Galbraith's theories on economic growth bring together two opposing sides: pro ad...

Economics

In any country around the world, one of the main objectives is to achieve economic growth. When it comes to the means of achieving it, some economists found that consumption may be a factor. It is believed that all the money spend on advertising, has its positive returns in form of consumption. It has been said that consumption increasing the GDP, hence economic growth. On the other hand, Galbraith was a Canadian economists that did not believe in advertisement. He believed that advertising should be blamed as it creates artificial need amongst consumers. This later on affects public goods, as consumption is falsely driven to private consumption. This paper explains the two contrasting theories as one supports advertisements, while the other blames it. Then an implication through an empirical study on a country to test both theories and find out which one applies in real life is completed.

Galbraith is an economists that was born in Canada and later studies in America to formulate some of the well-known theories of economics. Galbraith was mostly known for his despise of advertisers and entrepreneurs or businessmen using advertising to affect consumers. He believed that businessmen create artificial needs for consumers by shaping their needs. The problem here lies in the fact that these needs are drawn away from the needed public needs that an economy needs. By creating unnecessary needs, a country’s resources shifts away from the necessary production. In his book “ The Affluent Society”, Galbraith named this theory as the dependence effect. It explains how instead of suppliers produce what the consumers need; the consumers are the dependent factor. The producers shape the needs of consumer as what they wish to produce. These productions, whether them beings goods or services, aim to maximize a business's profit. In the first section of this paper, his theory is explained in detail. However, it was challenged in the empirical analysis as the data showed otherwise. Nations all of the over the world strive to have high levels of economic growth. The interest is mutual, however the methods to achieve this growth varies amongst economists. A perspective that has been known since famous economists like Keynes and Harrod Domar is achieving high levels of GDP by increasing consumption, which leads to economic growth. The second section of this paper applies this theory to prove its effectiveness. The United States' economic indicators relative to our proof of the theories are explained in detail. Major indicators like household consumption and economic growth are compared to test if there is a direct relation. This empirical study relates to consumption theories that are explained in the second part of the literature review. The theoretical part explains how demand, in other words consumption, effects the economy of a country; these effects later on reflect on the GDP and the economic growth.

Literature Review

Galbraith's theory of the dependence effect

Galbraith was a Canadian economist that theorized about consumer wants and is the founder of the dependence effect. The dependence effect states that advertising and producers are to blame for creating the wants that shape the consumer's purchases. Capitalism, according to Galbraith is dominated by huge enterprises and that these companies produce abundant products that satisfy the wants of the consumers shaped by massive advertising and planning. The huge firms are the true sovereign in modern industrial system, who produce services and market goods. Producers choose what is to be produced and the tastes of consumers are modeled accordingly to buy these products. (Brue, 2001)

Lamdin (2008) stated that, orthodox economics assume that initiative lies with consumers who buy goods and services according to their personal demands and desires. Galbraith says that the fact that consumer maximize their utility sheds light on the important question of how these wants are formulated in the first place. Also, if advertisement creates wants, how urgent can these wants be? Moreover, the neoclassical theory of consumer demand implies that markets dictate the optimal alignment of allocation or resources and output. To our economist it makes no sense that production is defended to be a source of satisfying wants as the mere goal of production is to create those wants. His theory has an important policy implication that resources are misallocated from public goods; this is what he called social imbalance. This creation of artificial wants dependent of advertising shift the resources from public goods that have great inherent value, to public goods. For example new automobiles are seen to be of more importance that new roads. Also products like comic books, alcohol, and mouthwashes take greater aggregate importance than schools. A way that this imbalance can be fixed is to impose taxes on the consumer goods and services, and to use these proceeds to increase availability of public sector goods and services.

Galbraith explained how wants create more wants and that people become dependent on production of goods/services to fill a void that has been created by producers. Because of this, the wants cycle never ends as wants are unlimited. Needs, in definition, are things a human requires to function properly like food, water, and so on. On the other hand, wants are often used to fill voids or to give social satisfaction. Hence, wants are more profitable as there is always an opportunity to create more of it and it has a larger price settings according to the demand on it. Marketing wise, the idea ‘ selling a feeling’ is used by business men to set higher prices to a product purchased due to an emotional ‘ need’. However, this is also risky for producers as it is compared to a gambling game. This is because it is not certain how long a product will be desired whether it being a need or a want. Societies are conflicted because as an economy the need for having high standards of living is important. But, advertising and salesmen focus on the idea of creating needs to satisfy them and achieve profits. They play on emotion as wants are purchased with an emotion in mind. (Galbraith, 1958)

According to Lamdin (2008), there is a direct link between wants provided by institutions of salesmanship and advertising and production. These can’t be resigned with the idea of independent determined desires, as the central function of producers is to create needs that previously didn’t exist. This is accomplished in a relation between what is spent on providing goods and services and the money spend in creating the desire for these products. A new product has to be introduced with suitable advertisement campaigns to stimulate an interest in it. The path to expand an output must be backed by an expansion of the advertising budget. The actual manufacturing of the product is not as important as the strategy set by business men for creating a demand for this product. This integration means that we must recognize that wants are dependent on the production. It is up to the producers to create both goods and their desire amongst consumers through advertising and such related activities.

This theory has not been ignored, yet raised conflicts between economists and producers using this tactic. The idea of advertisement has been regarded with unease by economists as they are considered a waste of resources and come in contrast with the concept of production efficiency. This is generally the concept of the dependence effect as explained by Galbraith, where wants and needs depend on the products that producers decide to make available. (Brue, 2001)

Consumption and economic growth

Economists all over the world agreed that economic growth is very important for any country, but the question here lies on how to achieve this growth? One was that has been studied is that consumption can actually be a factor to increase economic growth. Consumption is defined by the money that individuals and households spend in an economy. For an economy, consumer spending is viewed as a major growth engine. One way to know how much of economic growth has been achieved is by measuring the GDP. The GDP’s formula depends on four factors being consumption, investment, government spending, and next exports. Any increase in consumption, positively affects the growth rates of the GDP as it is a vital part of the equation measuring economic growth. (Kim, 2017)

To stimulate this consumption businesses use advertising means. Development of a country means that advertising expenditures rise leading to higher levels of consumption. When a country has a higher GDP it means that the ad spending is higher affecting consumers. It is believed that economic growth has a direct relation with rising advertising expenditure. Per say, aggregate advertising demand is a measure of advertising expenditures as microeconomic theory states when income increases the demand increases. Companies that want to have a share of the growing economic pie, use advertising for attracting new customers and grow demands for the ability to increase their advertisement.

There has been evidence that show that advertising expenditures have a correlation with macroeconomic growth, as well as general economic activity. In times of recessions, advertising expenditures decline as well. McComb formulated a principle PRC (Principle of Relative Constancy) which proclaims that patterns of economic support for the mass communication is almost constantly relative to the general economy.

Advertising spending has varied not only in time, but also in countries. The proportion from GNP spent on advertising initially depends on the social and economic development as well as the economic importance of retail and wholesale trace industries. Industrialization and urbanization cause and increase in advertising levels in their earlier periods. In low developed countries, advertising expenditures are low as they depend on producing and exporting primary goods that do not require much advertisement. (Wurff, Bakker, & Picard, 2008)