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Advertising, Welfare Economics and Ethics

by

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'You cannot desire what you do not realise that you lack.'
(Diotima, in Plato's *Symposium*.)

'… one of the most fundamental weaknesses of the market system is the use of persuasive influence by sellers upon buyers and a general excessive tendency to produce wants for goods rather than goods for the satisfaction of wants.'
(F. H. Knight, 1982 [1934].)

'… *advertising* … is measurable (in terms of resources expended on it), it is seldom consciously purchased, and it affects choices. There is thus no case for ignoring it'

(J. de V. Graaff, 1967.)

Introduction

If Frank Knight, an acute observer of economic matters, was even approximately correct in the remark quoted above, then it is disappointing that over the nearly eighty subsequent years the 'persuasive influence [of] sellers upon buyers' has certainly not acquired a central place in standard analyses of exchange and production. (The recognition of selling costs in imperfect/monopolistic competition theory and the existence of specialized works on advertising do not contradict this.) How often, for example, does an Edgeworth Box analysis of exchange allow for the possibility that agents might use part of their endowment to alter, in their favour, the preferences of those with whom they exchange? Although 'general' equilibrium theory *à la* Debreu takes as data (a) the conditions of production, (b) resources, the

pattern of their ownership and the laws of property and (c) preferences, the purely relative nature of the grandiose adjective 'general' is widely acknowledged with respect to elements (a) and (b). Thus many economists reject (a) and study invention, innovation, technical progress, diffusion and so on; others waive aside (b) and study corruption, rent-seeking, directly unproductive profit-seeking, etc.. Now the use of resources to change preferences over goods and services is no less a fact of economic life than are, say, innovation and rent-seeking, yet element (c) is generally treated with far more deference than are elements (a) and (b). This constitutes a *failure* on the part of basic economic theorizing. 'Preference-shifting' uses of resources ought to be incorporated within our standard analyses of production, exchange and consumption. Part I of this exploratory paper will show how, to some extent at least, familiar explanatory tools of the economist's trade can be modified to allow for the role of advertising (taken here to stand in for all forms of marketing, even though the former is, strictly speaking, only one form of the latter). Part II will then move on to consider both some simple implications for standard welfare economics and some broader ethical issues that welfare economics ought perhaps to incorporate by widening its (currently very narrow) scope.

Part I. Familiar Economic Models

With no claim to have provided a full, let alone exhaustive treatment, we now seek to indicate how the role of sales promotion might be handled explicitly in some familiar kinds of simple economic model. The first is the two-commodity pure exchange analysis as presented in an Edgeworth box; the second is the two-period model of lending and borrowing; others introduce first labour, then labour and capital, and finally international trade.
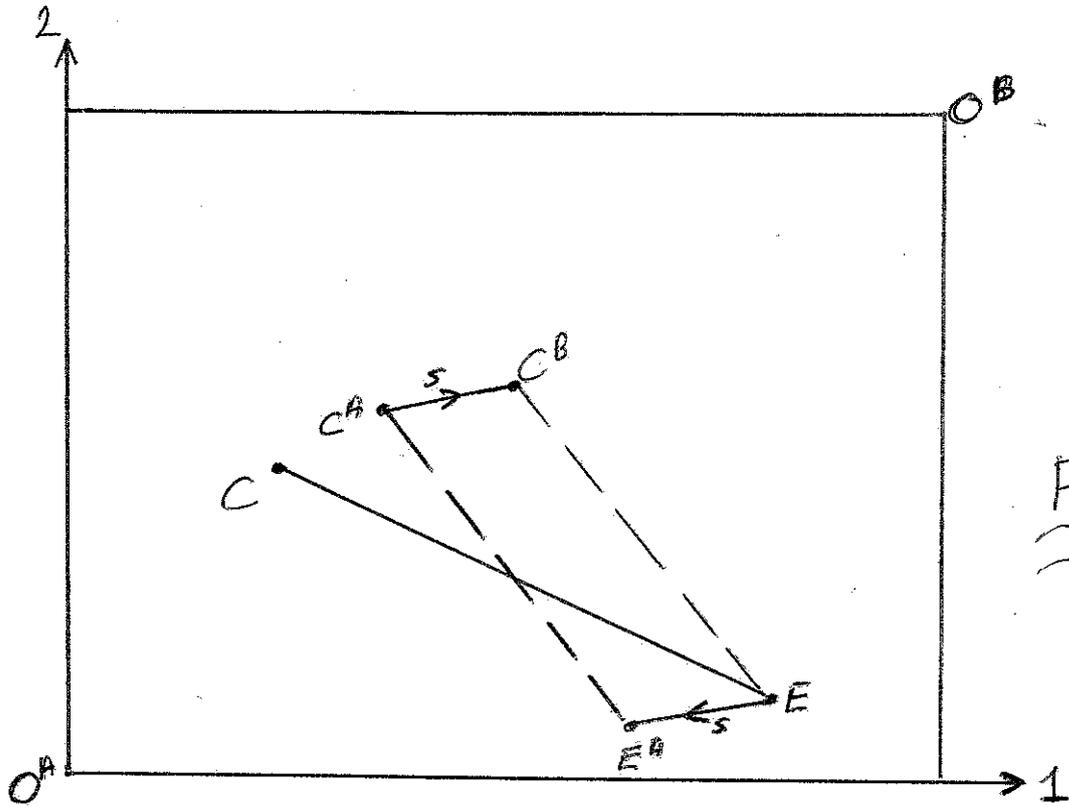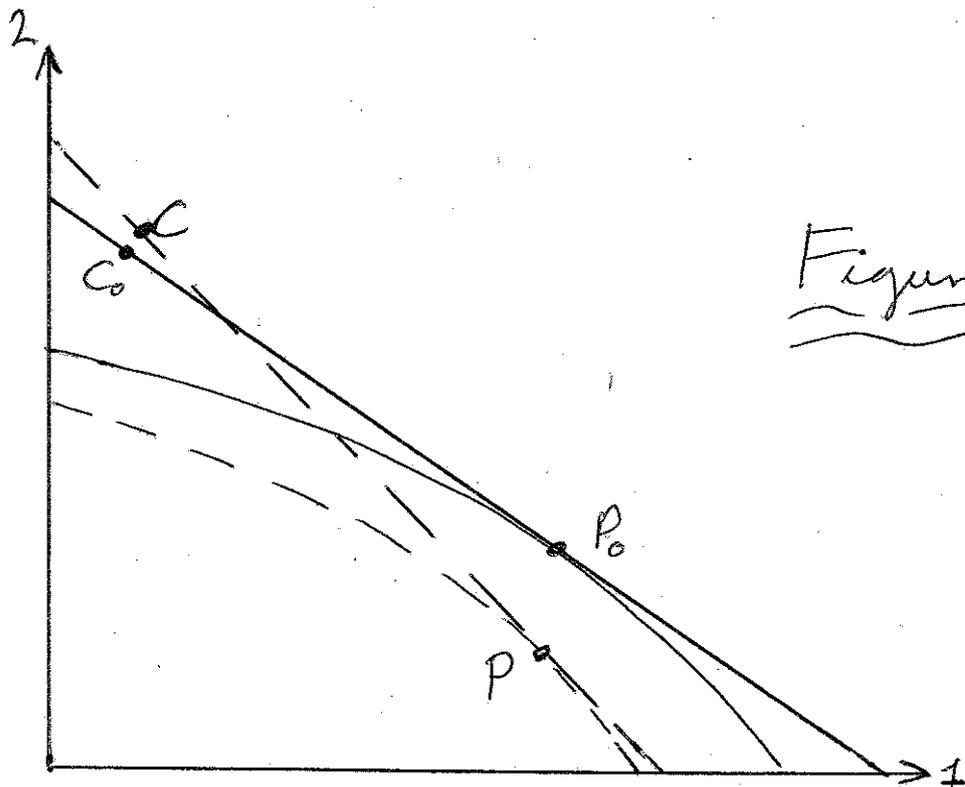
Figure 1

Figure 2

a) Pure exchange

Figure 1 shows an Edgeworth exchange box with the origin for agent(s) A at the southwest corner and that for agent(s) B at the northeast corner. Point E is the endowment point and C the consumption point in the absence of sales promotion. (The absolute slope of EC is of course the commodity price ratio). Suppose now that by devoting the commodity vector 's' to sales promotion – and thus having only the 'endowment' E^A left for consumption and trading – A can raise the exchange ratio to the absolute slope of the dashed line through E^A. This will involve shifting B's preferences towards the consumption of 1, which A is selling. A now consumes at C^A, which is preferred to the situation at C. B's new consumption bundle, at C^B, is reached from C^A by reversing the vector 's'; but it still lies on a (new) price line through E. It is thus shown how resource allocation has changed due to 'sales' activity by A. Note carefully that this is all to be interpreted in a strictly comparative statics manner; thus 'A can raise the exchange ratio' means 'the exchange ratio is greater', etc.

Encroaching somewhat on the discussion of Part II below, we notice at once that B consumes less of each commodity at C^B than at C. Note, though, that Figure 1 could have been so drawn that B consumes more of one commodity at C^B than at C – this occurs if one commodity is so inferior for A that the reduction in its consumption by A exceeds the amount used up by A in 'selling' activities.

We shall return below to welfare assessments; more pressing here is the interpretation of Figure 1. If it be interpreted in terms of very many identical A's and very many identical B's an obvious 'free-rider' question arises. Why does not each individual A 'leave it to the others' to use 'endowment' for the purpose of sales promotion – with the result that none takes place? The discussion here could no doubt

go in various interesting directions – but our main object is simplicity in the introduction of our central concern within a broadly familiar analysis. We can proceed in either of two ways. In the first we take A to be a single agent. A has no 'monopoly power' in the usual sense, however, because – both in the absence and in the presence of sales promotion – all the B's have identical preference maps consisting of parallel straight lines. (More pretentiously, identical CES utility functions of indefinitely large elasticity). Thus A has no power to influence the price ratio by selling more or selling less – but does have the ability to change, via sales promotion, the absolute slope of B's indifference curves and thus the terms of trade. In the second interpretation, there <u>are</u> many competing A agents, producing an identical product, and the advertising for the <u>generic</u> product is carried out by a 'trade association', or by an agricultural 'marketing board', or perhaps – in an international trade setting – by a government 'export promotion council.' Stonier and Hague (1980) call this 'promotional' advertising as opposed to 'competitive' advertising for the product of a specific firm. As an example of the former, they note that 'in the UK there has been advertising by the whole hat-making industry, intended to increase sales of hats in general, not those of any one particular producer' (p.221). Issues of financing, free-riding, etc. may still arise but we do not face them here. (We may note though that an advertisement by the British Potato Marketing Board, designed to promote the consumption of potatoes in general, was 'funded by Britain's potato farmers, packers, processors and merchants.')

   If the diagrammatic analysis is to be supplemented/replaced by an algebraic one, then the obvious tool to use is A's <u>indirect utility function</u>. A particularly simple example would be one in which A's endowment consisted exclusively of commodity 1 and in which A's objective was to choose 's', to maximize:

$$u^A = \frac{p_1\left(e_1^A - s\right)}{\left(p_1^{(1-\alpha)} p_2^{\alpha}\right)} = \left(e_1^A - s\right) p(s)^{\alpha}$$

,where $p \equiv (p_1/p_2)$ is increasing in s. Both in this particular example and in any more general one, it is important to consider the possibility of a corner solution, with s = 0. Simply to assume that p(s) is increasing in s is not to ensure, ipso facto, that sales promotion will be beneficial to A; the effect of s > 0 on the exchange ratio must be sufficiently great to overcompensate the negative impact effect on u^A of the 'loss of endowment'. More specifically, the condition is that, if $p''(s) < 0$,

$$\alpha e_1^A \left(\frac{dp}{ds}\right)_{s=0} > p(0)$$

This condition is more likely to be met the greater are (i) the importance of good 2 for A's utility, (ii) A's endowment of good 1 and (iii) the responsiveness of p to s.

The interested reader is of course welcome to analyse in detail both this and more complicated examples, using general indirect utility functions, recalling Roy's Identity and considering carefully when the optimal sales promoting use of A's endowment will be zero. With respect to the p(s) relation, it might well be supposed that this is of the logistic /Gompertz/ Richard's curve family. For example, one could assume that

$$p(s) = p(0)\left[\frac{p(0) + p_* e^{\pi s}}{p_* + p(0)e^{\pi s}}\right]$$

where $p_* > p(0)$. Or, more simply, one could assume that $p(s) = p(0)$ for $0 \leq s < s_1$, that $p'(s)$ is positive and constant for $s_1 < s < s_2$ and that $p(s) = p_*$ for $s_2 \leq s$. Here, of course, it is not enough to consider $p'(0)$ to determine whether s > 0 can be advantageous to A; $u^A(s)$ might fall, then rise, then fall again.

(It has been assumed above that the use of A's resources in sales promotion, while it changes the terms of trade, leaves unchanged the direction, the pattern of

trade. It must be noted, therefore, that sales promotion might be able so to <u>lower</u> (p_1/p_2) that A could become better off than at C, in Figure 1, by <u>selling</u> commodity 2 and <u>buying</u> commodity 1, thus reversing the no-sales-promotion pattern of trade).

It may be of interest to note that the condition for A to gain from selling activities is that the increase in the value of its (pre-advertising) sales of good 1 must exceed the value (in the new prices) of the resources devoted to advertising. In symbols:

$$\Delta p \, (e_1{}^A - c_1{}^A) > (p + \Delta p) \, s_1 + s_2$$

At this point, any reader interested primarily in the welfare aspects of the argument could jump straight to section f) below, or even directly to Part II. For the reader who is also interested in extending our familiar explanatory arguments, however, we now turn to consider intertemporal exchange.

b) Lending and borrowing

To derive a very simple account of how a lender might employ resources to increase the borrowers' rate of time preference and hence the interest rate at which loans are made, one need only reinterpret Fig. 1 above. A becomes the lender, commodity 1 (2) becomes consumption 'today' ('tomorrow') and the absolute slopes of the price lines become (1 + the rate of interest). It will perhaps be natural now to suppose that A can use <u>only</u> 'commodity 1' as a means of increasing the absolute slopes of the borrowers' linear indifference curves but the argument will otherwise be little changed.

c) Labour services

Consider a producer – or perhaps a typical member of a cooperative of producers – who allocates each period of time T not only to leisure, l, and to

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productive labour, l_p, but also to 'selling labour', l_s. ($l_s + l_p + l = T$). The agent seeks to maximize

$$u = c^\gamma\, l^\lambda$$

where c is consumption (of a single good, or a fixed proportions composite good, other than the one produced). Output of the produced good is l_p^α and hence

$$c = (p_0 + \pi\, l_s)\, l_p^\alpha$$

where $(p_0 + \pi\, l_s)$ is the price at which the good produced can be sold, per unit, when labour time l_s is devoted to 'sales' activity. Hence

$$u = (p_0 + \pi\, l_s)^\gamma\, l_p^{\alpha\gamma}\, l^\lambda$$

How should this agent allocate time so as to maximize u?

Provided that $(\pi/p_0)T > [\alpha + (\lambda/\gamma)]$, the following three positive l values, each less than T, will maximize u:

$$[1 + \alpha + (\lambda/\gamma)]l_s \qquad = T - [\alpha + (\lambda/\gamma)]\,(p_o/\pi)$$

$$[1 + \alpha + (\lambda/\gamma)]l_p \qquad = \alpha\,[T + (p_0/\pi)]$$

$$[1 + \alpha + (\lambda/\gamma)]l \qquad = (\lambda/\gamma)\,[T + (p_0/\pi)]$$

If the proviso does not hold, of course, this means that the 'corner solution' $l_s = 0$ is best. For the interior solution described by our equations, the comparative statics are as follows:

	l_s	l_p	l
(π/p_o)	+	−	−
α	−	+	−
(λ/γ)	−	−	+

Labour time devoted to sales, l_s, will be greater (i) the greater is the responsiveness of the selling price to sales effort (π/p_0), (ii) the smaller is the elasticity of output w.r.t.

productive labour (α) and (iii) the <u>smaller</u> is the importance attached to leisure relative to consumption (λ/γ).

<u>d) Production with capital and wage-labour</u>

Our next example of how 'sales promotion' may be incorporated into a simple piece of analysis considers a closed, one commodity economy in which production is by means of labour and the single, circulating capital good. Some amount of that capital good may be devoted, however, not to use in production but to changing workers' preferences; more specifically, to lowering the constant real wage rate at which any amount of labour may be employed. We suppose that capital (K) is given and that only employment (L) and the amount of capital devoted to 'sales promotion' (S) are freely chosen.

Consider, then, the problem of choosing S and L to maximize:

$$\Pi = Q(K - S, L) - K - w(S)\,L$$

, where Q ( ) is gross output and w (S) is the real product wage, which is decreasing in S. In obvious notation,

$$\Pi_L = Q_2\,(\;) - w(S)\;;\;\Pi_S = -\,Q_1\,(\;) - w'(S)\,L$$

Now if
$$Q_1\,(K, L) > -\,w'(0)\,L$$

then Π_S will be negative at S = 0 and thus S = 0 may be part of the solution.

However, a solution with S > 0 will be characterized by:

$$Q_1\,(K - S, L) = -\,w'(S)\,L$$

and

$$Q_2\,(K - S, L) = w\,(S)$$

[The second order conditions are $Q_{11}\,(\;) < w''(S)L$, $Q_{22}\,(\;) < 0$ and

$$[Q_{11} - w''(S)\,L]\,Q_{22} \geq [Q_{12} + w'(S)]^2$$

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Note that $Q_{11} < 0$ and $Q_{11} Q_{22} \geq Q_{12}^2$ may not be required].

To illustrate, suppose that $Q ( ) = (K - S)^{(1-\alpha)} L^\alpha$ and $w (S) = w_0 e^{-\beta S}$, where $\beta > 0 < \alpha < 1$. When the first order conditions both hold as equalities, the second order conditions are met and we find that

$$S = K - \left(\frac{1-\alpha}{\alpha\beta} \right) \quad (1)$$

, so that S is increasing in α, β and K. (All intuitively understandable findings). It is of course implicit in (1) that $\alpha K \beta < (1-\alpha)$ is the condition for a corner solution with $S = 0$. For $S > 0$, it is not enough that this can lower the real wage ($\beta > 0$); it must lower it sufficiently to offset the withdrawal of capital from production.

The level of employment is given by

$$w_0 (\beta L)^{(1-\alpha)} = (1-\alpha)^{(1-\alpha)} \alpha^\alpha e^{\left(\beta K - \frac{(1-\alpha)}{\alpha} \right)}$$

and, unsurprisingly, L is decreasing in w_0 but increasing in both β and K. Now in an otherwise identical economy in which β (and hence S) were zero, we should have $w_0 (L_0 / K)^{(1-\alpha)} = \alpha$ and it can be shown that

$$L > L_0$$

It can be shown too that gross output

$$Q > Q_0$$

and that the aggregate wage bill

$$W > W_0$$

By comparison with the $\beta = 0$ economy (or indeed a $\beta > 0 = S$ economy), the with-sales-promotion economy has higher output (gross and net), higher employment and higher aggregate wages. Needless to say, no one in their right mind will wish to relate this result directly to claims that, in the US economy for example, workers would be better off both working and consuming less. And this not only because of the extreme

simplicity of the model analysed here. Even within this type of model, the findings in question are specific to the particular example given and cannot be generalized. (To see this, draw a simple diagram showing, for $S = 0$, the falling marginal product of labour curve intersecting a horizontal line at height w_0. Now suppose that, with $S > 0$, both the MPL curve and the fixed real wage rate 'fall'. It will be seen at once that L may rise, fall or remain unchanged; and that, if L rises, then W may rise, fall or remain unchanged).

e) 'Ricardian' trade theory

Consider the textbook travesty of Ricardo's 'Chapter 7' theory of trade, with two countries (A and B) and two commodities (1 and 2). The total labour supplies are L_A and L_B and the unit labour costs satisfy $(l_{1A}/l_{2A}) < (l_{1B}/l_{2B})$, so that A has the comparative advantage in producing 1. To keep matters simple, we shall assume that, with or without 'sales' activity, both countries will be fully specialized when trading. Let demand conditions in A be represented by $U_A = C_{1A}{}^{\alpha 1} \cdot C_{2A}{}^{\alpha 2}$ and those in B by $U_B = C_{1B}{}^{\beta 1} \cdot C_{2B}{}^{\beta 2}$ If $l_{1A} Q_{1A} \equiv L_A$ and $l_{2B} Q_{2B} \equiv L_B$ then $(\alpha_1 + \alpha_2)C_{1A} = \alpha_1 Q_{1A}$ and $(\beta_1 + \beta_2)C_{2B} = \beta_2 Q_{2B}$. The 'no advertising' terms of trade, p, are given by

$$\alpha_2 (\beta_1 + \beta_2)Q_{1A} p = \beta_1 (\alpha_1 + \alpha_2)Q_{2B}$$

and it follows that, with 'no advertising' trade, $\ln U_A$ is proportional to

$$(\alpha_1 + \alpha_2)\ln Q_{1A} + \alpha_2 \ln \left(\frac{\beta_1}{\beta_1 + \beta_2} \right).$$

Consider now an alternative 'with advertising' trade equilibrium in which A's 'export promotion council' devotes amount S of Q_{1A} to making $(\beta_1/\beta_1 + \beta_2)$ greater than it would have been in the absence of advertising. Then u_A will be

$$(Q_{1A} - S)^{(\alpha_1 + \alpha_2)} \beta(S)^{\alpha_2}$$

where $\beta \equiv (\beta_1/\beta_1 + \beta_2)$ is increasing in S. It could be, for example, that

$$\beta(s) = \beta(0)\left[\frac{\beta(0) + \beta_* e^{bS}}{\beta_* + \beta(0)e^{bS}}\right]$$

where $\beta(0) < \beta_* < 1$. In this case, u_A is increasing with S, at S = 0, when

$$\left(\frac{\alpha_2}{\alpha_1 + \alpha_2}\right)\left[\frac{\beta_* - \beta(0)}{\beta_* + \beta(0)}\right]bQ_{1A} > 1$$

, so that this is certainly a <u>sufficient</u> condition for S > 0 to occur. It is less obvious that

it is a necessary condition, however. $\beta'(S)$ is <u>increasing</u> up to $e^{bS} = [\beta_*/\beta(0)]$, so that

there is the possibility that U_A may fall, rise and fall again as S increases. If this

indeed occurs and if the local maximum is the global maximum then it will illustrate a

strong form of 'increasing returns' to selling activity; a little such activity might make

A worse off and yet substantial such activity might make A better off than in the 'no

advertising' situation. Note that if $\beta(S)$ is a step-function, with β jumping from $\beta(0)$ to

β_* at S=<u>S</u>, then it is <u>certainly</u> possible for S=<u>S</u> to be U_A maximizing, even though a

'small' value of S would reduce U_A <u>below</u> $U_A(0)$. The same must be true for a

piecewise-linear $\beta(S)$ with a steep enough middle section.

<u>f) A small open (H-O-S) economy</u>

We may now consider a small open economy in which production is carried

out by means of land and labour (<u>à la</u> Heckscher-Ohlin-Samuelson). The country's

terms of trade are independent of its volume of trade but they can be influenced by

devoting amounts (T_s, L_s) of land and labour to sales (export) promotion activities.

Just how this is organized to circumvent the free-rider problem and how the export

promotion is financed may, of course, be important issues but we shall not pursue

them here. Nor shall we go into any detail about the relative 'land-labour-intensities'

of the three activities of producing commodity 1, producing commodity 2 and

promoting exports of commodity 1 (say).

In Fig. 2 the solid curve and line represent the no-sales-promotion production

possibility frontier and terms of trade line; P_0 is the output point and C_0 the

consumption point. When resources (T_s, L_s) are devoted to export promotion,

however, the production possibility frontier moves inward to be represented by the

dashed curve and the terms of trade line becomes the (steeper) dashed line; P and C

are the new production and consumption points and C is preferred to C_0. Of course, it

might be that <u>no</u> positive use of resources in sales promotion could yield a C preferred

to C_0; a 'corner solution' might be optimal, with $T_S = 0 = L_S$.[1]

A more formal examination of the issue leads to many conditions

familiar to any trade theorist – and to the following less familiar one (in which $p \equiv$

(p_1/p_2) is the terms of trade);

$$\left(\frac{\partial p}{\partial T_S} \bigg/ \frac{\partial p}{\partial L_S} \right) = \left(\frac{\partial Q_1}{\partial T_1} \bigg/ \frac{\partial Q_1}{\partial L_1} \right) = \left(\frac{\partial Q_2}{\partial T_2} \bigg/ \frac{\partial Q_2}{\partial L_2} \right)$$

Unfamiliar as it may be, the first element of this condition for an interior solution will

immediately be understood. [It can in fact be shown that

$$(Q_1 - C_1) \frac{\partial p}{\partial T_S} = r$$

$$(Q_1 - C_1) \frac{\partial p}{\partial L_S} = w$$

where C_1 is the country's consumption of 1 (so that $(Q_1 – C_1)$ is its exports of 1), r is

the land-rent and w is the wage-rate].

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[1] Our references to trade theory might well provoke the reader into thinking about the effects of sales promotion in terms of the offer curve diagram. And this could lead to thoughts about retaliation and advertising (as opposed to tariff) 'wars'. The ability to advertise may often be asymmetrical, however – as in the case of section d) above involving capitalists and workers.

Note that this H-O-S example highlights the fact that, when resources can be used to change prices, the Separation Theorem no longer holds.

Simple – perhaps over simple – as the above six models may be, they may serve to indicate that it is not so difficult to integrate one kind of sales-promoting use of resources into very familiar forms of elementary economic analysis and hence that there is no excuse for avoiding such integration. They do nothing, however, to show how such use of resources may affect the necessary forms of argument in normative assessment of alternative economic states, the matter to which we now turn.

Part II. Welfare Economics and Ethics

To begin this Part, let us return to Figures 1 and 2 supposing that both commodities are superior for A (as shown in the figures) and bearing firmly in mind that our analysis here is of a purely comparative statics nature and refers only to Stonier and Hague's 'promotional' advertising (for A's generic product), or to the special case in which B has straight-line indifference curves. Since total endowments – whether of commodities, as in Fig. 1, or of primary inputs, as in Fig.2 – are the same in the no-advertising and with-advertising situations, and since A consumes more of both commodities in the latter situation than in the former, it follows at once that B consumes <u>less</u> of <u>both</u> commodities in the presence of advertising. Thus whether the two situations are compared, from B's standpoint, in terms of B's no-advertising preferences <u>or</u> B's with-advertising preferences – or, indeed, any standard preferences – B is <u>worse off</u> in the presence of advertising. A is better-off <u>at B's expense</u>; we are <u>not</u> dealing here with a Pareto improvement, with mutually beneficial exchange.

Is B nevertheless better off in the with-advertising situation than in the no-exchange (autarky) situation? Consider the case in which advertising provokes a change in the slope of B's straight-line indifference curves. In terms of the with-advertising preferences, B is <u>indifferent</u> between the with-advertising and no-exchange situations. In terms of the no-advertising preferences, B is actually <u>worse off</u> in the former than in the latter situation. There thus appears to be no sense, within the present analysis, in which advertising is 'good news' for B. But if there thus exist circumstances in which economic activity is not to the mutual advantage of all the participants, this fact ought to be standardly acknowledged within basic economic theory, whether by means of such diagrams as Figures 1 and 2, or otherwise.[2]

Public goods, externalities, market power and classical liberalism

Could it perhaps be argued that standard economic theory does in fact adequately capture the issues just mentioned, under one or more of the headings listed in the title of this section? The following discussion is particularly tentative and reactions to it will be very welcome.

(a)   Consider display advertising on hoardings, or billboards (as opposed to advertising in magazines, or on the internet). It is <u>non-rival</u> and <u>non-excludable</u> in 'consumption'. It is also what Gravelle and Rees (1992, p.525) call '<u>non-optional</u>' in their discussion of public goods; as they put it, a radio or television broadcast is optional, while defence is non-optional. Thus display advertising has some common

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[2] When this paper was presented at the Jena seminar, Werner Guth reminded us all of another possible situation in which 'A' could benefit at the expense of 'B'. If the A agents costlessly <u>destroy</u> part of their endowments (overcoming somehow the free-rider problem), they might improve their terms of trade sufficiently to more than offset their 'loss' of endowment, so that they consume more of both commodities than they would have done in the absence of such destruction. Clearly, then, the B agents now consume <u>less</u> of each commodity – and the A's have gained at the expense of the B's. Even if the law permits one to destroy one's own property, not everyone will judge it to be morally acceptable that the A's have advantaged themselves in this way.

features with a non-optional public good (such as defence provision). Of course, different people may judge the advertisement differently, some finding it informative and/or attractive, while others find it irritating, intrusive or even vulgar; some may see it as a 'good', others as a 'bad'. But equally, a strict pacifist might see all defence spending as bad, while an opponent of nuclear weapons might see some but not all such expenditure as bad. Can display advertising then be assimilated to the category of non-optional public goods? Certainly one could <u>not</u> apply straightforwardly the textbook analysis of the optimal provision of a public good, since that presupposes <u>given</u> preferences for both (all) agents, whilst the very point of advertising is to change preferences over commodities (whether or not they are changed over characteristics). Less fundamentally, we may note that advertising does not raise the same issues of financing as does a typical public good.

(b)   Markets work best when agents are well informed and information has, of course, some public good aspects. In so far as advertising diffuses information – and some have argued that consumers today are (or at least can be) better informed than ever before – it can be brought under this familiar economic heading. But we shall return to this below.

(c)   An externality is defined by Gravelle and Rees (p.517) as existing 'if some of the variables which affect one decision-maker's utility or profit are under the control of another decision-maker.' Mankiw and Taylor (2010, p.189) give a slightly different emphasis, writing that, 'An <u>externality</u> arises when a person engages in an activity that influences the well-being of a bystander and yet neither pays nor receives any compensation for that effect.'

Now advertising is certainly something under the control of one decision-maker that can influence the utility/the well-being of another decision-maker. We

note, though, that the one influenced is no 'bystander' – not a mere third party – but is someone that the other decision-maker is <u>aiming</u> to affect. Moreover, the latter decision-maker, the advertiser, most certainly <u>aims</u> to be (more than) compensated for the cost of the advertising. (In practice, advertising expenditure may be a cost with a particularly uncertain return – but we are not facing that (important) issue here.) Thus while advertising introduces, by its very nature, agent interdependence, it is not obvious that the familiar concept of a (beneficial or harmful) externality is well suited to deal with it (whether a pecuniary or technical externality).

d) A standard topic within the economic discussion of advertising is whether it increases market power, for example by increasing brand loyalty and/or strengthening entry barriers. Important as these matters may be, however, they would not appear to cohere well with the discussion of Part I, with its emphasis on 'promotional' advertising, or a monopolist selling to consumers with straight line indifference curves. That discussion claims only to be an introduction to the matter of advertising, after all, and we are here simply recognizing one aspect of its restricted nature.

e) Classical liberal defences of the market system are not, of course, greatly impressed by Paretian welfare economies in any case, so they are not going to be that interested in whether or not promotional advertising can be shown to create difficulties for that style of welfare reasoning. But such authors as Friedman (1962) and Kirkpatrick (1994) certainly do defend advertising, claiming that non-fraudulent free activity must be acceptable. (See also Brenkert, 2008, pp.147-9, on the 'commercial free speech' defence of advertising, sometimes linked to the U.S. First Amendment. It is relevant here that it can be ethical to refrain from exercising a legal right.)

Welcome, advertising and the characteristics model

Welfare, advertising and the characteristics model

We turn now to consider in terms of Lancaster's 'characteristics' model, first, sales promotion that gives true information about commodities (in place of potential purchasers' vague or false beliefs about them)[3] and, second, sales promotion that seeks to change the public's preferences over characteristics. (In both cases, of course, preferences over commodities can be expected to change but it is not immediately obvious that one must evaluate both kinds of sales promotion in the same way).

(i) Provision of true information

How is one to make a welfare, or an ethical comparison of two alternative economic equilibria which differ because in one of them resources are being used to make some of the agents' preferences different from what they would have been in the absence of such resource use? By definition, one cannot adopt a straightforward Paretian Welfare Economics approach; the very nature of the difference between the alternatives renders that approach inapplicable. One might of course assess the two alternatives from both the perspective of the unchanged preferences and that of the altered preferences, hoping that the two rankings will be the same (as in Fig.1and Fig.2). But they may not be.

More fundamentally, perhaps, there is a problem even if the two rankings agree. Suppose that sales promotion activity induces a preference ordering over commodities based on true beliefs about commodities and characteristics, whilst the no-advertising ordering is based on (at least partly) false beliefs. James Griffin (1986)

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[3] We refer to giving true information – and not merely to giving 'more accurate' information – because it has been shown, in Currie and Steedman (2000), that more accurate but still inaccurate information can have surprising implications for consumer welfare. (See below on 'complete' information.) With reference back to Part I, note that Lancaster's assumption of linear relations between commodity and characteristics quantities combines easily with an assumption of straight line indifference curves over the latter, to yield similar indifference curves over the former. One can then consider simultaneously the influence of advertising on consumer beliefs and on deep-level preferences.

has argued, plausibly enough, that the satisfaction of 'well-informed preferences' is more valuable than that of ill-informed preferences. Does this mean that only the with-advertising ranking of alternatives is to be reckoned into one's overall assessment? Suppose that situation P is marginally better than situation Q, according to the well-informed ordering, but far worse than Q, according to the ill-informed ordering; how are the two rankings to be combined into an overall judgement?

Be that as it may, there is a further type of question to be asked, one that lies well beyond the boundaries of Paretian Welfare Economics. As McPherson (1987, p. 402) pointed out, when alternative preference orderings are at issue, procedural questions come to the fore and one must ask not only what preferences happen to be but also how they came to be as they are. In the present context, does it matter (ethically), for example, that the sales promoters have provided correct information because it is in their own interest to do so? Can they properly be criticized for 'acting selfishly'? Or is this rather a matter in which everyone is made better off – the sales promoters by increasing their levels of preference satisfaction and others by becoming better informed? In so far as the answer is 'Yes', does this offset – partially or fully – any reduction in the preference satisfaction levels of the 'others' (as in Fig.1 and Fig.2)?

A failure to provide true information, on the part of sales promoters, can sometimes provoke strong criticism, the 'caveat emptor' notion notwithstanding. (Implying that the provision of true information is approved of).Think for example of the fierce arguments that raged around the issue of cigarette promotion and the (statistical) relationship between smoking and certain kinds of illness. Yet it is impossible (logically impossible) to provide a 'complete' description of any commodity, so that (sensible) criticism can only be to the effect that

'significant/relevant' true information has been withheld. How is this to be defined and by whom? Such issues, it need hardly be said, are commonplace in both popular thought and the law courts; should they not also be standard fare within basic welfare economics? Their treatment, it is true, requires both that deliberately induced (or not induced) differences in preferences over commodities be considered and that account be taken of the possibility that a resource owner may have a moral <u>obligation</u> to use resources for the benefit of others. (i.e., to use resources in providing true information to others). Basic welfare economics will then need to be conceived of rather more generously than in strict Paretian Welfare Economics – but what of that? The discipline is to be designed to deal with reality; reality is not to be seen with blinkers so that it fits into a Procrustean Welfare Economics. (It is <u>not</u> implied that a wider ranging welfare economics will be perfectly simple to construct; nor that there are no relevant elements already to hand in the literature of economics).

Important as it may be to consider how well pre-given preferences over commodities are satisfied, responsible assessment of economic systems cannot be <u>confined</u> to such consideration. For it is just a fact that resources are used to change preferences over commodities.. It is true both that a more ambitious welfare economics will go against the grain of economists' traditional caution in such matters and that that caution has a defensible (anti-paternalist) background. But even the cautious nature of Paretian Welfare Economics is not entirely uncontentious, since not every change making each and every individual better off will be regarded as an overall improvement by a strict egalitarian. (For example, the change from (1,10) to (1.001,100)). And it hardly furthers the cause of anti-paternalism simply to refuse to recognize that resources are being used to influence the preferences of others. Cutting

against the grain or no, we have a responsibility to open up welfare economics in order to assess the realities we face.

(ii) Influencing deep-level preferences.

We now consider sales promoting activities that make a difference not to beliefs about the relations between commodities and characteristics but, rather, to preferences over characteristics. While both kinds of sales promotion may equally affect preferences over commodities they may not be ethically equivalent. (On September 19th, 1786, while in Italy, Goethe wrote that, 'One gets small thanks from people when one tries to improve their moral values, to give them a higher conception of themselves and a sense of the truly noble'.)

It is probably not that difficult, in many cases at least, to identify true beliefs about commodities and characteristics. But how far could even a determined moral realist go in maintaining that there is a true ranking of states of being and of actions and hence, derivatively, of commodity characteristics? How far is there an analogue here to 'well-informed' preferences? Such questions might appear to be overblown, even pretentious in the present context; not a great deal of sales promotion refers to ultimate values, or to the relations between Goodness and Beauty, or between Justice and Mercy! Nevertheless, they should not be brushed aside too easily. As Wicksteed, for example, made very clear, there is no sharp dividing line between the deepest ethical questions and the query 'What ought I to be doing with my time?', or between that query and the modest, 'What shall I buy?' The world of practical reason is not ultimately compartmentalized, even if we do tend to focus our attention on one level at a time. And if sales promotion does not commonly give lectures on ultimate values, it can and sometimes does endorse – perhaps implicity – the idea that some emphases

in life are of great importance, whilst leaving other – and perhaps equally or even more valuable – emphases unmentioned. Is there anything wrong with this? <u>If</u> 'strong moral realism' is correct <u>and if</u> we can know the moral truth then the answer is, presumably, 'It is wrong to endorse moral falsehood – just as it would be to purvey false information about commodities'. Perhaps the satisfaction of vicious preferences is no better than that of ill-informed preferences? (There are, of course, moral realism traditions according to which 'bad' actions are always 'ignorant' actions).

How do matters stand, though, if we do not know the moral truth – and do not even <u>know</u> what would be the derived 'correct' preference ordering over characteristics? [Aside: To speak of 'preference' may seem odd here – we don't have preferences over truths! How is one to relate moral truths <u>re</u> states of being and <u>re</u> actions, on the one hand, to idiosyncratic 'tastes' and 'preferences', on the other? Perhaps these latter refer only to matters that are 'indifferent' or 'adiaphoros' in terms of the former? And note the claim of von Wright (1987, p.944) that 'the value – absolutes [of goodness and badness] cannot be defined in terms of preference alone.']

Can there be anything wrong with influencing a deeper-level preference ordering, even if there is no such thing as a correct or true deeper-level ordering? Some will say that there can, on the grounds that such influence violates the autonomy of preference-holders (or the authenticity of their actions). Thus Crisp (1987), for example, insists that many have – and all ought to have (p.415) – 'a strong second order desire not to be manipulated by others without our knowledge, and for no good reason' (p.414). Persuasion is not necessarily wrong – and if we attend a film, a play, a sermon or a lecture we may be glad to be persuaded. But persuasive advertising, Crisp argues, is not always comparable to these cases and can involve an assault on our (Kantian) autonomy, in which we are treated simply as a means and not

at all as ends. ' It seems, then, that persuasive advertising does override the autonomy of consumers, and that, if the overriding of autonomy, other things being equal, is immoral, then persuasive advertising is immoral' (pp.416-7). (See also Chryssides and Kaler, 1996, pp.128-9; Velasquez, 1998, pp.347-9; Crane and Matten, 2004, pp.87-90.) We may, of course, ask whether all consumers are innocent dupes whose values can be led this way and that without their conscious participation in the value changing process? The answer to this last question may well be, 'No, not all. But some are more easily swayed than others, and not only children.' (Cf, Griffiths and Lucas, 1996, p.108.) In so far as this is true, with respect to which consumers is the acceptability or otherwise of value-changing sales promotion to be assessed? And do consumers themselves have a responsibility to appraise – and where appropriate reject – such sales promotion? (Cf, Brenkert, 2008, pp.140-144.)

If and when it is wrong to attempt to influence the deeper-level preferences of others, can making such an attempt be harmful to those who make it? Does it, or can it at least, encourage in them a cynical, manipulative mentality, with the result that the activity in question harms them ethically even as it is profitable to them?

Such questions may not be easy to answer. But that does not make them non-questions. Their answers are relevant to assessment of the use of resources to affect others' preferences – and the familiar armoury of Paretian Welfare Economics provides little enough help in finding those answers. We shall have to move beyond its cautious constructions if we are to build a welfare economics capable of dealing with the type of resource use at issue here.

Other thoughts

(i) Much sales promotion, of various types, is such that it is seen and/or heard by many who have no wish to see or hear it; even by many who dislike intensely the

seeing and/or the hearing of it. To the more sensitive (?), it is sometimes a serious 'negative externality' that they are unable to avoid having their minds filled by (what is to them) garbage. Sir John Hicks once likened the 'right to advertise' to 'freedom of speech'; but any legal right to advertise on bill boards and the sides of buses and taxis can limit our ability to move around in public spaces free from visual pollution. Any right to 'cold call' is incompatible with a right to freedom from unwanted invasion of one's privacy at home. The legal right to track our internet searches and to direct internet advertisements accordingly can be seen as an invasion of privacy – and this has become a contentious issue in the U.S.A. (See Advertising Age (2010, September 20th, pp.24-5.) Various asserted 'rights' in such matters may simply not be compossible. (See, again, Brenkert, 2008, pp.147-9 on 'commercial free speech'.)

Of course, some people may on occasion benefit from seeing billboards, or even from a 'cold call'. And, sadly, it seems that some find sales promoting activities 'entertaining'; if conversant with the terminology, they could thus say that there is a 'positive externality' to some sales promotion. How could one reach an overall assessment of the just - mentioned negative and positive externalities without making a value judgement as to the relative worth of freedom from degrading visual and aural pollution, on the one side, and utterly trivial, mind-numbing entertainment, on the other (to put it in strictly neutral terms)?

(ii) Consider a sales promotion activity which suggests that some particular commodity has the characteristic of 'being very much in fashion'. If this is widely believed, the suggestion might become a truth, even if it had not been one initially. Suppose, in fact, that it is at first a falsehood but becomes a truth; how would a useful welfare economics assess this sales promotion activity? It is a commonplace that the market works best in a context of trust and truth-telling – but here a falsehood

becomes a truth. Can the sales promotion involved be criticized both on the grounds that it began with the dissemination of falsehood and on the grounds that this fact will have tended to undermine trust (despite the eventual truth of the 'fashionability' claim)? Whatever the correct answer, this type of question is relevant to the welfare and ethical assessment of the economies we actually live in and hence it is <u>not responsible</u> to imprison ourselves within a form of welfare economics inherently incapable of responding to such questions.

(iii) The above reference to fashion may give rise to thoughts about how advertising relates to desires for novelty and/or conformity to social norms; and about whether it can affect aspiration levels, with implications for a 'satisficing' approach to human action. Needless to say, such thoughts may not all find a ready home in the profit maximizing, utility maximizing, comparative statics analysis of Part I above. But that is no reason for declining to entertain such thoughts if they help us to think clearly about a world shot through with uncertainty and with (deliberately created) novelty. (Cf, Witt, 2009, pp.370-371.) The arguments of Part I are intended to inch familiar analyses towards reality, not to create new straightjackets on thought! It would indeed be ironic to associate advertising too strongly with certainty, since there seems to be strong agreement about the uncertainty of the actual effects of advertising. (Recall John Wanamaker's quip, 'I know half my advertising is wasted, I just don't know what half'.)

Is advertising the worst possible source of information about improved or new commodities – except, that is, for all the alternatives, which are even worse? Discuss, using the tools of welfare economics!

(iv) A common complaint about sales promotion relates <u>not</u> to any particular advertisement but, rather, to the pervasive, intrusive 'environment' created by the

collective mass of advertisements of various kinds, an environment which is said to foster a mind-set directed towards a specific – and limited – view of human values, of what matters in life. If the proponents of such a complaint are not merely claiming that 'other people' are thus affected (they themselves being immune), the complaint is perhaps to some extent self-validating. But the questions remain – how do we know? How do we assess the extent of such an effect? How do we evaluate it? Whatever the answers may be, the complaint is relevant to welfare assessments of the market system, yet cannot be faced within welfare economics as we now know it. That is not something we can be proud of.

Concluding remarks

Since resources are in fact employed to make a difference to others' preferences over commodities, basic economic theory, both explanatory and evaluative, should be able to deal with that issue. It has been suggested in Part I that, in some simple forms at least, the matter is tractable with respect to explanatory analysis. (We did not of course claim to go very far in this regard). In Part II, we were less able to be constructive in regard to evaluative analysis but did indicate clearly, we hope, that there are good reasons for saying that a responsible welfare economics, able to give guidance in the assessment of real world economic processes, has not only to step outside the confines of Paretian Welfare Economics but to grapple with inherently more difficult – and perhaps more contentious – ethical questions than welfare economists have recently been in the habit of facing.

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