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Consumers Can Still Spot Value in a Crisis

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Consumers get no respect -- we value thrift and deplore the spending that supposedly undermines the investment necessary for our long-run prosperity. In fact, the venturesomeness of consumers has nourished unimaginable advances in our standard of living and created invaluable human capital that is often ignored.

Economists regard the innovations that sustain long-run prosperity as a gift to consumers. Stanford University and Hoover Institution economist Paul Romer wrote in the "Concise Encyclopedia of Economics" in 2007: "In 1985, I paid a thousand dollars per million transistors for memory in my computer. In 2005, I paid less than ten dollars per million, and yet I did nothing to deserve or help pay for this windfall."

In fact, Mr. Romer and innumerable consumers of transistor-based products such as personal computers have played a critical, "venturesome" role in generating their windfalls.

Buying something new requires taking risks. Products that work in a lab may not function as well in the real world. Repeated use of a product may reveal flaws that cause malfunctions, increase operating costs, or pose health and safety hazards to the user or the environment.

Technical failures can cost users more than they paid for a product. Software that costs just a few hundred dollars could malfunction and wipe out years of files and correspondence. A defective battery in a laptop can start a fire that burns down a house (this happened to a friend of mine). Defective tires can have fatal consequences.

Consumers also face risks if they buy a product that works well, but fails to attract a critical mass of users. If that happens, vendors often abandon the product and stop providing maintenance, upgrades and spare parts.

Customers also face uncertainty about the value of an innovation in relation to its price. Can anyone who wears glasses quantify the benefit of corrective laser surgery? Can a conventional TV user gauge the value of switching to a higher-definition digital product? Indeed, value can rarely be estimated even after the fact. I have invested in the latest in personal computer hardware and software for decades, but I have no idea of the value of my numerous upgrades

(or even have a good estimate of the time and opportunity costs I have incurred).

Realizing the economic value of most innovations requires consumers to engage in resourceful and time-consuming problem-solving. There are very few products that humans can use immediately. We have to acquire the knowledge, and sometimes the taste, for almost everything we consume. We must learn how to brush our teeth, tie our shoelaces, knot ties, savor espressos, and drive cars.

Differences in how products are used require consumers to do more than just acquire the knowledge of a "standard technique." They have to develop know-how tailored to their own requirements and cannot simply repeat what has worked in the past. Like the developers of new products, users must also act resourcefully with a can-do attitude, imagination, willingness to experiment, and so on.

Alluring features of new personal computers and programs for instance rarely work "out of the box." Consumers spend countless hours getting new gizmos to work, or trying to stop inexplicable crashes. And the toil is far from mechanical. We have to guess what might be wrong, conduct experiments, and ask other consumers how they solved similar problems.

Moreover, figuring out how something is supposed to work is often only half the battle. Users of spreadsheets don't just learn how standard pull-down menus and commands work. They have to develop, or at least modify, their own templates and models.

All told, it could be argued that the risks and resourceful efforts of 100 million plus U.S. computer users far exceed those of the employees of hardware and software companies. Consumers certainly have, as Mr. Romer points out, secured the lion's share of the benefits, but it hasn't been a gift, it's been a joint effort.

The collective confidence and know-how of computer users represents an enormous asset that will help sustain national prosperity for decades to come -- even if the time and effort put into its accumulation never show up as "savings."

Of course, all consumption isn't equally venturesome or helpful to long-run growth. Consuming unhealthy food or buying unaffordable houses doesn't involve uncertainty. It is a predictably bad deal and does not require resourceful problem-solving. Nor does it contribute to our stock of productive know-how. In excess, such consumption diverts resources from productive investment. Even in a knowledge economy we need to put aside real money for tangible brick-and-mortar investments, and not just rely on the human capital accumulated through venturesome consumption.

Thanks to a lax monetary policy, a jump in China's capacity to produce without an increase in its capacity to consume, and a financial system that lent to borrowers who had no capacity to repay, recent years have witnessed an unsustainable surge in all kinds of consumption -- venturesome as well as dumb. Inevitably, in the face of the financial crisis, consumers are now pulling back and defying the efforts of lawmakers and the Federal Reserve to get them spending

again.

The good news is that the cutbacks are likely to be more severe in the less productive kind of consumption. History suggests that Americans don't shirk from venturesome consumption in hard times. The personal computer took off in the dark days of the early 1980s. I paid more than a fourth of my annual income to buy an IBM XT then -- as did millions of others. Similarly, in spite of the Great Depression, the rapid increase in the use of new technologies made the 1930s a period of exceptional productivity growth. Today, sales of Apple's iPhone continue to expand at double-digit rates. Low-income groups (in the \$25,000 to \$49,999 income segment) are showing the most rapid growth, with resourceful buyers using the latest models as their primary device for accessing the Internet.

Recessions will come and go, but unless we completely mess things up, we can count on our venturesome consumers to keep prosperity on its long, upward arc.

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