfare, and they suggest that an ad improves welfare whether it is informative or persuasive. When advertising complements the product by providing information about it, consumers value that complementary information. When advertising provides no information

but trumpets the prestige value of a product, according to the proponents, consumers value the additional prestige that complements the product.

Although the subject is little discussed in the early literature, Simon (1970) notes that Barnes (1913) suggests that ads complement the product to which they are attached. Braithwaite (1928) also notes the complementary nature of advertising. She writes: “Consumers who, by advertisement, are induced to increase their purchases of advertised goods, do so because the marginal utility of the commodity has been raised for them, or we may say that with the original commodity they choose to buy this new immaterial commodity—reputation” (21).

While Kaldor (1950-1951) conceives of advertising as a subsidized commodity that complements the advertised product, he seems to be skeptical that its complementary nature has a positive impact on consumer welfare. Since the cost of an ad is included in the price of the good or service it complements, he explains, consumers have no way to indicate their willingness to pay for ads; rather, they must pay for the ad if they buy the product. “Under a system of joint pricing (where the whole bundle of goods and services is sold together for a lump sum) the buyer has no means of selecting some of the services and refusing to take others”—even though he might “prefer to go without them, if the commodity could also be obtained without these services, at an appropriately lower price” (23). In a purely competitive system, prices would be separate, since “if one seller refused to price distinct services or ‘improvements’ separately, there would always be some others who did so” (23). Kaldor allows, however, that in some cases advertising does seem to add to the utility of a commodity. “Satisfaction of the snob-instinct, as conveyed by particular

advertising appeals, . . . undoubtedly add[s] to the value . . . to the particular buyer . . . and in this sense improves the final ‘product,’” Kaldor writes (23).

According to Corden (1961), the reputation with which advertising complements an advertised product may be purely psychological. He notes that some strong ad advocates agree with him on that point but go further, contending that an inhering “psychological reputation” increases a good’s value. If buying an advertised good gives the consumer a psychological boost that a physically identical, unadvertised good fails to supply, then the advertised good is clearly worth more, the advocates claim. According to Corden, however, the “trouble with this logic is that it justifies any kind of commercial fraud, provided only the customer does not know she has been defrauded” (15).

Stigler and Becker (1977) note that consumers place a higher value on intensively advertised products due to the advertising that complements the product. According to the authors, the complementary advertising makes buyers believe they get more for their money—whether or not they actually do.

Going a step further, Becker and Murphy (1993) evaluate the impact of advertising on welfare by formally assimilating advertising theory into the theory of complements. “In consumer theory,” they write, “goods that favorably affect the demand for other goods are usually treated as complements to those other goods, not as shifters of utility functions” (942). Becker and Murphy enter advertising into a utility function as a complement to the good such that  $U = U(x, y, A)$ . The marginal utility of an ad may be positive or negative, they explain. When the ad is experienced as a good, it raises utility directly. When it is a bad, advertisers may subsidize

entertainment or information as indirect compensation to consumers for the utility-lowering effect of the ad. Even with the indirect compensation, Becker and Murphy explain, “many advertisements lower utility and yet raise demand for the advertised goods” (962).

According to Comanor and Wilson (1974), however, the argument that firms supply advertisements and products jointly, as complements, is undercut by a couple of conceptual difficulties. One difficulty is that most of the people who receive the advertising messages never buy the advertised product, and some of the individuals who do buy the product never see the ads. Another difficulty, according to Comanor and Wilson, is that the advertised products and the advertising messages are not parts of the same production process; thus, their provision, “in the standard economic sense,” does not represent joint supply.

Comanor and Wilson seem to present a minority view, however. Most of the economists who address the issue maintain that an advertisement is a jointly supplied complement to the product it promotes. According to some economists (e.g., Nichols 1985; Bagwell 2005), moreover, when advertisements provide prestige as a complement to the advertised good, a monopolist may provide a socially inadequate amount of advertising—even when advertising increases the good’s price. Apparently, these proponents assume that advertising increases social welfare when it conveys an aura of high status to owners of certain goods. Recent research, concerning the impact of materialistic values on the happiness of individuals (and societies) (see Chapter 7), provides evidence to dispute that assumption, however.

## ***Goods or bads?***

According to some economists, whether an advertisement is a good or a bad depends upon the judgment of the person who receives it. Becker and Murphy (1993), maintain that ads count as goods in utility functions if consumers are willing to pay for them. If, on the other hand, consumers must be compensated in order to accept the advertisements, the ads count as bads. Similarly, Baye, Jansen, and Lee (1992) find that advertisements can either raise or lower utility levels and can, therefore, be counted as both goods *and* bads.

Reaching a related conclusion, Telser (1978) finds that an ad can be a good for some of the people who receive it and yet be a bad for other people. Since ads reduce the welfare of some recipients, “the implicit market clearing price for the advertising messages is negative,” he writes, and everyone who receives them is given remuneration, in the form of information or entertainment. Advertisers would be unwilling to provide such remuneration if all ad recipients treated ads as bads, however. “That [some] recipients act as if the advertising is a good is shown by their purchases of the advertised product,” Telser explains (88). As Comanor and Wilson (1974) see it, however, “the fact that advertising has a clear effect on consumer decisions does *not* imply that consumers require or prefer the volume of messages received” (247; italics in the original). Even if consumers do purchase advertised goods, in other words, the ads themselves may reduce overall utility.

According to Schmalensee (1972), some ads reduce welfare because they are offensive or annoying. Although the objectionable aspect of ads “may be regarded as an externality of sorts,” Schmalensee writes, “economic analysis suggests no obvious

solutions, short of necessarily arbitrary censorship, other than establishing standards of truthfulness” (4). Such standards are inadequate, however, since ads can be truthful and still be offensive or annoying.

The impact of television commercials on welfare has been the focus of a number of studies. Anderson and Coate (2005), for example, note the existence of a nuisance cost that inheres to television commercials. According to Barnett et al. (1966), television commercials “are negative economic goods to the viewer, which he must ‘consume’ in order to obtain the entertainment program” (467). Not surprisingly, Danaher (1995) notes that television-program ratings fall during commercial breaks. Yorke and Kitchen (1985) find that members of a sample population use either the fast-forward or the pause button on a VCR to eliminate commercial breaks in “practically *all* instances” (24); and using a game-theoretic model, Wilbur (2004) finds that television viewers avoid commercials by using ad-avoidance technology whenever possible.

According to Kaldor (1950-1951), advertising belongs to a category of services that are “*not* provided in response to market demand” (5; italics in the original). In order to determine whether or not such a service adds to or detracts from welfare, Kaldor suggests, one should ask if there is a real need for the service, if the service satisfies that need, and if the size of the expenditure to satisfy the need is justifiable. In his view, the need for market information is real, but advertising satisfies that need poorly and at too high a cost.

In sum, while opinions about advertising's impact on welfare vary somewhat, the overwhelming bulk of the empirical literature seems to indicate that for most people an advertisement is a bad rather than a good.

### ***Wasting economic resources or improving market performance?***

According to some economists, advertising tends to waste economic resources. This view seems to have been especially prevalent among the early students of the economics of advertising. Marshall (1919), for one, maintains that advertising sometimes plays a wasteful, business-stealing role. Pigou (1932) agrees. In his view, the ad expenditures of competing firms may cancel each other out. If they do, each firm's expenditures are for naught, and the resources devoted to advertising are wasted. Braithwaite (1928) finds most advertising wasteful for a different reason: It distorts consumers' true preferences and creates false demand.

Borden also considers ad-induced distortion of demand to be a source of economic inefficiencies. Investigating whether advertising causes waste in distribution, Borden (1942) finds that in some cases economies of scale associated with advertising more than offset ad expenditures. In other cases, he finds no evidence that ad expenditures are offset, however. "The high costs persist," he writes, "because effective price competition has been prevented by the existence of other strong appeals which have affected consumers' valuations" (875). Similarly, Comanor and Wilson (1974) find that advertising is likely to induce inefficiencies, because it leads to resources being allocated in a manner other than according to

consumer preferences. They write: “To some extent, excess advertising represents resources that are wasted in that there is no effective demand for the output that is produced” (241).

Robinson (1933), Kaldor (1950-1951), Bain (1956), Galbraith (1967), Solow (1968), and Daly and Farley (2004), among others, suggest that advertising is (at least) sometimes economically wasteful and impairs market performance. Corden (1961) suggests that if advertising expenditures are, in fact, an economic waste, then, of course, the amount spent is enormous. If, however, advertising is essential to the distribution process, then ad expenditures, representing only a small part of all distribution costs, are relatively minor. According to Corden, while many economists doubt the economic value of about half of all ad expenditures, few economists dispute the worth of most classified ads, financial ads, trade-and-technical-journal ads, and other non-commercial ads. In Corden’s view, however, “even if the economic effects of this half are not necessarily adverse, [advertising] is unlikely to be worth the cost” (38).

Acknowledging that many economists find advertising to be a waste of resources, Telser (1966) summarizes the critics’ argument and then attempts to refute it. According to Telser, the critics maintain that if firms could charge a positive price for their ads, they would. Firms supply ads without charging for them; thus, “advertisers may believe that the amount of advertising that would be demanded at a positive price is less than the amount they should provide to maximize their profits” (457). So, firms provide ads, they profit, and they transfer their ad expenditures—in the form of higher prices—to consumers. Since the quantity of advertisements

supplied exceeds the quantity demanded, consumers “have more advertising foisted off on them than they would be willing to purchase in a separate market for advertising services.” All of this “implies a departure from marginal cost pricing and a consequent waste of resources” (457). Or so the argument goes, Telser explains. He disagrees, however. In his view, perpetually changing market conditions generate a continuous demand for the information that advertising supplies. “The turnover of customers, the ease of obtaining direct information about goods, the frequency of purchase, the expense of trial purchases, and the satisfaction with existing goods—all play a role in the supply and demand for advertising messages” Telser writes (466).

A number of other economists maintain, along with Telser (1964, 1966) that advertising tends to improve market performance. Among those who defend advertising in this way are: P. Nelson (1974), R. Nelson (1976), Demsetz (1979), Lynk (1981), Arrow, Stigler, Landes, and Rosenfeld (1990), and Raimondi and Klein (as reported by O’Malley 2004).

Without taking sides, Schmalensee (1972) finds the mere task of analyzing the market performance of advertising with normal economic tools problematic, given that “advertising by its nature tends to induce changes in tastes” (6).

Thus, while some economists maintain that advertising supplies information to consumers and therefore improves market performance, others argue that the biased information that many ads supply is a waste of resources. Furthermore, in many cases, consumers of ads have no use for the information that the ads supply. (The information in ads for PoliGrip, a denture adhesive, is wasted on children, for example.) According to some critics, advertising is combative, resulting in the

mutual cancellation of the effectiveness of each advertiser's message by its rivals. In addition, some economists maintain that since advertising tends to alter consumers' preferences and a market's ability to satisfy consumers' preferences defines its efficiency, advertising undermines consumer sovereignty.

### ***Advertising and consumer sovereignty***

A number of economists address the impact of advertising on consumer sovereignty. While some economists argue that advertising's association with profits shows that it promotes consumer sovereignty, Kaldor (1950-1951) maintains: "Profitability is a test of consumers' preferences only in a purely competitive system where the price-mechanism accurately registers the pull of competing attractions" (4). Since advertising differentiates products and restricts competition, profitability fails to indicate consumers' true preferences. Furthermore, Kaldor continues, when firms supply ads, it is not "*in response* to consumers' demand," nor do firms base their ad expenditures on the preferences that consumers register via the price-mechanism; rather, "purely extraneous considerations" determine the quantity of ads that firms supply (4; italics in the original). Given their lack of control over advertising, consumers can hardly be thought to be sovereign.

Galbraith (1958) goes farther. He argues that advertising actually undermines consumer sovereignty by generating artificial demand. "First you make the good, then you make the market," he writes. And how do you make the market? By advertising. The process of artificial-demand creation is, however, "deeply in conflict

with accepted economic thought. In that, nothing was so fundamental as the concept of consumer sovereignty—the according of final economic authority to those the economic system serves” (ix).

In the past, Galbraith explains, economic theory sought to meet consumers’ needs for the essentials of existence with a sense of urgency. In the modern affluent society, however, advertising creates wants in individuals whose needs are already satisfied. “The fact that wants can be synthesized by advertising, catalyzed by salesmanship, and shaped by the discreet manipulations of the persuaders shows that they are not very urgent. A man who is hungry need never be told of his need for food. If he is inspired by his appetite, he is immune to the influence of [ad men]” (129).

According to Galbraith, that earlier sense of urgency to provide the essentials is now applied “to a world where increased output satisfies the craving for . . . the entire modern range of sensuous, edifying and lethal desires” (115). Given that advertising is responsible for generating many of those desires, they cannot be urgent, since, to be urgent, desires must originate within the individual. Thus, Galbraith insists, advertising runs counter to the principle of consumer sovereignty. He writes:

Consumer wants can have bizarre, frivolous or even immoral origins, and an admirable case can still be made for a society that seeks to satisfy them. But the case cannot stand if it is the process of satisfying wants that creates the wants. For then the individual who urges the importance of production to satisfy these wants is precisely in the

position of the onlooker who applauds the efforts of the squirrel to keep abreast of the wheel that is propelled by his own efforts (125).

Incorporated in the productive process are the means (i.e., advertisements) to create consumer demand, Galbraith explains. And if the same production process that satisfies wants contrives them as well, “the whole case for the urgency of production, based on the urgency of wants, falls to the ground” (124).

Zinkin (1967), however, criticizes Galbraith’s conclusions. In response to Galbraith’s assertion of ad-created demand, Zinkin writes: “Whether one considers that the firm creates the demand, or responds to it, depends upon how one defines the word ‘create’” (5). In one sense, the word “create” can be used to describe the generation of demand that “was not there before in that form” (5). In that limited sense, firms “very often do create demands,” Zinkin writes (5). No one could want an automobile before it was invented, for example. In another sense, however, the word “create” is sometimes used incorrectly to describe the generation of an artificial want. In reality, however, “the new want is nearly always an old want but satisfied in a new way,” (5). The automobile, he explains, fulfills a demand for transport that has always existed, though not in that particular form. Thus, in Zinkin’s view, it “is normally not true” that advertising “creates” demand in this second sense (5).

Galbraith notwithstanding, the consumer is sovereign, Zinkin maintains. “Firms, however big, however impressive their advertising, do not have the capacity to impose their products upon the consumer. Firms which misjudge the consumer’s desires can still make losses” (3). Nevertheless, this fact “does not mean that

bankruptcy stares every firm in the face.” For while the “consumer may be sovereign,” Zinkin explains, “she is not therefore arbitrary” (7).

Demsetz (1968) also criticizes Galbraith’s views. He disputes, for one thing, what he says is the “first line of attack in Galbraith’s thesis”; that is, “the demise of consumer sovereignty and the creation of an imbalance in modern life unfavorable to leisure and art” (807). “Once Galbraith’s view of a monolithic business world is challenged,” Demsetz writes, “it becomes apparent that considerable market forces also exist to further leisure and the aesthetic qualities of life” (809).

Demsetz allows that advertising may influence wants. “No doubt wants are modified by Madison Avenue,” he writes, but they are also “modified by Washington, by university faculties, and by churches.” As he sees it, “the formation of wants is a complex process,” involving many influential inputs (810). Thus, Demsetz concludes, Galbraith is mistaken in charging advertising with abrogating consumer sovereignty.

Solow (1967) also disagrees with Galbraith. He writes: “In the folklore, [the consumer] is sovereign; the economic machinery holds its breath while the consumer decides, in view of market prices, how much bread to buy, and how many apples. In Galbraith’s counterfable, . . . the consumer is managed by Madison Avenue into buying what the system requires him to buy” (104). Thus, Solow continues, “the issue is whether the art of salesmanship has succeeded in freeing the large corporation from the need to meet a market test, giving it ‘decisive influence over the revenue it receives’” (105), or, in other words, whether advertising has succeeded in substituting producer sovereignty for consumer sovereignty.

Solow criticizes Galbraith for making assertions without presenting statistical evidence to back them up. While acknowledging that the issue is a difficult one to resolve, especially “if you insist on evidence,” Solow supposes “that much advertising serves only to cancel other advertising, and is therefore merely wasteful” (105). For Solow, like Demsetz, Galbraith’s concern about advertising’s impact on consumer sovereignty is unfounded.

Intervening in the “Solow-Galbraith controversy,” Marris (1968) notes that Solow criticizes Galbraith for making assertions without providing any statistical evidence to support them. According to Marris, however, “the leading exponents of the new, [statistical] methods [such as Solow] have chosen largely to confine themselves within the framework of the traditional assumptions,” and that framework tends “to preclude answering many of the questions”—such as the influence of advertising—that Galbraith raises. “When the question [of advertising] arises it is customary to say that the traditional framework, now endowed with statistical flesh, provides a reasonable explanation of observed behavior, so that it is probably unnecessary to worry about Madison Avenue.” If pressed further, the advocates of this school “usually themselves resort to assertions: specifically, they assert that the effects of large-scale advertising largely cancel themselves out, leaving the broad pattern of consumer expenditure undisturbed.” According to Marris, Solow “followed this line of argument almost precisely” in his critique of Galbraith (38).

Differing from Galbraith somewhat, however, Marris concludes that “consumer tastes develop as a complicated interaction of personal influence” and advertising (39). If Galbraith conceives of “advertising” as a portmanteau for

producers' overall influence, however, Marris agrees with Galbraith once again; for, as Marris sees it, producer-influenced, consumers' sovereignty is an oxymoron. "Once we accept this kind of picture," Marris argues, "the notion of 'consumers' sovereignty' becomes vague, to say the least, and we are provided with a virtually complete justification for a wide range of political action to impose social value judgments in the direction of consumption patterns" (40).

Offering a different perspective, Lerner (1972) describes consumer sovereignty in terms of Pareto optimality. He writes: "The basic idea of consumer sovereignty is really very simple: arrange for everybody to have what he prefers whenever this does not involve any extra sacrifice for anybody else" (258). In his view, consumer sovereignty is "far from completely achieved even where appropriate institutions have been fully developed. Where the approximation to consumer sovereignty is left to perfect competition, we do not reach it if the competition is not perfect" (259). As he sees it, however, claims that advertising manipulates preferences and undermines consumer sovereignty are exaggerated.

Exaggerated or not, Doyle (1968) notes that a common complaint among economists about advertising is that it "misinforms consumers about products and detracts from consumer sovereignty considerations" (570). Similarly, Richard Caves (1974) refers to "the nervousness long felt by economists about 'consumer sovereignty' as the immutable hook from which dangles our justification for the allocation of resources produced by capitalistic markets" (xiii).

Quarles and Jeffres (1983) deny that economists have reasons for such nervousness, however. In a study of 53 nations, they find "little evidence for

Galbraith's view of advertising as a high priest of materialism with the persuasive force to alter the spending and savings habits of people and nations" (13).

Attempting to clarify the concept and significance of consumer sovereignty, Lowery (1998) writes: "The traits that are perhaps most important to advocates of market institutions are those associated with the concept of consumer sovereignty" (139). Citing Rothenberg, he explains that economists use that concept in two, somewhat different ways. When used in a descriptive sense, the term "consumer sovereignty" signifies that consumers' preferences ultimately direct the production and distribution of goods and services. The descriptive use of the term, Lowery explains, is central because it "subsumes or implies many other expected outcomes of market exchange. It is the constraint of consumer sovereignty, for example, that generates incentives to innovate and orchestrates coordination of supply and demand" (139).

In a second sense, however, the concept of consumer sovereignty has "a normative meaning rooted in the utilitarian vision of the good life" (139-140). Consumer sovereignty in this second sense, Lowery explains, evaluates an economy's performance in terms of its ability to fulfill consumers' wants. Seen as a normative principle, consumer sovereignty also establishes want-fulfillment as the criterion by which the social desirability of public policies and institutional structures should be judged.

"Under ideal conditions, then, markets both provide consumer sovereignty and are justified by it" (140). Consumer sovereignty can be compromised, however, when consumers' preferences are formed in error, due to personal ignorance or to

external manipulation. As Lowery notes, Galbraith (1998) makes ad-manipulated preferences the core of his critique of advertising, and a study by Smith and Meier (1995), regarding school vouchers, observes preference manipulation by advertising “in a manner that fully parallels Galbraith’s argument” (Lowery 1998, 152).

Public choice scholars seem to recommend a laissez-faire solution to the problem of ad-manipulated preferences, arguing “that markets provide their own cure through competitive advertising” (152). For public choice scholars, therefore, the answer to bad advertising is more advertising. In Lowery’s view, “the efficacy of this solution often seems to be founded more on faith than on evidence.”

Nevertheless, he finds this solution somewhat plausible when actual competition exists, “as opposed to cases where the market is merely contestable” (153). “But,” he writes, “consumer sovereignty may still be compromised if there are too few competitors, if preferences are ill-informed or are biased by manipulation” (165). According to a number of economists, advertising may facilitate such market conditions and may, thereby, compromise consumer sovereignty.

Daly and Farley (2004) describe the self-perpetuating nature of advertising, by which consumer sovereignty is subsumed. They write: “There are many Pareto optima, one for each distribution of income, set of technologies, and set of wants or preferences”; however, advertising can make a Pareto-optimal allocation of resources problematic. According to the authors, if advertising creates wants and alters preferences, such that firms manufacture both the need for the product and the product itself, “then production begins to look like a treadmill. If we produce the need along with the product to satisfy it, then we are not really making any forward

motion toward the satisfaction of pre-existing needs.” Producer sovereignty replaces consumer sovereignty, and “the moral earnestness of production, as well as the concept of Pareto optimal allocation of resources in the service of such production, suffers a loss” (135).

In sum, although no clear consensus exists among economists concerning advertising’s impact on consumer sovereignty, the literature indicates that many economists think that its impact is detrimental.

### ***Advertising’s role in providing market information***

*There is no way for the American economic system to function without advertising. There is no other way to communicate enough information about enough products to enough people with enough speed.*

—John O’Toole (1981)

*The cost of an independent information service about commodities—quite disregarding the great improvements in the quality and the quantity of information which it would bring about—could only amount to a fraction of the present cost of advertising to the community.*

—Nicholas Kaldor (1950-1951, 7).

While economists generally agree that advertising supplies information, opinions differ as to whether the information it supplies is useful to consumers. The disagreement appears early in the literature. Marshall (1919), for example, maintains that some advertising plays a constructive role by informing the public about the existence of a product or service, its price and quality, and where it is sold. Pigou (1932), too, notes that some advertising “fulfils a social purpose, in informing people

of the existence of articles adapted to their tastes. . . . Without it many useful articles, such as new machines, or useful services, such as that of life insurance, might not be brought at all to the notice of potential purchasers who have a real need for them” (n.p.). Braithwaite (1928), however, disagrees. In her view, since advertising fails to supply accurate, detailed facts, it fails to provide guidance for consumers as they attempt to assess the relative utility among like commodities, among different commodities, or between commodities and leisure.

Chamberlin (1933) suggests that advertising spreads both information and misinformation about products and services. Ads that misinform or target consumers’ vulnerabilities are manipulative, not informative, Chamberlin contends. Borden (1942) goes further. In his view, advertisements are typically devoid of detailed, factual information. Advertisers fail to provide useful information, according to Borden, because they believe that highly informative ads fail to stimulate large increases in consumption, whereas persuasive ads (presumably) do.

Kaldor (1950-1951) maintains that most advertising provides little or no information and that the information it does provide tends to be biased. While he notes that obtaining information about products and services is important to consumers’ welfare and he acknowledges that advertising may occasionally provide such information, Kaldor finds that advertising is an inefficient, inaccurate, and expensive means of information dissemination. “We find that the cost of providing this highly inadequate and defective information-service is exorbitantly high,” he writes (6). Advertisements fail to mention alternative suppliers, generally accentuate some attributes of the advertised good while ignoring others, and attempt to influence

consumer behavior “by forcing a small amount of information through its sheer prominence to the foreground of consciousness” (5). To be useful, information should be objective. Since a firm’s advertising lacks financial independence from the advertised good, it also lacks objectivity, Kaldor maintains. In his view, consumers may actually have access to less information—at a higher cost—with advertising than they would have without it, because “its development has indirectly led to the suppression of other channels of information about commodities” (6). An independent source of information for consumers would provide more and better information at a fraction of advertising’s cost to society, Kaldor concludes.

Beginning in the early 1960s, as economists of the Chicago school rose to prominence, advertising’s informative role began to receive more attention and appreciation. Although early members of the school, such as Henry Simons, had been highly critical of advertising’s influence on the economy, later members, such as George Stigler, Gary Becker, Harold Demsetz, and Lester Telser offered a number of economic justifications for advertising, including the role advertising plays in providing market information. In general, proponents of advertising’s informative role explain that search costs can result in market inefficiencies if they discourage consumption. Advertising, they claim, reduces search costs by providing low-cost information concerning a good’s price, quality, and availability.

Stigler (1961) stresses the informative role of advertising in his oft-cited article: “The Economics of Information.” As Stigler sees it, the traditional economic model, which assumes that market information is perfect, “rarely obtains in the real world—if it did, there would be no need for advertising” (Arrow et al. 1990, 10).

Since the model rarely obtains, consumers need information about the availability, price, and quality of products. Advertising “is clearly an immensely powerful instrument for the elimination of ignorance,” Stigler writes (220). Because it provides market information, advertising’s impact on prices “is equivalent to that of the introduction of a very large amount of search by a large portion of potential buyers” (224).

According to Stigler, price dispersion exists, in part, because the high cost of collecting and analyzing information about goods discourages consumers from searching for market information. When consumers are ignorant about the range of market prices for a good, suppliers are less inclined to compete on price. Advertising reduces search costs; as a result, consumers are better informed, and firms are forced to price their goods competitively.

Corden (1961) is less sanguine about advertising’s informative role, however. While he acknowledges that advertising informs consumers about the existence of some goods and plays a large role in launching many genuinely innovative products onto the market, Corden wonders “whether advertising provides an *adequate* information service at *reasonable* cost” (13; italics in the original). Ultimately, he agrees with critics who maintain that the information advertising supplies “does not help the consumer to make an intelligent choice” (13).

Corden draws no distinction between “informative” and “persuasive” advertising. Noting that a number of earlier analysts had drawn that distinction, he writes, “it has been realized that all advertising contains a little information, if only

the name of the product, while even the most informative advertisements have persuasion as their aim” (14).

Although much of the information in ads is puffery, Corden explains, the ads are persuasive, nonetheless. “The net result of all this is that consumers often purchase expensive products when they could buy exactly the same basic product, but unadvertised and cheaper” (14). An example he cites is aspirin. Although the active ingredients are identical, the divergence in prices between generic aspirin and advertised brands is generally great. “If buyers were well informed,” Corden writes, “not a single bottle or packet of the expensive brands would be sold, and the cost of living—or the cost of a headache—would immediately go down” (14).

In accord with Kaldor, Corden notes that advertising may actually inhibit the supply of product information. Newspapers, he notes, review books and films, but avoid giving like scrutiny to the ordinary commercial products that they advertise. If consumers received accurate information about products from consumer services rather than the biased messages they get from advertisers, the public would be more aware of differences in price and quality. As a result, “price and product competition rather than advertising would be the instrument by which industries achieved the degree of concentration needed to attain the benefits of mass-production” (26). In his view, compared to most advertising, a publicly operated consumer advice service would provide more useful, less biased information and provide it at a lower cost.

Telser (1964), on the other hand, finds some empirical support for the view that advertising supplies useful information about goods and services to consumers. Benham (1972) adds to that support. In a study of the eyeglass industry, Benham

finds that the benefits consumers derive from the information ads supply “outweigh the price-increasing effects of advertising” (349).

Philip Nelson (1974) contends that advertising supplies valuable market information, as well. He argues, in fact, that “the major features of the behavior of advertising can be explained by advertising’s information function” (729). The character of that information depends, however, on whether “search qualities” or “experience qualities” predominate in the advertised good. Search qualities, he writes, are qualities that consumers can evaluate before they purchase a product. Experience qualities, on the other hand, cannot be evaluated until after consumers purchase and use the product. While the information provided by advertisements for search goods (i.e., those that can be characterized as having mostly search qualities) tends to be factual, in the case of experience goods, “the most important information conveyed by advertising is simply that the brand advertises” (729).

As Nelson sees it, such indirect information is useful to consumers because, for one thing, it signals that the firm doing the advertising is efficient. Efficient firms benefit more from demand expansion than do inefficient firms, Nelson explains. Since advertising increases demand, efficient firms are more likely to advertise heavily. They are also more likely to lower prices and improve quality, since doing so may also increase demand. Thus, Nelson concludes, intensive advertising signals efficiency, telling consumers where they can get a good deal, and it provides useful market information, whether that information is direct or indirect.

Comanor and Wilson (1974) are less enthusiastic about advertising’s informative role. They maintain that while consumers need reliable information in

order to make welfare-enhancing purchases, advertising, as a source of product information, is far from objective. On balance, however, the authors conclude that social welfare would not necessarily improve if advertising were substantially reduced while all else remained unchanged. They write: “Given consumer ignorance and the inadequacies of investment in the provision of public information, advertising may represent a useful solution to the twin problems of providing information to consumers and financing the provision of public entertainment and information through the media” (248). Still, they argue, market information could be supplied at a lower cost to society, improving economic efficiency and increasing social welfare. In their view, consumers’ demand for objective information about market goods must exceed their demand for advertising, which, “by its very nature represents a biased form of information” (247). Given the higher demand for objectivity over puffery, consumer welfare would be increased if the resources now devoted to advertising were, instead, devoted to the supply of more objective information.

Robert Nelson (1976) maintains that advertising supplies useful information, even if that information is sometimes indirect. By his analysis, consumers behave rationally, *ceteris paribus*, when they purchase advertised goods—whether or not they believe that the informational content of advertising is truthful. Nelson explains that since advertising campaigns are expensive, only firms that expect to be in business long enough to make the investment worthwhile will engage in advertising. In order to remain in business for an extended period, firms must offer a satisfactory product and maintain its quality. Thus, when a firm advertises, it offers implicit

assurance that it supplies an acceptable product, and that assurance—regardless of the ad’s substantive content—is sufficient to make the ad useful to consumers.

Stigler and Becker (1977) contend that by providing product information, advertising increases the utility consumers obtain from a commodity. In the authors’ words, a “consumer may indirectly receive utility from a market good, yet the utility depends not only on the quantity of the good but also the consumer’s knowledge of its true or alleged properties” (84).

Lynk (1981) finds another reason to suppose that advertising provides useful market information. The results of his study indicate that the information about goods and sellers that advertising provides does more to increase the market share of small brands than of large brands. Market ignorance, he concludes, has the converse effect. Thus, according to Lynk, advertising expands the range of consumers’ choices.

Hoch and Ha (1986) implicitly question whether or not the information advertising provides actually adds to consumers’ welfare, however. The results of their study indicate that consumers tend to accept advertisers claims without requiring truly convincing evidence. So long as the information supplied by the ad does not blatantly contradict the evidence of their experience, consumers generally accept the ad’s representation of the product and search no farther for additional information. According to the authors, “if an advertiser makes a claim and the consumer discovers through product testing that the claim is valid, . . . the consumer may not really care whether other products also satisfy that claim . . .” (230). Thus, while an ad may

inform consumers about a particular product, it may inhibit their gathering sufficient information to make an optimal choice among products.

Arrow, Stigler, Landes, and Rosenfeld (1990), in an ad-industry sponsored study, argue that one of advertising's greatest virtues is its ability to provide information to consumers efficiently. As an example of that virtue, the authors cite a study by Ippolito and Mathios (1990) in which the researchers found that consumers switched to high-fiber cereals once the government lifted a ban that had prohibited ads from promoting the health benefits associated with eating fiber-rich foods. Advertising, Ippolito and Mathios report, "was an important source of information once the ban was lifted" (459). Although information about the health benefits of high-fiber cereals had been available for several years before the government lifted the ad ban, that information "had limited impact on fiber cereal choices in the years prior to the advertising" (459). Ippolito and Mathios conclude that advertising lowered "the costs of acquiring information for broad segments of the population" (459).

No doubt their conclusion is correct. Still, the Ippolito-Mathios study brings to mind several questions. First, if, instead of advertisements, an unbiased source had promulgated information about the cereals' benefits, would the public have been informed less or more efficiently? Given that many people insist they are skeptical of claims made by advertisers, the resources devoted to ads touting the benefits of high-fiber cereals to such people were probably wasted. Government-funded public service announcements might have been more effective and efficient—particularly if

the same monetary and creative resources were devoted to supplying those announcements as were devoted to the advertisements.

Second, while the Ippolito-Mathios study seems to show that ads lowered the cost of spreading welfare-enhancing information about fiber-rich cereals, in other instances, might ads spread welfare-*reducing* information just as efficiently? In a nation plagued by increasing rates of obesity (and attendant diseases), do messages that shout “EAT JUNK FOOD!” provide welfare-enhancing information? In the absence of such ads, might people eat less junk food? Might they, to take a salient example, choose breakfast cereals based on cost, taste, and nutritional value rather than because a football star or cartoon character promotes the product? If so, would they not be better off?

Apparently, such questions were beyond the scope of the Arrow (et al.) study. Rather, the emphasis was on the efficiency of advertising in reducing consumer ignorance. According to Arrow et al., “for many products, advertising is by far the most efficient way to reduce consumer ignorance. . . . Advertising is a particularly efficient way of economizing on consumers’ search costs because it has aspects of a public good. . . . In contrast,” the authors continue, “if each consumer has to search for prices (or qualities) individually, the total cost will be proportional to the number of consumers searching” (10-11).

As Arrow and his colleagues see it, there are other reasons to praise advertising’s informational role beyond its ability to lower search costs. For one thing, a single firm’s advertising can provide consumers with information that helps to create demand—not only for the advertiser but also for every other firm in the

industry. As a specific example, the authors explain that when the pioneering firm, Amana, introduced microwave ovens, it used advertisements to inform the public about the ovens' innovative features. Those ads helped create consumer demand for microwave ovens in general; subsequently, other firms captured some of that ad-generated demand. Thus, Amana shared the benefits of its advertising with an entire industry that it had founded. Because such cases occur, the authors conclude that firms will sometimes "have *too little* incentive from the viewpoint of society to engage in advertising" (18-19; italics in the original).

Arrow and his colleagues suggest that some of the ads that critics consider wasteful actually provide useful information to consumers. Echoing conclusions by P. Nelson (1974) and R. Nelson (1976), Arrow et al. maintain that ads for experience goods provide quality assurance—regardless of the ads' substance. "It is not the content of the advertising message, but the fact that a seller *chooses* to advertise that provides information about products with experience qualities; i.e., the mere fact that the advertising exists signals that the advertiser believes his product is a 'good buy' and thus worth advertising" (15; italics in the original). Using as an example introductory ads for Diet Coke that featured a number of Hollywood stars but no substantive information, the authors explain: "Because the advertisement is flashy, people are more likely to notice it and seek out the product" (17). So even though the ad lacks "hard" information, it "benefits consumers by bringing to their attention the news that a new product they may enjoy has been introduced" (17). Some critics of the ad, on the other hand, might note that it promotes a product that has no nutritional

value and that manufacturing, promoting, storing, and distributing Diet Coke (like other junk-food products) wastes resources and creates pollution.

Some individuals, particularly those with a libertarian bent, might argue, however, that if people want to consume junk food they should be free to consume junk food and that advertisers should be free to inform them about the existence, availability, quality, or price of junk food. The results of experimental studies, including those of Hoch and Ha (1986), Hoyer and Brown (1990), and Van Osselaer and Alba (2000), however, indicate that advertising does more than merely inform; it also influences consumer choice by engendering preferences for advertised brands, regardless of their quality.

Moorthy, Ratchford, and Talukdar (1997) provide theoretical support for the position that the information in advertising can be influential even when the product being considered belongs to a category (e.g., automobiles) in which potential customers are expected to search for objective sources of information. According to the authors, advertising can influence the order of search by developing “top-of-mind” awareness in the public, and “being high in the order of search may well determine the ultimate choice” (275). Like a number of earlier studies, the Moorthy study seems to indicate that advertising may tend to limit the extent to which consumers are actually informed.

According to R. Nelson (2001), however, some ads clearly do inform consumers. While he acknowledges the “long tradition within economics of scornful treatment of the practice of advertising—commonly seen as ‘manipulating’ consumers for ‘unproductive’ purposes,” Nelson maintains that “much of the

advertising in newspapers and other places is useful in spreading information about prices and the availability of products and brands” (214).

Bagwell (2003) also notes the usefulness of the information that ads provide. He suggests, in fact, that advertising is *undersupplied* when it provides information to consumers who would otherwise have been uninformed. Since the advertiser is unable to appropriate the entire ad-created consumer surplus in such circumstances, the ad’s benefit to society exceeds its benefit to the firm; thus, the firm undersupplies advertising. When two or more separate firms’ ads reach a consumer, however, social welfare remains unchanged if the ads merely redistribute sales among firms, and advertising may, in that circumstance, be *oversupplied*.

Lawrence Klein summarizes the argument of those who defend advertising’s informative role: “Advertising fulfills the critical role of informing and educating consumers about the many choices available to them in the marketplace” (qtd. in Michigan Production Alliance 2004).

In sum, a review of the literature reveals an obvious lack of consensus concerning advertising’s informative role. One economic camp insists that advertising plays a vital role by providing useful market information; another argues, just as forcefully, that advertising misinforms far more than it informs and that it wastes valuable economic resources. A third camp, meanwhile, contends that since some ads inform and others misinform, it is hard to determine whether the information advertising supplies is, on balance, truly useful to consumers; and a fourth maintains that people might make freer, better informed choices if they searched on their own or if the government provided unbiased product information.

## ***Opportunity cost***

Pashigian and Bowen (1994) report that the information advertising provides has become more valuable as women have entered the workforce in greater numbers, and the opportunity cost of shopping has increased. According to the authors, shoppers are increasingly relying on brand names in an attempt to save time and reduce search costs. As Schudson (1984) explains, advertising “takes on greater importance—and greater value for the consumer—in a time-scarce society. . . . Advertisers simultaneously close the information gap by providing information and exploit the information gap that remains by using noninformational persuasion” (200). Linder notes that “one actually *wants* to be influenced by advertising to get an instant feeling that one has a perfectly good reason to buy this or that commodity, the true properties of which one knows dismally little about” (qtd. in Schudson 1984, 200-201). Because ads offer “a perfectly good reason to buy,” many busy people lower search costs by purchasing advertised products. It seems worth noting, however, that advertised goods typically cost more than generic ones; thus, people must work more (i.e., become even busier) in order to be able to buy them.

It should be noted, in addition, that while advertising may lower opportunity costs associated with shopping, advertising inflicts opportunity costs associated with ad exposure. Consuming the information that advertising supplies is time consuming. Even making a decision to ignore an ad takes time—precisely how much time is

anyone's guess, but it must be substantial: According to the Union of Concerned Scientists (n.d.), the average American is exposed to over 3,000 ads per day.

Barnes (2001) discusses the opportunity cost of captured attention in this way:

The problem . . . is a scarcity unrecognized by markets. Though demand for our attention inexorably rises, our supply of attention is inherently limited. It's constrained by two factors that are quintessentially scarce: time and brain capacity. There are only twenty-four hours in a day, and we sleep for a third of them. Even when we're awake, there's only so much sensory input our brains can handle. The more our brains are filled with commercial stimuli, the less room we have for love, gratitude, and contentment (114-115).

In addition to diverting attention away from other pursuits, ads sometimes offend or annoy. Exposure to a firm's ad campaign can be a bit like listening to an old friend or a relative tell a story—that you had no interest in hearing the first time—over and over again. The amount consumers are willing to pay for devices that allow them to skip ads (e.g., video I-pods, digital video recorders, video cassette recorders, and remote controls with mute buttons) provides a partial indication of the opportunity cost of advertising.

### ***Advertising's impact on product quality***

Some early analysts of the economics of advertising, such as Fogg-Meade (1901), Shaw (1912), and Marshall (1919), attribute a welfare-enhancing, quality-

guaranteeing effect to advertising. Shaw, for example, contends that advertising provides incentives for firms to supply high-quality products and thereby establish solid reputations for their brands. Knowing that the quality of an advertised brand will be the same every time they buy it—no matter where or from whom they buy it—increases consumers' welfare, some ad proponents maintain.

Braithwaite (1928) concurs on that specific point. She refutes, however, the claim of those who argue that since “it is not worth a manufacturer's while to stake his name and spend his money on advertising an article of poor quality,” advertised goods must be of high quality (36). In the first place, she maintains, advertising sometimes creates good reputations for inferior goods. Unless or until the public learns the truth, the manufacturers of these inferior goods are able to accrue considerable profits. Second, in many cases, consumers can detect only gross quality differences; yet, the legitimacy of the argument made by advertising's proponents depends on consumers being competent judges of quality over the long run. Third, consumers can purchase unbranded goods at a retail outlet and depend on the retailer's desire to maintain its good name as a guarantee of quality, just as ad defenders suggest that consumers rely on advertisers to protect their brands' reputations. Thus, Braithwaite concludes: “For these reasons, I think that reputation does not offer to consumers advantages commensurate with the subjective valuations put upon it, nor advantages sufficient to outweigh the harmful effects of advertisement” (37).

Borden's (1942) views seem to represent those Braithwaite opposes. According to Borden, advertising helps ensure product quality because it creates

goodwill for the brand. If a firm were to sully its brand's reputation by failing to maintain consistently high quality, it would deplete the goodwill that it had accumulated over time by advertising. Depleting its investment in goodwill would represent a loss to the firm. According to Borden, advertising also encourages firms to improve the quality of their products, because advertising facilitates public adoption of such improvements. Simon (1970), however, is unconvinced on that score. As Simon sees it, product improvement is an insufficient justification for many of the most intensively advertised products. "Aspirin will remain aspirin, no matter how much is spent on advertising," he writes (274).

Corden (1961) notes that some economists argue that since a central purpose of advertising is to help consumers remember their products' names, the promise of monetary gain motivates advertisers to maintain good reputations for their brands. In order to maintain those reputations, advertisers must supply high quality products consistently. As Corden sees it, however, that argument is unconvincing, since less expensive means can provide the same benefits. Retailers, for example, can (and many do) ensure the quality and consistency of all the products they sell—regardless of whether the products are branded—in order to maintain their stores' reputations. In addition, Corden explains, many suppliers of unbranded goods are motivated by the promise of monetary gain to maintain their reputations for high quality.

In an argument similar to the one Borden advances, Philip Nelson (1974) maintains that advertising tends to ensure quality, because it helps consumers remember products by their brand names. Once consumers try a product, he explains, remembering its quality is relatively easy. Since consumers are apt to remember not

only the name but also the quality of an advertised product at purchase-time, firms that offer high-quality brands have more reason to advertise than firms that supply low-quality merchandise.

Analyzing the relationship between advertising and quality from a different perspective, Comanor and Wilson (1974) suggest that consumers tend to perceive an association between the two and rely on that association to minimize risk. In the Comanor-Wilson view, advertising may strongly influence consumers' selections among products when the consumers lack direct information about quality differences among alternative products. "In choosing a well-known, highly advertised, but expensive brand over an unknown, little-advertised, but low-priced product," Comanor and Wilson write, "the consumer may simply be doing his best to cope with his lack of objective information concerning relative product quality . . ." (25). Relying on advertising in this way "may represent a reasonable method of minimizing risk, [since] consumers may regard advertising as an implied warranty regarding product performance" (25).

Robert Nelson (1976) suggests that widespread advertising provides some assurance of quality, since a firm that advertises must stay in business long enough to recoup its ad expenditures, and in order to do that, it must offer products of acceptable quality. According to practitioners of the new institutional economics, Nelson (2001) explains, "even advertising that is altogether empty of content (as is often the case for, say, television ads) may still 'signal' important information" (214). Since advertising is expensive, a "true fly-by-night firm would never be able to afford the investment of a large payment for advertising on a television station or other

expensive outlet. It would lose its customers before it would be able to sell enough goods to recover such a large investment cost” (214). Thus, a firm that advertises must offer products that are of sufficient quality to generate repeat customers. As Nelson sees it, by “throwing away” substantial sums on advertising, firms signal to the public that they intend to stay in business, and they assure consumers that the quality of their products will remain high.

Rotfeld and Rotzoll (1976), however, find “little or no correlation” between advertising expenditures and quality in their sample of nationally advertised brands. In their view, the quality difference between highly advertised brands and their non-advertised counterparts might be too small to justify the higher prices consumers are required to pay for advertised goods. Summing up, the authors conclude that no sweeping generalizations should be made about the association between advertising expenditures and quality. “Advertised products,” they write, “are apparently of better quality than non-advertised goods for some products, when rated by certain criteria, in some years” (46). Overall, however, “advertising is not well correlated with product quality,” Rotfeld and Rotzoll report (46).

Based on the results of his study, Schmalensee (1978) suggests a reason for the lack of correlation: Manufacturers of low-quality goods can increase their relative market shares through intensive advertising. So long as their marginal costs are lower than the marginal costs of high-quality firms, they may be able to benefit disproportionately by expanding demand. “For some parameter values,” he writes, “the lowest-quality brands have the largest equilibrium market shares, advertising budgets, and profits. This is especially likely if buyers’ behavior indicates confidence

that better brands spend more on advertising” (485). If advertising persuades consumers to believe that advertising intensity directly correlates with quality, in other words, low-quality firms have a clear incentive to advertise heavily.

According to Telser (1978), however, advertising does provide quality assurance. Since advertising can only increase a consumer’s propensity to make an initial purchase, repeat sales depend on the consumer’s experience with the product, Telser explains. If the quality of the product is unacceptable, the first purchase will be the last, and the investment in advertising will be for naught. For that reason, he concludes, manufacturers subject their highly advertised products to careful quality control.

For the most part, more recent studies find, at best, a tenuous relationship between advertising and quality. Milgrom and Roberts (1986), for example, find that advertising intensity may signal quality, but only when price alone fails to differentiate the product sufficiently. In their words, “inclusion of the pricing decision upsets the intuition that a high-quality producer will have a higher marginal benefit from attracting an initial sale and that this would provide the basis for the high-quality firm’s being willing to advertise more.” Making an argument similar to Schmalensee’s, Milgrom and Roberts note that since high-quality firms tend to have higher costs, if price and quality are held constant and advertising generates additional sales, the marginal benefit of those additional sales is greater for the low-cost, low-quality firm than for the high-cost, high-quality firm.

In a controlled experiment, Hoch and Ha (1986) examine advertising’s influence on consumers’ experience with various product categories. They find that

consumers' evaluations of product quality are unaffected by advertising and depend solely on physical evidence *only* when the evidence concerning the products' quality is unambiguous. When there is any ambiguity in the physical evidence, however, advertising has "dramatic effects on perceptions of quality" (221).

Carpenter (1987) reports that his study of a cross-section of 1,100 firms indicates that price signals quality, but advertising intensity does not. In Carpenter's words, the "net result of [the] sample is no systematic relationship between quality and promotional intensity" (218). Reaching a similar conclusion, Tellis and Fornell (1988) find that the effect of the relationship between levels of advertising and quality is too small—even if positive—to provide any useful guidance for consumers.

In an examination of consumer behavior, Hoyer and Brown (1990) find that test subjects tend to rely on known brands as a "choice heuristic" when asked to sample a set of like products and then select the one they prefer. In a controlled experiment, the subjects who lacked brand awareness tended to select the highest quality brand after sampling the set, while the subjects who were familiar with one of the brands in the set tended to choose that brand—even when other sampled products were actually higher in quality. The authors conclude that "the presence of a known brand in a choice set may have some negative effects on the consumer's ability to detect differences in product quality across brands" (147). Thus, in the Hoyer-Brown study, rather than providing a shortcut method for consumers to infer the actual quality of a product, advertising appears to interfere with consumers' perceptions of actual product quality.

Horstmann and McDonald (1994) fail to find a positive relationship between advertising and quality. Observing that consumers who enjoy a product in the first period may find the same product unsatisfactory in the second period, the authors conclude that advertising provides no signal of new product quality and imperfectly signals the quality of established products. Caves and Greene (1996), after calculating correlations between advertising expenditures, prices, and quality ratings (as evaluated by Consumer Reports) for almost 200 products, also conclude that advertising fails to serve as a signal of quality.

Thomas, Shane, and Weigelt (1998) buck the trend of conclusions concerning the relationship between advertising and quality, however. In their study of the automobile industry, they find that car manufacturers use intensive advertising in order to signal high quality. As they explain it, since it is impossible for potential buyers to evaluate all aspects of an automobile's quality before purchase, carmakers attempt to signal intangible or unobservable attributes by spending "large unrecoverable sums on advertising" (429). According to the authors, the results of their study are consistent with those of signaling-game modelers, who find that makers of high-quality products increase their profits by, ostensibly, squandering money on advertising. Rather than being squandered, however, the firm considers its advertising expenditure an investment that pays off in higher profits.

Sethuraman and Cole (1999) find that among survey respondents the most important factor explaining the premiums that consumers are willing to pay for advertised, national brands compared to unadvertised, store brands is the supposed

difference in quality. Respondents believe that the quality of advertised brands is higher.

Setting aside what respondents believe, Van Osselaer and Alba (2000) cast doubt on the actual existence of a positive association between quality and advertised brands. In a series of experiments with results similar to those of Hoyer and Brown (1990), Van Osselaer and Alba find that once test subjects associate a product's brand name with quality, they tend to inhibit additional sensory information concerning a product's actual attributes and overall quality. "Stated simply," the authors explain, "brand cues may 'block' the learning of quality-determining attribute cues" (14).

Zhao's (2000) results also cast doubt on the hypothesized relationship between advertising and quality. Applying game theory, Zhao finds that the correlation between advertising expenditures and product quality tends to be negative. Compared to high-quality firms, low-quality firms generally spend more on advertising in the separating equilibrium. Zhao notes, however, that in some cases high-quality firms use high-intensity advertising to flaunt their prosperity, hoping that consumers will equate firms that squander money with firms that offer high-quality products. This strategy may backfire, however. According to Zhao, if consumers associate high advertising levels with high quality products, there is a strong incentive for low-quality firms to increase their ad expenditures. "Given that [the low-quality firm's] marginal cost is lower than the high-quality firm's, its profit margin will be much larger in mimicry than in revealing its true quality [and] even greater than the high-quality firm's," he explains (390).

Zhao notes that a number of earlier studies interpret a firm's willingness to squander money on excessive advertising as evidence of the firm's intention to signal high quality. His results indicate that "burning money" alone is an insufficient quality signal, however. In his view, the wiser strategy for high-quality firms is to advertise modestly, at least initially, and allow the price of the good to signal its quality, since mimicry in advertising is a common tactic of low-quality firms.

Tremblay and Martins-Filho (2001) use a game-theoretic model to analyze the positive relationship between advertising and product quality that some previous studies report. According to their model, advertising neither signals quality nor does it induce a firm that introduces a high quality product to maintain its initial quality level.

Whatever the relationship between advertising and quality, *The Economist* (2001) maintains that consumers benefit by relying on advertised brand names, because brands lift "the curtain of anonymity" and make the advertiser "accountable for the quality of its product" (Bagwell 2003, 97). So, while advertising may fail to provide valid signals of quality, it can still help consumers by increasing firms' visibility and thus their accountability. Robert Nelson (1976) makes a similar point.

Reviewing the "huge theoretical literature" that focuses on the association between advertising and product quality, Bagwell (2003) finds some instances of a positive relationship and some instances of no relationship. He concludes that the "main empirical implication is that no systematic correlation between advertising and quality is expected, since the relationship reflects market circumstances and the simultaneous use of price and advertising as signals of quality" (102). In sum, the

evidence reported in the studies mentioned above leans heavily toward the conclusion that advertising intensity fails to relate directly to product quality.

### *An intangible asset?*

Related to the question of whether advertising helps firms create reputations for product quality is the question of whether advertising is an investment in goodwill for the advertiser. A number of studies, questioning the long-term impact of advertising on sales and profits, ask the following question: Are advertising expenditures a type of capital investment?

Some economists, such as Braithwaite (1928), note that advertising can create an enduring reputation for the products it promotes. Borden (1942) suggests that advertising can turn a firm's product into a widely recognized brand; and, by so doing, it can create a "goodwill asset" for the firm. According to Corden (1961), most advertising expenditures may fairly be considered a kind of capital investment—an "investment in the intangible asset of goodwill" (32). Doyle's (1968) review of the literature leads him to the same conclusion.

Stigler (1958) writes: "long continued advertising may have a cumulative impact" (66). Subsequently, Palda (1964), using Koyck's distributed-lag model, reports finding empirical evidence of advertising's lagged effects—effects about which others, such as Stigler, had hypothesized.

Nerlove and Arrow (1962) note the similarities between investments in durable plant and equipment and advertising expenditures. The authors provide, in

addition, explanations for advertising's diminished effectiveness over time. They point out, for one thing, that in the wake of one firm's advertising campaign, other firms advertise as well, and, by doing so, draw away customers from the first firm that advertised. In addition, the authors explain that a successful advertising campaign may reorder individuals' preferences in the short run, but be unable to affect a permanent change. Preferences, they say, have a tendency to revert to their habitual state. Nevertheless, the authors conclude that the impact of an advertising campaign tends to persist, but to a steadily weaker extent over time.

As Comanor and Wilson (1974) see it, treating advertising like a capital asset “implicitly assumes that all the advertising by firms in the industry generates only positive asset values which are added up to obtain the net goodwill stock” (171); however, this ignores the fact that advertising by rivals—and even the advertising of other industries—may create “negative goodwill.” According to the authors, “only the entry-barrier effects of advertising create an unambiguously positive intangible asset that is not at least partly offset by the activities of rivals or firms in other industries” (173).

In addition, Comanor and Wilson maintain that expenditures on advertising and capital differ in two critical ways. For one thing, unlike ad expenditures, many capital expenditures precede the onset of the revenue they generate. The gestation lag that tends to characterize capital expenditures is small or nonexistent for advertising. For another thing, a percentage of a firm's current advertising expenditures can be considered necessary for maintaining the goodwill that earlier expenditures created. Since the maintenance of plant and equipment are expensed, the authors reason, the

portion of advertising devoted to maintaining goodwill should likewise be treated as a current expense.

Dhalla (1978), however, argues that “advertising is essentially an investment and not an operating expense” (88). Utilizing a distributed lag model to measure the effects of advertising at the brand and industry levels, he finds that the marginal advertising dollar sometimes fails to contribute to profit when only the immediate effects of ads are considered, but that advertising is profitable in all of the tested cases—so long as advertising’s carryover effects are included in the model. Rather than being created as a lump sum, Dhalla concludes, sales revenue induced by advertising “flows like a stream over time” (88).

Telser (1978) writes: “One cannot understand advertising without recognizing how it works as a capital asset” (89). While other writers tend merely to designate advertising’s carryover effects (sometimes using words such as “reputation” or “goodwill”) as capital assets, Telser explains, in addition, how advertising capital accumulates. As he sees it, advertising informs consumers about products, and consumers respond to ads by buying and trying some of those advertised products. When consumers try the products, they learn which ones satisfy their preferences; thus, advertising adds to their knowledge of the marketplace. Telser concludes that since advertising increases knowledge, and knowledge is a form of capital, advertising should be considered a capital asset.

Mundstock (1987b) reports that a “substantial body of economics literature” finds an economic similarity between expenditures on advertising and expenditures on depreciable assets. According to that literature, both types of expenditure increase

the future income of the firm, while contributing to its current earnings. Compared to other depreciable assets, however, the value of advertising is intangible, Mundstock explains.

Summers (1987) concurs, noting that investments in advertising differ from tangible investments in that “much of advertising cancels itself out, as firms compete with one another for a pool of customers” (15). Despite that difference, advertising should be treated like a tangible, capital investment for tax purposes, according to Summers, because current tax policy favors intangible-ad investments over productivity-enhancing expenditures.

Sid Bernstein (1988), long-time president of *Advertising Age*, takes up the issue in an editorial. He writes: “The fact is that good advertising does have an extended life. Those fantastic prices currently being offered for top-rated brands are ample proof of that” (16).

According to Arrow, Stigler, Landes, and Rosenfeld (1990), however, the durability of advertising is very difficult to measure, because, for one thing, advertising is an extremely heterogeneous product, and, for another, no good, testable models are available to economists to help them explain the way advertising influences sales. Citing a survey article by Clarke (1976), who finds that depreciation rates vary widely, Arrow and his colleagues suggest that the diverse results of empirical studies may be due to poorly designed economic models. The empirical studies that find advertising is durable, the authors argue, “suffer from serious technical and conceptual flaws” (5).

Nevertheless, Arrow et al. report that studies by Ayanian (1983), Bloch (1974), Hirschey (1982), and Hirschey and Weygandt (1985) all find that advertising is quite durable. Bagwell (2003) notes that Lambin (1976), Peles (1971), and Telser (1962) find that the goodwill advertising creates can affect sales for years. Based on their review of the empirical literature, Corrado et al. (2006) estimate that about 60 percent of total advertising expenditures pay for ads that have long-lasting effects and that the advertising capital that those ads create depreciates about 60 percent annually. Similarly, Kamber (2002) finds that although ad expenditures made in one year (in the case under study, a recessionary year) have an impact on sales in subsequent years, the impact is greatest in the initial year.

On the other hand, Bublitz and Ettredge (1989) find that advertising's effects are short-lived. Likewise, Bagwell (2003) reports that Leone (1995), Boyd and Seldon (1990), Seldon and Doroodian (1989), Ashley, Granger and Schmalensee (1980), and Clarke (1976) all conclude that advertising's impact on sales depreciates, to a great extent, within a year. For his own part, Bagwell (2003) notes that past advertising can create 'goodwill' that influences future sales. While often brief, advertising's goodwill effect can vary in length. Thus, in Bagwell's view, untangling the impact of current advertising expenditures from past expenditures can be problematic.

The Congressional Budget Office (1997) seems to find untangling the impact problematic for much the same reason. Although the CBO recognizes that advertising can provide income beyond the current year by creating goodwill, it notes that advertising's actual depreciation rate is variable, unknown, and controversial.

To reduce the confusion, several studies attempt to estimate the length of advertising's carry-over effect. Baye, Jansen, and Lee (1992), for example, find that ads presented five years earlier have approximately one-sixth the positive impact of current ads on current consumption. Looking at a three-year time span, Lodish et al. (1995) find, in a cross-sectional study, that second- and third-year sales double the impact of the first-year sales of a successful campaign. According to the authors, if the ad campaign fails during its first year, however, its impact on future sales is negligible. Seldon and Jung (1995) find "that advertising effects linger for nine years" (209). At the microeconomic level, however, the authors suggest that advertising's impact depreciates quite rapidly, due to counter-advertising by competitors. Also, in a recent study of the carry-over effect, Corrado, Sichel, and Hulten (2006) estimate that the depreciation rate for advertising capital is approximately sixty percent per year.

In sum, most economists agree that advertising creates intangible capital. Opinions vary over the length of advertising's goodwill effect, however. As Chapter 9 reveals, even more contentious is the suggestion of some economists and policymakers that ad capital should be taxed just as other forms of capital are taxed.

### ***Facilitating or impeding entry?***

According to Taylor and Weiserbs (1972), there is a general consensus among economists that advertising is an important barrier to entry for new firms, and, indeed, many of the early students of the economics of advertising emphasize its entry-

deterrent effect. Robinson (1933), for example, argues that the consequences of advertising are strongly anti-competitive, due to its tendency to deter entry.

According to Kaldor (1950-1951), advertising raises barriers to entry that lead to greater concentration in industry. Analyzing cross-sectional data, Bain (1956) finds that product differentiation creates barriers to entry and that advertising differentiates products by engendering consumer fidelity to the advertised brand. Still, he allows, other factors may present greater obstacles to entry than those that advertising erects.

Braithwaite (1928) suggests that incumbent firms develop reputations through their advertisements that act as entry barriers for potential market participants. In her view, when incumbent firms initially entered the market, they merely needed to create reputations for their products. Aspiring firms, on the other hand, are required not only to create reputations but also to draw customers away from the well-known, incumbent firm. That extra requirement imposes an additional barrier for firms endeavoring to enter the market.

Although the early literature seems to indicate a general agreement among economists that advertising erects barriers to entry, some economists, primarily members of the Chicago School, began to present contradictory evidence in the 1960s, which frayed that early consensus. According to their studies, rather than restricting entry, advertising sometimes facilitates it by enabling new firms to disseminate information about the existence, quality, and price of their products. Telser (1964), for one, expounds that view, concluding that advertising frequently provides a means of entry. While the Economists Advisory Group (1967) offers no support for such a positive declaration of advertising's influence on entry, the Group

nevertheless reports finding no decisive evidence that advertising creates barriers to new firms aspiring to enter a market. In accord with the Economists Advisory Group, Schmalensee (1972) reports finding no evidence for the assertion that the advertising expenditures of some firms create entry barriers for others.

Doyle (1968) concludes that while advertising does raise entry barriers in some industries it would be a mistake to assume that it does so across the board. Instead, due to the heterogeneity of advertising, the issue should, in his view, be considered “on an industry-by-industry basis rather than by searching for global solutions” (596).

Lambin (1976) harks back to Braithwaite, however, explaining that firms create goodwill by advertising and that the goodwill their ads create may lead to purchasing inertia in consumers. Since new firms must somehow overcome consumer inertia, advertising may present a barrier to market entry. According to Lambin, his empirical results “clearly show that a substantial degree of inertia exists in the sample [advertising-intensive] markets,” and that this “is prima facie evidence that advertising helps erect entry barriers” (115). Nevertheless, after finding no statistical relationship between advertising intensity and brand inertia, Lambin attributes purchasing inertia to some other cause; he concludes, in fact, that advertising is positively related to market-share *instability*. As Lambin sees it, this result offers empirical support to those economists who claim that advertising is a destabilizing force, one that motivates consumers to overcome their inertia and try new brands.

Taking a step back, Comanor and Wilson (1974) explain that advertising creates no barriers to entry *unless* potential entrants face higher advertising expenditures to secure a place in the market than incumbent firms initially encountered. They note, however, that aspiring entrants often do find that they must exceed the advertising expenditures of established firms in order to attract customers. For one thing, potential entrants may encounter barriers to entry if economies of scale apply to established-firms' advertising. As the authors explain, such economies may occur if a firm's ads become increasingly effective as their expenditures go up or if the media carrying the firm's ads give quantity discounts. Furthermore, the entrant may encounter a barrier if it is required to pay more to finance its advertising than the already established firm has to pay. Such may be the case, according to the authors, because entrenched firms typically have "lower average costs of capital than new entrants to a market" (61). In some cases, an incumbent will engage in extremely intense advertising to outspend the potential entrant, drown out its commercial messages, and raise a high barrier to entry. Comanor and Wilson refer to this as the "noise effect." (Hilke and Nelson, in a 1984 study, offer evidence that Maxwell House attempted to deter Folger's entry into the coffee market by utilizing this strategy.) Overall, Comanor and Wilson argue that their study of cross-sectional data provides empirical support for the conclusion "that heavy advertising creates a significant barrier to new competition in a number of important industries" (245).

Smiley (1988) and Bunch and Smiley (1992) also find evidence of entry barriers due to advertising. In both studies, the authors conclude that firms use advertising strategically to create loyalty for their own brands and to deter the

entrance of new firms. In a related finding, Bagwell and Ramey (1988) report that low-cost incumbents may deter entry and reap higher profits by over-investing in advertising.

Mundstock describes a different sort of barrier to entry associated with advertising. According to Mundstock (2007, personal correspondence), substantial portions “of most new businesses’ start-up expenditures” are devoted to advertising; however, “Section 195 of the [U.S. Tax] Code disallows the deduction of ‘start-up expenditures.’ Thus, while not aimed at advertising, an important effect of Section 195 is to disallow advertising deductions of new firms.” In Mundstock’s (1987b) view, since incumbent firms can deduct advertising expenditures from their income taxes, while start-up firms cannot, “*new businesses bear an extra tax burden competing with established firms*” (1; italics in the original). This additional expense for new businesses represents a barrier to entry.

Metwally and Tamaschke (1981) offer an indirect reason to explain why advertising may sometimes facilitate market entry. As they see it, advertising increases consumption, and the higher, ad-induced level of consumption may signal the existence of an open, easy-to-enter market environment to potential entrants.

In studies of specific markets, Eckard (1991) (cigarettes) and Sass and Saurman (1995) (beer) find that restrictions on advertising are associated with entry barriers or market-share stability. In both cases, however, the products seem to fall into a special class; i.e., products that can be addictive. With other products, a major goal of advertising is to establish brand loyalty so that people will stick with the advertiser’s brand even when it is priced higher than competing brands. With

addictive products, however, people tend to be particularly brand loyal (Shum 2004). Thus, a major goal of cigarette advertising, according to the tobacco industry, is to persuade users of rivals' products to switch brands (Joossens 2000). While that goal may be common to most advertising, it takes on particular importance for goods like cigarettes and alcohol (Casswell and Zhang 1998; Myers and Roberts 1991). When products are, or can be, addictive, people who use them tend to be accustomed to receiving their "fix" in a certain package, with a particular taste, look, feel, etc. For that reason, users of addictive products tend to resist ads for other brands, and advertisers must overcome their resistance through persuasion. Tareyton cigarettes capitalized on that resistance, from 1963 through 1981, with the highly successful "I'd rather fight than switch!" campaign. By implying that Tareytons were so satisfying that people who tried them once would never consider switching to another brand, the slogan motivated smokers of other brands to switch to Tareytons. At the same time, it appealed to the brand loyalty of the existing pool of Tareyton smokers.

In a study of beer-industry advertising, Seldon, Jewell, and O'Brien (2000) suggest that intense advertising fails to explain barriers to entry. Kadiyali (1996), on the other hand, finds that Kodak used high-intensity advertising and limit pricing to maintain entry barriers (and a monopoly position) for many years in the photographic film industry.

Summing up the relevant literature, Bagwell (2003) writes: "In total, the direct evidence of the association between advertising and entry is somewhat mixed. Advertising may be used to raise the cost of entry, but it also may be the means of effective entry. The appropriate interpretation of the advertising-entry relationship is

subtle and seems to vary across industries” (47). In addition, the author notes, endogeneity and measurement problems make drawing broad inferences about the relationship between advertising and entry problematic in any case. Nevertheless, the bulk of the studies seem to indicate that advertising tends to erect barriers to entry in at least some industries.

### ***Advertising and market power***

A common area of interest among students of the economics of advertising concerns the extent of an association between market power and advertising.

In the minds of many of the early students, the association seems to be confirmed. Robinson (1933), for example, maintains that advertising generates and sustains market power. In its absence, she suggests, price competition would provide market discipline. Bain (1956) finds that advertising can be “a source of high and very high barriers” (282), which can enable established advertisers to earn monopoly profits. For the same reason, Nicholls (1951) finds that advertising expenditures are responsible for high aggregate profits for incumbent firms (in the American cigarette industry).

Telser (1964) suggests two reasons to suspect a relationship between advertising and market power. First, since firms that do have some monopoly power can rely on getting most of the ad-stimulated sales, they are more likely to advertise than firms without it. Second, firms can gain a measure of market power by differentiating their products through advertising. Nevertheless, Telser reports that

the results of his empirical study provide no support for the charge that advertising is anti-competitive. If “advertising succeeds in sheltering a firm’s products from competitive inroads,” Telser reasons, “this should be reflected in more stable market shares of the more advertised goods” (547). The results of his study indicate that the opposite is true.

Nevertheless, Simon (1970) reports that the literature generally concludes that advertising, combined with industry concentration, results in market power and above-average profits. Economists generally regard market power as undesirable, Simon explains, because firms that have it: (1) tend to earn high profits by charging high prices; (2) may be less motivated to innovate and improve efficiency; and (3) may have disproportionate social power. By Simon’s analysis, however, the available data fail to indicate whether the elimination of advertising would result in more or less market power. “Every sort of effect would probably appear in some industry,” he writes.

Doyle (1968) expresses some uncertainty about the association between advertising and market power, as well, noting that firms are often unable to estimate the required level of advertising expenditures to maximize profits over the long-term, due to their inability to isolate advertising’s impact on profits from the “welter of other factors” that influence sales and profits (595).

For many of the more recent students of the economics of advertising, a relationship between advertising and market power is assumed, but the direction of causality is ambiguous. Schmalensee (1972), for example, considers advertising to be an endogenous variable. In his view, it may even be possible that profitability causes

advertising—rather than the other way around—if firms devote part of their profits to advertising. Thus, treating advertising as if it were an independent variable can lead to spurious results, Schmalensee explains.

Comanor and Wilson (1974) attempt to respond to the concern about endogeneity (expressed by Schmalensee, among others) by extending their analysis to control for a number of factors. In the authors' view, the hypothesis that firms in ad-intensive industries have the ability to increase price-cost margins and, thereby, reap greater profits than firms in less ad-dependent industries is consistent with the empirical evidence. The results of their research, based on cross-sectional data, indicate the existence of an association between advertising and high profits in some industries. In their view, the profit increase is due to advertising's ability to exploit the gains of product differentiation effectively. "Our primary finding," the authors write, "is that heavy advertising leads to increased profits" (130).

Several economic inefficiencies inhere to ad-induced market power, Comanor and Wilson note. One is the technical inefficiency that occurs when actual average costs exceed minimal average costs; the second is the dead-weight loss that arises when prices are higher than marginal costs; the third derives from the income that consumers transfer to the firms that have market power. Over all, the authors note, advertising is likely to induce inefficiencies because it leads to resources being allocated in a manner other than in accordance with consumer preferences. The authors "conclude that the costs of market power in the consumer goods industries are significant and that advertising itself directly and indirectly accounts for a substantial portion of these costs" (245).

Philip Nelson (1974) seems to undermine the notion that advertising leads to market power and high profits, however. In his view, the firms that advertise most intensively tend to be the ones that are most efficient. Thus, their efficiency—not their advertising—explains their high profits.

More recent studies, looking merely at the extent of the association between advertising and market power, and not at causation, offer inconsistent results. Erickson and Jacobson (1992), for example, investigating whether advertising enables firms to reap “supranormal” profits, report finding substantially smaller stock market and accounting returns in their study than had been found by earlier researchers.

In a study conducted for the Association of National Advertisers, the New England Consulting Group (Levin 1993) finds that although advertising increases firms’ sales reliably, it fails to boost firms’ profits consistently. Examining same-year as well as ten-year effects, the authors report finding a strong relationship between five of the ten advertised brands they tested and increasing profits, however.

Bagwell and Ramey (1988) report that their model predicts that intensive advertising by established firms is related to reduced entry rates and high profitability levels. Rather than explaining the profits as being the result of “advertising-induced brand loyalty” (as some economists have), the authors suggest, in accord with Philip Nelson, that incumbent firms advertise more and are more profitable because they are more efficient.

Tremblay and Martins-Filho (2001), on the other hand, find that firms create brand loyalty through persuasive advertising, which, along with vertical differentiation, allows them “to create greater real and perceived distance between

products” (3). Once they have created that distance, according to the authors, firms are able to dampen price competition and increase market power.

In a study of the impact of advertising across four media (newspapers, magazines, radio, and television), however, Notta and Oustapassidis (2001) find that television is the only medium that significantly increases profitability. In addition, the authors note that the profit increases associated with television occur only in the case of high-intensity, consumer-goods advertising. Andras and Srinivasan (2003) find, meanwhile, that high advertising intensity is both positively and significantly associated with the profit margins of consumer product organizations.

Summarizing the empirical literature, Bagwell (2003) finds evidence of a positive association between advertising and profitability for producers of consumer goods. The strongest association, he notes, is for convenience items. For producer goods, the relationship between advertising and profitability is positive, but less strong. For retailers, the association between advertising and profitability seems to break down, however. In fact, some studies predict an inverse relationship between retailers’ profit margins and manufacturers’ advertising intensity. According to Bagwell, this negative relationship may be explained, in part, by a temptation among manufacturers to raise the wholesale price of heavily advertised products or by the practice among some retailers of using heavily advertised products as loss leaders.

In sum, although the extent (and even the existence) of an association between advertising and profitability seems to depend on a number of factors, the bulk of the studies indicate that advertising does tend to facilitate market power.

## *Advertising's impact on prices*

“Does advertising raise or lower prices?” is a question that many economists attempt to answer. Braithwaite (1928), one of the first to address the question, concludes that advertising tends to raise prices, because it artificially differentiates products and concentrates markets.

Chamberlin (1933), another early student of the economics of advertising, explains that advertising may lead to either higher *or* lower prices. Since producing and disseminating advertisements adds to the firm's costs, firms often raise the prices of their advertised products to recoup those costs. Advertising can lead to lower prices, however, if it expands demand for a firm's goods to such an extent that it enables the firm to attain economies of scale. If that occurs, the firm's costs of production or distribution may fall more than advertising raises them, and the firm may offer lower prices.

According to Chamberlin, advertising can also raise or lower prices by affecting the elasticity of demand for a firm's output. When persuasive advertising creates wants and engenders brand loyalty, the absolute value of the elasticity of demand for the advertised good tends to fall, and the price of the good tends to rise. The converse impact on elasticity and price tends to occur when ads provide factual market information that enables consumers to compare competing products. Informational advertising about a firm's output, in other words, tends to increase the elasticity of demand for the product and, in turn, lower its price. Overall, Chamberlin

concludes: “The effect of advertising in any particular case depends upon the facts of the case” (167).

Dorfman and Steiner (1954) confirm Chamberlin’s conclusion. Their formal theory suggests that advertising’s price impact depends on the extent to which advertising affects both economies of scale and elasticity of demand.

Taking a different approach, Borden (1942) examines whether advertising frees firms from engaging in price competition. He concludes that strong forces within the economic structure “counterbalance any tendency for competition to turn solely to non-price forms and for sellers to be free from price competition” (862). Nevertheless, firms that are able to differentiate their products through advertising sometimes choose that course rather than compete by lowering prices. In addition, manufacturers of many advertised brands assume they can maintain steady prices during economic downturns without losing sales because their ads have made demand for their products relatively inelastic. Ultimately, such inconsistent results lead Borden to conclude that advertising’s impact on price varies from industry to industry and brand to brand.

According to Kaldor (1950-1951), advertising can affect prices directly and indirectly. The direct effect is to raise prices, because advertising is priced jointly along with the product. Since no separate market for advertising exists, consumers must buy the product’s ad, if they buy the product. When advertising concentrates markets, it can have the indirect effect of raising or lowering prices. It tends to raise prices if the ad-induced concentration enhances the surviving firms’ market power. If

economies of scale result from the industrial concentration, however, surviving firms have the option of passing along the savings to their customers.

Corden (1961) seems to side with advertising's critics in doubting that advertising-induced concentration of industries leads to lower prices in the final analysis. According to Corden, the costs of advertising can overwhelm the economy-of-scale savings, in which case, as far as consumers are concerned, ad-induced industrial concentration provides no benefit. As Corden sees it, some firms intentionally use advertising to attain market security and set their prices higher. Corden thus concludes that, on balance, advertising tends to raise prices.

In separate studies using cross-sectional data, Bain (1956) and Comanor and Wilson (1974) determine that advertising engenders brand loyalty, which allows advertisers to charge high prices without encouraging new firms to enter.

Agreeing with ad critics, the Economists Advisory Group (1967) concludes that prices of advertised products tend, in general, to be higher, even though competition with unadvertised products provides some market discipline. Doyle (1968) goes further, suggesting that advertising can raise prices so much it can actually spur inflation.

The view that advertising raises prices is far from universal, however. According to Ozga (1960), Stigler (1961), and P. Nelson (1974), high prices are the result of consumer ignorance. By providing market information, advertising enhances market performance and, in fact, lowers prices.

Supporters of advertising frequently reference a study by Benham (1972) as evidence that advertising has a price-lowering effect. In that study, Benham

examines the impact of advertising on the price of eyeglasses. He finds that eyeglass prices are lower in states that allow eyeglass advertising than in those that do not. According to Benham, although eyeglass prices are lowest in states that allow price advertising, they are lower even in states that allow only non-price advertising than in states that allow no advertising at all. Benham concludes that his results “are consistent with the hypothesis that, in the market examined, advertising improves consumers’ knowledge and that the benefits derived from this knowledge outweigh the price-increasing effects of advertising” (349).

Although Benham recognizes that prices of eyeglasses might be a special case, some advocates for advertising apply his results to advertising in general. The validity of doing so seems dubious, however. For one thing, the population of eyeglass wearers varies little with eyeglass price. As Benham notes, demand for eyeglasses is inelastic. Thus, when optometrists advertise, the size of the eyeglass market remains relatively stable, and those who advertise tend to steal business from those who do not. Given this business-stealing externality, non-advertising optometrists might lower their prices in order to retain patients and protect their market shares.

In addition, prior to the onset of eyeglass advertising, patients probably selected optometrists, as they did doctors and dentists, on the basis of reputation, proximity, or both. When patients focused on the optometrist, he or she was, in effect, a monopoly provider of a good with inelastic demand. Since quality of service is difficult to convey through advertising, optometrists’ ads tended (then, as they do now) to focus on eyeglass price and selection. Once advertising shifted the

consumer's focus from the service (optometry) to the product (eyeglasses), optometric services became more homogeneous. Less central themselves, optometrists differentiated their practices from those of their rivals by advertising, lowering their prices, or both.

Do the results of studies of advertising's impact on the prices of eyeglasses apply to its impact on the prices of other goods? That hardly seems likely. As the above discussion attempts to show, eyeglasses are probably a special case. The results may not even apply to the eyeglass industry any longer, since the price-lowering effect may have been associated with the impact of the *introduction* of advertising on the prices of eyeglasses. Given that the introduction of eyeglass advertising took place decades ago, the price-lowering effect may have long since dissipated.

Nevertheless, a number of studies, other than Benham's, find that advertising tends to lower prices. Lambin (1976), for example, suggests that firms may respond to competitors' "advertising assaults" by adjusting their own advertising, product quality, or price. "Thus," he concludes, "advertising may in some cases stimulate, rather than inhibit, price and product quality competition" (163).

Stigler and Becker (1977) are confident that advertising lowers *perceived* prices. As advertising intensity increases, the authors explain, "the household is made to believe—correctly or incorrectly—that it gets a greater output of the commodity from a given input of the advertised product" (84). Thus a particular good at a given price seems to be a better deal if it is advertised than it would seem to be if it were unadvertised. The advertised good delivers greater output, in other

words, because the advertisement *persuades* the consumer that the good delivers greater output, whether or not it truly does. As Stigler and Becker see it, advertising seems to lower the prices of goods from the consumers' standpoint, because consumers believe that they get more for their money when they buy an advertised product.

According to Carpenter (1987), not only can advertising lower perceived prices, it can also lower actual prices. Advertised products, he finds, tend to have low price-cost margins, since advertisers engage in intense price competition.

Arrow, Stigler, Landes, and Rosenfeld (1990) maintain that advertising lowers prices, as well. In their ad-industry-commissioned study, the economists discuss a 1974 experiment in which consumers in one city—but not in a second—received information (in publications or in the mail) about food prices. During the experimental period, food prices were lower in the informed city than they were in the uninformed city. After the experiment ended, the prices in the informed city returned to their previous, pre-experiment levels. According to Arrow et al., this study provides evidence that advertising tends to lower prices. Given the seemingly artificial nature of the experiment, the authors' conclusion seems debatable, however.

Bagwell (2003) notes that because advertising is an alternative source of pre-purchase information to point-of-sale services, high-intensity brand advertising by manufacturers allows retail stores to cut back on sales personnel. High-intensity advertising also stimulates high-level demand, which encourages retail firms to invest in cost-reducing technologies (Bagwell 2003; Bagwell and Ramey 1994). As a result

of the capital investments and personnel reductions, the firm's costs tend to fall, and the resulting savings can be passed on to consumers.

Reviewing the body of literature, Bagwell (2003) notes that a number of empirical studies (e.g., Borden 1942; Telser 1964; Backman 1967; Nickell and Metcalf 1978; Scherer and Ross 1990; and Tremblay and Tremblay 1995) find that ads persuade consumers to pay more for advertised brands than for similar, but less-advertised goods. According to Bagwell, however, consumers' willingness to pay more for advertised brands might be explained not by the ad's ability to persuade consumers falsely of the product's superiority but by the higher quality or the assumed prestige that inheres to the product.

Some studies, Bagwell notes, find that heavily advertised brands actually sell for less in retail markets than other, less-advertised goods. Bagwell suggests that in such cases, the brands might be serving as loss leaders. Since certain brands are highly identifiable, they can operate as benchmarks for consumers to compare prices across retailers. When the prices of these highly advertised brands are low, consumers assume, rightly or wrongly, that other prices will be low, as well. Thus, consumers pay less for the loss leaders, but whether they actually save money on their overall purchases is an open question.

In sum, the studies fail to indicate definitively whether advertising raises or lowers prices. As with many other questions about the economic impact of advertising, the answer depends on numerous variables.

### ***Impact on the elasticity of demand for an advertised product***

Does advertising increase or decrease the elasticity of demand for an advertised product? The answer to that question is: It depends. Nerlove and Arrow (1962) find that advertising can increase elasticity by broadening the market for a product, or it can reduce elasticity by engendering brand loyalty. Chamberlin (1933) finds that advertising can increase or decrease the elasticity of demand for a product, as well.

In a study of short- and long-term advertising effectiveness, involving 128 econometric models, Assmus, Farley, and Lehmann (1984) find that the elasticity of demand for advertised goods varies across settings and products. Specifically, the authors find that elasticities are lower in the United States than they are in Europe and that elasticities are higher for advertised foods than for other products. In addition, they note that when models incorporate the carryover (i.e., goodwill) effects of ads, short-term elasticities are significantly lower than when carryover effects are ignored; furthermore, long-term elasticities are even lower than short-term elasticities when carryover effects are incorporated.

Krishnamurthi and Raj (1985) also find that advertising tends to reduce the elasticity of demand for advertised products. Analyzing panel data derived from consumer diaries, the researchers conclude that as advertising increases, demand for the brands that the subject families purchase regularly becomes less elastic.

Evaluating the relevant literature, Bagwell (2003) explains that although some studies find a relationship between advertising and inelastic demand, the assumption that causation runs one way—from advertising to inelasticity—may be false. Rather,

advertisers may be “attracted to markets in which consumers are poorly informed” or may choose to “operate in markets with inelastic demands” (26).

### ***Comparing average price elasticity to average advertising elasticity***

In addition to studies that examine advertising’s impact on the elasticity of demand for a product, some studies consider whether demand is more responsive to changes in price or changes in advertising. Such studies compare average price elasticity to average advertising elasticity (defined by Broadbent (1989) “as the percent increase in sales when advertising is increased by 1 percent”).

Tellis (1988b), for example, considers whether markets are more responsive to changes in advertising intensity or to changes in price using estimates of average elasticity as his basis of comparison. In a meta-analysis of 367 econometric models, he finds an average price-elasticity estimate of -1.76. Comparing that figure to 0.22, an estimate of the average advertising elasticity by Assmus, Farley, and Lehmann (1984), Tellis concludes that the benefit of price cuts to consumers exceeds the benefit of additional advertising and that markets are less responsive to changes in advertising intensity than to changes in price.

Broadbent (1989) agrees with Tellis that the average advertising elasticity (0.22) is much lower in absolute value than the average price elasticity (-1.76). In his view, however, increasing the intensity of advertising sometimes contributes more to increasing demand than does lowering the price. While cutting prices increases sales more than increasing advertising does *on average*, in many *specific* instances, raising

the intensity of advertising is more effective than cutting prices. Thus, Broadbent implies agreement with Chamberlin, Nerlove and Arrow, Assmus et al., Krishnamurthi and Raj, among others, who find that advertising may reduce the elasticity of demand for the particular, advertised product.

### ***Advertising and industrial concentration***

According to Corden (1961), the essential, economic case made by advertising's early proponents is that advertising concentrates industries and thereby helps to bring about the benefits associated with mass production and distribution.

Accepting the common view as axiomatic, Kaldor (1950-1951) explains why the industry-concentration process set in motion by advertising tends to lead to an oligopolistic, rather than a monopolistic, market structure. According to Kaldor, when the ad investments of one firm are greater than those of its competitors, "the 'pulling power' of the larger expenditure must overshadow the smaller ones" (13). Consequently, the big ad-spenders' sales forge ahead, while the smaller advertisers' sales lag behind. In markets that had previously been constituted by firms of approximately the same size, the new market leaders "are bound to increase their lead, as the additional sales enable them to increase their outlay still further" (13). The market structure becomes more concentrated, as large advertisers increasingly dominate the industry. At some point, however, "the market becomes 'saturated' with advertising" (14). When additional outlays yield only rapidly diminishing returns, the surviving firms are less and less able to take market-share from their

rivals by increasing their ad expenditures. “Hence,” Kaldor explains, “the ultimate effect of this concentration process is much more likely to be some form of ‘oligopoly’ . . . than monopoly” (14).

In an explication much like Kaldor’s, Corden (1961) describes advertising’s role in structuring markets as a transformational process that begins with a competitive market, proceeds through a period of ad-induced industrial concentration, and culminates in an oligopolistic market structure. He suggests that if, say, fifty firms in an industry all initially advertise, the ones that advertise more intensively or more effectively increase their market-share. As these firms expand, “they find that their costs fall, enabling them to expand even further either by lowering prices or, more likely, by advertising even more” (16). Since, in Corden’s view, advertising yields its own economies of scale, the more these market leaders advertise, the more effective their advertising becomes. Over time, more and more of the firms in the original group of fifty drop out of the market, as they find that they are unable to compete with their big-ad-spending rivals. “The process will go on,” Corden writes, “until there are a few large firms left, competing against each other not by price cuts but by advertising” (16).

Other studies offer a line of conclusions that seems to zigzag across time. Examining twenty industries, Bain (1956) finds that advertising tends to concentrate industries indirectly by instilling brand loyalty. Telser (1964) finds a weak, unimpressive relationship between advertising and concentration in a study involving forty-two groups of consumer products. The Economists Advisory Group (1967) fails to find a “systematic relationship” between advertising and concentration. After

reviewing the relevant literature, Doyle (1968) goes one way and then turns back—first finding that some studies confirm a positive relationship in certain industries between advertising and oligopoly and then noting that evidence of an association between advertising and concentration seems to be lacking for industries, overall. Simon (1970) simply says that evidence of stable or decreasing concentration among brands “suggests that whether or not advertising has an important role in increasing concentration is itself not too important a question” (235).

Comanor and Wilson (1974) consider advertising’s impact on concentration and reach a surprising conclusion. While some of the early students of the economics of advertising (e.g., Pigou, 1932; Chamberlin, 1933) express doubts about the efficacy—even the reasonableness—of advertising homogeneous products (as noted above), Comanor and Wilson explain that advertising may be used in order to concentrate such markets. They begin by positing that advertising exhibits some of the attributes of a public good, in that one firm’s advertising may help or hurt the sales of its competitors. Whether it helps or hurts depends, primarily, on whether the goods being advertised are homogeneous or heterogeneous. In the case of homogeneous products, one firm’s advertising creates positive externalities for the advertisers’ competitors, and the entire industry benefits from the ads of any single supplier. Since the advertiser reaps only a small portion of the derived benefit, profit-seeking suppliers of homogeneous goods should be expected to advertise little, if at all. However, if certain firms within an industry find ways to concentrate the market—by branding their goods and advertising, for instance—the firms that capture large market-shares can internalize benefits that were once external. Thus, Comanor

and Wilson conclude, “for relatively homogeneous products, we should expect a positive relation between concentration and the level of advertising” (144). This implies that a single firm (or small group of firms) can use advertising to concentrate and thereby dominate a homogenous market. Take, for example, Sunkist Oranges, Morton’s Salt, or C&H Sugar. These firms distinguish products—which are essentially identical to those of their competitors—by advertising, and the benefit derived from their ads accrues nearly exclusively to the firms themselves, rather than to the industries of which they are a part. As a result of their advertising, the firms come to dominate their industries, and their respective markets become more highly concentrated.

In the case of multi-firm, heterogeneous-product markets, the benefits of advertising tend to accrue to the advertiser alone. As Comanor and Wilson explain, the firm ignores the *negative* (business-stealing) externalities that inhere to its advertising when it determines the level of its ad expenditures. In the face of increasing market concentration, however, a firm may or may not increase its advertising. Some factors tend to discourage advertising. When a market is concentrated to the point of oligopoly, for instance, a firm’s anticipation of how its competitors will react if it increases its advertising may deter it from making additional advertising expenditures. If, on the other hand, greater concentration in a market leads to higher price-cost margins, then firms will tend to engage in higher levels of advertising. In the case of oligopolies, where price competition is problematic, firms may depend on advertising as their primary arena for combat. This suggests to the authors that “an increase in concentration up to a certain point

might lead to increased advertising activities as rivals respond competitively to each other's advertising" (145). Past that point—that is, the point at which the market concentrates into a completely collusive oligopoly or into an absolute monopoly—advertising expenditures should decline. Thus, the authors' results indicate that ambiguity characterizes the overall relationship between concentration and advertising.

Some later studies find instances of a predictable relationship between advertising and concentration. Metwally and Tamaschke (1981), for example, report that their "simultaneous-equation aggregate and disaggregate analyses suggest that advertising intensity is an important determinant of market concentration and vice versa" (283). And Bagwell and Ramey's (1994) retail-market model indicates that advertising tends to produce a concentrated structure.

In sum, many economists argue that advertising tends to concentrate markets; some, however, maintain that it does not. Economists in the latter camp (e.g., Telser, 1964) suggest that advertising allows prospective market entrants to inform the public of their existence, which facilitates entry and promotes market expansion. Many of the advocates of the opposing view contend, however, that advertising tends to concentrate markets by artificially differentiating the advertiser's product from those of other firms in the industry. Reviewing the economic literature overall, Bagwell (2003) concludes that the "relationship between advertising and concentration is complex" (40).

## *Impact on economies of scale*

By the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, with the Industrial Revolution well in its stride, significant technological innovations in communications and transportation inspired manufacturers to develop more efficient methods for the production and distribution of their goods. Enabled by these innovations, many manufacturers attained economies of scale and recognized that they could boost their profits—if they could stimulate demand sufficiently to match buyers to their increased output. Subsequently, many firms adopted advertising as a demand-stimulating tool (Cross 2000; Schudson 1984).

Many of the early observers of advertising's economic impact assumed that advertising leads to economies of scale in production. As Pigou (1932), for example, explains, “some advertisement serves to develop an entirely new set of wants on the part of consumers,” and the development of those wants “on a large scale at the same time enables the commodity that satisfies them to be produced on a large scale and, therefore, cheaply” (n.p.). Braithwaite (1928) concurs. She writes: “In practice it appears that considerable price reductions have in many cases resulted from the increased output which advertisement has made possible. Indeed it is probably true to say that advertisement has played a great part in facilitating . . . economies of standardization and mass production” (27). In concert with Pigou and Braithwaite, Chamberlin (1933) maintains that advertising enables firms to attain economies of scale in production due to its positive impact on demand.

Some economists examining the evidence dispute the assumed existence of a tight association between advertising and economies of scale, however. Borden

(1942), for example, argues that establishing a causal link between advertising and reduced costs of production is impossible. In his view, although advertising has facilitated economies of scale in some industries by generating high-volume demand, its use is neither necessary nor sufficient. Some industries, he explains, have been able to generate ample demand to produce economies of scale in their manufacturing operations without advertising. Other industries have failed to attain production economies even though they advertise heavily. In addition, Borden notes, the cost of advertising sometimes exceeds the savings associated with large-scale production economies when they do occur. Thus, in his view, the causal link between advertising and reduced costs of production is unproven.

Extending Borden's line of thought, Kaldor (1950-1951) explains that if there were no advertising, firms would be "driven to compete on the basis of price, and price-competition would [bring] about the same result, in a more beneficial way to the consumer" (14). Still, Kaldor acknowledges, advertising can lead to concentrated markets, which can, in turn, lead to economies of scale, if the firms that survive the concentration process invest in cost-saving technologies. In such cases, advertising may, in fact, benefit consumers, even if price-competition would benefit them more. When concentration within industries fails to eventuate in economies of scale, however, the advertising-induced concentration "is definitely harmful," because it raises the prices paid by consumers, restricts the entry of market newcomers, and increases the market power of the advertisers.

According to Corden (1961), the "essential case in favour [*sic*] of advertising," is that it brings about concentration within industries, enabling the

strong, remaining firms to achieve economies of mass production and distribution. The proponents of this argument contend that the cost-savings associated with ad-facilitated economies of scale are not “swallowed up” by advertising expenses; rather, they are passed on to consumers in the form of lower prices.

As Corden sees it, however, the pro-advertising argument should be challenged. For one thing (as Kaldor also explained), the requisite concentration could be achieved through price competition, instead of advertising. For another, a public or private product-information service could provide more accurate and reliable information than consumers receive from advertising; and, if the public were sufficiently informed, competition based not on advertising but on price and quality could concentrate industries sufficiently to enable economies of scale. Furthermore, “in some of the most heavily advertised fields of industry firms have not thought it necessary to concentrate production in a single plant,” Corden writes (17).

Drawing on a study by Nicholls (1951) of the extent to which advertising concentrates the U.S. cigarette industry, Corden notes that none of the major firms locate all of their production facilities in one big plant to take advantage of economies of scale. Above a certain sales volume, the Nicholls study concludes, advertising alone yields higher returns for cigarette manufacturers. This suggests to Corden that the extent of concentration may exceed what is required to achieve economies of scale in production (17). (On the other hand, economies in distribution may provide an additional explanation for the dispersed production, Corden admits.)

According to Doyle (1968), the argument that advertising enables economies of scale is unconvincing for a large percentage of ad expenditures. He writes: “It is

generally accepted that high advertising is associated with product differentiation and rapid obsolescence of products. To the extent that in practice advertising is a causal factor in this situation, the economies-of-scale argument is reversed—advertising prevents standardization and the benefits of scale economies” (583-584).

Furthermore, he explains, “even where advertising does produce cost savings, its effects on prices are not unambiguous [but] will depend to a large extent on the number of firms in the industry and the degree of price competition” (584-585).

Echoing Corden, Doyle notes that some studies (e.g., Bain 1956; Nicholls 1951) find that in a number of industries the optimal firm size for advertising purposes greatly exceeds the optimal firm size for production purposes. “Where this is the case the dangers of oligopoly may be increased without any benefit of increased productive efficiency,” he maintains (584).

On the other hand, in a more recent study of retail markets, Bagwell and Ramey (1994) find that advertising tends to produce a concentrated structure that utilizes economies of scale to lower consumer prices.

### **Economies of scale in another sense**

The literature reveals two different senses by which economists associate economies of scale with advertising. In the early literature, when economists discuss the association, they are generally referring to an indirect process by which advertising concentrates industries, and the surviving firms invest their profits in production (or, in some cases, distribution) technologies that allow the firms to attain

economies of scale. In the previous section, that is the sense in which the term “economies of scale” is used.

A related sense of the term is one that is used in a number of studies that seek to determine whether or not economies of scale *in advertising* exist. These studies investigate, in other words, whether advertising, itself, is subject to economies or *diseconomies* of scale. As Bagwell (2005) explains, although “scale economies are normally defined with reference to a proportional increase in *all* inputs, . . . under some circumstances, . . . the costs of advertising and production are plausibly separable . . .” (34; italics in the original). Since economies of scale in advertising can lead to economies of scale in production or distribution if firms invest ad-inflated profits in cost-saving technologies, the distinction between the two senses of the term can be fuzzy. To clarify, in one sense, advertising may lead to economies of scale in production or distribution (indirectly) by concentrating industries. In a second sense, an advertising campaign can become more effective as expenditures increase, and, in that way, increasing expenditures can lead to scale economies in advertising.

Chamberlin (1933) may have been the first to discuss economies of scale in this second sense. In his view, increasing returns to scale in advertising are likely to exist. For one thing, a firm may not know, initially, which advertising medium will most effectively promote its products. If, with experience, the firm shifts to more and more effective media, it may experience increasing returns as its advertising increases. In addition, exposure to increasing quantities of a firm’s advertisements may make consumers more responsive to the suggestions the ad makes. At some point, however, Chamberlin explains, increasing returns to scale in advertising give

way to diminishing returns. The primary reason that Chamberlin provides for diminishing returns might be called the low-hanging-fruit effect; that is, advertising exploits the most susceptible consumers first. Subsequently, as advertising expenditures grow, they meet increasing sales resistance.

Kaldor (1950-1951) offers a similar assessment. As he explains it, advertising sometimes saturates a market. When it does, further expenditures “yield rapidly diminishing returns” (14). Ozga (1960) concurs. Distinguishing his work from Chamberlin’s, he explains that, according to his model, diminishing returns are due to the fact that a firm’s advertising effort is increasingly wasted as more and more people who have already seen an ad and are familiar with its content are exposed to the ad over and over again.

Corden (1961) sees the matter differently. In his view, successful advertisers’ businesses expand at the expense of non-advertisers and less-successful advertisers. Their subsequent success allows them to advertise even more. “And the more they advertise the more effective [their advertising] gets, for advertising yields economies of large scale,” he writes (16). Simon (1970), on the other hand, argues that “there is not one single piece of strong evidence to support the general belief that increasing returns exist in advertising” (21). In his view, although firms that advertise multiple goods may experience increasing returns, for individual brands the “efficiency of advertising always decreases” (22). Schmalensee (1972) agrees, explaining that expanding the number of ad observers without increasing the number of repeat exposures is generally impossible. For that reason and for “other a priori

considerations . . . any firm must eventually encounter diminishing returns to advertising messages” (244).

In their analysis of advertising expenditures, however, Comanor and Wilson (1974) find a pattern that appears to be consistent with the existence of economies of scale in advertising. The results of their empirical analyses, they write, “suggest that there are net advantages to large firms—beyond those attributable to economies of large-scale plants—in industries in which product differentiation via advertising is an important dimension of industry structure” (234).

Nevertheless, Lambin (1976) finds “*strong evidence that decreasing returns to the advertising factor is the general rule*” (95; italics in the original). In his view, once advertising expenditures surpass a threshold level, their efficiency “always decreases.” Lambin, like Chamberlin, suggests that advertising’s effectiveness seems to be subject to a low-hanging-fruit effect. “In most market situations,” he writes, “the pool of readily susceptible buyers is quickly exhausted” (97-98).

Simon and Arndt (1980), after reviewing more than one hundred studies, conclude that advertising’s response function exhibits diminishing returns. Regardless of the category of advertised product, advertising media, geographical area, or researchers’ methodologies, the conclusions of all the studies are substantially the same: Decreasing returns to scale characterize advertising. In addition, Simon and Arndt find no reliable cases in which advertising manifests increasing returns to scale. Going further, Seldon, Jewell, and O’Brien (2000) find evidence of *diseconomies* of scale for advertising in their examination of more than ten years of beer-industry data.

In sum, the literature reveals two different senses by which economists associate economies of scale with advertising: (1) Advertising can concentrate industries, leading to reduced costs of production or distribution; and (2) advertising can be more effective as ad expenditures rise. In the first sense, although many early students of the economics of advertising suggest that advertising leads (indirectly, via concentration of industries) to economies of scale in production or distribution, a number of later researchers dispute the assumed relationship or argue that less wasteful methods of achieving scale economies are both possible and preferable. In the second sense, studies generally indicate that—past a certain point—the effectiveness of a firm’s advertising tends to decrease as its expenditures increase.

### ***Advertising and selling costs***

*Advertising is a valuable economic factor because it is the cheapest way of selling goods, particularly if the goods are worthless.*

—Sinclair Lewis

The debate concerning advertising as a selling cost seems to have been waged, for the most part, among the earlier students of the economics of advertising. Selling costs, Braithwaite (1928) writes, “are made up of the expenses of all middlemen and of those expenses which the producer incurs, over and above the cost of manufacture, in the process of selling goods” (16). According to Braithwaite (1928), selling costs—*true* selling costs—are as much part of a product’s final price as are any of the costs of manufacture. Advertising expenditures, however, are not true selling costs,

in her view. “Advertisement cost,” Braithwaite writes, “represents expenditure by the seller, not in putting the goods on the market, but in inducing the buyer to accept them” (17). Being arbitrarily added to production costs, “the sums spent on advertisement are not on a par with other costs, and cannot be considered as part of the ordinary cost of production of the commodity,” Braithwaite writes.

Chamberlin’s (1933) conception of selling costs differs from Braithwaite’s. He writes: “Selling costs are defined as costs incurred in order to alter the position or shape of the demand curve for a product” (117). Thus, Chamberlin categorizes advertising as a selling cost for the very reason that Braithwaite rejects that categorization; that is, for Chamberlin, advertising is a selling cost because firms incur advertising expenditures in order to change their demand curves. Whereas production costs are “made to adapt the product to the demand,” selling costs are “made to adapt the demand to the product,” Chamberlin explains (125).

In Kaldor’s view (1950-1951), the distinction between production and selling costs is “merely the consequence of the (tacit) insistence of economists on looking upon a ‘product’ as a single, indivisible whole,” rather than “a basket containing a bundle of commodities” (22). Kaldor quotes Knight, who writes: “In fact, the advertising, puffing, or salesmanship necessary to create a demand for a commodity is causally indistinguishable from a utility inherent in the commodity itself” (qtd. in Kaldor, 22). Kaldor maintains, however, that consumers have no way of refusing advertising when they purchase the rest of the commodity-bundle.

According to Comanor and Wilson (1974), the selling costs incurred through advertising can be high—to the detriment of the public. The “cost inflicted on

consumers by certain industries that are heavy advertisers can be as high as 16 percent of the industry's value added" (xii).

Meanwhile, advocates extol advertising for lowering sales costs. Moskin (1973), for example, argues that mass-media advertising sells what firms produce in the cheapest and most efficient manner. He quotes part of a speech by the chairman of PepsiCo, Donald Kendall, to the Federal Trade Commission:

There is literally no way to count how many salesmen at the front door it would take to reach the number of people who see and hear a television commercial. . . . But even if such a massive sales force *could* be assembled, the costs of their salaries or commissions would raise product prices astronomically. The use of media advertising . . . represents a conscious choice as to the most effective and efficient way to generate consumer demand. Where the product provides a wanted consumer benefit, advertising is a highly efficient way to generate a mass market for this product, lowering the costs of production and distribution (13).

Similarly, in an American Enterprise Institute Round Table report, Tom Dillon, chairman of a major advertising agency, argues that, rather than raising prices, advertising tends to lower them by reducing selling costs.

An important fact that tends to be forgotten is that there is a marketing cost of some sort in getting a product from the loading dock to the consumer. It can be spent on various promotional devices other than advertising. It can be spent on samples and coupons or on salesmen. . .

. The reason a manufacturer uses advertising . . . is that he believes it reduces his costs in moving his products from the loading dock to the consumer. The product does the consumer no good on the loading dock. It has to be in the consumer's house (qtd. in J. Daly 1976, 5).

Borden (1942), however, dismisses the “sweeping generalization,” of advertising proponents who maintain that high advertising expenditures lead to low selling costs. Examining advertising's impact on distribution costs, Borden finds that where intensive competition among advertisers exists, advertising *increases* distribution costs. According to Borden, firms use advertising to sell “certain volumes of merchandise at certain prices,” not to minimize selling costs (853).

In sum, the literature reflects disagreement concerning advertising's impact on selling costs. In part, the ambiguity of the term “selling cost” may hinder a consensus. Nevertheless, it seems fair to say that ad proponents lack clear evidence to substantiate their assertion that advertising lowers the cost of selling goods.

### ***Influence on the size of the firm***

A number of studies suggest a positive association between advertising and firm size. Corden (1961), for example, notes that only the largest firms can afford the enormous initial advertising expenditures that launching a new product requires.

Comanor and Wilson (1974) explain that advertising “may influence the relation between large firms and small by affecting both relative costs and relative prices” (217). Concerning prices, the authors explain that since consumers often

associate high product quality with high advertising expenditures, heavy advertisers are able to command a higher price for their goods, and light advertisers often must lower their prices in order to attract buyers for their “substandard” goods.

Concerning costs, Comanor and Wilson report that the results of three sets of regressions indicate advantages for the largest firms that differentiate their products through advertising. In sum, the authors conclude: “in a number of industries advertising appears to create major advantages for large firms relative to their smaller competitors” (239).

According to Philip Nelson (1974), firm efficiency may explain the association between advertising and size. Because efficient firms derive greater benefit from demand expansion than do their inefficient rivals, they tend to advertise more and, consequently, grow larger.

Robert Nelson (1976) notes that firms can convey important information about the quality of their products via advertising. Small firms, Nelson explains, find it prohibitively expensive and ultimately wasteful to advertise to broad audiences comprised of individuals who are not potential customers; thus, large firms are much more likely to engage in large-scale advertising. Given their access to broad audiences, “large firms will have major advantages over small firms in the speed at which they can establish product quality assurance,” Nelson writes (287).

Bagwell and Ramey (1994) credit advertising for being at least partially responsible for the recent proliferation of “big-box” stores. Their formal model predicts that heavy retail advertising can lead to markets comprised of small numbers of very large stores. Commenting on the Bagwell-Ramey model, Norton (1994)

suggests that it explains, in part, the success of “retail juggernauts,” such as Home Depot, Wal-Mart, IKEA, and Circuit City.

Bagwell (2003) explains that brand advertising by manufacturers and point-of-sale service by retailers substitute for each other as suppliers of pre-purchase information about products. When people get pre-purchase information from ads, they need less information from retailers. Thus, Bagwell concludes, “greater manufacturer advertising is associated with the emergence of large-scale retailers that offer modest service and low prices” (49).

In sum, the literature seems to suggest that advertising tends to produce market structures in which large firms dominate. As some of the studies indicate, large firms can engage in more intensive and widespread advertising than can small firms. The higher level of advertising then stimulates greater demand for the advertisers’ product, which tends to set in motion a positive-feedback loop—more advertising leads to greater demand, which leads to more advertising, and that, in turn, leads to greater demand—increasing the large firm’s advantage.

### ***“Big-box” stores and the trade deficit***

According to Bagwell and Ramey (1994), as noted above, advertising may be an essential factor in the emergence and proliferation of “big-box” stores (e.g., Wal-Mart and Home Depot). As they explain it, stores that engage in intensive advertising tend to communicate a successful image to consumers. As a result, consumers may utilize “they-must-be-doing-something-right logic” and flock to such stores. Since

advertising supplies pre-purchase information, retailers can concentrate “more on price and less on service” (49). With low prices, the stores reap high sales. With high sales, the stores have the wherewithal to employ economic factors that reduce costs and lead to increased consolidation. These factors include: economies of scale, bulk purchasing, efficiency-enhancing technologies (e.g., bar-code scanners), and efficiency-enhancing methods of distribution, internal organization, and logistics. “These factors are reinforced,” Scheelings and Wright (2006) explain, “by changes in consumer purchasing behavior; consumers now prefer to do most of their shopping in single locations for convenience” (n.p.).

Why has the purchasing behavior of consumers changed? Pashigian and Bowen (1994) point to one factor: working women. According to the authors, working women increasingly rely on advertised brands. Why? Because the opportunity cost of shopping has increased. The personal service that women once enjoyed is now a luxury that they can no longer afford. For time-constrained consumers, interacting with salespeople and running from shop to shop in search of bargains can be burdensome. One-stop shopping for advertised brands at self-service, big-box stores, on the other hand, saves time and reduces search costs. Combine the time constraints of harried shoppers with advertised promises of low prices on name brands, and the appeal of the “big box” is clear.

Nevertheless, competition policy specialists, among others, raise concerns about the market power that big-box chains wield over their input suppliers. The big-box chains tend to be monopsonies or oligopsonies, impairing competition through the exercise of buyer power. “In economic terms,” Scheelings and Wright (2006)

write, “buyer power allows buyers to force sellers to reduce the price below the price that would result in a competitive equilibrium” (n.p.).

Lande (2004) explains that the impact of buyer power on consumers can be either positive or negative. On the upside, the monopsonist (or oligopsonist) can pass input savings along to the consumer. On the downside, however, buyer power can harm consumers, according to Lande, if:

1. the discounts that the large buyer extracts from input suppliers eventually put its rivals at such a disadvantage they are driven to bankruptcy, resulting in restricted consumer choice (or, alternatively, in an attempt to avoid bankruptcy, the disadvantage forces rivals to externalize more of their costs to the detriment of the public and the environment—a point Lande fails to mention);
2. the large buyer (or buyers) achieves market power as a supplier, as well, and subsequently raises the prices it charges consumers;
3. the power-wielding buyer forces input sellers to raise the prices they charge the buyer’s rivals, leading to higher prices for consumers;
4. the buyers are sheltered from tough competition to such an extent that they become less efficient, and, as a result, their costs rise;
5. wary investors avoid the industry, which leads to long-run consumer losses.

Regardless of the downside, Lande notes, “the conventional wisdom is that buyer-side market power . . . is usually benign, except in rare circumstances” (n.p.).

Antitrust policy apparently reflects the conventional wisdom. As Scheelings and Wright (2006) explain, consideration of monopsony, from an antitrust standpoint, “need only be concerned with the welfare of the final consumer. The end-customer only cares about the quality, quantity, and price of the final product. What transpires upstream in the process of producing the final product is irrelevant to the consumer of the final good” (n.p.).

Scheelings and Wright, citing Salop, note that U.S. courts and federal agencies focus consistently on the price effects of buyer power and adhere to a consumer-welfare standard. By so doing, they reject legal “arguments that conduct which harms competitors while benefiting consumers, even when the former outweighs the latter in some quantitative sense, violates the antitrust laws” (n.p.).

### **Big-box stores and consumer welfare**

But is *price* the sole determinant of consumer welfare? According to the courts and federal agencies, apparently, it is. A LexisNexis search of newspaper articles (using keywords: “Wal-Mart” and “protest”), however, reveals hundreds of instances in which people evince alternative concepts of consumer welfare. The stories reveal concerns about the impact of the big-box chain, Wal-Mart, on existing local businesses, the natural environment, traffic congestion, area noise levels, and so forth. In Tarpon Springs, Florida, for example, when workers unearthed gopher tortoises at the site of a proposed Wal-Mart, local activists protested Wal-Mart’s environmental impact, carrying signs that read: “Wal-Mart is an environmental predator” and “First the turtles, next 800 trees, then our heritage and way of life”

(Reeves 2007). In Glen Carbon, Missouri, concerns that a Wal-Mart expansion could affect local businesses, increase traffic congestion, cause drainage problems, and, potentially increase local crime led area residents to form: “Glen-Ed Citizens for Fair Growth.” Reporting the story, Terry Hillig, of the *St. Louis Post-Dispatch*, writes: “It’s not clear whether opponents of a proposed Wal-Mart expansion constitute a majority of village residents here, but if they’re a minority, they’ve been a vocal one” (Hillig 2007).

Nor are concerns about negative externalities associated with big-box chains confined to the United States. According to a report in the *New York Times*, demonstrators in New Delhi, India, marched on government buildings, carried signs that read: “Save Small Retailers,” and shouted: “Go back Wal-Mart!” (Reuters 2007b)

Of course, not everyone is a small retailer, but everyone is a consumer, and according to Ben Stein, “Wal-Mart is about as good a friend as the consumer ever had. . . . When a Wal-Mart opens in a town, . . . it’s as if everyone in the town [gets] a raise. That’s because the stuff at Wal-Mart is so much cheaper than that same merchandise [is] elsewhere” (Stein). Stein is not alone; big-box stores have many boosters. Nevertheless, the prices of their goods fail to reflect the environmental damage that the production, distribution, and consumption of those goods cause; thus, the low prices that big-box stores advertise facilitate a massive misallocation of scarce resources.

## **Advertising, big boxes, and trade deficits**

In order to deliver on its promise of low prices, Wal-Mart uses buyer power to drive hard bargains with its suppliers. As Jon Lehman, a former Wal-Mart store manager, told Hedrick Smith of *Frontline*:

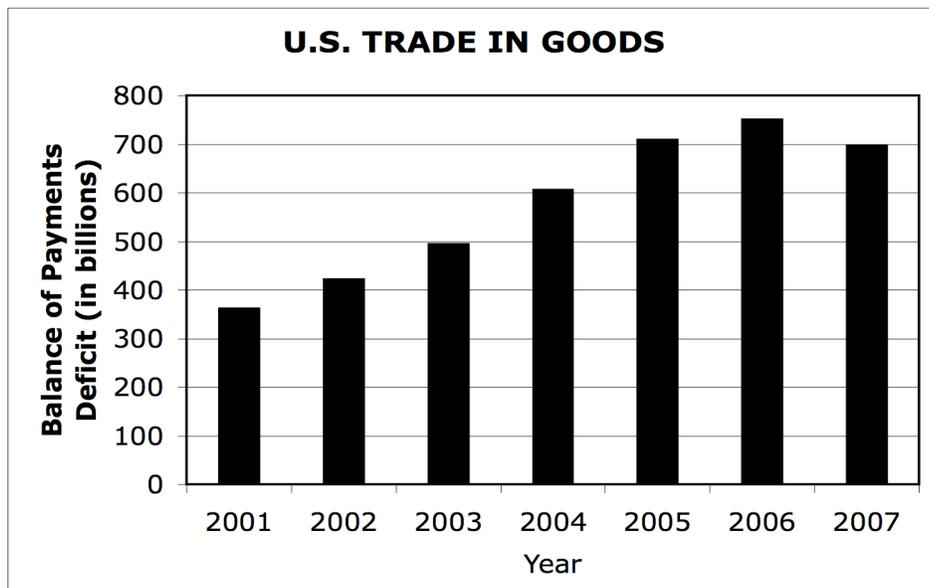
Well, it's very one-sided. There is no negotiation. . . . They know every fact and figure that these manufacturers have. They know their books. They know their costs. They know their business practices. . . . Wal-Mart calls the shots. "If you want to do business with us, if you want to stay in business, then you're going to do it our way." And it's all about driving down the cost of goods (Smith 2004).

Driving down costs can also mean driving U.S. manufacturers overseas. According to Duke sociology professor Gary Gereffi, "Wal-Mart basically tells its suppliers, 'We need to get those products at 30 percent lower price. You need to move to Asia, you need to move to China because that will meet our bottom-line price figures'" (Smith 2004).

By wielding buyer power, Wal-Mart maintains low prices. Those low advertised prices keep more than 100 million Americans flocking to Wal-Mart stores every week. Similar, if smaller, crowds flock to other big-box stores in search of low prices. Attached to those low prices, however, are assorted externalized costs. As former U.S. Secretary of Labor Robert Reich writes: "The fact is, today's economy offers us a Faustian bargain: it can give consumers deals largely because it hammers workers and communities" (Reich 2005).

The U.S. balance of trade is also being hammered. Since prices for goods manufactured overseas tend to be significantly lower than prices for similar goods made in the United States, big-box chains, focusing on the bottom line, buy a high percentage of their merchandise overseas. Many analysts suggest that overseas purchases by big-box chains provide a partial explanation for the massive U.S. trade imbalance (see Figure 4.1). With the exception of 2007, the trade deficit has hit a record high every year since 2002.

Figure 4.1



Source of data: U.S. Census Bureau, Foreign Trade Division

According to the Congressional Budget Office, a major cause of the growing U.S. trade deficit can be traced to “a long decline in saving as a share of gross domestic product (GDP) that began in the mid-1950s and accelerated in the 1980s . . .” (Congressional Budget Office 2000). As previously noted, a number of

economists, including Corden (1961), Comanor and Wilson (1974), Taylor and Weiserbs (1972), and Jung and Seldon (1995), suggest the existence of an inverse relationship between advertising expenditures and savings rates. Thus, advertising may affect the trade deficit in two (probably interacting) ways: (1) by impacting savings (e.g., America borrows from other nations to finance the trade deficit) and (2) by fostering the emergence and viability of big-box chains.

It is worth noting that Americans' consumption exceeded their incomes in 2005 and 2006. In those two years, the savings rates were -0.4 percent and -1.0 percent, respectively. According to government records, the last time savings rates were negative was during the two worst years of the Depression, 1932 and 1933 (Huntley 2007).

Low prices would seem to offer an opportunity to reduce spending. Given the low prices that big-box stores offer, it should be possible for Americans to increase their savings to some extent. Why, then, is the U.S. savings' rate negative? While a number of factors are certainly involved, one counter-intuitive cause might be the low prices, themselves. If, for example, people expect to pay \$20 for a pair of sandals, and they find a pair at Wal-Mart for \$12 that they want, they might indulge themselves and buy two pairs instead of one. Although they end up spending more than they had originally planned, they go home happy, because they believe they've gotten a real bargain—two pairs of sandals for just a bit more than they would have paid for one. Alternatively, they might treat themselves to a different product with the \$8 they “saved” on the sandals, and that product might cost more than \$8. As Danziger (2004) notes, with indulgences, “the more you buy, the better. . . . Because

indulgences are often spur-of-the-moment purchases, a dynamite sale or special offer is overwhelmingly compelling to get consumers to open their wallets and buy” (47-48).

In sum, advertising seems to be facilitating an economy in which: big-box chains replace small, independent retailers; goods made by foreign workers replace goods made by domestic workers; the trade deficit grows; and low prices encourage people to buy more and save less. Perhaps it is time to ask ourselves if this is the kind of economy we truly want.

### ***The heterogeneity of advertising’s economic effects***

As the previous sections demonstrate, no single word better describes the economics of advertising than *heterogeneous*. The inconsistency in the results of empirical studies brings to mind the famous Harry Truman quip: “I’m tired of economists who say, ‘On the one hand . . . and then on the other hand.’ Send me a one-armed economist!” Given the heterogeneity of advertising’s effects, a modern-day Truman seeking advice might complain about economists with as many arms as the Hindu goddess Durga. Factors influencing advertising’s economic impact are far too numerous to enumerate, but they include the following:

- ***The advertising of rival firms.*** The impact of one firm’s ads can be augmented or diminished by the ads of its rivals. While a negative externality (i.e., business stealing) inheres to most ads, in some cases one firm’s ads expand the market for the advertised good—and its generic

equivalents—to such an extent that it generates a positive externality (i.e., increased demand) for its rivals.

- ***The appropriateness of the medium chosen for a particular ad.*** Ads will be most effective when the medium chosen suits the product. A jazz concert advertised on an FM jazz station, for example, will probably be more effective than a jazz concert advertised on a talk-radio program or in a gardening magazine. (Generally speaking, however, TV is the most effective advertising medium.)
- ***The content of the ad itself.*** The content of ads (i.e., the words, images, music, etc.) vary in their ability to motivate audiences to buy the goods the ads promote.
- ***The popularity of the content of the media “frame.”*** It seems reasonable to expect that the audience viewing an ad aired during the Super Bowl will be larger than the audience for the same ad aired during a documentary about the genocide in Darfur, for example.
- ***The intensity of the advertising.*** Below a certain threshold of intensity, advertising may have little effect. Over that threshold, an ad campaign may benefit from increasing returns to scale, until diminishing returns take hold.
- ***Whether media act as substitutes or complements, if the ad campaign utilizes more than one medium.*** If the ads on the chosen media complement each other, they will be more effective than if the media chosen for the ads act as substitutes.

- ***The type of good advertised.*** Is it a search or an experience good? A homogeneous or heterogeneous good? A luxury, necessity, or convenience good? An ad's effectiveness depends, to some extent, on the type of good that is advertised.
- ***The scope of the advertising.*** The effectiveness of ads that are broadcast may be different from those that are narrowcast, for example.
- ***The demographic group the ads target.*** Some demographic groups are larger or have a greater propensity to consume than others. Advertising aimed at large, high-consuming demographic groups tends to have a greater influence on sales than ads that target other groups.

All of the above factors, and more, can affect the datasets utilized in empirical studies and, consequently, influence the studies' conclusions about advertising's economic impact. In addition to the variability of datasets, differences in methodology can also increase the disparity of results in the economics-of-advertising literature. Given this heterogeneity, few generalizations about the economics of advertising stand up to scrutiny.

But beyond differences in datasets and methodology, researchers' ideological views can influence their results. As Meadows et al. (2004) note, "it is crucial to remember that every book, every computer model, every public statement is shaped at least as much by the worldview of its authors as by any 'objective' data or analysis" (4). Cohen (1995) agrees. As he sees it, "any prediction about human affairs necessarily rests on a very large number of assumptions" (134). Researchers'

assumptions about the world attract them to some bits of data and repel them from others.

Making a pair of observations that apply as well to the economics of advertising as they do to the object of his study (i.e., the carrying capacity of the planet), Cohen writes: “The diversity of the estimates suggests that the people who made them were trying to measure different concepts or had different data at their disposal or made different assumptions when data were lacking” (216).

“Notwithstanding their cloak of quantification, many of the published estimates . . . [might be] less dispassionate analyses than they are political instruments, intended to influence actions one way or another” (233).

## Chapter 5: Advertising's Impact on Innovation, Employment, and Savings

### *Advertising and innovation*

A number of supporters of advertising's economic role argue that advertising facilitates product innovations and improvements. Alfred J. Seaman, once president of a New York ad agency, claims that the benefit of advertising's influence on product improvement and innovation for consumers is a "very big one!"

The desire to sell more—and that means in part having a more persuasive advertising story—spurs the manufacturer on to build a better product. In this upward spiral of improving products, breakthroughs are few and far between. . . . Products improve little by little. . . . Our job [as advertisers] is to make those small margins of superiority meaningful to the consumer—and thus make the race for better products even swifter" (qtd. in Moskin 1973, 16).

While less enthusiastic, Pigou (1932) seems to agree that advertising spurs innovation. In his view, were it not for advertising, many new and useful products and services might never come to the attention of consumers who truly need them. Some ads, Pigou maintains, serve "to develop an entirely new set of wants on the part of consumers, the satisfaction of which involves a real addition to social well-being" (n.p.). Borden (1942) also supports advertising for this reason. As he sees it, advertising expenditures should be considered costs of economic growth, since much

of advertising promotes new and improved products, and, by so doing, expands the economic frontier. Borden writes:

As a result of the process of constantly offering new differentiations, enterprise has placed on the market improved products which better fill consumers' desires and needs than did previous products. This product improvement has been rapid and striking in the case of relatively new products, such as . . . refrigerators. But even for merchandise long on the market, the improvement has been substantial over a period of time; this is true, for example, of products such as gasoline. . . . Always the improvements of one manufacturer which have proved desirable have had to be matched by competitors (868).

Reviewing the literature, Bagwell (2005) cites a number of studies that offer support for the claim that advertising facilitates product innovations. Among those he lists are Telser (1962), Ferguson (1967), Alemson (1970), Hirschey (1981), and McDonald (1986). In addition, Bagwell notes that Backman (1967), Lambin (1976), Farris and Buzzell (1979), Leffler (1981), and Eckard (1991) find a positive correlation between advertising intensity and product innovations for some industries and product classes, and Porter (1978) observes that the rate of innovations to a firm's product line "is strongly and positively associated" with the amount it advertises on network TV (45). Bagwell cautions, however, that care should be taken in interpreting these results. In a footnote, he writes: "The interpretation of a positive relationship between new product innovations and advertising is not straightforward:

such innovations might reflect entry (a new product from a new firm) or entry deterrence (product proliferation by an established firm)” (46).

Corden (1961) reports that in the view of some ad supporters only large firms can make the enormous expenditures that are generally required to research and develop innovative products; thus, advertising indirectly helps to promote product innovation by facilitating a market structure that favors large firms. For his own part, however, Corden disagrees. In his view, “advertising may actually hinder progress,” because “progress has become dependent on the activities of a relative handful of large firms, and the introduction of new ideas and the development of new products depends upon large firms adopting these ideas” (20). Furthermore, Corden questions the supposition that advertising fosters technical progress. Due to advertising, “progress tends to take the special form of developing products with properties that lend themselves to large-scale selling campaigns” (22). Innovations that fail to fit that special form face high barriers to development and entry, Corden explains.

Corden quotes Lord Heyworth, then Chairman of Unilever, who argues that advertising facilitates innovation “by making people receptive to the idea of change” (20). According to Heyworth, advertising helps consumers overcome their natural inertia and brings “people to see that the old ways are not necessarily the best ways” (20). To illustrate his point, Heyworth asks rhetorically, “But for the first Lord Leverhulme’s passionate belief in advertising, [how] much longer would it have taken to get beyond the anonymous bulk of the long unwrapped bars that were the normal form of soap until he burst upon the scene . . . ?” (qtd. in Corden, 20). (One is left to wonder, in the wake of Leverhulme’s observation, how great of a loss humanity

would have suffered if the momentous innovation of wrapped soap-bars had somehow failed to occur.)

For his own part, Corden maintains that the supposed association between advertising and economic progress requires some qualification. “For it must be remembered,” he writes, that advertising is designed to entrench firmly in consumers’ tastes *existing* products and the names of existing brands” (20). In addition, advertising tends to create goodwill for the advertised product, which provides “security of markets” and enables firms to set the prices of their advertised goods higher than their marginal costs and higher than their competitors’ prices. Thus, Corden concludes, goodwill presents a great hurdle for new entrants and new products. “In fact,” he writes, “one can say that while advertising of new products contributes to progress, advertising of existing products holds it up” (20).

Some supporters of advertising argue that advertising promotes technical progress by reducing market uncertainties. Borden (1942), for example, writes: “Advertising and aggressive selling . . . have promised the stability of demand and of profit to an enterprise which is attractive to investment” (870). As Doyle (1968) sees it, however, “stability would not appear either theoretically or empirically a sufficient cause of innovation” (596).

In sum, economists’ opinions about advertising’s impact on product innovations and improvements vary. As with many other issues concerning the economics of advertising, ad proponents and critics seem to rationalize their conclusions by stressing different findings.

*Innovations and human welfare*

Arrow et al. (1990) credit advertising with facilitating the acceptance and dispersal of many innovative products and product improvements. Providing microwave ovens as an example, they contend that when one firm advertises an innovation, it helps create a market that rival manufacturers may choose to enter and exploit. According to the authors, consumer welfare improves due to the introduction of the product and the subsequent, price-lowering competition; thus, nothing should be done to dampen incentives to advertise innovative products.

Clearly, the authors presume that a microwave in every kitchen improves social welfare. But does it? Now that many Americans have not only microwave ovens but also a myriad of other innovations that advertising has promoted over the past few decades, are they any happier than they were before such products had a place in their homes?

According to a number of happiness studies, they are not. As Barry Schwartz (2004) writes:

In the last forty years, the . . . percentage of homes with dishwashers has increased from 9 percent to 50 percent. The percentage of homes with clothes dryers has increased from 20 percent to 70 percent. The percentage of homes with air-conditioning has increased from 15 percent to 73 percent. Does this mean we have more happy people? Not at all (106-107).

Thus, the question arises: If the innovations that advertising facilitates fail to improve the overall quality of people's lives, should advertising be celebrated for facilitating the adoption of those innovations?

For ad supporters and technology enthusiasts, the answer is definitely yes. As they see it, innovations are unmixed blessings in many, if not most, instances. For one thing, innovative products improve people's lives—they must or people would not buy them. Thus, the speculation that innovative products fail to improve people's lives must be wrong. For another thing, the production, distribution, and sale of innovative products create new markets, fuel economic growth, and generate new jobs, and each of those outcomes increases human welfare.

On the other hand, such analysis seems to ignore the personal, social, and environmental costs that are often associated with the production, use, and disposal of goods. Since such negative externalities are generally ignored, the prices that consumers pay generally fail to reflect the goods' true costs. This is particularly true in the case of newly introduced goods, because, in most cases, time must pass before all of the associated costs become apparent. Enabled by artificially low prices, however, ad-assisted dispersal of innovative products across American society is extensive. If, as many economists recommend, the prices of goods were adjusted (with a tax added, for example) to reflect actual costs, for some people the adjusted prices would be prohibitively high. People who purchased goods before the price adjustment might be unable to replace the items when necessary. Some children who grew up using the items might be unable to buy them when they moved out of their parents' homes. Such losses could take a significant toll on the psychological well

being of affected individuals. According to Kahneman et al. (1991), once a good becomes part of a person's endowment, giving it up entails a loss; and, as Schwartz (2004) notes, several studies find that the psychological impact of such a loss is more than twice as harmful as an equivalent gain is good. Thus, before advertising is applauded for expediting the acceptance and dispersal of innovative goods, the harm that psychologists, such as Schwartz, Kahnemann, and others, tell us is associated with losing a good that one once owned should be taken into account.

### **Advertising and catastrophic innovations**

While the psychological harms just described are conjectural, some costs associated with ad-promoted innovations are concrete. For example, advertising has facilitated the widespread use of innovative products that, over time, have proven to be catastrophically harmful. Prior to the discovery of their negative effects, however, some analysts credited advertising for helping to promote the acceptance and dispersion of these ostensible boons to humanity. Borden (1942), for example, credits advertising for spurring firms to differentiate their products. "As a result of the process of constantly offering new differentiations," he writes, "enterprise has placed on the market improved products which better fill consumers' desires and needs than did previous products" (868). Two of the improved products that Borden specifically mentions, as noted above, are refrigerators and gasoline. Writing in 1942, he could not have known that the improvements he touted—chlorofluorocarbon, a safer coolant for refrigerators, and tetraethyl lead, a "no-knock" agent added to gasoline—would inflict incalculable environmental damage and

impair human health. (High lead levels in blood have produced a variety of health problems; chlorofluorocarbons have thinned the ozone layer, which has led to increased rates of skin cancer, among other problems.) While these innovations seemed to be wondrous achievements in the short run, ultimately their side effects have been disastrous.

Nor has the introduction of products with potentially catastrophic side effects been confined to Borden's time. Ads for the painkiller Vioxx provide a more recent example. After several years of intensive advertising campaigns and soaring sales, studies found that Vioxx increased the risk of heart attack and stroke significantly. The precise extent to which advertising contributed to the drug's popularity is a matter of speculation; however, studies of consumer demand by Rosenthal et al. (2002), Iizuka and Jin (2002), and Wosinska (2002) suggest that direct-to-consumer advertising of prescription drugs is having a large market-expanding effect. In addition, Iizuka (2004) finds that direct-to-consumer advertising in the U.S. has "skyrocketed" since the relaxation in 1997 of regulations limiting such ads. Taken together, these findings suggest that heavy advertising did lead to widespread use of Vioxx, and the results of that use have, in some cases, been tragic.

Thus, the benefits associated with advertising's role as a facilitator of innovation are hardly unalloyed. Rather than accurately heralding technological progress as its advocates claim, advertising seems often to supply biased and misleading information by spotlighting the benefits of new and improved products while ignoring many, if not all, of the costs. In addition, advertising generally speeds the acceptance and dispersion of products long before all of the costs are known. If

advertising deserves credit for facilitating innovation, it should also be held responsible, in part, for the problems inherent in the production, use, and disposal of innovative products.

### ***Advertising's influence on employment***

According to the ad industry, advertising is a major job creator. Is the industry correct? Surprisingly few studies have examined advertising's impact on employment. Some of those that do have been sponsored by the ad industry, making their results suspect.

Providing some independent support for ad-industry claims, however, are a pair of empirical studies in which researchers find that advertising and unemployment are inversely related. Chowdhury (1994) finds "strong uni-directional causality" between the level of advertising and the rate of unemployment, and Hamada (1999) finds that advertising in Japan increases the demand for labor. Explaining his results, Hamada notes that advertising increases demand; consequently, firms hire additional labor to satisfy that demand. Advertising may also help maintain employment rates during economic downturns, Hamada notes.

In a 2004 Global Insight study of the impact of advertising expenditures on economic activity and job creation (commissioned by lobbyists for the Advertising Coalition), Raimondi and Klein predicted that advertising would be responsible for approximately 21 million jobs in the U.S. in 2005 (O'Malley, 2004). According to

the authors, advertising would create nearly half of the jobs directly and generate the rest indirectly.

Godshaw and Pancoast (1987) consider the impact on unemployment of a tax on advertising, in an ad-industry sponsored study. They conclude that such a tax would cause the quantity of advertising to fall, which would lead, in turn, to a decrease in sales and an increase in unemployment. The authors assert, in fact, that an ad tax in Florida would result in an immediate loss of 10,400 jobs and a loss of 46,000 jobs within two years. The increase in unemployment over time would be due to a multiplier process, whereby early job losses would lead to additional losses in other industries in later periods. In addition, Godshaw and Pancoast note, a study by Aker and Myers (1975) indicates that a reduction in advertising can lead to higher selling costs by other means. What Godshaw and Pancoast fail to note, however, is that those other means would certainly utilize employees, and the jobs created might exceed the jobs that would be lost due to the reduction in advertising.

*The Multinational Monitor* (1990) notes the potential impact of a ban on tobacco and liquor advertising on employment. According to the article, “the biggest names in the tobacco, liquor and advertising industries claim that 16,100 media jobs will be lost” if ads for their products “are banned from print media” (n.p.)

Two years later, when the U.S. Senate considered legislation to reduce the tobacco industry’s tax deduction for advertising, a marketing manager for Fruit of the Loom stressed his view of advertising’s impact on employment in a letter to Senator Mitch McConnell, as recorded in the *Congressional Record* (1992). “Advertising creates demand, which in turn creates jobs,” he writes. “To penalize businesses, and

thereby reduce job opportunities for Americans . . . is bad tax policy and irresponsible” (n.p.).

## **Lobbying Congress**

Whenever policymakers have proposed changing advertising’s tax status, many ad-industry advocates have promoted advertising’s ostensible role as a job creator. In response to a proposal in Congress to reduce advertising’s tax deduction, for example, John Kamp, senior vice president for the American Association of Advertising Agencies, urged the trade organizations’ members to tell Congress that “advertising drives the economy, creates jobs, and stabilizes the tax base” (Fisher 1994, 41). At the same time, Dan Jaffe, executive vice president of the Association of National Advertisers, told members of his organization that the mere fact of Congress raising the possibility of reducing the deduction “is highly troubling. . . . It’s important to scream very loud” (41).

William Diefenderfer, a lobbyist for the Leadership Council on Advertising Issues, advised media companies, major advertisers, and ad agencies to stress to Congress and the White House the increased unemployment that would accompany a reduction in advertising. Offering what seems to be a specific example of the strategy, Wally Snyder, president of the American Advertising Federation, told *Advertising Age* (Colford 1994b):

We put a lot of effort into educating [then Chairman of the House Ways and Means Committee] Rostenkowski on the value of advertising. . . . We had a couple of important meetings with him in

recent years in his district in Chicago with people from Quaker Oats [a major advertiser] and Leo Burnett [one of the world's largest ad agencies] and others. At one of them, Clark Hines from Quaker looked out a window and pointed out the Tribune Building and Leo Burnett and Quaker and noted that they all employed a lot of people in Chicago because of advertising. That, I think, brought the message home to [Rostenkowski] (58).

To persuade policymakers that advertising is a job creator, coalitions comprised of advertising trade associations, major advertisers, and media corporations have hired economists to conduct studies to verify ad-industry claims. One such study was so obviously biased it proved useless for that purpose. According to the director of the Advertising Tax Coalition, Jim Davidson (2005, personal communication), a 1987 study, which had been hastily prepared in response to a proposed Florida ad tax, was “so totally biased it was laughed at by economists.” For that reason, Davidson explained, he has subsequently hired Nobel Prize winning economists (such as George Stigler, Kenneth Arrow, and Lawrence Klein) to perform studies, because “they have reputations to protect and no reason to slant their reports in favor of the ad industry.” If, when completed, the results of such studies oppose his clients’ interests, “they bury them,” Davidson said. Thus, Global Insight’s prediction that advertising would be responsible for precisely 21,117,903 jobs in 2005 (O’Malley 2004) and Godshaw and Pancoast’s (1987) prediction that over 46,000 Florida jobs would be lost in less than two years if a tax on advertising were enacted should probably be taken with a grain of salt—Morton ® Salt, of course.

But even if Global Insight's predictions are accurate, there seems to be no way to verify them, since they are proprietary and unavailable to the public (Pundit 2005, personal correspondence). And no comparable, independent study seems to exist. Nevertheless, the Global Insight study purports to define "the relationship between the amount spent on advertising by businesses throughout the economy and the impact those expenditures have on economic activity and job creation in all states, metropolitan areas and congressional districts in the United States" (Association of National Advertisers 2004). It seems reasonable to suppose that senators and House members would be intensely interested in—and, one might suspect, influenced by—statistics showing economic activity and job creation in their states and congressional districts. Given the circumstances surrounding the statistics' creation and the lack of independent verification of those statistics, the impartiality of the studies is open to doubt, however. Relying on ad-lobby funded studies to inform policymakers about advertising's impact on employment seems to be a good way to promote the interests of the ad lobby. Whether or not that reliance also promotes the common good is another question.

### **Job creation and resource allocation**

Kaldor (1950-1951) is skeptical of the claim that advertising increases employment. But whether or not advertising stimulates employment is not the critical issue for Kaldor; rather, he wonders whether advertising is a better or worse means of generating jobs than other possible methods. As he sees it, when effective demand, rather than available resources, determines the general level of production,

the ordinary rules of welfare economics are, in a sense, reversed: here ‘waste’ is economical and economy is wasteful. In such an economy, a higher output of any particular commodity or service will not mean a lower, but usually a higher output of other things; the marginal social cost of one commodity or service, therefore, is not positive, but zero or even negative. . . . On these assumptions no expenditure *can* be wasteful. . . . In order, therefore, to arrive at a balanced judgment on the social benefits derived from advertising (or of anything else) the employment effects must be kept rigidly separate from the others; as regards the former, the question to be investigated is whether advertising is an appropriate and socially beneficial method for curing unemployment; while as regards the latter, the same criteria must be employed as are appropriate in an economy where the general level of production is determined by the scarcity of available resources (10; italics in the original).

Thus, Kaldor is critical of those who claim that advertising creates jobs, because they fail to recognize that resources are finite. If resources were truly unlimited, creating jobs by generating demand for goods through advertising might be “an appropriate and socially beneficial method for curing unemployment.”

Recognizing that available resources are, in fact, finite, however, Kaldor questions whether generating demand via advertising—and producing more-and-more goods in order to create more-and-more jobs—ultimately leads to wise uses of scarce resources. This seems to be a critical, but generally overlooked, question.

To take a relatively uncontroversial example, consider cigarette advertising. If advertising increases demand for cigarettes and higher demand for cigarettes leads to higher demand for workers, do the newly created jobs justify cigarette advertising? While tobacco is a renewable resource, many of the resources that go into cigarette production and distribution are scarce. Also scarce are the resources devoted to the health care of smokers—not to mention the scarcity of moments in the lives of individuals that are lost as a result of smoking. To take another, possibly more controversial example, consider sport utility vehicles. Keeping in mind that SUVs leave substantial plumes of carbon dioxide in their wake, and the scientific consensus is that such emissions fuel global warming, does it make sense to create jobs by generating demand for SUVs through advertising?

At the macroeconomic level, advertising contributes to GNP growth by fueling consumption. It thereby feeds the illusion that the economic pie can be made forever larger. As Daly (1993) explains, the same illusion underlies neoclassical economics. In his words, “continual growth in both capacity (stock) and income (flow) is a central part of the neoclassical growth paradigm. But in a finite world continual growth is impossible” (15). And that is the rub, because, according to the neoclassical paradigm, perpetual “growth of GNP is necessary to maintain full employment” (15). Since resources are finite, their scarcity should be considered before advertising is touted as a job creator, and policies for job creation should be conceptually decoupled from the assumed need to fuel consumption.

## **Advertising, employment, and the business cycle**

If, as many observers agree, firms generally set their ad expenditures as a percentage of recent sales, then, when those sales have been high, advertisers increase their future ad budgets, and when those sales have been low, they reduce their upcoming ad expenditures. This fluctuating pattern may explain why Borden (1942), Kaldor (1950-1951), and Yang (1964) find that advertising tends to amplify economic fluctuations. According to Kaldor, advertising may be responsible for increasing the ranks of the short-term unemployed, even if it does raise the *average* employment rate. “Hence,” Kaldor writes, “any beneficial effect on the average level of employment would have to be set against the increased instability of employment” (11). Given, also, that intensive advertising failed to prevent mass unemployment during the Great Depression, Kaldor concludes: “As a possible method of ensuring an adequate and steady demand for labour [*sic*], advertising comes out pretty badly” (11).

Kaldor’s point is worth noting. As studies of life satisfaction show, unemployment reduces happiness levels substantially and, even after returning to work, some residual unhappiness lingers. If advertising increases employment instability, as Kaldor suggests, the addition to welfare associated with increased employment must be set against the diminishment of welfare that happiness researchers (e.g., Layard 2005; Graham and Pettinato 2002a; Clark et al. 2001; Di Tella et al. 2001; Winkelmann and Winkelmann 1998) associate with unstable employment.

In comments similar to Kaldor's, Corden (1961) notes that some apologists maintain that advertising, over time, increases the average employment rate by generating sufficient demand to ensure that the output of mass-production is sold. According to these ad proponents, even if advertising intensifies business-cycle fluctuations and increases short-term unemployment, it still increases welfare, because it facilitates full employment in the long run. Corden, however, has no sympathy for that argument. In his view, the "necessity to maintain full employment would be adequate justification for advertising only if there were no other way of creating demand for goods" (11). As he sees it, however, that is not the case. Governments can step in with a wide range of monetary and fiscal policies to stimulate aggregate demand. They can, for example, cut taxes to increase consumer spending, or they can lower interest rates and thereby encourage private capital formation, or they can increase spending on public infrastructure. "It is not necessary to urge consumers to buy more soap or cigarettes," he writes (11). "In fact," Corden continues, "the argument that advertising raises consumer spending and so increases employment can be stood on its head to provide a powerful criticism of the economic effects of advertising" (12). For one thing, he argues, advertising stimulates demand; thus, its effects must be pernicious in times of inflation. In addition, increased consumer spending must come at the expense of public works, and government projects also provide employment.

Corden speculates that disallowing a tax deduction for advertising might reduce employment in industries that are directly associated with advertising, such as advertising agencies and printers, and in industries that depend heavily on stimulating

demand through advertising, such as manufacturers of toiletries and patent medicines. To avoid hardship among the affected workers and industries, Corden suggests reducing the deduction gradually and creating government jobs for displaced labor.

### **Working more; relaxing less**

Examining another aspect of advertising's impact on employment, Braithwaite (1928) explains that "all advertisement is competitive, either between commodities or between commodities and leisure" (24). In her view, advertising has increased consumers' wants to such an extent that it has tipped the balance between the utility of commodities and the disutility of work, by constantly promoting the attributes of goods.

Decades later, Fraser and Paton (2003) find that work hours in industrialized countries remained relatively constant—even though wages rose exponentially—during the second half of the twentieth century. The authors attribute the constancy of work hours to steadily increasing societal preferences for consumption over leisure. According to Fraser and Paton, causality runs only one way, from advertising to hours worked, and the positive relationship between advertising and work hours is true for both men and women.

Similarly, Brack and Cowling (1983) confirm Braithwaite's (1928) speculation that advertising tips the balance between work and leisure in favor of work. Analyzing a thirty-year span, Brack and Cowling find a negative relationship in the U.S. workforce between advertising intensity and leisure hours. The authors

note that although aggregate income grew exponentially in the three decades following World War II, an expected, corresponding gain in leisure failed to occur.

Summing up the conventional wisdom about work and leisure in the post-war period, Blakelock writes in 1960:

As industrialization of our society has increased, the number of work hours per week has declined. Every indication is that this trend will continue, shorter working hours being an alternative to technological unemployment resulting from increasing automation. As a concomitant to the decrease in the hours of work, . . . there is automatically an increase in the hours of leisure (446).

Thus, the post-war expectation was that people would soon have too much, not too little leisure (Blakelock, 1960; and Hendee, 1971). According to Ngai (2006), however, the average weekly hours of work for the U.S. working-age population (ages 15-64) has actually shown a substantial increase since 1960, rising from approximately 24 to 28 hours.

The discrepancy between the post-war predictions of increased leisure in coming decades and the post-war findings that *work*-hours in the U.S. have, instead, increased is certainly worth noting. Are increasing advertising levels in the post-war period responsible for this discrepancy? Perhaps. According to Brack and Cowling, advertising encourages workers to favor consumption over leisure by arousing desires for the goods that ads promote. Reekie and Allen's (1983) cross-sectional analysis of twenty-four countries also offers empirical support for the notion that advertising intensity positively influences aggregate hours of work.

On a related topic, Courard-Hauri (2005) finds that workers reduce their well-being by spending too much time on the job and too little time engaged in other activities. In his view, individuals' access to their internal utility functions is imperfect, leading them to "negatively affective overconsumption" (1). According to the author, advertising may exploit consumers' transient desires for the products they see promoted, and it may thus exacerbate their tendencies to overconsume. In order to increase their capability to consume (and overconsume), they generate more income by working long hours.

In sum, while the inclusion of many variables is probably necessary to provide a full explanation, the combined work of Braithwaite, Brack and Cowling, Reekie and Allen, Fraser and Paton, and Courard-Hauri (among others) seems to indicate that advertising has played a role in shifting the balance of preferences between work and leisure by perpetually emphasizing the utility of consumption.

### **Leisure as consumption (or consumption as leisure)**

Offering a different perspective, Demsetz (1968) claims that advertising promotes not only goods but leisure, as well. "Who," he asks, "can claim that the promotional campaigns of travel agencies, hotels, airlines, and makers of boats and camping equipment have not whetted his appetite for more leisure time?" Certainly, Demsetz makes a valid point. What he fails to note, however, is that advertising promotes leisure as a *consumption* activity. Consuming goods (such as travel-agency services, hotel rooms, airline tickets, speedboats, water skis, tents, sleeping bags, etc.) is requisite to the types of leisure that ads promote. (Where are the ads suggesting

that people sit on their front porches and chat with their neighbors?) The enjoyment of the forms of leisure that ads promote takes money, and getting that money generally takes work. As Layard (2005) explains, if people “work harder, they can indeed consume more but only at the sacrifice of something—their family life or their tennis or whatever” (152). They can consume more, in other words, if they sacrifice leisure. Whereas engaging in many forms of leisure (e.g., conversing with families and friends, participating in community activities, observing nature) requires not hours at work but time away from work, advertising promotes the sorts of leisure activities that require working more hours to acquire the funds to buy the recreational goods and services that ads promote.

### ***How advertising impacts savings***

How does advertising affect the amount consumers save? As Kaldor (1950-1951) explains, devising a statistical method to reveal the amount that consumers would save if there were less advertising is impossible; nevertheless, a number of studies find a negative relationship between advertising and saving. That relationship appears to be particularly strong when consumers have access to credit, and as Corden (1961) notes, various forms of credit are generally available to low- and middle-income people to enable them to spend beyond their incomes.

Not everyone agrees that advertising affects savings, however. For his part, Schmalensee (1972) maintains that advertising “cannot influence the decision to save”; thus, it “cannot be all-powerful” (86). Also dubious of the supposed

relationship, Solow (1968) writes: “It is open to legitimate doubt that advertising has any detectable effect at all on the sum total of consumer spending or, in other words, on the choice between spending and saving” (48).

Taylor and Weiserbs (1972) disagree with Solow, however. The results of their study provide evidence that advertising may influence the way consumers allocate their incomes when making choices between spending and saving. Specifically, they find that as advertising goes up, consumption goes up, and saving goes down. Similarly, Jung and Seldon (1995) suggest that ads induce consumers to increase the amount that they currently consume at the expense of the amount they can consume in the future (i.e., at the expense of their savings).

Jacobson and Nicosia (1981) investigate the impact of the past year’s ad expenditures on the current year’s savings. Their results indicate that when advertising expenditures increase in the previous year, consumption in that year also increases, but consumption in the next year decreases; and when the past-year’s consumption increases, consumers have less money to spend or save in the current year. Thus, the authors find a statistically significant, negative relationship between the past-year’s advertising expenditures and the current-year’s consumption, which, according to the authors, may be evidence of a “budget effect.”

Quarles and Jeffres (1983) take an international approach. Drawing on annual data from fifty-three nations, the researchers find that disposable income “severely” constrains consumption; thus, advertising can do little to increase spending at the expense of savings. The authors note, however, that their analysis describes spending behavior only in the aggregate; thus, they are unable to comment on economic

behavior within individual nations. Acknowledging an additional limitation on their analysis, the authors explain that they are unable to deny the possibility that some ads, in some contexts, might overcome the constraints imposed by limited disposable income, even though those constraints hold for aggregate spending across fifty-three nations.

Focusing on savings in the U.S., Summers (1987) advocates reducing the tax deduction for advertising expenditures in order to reduce consumers' exposure to advertising and, thereby, inhibit consumer spending and increase consumer saving.

Over all, the literature seems to indicate that advertising does affect households' decisions concerning spending and saving. It influences those decisions by encouraging people to gratify their desires to consume in the present rather than to save for the future. According to some studies, when credit is *unavailable* the relationship between advertising and savings is likely to be negative, and when credit *is* available, the relationship is also likely to be negative, but to an even greater extent.

## Chapter 6: The Economic Impact of Advertising on Media

### *Subsidizing media*

Most economic observers presume that advertising subsidizes media, and many ad proponents justify advertising for that reason. Some attempt to explain why it is in the advertiser's self-interest to provide this subsidy. In general, their explanations acknowledge that advertising is a "bad," which consumers must be paid to accept. As the common explanation goes, firms subsidize communications media in order to expose consumers to advertisements. As a result of the subsidy, the medium showcasing the ad is able to offer information or entertainment at a lower price. Due to the medium's subsidy-enabled affordability, more consumers are able to enjoy its content and, at the same time, be exposed to the advertising messages that it contains than would have been the case without the subsidy.

Kaldor (1950-1951) explains that the expectation of higher demand for the advertised goods and services provides the economic motivation for the subsidy. Advertising, Kaldor argues, "is not supplied *in response* to consumers' demand," nor is the amount of the advertising expenditure determined by consumers' preferences, "as registered through the price mechanism, but by purely extraneous considerations" (4).

According to Comanor and Wilson (1974), "the relevant price for most [advertising] messages is negative, since consumers are paid to consume them" (14). The authors suspect, in fact, that the amount that firms would be required to pay

consumers to compensate them for accepting ads could be much higher than the cost of the media subsidy. So, rather than pay consumers to accept ads directly, advertisers subsidize media content and, in that way, compensate consumers indirectly. By lacing their ads throughout the medium's content, firms make it difficult for consumers to enjoy that content without being exposed to ads. According to Comanor and Wilson, the ads "are in effect forced on the consumer of the medium" (15). Firms are thus seen to serve their self-interest by subsidizing media.

Telser (1978) seems to agree. As he sees it, advertisers provide entertainment or information to compensate those who receive their messages, because "the implicit market clearing price for . . . advertising messages is negative" (88). According to Telser, advertisers are willing to pay for the media content because some consumers will purchase the product after observing the ad.

### **Should advertising subsidize media?**

Some economists question whether advertising *should* subsidize media. Corden (1961), for example, notes that a common defense of advertising is that it "possibly provides the economic basis for the survival of a large number of independent newspapers and magazines" by supplying subsidies (13). In the absence of advertising, the argument goes, many papers would be unable to survive without raising their prices. "*But why has the press to be subsidized at all?*" Corden asks (22; italics in the original). If other businesses are able to raise the prices of their products as necessary to survive, why are newspapers and magazines unable to set their prices high enough to be viable without a subsidy from advertising?

Corden (1961) discusses the impact of reducing the ad subsidy on concentration in the newspaper industry. As he sees it, if the subsidy to media were reduced or eliminated, newspaper prices would have to rise, and the demand for newspaper copies would undoubtedly fall. He speculates, however, that the number of separate publications might not decline if advertising subsidies fell for all newspapers—high- as well as low-circulation. According to Corden, when small or new publications receive subsidies from advertisers, their numbers increase. When large, existing papers receive subsidies, however, the effect of the subsidies is to strengthen the position of the already strong against weak rivals and potential entrants. “Advertising,” Corden writes, “helps to make the newspaper industry Big Business” (24).

Doyle (1968) contends that the current supply of media is unlikely to represent an optimal allocation of resources, since the media must be subsidized in order to sustain demand at the current level. In an argument similar to Corden’s, Doyle maintains that if consumers were willing to pay the true cost of media, then no subsidies would be required to sustain sales. For Doyle, the argument that ads subsidize communications media fails to provide a cogent defense for advertising. It is an especially weak argument if advertising has detrimental social effects, he argues. Although the supply of media services would, no doubt, be reduced by a severe cutback in advertising, Doyle seems to doubt that social welfare would suffer as a result. As he sees it, “unless consumers are willing to pay an economic price for [media services], there is no reason to believe that the present supply produces an optimal allocation of resources” (596).

According to Simon (1970), advertising's support for media "is not a *justification* of advertising [since there] are many other possible economic arrangements . . . that would be no more costly to society in the long run" (276; italics in the original).

### ***Media revenues: ad subsidies vs. sales***

Although most economists take as given the supposition that advertising subsidizes media, the Economists Advisory Group (1967) rejects that belief. According to the Group, advertisers and media trade in the market for advertising space in order to maximize private—not social—benefits; thus, in their view, the common representation of advertising as a subsidy to media is "quite incorrect."

Despite the analysis of the Economists Advisory Group, most observers agree that advertising subsidizes information media. Corden (1961) compares the contributions to total revenues made by advertising to those made by sales for newspapers and magazines. In the case of one large, representative newspaper, he finds that advertising accounts for 39 percent of total revenues. Corden speculates that "some of the large-circulation national papers could have survived completely without advertising and without having to raise their prices" for a time after World War II. He acknowledges, nevertheless, that some publications are highly dependent on the subsidies provided by classified advertising (4).

More than four decades after the publication of Corden's article, Evans and Schmalensee (2005) find that "most advertising-supported media earn much of their

revenues—and probably all of their gross margins—from advertisers.” Often, the prices readers pay for print media are “something close to or below the marginal cost of printing and distribution” (8). In fact, Evans and Schmalensee maintain, some media, such as broadcast television and radio, yellow-page directories, certain newspapers, and most web portals, are entirely subsidized by advertising.

### ***Advertisers’ media costs***

A number of studies address advertisers’ media costs. In the case of a newspaper’s costs, advertising’s share is proportional to its share of newsprint space. According to Corden (1961) newsprint “is usually a very important part of a newspaper’s expenses” (5). In fact, newsprint (along with ink) accounts for almost half of the expenditures of the large, representative paper in Corden’s 1961 study.

The marginal cost of newspaper advertising remains high today. For that reason, some print advertisers are turning to the Internet. Media analyst John Morton comments that online advertising requires no infrastructure (e.g., printing presses and delivery trucks). In fact, he adds, “some studies have indicated that 40 cents . . . of advertising revenue on a Web site for a newspaper can be more profitable, actually, than \$1 on the newsprint side” (NewsHour 2006). On a related point, Dupont (1997) notes that the marginal cost of additional content in Internet “e-zines” is essentially zero, since they require no ink, paper, or postage.

Simon (1970) explains that when additional media outlets for ads become available, media prices decrease, and the marginal cost of advertising falls, *ceteris*

*paribus*. When the cost of a factor of production falls, total output typically increases. Thus, according to Simon, all else remaining the same, an increase in media outlets lowers ad prices and increases their number.

Brown (2000) discusses the effect of an increase in television outlets on advertising costs. He explains that the digitization of broadcast signals is narrowing the bandwidth required for television and radio and therefore expanding the carrying capacity of the broadcast frequency spectrum. As a result, channel scarcity is being virtually eliminated. Brown's model suggests that as the number of channels increases, the average audience size will decrease. With programs drawing smaller audiences, average ad cost per audience member will rise, and revenues per program as well as profits per channel will fall. Therefore, although digitization has the potential to generate a sizeable increase in the number of broadcast channels, Brown concludes that market forces may prevent that from occurring.

Addressing a different aspect of the media-cost issue, Bagwell (2003) suggests that advertisers' profits may rise with rising ad costs. As he explains it, the effect on advertising of a cost increase is a decrease in the quantity of advertising and a reduction in the elasticity of demand for the products of firms that continue to advertise after the cost increase. Due to the elasticity effect, Bagwell explains, (remaining) advertisers tend to benefit when the cost of advertising goes up (so long as the cost increase is affordable).

## *Two-sided platforms*

Some economists conceive of advertising as having a two-sided nature. Comanor and Wilson (1974), for example, describe two different demands, with two different sets of prices, in the market for advertising. Constituting one demand are firms that are willing to pay media for access to prospective consumers. Constituting the other demand are consumers who want information about products and typically ‘pay’ a negative price for the ads they demand.

Gabszewicz, Laussel, and Sonnac (2004) describe advertising’s two-sided nature in a slightly different way. In their view, media owners act as the interface between two groups of consumers: advertisers, who demand ad space, and media consumers, who demand entertainment or information. Concerning television, the authors explain that the “ratios [of programming to advertising] play the same role as prices in usual horizontal differentiation models” (657). By differentiating their programming-to-advertising ratios, broadcasters compete for both consumer groups (i.e., advertisers and audiences). Cross-externalities exist, however, because advertisers want to increase the size of the audience that receives their ads, while television audiences tend to dislike ads and avoid them whenever possible.

Some economists describe advertising as an example of a “two-sided platform,” with media suppliers and media consumers constituting the two sides. Evans and Schmalensee (2005), for example, explain that two-sided platforms “cater to two or more distinct groups of customers, facilitating value-creating interactions between them” (1). In some cases, the authors note, two-sided platforms charge customers on one side of the platform less than the marginal cost of the good

supplied; in other cases, two-sided platforms supply the good for free; and in still other cases they actually compensate recipients of the good.

According to Evans and Schmalensee, television, radio, magazines, newspapers, and web portals are examples of ad-supported media that are based on the two-sided business model. In the case of ad-supported media, the media-platform either buys or creates non-ad content, which it uses to attract the public, with the intention of exposing the public to ads. The media-platforms attract advertisers by offering them access to the segment of the public that their content attracts.

Also noting the two-sided nature of advertising are Gal-Or and Dukes (2003), Wilbur (2004), and Anderson (2005).

### ***Cross-price elasticity of demand for media***

The cross-price elasticity of demand for media seems not to have been particularly salient to the early students of the economics of advertising. Toward the end of the 20<sup>th</sup> century, however, researchers began to investigate the extent to which one advertising medium substitutes for another. Busterna (1987), for example, finds that the coefficients of the cross-elasticity of demand between newspapers and his other sample ad-media (i.e., daytime network television, evening network television, national spot television, network radio, national spot radio, consumer magazines, and outdoor/billboard) indicate that newspapers reside in a separate product market for national advertising. According to Busterna, newspapers are not substitutes for other

mass media, and they do not compete with other media for the attention of consumers or the dollars of advertisers.

Seldon and Jung (1993) report that calculated elasticities of substitution indicate that various advertising media, such as broadcast, print, and direct mail, are “fairly good substitutes” (3). However, the estimated own-price elasticities suggest to the authors that demand for broadcast is the least elastic of any advertising media. As a result, the authors conclude that broadcast is the most effective (and least substitutable) of the various advertising media.

Bush (2002) finds that substitutability of advertising among various forms of local media (i.e., newspaper, radio, and television) is weak based on the ordinary cross-price elasticities and elasticities of substitution that he estimates. While his results indicate that the demand for advertising time on local television and radio stations is inelastic, he finds that the elasticity of demand for retail advertising in local newspapers is approximately unity and negative. According to Bush, between local television and radio, the elasticity of substitution is not statistically different from zero; rather, the cross-price elasticities indicate that local radio and television advertisements are complementary inputs for firms’ sales efforts, as are local newspaper and television ads.

Seldon, Jewell, and O’Brien (2000), examining beer-firm data, find evidence that three media categories, television, print, and radio seem to be highly substitutable.

According to Silk, Klein, and Berndt (2002), substitute relationships among direct mail, magazines, newspapers, outdoor, network radio, spot radio, network

television, and spot television by national advertisers, although weak, are slightly more prevalent than complementary ones.

Ekelund, Ford, and Jackson (1999) find low substitutability between local radio markets and other media. They conclude that the elasticity of substitution is so low, in fact, “that radio advertising is an antitrust market” (239). The same researchers (Ekelund, Ford, and Jackson, 2000) find substantial substitutability in the local television market, however. Specifically, they find that newspaper and radio ads are substitutes for television ads. In a related study of the New Zealand ad market, O’Donovan, Rae, and Grimes (2000) report that newspapers and magazines seem to be complements for each other but substitutes for television advertising.

Tackling the impact of a new advertising medium, Silk, Klein, and Berndt (2001) note that the adaptability of the Internet enables it to serve a wide array of advertisers. According to the authors, the Internet “looms as a potential substitute or complement for all of the major categories of existing media” (129), and “represents a major long-run threat to established patterns of intermedia rivalry” (145).

### ***Own-price elasticity of demand for media***

How sensitive are advertisers to media price increases? When prices go up, do advertisers demand less media space (or time)? A number of economists tackle these questions by examining the elasticity of demand for media by advertisers.

According to Simon (1970), whether a firm’s total advertising expenditures rise or fall when the price of advertising decreases (or increases) depends on the price

elasticity of demand for advertising. Baye (1981) finds that a firm's price elasticity of demand for advertising determines whether its ad expenditures fall or rise when it increases (or decreases) the physical number of ads it purchases. If the firm's demand for advertising is inelastic and the quantity of ads it purchases remains constant, its expenditures rise with increases in price. On the other hand, if its demand is elastic, as the price of ads goes up, the quantity of ads the firm purchases goes down, and its total advertising expenditures rise or fall, depending on the extent of the price increase and the number of ads it purchases. If the price of ads falls, and it falls far enough, then a firm may run more ads than it did before the price reduction and still have lower total ad expenditures.

In a study of media markets in South Africa, Reekie (1986) estimates that the elasticity of demand for advertising is well above unity in some cases and in most other cases is nearer unity than zero. Simon (1970) notes that the price elasticity of demand for advertising, over all, is far less than the elasticity of demand "for a single radio station's time" (77) or for time or space in any other sort of media outlet. Comparing different media, Silk, Klein, and Berndt (2002) find that the aggregate demand for direct mail, magazines, newspapers, outdoor, network radio, spot radio, network television, and spot television by national advertisers is own-price inelastic.

Bowman (1976) finds that although the price elasticity of demand for viewers of commercial messages is not significantly different from one, the supply of television network audiences is highly inelastic. Bowman writes: "Our elasticity estimates imply that small decreases in the number of hours of programming offered by the networks, in the number of commercials per hour, or in the aggregate audience

size (as examples) will not change or will very slightly increase the total revenues of the networks” (266).

Several studies focus on the elasticity of demand for television advertisements. Hendry (1992) finds that the long-term price elasticity for TV advertising (in the United Kingdom) is about -2, and is, therefore, quite elastic. Masih (1999), however, finds that the price elasticity of demand for television advertising (in Sydney, Australia) is near unity in the long term, but substantially less in the short term. While acknowledging that his results differ from Hendry’s findings of elastic demand, Masih reports that his estimates are consistent with the results of studies by Cave and Swann (1986) and Tavakoli, Swann, and Cave (1989). And, in a study of the New Zealand advertising market, Allen, Eagle, and Rose (2002) find that scarcities of both broadcast airtime and potential viewers make the demand for TV advertising, in the short run, relatively inelastic.

According to Seldon and Jung (1993) the estimated own-price elasticities of various communications’ media indicate that demand for broadcast is the least elastic of all advertising media. Similarly, Bush (2002) finds that advertisers’ demand for time on local radio and television stations to air their commercials is inelastic.

Due to the short-run inelasticity of demand for television airtime, TV broadcasters reap “embarrassingly large profits,” according to Corden (1961). Similarly, Anderson and Coate (2005) find that exclusive access to viewers allows television broadcasters to exercise market power against advertisers. Due to this market power, broadcasters are able to reap high profits by holding down advertising levels.

### ***Ad subsidies and media independence***

If advertising subsidizes media, does it enable media freedom or engender media dependence? Although the early economic literature dealing with this question is sparse, Kaldor (1950-1951) notes a dichotomy of opinions. Doyle (1968) suggests that the notion that advertising promotes media independence lacks cogency; rather, the subsidy may instill in media a dependence that “opens it to pressures and influence from advertisers which threaten the integrity of the editorial comment and affect the composition” (591). As Corden (1961) explains, advertisers can threaten to withdraw a subsidy, if a medium they sponsor, in some way, threatens their interests. “Apart from direct influence,” he writes, “there could also be some indirect influence brought to bear, in so far as papers propounding certain views do not get the amount of advertising support that they could expect if their policies changed” (23).

### ***Advertising and media diversity***

In defending advertising’s social role, the ad lobby argues that advertising subsidizes small and minority media outlets and thereby enables their existence. The economic literature provides scant support for that argument, however. According to Corden (1961), for example, advertising expenditures actually seem to improve the position of already strong media outlets against their weaker rivals.

A number of reports indicate that advertisers have often discriminated against minority broadcasters and programming aimed at minority audiences. Representative Cardiss Collins, for example, notes that the National Association of Black-Owned Broadcasters reports that “black-owned radio and television stations, print media, and black-owned advertising agencies are subjected to systematic discrimination” from advertisers (Congressional Record 1991, E32). According to a study by the Leadership Council on Advertising Issues (Federal Communications Commission 1994), minority radio stations “are disproportionately affected by changes in advertising revenues” and tend to be financially insecure. Also, Kofi Ofori of the Civil Rights Forum reports that ad revenues for minority-targeted broadcast stations are lower if the stations are minority-owned than if they are non-minority owned (Association of National Advertisers, 1998).

According to Huntemann (1999), the radio industry in the U.S. “has undergone unprecedented merger activity” in the wake of the 1996 Telecommunications Act; consequently, the industry is now highly concentrated. “Advertising dollars and economies of scale rule the bottom line of large radio groups,” Huntemann writes. “As a result, formats attracting high-consumption demographics are replacing formats that appeal to working-class, urban, and nonwhite audiences” (390). According to Einstein (2003) this policy change came about due to exponential growth in media outlets in the 1980s and early 1990s, which stretched advertising dollars thin. The Federal Communications Commission sought changes in communications policy, in part, to promote the viability of diverse media outlets. Apparently, the commissioners believed that consolidation would enable

stations to achieve economies of scale, and, broadcasters would invest the resulting increase in profits in diverse programming. Instead, Huntemann (1999) finds, advertisers have continued to demand large audiences from corporations that, post-consolidation, control larger audience segments, and the result has been a decline in minority programming.

Siegelman and Waldfogel (2001) find that “market provision of radio programming is beset by possible inefficient underprovision of formats appealing to small audiences whose social benefit of programming—but not advertising revenue—exceeds their costs” (n.p.). While majority-group listeners derive programming benefits through “preference externalities” (i.e., their preferences dominate popularity-based programming), those externalities are positive only for the majority group. Thus, the authors “expect problems of inefficient underprovision to be more likely for small minority populations” (n.p.).

Although Napoli (2002) finds a negative relationship between minority prominence and the value to advertisers of radio station audiences, Brown and Cavazos (2003) find that “minority programs do not appear to suffer from any advertiser bias” (13). Nevertheless, Brown and Cavazos (2002) note that “despite the absence of bias, the advertiser-supported broadcast market likely produces less than the socially optimal amount of African American programming” (227).

Concerning diversity in television programming, Owen, Beebe, and Manning (1974) find that the system of advertiser-supported media tends to supply wasteful duplication at the expense of diversity in programming. Einstein (2003) explains that “television’s reliance on advertising as its primary source of revenue is the reason we

have so few program choices” (vii). In her view, this reliance affects program content by limiting program length, by creating “a ‘lowest common denominator’ mentality,” and by restricting controversial or product-denigrating topics. Lowest-common-denominator programming fails to serve the needs of “audiences that are not attractive to advertisers, specifically older, poorer, and minority audiences,” she writes (4).

While some observers point to the niche programming (e.g., golf, cooking, and historical programs) that cable channels offer and argue that diversity in television programming is increasing, Einstein disagrees. As she sees it, the appearance of diversity is just that—an appearance. “Even if programming is geared toward a niche market, that market has to be large enough to attract advertisers,” she writes (4). In order to attract a large enough audience to satisfy advertisers, niche programs tend to be of the lowest-common-denominator variety.

According to Einstein, the same pool of producers creates most of the programs that are aired on cable *and* broadcast television. Thus, TV shows tend to be similar, wherever they are aired. In addition, some media conglomerates own multiple cable networks, and some companies that own broadcast networks also own cable networks. Summing up, Einstein observes that reliance on advertising means that popularity determines the content of programs, “because a mass audience [is] the product being sold to advertisers” (11).

Reaching a parallel conclusion, Anderson and Coate (2005) maintain that the “market may . . . misallocate resources by providing multiple varieties of popular programs types, when society would be better served with programs of different

types” (36). Since broadcasters want to entice advertisers by offering the sorts of programs that attract the largest audiences, the market may undersupply socially valuable programs.

Similarly, Gal-Or and Dukes (2003) find that commercial media (television stations, for example) tend to offer similar content because they reap higher profits when they minimize the amount they differentiate. According to the authors, their model shows “that media have incentives to minimize the extent of differentiation between them,” based on advertising’s assumed informative role and its reception by audiences “as an ultimate nuisance” (291). When “media tacitly coordinate . . . in order to reduce advertising levels,” and television stations minimize the differences between their programs, advertisers choose to reduce the quantity of ads they purchase, and the products that they choose to advertise are then displayed in a less-cluttered showcase (316). With a lower quantity of ads, stations are able to negotiate higher rates for their commercial minutes, and advertisers, the authors maintain, “gain higher margins on product sales” (291).

In a similar vein, Brown and Cavazos (2003) explain that broadcasters supply a public good (i.e., non-rival, non-excludable programming) and profit by selling advertisers time and access to audiences. According to the authors, advertisers’ preferences generate a market failure by distorting program choice: Advertisers want the program content to provide the best possible “frame” for their ads. This means that program content tends to be uncontroversial, light and “unchallenging.” In the view of the authors, this distortion inhibits program diversity and represents a market failure.

Beyond entertainment programs, advertisers' preference for attractive frames for their ads extends to news programs. Thus, the virtually endless string of cable-news programs (and network-news stories) that have been devoted to murdered-or-missing, young, beautiful, blonde women, over the past decade or so, might be explained by advertisers' desire for programs that target a prime demographic group and provide light and unchallenging frames for their ads. And, all the while, substantive, but challenging, stories remain untold for lack of advertiser support.

Anderson and Gabszewicz (2005) note that demand by advertisers to contact potential customers underscores the business model for most media industries. Since the object of program sponsorship is to reach the segment of the public that spends the most money on advertised products, media outlets offer content catering to that group. "Competition for viewers of the demographics most desired by advertisers implies that programming choices will be biased towards the tastes of those with such demographics" (n.p.).

## PART III: ADVERTISING, UTILITIES, AND DISUTILITIES

### *Introduction*

When pollsters ask people to name something that would improve the quality of their lives, most people respond: “money” (Campbell 1981). Thus, U.S. policymakers—believing that economic growth leads to higher personal income and equating increased income with increased well-being—design legislation and administer programs with economic expansion as their goal. In pursuing that end, they are generally successful; since World War II, annual economic growth has been the rule with few exceptions. Evidence gleaned from numerous studies suggests, however, that increased income does not necessarily equate with increased welfare (e.g., Brickman et al. 1978; Diener et al. 1993; Diener and Oishi 2000; Easterlin 1995; Kasser and Ryan 2001; Myers 2000; Ryan et al. 1999; Sheldon and Kasser 1998). The literature indicates that once people have enough money to meet their essential needs, increased income generally fails to improve their lives significantly. In fact, as Diener and Biswas-Diener (2002) note, a number of studies conclude that rising income predicts higher divorce rates (Clydesdale, 1997), increased stress (Thoits and Hannan 1979), lower global well-being (Diener et al. 1993), and reduced

enjoyment of ordinary activities (Brickman, Coates, and Janoff-Bulman 1978). The literature provides, in other words, some evidence that increasing income may actually be detrimental to welfare.

According to Diener and Seligman (2004), “income, a good surrogate historically when basic needs were unmet, is now a weak surrogate for well-being in wealthy nations” (10). And while domestic policymakers continue to focus on the economic consequences of their policies, the economic indicators on which they rely “omit, and even mislead about what society values” (1). Meanwhile, quality-of-life studies, spanning across behavioral- and social-science disciplines (e.g., economics, psychology, neuroscience, political science, anthropology, and sociology), point to various factors that actually make substantial contributions to individual and societal well-being.

Among those factors, good relationships seem to top every list (Layard 2005; Ryff 2005), and family relationships are the most important of all (Easterlin 2003; Helliwell 2003; Juster 1985; Kasser 2002; Lane 1993, 2000; Layard 2005). Some studies find a positive relationship between marriage and well-being (Blanchflower and Oswald 1999; Graham and Pettinato 2002a; Helliwell 2003); others find a strong positive relationship between family breakup and *unhappiness* (Easterlin 2003; Helliwell 2003; Lane 2000; Layard 2005).

Ranking high among contributors to well-being are friendship (Diener et al 1999; Juster 1985; Lane 2000; Layard 2005; Scitovsky 1977) and participation in community life (Diener and Seligman 2004; Helliwell 2003; Lane 2000; Layard 2005).

Whereas rising income, as noted above, is a poor predictor of well-being in wealthy nations like the United States, *satisfaction* with income is positively associated with well-being (Blanchflower and Oswald 1999; Diener et al. 1999; Graham and Pettinato 2002a; Lane 1993; Layard 2005). Studies show that having a satisfying job contributes greatly to happiness (Andrews and Withey 1976; Diener and Seligman 2004; Juster 1985; Lane 2000; Layard 2005; Scitovsky 1977) and, not surprisingly, that unemployment is a major cause of unhappiness (Blanchflower and Oswald 1999; Clark and Oswald 1994; Di Tella et al. 2001; Diener and Seligman 2004; Frey and Stutzer 2002; Graham and Pettinato 2002a; Helliwell 2003; Layard 2005; Kposowa 2001; Viinamaeki et al. 1996). And while employment is clearly a factor, research shows that leisure is important, as well (Csikszentmihalyi 1999; Diener 2000).

Additional studies find that having a purpose in life (Helliwell 2003; Ryff 2005), an upbeat attitude (Diener et al. 1999; Ryff 2005), and an even temperament (Diener et al. 1999) increase well-being. Moreover, studies link well-being with experiencing: autonomy (Lane 1993, 2000; Layard 2005; Ryff 2005), personal growth (Csikszentmihalyi 1999; Diener et al. 1999; Helliwell 2003; Lane 2000; Layard 2005; Ryff 2005; Scitovsky 1976; Van Boven and Gilovich 2003), security (Kasser 2002; Layard 2005), and health and longevity (Diener and Seligman 2004; Easterlin 2003; Helliwell 2003; Layard 2005).

The preceding factors are only some of the contributors to happiness that appear in the literature; nevertheless, they are among the most often discussed and least controversial. It is worth noting that enjoying high levels of consumption is not

among the major factors contributing to well-being. On the flip side, numerous studies (e.g., Diener and Biswas-Diener 2002; Kasser 2002; Kasser and Ryan 1993; Richins and Dawson 1992; Sirgy 1997) conclude that materialistic values are a major contributor to *unhappiness*. As we shall see, advertising contributes to the adoption and development of materialistic values.

## Chapter 7: Advertising's Impact on the Individual and Society

*Advertising at its best is making people feel that without their product, you're a loser.*

Nancy Shalek, president of the Shalek Agency

### ***Linking advertising to materialism***

Researchers have confirmed what the candid, ad-agency president, Nancy Shalek, implied: Advertisements are often designed to make the people who observe them feel inferior—like *losers* (Halliwell and Dittmar 2004; Richins 1991). A number of studies report that people often rely on advertisements to provide measures of social comparison (Groesz et al. 2002; Martin and Kennedy 1993; Shaw and Waller 1995). As Kasser et al. (2004) note, ads often “show idealized versions of life within the context of the advertisement” and engender feelings of inferiority by engaging exceptionally attractive people to “display products amidst a level of wealth that is unattainable by the average consumer” (16-17). Between the fade in and fade out of a typical commercial, an actor discovers that a vexing problem (“ring around the collar,” perhaps) can be solved by using the advertised product. The ad then leaves viewers to compare themselves to the actor they have seen and to deduce what they must do to be transformed—in one way, at least—into a *winner*.

But if advertisers are, in fact, *trying* to make people feel inferior, what motivates them to do so? Do they do it, as some of the industry's critics have

implied, to make people feel miserable so that they can then convince the poor wretches that the advertised product—and *only* the advertised product—will make them feel better? If that is their aim, advertisers generally miss their mark (Brack and Cowling 1983). Few people (with the exception of very young children) are consistently gullible. On the other hand, as Kasser et al. (2004) explain, if the comparisons that people make between their own attributes and those of the idealized people they see in ads “heighten feelings of personal insecurity,” the ads “may then activate compensatory mechanisms designed to alleviate negative feelings.” Although people can choose among a variety of compensatory methods in response to those negative feelings, “the likelihood of [their] choosing a materialistic or consumption-oriented method is increased by the fact that the ads themselves always present a very clear option for feeling better. . . .” And that option is, of course, to “buy the product!” (Kasser et al. 2004, 17).

As Schudson (1984) explains:

Advertising might be said to lead people to a belief in something. Advertising may make people believe they are inadequate without Product X and that Product X will satisfactorily manage their inadequacies. More likely, it may remind them of inadequacies they have already felt and may lead them, once at least, to try a new product that just might help, even though they are well aware that it probably will not. Alternatively, advertising may lead people to believe generally in the efficacy of manufactured consumer goods for handling

all sorts of ills, medical or social or political, even if a given ad fails to persuade that a given product is efficacious (224).

Moreover, advertising may inculcate “the view that products and their acquisition are the basis for determining one’s personal worth” (Kunkel et al. 2001). It may, in other words, make people materialistic.

Buijzen and Valkenburg (2003b) propose two reasons to explain why advertising enhances materialism: (1) “[Advertising] is designed to arouse desires for products that would not otherwise be salient”; and (2) advertising “propagates the ideology that possessions are important and that desirable qualities—such as beauty, success, and happiness—can be obtained only by material possessions” (485).

Television seems to be particularly effective in propagating that ideology, as indicated by a number of studies that report a positive relationship between time spent watching television commercials and adherence to materialistic values. Studies drawing on samples across different age groups (e.g., Adler et al. 1980; Greenberg and Brand 1993; Kasser and Ryan 2001; Rahtz, Sirgy, and Meadow 1988, 1989; Sheldon and Kasser 1995) and from various countries (Cheung and Chan, 1996; Khanna and Kasser, 2001) find positive correlations between TV viewing and materialistic values. Reviewing the literature, Buijzen and Valkenburg (2003b) note positive correlations between advertising exposure and materialism in studies by Atkin (1975a,b), Churchill and Moschis (1979), Moschis and Churchill (1978), Moschis and Moore (1982), and Ward and Wackman (1971). While some researchers (e.g., Kasser et al., 2004) accept the validity of that correlation, they wonder, nevertheless, about the direction of causality.

## **Disentangling Causation**

Because people in developed, capitalistic countries have generally been exposed to ads throughout their lives, researchers find disentangling the direction of causation between ad-exposure and materialism problematic when their studies employ adults or adolescents as experimental subjects. In a longitudinal study of adolescents, for example, Moschis and Moore (1982) find that “increased advertising exposure seems . . . to contribute to the development of materialistic values among those who have *not yet* developed such predispositions” (285; italics in the original). Does advertising make people who have *already* developed such predispositions more materialistic? Or is the positive correlation between ad exposure and materialism explained by some intervening variable? Are materialistic people somehow attracted to advertising? Put another way, do materialistic people expose themselves to ads more frequently than non-materialistic people, and is that the reason for the positive relationship between advertising and materialism? Studies that merely find correlations between ad-exposure and materialistic values are unable to answer those questions.

If the correlation between advertising and materialism can be *entirely* explained by a demonstrated tendency of materialistic people to gravitate toward advertising, then the supposed relationship between exposure to ads and the adoption of materialistic values by non-materialistic people may be spurious. Although disentangling these potential causes for the correlation is crucial to understanding the true nature of the relationship, once disentangled, the question of whether or not

materialistic people are drawn to advertising can be set to one side. For the purposes of this study, it is only necessary to determine whether or not exposure to advertising leads to the adoption and development of materialistic values.

Ideally, in order to disentangle the hypothetical causes, researchers would expose non-materialistic experimental subjects to ads for the first time. If, following sufficient exposure, researchers found materialistic values in formerly non-materialistic subjects, then the researchers could reasonably conclude that advertising is a cause of materialism.

Unfortunately, the ideal subjects for such a controlled experiment probably do not exist. Virtually everyone on the planet has had some exposure to advertising. Nevertheless, researchers have been able to approximate controlled experiments by studying two groups of low-ad-exposure subjects: (1) citizens of the People's Republic of China and (2) children from various Western countries.

### **Ad-induced materialism in children**

In one early experimental study, Goldberg and Gorn (1978) showed a treatment group of preschool children ads for toys, and showed a control group of preschool children no ads for toys. After the children in the treatment group watched the ads, they chose to play with the toys they had seen in the ads more often than they chose to play with other children. The children in the control group, on the other hand, chose to play with other children more often than they chose to play with the advertised toys. Thus, Goldberg and Gorn conclude, watching television

commercials apparently leads children “to select material objects over more socially-oriented alternatives” (22).

Examining British children’s letters to “Father Christmas,” Pine and Nash (2002) conclude: The more television commercials children watch, the more items they request, in general, and the more branded items they request, in particular. Comparing the British children, who frequently view commercials, to a matched group of Swedish children, who live in a country where advertising to children is prohibited, the researchers note that requests for items among British children are significantly higher than among Swedish children. Pine and Nash suggest that television commercials may socialize British children “to become consumers from a very early age” (529).

In a similar study, Buijzen and Valkenburg (2000) compare the Christmas wish-lists of 250 children to television commercials being aired during the pre-Christmas shopping season. Their results indicate that the wish-lists of two-thirds of the 7- and 8-year-olds, about half of the 9- and 10-year-olds, and two-fifths of the 11- and 12-year-olds include at least one advertised product. Analyzing the intended and unintended effects of advertising, Buijzen and Valkenburg conclude: “advertising is positively and directly related to children’s purchase requests and materialism” (483).

In a report for the American Psychological Association, Kunkel et al. (2001) note the positive correlation between children’s exposure to advertising and their acceptance of materialistic values. Similarly, Moschis and Moore (1982) and Greenberg and Brand (1993) find a direct relationship between ad exposure and materialistic values among middle school and high school students, and Adler et al.

(1980) find a positive association between television viewing and materialistic values among children in grades four through seven.

Thus, the results of a number of studies suggest not only that a positive relationship exists between advertising and materialistic values but also that advertising can lead to the adoption of those values—at least in children and adolescents. But what about adults? Can exposure to advertising make them materialistic? If they are already materialistic, can it make them more so?

### **Ad-induced materialism in adults**

Studies of Chinese adults may suggest an answer. China is particularly useful for research into the impact of advertising on the adoption and intensification of materialistic values, because widespread materialism is a relatively new phenomenon in China. Traditionally, the dominant, Chinese value systems—both Confucian and communist—eschewed materialism (Paek and Pan 2004). Perhaps more relevant, the Chinese government, under Chairman Mao, banned advertising at the start of the Cultural Revolution, and the ban remained in place until 1979, when Deng Xiaoping enacted the “Four Modernizations” (Zhou et al. 2002). As Tse, Belk, and Zhao (1989) note, “the changes in the country’s economic policies have created an unprecedented field experiment involving one billion subjects . . . in which the learning of modern consumption can be investigated” (458).

Kasser et al. (2004) cite Ryan et al. (1999) and Sen (1999) in positing that advertising encourages the spread of free-market economies to economically developing countries by instilling both insecurity and materialistic values.

Furthermore, the authors note, anthropological literature (e.g., O'Barr 1994) makes clear that advertisers purposefully aim to promote materialistic values in developing countries. Advertising and the media it sponsors flood potential consumers with messages implying that the road to happiness is paved with material goods and that happiness itself is attained by owning the right products (Mander 1991). "Inevitably, these messages are internalized to some degree and have the net effect of promoting materialism" (Kasser et al. 2004, 18).

Following China's economic liberalization, advertising began to be deemed "an essential tool of economic development" (Zhou et al. 2002, 74). One top Chinese legislator told the World Advertising Conference that by 1987 advertising was an "indispensable element in the promotion of economic prosperity" (qtd. in Zhou et al., 74). During the 1990s, advertising in China grew more than 40 percent per year.

Wei Ran (1997) finds that, among Chinese, opinions about advertising vary by generation. Older people tend to disapprove of advertising and attempt to maintain traditional Chinese ways, whereas young people seem to "view advertising positively, spend freely and favor a Western lifestyle" (261). As Lin (2001) notes, young people in China have begun to spend significant proportions of the family income on brand-name (i.e., advertised) clothing.

According to Paek and Pan (2004), advertisements "play a significant role in shaping consumerist orientations among China's urban residents" (491). Other researchers report similar findings. Numerous content analyses of ads appearing in China confirm the conclusion that advertising attempts to promote materialistic values (Chan and Cheng 2002; Cheng and Schweitzer 1996; Lin 2001; Tse, Belk, and

Zhao 1989). In an empirical study of Chinese consumers, Wei and Pan (1999) find a relationship between exposure to advertising and materialism in China, noting, more specifically, a relationship between advertising and the acceptance of “conspicuous consumption, self-fulfillment, individual indulgence, and worshipping of Western lifestyles” (Paek and Pan 2004, 495). Field studies by Davis (2000) and Wu (1999) suggest that the Chinese people devote an increasing amount of time and energy to consumption, as their exposure to advertising increases. Similarly, Paek and Pan conclude that their “study shows significant linkages between positive attitudes toward advertising and the acceptance of consumerist values” (508).

In sum, the results of numerous empirical studies involving children, adolescents, and Chinese adults provide evidence that exposure to advertising can lead people of all ages to adopt materialistic values.

### ***The impact of materialistic values on well-being***

According to Kasser (2002), “existing scientific research on the value of materialism yields clear and consistent findings. People who are highly focused on materialistic values have lower personal well-being and psychological health than those who believe that materialistic pursuits are relatively unimportant” (22).

Although evidence from numerous studies indicates that achieving materialistic goals—obtaining wealth, status, and possessions—fails to increase human happiness or well-being over the long run (Kasser 2002), advertising (and the consumer culture in which it is embedded) insists that “we can counter insecurity by buying our way to

self-esteem and loveworthiness” (Ryan 2002, xi). At the same time, ads engender insecurity by implying that we are unworthy and unlovable unless we use the advertised product. Thus, we attempt to alleviate our insecurity through consumption, but our insecurity remains, because the purchased product fails to change our lives and the messages urging us to consume never end. As B. Schwartz (1994) explains, the “disappointment we feel with consumption induces us to consume more and more and different things in the elusive pursuit of pleasure” (162).

Empirical studies have consistently found that “people who strongly value the pursuit of wealth and possessions report lower psychological well-being than those who are less concerned with such aims” (Kasser 2002, 5). According to a number of studies, materialistic people tend to be less satisfied—even *dissatisfied* with their lives (Ahuvia and Wong 1995; Belk 1985; Dawson 1988; Dawson and Bamossy 1991; Kasser 1994; Kasser and Ryan 1993, 1996; Richins and Dawson 1992; Sirgy et al. 1995). Compared to their less materialistic peers, materialists tend to feel less vital (Kasser 1994; Kasser and Ryan 1993, 1996), are less self-actualized (Ahuvia and Wong 1995; Kasser and Ryan 1996; Mick 1996), and feel less positive affect (Solberg, Diener, and Robinson 2004).

While much of the research involves American researchers and subjects, a number of studies investigate the impact of materialism in other nations. A study of over 7,000 college students from 41 countries, for example, found negative associations between materialistic values and life satisfaction (Diener and Oishi 2000). Individual studies of college students in Australia (Saunders and Munro 2000), Britain (Chan and Joseph 2000), Denmark (Khanna and Kasser 2001),

Germany (Schmuck et al. 2000), India (Khanna and Kasser 2001), Romania (Frost 1998), Russia (Ryan et al. 1999), and South Korea (Kim et al. 2003); studies of adults in Germany (Schmuck 2001), China, Turkey, Australia, and Canada (Sirgy et al. 1998); and studies of business students in Singapore (Kasser and Ahuvia 2002) all confirm the results of research done in the United States. Apparently, holding materialistic values reduces the well-being of individuals who live anywhere in the world.

Not only do researchers report a negative relationship between materialism and well-being across nations but also across study participants' ages, genders, and income ranges (e.g., Ahuvia and Wong 1995; Kasser 2002; Mick 1996; Sheldon and Kasser 2001). Summing up the results of a series of thirteen experiments, Solberg, Diener, and Robinson (2004) conclude: "The results of our studies suggest that materialism appears to be toxic to [subjective well-being] and that this relation is multidetermined" (45). Similarly, Richins and Dawson (1992) find a negative relationship between materialism and satisfaction in "all aspects of life measured" (313).

According to Diener and Biswas-Diener (2002), however, *wealthy* materialists may be an exception to the rule. "People who prize material goals more than other values tend to be substantially less happy, unless they are rich," they write (119). Nevertheless, Solberg, Diener, and Robinson (2004) note that even rich materialists are generally less happy, because they tend to be highly status conscious. Since no one—not even the richest person alive—can own everything, materialists who feel they must own the most superlative goods (the newest, finest, rarest, etc.) can never

be satisfied. In Kasser's words, "even the successful pursuit of materialistic ideals typically turns out to be empty and unsatisfying" (2002, 43).

According to some observers, materialists are less happy than non-materialists because they devote their time and energy to things rather than people (e.g., Durning 1992; Kasser 2002). Materialists tend to work harder and longer in order to earn the wherewithal to purchase what they can from the endless list of things they desire. After purchase, materialists expend effort maintaining, storing, replacing, upgrading, and managing the things that they buy. What little time they find for leisure is often spent consuming ad-filled media, which urge them to keep investing in things. "Thus," Ryan (2002) suggests, "in the journey of life, materialists end up carrying an ever-heavier load, one that expends the energy necessary for living, loving, and learning—the really satisfying aspects of that journey," (xi).

In sum, the literature seems to indicate that materialists suffer reduced well-being, in part, because the time and energy they devote to things prevents them from developing good relationships. Lacking good relationships, they feel insecure, and, feeling insecure, they turn to things. The things that they turn to prove ultimately unsatisfying, however, and the time and energy materialists devote to those things prevent them from developing good relationships. Thus, lacking good relationships, materialists feel insecure, and, feeling insecure, they turn to things, and the cycle repeats *ad infinitum*.

## *Ad-induced materialistic values and human health*

### **Direct effects**

For the most part, advertising's impact on health is indirect, affecting mental health by inculcating materialistic values. Advertising can directly impact physical health, however, in positive and negative ways. On the upside, advertising can spread information about health-promoting products and services. Arrow et al. (1990) note, for example, the wave of consumers who switched to high-fiber cereals as soon as advertisers began to publicize the health benefits of whole grains. On the downside, however, advertising can persuade people to engage in harmful activities (e.g., overeating, compulsive shopping, and addictive gambling) or indulge in consumption of harmful products (e.g., tobacco), potentially harmful products, (e.g., alcohol and junk food), and products that, over time, are found to be harmful (e.g., the prescription arthritis drugs, Vioxx and Celebrex, which were found to increase patients' risk of experiencing blood clots, heart attacks, and strokes).

### **Indirect effects**

By and large, however, advertising affects health indirectly, by inundating and overwhelming the human mind with materialistic messages. According to Kasser (2002), numerous studies, utilizing various methods and measures, find "a clear pattern of psychological (and physical) difficulties associated with holding wealth, popularity, and image as relatively important" (14). Ads often imply that those exact

values are indeed crucial and that they are in fact achievable for any consumer who purchases advertised products.

The literature reveals an association between materialism and an array of psychiatric problems, including narcissism, personality disorders, depression, anxiety, and addiction (Kasser 2002; Kasser et al. 2004). In addition, some authors find a relationship between materialistic values and stress, noting that stress is a major contributor to a number of physiological and psychological maladies (De Graaf et al. 2002; Lane 2000; Linder 1970).

### **Ad-induced materialism and self-esteem**

Some studies find an association between low self-esteem and materialistic values. Kasser and Ryan (1993) and Richins and Dawson (1992) speculate that such values reflect feelings of “contingent worth’ predicated on *having* rather than *being*,” which are corrosive to self-esteem. “When people believe that their worth depends on external signifiers such as money and status, they are much more easily buffeted by the whims of fate than when they have a secure, stable, and deep sense of esteem that is not dependent on such accomplishments” (Kasser 2002, 50).

According to Kasser (2002), most psychologists believe that people gain self-esteem by pursuing and attaining goals. The pursuit of an unattainable goal, however, reduces self-esteem. Since achieving materialistic goals fails again and again to bring sustained well-being, the self-esteem of those who pursue them tends to suffer.

## **Narcissism**

According to Richins and Dawson (1992), materialists have an abnormal preoccupation with themselves. Given their narcissism, they tend to have fewer social skills than people with less materialistic values. Kasser (2002) explains that materialists and narcissists share a desire for external validation and notes the view, common among some psychologists and social critics (e.g., Barber 2007; Lane 2000; Lasch 1979), that the “Have-It-Your-Way” consumer culture promoted in advertisements “breeds a narcissistic personality by focusing individuals on the glorification of consumption” (Kasser 2002, 12).

## **Depression and anxiety**

Advertising is linked to depression and anxiety via materialism. According to Kasser and Ryan (1993, 1996), people with strongly held materialistic values suffer “significantly higher levels of depression and anxiety” than people with less materialistic values (7-8). Wachtel and Blatt (1990) find that individuals with high scores in the constructs of materialism are more likely to be depressed, and Schroeder and Dugal (1995) find that high scorers are more likely to suffer from social anxiety.

Rates of depression are on the rise throughout wealthy nations. According to Myers (2000), depression is listed as the second most prevalent disease among residents of high-income nations in a table of world diseases. The Harvard Mental Health Letter (1994) reports that a dozen independent studies, involving 43,000 people from several countries, reveal an increasing depression rate throughout the twentieth century.

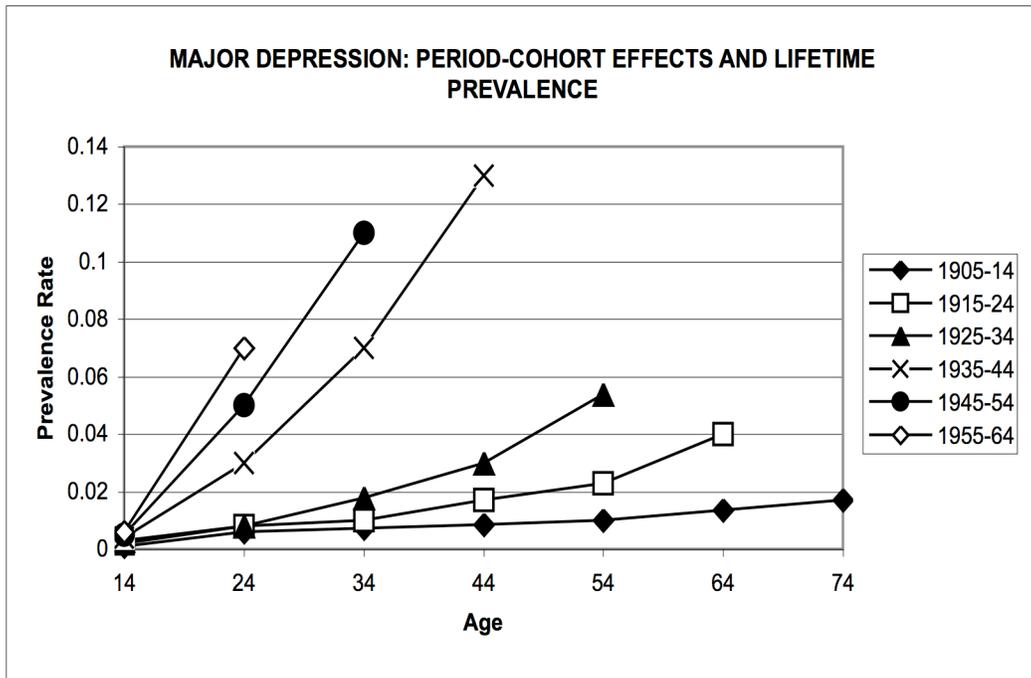
What worries some observers is the correspondence between rising rates of depression and income (Layard 2005; Moore and Simon 2000). As Diekstra (1995) notes, the evidence suggests that the rise is largely confined to the white populations of North America and Northern Europe, because studies employing an identical design on other populations fail to confirm this finding (Canino et al. 1987; Karno et al. 1987). Within the United States, the depression rate among the dogmatically non-materialistic Old Order Amish is approximately one-tenth of their non-Amish neighbors (McKibben 2007). Seligman maintains that the evidence explaining the rise in depression “points to a purely environmental effect,” rather than a gene-environment interaction (qtd. in Lane 2000, 348), and McKibben speculates that the surge in depression is due to “some dramatic change in human circumstance in recent decades” (111-112). As Lane (2000) explains, “the idea that it is the advanced and not the less-developed countries or the collectivist countries of Asia that bear the brunt of this epidemic has been fairly well established” (348).

In the U.S., clinical depression affects approximately one-quarter of the population sometime in life (Lane 2000). According to Kessler et al. (1994), approximately one-half of the U.S. population has been unable to function normally due to severe depression for a period of at least two weeks during their lifetimes, and about one-fifth of the population meets the criteria for a lifetime diagnosis of dysthymia or major depression.

As a number of studies reveal (e.g., Hagnell et al. 1982; Robins, Locke, and Regier 1991; Weissman et al. 1991) and the graph in Figure 7.1 illustrates, successive U.S. birth cohorts face an increased risk of experiencing major depression during

their lifetimes. Notice, for example, that at age thirty-four, people born between 1945 and 1954 were more than ten times more likely to experience major depression than people born between 1905 and 1914. According to Diekstra (1995), the increasing rates of depression are partially explained by a falling age of onset. Seligman (1990) agrees, noting that depression “strikes a full decade earlier in life on average than it did a generation ago” (10).

Figure 7.1



Source: The Epidemiologic Area Catchment Study NIMH, adapted from Weissman et al. 1991, as found in Diekstra 1995.

In addition to inflicting misery on its victims, depression exacts high economic and social costs. For one thing, the depressed tend to have poor relationships at home, at school, at work, with friends, and in the community (Lane

2000; Schwartz 2004). For another, depressed people tend to be less productive at school and on the job (Lane 2000). Depressed people seem to get sick more often. Studies show that mildly depressed Americans take one and a half times as many sick days as their non-depressed peers and that severely depressed Americans take five times more sick days than do mildly depressed Americans (Lane 2000; Schwartz 2004). In addition, on average, the depressed die at a younger age than the non-depressed, due not only to illness but also to violence—most notably to suicide.

In an otherwise sanguine appraisal of modern conditions, Moore and Simon (2000) find one sour note: America's increasing suicide rate. "It is troubling . . . to report," they write, "that despite all of the material progress of the past 50 to 100 years, a larger percentage of Americans take their lives today than was true in 1900. Teen suicide has risen at an especially disheartening rate" (19). Discussing the dimensions of the tragedy, Martin Seligman notes: "We are in the midst of an epidemic of depression, one with consequences that, through suicide, takes as many lives as the AIDS epidemic" (qtd. in Lane 2000, 21).

In sum, rates of depression and suicide have been increasing over the past century. Although correlation does not prove causation, it is worth at least noting that those rates have corresponded with increasing rates of advertising.

## **Addiction**

The connection between ads and addiction is, for the most part, indirect: Ads encourage people to adopt materialistic values, having those values makes people

depressed, and depression leads people to self-medicate with addictive substances or behaviors. In some cases, as noted above, advertising can provide a direct route to addiction, by encouraging people to consume addictive products (e.g., tobacco) and potentially addictive products (e.g., alcohol) or to participate in potentially addictive activities (e.g., gambling), by making those products or activities appear to be satisfying and glamorous.

Regardless of the means to addiction, the brain reacts to a lack of addictive stimulus with a change in brain chemistry. According to Klein (2006), whenever humans have a basic need that remains unfulfilled, their brains release a discomforting opioid, dynorphin, which signals a deficiency. Spurred on by the restlessness and irritability associated with dynorphin, the brain triggers an impulse to act and “look[s] for a signal to compensate for the deficiency” (113). At the instant people satisfy the basic need, however, their brains release dopamine, as a pleasant reward. Thus, when people need food, they feel hungry; when they eat, they feel pleasure with the very first bite.

Addictions involve the same processes, but greatly amplified. According to Klein, “the brain links the sight of the [addictive substance or activity] and the desire of it irradicably. An addicted brain that recognizes a cigarette immediately orders ‘Light it!’ or, stimulated by a ‘bottle,’ gives the order to drink” (123).

Advertising can encourage addictions by implying that an addictive substance or activity satisfies a genuine need (e.g., for food, drink, love, respect, or relief from suffering), and it can discourage abstinence by flaunting the addictive product or activity before the addict. To take one example, during the heyday of cigarette

advertising, “cigarette sales rose from 332,345 million in 1945 to 506,127 million in 1960.” As Cross (2000) explains, this is “a powerful, if negative, tribute to the impact of advertising” (88). To what extent advertising has contributed to tobacco or any other addiction is beyond precise determination. Nonetheless, the synthesis of Cross’s statistics with findings in neuroscience suggests the possibility of a direct link between advertising and addiction.

Often, however, the link between advertising and addiction is less direct. According to numerous authors, advertising inculcates materialistic values, which equate success with having things that other people admire, such as beauty, status, and wealth (Barber 2007; Kasser et al. 2004; Lane 2000; Schudson 1984). By definition, people who adopt materialistic values seek satisfaction from outside themselves through the pursuit of things, rather than through the pursuit of intrinsic, intangible goals (Kasser 2002; Kilbourne 2004; B. Schwartz 1994). Consuming material things, however, satisfies only certain needs and even then, only up to the point of diminishing returns. When materialistic people try to satisfy an intangible need for, say, romantic love or companionship, with a tangible, advertised thing, such as a bottle of perfume or a can of beer, they fail: The intangible need remains unfilled. Although materialists (and others) generally do experience pleasure for a time after a purchase, that pleasure passes as they adapt to having what they once believed would provide satisfaction (Diener 2000). Then, with the underlying, intangible need still unmet, they once again feel restless and irritable, in the way neuroscience writer Klein (2006) describes. Being persuaded—in part by advertising—that consumption can quell their discomfort, they make another purchase. When that fails, they make

yet another purchase. Even if it fails to satisfy over the long run, each purchase provides some immediate gratification; and even if it does nothing to satisfy the underlying, intangible need, perpetual consumption provides perpetual (short-term) gratification. Thus, some materialistic people become compulsive consumers—or “shopaholics.” As economics professor Herman Daly puts it: “Consuming becomes pathological because its importance grows larger and larger in direct proportion to our decreasing satisfaction” (qtd. in De Graaf et al. 2002).

Advertising can fuel compulsive consumption by appealing to materialists’ desire for status. Given their need for validation by others, materialistic people try to own items that send “the right signal” to the people they hope to impress. “The problem is that the world’s signals keep changing, so addicts [i.e., shopaholics] never reach a point of having enough” (De Graaf et al. 2002, 105). And advertisers ensure that the signals keep changing.

As noted above, materialistic values can be a cause of depression, and, as Lane (2000) explains, “depression has been found to be a contributing causal factor” in alcoholism and drug dependency (329). Thus, on one pathway, advertising leads to materialism, materialism leads to depression, and depression completes the journey to addiction.

The results of a number of empirical studies (e.g., Cohen and Cohen 1996; Kasser and Ryan 2001; Williams et al. 2000) indicate that people with a strong materialistic value orientation are “highly likely” to use tobacco, alcohol, and drugs frequently. While the extent to which ad-induced materialism is a factor in addiction is debatable, the fact that millions of Americans consume something compulsively is

beyond question. According to De Graaf et al. (2002), approximately sixty million Americans are addicted to tobacco, fourteen million use illegal drugs, twelve million are alcoholics, ten million are compulsive shoppers, and five million are addicted to gambling. In addition, more than sixty-six percent of adult Americans are either overweight or obese (National Center for Health Statistics 2008).

According to Lane (2000), advertising can be detrimental to individuals' capacity for deferred gratification. Experimental studies show that "deferred gratification is impeded by the visibility of the rewards to be earned." The "function of advertisements [is] to make visible and urgent the appeal of some attractive object," Lane explains. Thus, ads make "self-control a special problem for a consumer culture" (182).

Complicating that problem is the fact that one popular mechanism for delivering advertising can itself be addictive. According to Rutgers University psychologist Robert Kubey, millions of Americans' dependence on TV "fit[s] the criteria for substance abuse as defined in the official psychiatric manual" (Herr 2008).

### **Advertising and physical perfectionism**

By inculcating values that emphasize outer appearance, rather than inner substance, ads can affect physical as well as mental health. Kasser and Ryan (1996), for example, find that people holding materialistic values—regardless of age, wealth, or gender—suffer more headaches, sore muscles, backaches, and other physical ailments than people holding less materialistic values.

The materialistic values that ads promote can also be implicated in illnesses that clearly involve both mind and body. According to Kilbourne (2004), for instance, ads that promote an ultra-thin ideal for women, “contribute to the body-hatred so many young women feel and to some of the resulting eating problems, which range from bulimia to compulsive overeating to simply being obsessed with controlling one’s appetite” (257).

Schwartz (2004) explains that eating-disorder rates are much higher in cultures where ultra-thin is the ideal form for a woman’s body than where it is not. Furthermore, women who live in cultures where slenderness is idealized are twice as likely as men to be depressed. In Schwartz’s “admittedly speculative” view, women become depressed because they believe that they should be able to control their weight. When they fail to achieve the ultra-thin goal, they “not only have to face the daily disappointment of looking in the mirror, they also must face the causal explanation that this failure to look perfect is their fault” (214). Advertising plays a role, because ads attempt to engender the belief that looking perfect is possible and within a woman’s control—*if only* she buys this gym membership, that shampoo, this low-calorie cookie, that lipstick, these blue jeans, etc.

### ***Advertising and the well-being of children***

Estimates of recent, annual expenditures for advertising directed at children vary by source, from more than \$5 billion (McNeal 1999) to \$12 billion (Rice 2001) to “as much as \$40 billion” (Barber 2007). Whatever the precise sum, expenditures

dedicated to inducing kids' demand for advertised goods are substantial. As one marketing executive explained, corporations attempt to expose kids "to their brand in as many different places as possible throughout the course of the day or the week, or almost anywhere they turn in the course of their daily rituals" (Kjos 2002). Television, alone, exposes children to an average of 40,000 commercials every year (Kunkel 2001).

According to Levin and Linn (2004), advertising agencies and their corporate clients "routinely hire child psychologists" and other social scientists to discover ever more potent ways to motivate children to demand products (224). The Saatchi and Saatchi advertising agency, for example, hired a team of anthropologists and psychologists to conduct an "exhaustive" study of two hundred children in their homes. The sole purpose of this 1999 study was, in fact, "to help corporations market to children more effectively" (224).

Although advertising agencies and their corporate clients generally withhold the results of their research from public scrutiny, academic studies show that young children lack the cognitive skills to recognize the persuasive intent of advertisements (Levin and Linn 2004). According to the American Psychological Association, evidence from a large body of studies indicates that young children are "uniquely susceptible to advertising influence" (Kunkel 2001, 1). Thus, advertisers seek to establish brand loyalty as early in a child's life as possible. As Joan Chiamonte, a market researcher, notes: "If you wait to reach children with your product until they're eighteen years of age, you probably won't capture them" (qtd. in De Graaf et al. 2002, 52).

Anecdotal evidence suggests that marketers are capturing children quite early. One advertising executive explains: “What parents are telling us is that kids are requesting brands and are brand-aware almost as soon as their verbal skills set in” (Hood 2000, 15). According to the Center for the New American Dream, “by the time children head off to school most can recognize hundreds of brand logos” (Media Awareness Network, 2008).

The Internet enables advertisers to exploit a lucrative new category of consumers: “cybertots.” According to one ad man, the Internet’s ability to capture children’s attention is unprecedented “precisely because when kids go online, they enter the ‘flow state.’” As Csikzentmihalyi (1990) explains, when people enter the flow state they become totally immersed in an activity. Thus, Eric Gruen explains, “there is nothing else that exists like [the Internet] for advertisers to build relationships with kids” (qtd. in Barber 2007, 97).

In the view of the American Psychological Association, advertising directed at young children is “fundamentally unfair” (Kunkel et al. 2004, 23). The American Academy of Pediatrics (1995) concurs. “Advertising directed toward children is inherently deceptive and exploits children under [eight] years of age” (American Academy of Pediatrics 1995; qtd. in Levin and Linn 2004, 218-219).

### ***The Influence of Advertising on Adolescents***

As numerous studies cited in a previous section indicate, advertising contributes to the adoption and growth of materialistic values among people of all

ages. Teenagers may be particularly susceptible. According to Kilbourne (2004), people are “more vulnerable to the seductive power of advertising” during adolescence than at any other time, because teens are acutely sensitive to peer pressure. Understanding that they have the ability to generate and shape peer pressure, advertisers “do not hesitate to take advantage of the insecurities and anxieties of young people, usually in the guise of offering solutions” (252). A number of different types of studies indicate that people tend to focus on materialistic desires and values when they feel insecure (Maslow 1954; Fromm 1976; Rogers 1964; Inglehart 1977). By exploiting teen insecurity, ads offer solutions that inculcate materialistic values.

Moschis and Moore (1982) show that exposure to advertising contributes to materialism in adolescents. Other researchers find that materialistic values negatively impact adolescent behavior and well-being. According to Cohen and Cohen (1996), for example, adolescents who covet good looks, wealth, and status or put a priority on being rich are significantly more likely to violate individuals’ rights and society’s laws and to behave with hostility, defiance, or disobedience toward authorities. A number of studies find that highly materialistic teens are more likely than their less materialistic peers to function poorly in school, on the job, and in extracurricular activities (Kasser and Ryan 1993); to engage in sexual intercourse (Williams et al. 2000); to exhibit signs of conduct disorders (e.g., carry weapons, miss school, vandalize property) (Kasser and Ryan 1993); to have poor interpersonal skills (e.g., isolate themselves, act in passive-aggressive ways, violate others’ rights) (Cohen and

Cohen 1996); and to use drugs (Cohen and Cohen 1996; Kasser and Ryan 2001; Williams et al. 2000).

### ***The creation and perpetuation of stereotypes***

“Stereotypes consist of sets of beliefs about the characteristics of the members of social groups that influence attitudes and behaviors toward them” (Miller et al. 1999, 319). Cultural critics of advertising argue that ads reflect and reinforce stereotypes that tend to reduce well-being. In some cases, critics say, advertising presents stereotypical ideals that few can attain, leaving those who fail to measure up with feelings of inferiority; in other cases, advertising lowers self-esteem by excluding or under-representing members of certain demographic groups from participation in advertisements. Some observers suggest that underrepresented groups may suffer harm to their self-concepts, because they infer from their exclusion that advertisers deem them irrelevant (Bramlett-Solomon and Subramanian 1999).

### **Race**

The proportion of Whites in advertisements, according to almost every study going back to the 1970s, has been significantly higher than the actual proportion of Whites in the U.S. population (Weigel, Loomis, and Soja 1980; Riffe, Goldson, Saxton, and Yu 1989; Zinkhan, Qualls, and Biswas, 1990; Taylor, Lee, and Stern, 1995).

Until recently, African Americans, Native Americans, Hispanics, and Asian Americans had been underrepresented in ads or excluded from them completely. Now, however, both Blacks and Whites are seen in ads in numbers that exceed their true proportions, while other races continue to be underrepresented (Larson 2002; Li-Vollmer 2002). Furthermore, ads targeting children almost always include at least one White child, and many feature White children only. Virtually none, however, feature children of other races exclusively (Larson 2002; Li-Vollmer 2002).

Whites portray characters at every status level. According to Li-Vollmer (2002), however, when racial minorities appear in ads, they often play people in stereotypical, low-status roles. In a study of nearly 1,500 television commercials broadcast during children's programs, researchers found that Whites were the only race to play characters in authoritative or prestigious positions. According to the study, "African Americans serve[d] as the token minorities to give the impression of cultural diversity or [were] presented in traditional stereotypes as athletes, dancers, and musicians. . . . Children of other racial minorities [were] scarcely found to be worthy of attention at all, especially Native Americans" (Li-Vollmer 2002, 223). On the rare occasions that they were given roles in ads, Asians Americans were often stereotyped as high-tech wizards, Hispanic characters were confined to roles as fast-food-restaurant habitués, and other minorities were generally cast as extras in crowd scenes. "By exposing children to this worldview through stable and repetitive images," the author concludes, "television commercials have the ability to shape more than product preferences: They have the potential to shape children's definitions

and attitudes about race according to the racial biases projected by the media industry” (Li-Vollmer 2002, 225).

Featuring a world in which Whites play all sorts of roles, while other races are tokenized, stereotyped, or ignored, tends to shape the “definitions and attitudes about race” that adults hold as well. According to Swiger (2002), casting Whites as archetypal humans in ads reinforces a notion, prevalent in White culture, which says that “Whites are not of a particular race. They are simply the human race. . . . For those in power in the United States, as long as whiteness is felt to be the human condition, then it alone both defines normality and fully inhabits it. The equation of being white with being human secures a position of power” (199-200).

## **Disabilities**

Some studies find that advertising, in particular, or media, in general, can undermine stereotypes by spreading positive images of people with disabilities (Morrison and Ursprung 1987; J. Nelson 1996; Shapiro 1993). Several observers note that some major advertisers (e.g., Coke, Kmart, McDonald’s, and IBM) occasionally feature disabled characters in effective ad campaigns (Bainbridge 1997; Fost 1998; Shapiro 1993). Disputing these conclusions, however, are those who argue that advertising contributes to discrimination against disabled people, by stereotyping them in some cases and excluding them in others (“Discrimination” 1991). According to these critics, some ads create stereotypes by implying that disabled people can overcome their limitations through super-human acts. Bainbridge (1997), for example, notes criticism of a Nike ad, which features

paraplegic marathon athletes, for perpetuating the “super cripp” stereotype. Other critics argue that ads perpetuate degrading stereotypes of disabled individuals in order to raise money for charities (“Discrimination” 1991).

According to a number of critics, in most cases ads contribute to a discriminatory climate merely by ignoring and excluding the disabled. Some studies support their view. Farnall and Smith (1999), for example, find a relationship between negative stereotyping and infrequent exposure to disabled people. In a content analysis of approximately 3,000 commercials, Ganahl and Arbuckle (2001) find that perceptibly disabled people are “virtually excluded in prime time television advertising based on a comparison with US Census reports” (34). And Hardin et al. (2001) find not a single photograph of a person with a disability in a content analysis of more than 7,000 ads from 36 issues of *Sports Illustrated for Kids*.

## **Age**

A number of studies (e.g., Atkins et al. 1991; Hiemstra et al. 1983; Miller et al. 1999; Roy and Harwood 1997; Swayne and Greco 1987) report that elderly people are under-represented in advertisements. In a content analysis of more than 9,000 ads appearing in *Life* and *Ebony* magazines, for example, Bramlett-Solomon and Subramanian (1999) find fewer elderly people portrayed in advertisements of the 1990s than in ads of the 1980s. In addition, the elderly that do appear are featured almost exclusively in ads for products that are stereotypically associated with old people. The authors speculate that the stereotypes and under-representation of the

elderly in ads “may convey to media consumers that the elderly are not worthy of media attention” (571).

Roy and Harwood find under-representation of the elderly—particularly women—in a content analysis of nearly 800 television commercials. Even worse, the authors find that less than one percent of the ads in their sample include African-American seniors, and none of the ads include elderly members of other races.

Pollay (1986) cites several critics who complain that ads promulgate negative stereotypes of older people. According to these critics, ads often portray the elderly as feeble bumblers. Miller et al. (1999) find negative stereotypes in only four percent of the print ads in their sample, however. Similarly, Roy and Harwood (1997) report that the commercials in their sample present older adults “in a relatively positive light—as active, happy, and strong” (39).

### **Male stereotypes**

Although advertising tends to stereotype men, in this individualistic age, ads for different products present different images of masculinity. Alexander (2003) notes “a departure from the form of hegemonic masculinity associated with past generations” (550). The traditional, stereotypical male role of producer is being supplanted in advertisements by multiple stereotypes that reflect patterns of consumption. As Alexander explains:

What appears to be a popular culture filled with multiple constructs of masculinity obscures the structural conditions in which all versions of masculinity are built on a corporate brand. . . . Thus in a society based

on consumer capitalism, women and men increasingly share the belief that constructing one's gender identity is merely a matter of purchasing acceptable brand-name products. The multiplicity of masculine gender displays found in contemporary popular culture is exposed as capitalist hegemony in the form of branded masculinities purposely constructed by multinational companies for the purpose of increasing sales and profits at the expense of any authentic understanding of what masculinity really means today" (552).

Thus, by Alexander's analysis, the male stereotype that advertising presents today is some version of a corporate brand's image.

### **Female stereotypes**

If, as Alexander supposes, stereotypes of men in advertisements depict various constructions of branded masculinity, then the same is generally true, *mutatis mutandis*, for stereotypes of mature women in ads (to the extent that mature women appear in ads at all). Stereotypes of adolescent girls and young women, on the other hand, generally depict a single, branded, feminine ideal.

In the subtext of many advertisements depicting girls and women, Kilbourne (2004) explains, is the message that "they can and should remake their bodies into perfect commodities" (254). The perfect commodity—and thus the perfect girl or woman—is thin and beautiful. Thus, advertising "is one of the most potent messengers in a culture that can be toxic for girls' self-esteem" (254).

A number of studies find that girls and women feel worse about themselves after exposure to photographs of advertising's stereotypical women (Field et al. 1999; Groesz et al. 2002; Halliwell and Dittmar 2004; Kasser, 2002; Richins 1991; Then, 1992). Becker and Burwell (1999) report a relevant natural experiment from the island of Fiji. Subsequent to the introduction of commercial television to the island, the number of young women describing themselves as "fat" climbed dramatically, as did the number who developed eating disorders.

### ***Advertising, poverty, and crime***

In a number of inner cities throughout America, muggings for athletic shoes and other items of sportswear have become commonplace. Some social and behavioral scientists have linked these crimes to advertising and materialism. According to University of Pennsylvania sociology professor Elijah Andersen, "uneducated, inner city kids . . . feel the system is closed off to them. And yet they're bombarded with the same cultural apparatus that the white middle class is. They don't have the means to attain the things offered and yet they have the same desire. So they value these 'emblems,' these symbols of supposed success. . . . Advertising fans this whole process by presenting the images that appeal to the kids" (qtd. in Telander 1990). By featuring superstar athletes, who endorse the products in multimillion-dollar campaigns, the ads create "status from thin air to feed those who are starving for self-esteem." In the words of sociology professor Mervin Daniel, "the classic explanation in sociology is that these people are driven by peer pressure.

What is advertised on TV and whatever your peers are doing, you do it too” (qtd. in Telander 1990). According to one man who works with juvenile gang members, “these kids don’t feel like their lives would be worth anything unless they have the hottest product that’s being sold in the marketplace” (qtd. in De Graaf 2002, 82).

Disparities in consumption patterns have become blatant to people living in poverty, as their exposure to media has increased. According to Kasser et al. (2004), the “salience of these disparities is likely to fuel increased social comparison, which . . . is associated with increased materialism” (18).

According to psychology professors Allen Kanner and Mary Gomes (1995), exposure to advertising and other media socializes people living in poverty to identify with the values and attitudes of the wealthy. In the process, poor people learn to fear and condemn the poor; that is, they learn to fear and condemn *themselves*. This “media-induced narcissistic injury” engenders a sense of worthlessness. Taunted by media images of consumption standards that are beyond their means and struggling to escape the stigma of poverty, some of the poor turn to criminal activity. In the view of LaPoint and Hambrick-Dixon (2004), “although there are broader contextual factors that also play into these offenses, and the assailants themselves must bear some responsibility, the role of marketing cannot be ignored” (243).

Compared to wealthier people, the poor tend to watch more television (Certain and Kahn 2002; LaPoint and Hambrick-Dixon 2004; Meyersohn 1968; Singer et al. 1998), and people who watch a lot of television tend to have more materialistic values than people who do not (Adler et al. 1980; Cheung and Chan 1996; Greenberg and Brand 1993; Kasser and Ryan 2001; Khanna and Kasser 2001; Moschis and Moore

1982, Rahtz, Sirgy, and Meadow 1988, 1989; Sheldon and Kasser 1995). Thus, Lane (2000) suggests, young adults who live in poverty are “especially likely to emphasize attainment of wealth among their values” (149).

At the same time that ads engender materialistic values, ads for violent videogames, movies, and television programs “contribute to a violent media culture which increases the likelihood of youngsters’ aggressive behavior and desensitizes children to real-world violence” (American Psychological Association 2004b). Perhaps violent media help to explain Nordhaus and Shellenberger’s (2007) observation that “violence [particularly among children] was the fastest-growing value in America from 1993 to 2004” (169). According to the Federal Trade Commission (2000), evidence collected over a span of thirty years, from over one thousand studies, “points overwhelmingly to a causal connection between media violence and aggressive behavior in some children, as well as increases in aggressive attitudes, values, and behavior (Levin and Linn 2004, 221).

Additional evidence of the impact of violent media on behavior comes from a couple of natural experiments. After television was introduced to parts of Canada and the nation of Bhutan, incidents involving aggressive behavior in both places increased. Layard (2005) notes: “Quite soon [after TV came to Bhutan] everyone noticed a sharp increase in . . . crime and drug taking. In schools violence in the playground increased” (78).

## *Impact on values*

To what extent does advertising affect human values and how are those ad-influenced values reflected in the moral character of society? As previously discussed, numerous studies find that exposure to advertising is positively related to the adoption of materialistic values and many additional studies find that materialistic values lead to a wide assortment of welfare-reducing outcomes. Concluding that advertising has a negative impact on a society's moral character, therefore, may seem appropriate. If one accepts the argument, however, that advertising spurs economic growth and that economic growth promotes values that strengthen a society's moral character, then drawing the opposite conclusion—that advertising has a positive impact on a nation's moral character—would seem reasonable.

Without specifically commenting on advertising's impact on growth, Benjamin Friedman (2005) maintains that a growing economy improves a society's moral character. When the economy grows, he explains, the standard of living rises. "The value of a rising standard of living lies not just in the concrete improvements it brings to how individuals live but in how it shapes the social, political, and ultimately the moral character of a people" (4). Allowing that some consequences of economic growth—"like disruption of traditional cultures and damage to the environment"—can be harmful and "are a proper moral concern that we are right to take into account," Friedman argues that policymakers should also take into consideration the moral positives associated with growth (e.g., tolerance, generosity, civility, and openness). Thus, to the extent that advertising leads to economic growth, per

Friedman's argument, it has a positive—if indirect—impact on the nation's moral character.

According to B. Schwartz (1994), however, as “the economic stakes in society increase, the economic consequences of acting morally increase. This increased cost forces at least some people to abandon their moral concerns” (180). Thus, as advertising inculcates materialistic values, it tends to raise the economic stakes in society and thus motivates some people to behave immorally.

### ***Ad-induced materialism's influence on relationships***

Having good relationships tops virtually every list in studies of factors that contribute to human happiness (if survival needs have been satisfied) (Layard 2005; Ryff 2005; Schwartz 2004). According to Myers (2000, 62), a “mountain of data reveal that most people are happier when attached than when unattached,” and Lane (2000) suggests that relationships with family, friends, and colleagues deliver “genuine utility (in the Benthamite sense)” (67).

Literature from across the social sciences indicates that connecting with others is more than just a contributor to happiness: Maintaining connections with others is a basic psychological need (Bakan 1966; Baumeister and Leary 1995; Bowlby, 1969/1982; Buss, 1996; Deci and Ryan 1985, 1991; Epstein, 1990; Erikson, 1959, 1980; Greenberg and Mitchell, 1983; Hazan and Shaver, 1987; Maslow 1954; McAdams and Bryant, 1987; Reis and Patrick, 1996; Rogers, 1961). Kasser maintains that “it is clear from this corpus of work that our psychological health

depends in part on whether we feel close and connected with other people, and on whether we can give and receive love, care, and support” (61).

According to Lane (1993), “most studies agree that a satisfying family life is the most important [external] contributor to well-being” (58). Easterlin (2003), Helliwell (2003), Juster (1985), Kasser (2002), and Layard (2005) confirm Lane’s assertion. In line with the results of those studies, participants in a 1981 Gallup survey ranked “family activities” first on a list of activities that they said gave them “the most personal satisfaction or enjoyment day in and day out” (Lane 1993, 59). Twenty-five years later, “staying at home with family” was the most popular response when a Gallup poll asked Americans to name their favorite way to spend an evening (Gallup 2006b).

Conversely, a number of studies report a negative relationship between divorce and happiness. As Layard (2005) explains, “Family break-up can occur because of internal strains or external assault. Shortage of time is a major source of internal strain” (178). Perhaps that explains why Europeans, who work less and devote more time to their families than Americans, have much lower divorce rates than Americans (McKibben 2007). Blanchflower and Oswald (2004) estimate that the dollar value of a lasting marriage is \$100,000 per year. Of particular significance to this study, Rindfleisch et al. (1997), find a positive relationship between materialistic values and divorce.

While enjoying satisfying family relationships is generally thought to have the greatest impact on happiness, having good friends (Diener et al 1999; Juster 1985; Lane 2000; Layard 2005; Scitovsky 1976) and participating in community life seem

to be nearly as important (Diener and Seligman 2004; Helliwell 2003; Lane 2000; Layard 2005).

And just as the literature reveals a positive association between happiness and relationships, it also posits a negative association between happiness and separateness. Lane (2000), for one, reports that the “most powerful cause of depression is disruption of family and friendship relations” (78). According to Rosenberg (2004), the disruption of these relationships leads to inner emptiness, and inner “emptiness makes people more vulnerable to the influences of . . . the advertising industry” (114). Citing Cushman, Rosenberg explains that the “empty self needs filling, so it is easy to influence and control. This is a major mechanism encouraging consumption. Advertisers and major corporations seek to reassure or soothe us with products. Yet, advertising offers an illusory cure. Advertising cannot create a web of meaning like a rich communal, shared culture can” (114).

Advertising can inculcate materialistic values, however, and materialistic values make establishing and maintaining relationships difficult. According to a number of theorists, when people place a high value on materialistic ends, they tend to undervalue friends, family, and community. Highly materialistic people are more likely to treat others as if they were things, exploiting them so long as they are useful and then discarding them when their usefulness is at an end. “In the materialist mindset, people exist largely to reflect well on ourselves and to be used and manipulated to obtain what we want” (Kasser 2002, 68).

Some social critics, such as Robert D. Putnam and Robert E. Lane, note that the time and energy people devote to the pursuit of materialistic aims can “crowd out”

their interpersonal relationships, leaving little time for family, friends, and community (Kasser 2002). As Barry Schwartz puts it, “being socially connected takes time. First, it takes time to *form* close connections. . . . And close attachment, not acquaintanceship, is what people most want and need. Second, when we establish these deep connections, we have to devote time to maintaining them” (110).

Kasser (2002) explains that “materialistic values lead people to ‘invest’ less in their relationships and in their communities.” This lack of investment “is reflected in low-quality relationships characterized by little empathy and generosity, and by objectification, conflict, and feelings of alienation.” Under the weight of materialistic values, the fibers that otherwise “bind couples, friends, families, and communities together” tend to weaken and fray (72).

Empirical studies involving people of all ages and from nations throughout the world confirm a negative association between holding materialistic values and having good interpersonal relationships. According to the literature, materialistic people have difficulty forming and maintaining friendships (Kasser and Ryan 2001); their romantic liaisons are troubled (Kasser and Ryan 2001; Sheldon and Flanagan 2001); and they suffer from a lack of social, cultural, and community relationships (Cohen and Cohen 1996; Kasser and Ryan 1993; Keng et al. 2000; Khanna and Kasser 2001; McHoskey 1999; Richins and Dawson 1992; Ryan et al. 1999; Schmuck et al. 2000).

Schwartz and Sagiv (1995) find that materialistic values seem to conflict with the values that characterize strong personal relationships (i.e., loyalty, helpfulness, and love) as well as concern for the community (i.e., peace, justice, and equality). Other researchers find positive associations between materialism and tendencies to

use and manipulate others (S. H. Schwartz 1994; Khanna and Kasser 2001) and negative associations between materialism and generosity (Belk 1985; Richins and Dawson 1992), empathy (McHoskey 1999), and willingness to consider other viewpoints (Sheldon and Kasser 1995). Such results provide additional explanations for the difficulties materialistic people have forming and maintaining relationships.

Lane recognizes an “infelicitous cycle” in the interaction of materialism, unhappiness, and companionship. People who pursue materialistic goals, he explains, suffer disappointment as they fail to find happiness in things; being unhappy, they withdraw from and alienate people; being lonely, they become even unhappier.

But if interpersonal relationships contribute to well-being and materialistic pursuits detract, why do people continue to neglect relationships and pursue materialistic ends? Certainly, several factors are at work. For one thing, social ties, “actually decrease freedom, choice, and autonomy” (Schwartz 2004, 107). Having a relationship means allocating—even sacrificing—time and attention to others. For another thing, compared to the goods and services we consume, our relationships are unpredictable. Their impact varies from miserable to ecstatic and everything in between. The things we buy, on the other hand, never break our hearts even if they rarely elate us. Although our satisfaction with things tends to drop as time goes by, our disappointment is typically slight. Generally speaking, we have more control over the things we buy than over the people in our lives. Given the vicissitudes of relationships, investing in things may seem (probably at a subconscious level) to be the safer emotional choice. Even if devoting our time and attention to things leaves

us empty over the long run, in the short and medium run—or as far as we tend to foresee—investing in things may seem to pose less risk.

Another factor contributing to materialistic over interpersonal preferences is advertising. According to numerous thinkers across the social and behavioral sciences, advertising plays a role by stoking materialistic inclinations and thereby skewing preferences away from leisure activities and toward consumption of goods and services. And, more to the point, even though most people realize that relationships are more important to their happiness than are the things they buy, perpetual bombardment by advertisements linking satisfying relationships to the use of advertised products often persuades people that they buy the means to good relationships when they buy an advertised product.

Beyond attempting to convince people that buying products will result in good interpersonal relationships, some advertisers attempt to channel “our psychological needs and ambitions into consumption behaviors by romanticizing goods” (Pollay 1986, 450). Kevin Roberts, worldwide CEO of the advertising firm Saatchi and Saatchi, proposes creating brands “with which consumers can be made to fall in love and then persuaded to ‘own’ by savvy advertisers” (Barber 2007, 184). According to a Saatchi and Saatchi website, “Kevin is also the originator of Lovemark thinking. Lovemarks are brands that inspire loyalty beyond reason. People love them because of what they are, not because of what they do. Their appeal is emotional. Companies may own brands. But Lovemarks are owned by the people who love them” (Saatchi and Saatchi n.d.).

A 2008 Honda ad portrays a car owner who seems to be loyal beyond reason to a branded product. In the ad, a young man, beaming with pride, uses his cell phone to take pictures of a new Honda from a number of different perspectives. As he clicks another shot, a message appears on his cell-phone screen, telling him that he will have to delete an already stored picture in order to make room for the new one. He presses a button, and a wedding picture of himself—dressed as a groom, standing next to a woman in a bridal gown—appears on the screen. The young man appears to be weighing his options for a moment. Then, after looking briefly guilty, he shrugs, deletes the wedding picture, grins broadly, and takes another picture of his Honda.

### **Parent-Child Relationships**

Some of the people that Lovemarks aim to capture are very young people. According to Gene Del Vecchio (1998), author of *Creating Ever-Cool: A Marketer's Guide to a Kid's Heart*, marketers, with the help of child psychologists, “develop brands that [create] a relationship with the child by fulfilling emotional needs” (qtd. in Harsch 1999, 566). Given that young children believe in Santa Claus and the tooth fairy, getting them to accept the personification of brands is quite simple. Marketers imbue a personified brand with personality traits that fit “the nature of the brand and the emotional needs it satisfies” (Harsch, 565). As Del Vecchio (1998) explains, “this depth of personality is an aura that rises above mere product attributes and creates a strong bond between the child and the brand” (123).

Marketers exploit every opportunity to forge a child-brand bond. In some cases, they work with media producers and child psychologists to develop seamless

links between branded characters and television programs, movies, websites, computer games, toys, accessories, clothing, food, and other products (Levin and Linn 2004, 214). Although producers pay for traditional advertisements to promote all of the associated media and products, each of the products and media also promotes all of the rest. A Dora the Explorer doll, for example, serves as an ad for the Dora the Explorer television program, which serves as an ad for the Dora the Explorer Playhouse, which serves as an ad for the Dora the Explorer backpack, and so on and so forth. As a result of all this cross-marketing, ad and product become virtually indistinguishable.

A study from the 1970s provides some evidence that strong bonds between children and television characters have existed for decades. According to the study, most children said that they would take the word of a television character—even a cartoon character like Tony the Tiger—over the word of their parents, if the television character told them one thing and their parents told them something else (De Graaf et al. 2002).

As previously noted, young children lack the cognitive skills to recognize that a trusted TV or movie character who appears in an ad is only trying to sell a product. According to Levin and Linn (2004), the “powerful messages from the salient images of an advertisement can be more compelling than parents’ arguments against either the tactics of the ad or the nature of the product, potentially undermining parental authority and increasing stress on parent-child relationships” (218).

Additional stress on those relationships results from advertising techniques that encourage children to engage in bad behavior. “Anti-social behavior in pursuit of

a product is a good thing,” one prominent consultant told the attendees of a “Kid Power” marketing conference. According to De Graaf et al. (2002), the consultant explained to his audience that “advertisers could best reach children by encouraging rude, often aggressive behavior and faux rebellion against the strictures of family discipline” (54). A common strategy among advertisers, according to Levin and Linn is to evoke “pester power” or the “nag factor” in children, “without regard for how the practice affects parent-child relationships” (224).

Augmented, in part, by children who invoke the “nag factor,” materialistic values prompt parents to work longer hours in order to buy more for their children. Then, as Barbara Ehrenreich explains, “the longer hours [parents] work, the more stressful [their] lives become; and the greater the tensions at home, the more [they] try to escape to work” (qtd. in De Graaf et al. 2002, 48). Working so many hours and feeling guilty about being away from their children so much, parents try to compensate by buying the things that their children say they want (Martin 1998).

Ads feed into this cycle and create another by implying that children can have fulfilling relationships with inanimate objects. Lacking the cognitive skills to understand advertisers’ intent, many young children take ads literally. They nag for advertised goods, hoping for emotional fulfillment; and when their (guilt-ridden) parents succumb, the children are elated. Once the thrill of getting something they have wanted wears off, however, disappointment sets in. The products cannot respond to children’s genuine needs for intimacy, so children are left with feelings of emptiness. Rather than conclude that things are incapable of satisfying their inner longings, children—spurred on by ads—keep asking for the things they see

advertised. Even if those things ultimately fail to comfort them, at least they get the momentary emotional lift that inheres to achieving a goal (i.e., getting something they have wanted).

According to Karen Shanor, clinical psychologist and author of a book about children's brain development, gift-generated brain stimulation can cause chemical changes in the brain, such that the child's brain requires ever more stimulation. This stimulation-addiction can contribute to the development of attention deficit disorder and other mental syndromes (Martin 1998).

A 1993 survey found that 92 percent of the participants agreed with the statement: "TV commercials aimed at children make them too materialistic." Nevertheless, children watch a lot of television. In fact, as a weekly average, American children watch television 1,680 minutes but spend only 3.5 minutes "in meaningful conversations" with their parents. Of course, parents watch a lot of television, too. The average American household has a television turned on nearly seven hours a day (Herr 2008). Nor is the U.S. alone in this regard. Television commercials are affecting parent-child relationships throughout the world. Following the introduction of commercial television in Bhutan in 1999, for example, an impact study "showed that a third of parents now preferred watching TV to talking to their children" (Layard 2005, 78).

Kilbourne (2004), Lane (2000), and Schor (1998, 2004), among others, note the stress that advertising places on parent-child relationships. As Lane (2000) explains, "children have no direct way of knowing that they live in a society in which they have been devalued—but in growing up they will have experienced the pains of

that devaluation” (161). When ads evoke the “nag factor,” they potentially harm the parent-child relationship directly. When ads inculcate materialistic values, they devalue the worth of relationships of all kinds.

### ***Impact on social capital***

Beyond the need for intimate connections with family and friends, individuals need to be connected to groups. Layard (2005) expresses a sentiment that is common among social and behavioral scientists when he writes: “Humans are deeply social beings” (225). According to Diener and Seligman (2004), “experimental evidence indicates that people suffer when they are ostracized from groups or have poor relationships within groups” (1).

Evolutionists, psycho-dynamicists, social psychologists, humanists, and others offer theories to explain the human need for connection to others, and empirical studies lend support. Epidemiologists, for example, find that people with strong social ties are less susceptible to suffer from ill health or to die prematurely than people who are less connected (Cohen 1988; House, Landis, and Umberson 1988; Myers 2000). As Lane (2000) explains, finding companionship “is a genetically programmed behavior which we violate at risk of pain and deteriorating functioning: the blood chemistry of affiliation and cooperation is congenial to our physiological constitution” (84).

When individuals join groups, they contribute to the social capital of their communities. “Just as a bank account (financial capital) yields interest, social ties

tend to build trust, reciprocity, or information networks . . . ” (Gardner and Assadourian 2004, 170). And, as Helliwell (2003) notes, “societies with high averages of social capital, as measured by membership densities, also show higher levels of subjective well-being, other things held constant” (343).

Interestingly, some authors speculate that advertising helps to build social cohesion and, thus, social capital. Simon (1970), for example, notes a common, early claim that advertising “substitutes for coercion as a method of social control, and hence supports pluralistic society” (255). According to historian Roland Marchand, advertising can act as “integrative propaganda” for a nation comprised mainly of immigrants (Cross 2000, 35). Cross (2000) notes that advertisements provide “scripts of social dramas that [help] people cope with modern life by giving goods meaning and making them into props that [say] who consumers [are] or [aspire] to be” (35). At the same time, ads assert “the right of all to participate in a common material culture without necessarily giving up ‘who you really are,’ be it a Jew, an Appalachian farmer, or a Midwestern storekeeper” (37).

Historian Daniel Boorstin posits the existence of “consumption communities,” constituted by people who relate to each other through owning a particular brand. Apparently, Marshall McLuhan (1953) shares Boorstin’s perspective. He writes: “To use a brand of car, drink, smoke, or food that is nationally advertised gives a man the feeling that he belongs to something bigger than himself. He is part of a process or a culture that contains and nourishes him. And the irrational basis of the appeals made to him by the ads reinforces his sense of mystic communion” (qtd. in Pollay 1986, 461-462). Sociologist Michael Schudson (1984) argues, however, that the fact that

two people wear Jordache jeans or drive Harley-Davidson motorcycles “does not establish any kind of community a person could put much stock in” (159). In the words of environmental writer Bill McKibben (2007), “if buying Pepsi could make [anyone] part of a meaningful human community called the Pepsi Generation—then the twentieth century would have worked better than it did” (113).

A number of psychologists also contradict the theories of historians and others who maintain that advertising can promote social cohesion and build social capital. Their studies support the view that the individualistic, materialistic values promulgated by advertising tend to be antagonistic to the values needed to promote the good of the community. Empirical studies show that people who are highly materialistic are more estranged from society than non-materialistic people (Khanna and Kasser 2001; McHoskey 1999), they lack social interest and engage in more anti-social acts (Kasser and Ryan 1993; McHoskey 1999), and they compete more than they cooperate (Sheldon and McGregor 2000; Sheldon et al. 2001). Noting, among other things, a negative correlation between materialism and donations to environmental organizations, Lane (2000) concludes that “materialists are more self-interested than others” (145).

Self-interest can be self-defeating, however. According to Schwartz (2004), “deep commitment and belonging to social groups and institutions” can act as “a crucial vaccine against depression” (212). In order to be an active participant in a social group, however, one must, to some extent, subordinate the self. Thus, an inherent tension exists between being a self-defined individual and being a member of a group.

According to Kasser et al. (2004), “humans have a fundamental tendency to adopt ambient cultural and familial values and behavioral regulations” (16). But when people look to society for guidance about how to be a respected member of the group, and society—largely through advertisements—tells them to be individualistic and materialistic, people conform by increasing their personal consumption and withdrawing from civic engagement.

According to Putnam (2000), three factors—high rates of television watching, time limitations, and residential sprawl—explain approximately one half of the decline in civic engagement that has occurred in the U.S. over the past few decades. As Gardner et al. (2004) note, all three factors are associated with high consumption, and advertising, of course, encourages people to consume more and more.

“In the consumer society,” Durning (1992) writes, the “need to be valued and respected by others is acted out through consumption” (40). Since taxes subtract from the amount that consumers can devote to private goods and private consumption defines the individual’s status in society, public goods receive little public support. As Galbraith (1998) comments, “we are now more than ever affluent in our private consumption; the inadequacy of our schools, libraries, public recreation facilities, health care, even law enforcement, is a matter of daily comment” (xi).

According to Kuntsler, author of *The Geography of Nowhere*, since the 1930s, Americans have “mutated from citizens to consumers.” The change is harmful because “consumers have no duties or responsibilities or obligations to their fellow consumers. Citizens do. They have the obligation to care about their fellow citizens,

and about the integrity of the town's environment and history” (qtd. in De Graaf et al. 2002, 60-61).

### ***Freedom redefined as consumerism***

On the eve of the new millennium, *Time* magazine's managing editor Walter Isaacson wrote: “If you had to describe the century's geopolitics in one sentence, it could be a short one: Freedom won. Free minds and free markets prevailed over fascism and communism” (qtd. in Moore and Simon 2000, 1).

Historian Gary Cross (2000) has a different view. As he explains it, consumerism—not freedom—emerged victorious from the clashing ideologies of the twentieth century. “Visions of a political community of stable, shared values and active citizenship [gave] way to a dynamic but seemingly passive society of consumption in America, and increasingly across the globe” (1). “Consumerism succeeded where other ideologies failed because it *concretely* expressed the cardinal political ideals of the century—liberty and democracy” (2; italics in the original). Rather than being “an abstract right to participate in public discourse or free speech,” liberty, under consumerism, “means expressing oneself and realizing personal pleasure in and through goods. Democracy does not mean equal rights under the law or common access to the political process but, more concretely, sharing with others in personal ownership and use of particular commodities” (3).

According to Cross, during the 1930s, advertisers were the ones who “redefined freedom to mean not civil liberty or the right to work, but the ability to

find identity in the choice of goods to buy.” Ad people claimed to be “the mouthpiece of free enterprise” and the guardians of choice “that all too often was threatened by government” (134).

Clearly, consumers’ choices during the Great Depression and throughout World War II were limited, and they suffered as a consequence. Today, however, according to a number of psychologists, many Americans have become overwhelmed, anxious, stressed, dissatisfied, and even clinically depressed due to the glut of choices the market offers. “At this point,” Schwartz (2004) writes, “choice no longer liberates, but debilitates. It might even be said to tyrannize” (3).

Barber (2007) agrees. In his view, maximizing the number of private choices we make about the goods that we buy is “faux liberty.” Such choices are “not really crucial to human happiness” and limit “the choices we are able to make in public domains that are significant” (141).

Indeed, a critical distinction between public and private liberty is that it is precisely through democratic participation and the ensuing government intervention that we regulate private choices to constrain their negative sides, and that we focus on the public things that really matter to us as members of a civic (and civilized) community. . . .

Contrary to intuition, by constraining choice in the private sector we can actually facilitate the sense of liberty we feel (142).

Gardner et al. (2004) wonder whether the market offers consumers choices that meet their true needs. In the view of the authors, people might actually have more transportation options if given “safe and convenient access” to transportation

alternatives such as walking, cycling, mass transit, and car-sharing than if given a choice among hundreds of car models at auto dealerships.

Conflating private choice with liberty, many Americans are suspicious of collective choice, afraid that government decisions will restrict their freedoms. And, in fact, when the government makes a collective choice, the new policy often limits the freedom—or constricts the privileges—of those who have been enjoying and profiting from the status quo. To derail a proposed policy change, beneficiaries of the status quo sometimes claim that the change will restrict the freedom of all Americans. Advertisements help spread their claim.

Take, for example, the ad campaign that insurance companies ran in opposition to the Clinton health-care plan. In one ad, Harry and Louise sit at a kitchen table. A disembodied voice says: “The government may force us to pick from a few health care plans designed by government bureaucrats.” Louise looks disgusted. “Having choices we don’t like is no choice at all!” she says. Harry then starts a sentence that Louise finishes for him. “If they choose . . .” begins Harry, “we lose,” Louise concludes (YouTube.com 2008).

By focusing public attention on freedom of individual choice, the Harry-and-Louise ads diverted Americans’ attention away from the common good and, by slight of hand, limited their ability—if not their freedom—to make a collective choice.

### ***Influence of advertising on human autonomy***

When people make choices they assert their autonomy. Choice is critical to autonomy, and autonomy is critical to human well-being. As Schwartz (2004) notes,

social, moral, and political philosophers dating back to Plato have recognized autonomy's importance to the individual's sense of self.

Many psychological studies report negative associations between materialistic values and feelings of authenticity and autonomy. According to a number of these reports, materialistic individuals are less likely to value freedom and self-direction than people who are not materialistic (Kubey and Csikszentmihalyi 1990; Delle Fave and Bassi 2000). In addition, materialists are more likely to be self-conscious and tend to focus on external rewards (Deci 1971; Deci and Ryan 1985, 1991; Deci et al. 1999; Sheldon et al. 2001). Rather than focusing on the challenge or pleasure inherent in an activity, they tend to focus on its potential for rewards and praise (Gibbons 1990; Plant and Ryan 1985; Lepper and Greene 1975; Schroeder and Dugal 1995). They are more inclined to overwork, incur debt (Schor 1992, 1998), and, in general, pursue activities that make them feel pressured or compelled (Sheldon and Kasser 1995, 1998, 2001; Richins 1994; Srivastava et al. 2001). In sum, the literature suggests that having a materialistic orientation undermines the potential for experiencing freedom and autonomy. Rather, "people feel chained, pressured, and controlled when they focus on materialistic values" (Kasser 2002, 86).

### ***Advertising and anomie***

As some social critics see it, ad-assisted industrialization leads to anomie, alienation, and ennui. Although a number of scholars find that people derive great satisfaction from their jobs, according to van den Haag, industrialized society often

de-individualizes work and consumption in order to reap the benefits of mass production. Thus, “the production of standardized things by persons also demands the production of standardized persons,” he writes (qtd. in De Graaf et al. 2002, 75).

Work that is de-individualized tends to lack interest and meaning. “The worker/consumer is vaguely dissatisfied, restless, and bored, and these feelings are reinforced and enhanced by advertising, which deliberately attempts to exploit them by offering new products as a way out” (De Graaf et al. 2002, 75). In van den Haag’s view, ad-sponsored media and advertised products “drown the shriek of unused capacities, of repressed individuality” (qtd. in De Graaf 2002, 75). Thus, people use advertised brands to assert their identities because they lack meaningful work that would otherwise help to define them. An individual may project the identity of a Bud-drinking, Camel-smoking, Harley-driving, twenty-something male, or a Starbucks-sipping, Gucci wearing, Botox-injected, middle-aged female. Individuals are free to choose the brands that will define their identities; nevertheless, the identities that they showcase to others are merely composites of the brands they consume, not revelations of their authentic selves. Such composite individuals have “an insatiable longing” for the world to supply events that will fill their emptiness. But, as De Graaf et al. note, “what the bored person really craves is a meaningful, authentic life. The ads suggest that such a life comes in products or packaged commercial experiences” (76). Advertising encourages, therefore, the subconscious belief that branded things can suffuse an empty life with meaning.

On the conscious level, however, most people recognize that advertising distorts the truth as it attempts to manipulate their behavior. And because people

“recognize this tendency of ad language to distort, advertising seems to turn [the public] into a community of cynics” (Pollay 1986, 460). In that way, advertising can lead to “the normlessness known as anomie” (461).

At the same time that ads imbue cynicism, they fill minds with sounds and images. As De Graaf et al. speculate, “it may now be possible for a person to travel from one week to the next without thinking an original thought unshaped by manipulative messages! Much of the territory between our ears has now been commercially ‘colonized.’ The question is, if we get evicted from our own minds, who are we?” (118)

### ***Keeping up with the Joneses***

Too many people spend money they haven't earned to buy things they don't want, to impress people they don't like.  
—Will Rogers

More than half a century ago, conservative economist Wilhelm Ropke lamented those who adhere to a “keeping up with the Joneses” way of life and thus “lack the genuine and essentially non-material conditions of simple human happiness.” In Ropke’s view, “*Homo sapiens consumens* loses sight of everything that goes to make up human happiness apart from money income and its transformation into goods” (qtd. in De Graaf et al. 2002, 74).

Happiness researchers now provide results that flesh out Ropke’s intuition. They explain that in wealthy countries like the United States, other factors associated

with human happiness are more important than money. Despite the widely believed—even if generally disavowed—notion that money buys happiness, researchers find a “weak or even nonexistent relation between income and happiness in the United States” (Lane 2000, 65). Argyle (1996) attributes this counterintuitive result to the declining marginal utility of money. Once income exceeds a level whereby basic needs are easily supplied, the marginal utility of money declines rapidly. While increasing absolute income translates into greater happiness up to that level, beyond it, relative position in the income distribution seems to be what counts. As Frey and Stutzer (2002) put it: “It is not the absolute level of income that matters most but rather one’s position relative to other individuals” (411). Thus, as the saying goes, a rising tide lifts all boats, but (in wealthy countries) its ability to improve overall well-being is debatable. Although other factors may help to explain the apparent failure of higher aggregate income to translate into greater happiness, “without doubt, one of the most important” is the keeping-up-with-the-Joneses phenomenon (411).

Even in developing countries, where increases in absolute income contribute significantly to the happiness of the multitudes living in poverty, relative income is salient (Graham and Pettinato 2002a,b). Graham and Felton (2005) find, for example, that “relative income differences have large and consistent effects on well being in [Latin America]” (1).

According to Durning (1992), compared to the members of lower classes, the economic elites in any society seem to be happier. He notes, however, that the upper classes in rich countries are no more satisfied than the upper classes in poor countries,

even though the absolute income of the former may be considerably higher. In his view, to the extent that a relationship between income and happiness exists, it “is relative rather than absolute.” Durning concludes: “Consumption is thus a treadmill, with everyone judging their status by who is ahead and who is behind” (39). With well-being the supposed destination, members of the species *Homo sapiens consumens* jockey for position on that treadmill. Even though they consume more and more, they never reach their goal; they just keep consuming and running.

A study by Stein (1997) offers support for that conclusion. Using data from the 1993 General Social Survey, he finds that middle-class people are no happier if their absolute income improves unless their relative status improves, as well. Referencing the Stein study, Lane (2000) concludes that higher status—not income—increases well-being.

Nevertheless, people continue to believe that more money will make them happier. A 2006 Gallup poll of American workers finds, in fact, that “73% say they would be happier if they made more money . . .” (2006c). Thus, the public seems to accept as valid the economists’ formula equating increasing income with increasing utility. The economists’ formula, Lane (2000) writes, is persuasive because “it seems to correspond to both experience and common sense” (67). And clearly, among the poor, increases in absolute income do, in fact, improve well-being. Among the non-poor, however, increases in absolute income generally fail to affect well-being significantly; still, the non-poor want more money.

As Lane (2000) notes, the economists’ formula traces back at least to Adam Smith. But whereas Smith (1976, 50) believed in 1759 that “regard to the sentiments

of mankind” leads people to “pursue riches and avoid poverty,” today most Americans pursue riches not to avoid the shame of poverty but to surpass—or at least to keep up with—the Joneses.

Over the past half-century, as Americans have become wealthier, their love of money seems to have intensified. In 1965, just 64% of the workers polled by Gallup said that more money would make them happier—compared to 73% in 2006 (2006c). According to Nordhaus and Shellenberger (2007), “When asked what constituted the good life, far more people named material goods in 1995 than did in 1971. . . . Those who said ‘a second car’ went from 30 to 41 percent, ‘a swimming pool’ from 14 to 29 percent, and ‘a vacation home’ from 19 to 35 percent” (172).

As Schwartz (2004) explains, even though relative status has mattered to people “for as long as they have lived in groups,” today’s higher levels of materialism, affluence, and advertising are making status a more vital concern.

Berger and Luckmann (1964) point to one factor that increases the salience of consumption as a measure of status: mobility. In today’s highly mobile society, they write, “conspicuous patterns of consumption take the place of continuous interpersonal contacts within an individual’s biography. . . . Material objects rather than human beings must be called upon to testify to the individual’s worth” (qtd. in Schudson 1984, 156). And B. Schwartz (1994) notes that “material wealth is as good an index, or proxy, of success as there is” (164).

But for people who step on the consumption treadmill success is gauged not merely by having material wealth but by having *more and better*. The problem that such people ultimately encounter, however, is that no one—not even the richest

individual in the world—can own everything. Thus, the Smiths find that the satisfaction associated with getting ahead of the Joneses is soon eclipsed by the dissatisfaction associated with being behind the Browns.

Worse still, when the Smiths increase their status by moving ahead, they simultaneously lower the Joneses' status and well-being. Although the desire for status, as Layard (2005) explains, "is wired into our genes," it is, nevertheless, "totally self-defeating at the level of the society as a whole" (151). Since Smith's income rises relative to Jones's only to the exact amount that Jones's falls relative to Smith's, the "whole process produces no net social gain." It may, however, involve "sacrifice of private life and time with family and friends," as Smith works harder and longer to get ahead of Jones, and Jones works longer and harder to regain her original position (151). Given that happiness studies show that relationships are vital to well-being, the whole process would appear to produce a net social loss, and any factor, such as advertising, that tends to fuel the race for status would seem to undermine social welfare.

Traditional economics assumes, however, that increasing income—even if a race for status motivates it—improves social welfare. The assumption is that if one person's income rises, society benefits, so long as no one else's income is thereby lowered. Thus, if both Smith and Jones get raises, but Smith's is larger than Jones's, and Smith, as a result, surpasses Jones in income, standard economics would view the change as a social improvement. But, "standard economics" misses an "obvious piece of psychology" in thinking that "things have improved because no one has suffered" (Layard 2005, 44). In truth, Jones's fall in status lowers her welfare—more

perhaps than her *relatively small* raise improves it (Kahneman and Sugden 2005; van de Praag and Ferrer-i-Carbonell 2004; van Stadt et al. 1985). Status is so important, in fact, that a number of studies (e.g. Solnick and Hemenway, 1998) show that people “would be willing to accept a significant fall in living standards if they could move up compared with other people” (Layard, 42).

The race for status occurs at every economic level. As Kanner and Gomes (1995) explain, even many Americans earning more than \$100,000 a year claim that they “can’t make ends meet.” These “‘poor’ well-to-do Americans” should feel financially secure, and yet “their monetary struggles leave them feeling bitter and ineffective.” The authors fault the advertising industry for putting the ‘poor’ rich on the consumption treadmill. “The advertising industry has created false needs so potent that the most successful individuals in the richest country in the world perennially scramble to increase their ability to consume” (87).

Also illustrating the plight of the ‘poor’ rich, Gary Rivlin (2007) writes in the *New York Times* of “working-class millionaires” who inhabit California’s Silicon Valley. In the neighborhoods where the digital elite reside, keeping up with the Joneses might require owning a Cessna Citation X private jet. One multi-millionaire Rivlin interviewed told him, “You’re nobody here at \$10 million.” Another said: “Here, the top one percent chases the top one-tenth of one percent, and the top one-tenth of one percent chases the top one-one-hundredth of one percent” (n.p.).

Ads and ad-sponsored media show the bottom ninety-nine-and-ninety-nine-one-hundredths percent of the population how the richest of the rich live. Television is particularly potent in this regard. According to economists Juliet Schor and

Richard Layard, many Americans now compare themselves not to the Joneses next door but to the Joneses they see on television, and they find themselves lacking. Although not all of the people portrayed on TV are rich, most are at least upper middle class. Thus, Schor concludes, people who watch a lot of television “have highly inflated views of what the average American has” (qtd. in De Graaf 2002, 29). According to Layard (2005), there is a positive relationship between the amount of television people watch and the amount they overestimate other people’s income as well as the amount they underrate their own relative wealth. One study, which Layard cites, finds that people spend an additional \$4—on keeping up with the Joneses—for every additional hour of television they watch per week.

According to some psychologists and other observers, advertisers persuade people to buy their products by highlighting discrepancies between what the viewer has and what the Joneses in the ads have. The subtext of most ads might read something like this: “Like a lot of people, you lack true satisfaction with your life because you have a problem. If you use the advertised product, however, your problem will be solved, and you will be just as satisfied as the Joneses in the ad are.” But, as Lane (2000) explains, while the role of the market “is to satisfy human wants and so to maximize various satisfactions, it is not true that the function of advertising is to maximize satisfaction; rather, its function is to increase people’s dissatisfaction with any current state of affairs, to create wants, and to exploit the dissatisfactions of the present. Advertising must use dissatisfaction to achieve its purpose” (179).

“Many psychologists believe that people’s emotional states are largely a function of how far they are from who, what, or where they ideally would like to be”

(Kasser 2002, 51). As Solberg et al. (2004) explain, people are more satisfied when their desires are realistic than when they are out of reach. Ads undermine emotional health by implying that using a product or service will allow consumers to reach out-of-reach desires and by capitalizing on discrepancies between who people are and who they would be if they could be.

People who hold highly materialistic values (for whatever reason) are particularly susceptible to ads that play on such discrepancies. A number of studies report that discrepancies between their own lives and those presented in media (including ads) leave materialistic individuals feeling frustrated and dissatisfied (Rahtz et al. 1988, 1989; Sirgy et al. 1998; Richins 1991). In order to overcome such unpleasant feelings, materialists are prone to engage in conspicuous consumption, buying and flaunting products that ads claim connote high status (Braun and Wicklund 1989). Thus, Cadillac ads stress discrepancies that help persuade the Chevy-driving Smiths that they can keep up with the Cadillac-driving Joneses in the ad (and have a wonderful life) if they replace their Chevy with a Cadillac. And when the Smiths buy a Cadillac, the Browns next door are persuaded by an ad that they can overcome the discrepancy between themselves, as Honda owners, and both the Lexus-driving people in the ad and their neighbors, the Cadillac-driving Smiths, if only they buy a Lexus.

According to Kasser (2002), “materialistic people overidealize wealth and possessions and therefore experience discrepancies that cause them to feel dissatisfied and to want further materialistic means of feeling good about themselves. But the satisfactions from this compensation only temporarily improve their sense of worth,

and soon they return to another cycle of dissatisfaction” (57). The satisfactions are only temporary because materialistic people readily adapt to their new circumstances. Having achieved a higher standard of living, they make that their baseline and then compare themselves to real people and ad people who have even more (Kapteyn and Wansbeek 1982).

### ***Productivity, work, and leisure***

According to Moore and Simon (2000), productivity gains have been the “driving force behind the dramatic rise in [U.S.] living standards” (96). Between 1900 and 2000, they maintain, economic output increased approximately ten fold; between the middle of the century and the end, the average hourly wage (including fringe benefits) increased by more than fifty percent.

Perhaps Moore and Simon’s use of the *average* hourly wage explains the discrepancy between their conclusions and those of Friedman (2005), who notes that in recent decades *median* household income has gained little beyond inflation and who concludes that “most of the fruits of the last three decades of economic growth in the United States have accrued to only a small slice of the American population” (6). Similarly, Cohen (2004) contradicts Moore and Simon by arguing that although productivity gains have been substantial, “those gains have not found their way to paychecks” (n.p.). And Reich (2008) writes: “The income of a man in his 30s is now 12 percent below that of a man his age three decades ago.”

Nonetheless, Moore and Simon trumpet the growth in Americans' income and report that the increase in wages has accompanied an increase in leisure. Without explaining the apparent contradiction, they mention that the average workweek has remained a steady forty hours since 1950, while they also argue that the "most important change in working conditions over time has been that Americans work substantially less and have much more leisure time" (98). The authors note that a study by the Dallas Federal Reserve Board found that Americans have, on average, tripled their leisure hours over the past one hundred years. Analysis of the data supplied by Moore and Simon indicates, however, that many (if not most) of those additional "leisure" hours can be attributed to years in school and years in retirement. Compared to a century ago, children spend more years in school and people live longer. Thus, Americans seem to receive their additional "leisure" in lump sums at the beginning and end of their lives.

According to De Graaf et al. (2002), compared to Americans in 1900, the average American today gets twenty percent less sleep. Rather than resting and relaxing, Americans work long hours in order to earn the money that will enable them to buy more of what they want. On average, Americans now work the equivalent of an additional month compared to the average annual hours of workers in the late 1960s (De Graaf). According to a study by the United Nations' International Labor Organization, Americans put in more hours on the job than workers in any other industrialized nation (Anderson 2001). (Coincidentally, ad spending is higher in the United States than in any other industrialized nation.) Reich (2008) notes that the "typical American now works more each year than he or she did three decades ago.

Americans [are] veritable workaholics, putting in 350 more hours a year than the average European, more even than the notoriously industrious Japanese.”

Some authors argue that people in developed countries—particularly people in the U.S.—work more now than their distant ancestors worked in centuries past. Compared to today, working hours in industrialized nations are higher than they were before the Industrial Revolution (Durning 1992), in 13<sup>th</sup> and 14<sup>th</sup> century England (Schor 1992), and in medieval Europe (Rybczynski 1991).

Schor (1992) explains that the doubling of U.S. productivity between the late 1940s and early 1990s gave Americans a choice between stabilizing their standard of living at the 1948 level and working less every year thereafter. “Every time productivity increases,” she writes, “we are presented with the possibility of either more free time or more money” (qtd. in Durning 1992, 113). Rather than increasing their leisure, however, Americans have chosen to work as much as they did in 1948 and to earn more money.

Attempting to explain that choice, Brack and Cowling (1983) note that a number of economic studies find a positive relationship between the incidence of advertising and the average propensity to consume (e.g., Metwally and Tamaschke 1981; Peel 1975; Taylor and Weiserbs 1972; Yancey 1958). “If the failure of hours of work to decline is the result of an increase in the marginal valuation of goods *in general* relative to that of leisure, we may search for forces which might have brought this result about. Consequently one might wonder whether advertising can have such an effect” (Brack and Cowling 1983, 288). After testing that hypothesis, the authors

conclude that advertising intensifies the desire for goods and thereby “tilts the long-run supply-side decision about work and leisure towards longer hours” (303).

A study by Fraser and Paton (2003) provides support for the Brack-Cowling hypothesis of an advertising-induced shift in workers’ preferences away from leisure and toward consumption. In addition, their results indicate “unidirectional causality, for males and females, from advertising to hours worked” (1357).

According to Lane (2000), the consumer culture has a hidden agenda: “ever greater consumption implies longer hours at work and more intensive attention to earning, including working second jobs and overtime” (179). Barber (2007) seems to detect a contradiction in a culture that requires consumers who demand copious quantities of goods because they have a lot of time on their hands and a culture that leaves consumers “little time for anything but consumption and the hard work that pays for consumption” (114). Beyond hours spent working and shopping, Barber explains, staying abreast of all the products and services offered by the modern marketplace “makes for disciplined work”; and yet if consumers fail, “the market economy falters. No wonder leisure, squeezed between the extended hours of work, often feels like a full-time job,” he writes. But, as studies by Brack and Cowling (1983) and Fraser and Paton (2003) show, advertising keeps consumers wanting and working.

### ***Over-Consumption, Compulsive Shopping, and Debt***

The cultural ethos of consumerism mandates compulsive shopping to satisfy its need for compulsive selling.  
—Benjamin Barber

Are people actually *addicted* to over-consumption? Some, perhaps, are. Research has shown that, depending on the criteria used in diagnosis, between two and eight percent of Americans are compulsive shoppers (Harston and Koran 2002). According to Kottler et al. (2004), some consumers are affected by a psychological disorder, which manifests itself as “the neurotic pursuit of possessions” (151). Harston and Koran write: “Whether compulsive shopping is best characterized as an obsessive-compulsive disorder, impulse control disorder, or a behavioral reaction to major depression or another primary psychiatric disorder remains uncertain” (65).

The literature on compulsive and impulsive shopping indicates that perceived social image and self-identity play a central role in the decision to make a compulsive purchase (Kacen and Lee 2002). According to Roberts and Jones (2001), compulsive shoppers have an excessive desire for power and prestige and rely on material possessions to signal their status. Advertisers clearly “understand the strong link between the desire for power and prestige and spending” (235). They use that understanding to pull the hair-trigger on a compulsive consumer’s urge to buy and to motivate consumption in everyone else. Their success, in that regard, is considerable.

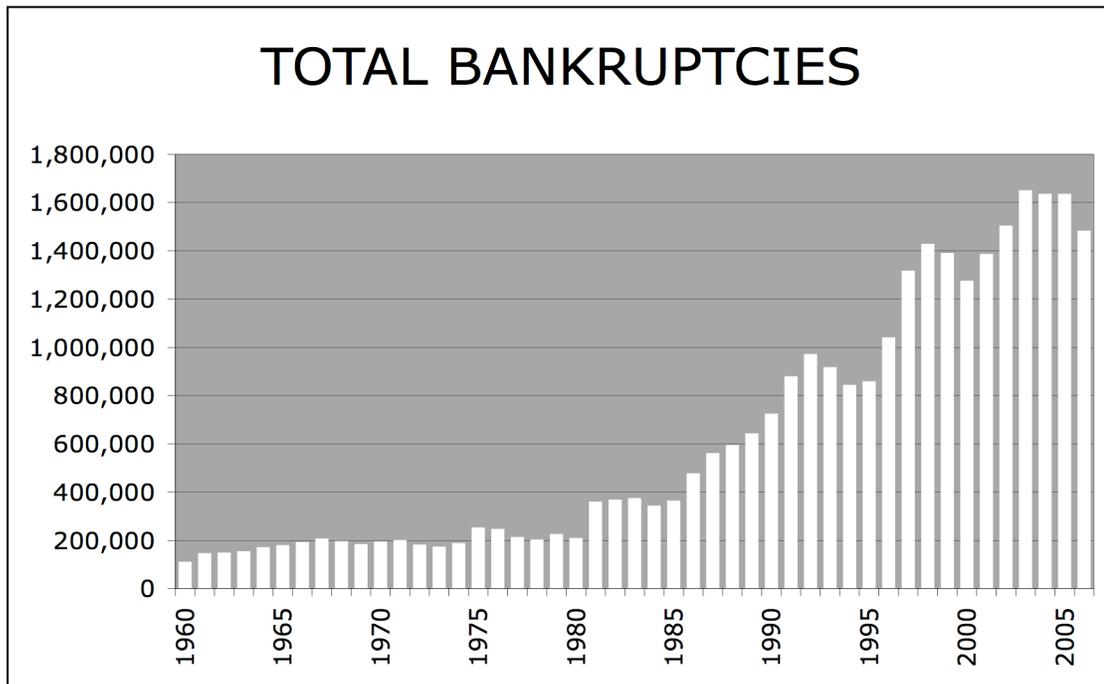
Increasing levels of ad-triggered consumption have played a part in creating unprecedented rates of consumer debt. Credit-card companies use ads to urge consumers to buy whatever they want *now*, “since the profits of companies issuing the cards depend on having consumers maintain large monthly balances” (Gardner et al. 2004, 15). As of February 2008, outstanding credit in the U.S., excluding mortgage debt, was \$2.54 trillion (seasonally adjusted). The average credit-card

balance for an American household in 2007 was approximately \$8,500—nearly triple the \$3,000 it had been in 1990 (Money-Zine 2008). In addition, credit-card and mortgage delinquencies are now at or near record highs, and home foreclosure rates have never been higher (Rucker 2008).

Not surprisingly, the number of bankruptcies has grown substantially over the past several decades. In 1960, when the U.S. population was about 179 million, for example, there were approximately 110,000 business and non-business bankruptcies in the United States. Compare that to 2005, when the population was approximately 300 million, and there were about 1.64 million bankruptcies. Over that 45-year span, the population less than doubled (CensusScope.org n.d.), while bankruptcies increased about fifteen times. (See Figure 7.2.)

As De Graaf et al. (2002) note, lending institutions have responded to the bankruptcy crisis by successfully lobbying Congress to make declaring bankruptcy more difficult. At the same time, however, lenders use advertising to encourage the public to increase their debt. In 2004 and 2005 (years with the most recent available data), American Express and Citigroup were two of the top 50 ad-spenders. Citicorp's "Live Richly" campaign, "which cost some \$1 billion from 2001 to 2006, urged people to lighten up about money and helped persuade hundreds of thousands of Citi customers to take out home equity loans" (Story 2008). According to Morgenson (2008), "eliminating negative feelings about indebtedness was the idea behind MasterCard's "Priceless" [ad] campaign" (n.p.).

Figure 7.2



Source: U.S. Courts. Available online at <http://www.uscourts.gov/bnkrpctystats/1960-0312-MonthJune.pdf>.

Ads tell us that we can solve our problems by consuming advertised products and services. But if consumption becomes compulsive or leads to debts that are overwhelming, what are we to do then? Should we buy some self-help books or pay for hours of psychological counseling? “What if the consumer culture that generates a response to pathological compulsive disorders and the consequences they bring (indebtedness and bankruptcy) is itself organized around and even defined by the very pathologies its therapies affect to address?” Barber (2007) asks. If the consumer culture offers treatments for compulsive-shopping disorders that require greater consumption (i.e., books, counseling, etc.), then, perhaps, “the culture is directly complicit in breeding the pathologies that putatively threaten it” (245).

## ***Overweight and Obesity***

According to the Center for Disease Control and Prevention (CDC), obesity in the United States has grown to epidemic proportions (San Jose Mercury News 2004). As Table 7.1 illustrates, approximately two out of three American adults are now either overweight or obese.

**Table 7.1: Overweight and Obese American Adults, 2007**

|            | All Adults             | Women                  | Men                    |
|------------|------------------------|------------------------|------------------------|
| Overweight | 34.6 %<br>70 million   | 28.4 %<br>30 million   | 41.0%<br>39.7 million  |
| Obese      | 31.4 %<br>63.6 million | 33.2 %<br>35.0 million | 29.5 %<br>28.6 million |
| Combined   | 66.0%<br>133.6 million | 61.6 %<br>65.0 million | 70.5 %<br>68.3 million |

Source: U.S. Department of Health and Human Services. "Statistics Related to Overweight and Obesity." WIN Weight-control Information Network. <http://win.niddk.nih.gov/statistics/index.htm>

While the percentages of overweight adults has remained relatively constant since 1960, the percentages of obese adults has more than doubled, growing from about 11 percent to 29.5 percent of adult males and 16 percent to 33 percent of adult females (U.S. Department of Health and Human Services 2007).

Approximately 300,000 U.S. deaths per year are currently associated with obesity (Carmona 2001). According to the National Institutes of Health, overweight and obesity are known risk factors for a number of serious illnesses, including: heart disease, type 2 diabetes, cancer (e.g., uterine, colorectal, kidney, gallbladder, and breast), stroke, hypertension, gallbladder disease, osteoarthritis, and sleep apnea. In addition, obesity is associated with elevated cholesterol, pregnancy complications, psychological problems (e.g., depression, anxiety, impulse control disorders), surgical risks, menstrual irregularities, stress incontinence, and hirsutism (National Institutes of Health 2004a). “Left unabated,” former Surgeon General Richard Carmona warned, “overweight and obesity may soon cause as much preventable disease and death as cigarette smoking” (Carmona 2001).

Not only does obesity inflict physical costs on the human body, it also exacts an economic toll, and not all of the costs are paid by affected individuals. Some are passed on to taxpayers, obese and otherwise. According to one recent study, states pay 11 percent of their Medicaid expenses for the treatment of obesity and 5 percent of their total medical disbursements for weight problems, in general. Due to the national epidemic of overweight and obesity, the general public must pay, in addition, higher premiums for health insurance due to the increased risk to insurers of weight-related claims (Lemov 2004).

The obesity epidemic is not confined to adults. “Today, more than 20 percent of all preschool children are overweight—more than double the number in 1970—and 1 in 10 are considered clinically obese” (Markel 2002). Results from the periodic National Health and Nutrition Examination Survey (NHANES) reveal the same

disturbing trend among American elementary, middle, and high school students. Between the surveys of the 1960s and the most recent (1999-2004) NHANES, the percentage of overweight children (ages 6 to 11) quadrupled, rising from 4 percent to 16 percent. Over the same period, the percentage of overweight adolescents (ages 12 to 19) rose from 5 percent to 16 percent (National Institutes of Health, 2004a). In addition, a study of teenagers in fifteen industrialized nations found that, of all the teens surveyed, Americans were the most likely to be overweight (National Institutes of Health 2004b). Given that an estimated 80 percent of overweight teens go on to be obese adults (San Jose Mercury News 2004), policymakers have begun to express increased concern about the future health of today's young people. According to former Surgeon General Richard Carmona, "the current generation of children might be America's first to suffer shorter life expectancy than their parents" (McConnell 2004). With epidemiological studies reporting that the obese face a fifty- to one-hundred-percent increase in the risk of premature death, his concern seems warranted (Carmona 2001).

### **The ad-weight connection**

The dramatic increase in the average weight of children since the 1970s (noted above) has coincided with a sharp rise in the average number of television commercials that children watch. According to researchers' estimates, in the 1970s, children saw, on average, about 20,000 TV ads per year. Today, that number has doubled (Kunkel 2001). A majority of those ads—an estimated 11-per-hour on Saturday mornings—are for food products (Kaiser Family Foundation, 2004), and

most, in the words of one researcher, “encourage the consumption of potentially obesogenic foods” (Lobstein 2003). Of all the TV commercials targeted at children, 32 percent are for candy, 31 percent are for cereal, and 9 percent are for fast food (Kaiser Family Foundation 2004). Expenditures for those ads—and thus the associated tax deductions—run into the billions. Fast food franchises, for example, spend \$3 billion annually on television commercials alone (Schlosser 2002). To quote a Kaiser Family Foundation report, “Clearly, the conclusion advertisers have drawn is that TV ads can influence children’s purchases—and those of their families” (Kaiser Family Foundation 2004).

Of course, television is just one medium for introducing the advertised message. Movies, magazines, radio, newspapers, websites, billboards, buses, and dozens of other media also promote the joys of consumption to children. Thus, some food advertisers have begun to worry that too many ads are competing for youngsters’ attention. Sensing that children are becoming inured to direct commercial messages, advertisers are turning to less overt methods of communication. For instance, advertisers have begun to pay to have their food products placed in movies, television programs, videogames, and rap songs. McDonald’s, for example, paid a videogame manufacturer millions to create a game that would allow players to direct the game’s characters “to eat Big Macs, fries, and Quarter Pounders with cheese” (Richtel 2002).

Does this blizzard of junk-food advertising contribute to overweight and obesity in children? Perhaps. The American Academy of Pediatrics notes a correlation between the increasing quantity of ads for high-fat, salty, and sugary foods

advertised to children, and the growing rate of childhood obesity (Fox 1996, 164). A number of studies, in fact, seem to indicate that children's food preferences and eating habits are significantly affected by advertising. The results of a few such studies are summarized below.

- Taras et al. (1989) find that hours spent watching television are directly related to (a) the number of times children ask their parents to buy advertised foods and (b) the number of calories the children consume.
- Several observers report that the desire to model the behavior of beloved television personalities and cartoon characters leads some children to choose unhealthy foods and to develop poor eating habits ("Thought for Food" 2003; McLellan 2002; McConnell 2004).
- According to a study by Borzekowski and Robinson (2001), two- to six-year olds who watch cartoons containing ads for food choose the advertised foods from pairs of similar products at a significantly higher rate than children who see the same cartoons without the embedded food ads. According to researchers, the differences in the preferences between the two groups are even more significant when products are advertised twice than when they are advertised once.
- Finding that adolescents eat fewer servings of fruits and vegetables with each additional hour of television they watch per day, researchers conclude that the inverse relationship (between eating healthy food and watching TV) might be due to the influence of television advertising (Boynton-Jarrett et al. 2003).

- Gorn and Goldberg (1982) report that the preferences of a group of 5- to 8-year-olds for Kool Aid over juice and candy over fruit correspond to the types of ads they watch.
- Two studies, taken five years apart by Signorelli and Staples (1992, 1997), find an association between the amount of television that fourth- and fifth-graders watch and the likelihood of their mistakenly saying that the less nutritious of a pair of foods is the more nutritious one (Signorelli and Staples 1992, 1997).
- Researchers report that 70 percent of the six- to eight-year-olds in their study believe that home-cooked foods are less nutritious than the fast foods they see advertised (Donahue and Henke 1978).
- Children who watch a cartoon on television that contains ads for food make more requests for those foods than do children in a control group (Brody et al. 1981).
- Researchers find that lean, overweight, and obese children who watch food ads consume significantly greater quantities of food, soon thereafter, than does a matched group of children who watch ads for non-food products only ( $p < 0.001$ ). The authors conclude: “Exposure to food adverts promotes consumption” (Halford et al. 2004, 221).
- McConnell (2004) reports that three out of four of the items children ask their parents to buy at the grocery store are foods they have seen advertised on television. In addition, the number of hours the children watch TV correlates significantly with the number of requests they make for advertised foods.

- According to a task force of the American Psychological Association (2004b), “children under the age of eight are unable to critically comprehend televised advertising messages and are prone to accept advertiser messages as truthful, accurate and unbiased. . . . This can lead to unhealthy eating habits as evidenced by today’s youth obesity epidemic” (n.p.).
- Bowman et al. (2004) report that between the late 1970s and the mid-1990s, consumption of fast foods by American children increased from two percent to ten percent of their total caloric intake, on average. Over nearly the same span of years, the number of fast-food restaurants doubled, and the number of overweight and obese children grew dramatically. “These trends,” the survey’s authors suggest, “seem to have been driven by massive advertising and marketing campaigns aimed at children and their parents” (112).

### ***Advertising and smoking***

The Federal Cigarette Labeling and Advertising Act of 1966 limits the states ability to restrict the place, time, and manner of cigarette ads (American Lung Association 2007), so that “commerce and the national economy may be . . . not impeded by diverse, nonuniform, and confusing cigarette labeling and advertising regulations with respect to any relationship between smoking and health” (“Federal Cigarette” n.d.). Although the Act was amended in 1971 to ban cigarette advertising from radio and television in 1971, cigarette manufacturers still find ways to spend billions on (tax-deductible) advertising every year. In 2005, for example, the five

largest U.S. cigarette manufacturers spent a combined \$13.11 billion on promotions and advertising (Federal Trade Commission 2007). Given all that spending, it is not surprising that American youths are exposed, on average, to hundreds of tobacco ads each year (American Lung Association 2007). Unfortunately, as the National Cancer Institute reports, the evidence that cigarette ads initiate smoking is seemingly “unassailable” (National Cancer Institute 2001).

As the American Cancer Society (2007) reports, tobacco use causes approximately 440,000—or nearly one in five—U.S. deaths annually. Smokers generally live shorter lives. According to the Centers for Disease Control and Prevention (2002), in the late 1990s, “adult male and female smokers lost an average of 13.2 and 14.5 years of life, respectively, because they smoked” (n.p.). Numerous studies show that smoking increases the probability of heart disease; causes cancers of the lung, esophagus, mouth, larynx, pharynx, and bladder; contributes to the growth of a number of other cancers; and either causes or contributes to a variety of lung diseases (e.g., chronic bronchitis, emphysema, chronic obstructive pulmonary disease). In addition, smoking is implicated in up to five percent of infant deaths.

### ***Summing up advertising’s impact on the individual and society***

On balance, the impact of advertising on the individual and society is—in two words—not good. As the previous sections indicate, numerous studies link materialistic values to reduced welfare and advertising to the inculcation of materialistic values.

Chapter 8, below, examines the impact of over-consumption, especially ad-induced over-consumption, on the environment.

## Chapter 8: Over-Consumption and the Environment

The previous chapter offers strong evidence in support of the claim that advertising inculcates materialistic values. According to the literature, people who adopt those values tend to buy all sorts of unneeded products, with the ad-inspired belief that the things they buy will improve their lives. Ultimately they suffer, psychologists explain, because the fleeting satisfaction they derive from unnecessary consumption masks their underlying feelings and distracts them from attending to their true needs.

When we consume, we deplete life-sustaining resources, generate wastes, and emit pollution. But since we must consume to survive, the benefits of consumption exceed the costs—up to a point. When we over-consume, however, we increase the costs more than the benefits, such that, on balance, increasing consumption reduces our welfare.

Currently, wealthy nations are consuming at rates that generally violate economist Herman Daly's rules for sustainable throughput: Renewable resources are being consumed faster than they can be regenerated, nonrenewable resources are being depleted before renewable substitutes have been developed, and pollutants are being released into the environment faster than they can be absorbed by their ecosystems.

As Oskamp (2000) notes, over-consumption of natural resources is a major source of environmental degradation. Due to widespread, heedless consumerism,

supplies of many useful natural materials are rapidly depleting. Myers and Kent (2004) report a salient fact about the resource-exploitation trend: “*Since 1950 the United States has used up more natural resources than all people who had lived on Earth before then*” (125; italics added).

For many Americans, the relationship between their own consumption and environmental degradation is far from obvious. True, most Americans, according to a Merck Family Fund survey, believe that the nation is too materialistic (New American Dream 2002). And a strong majority of Americans (70 percent) think of themselves as being either active environmentalists (12 percent) or sympathetic to environmental concerns (58 percent) (Harris Poll 2005). Nevertheless, most Americans consume at levels that are environmentally unsustainable. They miss the connection between their own consumption and environmental degradation, in part, because most of the harm that over-consumption inflicts on the environment is hidden from sight. This chapter attempts to bring the environmental consequences of over-consumption to the forefront.

### ***Unsustainable consumption***

As subsequent sections of this chapter show, some technological enthusiasts believe that concerns about resource depletion and environmental degradation are overblown. In their view, human ingenuity will forever ensure the availability of resources to satisfy human needs (Bailey 2000; Mankiw 2004; Moore and Simon

2000; Scarlett 2000). Many students of sustainability (e.g., Costanza et al. 1997; Daily et al. 1997; Daly, 2005; Daly and Farley 2004; Diamond 2005; Ehrlich and Ehrlich 1996; McKibben 2007; Meadows et al. 2004; Myers and Kent 2004; Oskamp 2000) disagree, however. They maintain that humans are drawing down natural capital at unsustainable rates. Having inherited a generous bounty of natural resources, consumer societies, like profligate heirs, squander vast sums on goods that often provide little more than momentary pleasure. By one estimate, an average of more than 120 pounds of natural resources (including farm products, wood, range grass, natural gas, oil, coal, minerals, metals, stones, and cement) are devoted to each Americans' *daily* consumption (Ryan and Durning 1997). Coupled with those high levels of resource exploitation are high levels of waste generation. According to a "rule of thumb," five tons of manufacturing waste and twenty pounds of extraction-site waste go into producing every ton of goods that consumers buy, use, and then eventually send to the landfill (Meadows et al. 2004). In some cases, the rule of thumb grossly understates the waste associated with resource extraction. To produce one ton of copper, for example, approximately 100 tons of earth must be moved and 100 tons of ore must be excavated (Oskamp 2000). Some mining companies remove entire mountaintops to extract coal cheaply, externalizing the environmental costs by dumping millions of tons of waste on land and streams in the valleys below. Overall, the wasted energy and materials associated with useless material flows of all kinds cost the United States at least \$1 trillion annually (Ryan and Durning 1997).

## *Coping with waste*

According to the EPA, the average American discards more than 32 pounds of trash per week (U.S. Environmental Protection Agency 2008). Finding places to put all of that trash is becoming increasingly problematic. Compounding the problem is the growing quantity of trash containing toxic components. Every year, the amount of toxic-laden electronic products that are cast into the waste stream grows. Rather than spend the sums required to dispose of all such materials safely at local sites, the U.S. ships millions of tons of worn-out high-tech devices to developing countries, where environmental standards are lax (Diamond 2005; Flynn 2005).

Some trash—toxic and otherwise—never reaches its ostensible destination. According to Chris Parry of the California Coastal Commission, an island of garbage twice the size of Texas, weighing more than three and a half million tons, is floating in the eastern Pacific Ocean between Hawaii and San Francisco (United Press International 2007). Bad as that sounds, it is only the half of it, because another island of garbage fouls the western Pacific. Combined, the two islands cover “an area twice the size of the continental United States” (Marks and Howden 2008). Giant islands coalesce when ocean currents circulate trash, in giant gyres, from “storm water discharges, combined sewer overflows, beach visitors, ships and other vessels, . . . landfills, offshore platforms, industrial activities, [and] illegal dumping” (Schwartz 2008, personal correspondence). Eventually, some of the trash leaves a gyre and drifts back to land. As Diamond (2005) notes, even the beaches of uninhabited, rarely visited Pacific atolls are recipients of sea-borne detritus, having, on average, one item of garbage per linear foot of shoreline.

Like the Pacific islands of garbage that few humans ever see (or smell), many of the consequences of human consumption occur in remote locations, hidden from view. Resource extraction, processing, and product disposal often take place far from where consumers actually use the associated goods. Not having witnessed the waste created and pollution emitted with the transformation of raw materials into consumer products or the transformation of consumer products into landfill, most people are unaware of the totality of environmental damage that their consumption inflicts.

### ***American McMansions***

With less than one-twentieth of the global human population, the United States consumes approximately one-quarter of the world's energy and large shares of many other commodities (Ryan and Durning 1997). Average new American homes are two times larger than average European or Japanese homes and twenty-six times larger than average African living quarters (Sawin 2004). Not only are American homes bigger than homes in other parts of the world, the size of new American homes has been increasing over time. In 1950, the average American house was 1,000 square feet (Gardner 2002). In 2006, the median floor area for new single-family homes was 2,248 square feet, up 46 percent from 1975; the average floor area was 2,469 square feet, up 50 percent from 1975 (U.S. Census Bureau "Median" n.d.).

At the same time that the average house-size has been expanding, the average number of people living in each house has been contracting. The average American household size dropped from 3.14 in 1970 (Bureau of Transportation Statistics 1998)

to 2.6 in 2005 (U.S. Census Bureau 2005). Thus, even if the U.S. population were static, the number of homes would have to increase to accommodate the increasing number of households. (Of course, the U.S. population is not static; it is continuing to expand.) According to Sawin (2004), energy consumption per person grew twenty-percent in industrial countries between 1973 and 1992 due to the effect of the shrinking number of people per household and the concomitant increase in the number of households.

Why are houses getting bigger while the number of people per household is getting smaller? Why do people need more room? Perhaps ad-inspired materialism is a factor.

Imagine a typical family of four. Assume that both parents work fulltime at jobs that pay well. Although their jobs prevent them from spending as much time with their children as they would like, the parents are able to compensate themselves for their own loss and make amends to their children by indulging everyone's ad-stimulated desires for material goods.

Soon, the parents' indulgence leads to overabundance. With their three-bedroom house unable to contain all of their possessions, the family packs up and moves to a new subdivision in the exurbs, where the houses are larger than comparably priced houses in the city or suburbs (primarily because commutes tend to be longer). Their new home has plenty of room for all of their stuff. In fact, it has more than enough room for all of their stuff. For the first time in years, the possessions they have are insufficient to furnish the space they have. They need additional carpets, drapes, dressers, chairs, sofas, lamps, tables, beds, sheets, towels,

shower curtains, curtain rods, paintings, and so on. Even as they fill the rooms with furnishings, they continue to buy themselves and their children additional clothing and other personal items. In no time at all, their 3,200-square-foot home in the exurbs is barely able to contain all of the family's possessions.

As studies cited in the previous chapter indicate, ad-induced materialism is associated with numerous psychological, physical, and social disutilities, any of which might affect this exurban family. Setting those disutilities to the side, however, one finds that all of the family's ad-propelled, materialistic over-consumption exacts a host of deleterious environmental consequences. For one thing, the move to the exurbs increases the family's greenhouse-gas emissions, because their commutes are longer and their house has more space to heat and cool. For another, environmental externalities inhere to all of the new things that the family buys to furnish the house. Pollution and waste accompany every stage in the lifecycle of a product—from the extraction of raw materials to the delivery of the finished product to its use and ultimate disposal as useless trash.

Of course, the environmental impact of one exurban family's consumption is relatively small. But if you add the impact of all of the resources that their consumption depletes to the impact of all of the pollution and waste that their consumption generates and multiply that sum by the ten-million-plus families who have moved to the exurbs (Berube et al. 2006), you find that the environmental impact is enormous. Consider, in addition, that as demand for exurban homes goes up, developers often disrupt ecosystems and diminish biodiversity by clearing land

for subdivisions, factories, roads, stores, schools, golf courses, offices, restaurants, and so forth.

### *Nations of new consumers*

An echo of that increase in consumption is occurring in the emerging economies of some formerly low-income nations. While the world's population is growing rapidly, per capita consumption in many parts of the globe is growing faster still—as much as eight to twelve times faster—in terms of environmental impact (Princen et al. 2002). According to many researchers' projections, population growth will stabilize by 2050, but consumption will continue to grow (Flavin 2004).

As residents of developing nations emerge from poverty, they devote substantial portions of their growing incomes to nonessential consumer products (Myers and Kent 2004). Currently, about one billion members of the consumer class live in developing nations. To date, none of those nations devours resources at the U.S. rate. If, however, China were to achieve the wherewithal to consume like Americans, world consumption rates would double; if India attained the U.S. level, they would triple; if every developing country were to consume like Americans, global consumption rates would increase eleven-fold, and “it would be as if the world population ballooned to 72 billion people (retaining present consumption rates),” Diamond (2008) writes.

Between 1985 and 1997, TV ownership increased by a factor of five in East Asia and the Pacific (Sawin 2004). By 2000, middle-class residents of economically

emerging nations (i.e., “new consumers”) owned approximately one-third of the world’s personal computers and sixty percent of the world’s television sets (Myers and Kent 2004). Watching television and surfing the Internet expose new consumers to a plethora of advertisements that flaunt lavish lifestyles and feed aspirations for all the trappings of the Western consumer culture.

Among those trappings are automobiles. In 2006, automakers spent \$1.9 billion on ads in China and nearly \$600 million in India (Reuters 2007a). According to many of the ads, cars confer power, prestige, and sex appeal to their owners; thus, new consumers signal their social ascendancy with cars (Myers and Kent 2004).

During the 1990s, auto sales in new-consumer nations surged. In one decade, car fleets grew in India and Columbia more than 200 percent, in South Korea more than 300 percent, and in China about 400 percent. Of the 560 million cars on the world’s roads in 2000, new consumers owned about 125 million. Analysts predict that by 2010 new consumers will own approximately one-third of the world’s projected 800 million cars (Myers and Kent 2004).

As the number of cars per area increases, more land must be devoted to roads, driveways, and parking lots. A stretch of land equivalent in size to a football field is paved with asphalt for every five cars added to the American fleet, for example (Myers and Kent 2004). In India and China, vast expanses of scarce cropland are currently being sacrificed to accommodate automobiles (Brown 2001).

Throughout China, auto dealerships are selling cars at the rate of seven million per year. Every day, approximately one thousand new cars jockey for position on Beijing’s congested streets (Bezlova 2007). Parity with the American rate

of car ownership would mean that China would add more than a billion vehicles to its roads and require fifteen million more barrels of oil than the world now produces. Furthermore, China's cars would emit more carbon dioxide than all of the rest of the world's cars combined (McKibben 2007).

### *Auto-related disutilities*

Throughout the world, as the number of cars increases, environmental concerns grow. Emissions from cars contribute to smog, acid rain, and global warming. Manufacturing cars is extremely energy intensive and produces tremendous amounts of pollution and waste. The construction and maintenance of roads, bridges, parking lots, gas stations, auto dealerships, auto parts stores, and other auto-related businesses require additional energy and generate additional waste and pollution (Sawin 2004). As a rule of thumb, individual cars put carbon dioxide equal to their own weight into the air each year. Most countries' transportation sectors emit as much of the greenhouse gas carbon dioxide as all other sources combined (Myers and Kent 2004). Extracting, refining, and transporting oil also generate pollution and waste.

Beyond a broad array of environmental costs, cars exact a variety of economic and social costs. In the Amazon and the Arctic, oil extraction endangers indigenous peoples' traditional ways of life. In the U.S., road congestion costs the American economy approximately \$80 billion per year due to lost time at work and wasted

gasoline (Myers and Kent). Throughout the world, accidents, traffic jams, and outbursts of road rage generate additional car-related costs.

Advertisements for cars generally focus on the image that the car confers to the driver. In ads, traffic jams pose no problems, because the advertised car is typically the only vehicle on the road. Ads show none of the negative externalities inhering to cars or driving, in fact.

### ***Environmental disutilities arising from increasing energy use***

Cars consume massive quantities of energy (about 20 million barrels of oil per day) and emit more than 333 million tons of greenhouse gases per year (Environmental Defense Fund 2007). As Sawin (2004) notes, however, not just cars but “everything we consume or use . . . requires energy to produce and package, to distribute to shops or front doors, to operate, and then to get rid of” (25). Given that most of the energy required to do all of those things is derived from fossil fuels, the more we consume, the more we emit greenhouse gases.

According to Dernbach (2008), individual Americans’ activities outside of work generate about one-third of U.S. greenhouse-gas emissions. Worldwide, consumers generate about two-thirds of their carbon-dioxide emissions driving cars and using household electricity. New-consumer nations are already making a significant contribution to global climate change. In 2000, their share of carbon-dioxide emissions reached forty percent, and those emissions have continued to grow (Myers and Kent 2004).

Of all the new-consumer nations, China contributes the most to global warming. In 2007, China claimed the dubious distinction of being the world's greatest greenhouse-gas emitter, a title formerly held by the United States (Knickerbocker 2007). According to Weber et al. (2008), China's carbon dioxide emissions almost doubled between 2000 and 2005, and "consumption in the developed world is [likely] driving this trend." In 2005, for example, approximately one-third of China's carbon dioxide emissions were probably due to the production of goods for export to wealthy nations.

Beyond greenhouse gases, fossil-fuel consumption (in China and elsewhere) infuses the atmosphere with a number of other pollutants (e.g., lead, mercury, arsenic, ozone, and carbon monoxide). Coal-fired power plants pump sulfur-dioxide and nitrogen-oxide molecules into the air, where they combine with water molecules. Eventually some of those molecules fall hundreds of miles away as acid rain. Particulate matter, emitted by power plants, often travels thousands of miles from before being precipitated. Some particulates that originate in China, for example, travel all the way across the Pacific to become components of the air pollution in Los Angeles (Kahn and Yardley 2007).

### **The expanding appliance market**

Energy consumption is increasing rapidly throughout the world, in part, because people believe that their lives will be better if they purchase a wide assortment of machines and appliances that depend on electrical energy to operate. Advertising has played and continues to play a central role in the widespread

acceptance of that belief. General Electric, the eleventh largest U.S. advertiser in 2004 and twelfth largest in 2005 (the two most recent years with available data), has been equating owning appliances with human progress and well-being for decades. Throughout the 1950s, '60s, and '70s, in fact, General Electric told the public: “Progress is our most important product,” and then, from 1979 through 2003, GE’s ads reiterated the slogan: “We bring good things to life.”

In a ranking of the fastest growing categories of energy use, appliances take second place, behind cars. Although manufacturers have been building more efficient models of many appliances for several decades, those efficiency gains have been eclipsed by subsequent demand for larger models and more amenities. In the U.S. between 1972 and 2001, for example, as refrigerators became more efficient, the number of refrigerators per capita grew, and their average size increased by ten percent (Sawin 2004).

Since 1990, most of the growth in appliance-related energy demand has occurred in the new consumer countries (Sawin 2004). Motivated by advertisements and enabled by rising incomes, the new consumers are buying vast quantities of washing machines, clothes dryers, air conditioners, refrigerators, freezers, microwaves, personal computers, televisions, cell phones, electric shavers, hairdryers and so forth. As a result, between 1989 and 1999, household electricity consumption tripled in China, grew at about the same rate in South Korea and Indonesia, and grew at an even higher rate in Thailand and the Philippines (Myers and Kent 2004).

Although consumers—new and old—clearly believe that all of their energy-consuming gadgets, equipment, appliances, etc., add to the quality of their individual

lives, as Sawin (2004) explains, worldwide evidence is mounting “that current patterns of energy consumption are actually degrading the quality of life for many people—worsening air and water pollution, increasing health problems, raising economic and security costs associated with fuel extraction and use, and weakening the natural systems on which we rely for our very existence, including the global climate” (42).

### ***Forest-clearing disutilities***

Ad-induced over-consumption is bringing about the rapid depletion of the world’s old-growth forests. In addition to diminishing biodiversity, forest clearing is a major contributor to climate change. According to Ryan and Durning (1997), logging is the source of one-quarter of British Columbia’s greenhouse-gas emissions, for example.

While temperate forests in North America are now logged primarily for the lumber and pulp they supply, Latin America’s tropical forests are often razed in order to provide more land for crops and pasture (as North America’s forests once were). The topography, soil, and climate of large areas of the Amazon basin are suitable for mechanized agriculture—once extant forests are removed. For that reason, over 540,000 hectares of Amazon forest were converted directly to cropland between 2001 and 2004 (Morton et al. 2006). Unfortunately, fields planted with crops provide little or no carbon offset for the rapid and complete removal of forest biomass. Neither does pasture; nevertheless, short-term economic considerations motivate the

conversion of vast expanses of tropical forestlands to pasturelands for raising cattle. According to the United Nations Framework Convention on Climate Change, between twenty and thirty-five million acres of the world's tropical forests are converted to pasture every year, and the conversion process is responsible for eighteen percent of the world's annual carbon emissions (UNFCCC 2006).

### ***Disutilities associated with meat consumption***

The world's growing appetite for beef has been the primary stimulus for the conversion of forest to pasture and cropland throughout the tropics. In the United States, most such conversion occurred decades or centuries ago. According to Ryan and Durning (1997), seventy percent of the grain currently grown in the U.S. is fed to livestock every year. Three-fifths of U.S. corn and approximately one-quarter of all the corn grown anywhere goes to feed American livestock. With worldwide demand for grain-fed beef soaring, it is worth noting that two-thirds of the world's total grain harvest would be devoted to Chinese meat consumption, if China were to consume meat at the American per-capita rate (McKibben 2007). Demand for grain as an input to meat production has already (in 2008) helped raise grain prices beyond the reach of many impoverished people. In Haiti, for example, some poor people have been reduced to eating baked mud—with a bit of sugar and fat added for flavor—due to out-of-reach grain prices (Lacey 2008).

Raising cattle and bringing them to market exacts an assortment of environmental costs. Livestock raised for meat production generate wastes that “are

widely implicated in waterway pollution, toxic algal blooms, and extensive fish kills” (Myers and Kent 2004, 40). According to Ryan and Durning (1997), the production of a quarter-pound hamburger requires the use of about a pound-and-a-quarter of feed, 1 cup of gasoline (most of it in the form of fertilizer), and hundreds of gallons of water. In addition, producing the quarter-pounder brings about the loss of about one-and-a-quarter pounds of topsoil and emits greenhouse gases that correspond to those released during a six-mile drive in a car (Ryan and Durning). “The annual beef consumption of a typical American family of four requires more than 260 gallons of fuel and releases 2.5 tonnes [i.e., about 5,500 pounds] of CO<sub>2</sub> into the atmosphere (through machinery on farms and through transport from countryside to cities), or as much as an average car over six months” (Myers and Kent, 48).

Beef consumption contributes to greenhouse-gas emissions in another way. According to the U.S. Environmental Protection Agency (2007b), cattle raised in the U.S. “emit about 5.5 million metric tons of methane per year into the atmosphere, accounting for 20% of U.S. methane emissions” (n.p.). Unfortunately, “methane is over 20 times more effective in trapping heat in the atmosphere than carbon dioxide . . . over a 100-year period (U.S. Environmental Protection Agency 2007a, n.p.).

In addition to all of the other environmental costs associated with beef consumption, raising cattle depletes freshwater stocks. Irrigated fields that are dedicated to growing grain for meat production require vast quantities of freshwater. As Ryan and Durning (1997) note, “eating less beef—thereby saving the water used to grow cattle feed—would cut deepest of all into the 375 gallons of water consumed per person per day in the United States” (71).

In many parts of the world, groundwater is being mined at unsustainable rates in order to grow grain that is used, in part, to produce feed for cattle. America's Ogallala Aquifer, formed over twenty million years ago (Guru and Horne 2000), has been seriously depleted since farmers, from Texas to South Dakota, began to use the aquifer intensively to irrigate their croplands following World War II (Lawrence Journal World and News 2003). According to Lee Allison, director of the Kansas Geological Survey, some western portions of the aquifer will only be replenished in our lifetimes if rainfall increases "1,000 percent." In a number of locations, the aquifer has been effectively drained. In many other spots, only a few decades of groundwater remain. "We're growing corn in a desert to feed cattle," remarked Sierra Club attorney Charles Benjamin (qtd. in Lawrence Journal 2003). As Cohen (1995) explains, when the grain and "beef fed on grain grown with mined water are sold at home or abroad, the price takes no account of the likely replacement cost of the water." Thus, water is, in effect, given away with the sale of the meat and grain. The costs associated with the depletion of the Ogallala and other aquifers "will be borne by future Americans, who may not benefit from the current profits or consumption of wheat and beef" (384).

### **Advertising's role in creating a new market for meat**

Speculating that advertising plays a substantial role in creating demand for meat seems reasonable. Year after year, McDonald's ranks among the top twenty U.S. advertisers. Ads for Tyson Chicken, Kentucky Fried Chicken, Church's Chicken, Popeye's Chicken, Jimmy Dean Sausage, Brown N' Serve Sausage, Bob

Evans Sausage, Oscar Mayer Wieners, Ball Park Franks, etc., etc., abound. As previously noted, the Department of Agriculture has required ranchers to support advertising campaigns, from time to time, for some homogeneous meat products, which would not otherwise be advertised. Thus, Americans have been treated to ads for beef (“It’s What’s for Dinner”) and pork (“The Other White Meat”).

To a great extent, however, new consumers are responsible for the recent surge in beef demand. Like having a car to drive, having meat on the table is considered a symbol of success for new consumers, and it is one that is within the reach of more of them. Over the 1990s, when meat consumption increased thirty percent worldwide, demand for meat in new-consumer countries increased twice as much (Myers and Kent 2004).

As Myers and Kent (2004) explain, many new consumers eat meat “to enjoy the good life as represented by what they see as the American dream” (48). Although they might see Americans enjoying meat in movies and on television programs, new consumers are more likely to be influenced to eat meat by advertisements that associate meat consumption with high status, prosperity, and the good life. McDonald’s alone spends several hundred million dollars advertising outside the United States every year (“Thoroughly Modern” 2005). (Visit the video website YouTube.com to find links to dozens of McDonald’s, KFC, and Burger King ads that have aired in new-consumer countries, such as Taiwan, South Korea, Philippines, Singapore, Thailand, Turkey, Malaysia, India, China, Brazil, Argentina, Mexico, and Poland.)

The United States Department of Agriculture subsidizes some advertisements for meat products overseas. In 2006, the Market Access Program allocated \$18 million to promote the U.S. Meat Export Federation (U.S. Department of Agriculture 2007). The Market Promotion Program (a forerunner to the present program) spent nearly half a million dollars in 1991 underwriting McDonald's overseas ads (Moore and Stansel 1995).

### ***Increasing demand and dwindling supply of cropland***

As worldwide demand for grains is soaring, the amount of land devoted to raising crops is declining. The world's grain-growing acreage decreased six percent between 1981 and 2000 (Oskamp 2000). Over the same time span, the global population increased by more than 33 percent (U.S. Census). Adding to the problem of a declining cropland-to-population ratio is the fact that soil quality in many parts of the world is deteriorating. According to Diamond (2005), salinization, acidification, erosion, alkalization, and fertility depletion "have resulted in a fraction of the world's farmland variously estimated at between 20% and 80% having become severely damaged, during an era in which increasing human population has caused us to need more farmland rather than less farmland" (490).

Lawns deplete the supply of farmland further still. In the U.S., for example, lawns reduce the land available for crops by forty-million acres—an area larger than the state of Louisiana. Turf grass is, in fact, America's largest irrigated crop (Hayden 2005). As such, its environmental impact is substantial. In addition to soaking up

copious amounts of water, most lawns receive applications of fertilizers and pesticides, which tend to harm wildlife and to pollute soils, water, and air.

Ads for a variety of yard and garden products depict a spacious, luxuriant lawn as a component of the American dream. Thus advertising plays an indirect role in the loss of cropland. It plays another indirect role by generating demand for goods of all kinds. Because land devoted to factories and stores tends to offer higher returns, commercial development often replaces cropland when demand for goods increases.

For the reasons mentioned, among others, the ratio of cropland to population in the U.S. is decreasing. According to some economic cornucopians (e.g., Bailey 2000; Georgia et al. 2000; Lomborg 2001), however, that loss is being more than offset by technological progress. Technological solutions, they maintain, allow us to reap larger quantities of food from smaller plots of land. Unfortunately, some of the technological solutions that the cornucopians tout—such as increasing the amount of available cropland by irrigating arid land or increasing crop yields through liberal applications of fertilizers and pesticides—are unsustainable due to the detrimental environmental impacts associated with their use. In addition, cornucopians' predictions of expanded agricultural production seem to depend on the use of petroleum-fueled farm equipment, which is growing increasingly infeasible. Dwindling supplies and high prices will force farmers to reduce fossil-fuel consumption. Perhaps human ingenuity will provide solutions for today's shortages as the cornucopians claim, but because technological solutions—should they

appear—tend to have unintended consequences, dismissing the diminishing supply of cropland as unimportant seems to be imprudent.

### ***Outsized ecological footprints***

Having fewer acres of farmland with more mouths to feed is one indication that humans are now straining against ecological limits. But there are many other indications of that strain. According to the organization Redefining Progress, humanity “would need to have over one third more than the present [2008] biocapacity of Earth to maintain the same level of prosperity for future generations” (Redefining Progress 2008). What is more, if everyone on the planet were to attain the consumption level of today’s average American, between five and six Earths would be required to support that consumption, which is another way of saying that the average American’s ecological footprint is currently five-to-six times larger than the planet can sustain, *ceteris paribus* (Creslog and Graesser 2001; Hoppe and Creslog 2002).

The “ecological footprint,” a concept created by Rees and Wackernagel, is defined by Meadows et al. (2004) as “the total impact of humanity on nature: the sum of all effects of resource extraction, pollution emission, energy use, biodiversity destruction, urbanization, and the other consequences of physical growth” (56). The smaller the average ecological footprint, the more people the planet can accommodate. In order to reduce its ecological footprint, a nation can (1) decrease the size of its population, (2) decrease the level of its consumption, or (3) increase its

resource efficiency through technological innovation. According to Meadows et al., taken together, decreasing all three “could reduce the human impact on the planet by a factor of *several hundred or more*” (127; italics in the original).

For one reason or another, however, most nations’ ecological footprints are expanding, not contracting. In low-income nations, ecological footprints are expanding because population growth rates tend to be high, even though individual consumption levels are typically very low. In new-consumer nations, although population growth rates are generally lower than in low-income countries, consumption levels are higher and are growing dramatically. In wealthy nations, populations are stable, growing slowly, or even shrinking slightly; nevertheless, ecological footprints are enlarging because average consumption levels are very high and still expanding. Technological innovations could reduce footprints by allowing consumers and producers to use resources more efficiently; however, as Jevons first explained in 1865, reduced production costs associated with resource efficiency tend to drive down product prices, and when prices fall, consumers often devote their savings to the purchase of more products. As a result, technological improvements have failed to reduce the ecological impact of growing human populations and increasing per-capita consumption.

### ***Beyond carrying capacity?***

According to Meadows et al. (2004), the planet risks a series of collapses—ecological, social, and political—at current levels of population, consumption, and

technology. “*There is pervasive and convincing evidence that the global society is now above its carrying capacity,*” they write (138; italics in the original). Simon (1990, 1996) and Wattenberg (2005), however, disagree. As they see it, carrying capacity grows along with population, because children confer benefits that outweigh any costs they might impose. For his part, Cohen (1995) doubts that carrying capacity is even a useful concept, because, in his view, humans can do a lot to influence the number of people that the Earth can support. Nevertheless, he notes that the global population is within the range that a substantial fraction of scholars believes is the outer bound for sustainability, and explains that if the population were to continue to increase at its 1995 rate, it would reach fifty billion within a mere 150 years (and reach five trillion in 436 years). The addition of that many people in so short a time would obviously be unsustainable, Cohen maintains.

As it has turned out, the human population in 2008 is increasing at a rate that is about four-tenths of a percent lower than it was when Cohen wrote in 1995 (Central Intelligence Agency 2008). If the world’s population continues to grow at the 2008 rate, it will take about 200 years for the population to increase ten-fold. Clearly, the lower rate of population growth suggests a move in the right direction. But even if population growth were to come to a complete halt, carrying capacity—that is, the number of people the Earth can support—would remain a concern so long as human consumption continues to grow unchecked. As Myers and Kent (2004) note, “in many parts of the world, the factor of per-capita growth in consumption is expanding 8-12 times faster than population growth as concerns environmental impacts” (62).

As Meadow et al. (2004) see it, “compulsive worship at the altar of consumption has brought humanity right to the edge of an environmental abyss—depleting resources, spreading dangerous pollutants, undermining ecosystems, and threatening to unhinge the planet’s climate balance” (97). Put another way, human consumption has grown so large it has begun to impair the ecosystem services (i.e., flows of energy, materials, and information from natural-capital stocks) upon which all earthly life depends (Costanza et al. 1997).

### **The impact of over-consumption on ecosystem services**

Natural ecosystems supply the materials and energy on which the human economy is based. Just as important, they provide a number of fundamental life-support services, such as climate regulation, air and water purification, genetic diversification, waste decomposition and detoxification, sediment retention, soil-fertility regeneration, and plant pollination, to name just a few. These essential services depend upon “a complex interplay of natural cycles powered by solar energy and operating across a wide range of space and time scales” (Daily et al. 1997). Their intricacy, complexity, and enormity rule out substituting current (or foreseeable) technologies for most of the services that natural ecosystems provide for free.

Although the value of such irreplaceable services “is infinite in total,” researchers have estimated the monetary impact of changes in the quality and quantity of a number of ecosystem goods and services. Costanza et al. (1997) estimated that seventeen ecosystem services had an annual economic value of \$16 to \$54 trillion (with an estimated average of \$33 trillion), at a time when the global GNP was

approximately \$18 trillion. But since most such services carry no price tags to signal changes in quantity or quality, they are often exploited in situations where long-term costs far exceed short-term benefits (Costanza et al. 1997; Daily et al. 1997; Oskamp 2000). “If ecosystem services were actually paid for, in terms of their value contribution to the global economy, the global price system would be very different from what it is today” (Costanza 1997, 259). Some early attempts to include the monetary values of ecosystem services in national economic accounts indicate “a leveling of welfare since about 1970 while GNP has continued to increase” (259).

Lack of awareness of the role that ecosystem services play in producing the goods that are traded in markets “helps drive the conversion of natural ecosystems to human-dominated systems (e.g., wheatlands or oil palm fields), whose economic value can be expressed, at least in part, in standard currency” (Daily et al. 1997, 3).

### **Over-consumption and biodiversity**

As Cohen (1995) sees it, “human ignorance is so extensive that people know only a few of the right questions to ask when trying to balance the costs and benefits of preserving biological diversity” (340). Obviously, the market cannot establish an equilibrium price for unrecognized goods. The Pacific yew tree, for example, had little if any monetary value until researchers found that it supplies an effective cancer treatment. If the forests where Pacific yews grow had been cleared before the trees’ pharmacological value was discovered, the harm to human well-being would have been unknown but, nevertheless, real. “Given the present primitive state of understanding of how the biological world works,” Cohen writes, “the suggestion that

the market mechanisms could be relied on at present to govern species conservation seems preposterous” (340).

To a great extent, however, markets do govern species conservation, and biodiversity is paying a price. Estimates of the total number of species vary wildly, from two million to one-hundred million, with a “best estimate” of approximately ten million (Answerbag.com 2008). Estimates of the rate of species extinctions vary, as well. According to statistician Bjorn Lomborg, author of *The Skeptical Environmentalist* (2001), the extinction rate is 0.014 percent per year. Lomborg, however, seems to have misinterpreted the research on which he bases his estimate (Fisher 2002; Lawton et al. 1998; Stork, 1997). According to biologist E. O. Wilson (2001), Lomborg’s estimate “is an order of magnitude smaller than the most conservative species extinction rates by authorities in the field.” For the most part, Wilson explains, extinction-rate estimates hover around 0.1 percent per year, which is approximately 1,000 times the pre-human extinction rate.

Not since the collision between a giant meteor and the Earth darkened skies and altered climates, sixty-five million years ago, has the loss of biodiversity been as great as it is currently (Wilson 1998). Habitat destruction is the primary cause of species extinctions (Cohen 1995; Oskamp 2000; Wilson 1998), and “today’s global economic juggernaut” is the primary cause of habitat destruction (Friedman 2007). Economic incentives motivate investors to convert wild habitat, which provides unpriced ecosystem services, into real estate, which supplies obvious, tangible benefits that are easily priced. Consequently, the houses, malls, factories, farms, ranches, airports, highways, and landfills (etc.) sited on converted land create new,

manmade habitats, as they destroy the old, wild ones. Creating reservoirs for hydroelectric-power generation, recreation, and water supplies, for example, inundates habitats and drowns wildlife; diverting water for human uses deprives myriad aquatic species of the habitat they depend on to survive (Oskamp 2000); introducing aggressive exotic species—along with the diseases they carry—sometimes leads to the eradication of indigenous species (Wilson 1998); burning fossil fuels contributes to climate change, which undermines the survival of countless species of plants and animals. Effluents from household consumption, industry, agriculture, and mining decimate aquatic species by warming and polluting streams, contaminating coasts, and causing the eutrophication or acidification of ponds, lakes, bays, and gulfs (Cohen 1995).

“Biological diversity,” Wilson (1998) writes, “is in trouble. Mass extinctions are commonplace, especially in tropical regions where most of the biodiversity occurs” (292). Extinction rates are high even in the temperate zones of modern, industrialized nations, however. The United States, for example, has the highest percentage and greatest number of plant species in danger of extinction of any nation in the world (Oskamp 2000). According to Wilson (1998), thirty-two percent of all U.S. species are now imperiled, and one percent has already been extinguished. Worldwide, the species extinction rate is “projected to rise, and very likely sharply” (Wilson 2001).

## ***Over-consumption, toxic pollution, and human health***

While the species *Homo sapiens* is hardly in danger of extinction, some human activities that increase extinction rates in other species impair human health, as well. When chemists design and consumers use pesticides, fungicides, herbicides, and insecticides, for example, they intend for the poisons to work on other species; nevertheless, the poisons may affect human health in known and (yet) unknown ways. Even ordinary production and consumption processes (i.e., ones not designed to kill other species) often generate toxins. Fossil-fuel combustion, for example, releases a variety of toxic molecules (e.g., carbon monoxide, sulfur dioxide, and nitrogen oxides) and toxic elements (e.g., mercury and arsenic) into the atmosphere. In some cases, sulfur dioxide or nitrogen oxides combine with water vapor and other molecules in the atmosphere to form acids that can later fall as rain, snow, or particulates and then contact surfaces on the ground. Although soils bind with and sequester toxic metals at normal levels of acidity, acid precipitation can break those bonds (Meadows et al. 2004). Subsequently, toxic metals are free to percolate down to groundwater and flow into streams, where they can enter the food chain and make their way up the chain to human beings.

Many toxic chemicals break down slowly—if at all. Unfortunately, human activities are degrading or eliminating ecosystems that break down toxins and purify water. For example, millions of acres of wetlands, which “act as filters to cleanse water of impurities,” have already been destroyed by human activities (U.S. Geological Survey n.d.). Between the 1780s and the 1980s, Americans’ activities

caused the loss of approximately 53 percent of the original wetlands in the forty-eight conterminous states (Dahl n.d.).

When production or consumption processes release toxins into the air, soil, and water, they become available for people and other living things to swallow, breathe, or absorb. A toxin's impact depends on the particular substance, the level of exposure, and the susceptibility of the individual.

Few people have been tested to determine which toxic chemical compounds reside within their bodies. Few are aware that they carry any at all. Nevertheless, according to Dr. Rick Smith, executive director of Canada's Environmental Defence [*sic*], "If you can walk, talk and breathe, you're contaminated" (qtd. in Environmental News Service 2005).

Journalist Bill Moyers' blood and urine were analyzed for toxic industrial chemicals as part of a study of human pollutant loads by New York's Mount Sinai School of Medicine (PBS n.d.). Among the toxic chemicals residing in Moyers' body were two organophosphate pesticide metabolites, two heavy metals (lead and methylmercury), three organochlorine pesticides, four phthalates, thirteen dioxins and furans, twenty-nine semivolatile organic compounds, and thirty-one PCBs. Although little is known about the effects of low-level human exposures, studies of laboratory animals and workers exposed to high levels link the toxins in Moyer's blood and urine to a variety of health problems. Among the chemicals found in Moyers' body were toxicants that affect the brain and nervous system (25 chemicals), blood or cardiovascular system (17 chemicals), developmental system (52 chemicals), endocrine system (21 chemicals), liver or gastrointestinal system (23 chemicals),

immune system (17 chemicals), kidneys (16 chemicals), reproductive system (20 chemicals), respiratory system (21 chemicals), and skin and sense organs (21 chemicals). The tests also revealed forty-eight separate carcinogens in Moyers' blood and urine. No one knows how interactions among these chemicals affect human health.

Another study tested the blood of eleven people from across Canada for eighty-eight toxic chemicals (Environmental News Service 2005). All together, the group's blood contained sixty different toxicants, including flame retardants, stain repellants, PCBs, DDT, lead, and mercury. The average number of chemicals per subject was forty-four. In addition to cancer, the health problems associated with the chemicals found in the Canadian study include respiratory, reproductive, developmental, and endocrine disorders. Of all the participants, the blood of Chief David Masty of the Whapmagoostui First Nation of northern Quebec contained the highest levels of persistent organic pollutants (e.g., PCBs) and mercury.

The evidence of pollutants in Chief Masty's blood contradicts conventional wisdom. For example, Benjamin Friedman (2005), author of *The Moral Consequences of Economic Growth*, writes: "The least polluted areas of the globe are, of course, those where there is no industrial activity and little or no human settlement" (380). But, as Diamond (2005) notes:

the highest blood levels of toxic industrial chemicals and pesticides reported for any people in the world are for Eastern Greenland's and Siberia's Inuit people (Eskimos), who are also among the most remote from sites of chemical manufacture or heavy use. Their blood mercury

levels are nevertheless in the range associated with acute mercury poisoning, while the levels of toxic PCBs . . . in Inuit mother's breast milk fall in a range high enough to classify the milk as 'hazardous waste' (518).

### ***Costs of environmental degradation***

In many cases, Friedman's point is valid, however. The people who are most affected by pollution are those who live or work close to its source. In China, where officials often turn a blind eye to sources of toxic emissions in the name of economic growth, pollution has become a major cause of death and infirmity. According to a study by the World Bank, air pollution causes 350- to 400-thousand deaths per year in China. Diseases associated with water pollution kill an additional 60 thousand Chinese people annually. In the United States, pollution is regulated to a greater extent than in China. Nevertheless, deaths attributed to air pollution "are conservatively estimated at over 130,000 per year" (Diamond 2005, 492).

Taken all together, the economic costs associated with environmental degradation, including pollution-related health costs, pollution abatement costs, and lost ecosystem-service costs, are astronomical. But as Diamond (2005) explains, environmental problems can also exact serious social costs. In his study of societal collapses, he finds that environmental degradation led to the collapses of the Anasazi, Easter Island, Greenland Viking, and Mayan civilizations. Modern industrial societies, as he sees it, "are rapidly advancing along [a] non-sustainable course"

(498). Problems such as toxic pollution, habitat destruction, species extinction, marine-fishery over-exploitation, soil degradation, fossil-fuel depletion, and ecosystem-service reduction “are like time bombs with fuses of less than 50 years”

(498). Diamond continues:

Thus, because we are rapidly advancing along this non-sustainable course, the world’s environmental problems *will* get resolved, in one way or another within the lifetimes of the children and young adults alive today. The only question is whether they will become resolved in pleasant ways of our own choice, or in unpleasant ways not of our choice, such as warfare, genocide, starvation, disease epidemics, and collapses of societies. While all of those grim phenomena have been endemic to humanity throughout our history, their frequency increases with environmental degradation, population pressure, and the resulting poverty and political instability (498).

Agreeing with Diamond that current production and consumption processes are unsustainable, Meadows et al. (2004) report that in thousands of runs of their complex computer model of the world, “overshoot and collapse” was “by far the most frequent” outcome. An overshoot occurs, they explain, when signals about the impending exhaustion of a once plentiful resource are delayed. In the authors’ words, *“If the signal or response from the limit is delayed and if the environment is irreversibly eroded when overstressed, then the growing economy will overshoot its carrying capacity, degrade its resource base, and collapse”* (164; italics in the

original). If, on the other hand, environmental signals are heeded and depleting resources are protected, collapse can be avoided.

### ***The role of technologies and markets***

Technologies that monitor the environment and facilitate communication about its health can help prevent collapse. According to some economists, market forces can lead to the development of such technologies. Ignoring the fact that prices cannot signal the scarcity of a multitude of *priceless* environmental amenities, some market enthusiasts claim that market forces are adequate to solve problems of resource conservation. As they see it, if a resource is in short supply, price signals will stimulate the development of technologies that all allow the resource to be used more efficiently or technologies that provide a substitute to perform the function of the depleted resource. For such reasons, Simon and Kahn (1984) disagree with pessimistic assessments that warn of overshoot and collapse. They conclude instead that “environmental, resource, and population stresses are diminishing, and with the passage of time will have less influence than now upon the quality of human life on our planet” (45).

According to Simon, Kahn, and a number of other economists, markets play a central role in resource *preservation*. Benjamin Friedman (2005) explains: “When markets for resources are allowed to function normally, so that increasing demand relative to supply creates higher prices, the result is not only to signal the resulting scarcity but to trigger actions that can, and more often than not do, work to alleviate

it” (376). Higher prices discourage producers and consumers from using a scarce resource even as they encourage the development of innovative technologies that increase resource-use efficiency. When oil prices soared in the 1970s, for example, producers and consumers began to take measures to reduce their use of petroleum products. As a consequence of their actions in response to higher prices, “energy consumption [fell] sharply compared to economic output and . . . even declined on a per capita basis despite the continued advance in American living standards” (376). Thus, in Friedman’s view, the market worked.

Many observers join Friedman in claiming that the market forces worked to conserve energy. As they see it, Americans began to cut back on their energy use in response to the energy shortages of the 1970s, and, as a result, U.S. per-capita energy use has been falling for several decades. But others question that claim. In today’s globalized economy, Sawin (2004) explains, “many manufactured goods cross borders and oceans to reach us, where the energy required to make and move them is omitted from national accounts. As a result, some experts argue that energy intensity is actually increasing in some nations, because they effectively import energy inputs from overseas” (36). Much of China’s spectacular growth has depended on energy-intensive industries, for instance. When the U.S. imports goods from China, it consequently imports energy that national accounts fail to reflect. Unless that energy is factored in, the claim that per capita energy consumption is falling is suspect. Nevertheless, the claim is made and is accepted as conventional wisdom.

According to Scarlett (2000), not just energy use but resource consumption, in general, is falling per unit of output, as manufacturers respond to higher material

costs by “dematerializing” more and more products. As a result of dematerialization, “a defined level of consumption is occurring with less resource use, less accompanying waste, and a ‘lighter’ footprint on the earth” (42). Thus, Scarlett explains, Malthusian concerns about scarce resources are unwarranted. She writes: “Because people seek particular attributes, not specific resources to satisfy their needs and desires, the production and consumption process holds near-endless opportunities for invention, exploration, substitution, and conserving technologies that, in effect, expand the potential resource base” (44).

Following a similar line of thought, economist Robert Solow (1993) notes: “There is no reason for us to feel guilty about using up aluminum as long as we leave behind a capacity to perform the same or analogous functions using other kinds of materials” (181). As he sees it, we are under no obligation to leave the next generation the world just as we inherited it. So long as we leave them the ability to live at least as comfortably as we live, we should modify the natural environment to extract more wealth and comfort for ourselves now. Future generations will profit from the intellectual and physical capital our generation creates and leaves behind.

Ausubel (1996) agrees. In his view, humans have always modified the natural environment to suit their needs. He notes, as an example, that the forests of the eastern Mediterranean region were cleared by the time of Alexander the Great, in the fourth century, B.C. Augmenting Ausubel’s point, Scarlett notes that horses in New York City deposited approximately 200 hundred tons of excrement daily onto city soils in the early twentieth century. “Waste, residuals from production, and other

environmental impacts are not a consequence of modernization and industrialization,” she writes (46).

If Scarlett means that humans have always generated waste and residuals and had other impacts on the environment, her assertion is obviously true. But even if environmental degradation is not purely a consequence of modernization and industrialization, the double-Texas-sized island of garbage that drifts around the eastern Pacific and its western-Pacific twin (mentioned above) certainly are.

The issue is one of scale. Consider that for most of human history, the total human population was small and so was its environmental impact. Given an abundant stock of resources and so few people to exploit them, the benefits of modernization and industrialization far exceeded their costs. When cornucopian economists look to history as their guide for future action, they assume, along with Dwight Lee, that the “relevant resource base is defined by knowledge, rather than by physical deposits of existing resources” (qtd. in Bailey 2000, 14). And a strong case can be made that until recently attaining wealth and comfort depended more on knowing how to use a resource than on its physical supply. As Bailey (2000) explains, “even the richest deposit of copper ore is just a bunch of rocks without the know-how to mine, mill, refine, shape, ship, and market it” (14). But while that assertion is true, it fails to recognize that the environmental impact of consumption and production involves something more than merely finding resources and having the know-how to use them. Extracting copper, for example, often contaminates streams and groundwater. If the cost of restoring water quality were included, the

costs associated with copper mining would certainly be much higher and might even exceed the benefits.

In many instances, the scale of humanity's ability to exploit resources seems to be outstripping the ability of ecosystems to cope. The technology that enables mountaintop mining, for example, is much more efficient than a pick and shovel at extracting coal. But comparing the environmental impact of the two is analogous to comparing the size and capabilities of an aircraft carrier to a rubber ducky or an intercontinental missile to a paper airplane. Looking backward in time, cornucopians seem to focus on the benefits of advancing technology and miss the enormity of the destruction wrought by current technologies as compared to those of the past.

As Daly and Farley (2004) explain, so long as the economic subsystem was tiny relative to the entire ecosystem, as it was throughout most of human history, the benefits of economic expansion were large and the opportunity costs were insignificant; thus, modernization and industrialization improved human welfare. A number of environmental signals now indicate, however, that the opportunity cost of further economic expansion exceeds the benefit.

Cornucopian economists counter that those who envision limits to growth underestimate "the power of technological advance, and [ignore] altogether the role of initially higher prices both in encouraging substitution by users and in stimulating new supplies" (Friedman 2005, 377). Scarlett (2000) maintains that the "relatively high cost of materials processing—from mining and harvesting through final production—motivates a search for ways to make each unit of material more

productive” (62) and “for closed-loop opportunities to recycle on-site plant wastes . . .” (45).

As they describe in their book, *Cradle to Cradle*, architect William McDonough and chemist Michael Braungart offer manufacturers such closed-loop opportunities for recycling. Challenging the notion that human industry inevitably degrades nature, McDonough and Braungart design products so that when they wear out they provide either “biological nutrients” for soil and water or “technical nutrients” that circulate in closed-loop cycles as valuable industrial materials.

As McDonough and Braungart (2002) explain, side effects inhere to virtually every process. “But they can be deliberate and sustaining instead of unintended and pernicious.” Using nature’s activity as a pattern, humans can “design some positive side effects to our own enterprises instead of focusing exclusively on a single end” (81).

Traditional recycling only slows the rate of environmental degradation, the authors explain. With each cycle, the quality of recycled materials deteriorates. Some forms of dematerialization make isolating recyclable materials in waste streams problematic. Worse still, recycling itself sometimes increases pollution significantly. The process of recycling secondary steel in electric-arc furnaces, for example, contributes a substantial proportion of the world’s dioxin emissions. McDonough and Braungart explain: “Just because a material is recycled does not automatically make it ecologically benign, especially if it was not designed specifically for recycling. Blindly adopting superficial environmental approaches without fully understanding their effects can be no better—and perhaps even worse—than doing nothing” (59).

Likewise, relying blindly on market forces to provide incentives for more efficient resource use can lead to greater environmental degradation. Markets spur industries to dematerialize, for example, in order to cut costs and increase productivity. Fulfilling environmental goals—should that occur—is generally a fortuitous side effect; thus, if making each unit of material more productive increases environmental degradation but cuts costs, manufacturers will likely dematerialize regardless of the detrimental environmental consequences.

Take, for example, the semiconductor chips that are used in computers and other electronic devices. Although semiconductors appear to be the epitome of dematerialization, as Sarin (2004) explains, their manufacture actually requires more intensive use of materials than most ordinary, non-high-tech goods. “The total mass of secondary materials used to produce [a] 2-gram chip is 630 times that of the final product” (44). The total mass of secondary materials used to build a car, on the other hand, is only about twice its finished weight in resources.

Not only is semiconductor production relatively material-intensive, it also generates massive amounts of toxic waste. Many semiconductor production facilities have contaminated nearby aquifers with their chemical effluent. In fact, no county in the United States is the home to more toxic waste sites than California’s Santa Clara County, which is where the semiconductor industry began (Sarin 2004).

Semiconductors are also associated with the generation of mountains of solid waste, because the useful lives of electronic devices that utilize semiconductors (e.g., computers, cell phones, I-pods, etc.) tend to be short. On average, Americans discard their cell phones after a year-and-a-half, for example (O’Meara Sheehan 2004).

Thus, the number of unusable cell phones is mounting. By one estimate, consumers had amassed 500 million such phones by 2005. Most of those phones “are likely to end up in landfills, where they could leach some 312,000 pounds of lead” (120). According to Sarin (2004), approximately “70 percent of the heavy metals found in U.S. landfills comes from e-waste” (45). If the toxics leach into the groundwater or soil, they can put people in danger of suffering from organ and central-nervous-system damage, endocrine disruption, cancer, and other health problems. If, instead of being buried in a landfill, discarded electronic devices are incinerated, some of their components will emit toxic dioxins and furans in the incineration process.

Sixty years ago, rudimentary computers (with fewer capabilities than inexpensive pocket calculators have today) performed their calculations using glass-and-metal vacuum tubes, not semiconductors. Those early computers were so large they filled entire rooms. ENIAC, the first vacuum-tube computer, used thousands of tubes and emitted so much heat it required “gigantic air conditioners” to keep it from overheating (“Computer Chronicles” 1998).

When technological optimists compare an early computer with a computer of today, they can boast honestly about the difference in the amount of resources devoted to each specific unit. Thus, some optimists (e.g., Scarlett 2000) use such comparisons to trumpet the resource-conserving properties of dematerialization. What such optimists ignore, however, is that few—if any—individuals owned computers when they were made from vacuum tubes. The cost of the ENIAC and other computers of its ilk restricted ownership to the U.S. government and other large organizations. With the dematerialization of recent decades, however, computer cost

is rarely a barrier to ownership. According to the Encyclopedia Britannica Online (n.d.), as of 2004, there were 741 personal computers for every 1,000 people (i.e., more than 200 million computers) in the United States.

Compared to the mass of each computer in the 1940s and 50s, the mass of each dematerialized computer is many orders of magnitude smaller; nevertheless, the total number of computers is many orders of magnitude greater. Dematerialization may mean, as Scarlett (2000) claims, that “a defined level of consumption is occurring with less resource use, less accompanying waste, and a ‘lighter’ footprint on the earth” (47). The trouble with that analysis is that it fails to recognize that dematerialization also means that armies of feet are free to trample the ground (and the footprints left by twelve size-one shoes cover more ground than the footprint left by one size-twelve boot.) So while there may be good reasons to celebrate the changes dematerialization has brought about, resource conservation in the aggregate is not one of them—not, at least, as a general rule.

This result is hardly surprising. The underlying motivation for dematerialization, after all, is to increase profits, not to conserve the environment. So long as welfare is equated with money, market forces can be relied upon to work with an invisible hand to maximize the welfare of traders. Many environmental benefits are difficult or impossible to trade, however. Without taxes or regulations that take account of environmental externalities, the profit incentive will tend to override environmental concerns. Generally speaking, purely market-driven dematerialization will bring about environmental conservation only by chance.

## Resource substitution

Dematerialization and recycling are two responses to price increases caused by resource scarcity. Substitution is another. According to many mainstream economists and technological optimists, the ability to substitute one material for another alleviates concerns about the depletion or ultimate exhaustion of any particular resource. As Gale Johnson puts it, “no exhaustible resource is essential or irreplaceable” (qtd. in Bailey 2000, 14). When Solow (1993) contends (as noted above) that exhausting a resource, such as aluminum, should occasion no remorse so long as substitutes are at hand to “perform the same or analogous functions,” he has a point, of course—or he would *if* performing a particular function were the only consideration. Unfortunately, other considerations are often at issue. Oskamp (2000) indicates two potential considerations: the availability of the substitute and its environmental impact. Is the substitute in plentiful supply? Something cannot be made from nothing, after all. If we exhaust the substitute, will we find another? If so, will its use be deleterious to the environment?

As we run through dwindling supplies of a resource with the optimistic belief that human ingenuity will provide substitutes in response to market signals, can we safely assume that the substitutes will be available when we need them? Aren't we a bit like someone who plays the lottery with his last few dollars, anticipating that he will be able to pay his bills with his winnings? Even if we have already discovered an abundant substitute that has few if any negative environmental affects, how can we be certain that we already know all of the functions the original resource is capable of performing? Perhaps future generations will realize that a resource that we currently

squander could have performed a crucial function for them if only they had enough of it.

In Diamond's (2005) view, optimists, who claim that "we can always switch to some other resource meeting the same need" if we exhaust a particular resource, "ignore the unforeseen difficulties and long transition times regularly involved" (506). In some cases, the resources that are required for making the substitute also become scarce. As Oskamp (2000) notes, manufacturers often substitute synthetic materials for natural ones. Use of synthetics is problematic, because they "are mostly made from petroleum, further decreasing oil reserves, and organic chlorine products [such as plastics] have been shown to have many dangerous ecological and health effects" (n.p.). Nonetheless, Mankiw (2004) chooses plastic to illustrate his claim that dwindling resources (e.g., tin and copper) should present no limits to growth because "technological progress often yields ways to avoid these limits" (248).

### **Market-driven technologies and overexploitation**

Markets often fail to recognize signs of resource overexploitation, and technologies sometimes exacerbate it. Marine fisheries, for example, are being rapidly depleted. As supplies dwindle, fishermen look to technology for help. But, according to Meadows et al. (2004), "rather than protecting fish or enhancing fish stocks, the kind of technology being employed seeks to catch every last fish" (232). "The market gives no corrective feedback to keep competitors from overexploiting a common resource such as marine fish. Quite the contrary, it actively rewards those who get there first and take the most" (233).

Market-driven technologies sometimes lead to overexploitation of resources, as in the case of marine fisheries, and environmental destruction, as in the case of mountaintop mining for coal. However, technological optimists (e.g., Bailey 2000; Moore and Simon 2000; Nordhaus and Shellenberger 2007; and Scarlett 2000) maintain that possibilities for technological solutions to problems of resource overexploitation and environmental destruction are limitless.

Some observers, such as the authors of *Limits to Growth*, though far less sanguine about the dependability of technological solutions, agree with the optimists that “it is [not] possible to bring about a sufficient, equitable, sustainable world without technical creativity and entrepreneurship and a relatively free market” (Meadows et al. 2004, 228). But since technologies and markets are merely tools, the “results they produce in the world depend upon who uses them and for what purposes” (228). Thus, if our purpose is to maximize efficiency and profits without regard to environmental consequences, then we can take a laissez-faire approach and the market will provide incentives for entrepreneurs to design and manufacture efficient—but potentially devastating—technologies. If, on the other hand, our purpose is to conserve resources and improve the environment, then we must exert the political will to ensure that market incentives focus not simply on efficiency but also incorporate environmental concerns.

As Meadows et al. see it, we cannot rely on an “invisible hand” to solve problems of resource depletion and environmental degradation, because technologies and markets “operate through feedback loops with information distortion and delays.” In fact, “technology-market feedback loops are themselves sources of overshoot,

oscillation, and instability” (225). The market for oil, for example, has exhibited instability since the oil shocks of 1973. The subsequent undershoots and overshoots in the price of oil “were a consequence of inevitable response delays in the oil market. . . . None of these rises and falls in price was related to the actual underground quantity of oil.” Nor were they related “to the environmental effects of drilling for, transporting, refining, and burning oil. The market’s price signal mainly provided information about the relative scarcity or surplus of available oil” (227).

### **Over-reliance on technology**

For some observers, relying on technology to solve environmental problems seems imprudent. Richard Benedick, the chief U.S. negotiator of the 1987 Montreal Protocol on Substances That Deplete the Ozone Layer, for instance, notes that although “technology has generally been able to come up with solutions to human dilemmas, there is no guarantee that ingenuity will always rise to the task” (qtd. in Cohen 1995, 267). Jared Diamond (2005) goes further, arguing that the “rapid advances in technology during the 20<sup>th</sup> century have been creating difficult new problems faster than they have been solving old problems.” Why should anyone think, he wonders, that beginning today, “for the first time in human history, technology will miraculously stop causing new unanticipated problems while it just solves the problems that it previously produced?” (505).

Some observers believe that our heavy reliance on technology is alienating us from the natural world in ways that are ultimately dangerous. In some cases, knowing how to read nature’s signals can mean the difference between life and death.

To take a stark example, the Moken people of the Andaman Sea managed to survive the great tsunami of December 26, 2004, in which hundreds of thousands of people died, because they were able to read signals that the sea and wildlife were supplying. The Mokens had no modern technological devices of any kind to aid them, and yet they were able to accomplish something that scientists with sophisticated technological instruments were unable to do (i.e., interpret natural signals and warn of the need to take preventive action).

Rather than reestablishing connections to nature, most of humanity seems to be alienating itself further. People in industrialized and rapidly industrializing nations are becoming increasingly dependent on technological devices, investing more and more of their time and attention to such devices with each passing year. Some people claim to be addicted to communications technology. When BlackBerry service failed for ten hours in April 2007, for example, some users (perhaps tongue-in-cheek, perhaps not) described feelings of isolation and “severe longing, not unlike drug withdrawal.” One woman told a *New York Times* reporter, “I quit smoking 28 years ago, and that was easier than being without my BlackBerry” (Stone 2007a).

In an editorial for *The American Psychiatric Journal*, Jerald Block (2008) argues that “Internet addiction appears to be a common disorder that merits inclusion in DSM-V” (i.e., the *Diagnostic and Statistical Manual of Mental Disorders*) (306). And, as previously noted, Kubey maintains that millions of Americans are essentially addicted to television (Herr 2008).

## **Advertising and faith in technology**

According to psychologists Kanner and Gomes (1995), “modern advertising . . . promotes an almost religious belief among Americans in the ultimate good of all technological progress, through its claim that there is a product to solve each of life’s problems” (84). In some cases advertised products solve problems but, in doing so, mask the underlying causes of those problems.

Take, for example, cholesterol-lowering drugs. On December 12, 2007, the three major networks’ evening-news programs (all three sponsored by pharmaceutical companies) reported that the average cholesterol level for American adults was in the ideal range for the first time since 1960. Katie Couric, on *CBS Evening News*, announced: “We’re starting to win the battle against cholesterol.” *NBC Nightly News* credited “the widespread use of cholesterol-lowering medications” for the improvement. And on *ABC World News*, Dr. Timothy Johnson said, “these drugs are absolutely remarkable. . . . I, I almost would dare use the word ‘miracle drug’ to describe what they can do for people.”

If asked, many proponents of advertising would surely trumpet these results as evidence of the important role advertising plays in informing the public about useful—even lifesaving—products. They would just as surely fail to mention that advertising also encourages people to eat too much and often promotes consumption of foods that are high in cholesterol. They would, no doubt, also deride the notion that by sponsoring television programs, advertising indirectly promotes a sedentary (“couch-potato”) lifestyle. In other words, advertisers would probably deny that advertising encourages people to adopt habits that put them at high risk for

developing the blood-cholesterol levels that the drugs they promote are designed to treat.

Some dispassionate analysts might note that advertising contributes to the creation of a problem (hypercholesterolemia) and then offers a solution (cholesterol-lowering drugs). But a number of psychologists are more critical, arguing that ads (or their subtexts) encourage people to eat foods in order to assuage unmet emotional needs. While some people have a genetic predisposition for developing high cholesterol, “in most cases . . . elevated cholesterol levels are associated with an overly fatty diet coupled with an inactive lifestyle” (“Hypercholesterolemia”). Thus, the vast majority of people who buy cholesterol-lowering drugs spend hard-earned money to solve a problem that need never have occurred had they only eaten sensibly and exercised. And even after the drugs lower their cholesterol, many people are left with an assortment of other health problems that are associated with obesity. Meanwhile, massive quantities of resources are wasted (and pollution generated) in the process of producing, packaging, transporting, distributing, and consuming the foods that create the high-cholesterol problem and the drugs that resolve it. Additional sums are devoted to transporting and disposing (or recycling) all of the associated packaging and other waste.

Do these drugs improve human welfare? Clearly, they improve the welfare of the people who need them. But taking a step back to gain a broader perspective, the drugs seem to be helping to mask a dysfunctional, welfare-reducing system. It is a wasteful system in which many people’s (partially) ad-driven appetites lead them to overeat and then to consume drugs to counteract the effects of eating too much.

## ***Economic growth and welfare***

From another perspective, however, widespread spending on cholesterol-lowering drugs might improve social welfare not only by providing health benefits but also by increasing the gross domestic product, and, for this, advertising would deserve some of the credit. Adhering to the production, packaging, transportation, distribution, and consumption of food and medicine are jobs, profits, and the many other benefits of a growing economy.

Economic growth is widely touted as being the solution to many social ills. Moore and Simon (2000), for example, credit economic growth for “more improvement in the human condition in the past 100 years than in all of the previous centuries combined since man first appeared on the earth” (1). As a consequence of growth, they explain, “almost every measure of material human welfare—ranging from health, wealth, nutrition, education, speed of transportation and communications, leisure time, gains for women, minorities, and children to the proliferation of computers and the Internet—has shown wondrous gains for Americans” (1). The U.S. poverty rate, the authors report, dropped from approximately one-half of the population in the early nineteenth century to about fifteen percent at the start of the twenty-first, and “real per capita living standards” quadrupled “in just 100 years” (8). Whereas fewer than 20 percent of Americans had running water, vacuum cleaners, or flush toilets in 1900, or had dishwashers, dryers, or air conditioners in 1950, “between 80 and 100 percent have all of these

conveniences” today (9). In addition, Americans now have “nonessentials that make life fun and entertaining,” and they have the time to enjoy those nonessentials. In fact, Moore and Simon note, Americans “have [three] times more leisure time over the course of their lifetimes than their great-grandparents did” (9).

As Moore and Simon see it, economic growth has begun to improve lives everywhere. They predict “that within the next 50 years most people in the world will attain an income level similar to that of the middle class in the United States today . . . [and] material deprivation will be a thing of the past” (18). Bailey (2000) agrees, and Lomborg (2001) maintains that human welfare is improving in every important, measurable way.

According to Friedman (2005), economic growth not only raises living standards but also tends to improve a people’s moral character. He writes: “Economic growth—meaning a rising standard of living for the clear majority of citizens—more often than not fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy. Ever since the Enlightenment,” he continues, “Western thinking has regarded each of these tendencies positively, and in explicitly moral terms” (4). Stagnating or declining living standards, on the other hand, tend to retard, halt, or even reverse moral growth.

The authors of *Break Through: From the Death of Environmentalism to the Politics of Possibility*, Ted Nordhaus and Michael Shellenberger (2007), make a similar argument. As they see it, prosperity tends to educe the best aspects of human nature—poverty and collapse, the worst. Authoritarian values, they explain, are strongest in societies where economic output is so low that people are unable to meet

their basic needs; however, such values strengthen even during economic downturns in otherwise strong economies.

Friedman (2005) and Nordhaus and Shellenberger (2007) agree that market forces acting alone systematically undersupply growth, because markets ignore some unpriced social benefits that inhere to economic growth, such as greater tolerance, openness, and generosity. Believing that those positive externalities outweigh any unpriced harm, the authors maintain that the optimal rate of economic growth exceeds the purely market-determined rate. Thus, they conclude, governments should foster higher rates of economic growth. According to advertising's proponents, one way for governments to foster economic growth is by providing a deduction for businesses' advertising expenditures.

Using advertising to spur economic growth may, however, be counterproductive to the goal of improving society's moral character if advertising intervenes in the relationship between economic growth and those improvements. Given that wages have continued to grow (albeit relatively slowly) even as the moral values that Friedman, Nordhaus, and Shellenberger celebrate have ostensibly retreated over recent decades, the relationship between growth and moral improvement seems to be specious. Perhaps being perpetually reminded by ads about goods they "need" makes people feel perpetually needy. Although most Americans consume more than enough to survive in comfort, advertising makes them feel deprived, and feeling deprived makes them less tolerant, open, and generous. Thus, no amount of economic growth will facilitate moral growth so long as advertising perpetuates this scarcity-mentality.

Some psychological research indirectly supports the contention that economic growth may improve social values, however. According to Kasser et al. (2002) a number of psychological studies reveal a positive relationship between materialistic values and economic deprivation. “Poverty alone may not lead to the adoption of materialistic goals,” they write, “however, poverty may work in combination with social modeling to produce a strong [materialistic value orientation]” (15). Implied by the psychological research is the notion that increasing economic growth—or lifting people out of poverty and increasing economic equality, at least—improves moral character, because people who feel less deprived tend to be less materialistic, and people who are less materialistic tend to have better social values. Sociological research indicates, however, that Americans’ perceptions of deprivation have little to do with their absolute income. As sociologist Dalton Conley (2008) explains, because “inequality rises exponentially the higher you climb the economic ladder, the better off you are in absolute terms, the more relatively deprived you may feel. In fact, a poll of New Yorkers found that those who earned more than \$200,000 a year were the most likely of any income group to agree that ‘seeing other people with money’ makes them feel poor” (n.p.). Thus, increased income may reduce materialism among the poor, but may aggravate it among the wealthy.

Nevertheless, some proponents of economic growth claim that high rates of growth lead to improved social values. In addition, many growth enthusiasts contend that an expanding economy provides the wealth that enables the development of innovative technologies for discovering and conserving resources. Noting that copper costs approximately one-tenth as much today as it did in 1800, Moore and Simon

(2000) maintain, for example, that “natural resources have become more available rather than scarcer,” by “any measure,” due to growth-enabled technological innovations (10). The authors fail to address the environmental costs associated with the extraction of all that copper, however, even though, according to geologists, “mineral extraction [is] the single most damaging environmental process undertaken by mankind” (University of Wisconsin n.d.).

Ignoring (or downplaying) the environmental consequences of over-consumption, some proponents of high rates of economic growth insist that prosperity is a prerequisite to environmental concern. According to Bailey (2000), Friedman (2005), Lomborg (2001), Moore and Simon (2000), and Nordhaus and Shellenberger (2007), among others, public demand for environmental protection only emerges when economic growth raises living standards well beyond subsistence. In Friedman’s words, “*societies* where living standards are high can afford to bear some cost for limiting pollution, and most choose to do so” (382; italics in the original). Americans, for example, “started to care more about problems such as air and water pollution and the protection of the wilderness and open space” as they “became increasingly wealthy, secure, and optimistic” (Nordhaus and Shellenberger 2007, 6). That concern led to environmental regulations and pollution-abatement technologies that have improved U.S. air and water quality over the past few decades. Compared to the 1960s, Moore and Simon (2000) explain, smog levels have declined approximately 40 percent, airborne lead has fallen by more than 90 percent, and carbon monoxide has dropped about 33 percent. As evidence that water quality is

improving the authors note that whereas a century ago tainted drinking water caused the deaths of hundreds of thousands of Americans, today such deaths are rare.

Many observers join Nordhaus and Shellenberger (2007) in positing the existence of “a very strong association between prosperity and environmental issues” in nations around the world (28). This association is often likened to one that Kuznets hypothesized between economic development and inequality. Like Kuznets’ original curve, the environmental Kuznets curve can be graphed in the shape of an inverted U. According to Friedman (2005), empirical studies of industrializing nations generally find that economic growth creates and exacerbates environmental problems until a nation becomes moderately prosperous and then, if economic growth continues, it allows the nation to limit and even reverse the environmental damage.

From the cornucopian point of view, environmentalists who believe that limits to economic growth exist are unduly pessimistic and even self-defeating. Given that humans have “a nearly infinite capacity” to conjure up innovative technologies—including technologies that conserve resources and reduce pollution—and given that economic growth fosters the development and implementation of new technologies, “economic growth leads to less pollution, not more,” Bailey (2000) writes (17). Nordhaus and Shellenberger (2007) go further, insisting that those who advocate limits to growth for the sake of the environment are actually undermining the cause they profess to advocate. “Few things have hampered environmentalism more than its longstanding position that limits to growth are the remedy for ecological crises,” they write. Rather than limits, what is required is “an explicitly pro-growth agenda that defines the kind of prosperity . . . necessary to improve the quality of human life

and to overcome ecological crises” (15). Echoing Marxists who maintain that material overabundance is requisite to the emergence of the altruistic socialist man, Nordhaus and Shellenberger explain that “ecological concern is a postmaterialist value that becomes widespread and strongly felt—and thus politically actionable—only in postscarcity societies” (52).

Friedman (2005) offers an additional explanation for the environmental improvements that accompany prosperity. As he sees it, when industrialized countries become wealthy, they often move away from manufacturing goods and toward providing services. Since service industries typically require fewer resources, an economy dominated by such industries tends to reduce its throughput of materials and wastes. Thus, advanced economies can be self-limiting, in terms of throughput, even as they grow economically.

Moore and Simon (2000) join other cornucopians in denying any limits to growth. As they see it, “there apparently is no fixed limit on our resources in the future. There are limits at any moment, but the limits continually expand, and constrain us less with each passing generation” (16-17).

We now stand on the shoulders of our ancestors and are able to draw upon the accumulated knowledge and know-how of the past two centuries. This knowledge is our communal wealth. Much more than the power to enjoy gadgets, our wealth represents the power to mobilize nature to our advantage, rather than to just accept the random fates of nature. There is no turning back the clock, only boundless opportunity for future advancement (18).

## **Reasons for skepticism**

Such technological optimism is far from universal, however. A number of observers are dubious that humans are able to “mobilize nature to our advantage” and create unlimited opportunities for future advancement *without* also generating harmful, unintended consequences. According to Meadows, Randers, and Meadows (2004), “growth can solve some problems, but it creates others” (8). Scholars find, for example, that growth is associated with greater socioeconomic inequality (e.g., Daly 2005; Friedman 2005; McKibben 2007; Meadows et al. 2004). “Growth, at least as we now create it,” McKibben writes, “is producing more inequality than prosperity, more insecurity than progress” (11). Similarly, Meadows et al. note that a “century of economic growth has left the world with enormous disparities between the rich and poor” (43).

Whereas Bailey claims that economic growth has made “the world safer, more comfortable, and more pleasant for both larger numbers of people as well as for a larger proportion of the world’s people” (13), according to the World Bank (2000), an estimated 1.2 billion people exist on an average of less than \$1 per day, and nearly three billion get by on less than \$2 per day. It seems quite unlikely that more people have ever lived in poverty at one time, since the human population was only 1.7 billion in 1900 (U.S. Census Bureau 1998). As Meadows et al. maintain, economic growth in the current system “generally takes place in the already rich countries and flows disproportionately to the richest people within those countries” (42).

Ultimately, limits to growth must exist, Meadows (2004) and her colleagues explain, because the Earth is finite. Rather than being restricted directly by “the number of people, cars, houses, or factories” that the Earth can support, growth is physically limited by “the rate at which humanity can extract resources . . . and emit wastes . . . without exceeding the productive or absorptive capacities of the world” (8).

Currently, economic growth depends on the combustion of fossil fuels to provide energy. Some stocks of fossil fuel are nearing exhaustion, but even if those stocks were infinitely abundant, the atmosphere’s capacity to absorb the carbon dioxide that results from fossil-fuel combustion without affecting the global climate is finite. According to the vast majority of the world’s climate scientists, that capacity has, in fact, already been surpassed.

According to Scottish economist Malcom Slessor, the growth process itself appropriates approximately 55 percent of all the energy people use. That figure seems hyperbolic, until one considers that the creation of growth’s central components—new buildings, machines, roads, etc.—requires “lots of steel and aluminum and cement, all of which are wildly energy intensive” (McKibben 2007, 230).

Economic growth also entails reconfiguring the environment in ways that tend to provide short-term economic benefits to humans, but inflict long-term costs on all species, including *Homo sapiens*. “The prosperity that the First World enjoys at present,” Diamond (2005) writes, “is based on spending down its environmental capital in the bank (its capital non-renewable energy sources, fish stocks, topsoil,

forests, etc.). Spending capital should not be misrepresented as making money. It makes no sense to be content with our present comfort when it is clear that we are currently on a non-sustainable course” (509).

When measures of economic growth fail to account for the environmental costs of growth, as is generally the case, the benefits of growth tend to be overstated. China’s economy, for example, is widely heralded for producing double-digit growth rates several times during this decade. But the environmental costs have been staggering. According to estimates by the World Bank and the World Health Organization, for example, the pollution that has accompanied that growth is responsible for 750,000 deaths per year. President Hu Jintao, in response to the pollution-caused deaths, as well as “thousands of episodes of social unrest,” launched an effort, known as Green GDP, to recalculate China’s gross domestic product in order to reflect pollution costs. The “early results were so sobering—in some provinces the pollution-adjusted growth rates were reduced almost to zero—that the project was banished to China’s ivory tower . . . and stripped of official influence” (Kahn and Yardley 2007). Similarly, during the last decade-and-a-half, Indonesia has experienced an annual growth rate that appears to be about seven percent when calculated in the standard way; however “when the World Resources Institute recalculated the figures to subtract the value of the extracted oil and logged trees from the country’s stock of assets, that growth was halved” (McKibben 2007, 190).

Of course, China and Indonesia are in the early stages of economic development, and as Kahn and Yardley (2007) note, “no country in history has emerged as a major industrial power without creating a legacy of environmental

damage that can take decades and big dollops of public wealth to undo” (n.p.). For those who believe in the validity of an environmental Kuznets curve (i.e., a curve showing that environmental degradation rises with per-capita income until a nation is relatively prosperous and then declines as per-capita income continues to rise), the environmental degradation that has accompanied economic growth in those nations is to be expected. As growth optimists see it, when China and Indonesia become sufficiently wealthy, they will take measures to reduce pollution and improve the environment.

According to a number of observers, however, even if China and Indonesia do take those measures, the global environment may continue to deteriorate. Suri and Chapman (1998), for example, explain that wealthy countries tend to reduce pollution, in part, by importing the most pollution-intensive manufactured goods, or, to put it another way, they improve their own environmental quality by exporting the processes that generate the most pollution. If so, the improvement illustrated by environmental Kuznets curves may reflect the outsourcing of pollution from wealthy countries to poor ones.

For their part, Stern (2003) and Perman and Stern (2003) claim that the environmental Kuznets curve (EKC) is, in fact, invalid. “The EKC idea rose to prominence because few paid sufficient attention to econometric diagnostic statistics,” Stern (2003) writes. Taking those statistics into account reveals that the hypothesized, inverted-U-shaped relationship between per-capita income and indicators of environmental degradation is spurious. Instead, Stern explains, most such indicators rise monotonically with income, and then fall over time regardless of

national income level. “In rapidly growing middle income countries the scale effect, which increases pollution and other degradation, overwhelms the time effect. In wealthy countries, growth is slower, and pollution reduction efforts can overcome the scale effect. This is the origin of the apparent EKC effect” (n.p.).

An environmental-performance ranking of 149 nations, conducted by researchers from Columbia and Yale Universities, provides additional evidence that the relationship between prosperity and environmental quality is much weaker than many observers suppose. According to the Environmental Performance Index (Esty et al. 2008), the United States ranks 39<sup>th</sup> among all 149 nations and last among the Group of Eight (where France is #10, Canada is #12, Germany is #13, United Kingdom is #14, Japan is #21, Italy is #24, and Russia is #28).

Many countries with higher environmental performance rankings have much lower incomes than the United States, as Table 8.1 below indicates. The per-capita gross domestic product of the U.S. is almost seven times that of Colombia, for example, even though the U.S. ranks thirty places below Colombia in environmental performance. If environmental quality depends upon income, as growth enthusiasts contend, then the environmental performance of the United States, which has a per-capita GDP of nearly \$46,000, should rank well above the environmental performance of Georgia (the former Soviet Republic), which has a per-capita GDP of less than \$5,000. In fact, the U.S. ranks below Georgia.

The Environmental Performance Index evaluates more than twenty measures, including air pollution, greenhouse gas emissions, sanitation, and agricultural policies. According to Daniel Esty, the lead author of the report, the United States’

ranking reflects its “bottom-tier” scores on regional smog and greenhouse-gas emissions. In general, the study finds positive correlations between GDP per capita and performance on indicators such as indoor air quality, sanitation, and success in combating diseases—but negative correlations between GDP and performance on such measures as agricultural policies and greenhouse-gas emissions. Although doing so was not its intended purpose, the Environmental Performance Index also provides evidence that GDP is a poor indicator of overall well-being.

**TABLE 8.1: Environmental Performance vs. GDP**

| <b>Country</b>     | <b>Environmental Performance Rank</b> | <b>GDP Per-Capita (PPP)</b> | <b>GDP Per-Capita Rank</b> |
|--------------------|---------------------------------------|-----------------------------|----------------------------|
| Costa Rica         | 5                                     | \$10,300                    | 100                        |
| Latvia             | 8                                     | \$17,400                    | 67                         |
| Colombia           | 9                                     | \$6,700                     | 123                        |
| Slovenia           | 15                                    | \$27,200                    | 45                         |
| Lithuania          | 16                                    | \$17,700                    | 65                         |
| Slovakia           | 17                                    | \$20,300                    | 58                         |
| Portugal           | 18                                    | \$21,700                    | 56                         |
| Estonia            | 19                                    | \$21,100                    | 57                         |
| Croatia            | 20                                    | \$15,500                    | 72                         |
| Ecuador            | 22                                    | \$7,200                     | 118                        |
| Albania            | 25                                    | \$6,300                     | 125                        |
| Malaysia           | 27                                    | \$13,300                    | 81                         |
| Russia             | 28                                    | \$14,700                    | 75                         |
| Chile              | 29                                    | \$13,900                    | 78                         |
| Spain              | 30                                    | \$30,100                    | 40                         |
| Panama             | 32                                    | \$10,300                    | 101                        |
| Dominican Republic | 33                                    | \$7,000                     | 121                        |
| Brazil             | 34                                    | \$9,700                     | 105                        |
| Uruguay            | 36                                    | \$11,600                    | 88                         |
| Georgia            | 37                                    | \$4,700                     | 143                        |
| Argentina          | 38                                    | \$13,300                    | 80                         |
| United States      | 39                                    | \$45,800                    | 10                         |

Source for GDP information: CIA, “Rank Order—GDP—per capita (PPP).” All figures are 2007 estimates. Source for Environmental Performance Rank: Esty et al. (2008).

As Daly (2005) explains, the gross domestic product (“defined as the annual market value of final goods and services purchased in a nation, plus all exports net of imports”) is simply a measure of economic activity in the aggregate—“not a measure of well-being or even of income” (105). Gardner and Assadourian (2004) agree. They write: “At the national level, the standard tool used to measure societal health, GDP, is much too narrow to serve as a yardstick of well-being because it sums all economic transactions, regardless of their contributions to quality of life” (172).

Among its other flaws, GDP fails to account for depreciating man-made capital (e.g., bridges and buildings) or for depleting natural capital (e.g., forests and fish) or for long-term harm to the environment (e.g., changing the global climate and depleting stratospheric ozone); it ignores non-market activities that add significantly to well-being (e.g., home cooking, housework, and parenting), and it includes utility-reducing expenditures that arise as unintended consequences of production and consumption (e.g., costs of pollution abatement) (Daly 2005). Cohen (1995) offers this example: “If a country spends millions to clean up pollutants from consumers . . . or from factories, and residues from mining, these defensive expenditures are counted positively in national income, rather than deducted from the economic production available for a people’s use” (383). In addition, Cohen explains, “GDP omits positive indicators of human development and well-being such as a rising life expectancy and an increasing rate of literacy as well as negative indicators such as rates of homicide, suicide and addiction to drugs” (383).

Jonathan Rowe puts it this way:

By the curious standard of the GDP, the nation's economic hero is a terminal cancer patient who is going through a costly divorce. The happiest event is an earthquake or a hurricane. The most desirable habitat is a multibillion-dollar Superfund site. All these add to the GDP, because they cause money to change hands. It is as if a business kept a balance sheet by merely adding up all transactions, without distinguishing between income and expenses" (qtd. in Barnes 2001, 86).

Predicted GDP expansion following Hurricane Katrina bolsters the critics' point. According to the Congressional Budget Office (House of Representatives 2005), recovery-related construction activities following Hurricane Katrina were expected "to increase both real GDP growth and employment above previous [2006] forecasts" (1). As Kogan and Aron-Dine (2005) explain, experts predicted "a relatively modest downward effect on national economic growth" at the end of 2005 due to Hurricane Katrina, followed by "faster economic growth in 2006 than would have occurred without the hurricane, because of the significant economic activity that [would] be created by the extensive rebuilding effort that [would] ensue" (n.p.).

GDP is a poor measure of well-being because, as Daly (2005) explains, it conflates quantitative increase with qualitative improvement. Nevertheless, "most governments make ongoing increases in gross domestic product . . . a chief priority of domestic policy, under the assumption that wealth secured is well-being delivered" (Gardner and Assadourian 2004, 164). Evidence is mounting, however, that when the governments of wealthy nations routinely promote GDP expansion by stimulating

consumption (e.g., through advertising), they reap diminishing returns. That conclusion is becoming increasingly salient as evidence of anthropogenically induced, global climate change becomes ever more apparent. Even growth-enthusiast Benjamin Friedman (2005) allows that “the one major environmental contaminant for which no study has ever found any indication of improvement as living standards rise is carbon dioxide” (385). Nevertheless, policymakers fail to perceive climate change as anything “that would call into question the doctrine of endless economic expansion. Alert to every snuffle of our constantly monitored economy, they seem entirely oblivious to the scale of the physical challenge—to the idea that civilization may be at stake” (McKibben 2007, 24).

According to Daly (2005), the costs associated with growth in the United States have recently been increasing faster than the benefits. Having reached the “futility limit,” the economy no longer increases human well-being as it grows. The economy must make a transition from one that makes a fetish of growth to “one that takes heed of the inherent biophysical limits of the global ecosystem . . . or we may be cursed not just with uneconomic growth but with an ecological catastrophe that would sharply lower living standards” (100).

## Chapter 9: Should Advertising Remain a Deductible Expense?

*Should advertising remain a tax-deductible business expense?* The previous chapters attempt to inform an answer to that question by addressing some legal controversies involving the deduction and by examining some of advertising's economic, psychological, sociological, and ecological effects. This chapter will offer a few rough estimates of advertising's monetary costs and benefits, discuss some of the potential consequences of reducing or eliminating the deduction, consider some obstacles to changing advertising's tax status, and provide a few policy recommendations, including a recommendation concerning advertising's tax status.

### *Attempting to estimate costs and benefits*

Due to a large assortment of variables—some obvious, some not—attempting to calculate anything approaching the exact costs and benefits of advertising's impact is bound to be an exercise in futility. Nevertheless, acknowledging the existence of costs and benefits and offering a suggestion about their size seems a worthwhile exercise *so long as* the monetary values proffered are known to be nothing more than a vague indication of the true magnitude of a (somewhat arbitrary) sample.

## ***Unmediated Costs Associated with Advertising***

Advertising's critics offer a variety of reasons to support their contention that the costs associated with advertising outweigh the benefits. In many cases, the connection between advertising and the costs that the critics cite is indirect, with materialism typically being the intervening variable (see Chapter 7).

### **Complementary costs**

In one case, at least, the connection between advertising and costs to the American public is direct. According to DeGraaf et al. (2002), advertising adds at least \$690 per person (converted to constant 2007 dollars from the 2002 value of \$600) per year to the cost of the products that Americans buy. All together, therefore, with a population of more than 305 million, Americans now pay more than \$210 billion annually for the advertising that "complements" their purchases.

### **Opportunity of cost of advertisements**

The average American is exposed to 3,000 ads per day, according to the Union of Concerned Scientists (n.d.). If individuals pay attention to each ad for only one second, then they each devote 50 minutes to ads per day. Taking 218 million as the number of adults in the U.S. (Bernstein 2007), and using the average hourly earnings of production and nonsupervisory workers on nonfarm payrolls in August 2008 (Bureau of Labor Statistics 2008a) to estimate the opportunity cost of one hour for each of those adults (i.e., approximately \$18 per hour), the estimated opportunity

cost of ad exposure is more than \$3.3 billion per day (i.e., \$0.30 per minute times 50 minutes times 218 million adults = \$3.3 billion). Yearly, using the same figures (and multiplying by 365), the aggregate cost is about \$1.2 trillion.

### ***Costs associated with ad-induced materialistic values***

As detailed in Chapter 7, advertising contributes to the adoption and development of materialistic values, and materialistic values are positively related to a variety of psychological and social disutilities, including:

- Low self-esteem
- Narcissism
- Anxiety
- Depression
- Addiction
- Psychosomatic ailments
- Body hatred and eating disorders (e.g., anorexia nervosa, bulimia)
- Overweight and obesity
- Adolescent behavioral problems
- Self-hatred among the poor
- Criminality
- Poor relationships with friends, family, and community
- Compulsive shopping

- Low saving rates
- Consumer debt
- Bankruptcy
- Home foreclosure

Although holding advertising entirely responsible for the social and psychological ills listed above is clearly wrong, the literature shows, nevertheless, that ad-induced materialism is a contributing factor. Thus, holding advertising responsible for a portion of the costs seems reasonable. The following sections examine some of the monetary costs associated with materialism.

### **Mental health disorders**

Dozens of recent psychological studies find positive relationships between materialistic values and a number of mental health disorders (e.g., narcissism, anxiety, depression, suicide, addiction). While mental illnesses impose a high toll on well-being, they also inflict substantial monetary costs. The American Psychological Association (2004a) reports, for example, that “untreated mental health disorders cost American businesses \$79 billion [in 1999 dollars, or \$98 billion in constant 2007 dollars] in lost productivity per year” (n.p.). In addition, the APA notes that expenditures for direct mental health treatments exceeded \$99 billion in 1996 (or \$131 billion in 2007 dollars).

Antidepressant sales provide another indication of the costs associated with mental health disorders. In 2001, for example, Americans spent \$12.5 billion on

antidepressants. According to the National Institute of Health Care Management (2002), antidepressants were the top sellers among all categories of prescription drugs.

### **Migraine headaches**

Hawkins, Wang, and Rupnow (2008) estimate that the direct costs of migraine to the U.S. economy (i.e., outpatient, inpatient, and emergency-room care, plus prescription drugs) are more than \$11 billion per year. Hu et al. (1999), on the other hand, find that the direct costs are much lower, just \$1 billion per year, but that the indirect cost of migraine headaches (i.e., missed workdays and impaired work function) “cost American employers about \$13 billion a year” (813).

### **Overweight and obesity**

Not only does obesity inflict a physical toll on the body and a psychological toll on the mind, it also exacts economic costs on individuals and society. In 1998, for example, Americans paid approximately \$93 billion in direct costs for weight-related health-care services, and the nation lost nearly as many billions due to work absences and other indirect expenses associated with excess weight (National Institutes of Health, 2004a). By 2004, the annual cost of obesity-related illnesses had risen to \$120 billion, and Americans were devoting an additional \$33 billion to “weight-loss schemes and dietary drugs” (Myers and Kent 2004, 49).

## **High cholesterol**

According to Devon Herrick (2005) of the National Center for Policy Analysis, cholesterol-lowering drugs cost Americans approximately \$14 billion per year. Beyond the cost of prescriptions, diagnostic tests and visits to doctors cost Americans another \$6 billion per year, for a total annual cost of about \$20 billion.

## **Diabetes**

As of 2007, 17.5 million Americans had been diagnosed with diabetes. Costs associated with the disease included \$116 billion in direct medical expenditures and \$58 billion due to reduced productivity, for a total of about \$174 billion (“Economic Costs of Diabetes” 2008).

## **Smoking costs**

According to the American Lung Association (2007), the advertising expenditures of the five largest cigarette makers in 2005 (the most recent year for which data is available) were more than \$35 million per day. Given that the National Cancer Institute considers “unassailable” the evidence that cigarette advertisements cause people to take up smoking (National Cancer Institute 2001), it seems reasonable to link some portion of the health costs associated with tobacco to advertising.

The costs associated with smoking include medical costs (\$75.5 billion in 1998) and death-related productivity losses (\$92 billion was the annual average for

1997-2001). According to the American Cancer Society (2007), “for each pack of cigarettes sold in 1999, \$3.45 was spent on medical care caused by smoking, and \$3.73 lost in productivity, for a total cost to society of \$7.18 per pack” (n.p.).

Additional disutilities associated with smoking include lost years of life: on average, 13.2 for men and 14.5 for women (Centers for Disease Control and Prevention 2002). While the value of those lost years is truly incalculable, for the purpose of making medical-allocation decisions, the average figure used internationally to represent the cost of giving a person “an additional ‘quality-of-life-adjusted’ year is \$129,000 (Stanford News Service 2008). Thus, the average value of lost years can be computed to be about \$1.7 million for each male smoker and \$1.9 million for each female smoker. But calculated another way, using the value of a statistical life, the cost of a smoking death is even higher. According to one estimate (Kniesner et al. 2007), the value of a statistical life is between \$5.5 and \$7.5 million. Given the estimated 438,000 premature tobacco-caused deaths per year (American Lung Association 2007), using this measure, the annual cost of tobacco-related deaths is between \$2.4 trillion and \$3.3 trillion.

## **Addictions**

Addictions drain the U.S. economy of hundreds of billions of dollars each year. Setting aside the costs that individual addicts incur to support their habits, addictions to illegal drugs, alcohol, tobacco, gambling, and food cost taxpayers approximately \$590 billion per year (Van Riper, 2006). Taken separately, alcohol addiction costs the U.S. economy approximately \$185 billion each year (National

Institute of Alcohol Abuse and Alcoholism), and illicit drug use costs about \$181 billion (Executive Office of the President 2001). Some of the costs associated with addiction represent “the loss of potential productivity from disability, death and withdrawal from the legitimate workforce” (Executive Office 2001, vi). Other expenses include funds that must be devoted to coping with the health and criminal consequences of drug addiction.

## **Crime**

A comprehensive econometric study (Anderson 1999) finds that crime costs Americans \$1.7 trillion annually (in 1997 dollars; \$2.2 trillion in 2007 dollars), including expenses associated with crime-related injuries, private-security measures, police services, criminal corrections, and stolen items. According to the study, criminals steal assets worth more than \$600 billion (\$775 billion in 2007 dollars) and are responsible for \$1.1 trillion (\$1.4 trillion) in lost productivity each year.

## **Relationship costs**

While all of the costs that damaged relationships inflict are probably impossible to quantify, Blanchflower and Oswald (2004) provide one illustrative estimate: Being in a lasting marriage is worth \$100,000 per person per year compared to being either widowed or separated.

## **Keeping up with the Joneses and the 2008 economic crisis**

According to conventional wisdom, the gap in income between the haves and have-nots in America has been widening over the past decade. Less commonly known, however, is that even though the average income of the top fifth of American households is fifteen times that of the lowest fifth, the average consumption of the top fifth is only four times more than the bottom fifth (Cox and Alm 2008). Certainly, part of the reason that the consumption ratio is four to one, and not fifteen-to-one, is that wealthy people spend a smaller proportion of their incomes on consumption. Another important reason, as Reich (2008) explains, is that non-rich Americans have been able to step up their consumption over the past few decades by working more hours, borrowing more money (e.g., taking out home-equity loans), and spending beyond their means. Now, however, American “consumers have run out of ways to keep the spending binge going” (n.p.). Reich’s solution is to give the non-rich more buying power by reducing income inequality in America. He argues that his proposed measures for reaching that goal “are necessary to give Americans enough buying power to keep the American economy going.”

Arguably, however, in addition to income inequality, ad-induced materialism is a central cause of the 2008 economic crisis. Ads have continued to urge people to consume more even though many Americans have been spending beyond their means for years. The massive debt Americans have accrued has contributed significantly to the current credit crisis. While Reich’s solution of increasing the incomes of the non-rich would, no doubt, allow them to continue to increase their consumption, it would

do nothing to change the underlying values that have led people to incur so much debt.

On October 3, 2008, the President signed a bill into law that provides \$700 billion to financial markets. Although the precise extent to which ad-induced materialism undermined the financial markets and contributed to the economic crisis is beyond the scope of this dissertation, the conclusion that advertising bears some of the responsibility seems warranted, given the positive relationships between (1) advertising and individuals' adoption of materialistic values, (2) advertising and low rates of saving, and (3) ad campaigns that encourage debt and rising consumer indebtedness.

### ***Some environmental costs associated with over-consumption***

As discussed in Chapter 8, a number of economists and other observers insist that economic growth is central to environmental concern. In their view, so long as people are struggling to survive, they will overlook the environmental impact of their activities; but once they have satisfied their basic needs, they will turn their attention to fulfilling their postmaterial needs, including their need for a healthy environment.

Advertising, however, intervenes. Although the survival needs of most Americans have been more than satisfied for a number of decades, Americans tend to believe that they need to add to their stocks of goods in perpetuity. In part, their neediness follows from their bombardment by the message that they must have whatever is being advertised in order to be *truly* fulfilled. So rather than focus on the

health of the environment and use their surplus wealth for environmental restoration, Americans tend to focus on consuming goods—particularly advertised goods—that add little or nothing to the quality of their lives but do add to humanity’s rapidly accumulating environmental debt. Even though Americans have demanded pollution abatement in the past when pollution has captured their attention by assaulting their senses, for the most part, the public has remained passive about any environmental damage that their senses have failed to perceive.

As Galbraith (1998) explains, “in the absence of the massive and artful persuasion [i.e., the advertising] that accompanies the management of demand, increasing abundance might well have reduced the interest of people in acquiring more goods” (219). Once people have enough to live comfortably, they are unlikely to devote much time to gaining the wherewithal to consume more goods than they need—*unless* they are goaded into believing that they need more goods continuously. As capitalism has evolved, businesses have used advertising to do the goading.

It is true that consumption is essential for existence. It is also true that human activities inevitably affect the environment to some extent. Nonetheless, much of what Americans now consume detracts from or adds little or nothing to their well-being. Worse still, their over-consumption greatly increases the environmental costs of their activities. Over-consumption augments the production of environmental bads, including:

- Litter
- Smog

- Acid-rain precursors
- Climate-changing greenhouse gases
- Stratospheric ozone depleting chemicals
- Toxic-chemical pollution
- Particulate matter in the air
- Toxic algal blooms

In addition, over-consumption depletes natural resources, including:

- Forests
- Fisheries
- Plant and animal species
- Habitat
- Groundwater
- Topsoil
- Cropland
- Non-renewable materials (e.g., minerals)
- Ecosystem services
- Natural amenities (e.g., starry skies)

What are the total costs of over-consumption? What is the value of the last sip of clean water to a thirsty man? How much is a haze-free view of the Grand Canyon worth? Although many environmental costs are immeasurable, a number of

economists have attempted to estimate the monetary costs of some of them.

Examples of those estimates follow.

### **Deaths due to air pollution**

The more that Americans consume, the more air pollution the processes associated with production, consumption, and waste disposal create. According to Diamond (2005), “conservatively estimated,” air pollution is the cause of 130,000 U.S. deaths per year. Taking that number and multiplying it by \$5.5 million and \$7.5 million (monetary estimates of a statistical life, as given in 2007 by Kniesner et al.) produces values of \$715 billion and \$975 billion.

According to other analysts, Diamond’s conservative estimate is not conservative enough. They put the number of U.S. air-pollution deaths at something closer to 75,000 (Medscape Medical News 2000). Taking Diamond’s number and the lower estimate as the boundaries of a range, a rough estimate of the monetary cost of deaths related to air-pollution (using the arguably unethical value of a statistical life) is between \$412 billion and \$975 billion.

### **Expenditures for pollution abatement**

Attempts to abate air, water, and solid-waste pollution are costly. According to a 2005 U.S. Census Bureau survey of businesses with 20 or more employees, capital expenditures for pollution abatement were approximately \$5.9 billion and operating costs associated with pollution abatement were about \$21 billion

in 2005. If there were less production and consumption, then, *ceteris paribus*, there would be less pollution.

## **Oil spills**

Inhering to the consumption of greater quantities of goods is the greater consumption of oil; and the more oil consumed, the higher the odds of an oil spill. According to estimates by government scientists, when the Exxon Valdez ran aground, in addition to shellfish and other species living in the local, intertidal communities, “approximately 250,000 marine birds died from direct exposure to the oil, along with approximately 2,800 sea otters and numerous harbor seals” (U.S. Department of Justice 2006).

Aside from the costs associated with slain and injured wildlife, spoiled habitat, and lost tourism, the cost to clean up oil spills is substantial. The initial cleanup expenses associated with the Exxon Valdez spill were more than \$2.1 billion (ExploreNorth 1999). Generically speaking, cleaning up oil spilled offshore costs an average of \$7,350 per (metric) tonne (in 1991 dollars, or \$11,000 per tonne in 2007 dollars). Shoreline remediation is much more expensive, costing between \$147,000 and \$294,000 (\$224,000 and \$447,000 in constant 2007 dollars) per tonne (Etkin 1999).

Of the estimated average of 706 million gallons of waste oil that enter the world’s oceans each year, only about 56 million gallons (eight percent) are the result of leaks or spills from ships and tankers or from offshore drilling and production operations (Water Encyclopedia n.d.). Suppose, for the sake of illustration, that all 56

million spilled gallons were cleaned up offshore. Converting from gallons to tonnes, fifty-six million gallons equals 182 kilotonnes of spilled oil (Answerbag.com n.d.). With an offshore cleanup cost of \$11,000 per tonne (in 2007 dollars), the total cleanup cost would be about \$2 billion per year. If all 182 kilotonnes of spilled oil were cleaned up along the shoreline, then the total cleanup cost would be between \$41 billion and \$81 billion per year. Cleaning up the entire 706 million gallons that enter the oceans from all sources annually would cost more than \$25 billion if cleaned up offshore and between \$515 billion and \$1 trillion if cleaned up along the shoreline.

### **Storing nuclear waste**

The U.S. Department of Energy (2008) estimates that storing nuclear waste in the Yucca Mountain repository over its 150-year expected lifecycle will cost \$96 billion (in 2007 dollars)—if the repository ever opens.

Currently, the U.S. is storing about 56,000 tons of high-level radioactive waste at more than 100 locations, scattered across 39 states. By statute, Yucca Mountain is constrained to a 70,000-ton capacity. While the Department of Energy maintains that Yucca Mountain could actually hold 120,000 tons of nuclear waste, even that increased storage would be insufficient if the U.S. were to build more reactors. At a 1.8 percent growth rate for nuclear waste after 2010, “the U.S. would fill a 120,000-ton Yucca by 2030 [and] would need nine Yucca Mountains by the end of the 21<sup>st</sup> century” (Spencer and Loris 2008). At \$96 billion each, ten Yucca Mountain repositories would cost nearly a trillion (2007) dollars.

## **Superfund**

Congress established Superfund “to reduce and eliminate threats to human health and the environment that result from releases or potential releases of hazardous substances, pollutants, and contaminants from abandoned or uncontrolled hazardous waste sites” (U.S. Environmental Protection Agency 2008). Between 1993 and 2003, total Superfund expenditures, in constant 2003 dollars, were approximately \$17 billion (Stephenson 2004).

## **Wasted Energy and Materials**

According to Myers and Kent, in 2004, wasted materials (e.g., soil, metals, water, wood, and fiber) and energy, plus transportation of wasted materials, cost the U.S. “at least \$1 trillion of its \$10 trillion economy . . .” (23).

## **Noise pollution**

As Americans increasingly exploit leaf blowers, lawn edgers, snowmobiles, motorized scooters, and other motorized outdoor equipment, noise-pollution levels rise. Taking jet skis as an example and basing their estimates on people’s willingness to pay for peace and quiet, Komanoff and Shaw (2000) find that “jet skis in the United States impose approximately \$900 million of noise costs on U.S. beachgoers each year.”

## **Algal Blooms**

Excessive nutrients, particularly phosphorus from fertilizer runoff, increase the growth of algae and plants in bodies of water. Over time, the algae dominate, and the large plants die. Bacteria that decompose the dead plants multiply rapidly and consume greater and greater shares of the water's dissolved oxygen. At some point, the amount of dissolved oxygen is insufficient to support fish and aquatic insects. As a result, the water becomes incapable of supporting life. One such "dead zone," in the Gulf of Mexico at the base of the Mississippi River, "may well be as large as Massachusetts" ("Death," 2008).

According to Anderson et al. (2000), the estimated annual economic impact from harmful algal blooms in the U.S. is about \$22.2 million in public health costs, \$18.4 million in losses to commercial fisheries, \$6.6 million in recreation and tourism losses, and \$2.1 million in monitoring and management expenses, or a total of \$49.3 million (in 2000 dollars).

## **Global warming cost estimates**

In 2006, Nicholas Stern predicted that stabilizing carbon dioxide at about twice the pre-industrial concentration (of about 275 parts per million) would cost approximately one percent of global GDP by 2050. In 2008, however, Stern revised his estimate. Saying that climate change is occurring faster than expected, he argued that more should be done to lower emissions. To reduce concentrations below 500 ppm, not one but *two* percent of GDP would be required. Otherwise, damage due to

climate change could cost more than five percent—and perhaps even more than twenty percent—of world GDP (Jowitz and Wintour 2008).

The average, annual, global, economic-growth rate between 1961 and 2005 was about 3.64 percent (World Resources Institute). According to the World Bank and the CIA World Factbook, global GDP in 2007 was between \$54 and \$55 trillion (U.S.) dollars. If global growth were to continue at the 44-year average rate of 3.64 percent, then in 2050 the global GDP would be approximately \$260 trillion (in 2007 dollars). Thus, if Stern is correct in asserting that stabilizing atmospheric carbon dioxide at about 500 ppm would cost one or two percent of global GDP per year by 2050, then in 2050 (given growth at 3.64 percent per year) coping with climate change would cost between \$2.6 trillion and \$5.2 trillion. Dedicating one percent of global GDP in 2007 would cost about \$550 billion; two percent would cost about \$1.1 trillion. In the years between now and 2050, if at least one percent of GDP were devoted to carbon stabilization, the amount spent would increase along with global GDP, but it would likely (barring an extended, worldwide depression) be between one-half and several trillion dollars annually.

### **Endangered and extinct species**

Housing subdivisions, shopping malls, six-lane highways, international airports, NASCAR racetracks, suburban industrial parks, and other forms of human sprawl reduce the land available for wildlife communities. As a result, species that were once in the foreground of the local landscape are, in some cases, disappearing from sight.

Although the actual worth of any species' existence is beyond measure, the brief boost that the ivory-billed woodpecker gave to Monroe County, Arkansas, offers a trivial example of that value.

In 2005, after a research team spotted an "extinct" species of woodpecker in an Arkansas bayou, the local economy boomed as birdwatchers, scientists, and journalists from around the world flocked to the area. Within six months, one local entrepreneur's Ivory-Billed-Woodpecker-T-shirt sales topped \$20,000, and the federal Fish and Wildlife Service recommended appropriating \$27 million for woodpecker recovery efforts. Before the sighting, Farrar (2008) reports, no one ever "imagined such a creature would emerge from the darkness of extinction and become a symbol of hope for their increasingly endangered delta towns."

## **Desertification**

Overgrazing, excessive soil cultivation, deforestation, groundwater mining, global climate change, and increased soil salinity contribute to the desertification of formerly fertile lands. Although analysts estimate that desertification costs the global economy \$42 million per year, they suggest that the human cost is even higher. Desertification "has been the catalyst for a number of conflicts in arid lands in recent years and the situation is set to get worse . . ." (United Nations Convention to Combat Desertification 2006). According to the United Nations, desertification threatens to displace 135 million people in the near term.

## **Ecosystem services**

Costanza et al. (1997) estimate that in 1997, when the global GNP was approximately \$18 trillion, the value of seventeen ecosystem services was about \$16 to \$54 trillion (\$21 to \$70 trillion in 2007 dollars). Over-consumption degrades those services, and the cost of that degradation is certainly well above \$0. Even if the precise dollar amounts are unknown, the existence of costs associated with degraded ecosystem services should be considered.

## **Additional costs associated with ad-induced over-consumption**

Because advertising fuels over-consumption and over-consumption has many welfare-reducing, unintended consequences, the examples given above describe only some of the monetary costs that are directly linked to over-consumption and indirectly (for the most part) linked to advertising. Advertising's precise share of all associated costs is beyond the scope of this dissertation, but it is clearly—as a gross understatement—well above zero.

## ***Estimated Benefits Associated with Advertising***

The ad lobby justifies deductibility by claiming not only that advertising is an ordinary and necessary expense but also that it supplies a number of benefits to individual consumers and to society at large. Previous chapters of this dissertation examine ad supporters' claims, along with counterarguments from ad critics, in some detail. The following (overly simplified) table summarizes those findings.

Table 9.1: Ad-Lobby Claims

| THE AD-LOBBY CLAIMS THAT ADVERTISING:  | TRUE (generally) | FALSE (generally) | AMBIGUOUS (high variance) |
|--|------------------|-------------------|---------------------------|
| Fuels consumption                      | X                |                   |                           |
| Stabilizes the business cycle          |                  | X                 |                           |
| Increases advertisers' profits         |                  |                   | X                         |
| Is a self-correcting market mechanism  |                  | X                 |                           |
| Promotes competition                   |                  |                   | X                         |
| Facilitate the entry of new firms      |                  |                   | X                         |
| Lowers prices                          |                  |                   | X                         |
| Promotes economies of scale            |                  |                   | X                         |
| Provides valuable market information   |                  |                   | X                         |
| Lowers search costs                    |                  |                   | X                         |
| Lowers selling costs                   |                  |                   | X                         |
| Improves product quality               |                  |                   | X                         |
| Promotes innovation                    |                  |                   | X                         |
| Expands consumer choice                |                  |                   | X                         |
| Enables social cohesion                |                  | X                 |                           |
| Increases employment                   |                  |                   | X                         |
| Is entertaining                        |                  | X                 |                           |
| Subsidizes media & lowers media prices | X                |                   |                           |
| Supports small and minority media      |                  |                   | X                         |
| Increases media diversity              |                  |                   | X                         |
| Enables media freedom                  |                  |                   | X                         |

As Table 9.1 indicates, the literature seems to validate only some of the benefits claimed by the ad lobby. In a number of cases, the results of different studies are contradictory. Some studies find that advertising tends to lower prices; others find that it tends to raise prices. Some studies find that advertising promotes innovation; others find that it has the opposite effect. In some cases, endogenous variables create confusion and lead to ambiguous results. Individual firms believe, for example, that their revenues increase when they advertise, but since many

businesses base their future ad expenditures on their previous sales, the firms are unable to assess the extent to which advertising actually does boost their revenues.

Although everyone seems to agree that advertising supplies information, many economists and other observers question how much that information benefits consumers. Some argue that the information in most ads is too biased to be useful. Others maintain that advertising supplies a torrent of information; thus, trying to get useful information from advertising “is like trying to take a sip of water from a firehose” (DeGraaf et al. 2002, 160). In addition, a number of psychologists contend that advertising tells people that there is a product or service to solve every problem. As a result, the information that advertising supplies tends to inculcate materialistic values, which reduce individual and societal welfare.

### **Economic benefits associated with economic growth**

As we saw in Chapter 3, the economic literature provides equivocal results concerning the impact of advertising on demand. Some studies show that advertising fuels demand, others find that demand fuels advertising, and still others indicate that each fuels the other. Incontrovertible, however, are government and ad-industry statistics showing that businesses’ constant-dollar ad expenditures have been growing dramatically over the years. And along with those expenditures, the public’s ad exposure has been growing dramatically, too. Since psychologists find that increased exposure to advertising leads to the inculcation of materialistic values and that having materialistic values drives people to over-consume, whether or not economic studies are able to determine the direction of causation (advertising to consumption or

consumption to advertising) is ultimately not important: Psychological studies supply the missing information that explains how advertising leads to over-consumption.

Over-consumption, however, leads to economic expansion, and of all the supposed benefits of advertising, probably the most influential and frequently cited is advertising's association with economic growth. With a GDP of approximately \$14 trillion (Bureau of Economic Analysis 2008), annual economic growth at 3.16 percent (the 1970-to-2004 average) adds more than \$440 billion to the U.S. economy. To the extent that growth in GDP indicates an improvement in Americans' well-being (a highly debatable point), advertising (which fuels consumption by inculcating materialistic values), deserves some of the credit.

Although the precise value of any particular benefit associated with economic growth is incalculable, it is safe to assume that the associated dollar amount is clearly above zero and could be in the billions—or even the hundreds-of-billions of dollars. Similarly, determining the exact value of advertising's contribution to economic growth and to employment is highly problematical. Nevertheless, an ad-industry-sponsored study, entitled “The Comprehensive Economic Impact of Advertising Expenditures,” predicted that advertising would “generate \$5.2 trillion in direct and indirect spending” and would account for 21,117,903 American jobs in 2005 (O'Malley 2004). Although the study's degree of mathematical precision and its sponsorship by the ad lobby render its results suspect, advertising's contribution to growth in consumption—and thus to economic growth—can be assumed to be substantial.

The extent to which a reduction in advertising would lead to a reduction in jobs is unknown, but clearly the monetary costs associated with unemployment are high. For one thing, as the unemployed reduce their consumption in response to their reduced income, the revenues of businesses with which they had previously traded tend to fall. Thus, the local economy can go into a downward spiral when area unemployment is high. Although unemployment insurance can mitigate this “multiplier effect,” most of the unemployed receive no benefits and the payments to those who do collect unemployment insurance (approximately 35 percent of the unemployed) are substantially less than their salaries had been (House of Reps. 2007).

Taking 2003 as an example, seven-to-eight million people collected unemployment insurance benefits of, on average, \$262 per week for 16.4 weeks. Thus, \$30-to-\$34 billion is a rough estimate of unemployment-insurance benefits paid in 2003 (Economic Policy Institute 2004). If the 20-to-23 million other unemployed workers had collected the average weekly benefit of \$262 over the average number of weeks (16.4), then total payments to those who received no benefits would have been between \$86 billion and \$99 billion, and the total benefits for all unemployed workers—covered and uncovered—would have been between \$116 billion and \$133 billion (in 2003 dollars). Of course, those figures give no hint of the extent to which a reduction in advertising would have affected the level of unemployment in 2003. They only indicate one of the costs associated with unemployment in 2003 and show that it was substantial.

In addition to unemployment’s economic impact (only hinted at above), psychological and social costs inhere to unemployment. According to an econometric

study by Blanchflower and Oswald (2004), males would require approximately \$60,000 (per man) per year to be compensated for the unhappiness—*not* the lost income—associated with being unemployed. A number of psychological studies find a positive relationship between unemployment and depression, suicide, and substance abuse (Dooley et al. 1994; Kessler 1997; Norström 1995).

In 1996, Americans' expenditures for direct treatment of mental health disorders exceeded \$99 billion (more than \$130 billion in constant 2007 dollars). Unemployment's share of those expenditures is a matter of speculation. But, just for the sake of producing a rough idea of the magnitude of those costs, one could multiply the ratio of unemployed workers to total American adults (30 million divided by 218 million) by \$130 billion (an estimate of expenditures for mental health disorders in 2007) and get approximately \$18 billion, which would be a very rough estimate of unemployed workers' mental health expenditures. That result depends on two assumptions, of course: (1) that the unemployed are equally likely to suffer from mental health disorders as are the employed and (2) that unemployment is the cause of unemployed workers' mental health problems. It is quite unlikely, however, that either assumption is true. Nevertheless, it is clear that the mental health expenditures associated with unemployment are considerable.

### **Economic benefits associated with lowering search costs**

The monetary value associated with lowered search costs depends on the opportunity cost of the span of time that is devoted to a search. Thus, as Mehta, Rajiv, and Srinivasan (2003) explain, "income has a significant impact on search

costs” (79). To get a rough idea of the value of advertising in lowering search costs, however, imagine that \$18 per hour (approximately the average hourly earnings of nonfarm, production and nonsupervisory American workers in August 2008) is the average opportunity cost associated with an hour of search for each adult. Then imagine that advertising saves each adult consumer one-half hour of search per week. According to the U.S. Census Bureau, there are approximately 218 million adults in the U.S. (Bernstein 2007). Given this scenario, advertising would reduce aggregate search costs by about \$2 billion per week (i.e., 218 million people times 0.5 hour per week times \$18 per hour), or about \$100 billion per year, as an extremely rough estimate.

### **Benefits associated with advertising’s subsidies to media**

According to Polinsky (1993), approximately 80 percent of newspapers’ gross revenues are derived from advertising. Evans and Schmalensee (2005) report that newspaper and magazine readers pay only the marginal costs of printing and distribution—if that; and consumers of some media (e.g., broadcast television, broadcast radio, certain newspapers, and most web portals) make no direct payments; rather, consumers’ access is entirely subsidized by advertising. How much would businesses reduce their advertising if the deduction were eliminated? Would consumers be willing to pay more for ad-free media? In the absence of the indirect subsidy that the government supplies media via the tax deduction for advertising, might government offer direct subsidies to media? Such questions make assigning even a tentative estimate of the value of advertising’s subsidies to media difficult.

Nevertheless, the values listed in Table 9.2 (below) offer a sense of the extent to which advertising subsidizes some informative and entertainment media. Elimination of the deduction would lead to less advertising and affect media subsidies, at least in the short run, to some extent.

Table 9.2 Advertisers' Expenditures by Medium

| MEDIUM              | ADVERTISERS' 2005 EXPENDITURES |
|---------------------|--------------------------------|
| Magazines           | \$23.2 billion                 |
| Sunday magazines    | \$1.7 billion                  |
| Local magazines     | \$0.5 billion                  |
| National newspapers | \$3.5 billion                  |
| Local newspapers    | \$25.5 billion                 |
| Network TV          | \$26.7 billion                 |
| Spot TV             | \$17.1 billion                 |
| Syndicated TV       | \$4.2 billion                  |
| Cable TV network    | \$16.5 billion                 |
| Network radio       | \$1.0 billion                  |
| National spot radio | \$2.6 billion                  |
| Local radio         | \$7.4 billion                  |
| Internet            | \$8.3 billion                  |
| -----               | -----                          |
| Estimated Total     | \$138 billion                  |

Source: Coen, 2006.

**Additional benefits?**

Certainly, the ad lobby can supply anecdotal evidence in support of each of their claims concerning the benefits of advertising. And, no doubt, the public does

derive additional benefits from advertising in specific instances. Ads entertain some people some of the time, for example, even though they annoy most people most of the time. Other benefits of advertising may be apparent to the reader. Although the literature supports only a few of the ad lobby's claims, the economic value of those few benefits is certainly substantial, and those benefits are worthy of consideration.

### ***Potential benefits of reducing or eliminating the deduction***

Reducing the psychological, social, and environmental costs associated with advertising—including, but not limited to those mentioned above—is the fundamental benefit of changing the tax status of advertising. The sections below discuss some of the benefits in greater detail.

#### **Tax revenues**

Although the U.S. has a high corporate tax rate, the taxes that corporations actually pay as a share of total tax revenues are quite low. Eliminating the deduction for advertising would raise tax revenues substantially, particularly in the short run. If, for example, advertisers had been required to pay taxes at the 35-percent corporate rate on the \$290 billion dollars that they deducted in 2007, federal tax revenues would have been more than \$100 billion higher (*ceteris paribus*).

Merely requiring businesses to amortize a portion of their advertising expenses would boost tax revenues considerably, as well. In fact, policymakers have considered amortization proposals to raise tax revenues on several occasions. In

1986, for example, the Treasury Department suggested a change that would have required businesses to amortize 20 percent of their ad expenditures over five years and allowed them an immediate deduction for the other 80 percent. The government estimated that the change would have raised tax revenues by \$20 billion (\$38 billion in 2007 dollars) over five years (Rosenbaum 1986).

### **Tax fairness**

Reducing or eliminating the deduction would tend to make the tax code more equitable. As it stands, the burden of funding government falls more heavily on individual taxpayers than on corporations, in part, because corporations are able to deduct advertising. Addressing the issue of tax fairness in 2000, Senator John McCain proposed reducing the ad deduction to raise revenues and eliminate one of “the numerous inequitable and unnecessary corporate loopholes, subsidies, and set-asides” (qtd. in Teinowitz 2000).

### **Value formation**

As the previous chapters have shown, advertising inculcates materialistic values, and materialistic values reduce psychological, social, and environmental well-being in a variety of ways. If there were less advertising, there would be fewer messages promoting materialism.

Although other forces, such as church, government, and school, influence value formation along with advertising, as Schudson (1984) sees it, “serious

objections [apply] to [advertising] that do not apply to some of the other forces. . . . There are ways for a community to exercise some control over its school system or over government policy,” Schudson writes, “but there is scarcely any effective way to regulate the messages that come into the community from the mass media, especially the broadcast media.” When, as happens so often, exposure to an ad “is largely unavoidable,” advertising is a “literally unaccountable influence” (242).

Many Americans believe that they, and especially their children, are exposed to decadent values by advertisements and ad-subsidized media but feel powerless to prevent that exposure (Harwood Group 1995). Few Americans realize, however, that the tax code allows businesses to deduct their ad expenditures regardless of the values that the ads (and ad-subsidized media) promote. Although the Constitution provides some protection for commercial speech, the First Amendment does not entitle advertisers to a tax deduction (see below). If the deduction were eliminated, taxpayers would no longer be paying, indirectly, to promote values that some find abhorrent.

### **Delayed gratification**

When one is seriously dehydrated, getting something to drink is more important than worrying about whether a pollutant in the water might cause cancer twenty years hence. When one is starving and fatty meat is the only food available, eating that meat is more important than worrying about one’s cholesterol level. Because satisfying immediate needs can be essential to survival, a primitive brain impulse can dominate rational thoughts about promoting long-term well-being.

Although people do, of course, use their reason sometimes to think of their long-term well-being, advertising perpetually conditions them to focus on short-term desires.

If not directly, then by implication, ads tell people that if they use an advertised product, they will feel better immediately. “Pleasure now!” is the message, but, of course, the reality is: “Pleasure now. Pay later.” Not surprisingly, ads and ad-supported media leave out the “pay-later” part. If people were subjected to fewer such messages, they might allocate their limited resources in ways that would improve their welfare to a greater extent over the long run.

### **Preferences for private consumption**

Advertising advocates private consumption. Ads tell consumers off-and-on, all day, everyday, that they need *private* goods. When people focus their attention on consuming private goods, provision and maintenance of public goods tend to be forgotten. Infrastructure crumbles (sometimes unlucky people get killed) and yet the public insists on lower taxes, because they want to increase their consumption of private—often advertised—goods.

The bottled-water phenomenon provides a particularly direct example of an ad-induced preference that is undermining the provision of a public good. In 2006, the bottled-water industry spent \$163 million on advertising in the U.S. The industry’s efforts were successful. In 2007, Americans spent almost \$12 billion on bottled water (Gies 2008), even though researchers say tap water is often just as good (Owen 2006). And bottled water is much costlier to the environment. The process of making water bottles generates greenhouse gases, as does transporting the bottles to

stores, homes, and vending machines. Meanwhile, the nation's drinking-water systems are in desperate need of maintenance. According to the Environmental Protection Agency, the nation's drinking-water systems need more than \$277 billion in repairs and improvements. The EPA's estimate is low in the view of many water-industry engineers, however. They claim that the drinking-water infrastructure needs \$480 billion of repairs and improvements (Long 2008).

Some see in this skewing of preferences for private consumption a subversion of democracy. "Marketers are not interested in people's desires if they cannot be met by commercially profitable commodities," Schudson (1984) writes. "A desire for urban public space is not considered but a demand for a new high-rise condominium is. . . . An interest in leaving a nontoxic environment to our children receives less attention than desires for consumer goods whose manufacture produces a by-product of toxic waste" (31). As Schudson sees it, "marketers do not actually seek to discover what consumers 'want' but what consumers want *from among commercially viable choices*" (235; italics in the original). Barber (2007) elaborates: "The powerful are those who set the agenda, not those who choose from the alternatives it offers. We select menu items privately, but we can assure meaningful menu choices only through public decision making" (139). By constantly stressing consumption, advertising preempts individuals' attention and channels their thoughts to private goods rather than the common good.

If the deduction were reduced or eliminated, the quantity of messages celebrating private goods would be lower, the chronic repetition of materialistic

messages would be lessened, and the public would be freer to attend to common concerns.

### **Media independence**

A number of analysts argue that advertisers exert too much influence over media content. According to De Graaf et al. (2002), “some advertisers issue policy statements to editors and news directors, requesting advance notice on stories that may put their products in an unfavorable light. Phone calls from CEOs of advertiser companies are like delete buttons on editors’ computers” (163). Furthermore, some ad critics maintain, anti-consumerist messages in media are virtually taboo for fear of reprisals from advertisers. Kalle Lasn, the founder of the anti-consumerist quarterly *Ad Busters*, explains that the major networks have refused to air almost all of his organizations’ “uncommercials.” When he tried to buy time to broadcast an anti-beauty-industry ad on a CNN fashion show, for example, a network executive told him that he thought CNN *should* be airing such ads. But, the executive said, “on an official level I can tell you right now, we will never air that spot because we would have Revlon and Maybelline and Calvin Klein coming down our throats the very next day, and that’s where our bread and butter is” (qtd. in De Graaf et al., 211).

Baker (1992) recommends taxing a medium’s advertising revenue and providing a subsidy to media consumers. “The immediate result,” he writes, “would be to reduce [media’s] incentive to respond to advertisers’ wishes concerning editorial content and to encourage [media] to provide a product for which readers [and users of other media] are willing to pay” (2181).

## **Savings**

Given the negative relationship between savings and advertising (see Chapter 5), reducing the amount of advertising should lead to higher rates of saving. The ad deduction encourages businesses to advertise, and advertisements encourage people to over-consume rather than save. Extremely low—even negative—saving rates have contributed to the current credit crisis. In light of the relationship between advertising and debt, eliminating the deduction should be considered as a way to increase household savings.

## **Consumption**

By allowing advertising to be deducted, “our current tax policies . . . encourage wasteful, destructive consumption” (Hymel 2000, 356). According to a consensus among economists, reducing or eliminating the deduction for advertising would reduce the quantity of advertising (see below). Since advertising encourages people to buy ever more products, fewer such messages should ease the cultural pressure to consume. Hymel puts it this way: “Eliminating preferential tax treatment of advertising would increase its after-tax cost. As a result, both advertising and over-consumption should decline. Predicting how much of a decline in either would be difficult, but that there will be a decline is certain,” (Hymel, 446).

Difficult or not, Godshaw and Pancoast (1987) estimate “that an increase in the price of advertising of one percent reduces the share of disposable income spent on consumption by 0.0345 percentage points” (5).

### **Reducing consumption: a dilemma for environmental policy**

Over-consumption is a central cause of environmental degradation. Dealing with over-consumption is problematic, however, because people insist on the right to buy virtually anything they want, anytime they want, and in any amount they want, so long as they have the money—or can borrow the money—to get it. Thus, proposals to cut consumption by raising taxes substantially or putting quotas on purchases of products that are particularly harmful to the environment (e.g., a quota on gasoline per person) would certainly meet strong public resistance.

Typically, environmental organizations have tried to motivate collective action by confronting the public with dire warnings, like: “The polar icecap is melting! Polar bears are drowning!” To a certain extent, those warnings have had their intended effect: Surveys show that most people are aware of environmental problems and are frightened by them (Dunlap et al. 1993; Harwood 1995; Immerwahr 1999). Unfortunately, however, environmentalists’ exhortations generally fail to motivate people to reduce the amount they consume—even though the warnings often connect ecological problems to human over-consumption.

Theoretical and empirical studies indicate that presenting scary scenarios with the hope that they will motivate people to reduce their consumption is likely to be counterproductive. Researchers find that when people feel insecure, frustrated,

afraid, or anxious, they generally become more materialistic—not less (Inglehart and Abrahamson 1994; Kanner and Gomes 1995; Kasser and Sheldon 2000; Nordhaus and Shellenberger 2007). Frightened people often comfort themselves by consuming more. (An illustration of the fear-materialism nexus likely occurred at the 2008 Republican Convention. The assembled delegates, having been recently exposed to numerous reports about skyrocketing energy prices, rising unemployment, and falling home prices, voiced their support for exploiting offshore oil—despite the environmental consequences—by chanting loudly and repeatedly: “Drill, baby, drill!”)

Polls show that people do, in fact, link over-consumption to environmental degradation. In response to a 1995 survey question about the underlying causes of environmental problems, 93 percent of the participants agreed that “the way we live produces too much waste,” 91 percent said that “we focus too much on getting what we want now and not enough on future generations,” and 88 percent said that “protecting the environment will require most of us to make major changes in the way we live” (Harwood Group 1995). While “89 percent agreed that buying and consuming is ‘the American way’” and an overwhelming majority of Americans (95 percent) characterized their fellow citizens as materialistic, only 51 percent thought that their “own buying habits [were having] a negative effect on the environment” (n.p.).

An “obstacle to change is rooted in the very strong American belief in freedom and choice; people are strongly opposed to impinging upon the freedom of themselves and others to live as they choose” (Harwood Group 1995, n.p.). Polls

show that people want a healthy environment, believe that over-consumption is harming the environment, but insist on the freedom to consume at will. At the same time, “four out of five Americans find they often consume more than they need” (Myers and Kent 2004, 124). Advertising is a plausible cause of this cognitive dissonance. While people ignore most of the ads they encounter, the overarching message, nevertheless, takes hold: “You need something! You need something! You need something!”

Offered a list of policy proposals for lowering the level of materialism and improving the environment, 80 percent of survey respondents said they thought curbing the quantity of ads on prime-time television would be a good idea, and 52 percent thought doing so would be helpful (Harwood Group 1995).

Currently, the government’s policies concerning over-consumption are somewhat schizophrenic. On the one hand, they recognize the need for conservation, and, on the other, they encourage consumption. Reducing the public’s ad exposure would automatically reduce the number of consumption-urging messages people absorb. Alone, such a reduction would be insufficient to transform a consumerist culture into a nation of ascetics—even if that were desirable. Nevertheless, reducing ad exposure would be one way to mitigate the intense, ad-abetted, societal pressure to consume.

An analogy might be useful, here. Suppose you are driving a car. If you want to slow down, first you reduce the pressure your foot is putting on the accelerator. If you want to stop the car, you will probably need to take other measures, such as stepping on the brake. But to begin the slowing process, you simply stop

accelerating. Advertising is an accelerator for consumption. Discouraging advertising by reducing or eliminating the deduction is like easing up on a car's gas peddle.

### ***Potential costs of reducing or eliminating the deduction***

As noted above, empirical research casts doubts on most of the ad lobby's claims concerning advertising's contributions to the common good. Moreover, the benefits associated with the claims that do, on balance, stand up to scrutiny are hardly unalloyed.

### **Growth and employment**

Advertising does motivate consumption, and when consumption increases, GDP grows (*ceteris paribus*), but the costs associated with much of that ad-induced growth seem to outweigh the benefits. Advertising may increase employment in some instances, but, as Kaldor (1950-1951) explains, generating employment by using ads to increase consumption of unnecessary goods is a questionable use of finite resources. Moreover, in some cases, advertising might actually reduce employment. Advertising can take the place of sales jobs, for example. Furthermore, ad-induced materialism has shifted the work-leisure balance in favor of work. Thus, many Americans are working longer hours than necessary in order to increase their ability to consume things that add little or nothing to the quality of their lives. If

individual over-workers decreased their hours, those hours would be available to employ other people.

## **Search**

Advertising may lower search costs for particular items, but ads also encourage people to buy more than they would otherwise. Thus, even though an ad might reduce the amount of time people spend searching for one item, it might increase the amount of time people spend searching cumulatively for goods. Generally speaking, advertising costs people much more time than it saves, since most people buy only a fraction of all the items they see advertised, and, as noted above, opportunity costs inhere to ad exposure.

## **Media viability**

Although most media currently depend on advertising for revenue, Simon (1970) maintains that advertising's support for media fails to justify advertising because there are "many other possible economic arrangements . . . that would be no more costly to society in the long run" (276). For example, if direct government subsidies replaced the indirect subsidies that the tax deduction for advertising provides, media dependence on advertisers could be reduced or eliminated. Alternatively, media could increase their prices. Under the present system, as Corden (1961) and Doyle (1968) explain, media must be subsidized in order for demand to

match supply; thus, the quantity of media supplied likely represents a less than optimal allocation of resources.

Given that many people currently pay a fee for commercial-free television channels, such as HBO and Showtime, experience shows that some media can survive by increasing their prices and improving their quality. Some of the world's most creative people work for ad agencies. If the deduction were eliminated, a lot of creative talent might be available to improve media content. If content were improved and ads were eliminated, the public might be willing to pay more for access to media.

### **Classified ads and public service announcements**

Some ad supporters and critics note that two types of advertising—classified ads and public service announcements—supply useful information without imparting materialistic values; thus, the social costs associated with denying deductibility for such ads might exceed the benefits. As a general rule, however, expenditures for these types of ads are not deducted as business expenses. Public service announcements, for example, promote no business's product or service. In fact, public service announcements sometimes attempt to persuade people *not* to buy a product (e.g., anti-smoking ads). In the case of classifieds, although some employers might deduct the cost of help-wanted ads, compared to other forms of advertising, such expenditures are negligible. Thus, whether or not help-wanted ads are deductible would seem to make little difference either to a business's tax obligation or to the government's tax revenue.

## ***Obstacles to changing advertising's tax status***

On balance, the benefits of reducing or eliminating the deduction appear to outweigh the costs, and a change in the tax code seems to be warranted.

Nevertheless, some potential obstacles to changing the tax status of advertising should be considered.

### **Defining advertising: An administrative nightmare?**

A number of economic analysts contend that any proposal to change the tax status of advertising would require coming up with a definition for “advertising” and that doing so is infeasible. Analysts at the Congressional Budget Office (1997), for example, warn that reducing the deduction “would require complex rules to distinguish advertising costs from other ordinary business costs” (377). Doyle (1968) explains that if the new law failed to frame advertising with care, firms would be tempted to switch to alternative marketing methods to avoid tax liability. If that were to happen, the result might be worse than if nothing had been done, in his view, because those methods might be as harmful to society as advertising, and they might be more expensive.

Arrow et al. (1990) also flag the difficulty of distinguishing precisely what constitutes advertising. “Is it advertising,” they ask, “when a firm places a coupon in the newspaper . . . [or] sponsors a sporting event with the proceeds going to charity? Should the brand or company logos on trucks or tee shirts be treated as advertising?”

As the authors see it, delineating the sorts of expenditures affected by a change in the tax code would be essential, however. A narrow definition would encourage firms to switch to other selling and promotion methods in order to avoid the tax. A broad definition, on the other hand, would discourage forms of advertising, such as retail promotions and manufacturers' coupons that benefit consumers immediately and directly by reducing prices. "In short," they conclude, "whatever one thinks of the theoretical merits of the proposed change, in practice it is likely to be an administrative nightmare" (9).

Writing in *Tax Notes*, Polinsky (1993) also anticipates problems defining advertising for the purpose of a tax-status change. As he sees it, "any amortization proposal would add complexity to the tax law and require the [Internal Revenue] Service to promulgate regulations distinguishing the tax treatment of particular marketing activities" (1665). Law professor Hymel (2000) agrees that defining advertising would be problematic (450).

On the other hand, can advertising truly be so hard to define? Businesses seem to have no trouble defining advertising when they calculate their tax obligations every year and claim ad expenditures as deductions. And certainly, businesses define advertising broadly, because the broader the definition, the lower the tax bill. Moreover, experience seems to support the conclusion that advertising is definable. Reekie (1986) finds, for example, that an across-the-board tax on advertising in South Africa was easy to collect and reduced aggregate advertising expenditures.

Comanor and Wilson (1974) imply that defining advertising is relatively straightforward. In fact, they base their thorough and comprehensive study of the

economics of advertising on “advertising expenditures gathered from tax returns. . . . What is reported as advertising expenditures,” they write, “is therefore what the individual firms consider to be such expenditures. The definition may vary from firm to firm, but it seems likely that most use roughly comparable definitions which include primarily payments made to the information media for messages distributed via those media” (5).

Corden (1961) offers a practical suggestion. “Perhaps,” he writes, “the necessary Act would include a simple definition of advertising, and a fairly comprehensive list of items held to be covered by the term, [which] would then be supplemented by case law” (35).

### **A distinction between informative and persuasive advertising?**

According to Corden (1961), the ideal tax would selectively exempt advertising that is entirely factual and informative. As he sees it, even if the effects of persuasive advertising are pernicious, informative advertising helps facilitate market transactions and should be deductible. Corden concludes, however, that no distinction between informative and persuasive advertising can be effectively drawn. “There was a time when economists made a distinction between ‘informative’ and ‘persuasive’ advertising,” he writes, “but it has been realized that all advertising contains a little information, if only the name of the product, while even the most informative advertisements have persuasion as their aim” (14).

## **Should the change in tax status apply to ads in every medium?**

If the deduction were eliminated for all forms of advertising, no particular medium would be disadvantaged. If, on the other hand, only broadcast and print media were denied a deduction, newspaper advertisers might shift to other forms of marketing (e.g., billboards, direct mail, the Internet, and point-of-purchase promotions), which would privilege certain media without necessarily reducing consumers' advertising exposure. Disallowing the deduction for all forms of advertising would do the most to reduce the ubiquitous pressure to consume.

## **Political obstacles**

Over the years, advertising's allies in business, media, and government have helped the industry defeat attempts to regulate or tax advertising on numerous occasions. During the 1970s, for example, when the Federal Trade Commission proposed a ban on advertising that targets children, advertising's friends in Congress not only overruled the ban but also punished the FTC by restricting its powers (Steyer 2002).

A review of attempts that have been made over the past few decades to change the tax status of advertising illustrate some of the political obstacles that proposals to reduce or eliminate the deduction might face in the future.

According to some reports, the first (post World War II) proposal to trim the advertising deduction was sent to the Senate Finance Committee in 1986 by the Treasury Department, as one entry in a list of revenue-raising options (House of Representatives 1992; Advertising Coalition 2004). A Reagan Treasury official later

denied that the proposal originated in the Treasury Department, however. He insisted, instead, that it “was the brainchild of the Senate Finance Committee staff and was rejected by the administration as bad fiscal policy” (Colford 1986b). Also denying responsibility for the controversial measure was the chief counsel for the Finance Committee, William Diefenderfer, who told a reporter for *Advertising Age* that the proposal was “never seriously considered,” because it lacked the support of committee members and business. Apparently, after the ad industry launched “an unprecedented lobbying effort” to kill the proposal, no one wanted to claim authorship (Colford 1986b).

The proposal faced an additional political obstacle. At the time, President Reagan was trying to get support for major tax-reform legislation. Some of his strongest supporters in the business community, corporations such as Procter & Gamble, IBM, and General Motors, were also major advertisers. “If they were going to go out on a limb and support tax reform,” one corporate executive asked, “would the administration want to then go against them?” (Colford 1986b.)

Despite the fierce opposition to the first deduction-limiting proposal, a few months after its ignominious abandonment, the House Ways and Means Committee considered a similar proposal to increase government revenues by requiring businesses to capitalize and amortize a percentage of their advertising expenditures. Daniel Rostenkowski, chairman of the committee, acknowledged that advertising often yields “a return over a period far longer than the tax year.” But, he said, determining “exactly how the expense and income streams should be matched” is “extremely difficult” (qtd. in Vettel 1987a).

Over the summer of 1987, the Senate Finance Committee and the House Ways and Means Committee listened to testimony from “a parade of advertising interests” (Hymel 2000). Representatives of the National Association of Broadcasters, the Association of National Advertisers, The American Advertising Federation, and the American Association of Advertising Agencies (among others) testified that changing the tax status of advertising would fail to raise revenues, because it would reduce sales (Vettel 1987b). Only one witness offered testimony in support of the proposal to amortize some advertising expenditures. Given the underwhelming support, the proposal was eliminated from the legislative agenda.

Just to be on the safe side, however, the ad industry prepared a “grim forecast,” supported by economic analyses, to educate Congress about the unintended consequences of forcing businesses to amortize their ad expenditures (Gordon and Colford 1988). According to that forecast, denial of full deductibility would lead to less advertising, higher prices for consumer goods, and fewer jobs, among other things.

After his inauguration in 1989, President George H. W. Bush allayed ad-industry fears that his administration would attempt to reduce the deduction by appointing William Diefenderfer to be second in command at the Office of Management and Budget. As chief counsel to the Senate Finance Committee in 1986, Diefenderfer opposed the first proposal to reduce the deduction. After that (but before his appointment by Bush), he was employed by the Leadership Council on Advertising Issues to formulate a strategy for countering any proposals by the White House or Congress to limit the deductibility of advertising (Colford 1989).

In defending the deduction, the ad industry and its supporters frequently frame the debate as being a battle between free speech and government control. Representative Michael Andrews of Texas, for example, told a congressional hearing: “Without advertising, media would become a State-run enterprise with all the constraints and burdens that entails. Advertising is, however, constantly under attack by one force we all know too well: the tax collector” (House of Representatives 1992).

Andrew’s “tax collector” soon waged another attack on advertising. In September of 1993, the House Ways and Means Select Revenue Measures Subcommittee held a hearing on a proposal requiring advertisers to amortize a portion of their ad expenses. Although a “long line formed outside the meeting room ahead of the proceedings,” it was entirely comprised of lobbyists and other ad supporters. According to a reporter for *ADWEEK*, “the industry’s witnesses were persuasive, the room was packed and the television cameras were rolling. The only problem was that, throughout the testimony, there was almost nobody from the subcommittee present to hear it” (Crawford 1993). Of the three congressmen who addressed the proposal, one had been a vice president at an ad agency before his election to the House, and the wife of another was a principal at an advertising firm at that time. All three congressmen denied that advertising creates goodwill and brand loyalty, and they all opposed the proposed change (Hymel 2000). One witness after another claimed that reducing the deduction would reduce the amount of advertising and that less advertising would mean lower corporate profits. With lower corporate profits, the tax base would be smaller; thus, tax revenues could go down rather than up.

“This form of taxation,” the president of the Association of National Advertisers, DeWitt Helm, testified, “could prove to be counterproductive” (qtd. in Crawford 1993).

Some observers of the proceedings wondered how the proposal ever found its way onto the hearing’s agenda, given that no one was even willing to have his name attached as its sponsor. “Often no one steps forward to claim authorship of an unpopular item, which is the case here,” a Capitol Hill “insider” explained to a reporter (Furchgott 1993).

“This is one proposal with no identifiable political support and clearly identifiable and powerful political opposition,” Polinsky (1993) explained in *Tax Notes*. “The representative or senator who supports the concept faces an overwhelming barrage of opposition from nearly every economic interest in his or her district or state.” In Polinsky’s view, regardless of its merits, “it is extremely unlikely that such a proposal will become law any time soon. And the reason has nothing to do with tax accounting practices and everything to do with practical politics” (n.p.).

Practical politicians rely on the old adage: Never pick a fight with people who buy ink by the barrel. During the 1993 hearing, as before, no elected official wanted to antagonize the media over a proposal that was being cast as “taxing advertising.” Nor did they want to take on manufacturers, distributors, wholesalers, “and every large and small retail establishment in America” (Polinsky 1993, n.p.).

In 1993, although Congress changed the tax code to require the amortization of other forms of intangible capital, it specifically exempted advertising. House Ways and Means Chairman Rostenkowski addressed the issue directly: “Some

persons have questioned whether this bill was intended to open the door for reconsidering tax deductions for advertising expenses. Let me be clear. The answer is no” (qtd. in Bokinsky 1994, n.p.). Nevertheless, Johns (1984) writes, “the tax treatment of these internally developed intangible assets is bewildering” to most tax practitioners and academics (n.p.).

Since 1993, academics, practitioners, and others have continued to propose reducing the deduction from time to time. A few days before Clinton’s 1995 State of the Union address, for example, rumors circulated that the president was considering mentioning advertising in his speech as an example of corporate welfare that needs to be cut. That rumor triggered an immediate response from ad lobbyists, ad agencies, trade associations, small businesses, and major corporations. In an interview about the events, a Treasury official said that his agency and the White House had been swamped by protests from advertisers and the ad lobby on the day before the address. “We even had inquiries from congressmen who had been contacted by AAF [the American Advertising Federation] and the ANA [the Association of National Advertisers], the Treasury official said (Mundy 1995, n.p.).

In the fall of 1995, when the House Ways and Means Committee “passed a \$30-million corporate-welfare bill with teeth [that bit] just about everybody,” the committee, nevertheless, spared advertising. A report in *ADWEEK* credited the chairman of Ways and Means, Bill Archer, for advertising’s exclusion. According to the article, Archer “is proving to be a lifelong friend of advertising” (Fitzgerald 1995, n.p.).

Meanwhile, policymakers from both political parties have spoken over the years about the need to reduce corporate subsidies. In the Senate, Republican John McCain and Democrat Edward Kennedy proposed creating a Corporate Subsidy Reform Commission. As a member of Clinton's Cabinet, Labor Secretary Robert Reich got the support of the Republican House and Senate Budget Committee chairmen, along with President Clinton, when he called for reducing "corporate welfare" (Hemphill 1997). Outside government, the libertarian Cato Institute issued a paper, by Stephen Moore and Dean Stansel (1995), entitled: "Ending Corporate Welfare as We Know It." From the left side of the political spectrum, the Progressive Policy Institute called for corporate-welfare cuts and proposed the amortization of some ad expenses. But as Robert Shapiro (1995) of PPI explained, "cutting industry subsidies seems to be a politically irresistible proposition in the abstract and a politically intolerable course in its particulars."

According to Hemphill (1997), whenever policymakers target a particular corporate subsidy, the associated lobby mobilizes to counter the threat. "Agency officials . . . highlight the economic benefits accruing to constituents in specific congressional districts and states. Business lobbyists . . . confirm the importance of these programs to the future economic success of companies in a legislator's domain" (n.p.). Elected officials also face "the omnipresent threat of . . . losing [campaign] contributions from disgruntled corporate and industry sources." In addition to those concerns, if advertising is the targeted industry, politicians confront the additional worry that ad-subsidized media will retaliate by running editorials and advertisements that disparage the proposal and the judgment of any politician who supports it.

In 2004, the Advertising Coalition claimed to have defeated “six separate proposals” voted on by the Senate “that would have adversely affected advertising” (Advertising Coalition 2004). According to the Coalition, it defeated those measures “by adhering to the wisdom of former House Speaker Tip O’Neill, who said: ‘All politics is local.’” In order to stress the importance of advertising to the economy of the legislator’s state or district, the Coalition brought members of relevant House and Senate committees together with advertising and media executives. In addition, as noted in Chapter 5, the ad-lobby paid for a study that purported to detail the impact of ad expenditures on economic activity and employment in every state and congressional district.

Clearly, any new proposal to reduce or eliminate the advertising deduction would face intense opposition. Advertising affects the earnings of many businesses. As difficult as it is to challenge the subsidy of one industry, taking on corporations, ad-supported media, ad agencies, manufacturers, retailers, wholesalers and others who benefit from the status quo would clearly require a Herculean effort.

Policymakers have justified previous attempts to reduce the deduction by arguing that the amortization of ad expenditures would increase government revenues. The ad lobby defeated those proposals easily by claiming that government revenues would actually drop if the deduction were reduced. According to the ad lobby, the loss of full deductibility would mean that businesses would advertise less, which would lead to depressed sales, which would lead to lower tax payments.

“Despite ample support under existing tax law and policy to change advertising’s tax treatment, tax policy alone will be insufficient to oppose the

powerful advertising industry” Hymel (2000) writes. If the rationale for the change is characterized as merely a way to gain revenue for projects that the public may or may not support, it will have little chance of withstanding the opposition. Reducing or eliminating the deduction for advertising expenditures will require the firm backing of the American people, because powerful interests opposing the change will push back forcefully.

### ***First Amendment Issues***

Would reducing or eliminating the deduction violate the First Amendment’s protection of commercial speech? According to some advocates for the ad industry, it would. As they see it, eliminating the deduction “is tantamount to imposing taxes on political speeches, protest demonstrations or parades” (Geier 1987). Nevertheless, the answer from the Supreme Court appears to be “no.” In 1959, for example, the Court ruled that the Internal Revenue Service could deny deductions to alcoholic-beverage dealers for advertising that was intended to defeat “dry-law” proposals in two states. “The Court based its decision upon the freedom-of-speech concept, and ruled that there was no interference with freedom of speech so long as anyone is free to use advertising for lobbying by paying full price for the advertisements, rather than by claiming a deduction as a business expense” (Wedding 1960, 17).

In *Regan v. Taxation with Representation* (1983), the Court upheld the denial of tax exemptions to nonprofit groups that lobby Congress—even though First Amendment free-speech protections apply to lobbying. Discussing the case, Hymel

(2000) writes: “Denying a business expense deduction does not infringe on any First Amendment rights or regulate any First Amendment activity. Congress has simply chosen not to pay for that expense.” If Congress can deny a tax deduction to lobbying, “which is fully protected speech, then it should not be required to subsidize advertising, which is not fully protected speech,” Hymel argues (463).

The ad lobby might seem to be on firmer ground, however, when it claims that eliminating the deduction for a particular product would violate the First Amendment. When several U.S. Senators proposed legislation to eliminate a deduction for tobacco advertising, for example, the president of the American Advertising Federation maintained that such a change would be “unconstitutional because you are only taking away the right for one speaker” (qtd. in Teinowitz and Sachs 1995, n.p.). Nevertheless, a number of legal analysts have concluded that, in the case of tobacco, even denying the deduction to a particular “speaker” can pass constitutional muster. They base that conclusion on the Supreme Court’s decision in *Central Hudson Gas & Electric Corporation v. Public Service Commissioner* (1980). In that case, the Court established a four-part test to determine the constitutionality of any proposed regulation of commercial speech. According to Virelli, (2000), the “test stated that regulation of (1) non-misleading, legal, commercial speech requires (2) a substantial government interest; if such an interest exists, the regulation must (3) directly advance that government interest, and (4) be no more extensive than necessary to serve that interest” (541). A proposal to eliminate the tax deduction for tobacco advertising “is permissible because it both materially advances an important government interest and represents a reasonable fit with that interest” (571).

Cohen (1998) takes a similar position. He writes: “As advertising is commercial speech, it is not entitled to the same level of First Amendment protection as other speech, and to make it more expensive by limiting its tax deductibility would apparently not violate the *Central Hudson* test that the Supreme Court applies in determining whether governmental restrictions on commercial speech are constitutional” (1). Furthermore, the “Supreme Court has held that Congress is not required to subsidize First Amendment rights through a tax deduction” (1).

Addressing the issue of First Amendment rights for commercial speech, Daly and Farley (2004) note: “The right to free speech . . . does not include . . . the right to amplification by a powerful megaphone. For example, no one is allowed to shout ‘fire!’ in a crowded theater if there is no fire, because it threatens the well-being of others. Shouting ‘fire!’ may not be fundamentally different from encouraging people to consume when such consumption threatens the wellbeing of future generations” (414).

In sum, the argument that limiting or eliminating the tax deduction for advertising would violate the First Amendment seems to have no basis in law.

### ***Impact of the elimination of the deduction on ad exposure***

If reducing individuals’ ad exposure is the goal, would eliminating the deduction be effective? If advertising were no longer deductible, would advertisers respond to higher prices by reducing their ad expenditures or would ad-carrying media lower their prices and increase the quantity of ads they carry in order to

maintain their revenue? Is it conceivable that reducing or eliminating the deduction might actually result in more advertising—not less? Eliminating the deduction might lead to more advertising if the marginal cost of supplying media time/space were low, because, if it were, media could lower their prices, increase the amount of time/space they dedicate to advertising, and still make a profit.

But is the marginal cost of supplying media space/time low? The literature indicates that for most media, it is not. Allen, Eagle, and Rose (2002) find that the “supply side of the market for TV advertising is represented by a steep, upward sloping marginal-cost curve . . . caused by the scarcity of the two major ‘resources’ used in TV advertising: broadcasting time and potential audience” (9). For the same reason, the marginal cost of radio advertising should be high. In the case of print media, the marginal cost is also considerable. According to Corden (1961), newsprint and ink account for nearly half of a newspaper’s expenses. Speculating that the marginal cost of billboards is also high (without confirming research) seems safe. Even when the marginal cost of additional ad space or time is low, as it is in the case of Internet “e-zines” (Dupont 1997), the public’s tolerance for advertising is limited. Numerous studies and surveys find that people dislike being exposed to most ads (e.g., Harwood Group 1995). Thus, the media are constrained in the amount of advertising they can carry, because consumers will abandon media that contain too many ads.

Generally speaking, limiting the quantity of advertising serves the interest of both advertisers and the media. Individual advertisers prefer limitations on (other firms’) advertising because, as noted in Chapter 6, they believe they can better

showcase their products in a less cluttered environment. As Bagwell (2003) explains, a reduction in the elasticity of demand for advertisers' goods accompanies a restriction in the quantity of advertising that a medium supplies. Where inelasticity of demand for ad time/space is high, media gain more from inframarginal units when they restrict quantity than they gain from increased sales when they increase the supply of ad time/space. In fact, until 1982 the National Association of Broadcasters set a limit for the number of commercial minutes per hour an affiliated television station was permitted to broadcast. In that year, however, the Justice Department claimed that the NAB's rules violated three antitrust laws by seeking to limit the supply of advertising minutes artificially in order to increase profits. Following the refusal of the court to dismiss two of the charges and its ruling that one of NAB's standards was a per se violation of the Sherman Act, the NAB agreed to stop disseminating and enforcing the ad limit (Cohen 1982; Owen and Wildman 1992).

Clearly, the ad industry believes that reducing the deduction would lead to a reduction in advertising. Otherwise, why would the industry oppose the change? If the change would mean more business, the industry should be all for it. In fact, however, in article after article, trade magazines reveal that the industry is vehemently opposed to any change in the tax status of advertising.

A number of economists seem to agree that reducing the deduction would lead to a reduction in advertising. Arrow et al. (1990) put it this way: "The result of [reducing the deduction] is obvious: an increase in the cost of advertising and a corresponding *decrease* in the amount of advertising" (1; italics in the original). In a study of options for reducing the deficit, the Congressional Budget Office notes that

reducing the deduction “would increase the after-tax cost of advertising and discourage its use” (377). A 1981 article by Baye “implies that the elimination of the tax deductibility of advertising expenses would reduce firms’ demand for advertising” (Baye 2007, personal communication).

According to a number of studies, when the price of advertising increases, the quantity of advertising decreases. Godshaw and Pancoast (1987), for example, estimate that when the price of advertising increases one percent the amount demanded falls by 0.7 percent. Masih (1999) finds that the demand for advertising, in the long run, drops approximately 1 percent for every percentage point of increase in price. Bagwell (2003) simply maintains that the effect on advertising of a cost increase is a decrease in the quantity of advertising. Reekie (1986) and Corden (1961) concur with Bagwell.

Perhaps businesses would continue to advertise without the deduction if media lowered their prices more than the tax change increased businesses’ ad expenses. It seems unlikely, however, that media could lower their prices enough to make up for the elimination of the deduction at the 35-percent corporate-tax rate.

### ***Should Advertising Remain a Deductible Business Expense?***

On balance, the costs associated with advertising now seem to far outweigh the benefits. Advertising instills materialistic values that make people want to consume. Given the individual, social, and environmental costs associated with American-style consumption, policies that encourage people to consume at ever

increasing levels undermine overall well-being. Thus, advertising should *not* remain a fully deductible business expense.

But should the deduction be *entirely* eliminated?

University of Arizona law professor Mona Hymel (2000) says no. In her view, advertising would be “significantly disadvantaged as compared to other economically similar investments,” if the deduction were completely eliminated. Moreover, “complete elimination would . . . create perverse incentives to characterize advertising as some more tax-favored asset” (450).

Hymel believes, nonetheless, that the “current tax treatment of advertising costs raises efficiency, fairness, adequacy, and administrability concerns. . . . Thus the tax treatment of such costs should be changed in a manner consistent with other . . . investments” that create intangible capital (453). “Rather than completely deny any deduction for advertising costs,” Hymel argues, “capitalization with amortization of some or all of the costs provides a stronger basis in tax policy, and is likely to be more politically feasible” than denying the entire deduction (459).

Perhaps, she is right. On the other hand, Knox College professor of psychology Tim Kasser (2002) thinks that it might be a good idea to “consider advertisements as a form of pollution” and “assess a tax on advertisers who spew materialistic messages” (109-110). Given all of the negative externalities that inhere to advertising, treating it like a pollutant seems reasonable. Although a number of economists have made a case for amortization based solely on tax equity considerations, if the psychological, societal, and environmental costs are taken into account, eliminating the deduction seems to be the best response.

The ad lobby is likely to wage a fierce battle to retain the deduction whatever the proposed change. Thus, the policy that has the highest probability of maximizing well-being should be the one pursued.

## Appendix: Recommendations for Further Research and Consideration

### *Redefine prosperity*

Over the past hundred years, economic conditions in the United States have changed dramatically, but, as Galbraith (1998) notes, “the total alteration in underlying circumstances has not been squarely faced. As a result, we are guided, in part, by ideas that are relevant to another world; and as a further result, we do many things that are unnecessary, some that are unwise, and a few that are insane. Some are a threat to affluence itself” (2).

Continuing to depend on the Gross Domestic Product to measure human welfare is, perhaps, an example of our failure to change with the times. Although GDP (and GNP) correlated positively with improvements in human welfare for most of the twentieth century, over the past few decades, measures of well-being have shown a slight decline, even though the GDP has grown substantially (Daly and Cobb 1994; Myers 2000).

As previously noted, economic bads (e.g., expenditures for disaster mitigation) are included with economic goods in GDP accounts. To reflect changes in welfare more accurately, such expenditures should be subtracted—not added. So long as expenditures that reflect reduced well-being are included in its formulation,

GDP is an inaccurate indicator of welfare. Thus, consideration should be given to reformulating GDP accounts or replacing GDP altogether with a new measure.

In the fall of 2008, as global financial markets plunged, economists, politicians, and others proposed restoring the *status quo ante* by stimulating GDP growth. Given that GDP is an obsolete, faulty, or—at best—incomplete measure of societal well-being in wealthy countries like the U.S., charting a new course seems to be in order. If maximizing well-being is the ultimate goal, then prosperity should be redefined in a way that “abandon[s] the outdated assumption that quantitative growth is unconditionally desirable and embrac[es] instead the notion of qualitative growth” (Renner 2004, 116).

Over the past few years, social scientists from around the world and across the political spectrum have suggested giving consideration to replacing GDP by some new measure, perhaps *Gross National Happiness* (Brooks 2008; Daly 2005; Graham and Chattopadhyay 2008). Motivating the interest in reevaluating GDP as a measure of well-being is the insight that money can buy only part of what people want and need.

Noting the results of happiness research, Gardner and Assadourian (2004) write: “Again and again, studies suggest that happy people tend to have strong, supportive relationships, a sense of control over their lives, good health, and fulfilling work. These factors are increasingly under stress in fast-paced, industrial societies, where people often attempt to use consumption as a substitute for genuine sources of happiness” (166). Perhaps people’s inability to satisfy their underlying needs for dignity, meaning, and intimacy through consumption—no matter how hard they push

themselves to acquire the means to consume—explains why pollsters find, again and again, that a majority of Americans believe that America is “on the wrong track” (PollingReport.com 2008).

### ***Reduce the quantity of messages that promote materialistic values***

With quantitative growth the goal, policymakers tend to favor methods, such as advertising, that are thought to increase the Gross Domestic Product. Advertising, however, instills materialistic values, which tend to undermine psychological, social, and environmental well-being. In the words of religious historian Robert Bellah: “That happiness is to be attained through limitless material acquisition is denied by every religion and philosophy known to humankind, but is preached incessantly by every American television set” (qtd. in Durning 1992, 147). With happiness the goal, public policy would discourage—not give favorable treatment to—messages that promote materialism and over-consumption.

### ***Stop exporting materialistic values through advertising***

Clearly, as a nation develops, economic growth improves well-being up to the point at which the people of that nation are able to satisfy their basic needs. Given the association between growth in consumption and growth in GDP, promulgating materialistic values in developing nations through advertising might seem to be prudent public policy. But research shows that materialistic values undermine the

well-being of the rich and the poor. Thus, exporting materialism through advertising undermines efforts to improve the well-being of people in developing nations.

### ***Make satiety the goal***

As Galbraith (1998) notes, the “concept of satiation has very little standing in economics” (117). But just as eating too little leads to malnutrition and eating too much leads to corpulence, consuming too few or too many goods lowers overall well-being. For the good of the individual, the society, and the environment, the goal of public policy should be to facilitate consumption just to the point of satiety.

To be clear, dictating to people what they can consume and how much they can consume is *not* what is being suggested here. Rather, the recommendation is for policies that enable people to reach a level of satiety but encourage them to stop there. Policies that encourage Americans to work hard so that they can become rich enough to buy whatever they want whenever they want it—that is, to over-consume at will—are counterproductive to the well-being of the environment, the society, and the individual.

### ***Provide public service announcements***

According to a 1995 Harwood Group poll (mentioned above), Americans from “all backgrounds . . . believe materialism, greed, and selfishness increasingly dominate American life, crowding out a more meaningful set of values centered on family, responsibility, and community” (n.p.). Apparently, when a question from a

pollster causes them to think about it, individual Americans reach the same conclusions about what maximizes well-being as do the social scientists who spend years studying the elements of happiness. Bombarded by advertising, however, Americans spend far less time contemplating values than they spend thinking about the things that they want to consume. Thus, Gardner and Assadourian (2004) conclude: “Consumption education . . . may be a necessary corrective to advertising’s incessant proclamations of the desirability of consumption” (177).

Public service announcements, placed in various media, could help bring about a societal shift from an emphasis on consumption to an emphasis on well-being. PSAs could inform the public, in creative ways, about the results of happiness research (e.g., that people will generally improve their lives more by strengthening their relationships than by increasing their incomes); PSAs could explain environmental issues in entertaining, informative, and easy-to-comprehend ways, and they could provide effective *anti*-consumption messages.

### ***Use happiness research to inform policy***

Happiness research indicates that policies aimed at promoting good health (e.g., universal health care, the Clean Air Act), strong relationships (e.g., the Family and Medical Leave Act), basic security (e.g., “COPS,” the Clinton administration’s police hiring program), and personal development (e.g., Pell Grants), while also providing an effective safety net to ensure that people can satisfy their basic survival needs (e.g., the Earned Income Tax Credit, unemployment insurance) do more to

increase the well-being of the American people in the 21<sup>st</sup> century than do policies aimed at maximizing economic growth. Recent experience shows that well-being can decline even while the economy grows substantially. Making the rich richer may increase GDP, but if the increased wealth fails to trickle down to the rest of the population, national welfare goes down, not up.

Unemployment is toxic to well-being. But in the U.S. today, the ultimate consequence of promoting advertising, in order to stimulate consumption, in order to boost economic growth, in order to increase employment, is diminished welfare, caused by the many negative externalities that inhere to advertising and over-consumption. Compared to increasing employment by stimulating growth, reducing the workweek from 40 to, say, 32 hours seems more likely to increase well-being. A 32-hour workweek would trade consumption for leisure. As a result, it would tend to reduce stress, reduce consumption (with all the aforementioned benefits of consumption reduction), and allow more time for personal growth and relationships. It would also tend to increase employment. (Cutting four employees' 40-hour workweek by eight hours could make one 32-hour-per-week job available for one additional employee, *ceteris paribus*.) While it is true that personal income might fall with a shorter workweek, complementary policies could nevertheless increase social welfare. If programs that facilitate well-being (such as universal health care, etc.) were in place, advertising were reduced such that people would be exposed to fewer materialism-inducing messages, and the conclusions of happiness research were more broadly promulgated, Americans might eventually conclude, along with Thoreau, that "most of the luxuries and many of the so-called comforts of life, are not only not

indispensable, but positive hindrances to the elevation of mankind” (qtd. in De Graaf et al. 2002, 132).

The government could reduce unemployment directly by hiring private contractors to rebuild the nation’s deteriorating infrastructure and hiring advertising agencies to produce consumption-reducing messages. Although free-market advocates have subjected such investments in public goods to intense negative scrutiny over the past several decades, as Galbraith (1998) notes, “private goods have had no such attention. On the contrary their virtues have been extolled by the massed drums of modern advertising.” In his view, the “social consequences of this discrimination—this tendency to accord a superior prestige to private goods and an inferior role to public production—are considerable and even grave” (112). Public policies that favor private transportation over public transportation have, for example, produced serious environmental consequences. As Renner (2004) notes, “forward-looking government policies—improved land use planning, environment-oriented norms and standards, and the creation of a reinvigorated public infrastructure that allows for greater social provision of certain goods and services—will help ensure that consumers are not overly compelled to make consumption-intensive ‘choices’” (112).

## Afterword: A Note about the Current Economic Crisis

Consumer spending rose every quarter between 1991 and the third quarter of 2008, when it dropped at a 3.1-percent annual rate—the steepest decline since 1980 (Krugman 2008). Expecting consumer spending to continue to fall in the foreseeable future, some economists fear that the U.S. economy may be descending into a deflationary spiral (Goodman 2008).

The ad industry has already been hit by the economic downturn. To cite a few examples, during the third quarter of 2008, net income from advertising at the Internet portal Yahoo dropped 64 percent (Harrison 2008), advertising pages in consumer magazines dropped 12.9 percent (Fell 2008), and local-television-stations' ad revenues—excluding sales of political advertisements—dropped three percent (MarketWatch.com 2008). Nevertheless, advertisements remain ubiquitous. With hard financial times constraining consumer spending, continued exposure to present levels of materialism-inducing, pro-consumption advertising will, in all likelihood, only make frustrated consumers feel worse. Anti-consumption *un*commercials that focus on the true sources of happiness could mitigate the disappointment that many people are likely to feel when economic conditions force them to consume less.

In past economic downturns, policymakers have sought to spur economic growth by stimulating consumption. Advertising stimulates consumption; thus, eliminating the deduction when the economy is contracting may seem counterintuitive. Nevertheless, psychological research indicates that ad-induced

materialistic values are always harmful. In addition, the over-consumption that accompanies materialism is clearly deleterious to the ecological health of the planet. Ironically, materialistic values may even be harmful to the economy itself, because they tend to induce greed, and greed, as the economic crisis of 2008 has shown, can be a major contributor to the conditions that lead to financial collapse.

As we have seen, numerous studies link advertising to materialism and materialism to a number of disutilities, including environmental degradation. Continuing to rely on ever-expanding consumption to promote well-being will exacerbate and add complexity to environmental problems in coming decades. For the sake of the environment and our futures in it, we must choose a different path.

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