

**BOOK EXCERPT by Robert Frank
Illustrations by Jim Tsinganos**

Luxury Fever

Why Money Fails to Satisfy in an Era of Success

Spending more and enjoying it less?

The ironic joys of consumerism have long been fodder for bumper-sticker philosophers – as in "He who dies with the most toys wins." But serious economists seem stuck with the idea that more stuff makes people happier.

Correction: most serious economists.

Bob Frank of Cornell University earned his spurs as the thinking man's liberal, first as an architect of airline deregulation in the 1970's and later as an investigator of the no-man's land between psychology and economics. His 1995 book, *The Winner-Take-All Society* (written with Philip Cook of Duke), illuminated a trend toward income inequality in professions ranging from law to basketball.

Now, in the tradition of Thorstein Veblen, Frank is challenging the logic of the consumerist rat race. Consumption, he argues, generates external costs to society the way industry production generates environmental pollution. And the solution is to "internalize" these costs with radical tax reform.

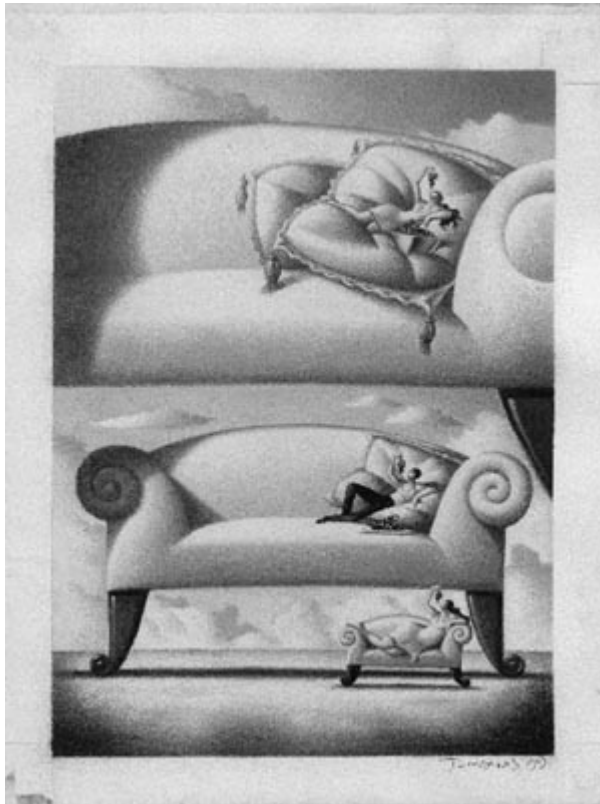
Sound like a stretch? Read this excerpt from *Luxury Fever* (© Free Press, 1999), and decide for yourself.

The propane grill I bought during the 1980's has been on a downhill slide for several years. First to go was its ignition button, the crude mechanical spark generator that normally fires up the gas. Lighting the grill is now a delicate operation. I turn on the gas, wait a few seconds and then throw a match inside. Throw it in too soon, and it goes out before it reaches the burner below. Wait too long, however, and it sets off a small explosion. A second problem is that the metal baffle atop the burners has rusted through in the middle. This concentrates an enormous amount of heat over a small area near the center of the cooking surface, but very little elsewhere. I am still able to cook reasonably good chicken and small steaks if I quickly rotate pieces in and out of the hot zone. But grilling a big fish fillet has become impossible.

My grill's various deficiencies could surely be repaired, but I have no idea by whom. And even if I did, the cost would almost surely exceed the \$89.95 I originally paid for it. And so, reluctantly, I find myself in the market for a new one.

If you have searched this market yourself recently, you know that the menu of available choices is profoundly different from what it was 10 years ago. I vaguely remember models available then with built-in storage cabinets and shelf extensions on either side. But even with these embellishments, the most you could spend was a few hundred dollars. There was nothing – absolutely nothing – like today's Viking-Frontgate Professional Grill.

Powered by either natural gas or propane, it comes with an infrared rotisserie that can slowly broil two 20-pound turkeys to perfection while you cook hamburgers for 40 guests on its 828-square-inch grilling surface. It has a built-in smoker system that "utilizes its own 5,000-B.T.U. burner and watertight wood chip drawer to season food with rich woodsy flavor." Next to its grilling surface sit two ancillary range-top burners. Unlike the standard burners on your kitchen stove, which generate 7,500 B.T.U.'s, these burners generate 15,000 B.T.U.'s, a capability that is useful primarily for the flash-stir-frying of some ethnic cuisines and for bringing large cauldrons of water more quickly to a boil. If you have ever longed to throw together a Szechwan pork dish on your backyard patio or feared getting off to a late start when you have guests about to arrive and 40 ears of corn left to cook, the Viking-Frontgate has the extra power you may need. The entire unit is constructed of gleaming stainless steel with enamel and brass accents, and with its fold-out workspaces fully extended,



it measures more than seven feet across.

The catalogue price of the Viking-Frontgate Professional Grill, not including shipping and handling, is \$5,000. If that's more than you want to pay, many cheaper models are available. For instance, the all-stainless Weber-Stephens Summit Grill, which the company touts in four-page spreads in *Forbes* and *Vanity Fair* and which has almost as many bells and whistles as the Viking-Frontgate, sells for only \$3,000. And for shoppers who feel they can get by with an 18 by 24 inch grilling surface and only one ancillary range-top burner, Frontgate offers a model for \$1,140 that delivers "professional results at a great value."

Even Frontgate's stripped-down model, however, sells for considerably more than most of us would have dreamed possible a mere decade ago. And indeed, most of the 12 million charcoal and gas grills sold annually in the United States still cost less than \$700, a category that will surely include my own next grill as well. Yet grills costing more than \$2,000 are by no means rare in the current market. On the contrary, they have become by far the fastest-growing sector in the \$1.2 billion-a-year industry.

The evolution of spending patterns in the gas-grill industry is part of a much broader change that has been occurring in recent decades. Popular impressions of what has been happening may be misleading since only the most spectacular examples tend to capture media attention. In one typical recent piece, for instance, *The New York Times* interviewed Alan Wilzig, 32, a Jersey City banker, about the lavish, medieval-style castle he and his brother had just built in the Hamptons.

Q: This place cost you nearly \$10 million to build. Why build something so opulent?

A: To build. It's like having the biggest erector set in the world. It takes about the same amount of effort to buy a \$200 million bank as it does to buy a \$20 billion bank. Same with a house. You might as well buy the biggest one that you can handle responsibly. We built 14,000 square feet in 14 months. What would have been different if we had built an 8,000-square-foot house with half as many fun things to do?

Q: You have an underwater sound system in your swimming pool, indoor and outdoor hot tubs, a tennis court, 80 gilt mirrors and six suits of armor. If you could add one toy or feature to the castle, what would it be?

A: [pauses] Nothing. If we would have thought of it, we would have built it.

The spending habits of people like the Wilzigs, so remote from what most of us experience, may seem to have little relevance for our own lives. And indeed, the spending of the superrich, though sharply higher than in decades past, still constitutes just a small fraction of total spending. Yet their purchases are far more significant than might appear, for they have been the leading edge of pervasive changes in the spending patterns of middle- and even low-income families. The runaway spending at the top has been a virus, one that has

spawned a luxury fever that, to one degree or another, has all of us in its grip.

Thus, although it is the mansions of the superrich that make the news, the far more newsworthy fact is that the average house built in the United States today is nearly twice as large as its counterpart from the 1950's. And although it is the \$250,000 sticker price of the 12-cylinder Lamborghini Diablo that prompts the finger-wagging of social critics, the more telling observation is that the average price of an automobile sold in the United States now exceeds \$22,000, up more than 75 percent from just a decade earlier.

No matter where you stand on the income scale, no matter how little you feel you are influenced by what others do, you cannot have escaped the effects of recent changes in the spending environment. Among other things, they affect the kinds of gifts you must give at weddings and birthdays, the amounts you must spend for anniversary dinners, the price you must pay for a house in a neighborhood with a good school, the size your vehicle must be if you want your family to be relatively safe from injury, the kinds of sneakers your children will demand, the universities they'll need to attend if you want them to face good prospects after graduation, the kinds of wine you'll want to serve to mark special occasions and the kind of suit you'll choose to wear to a job interview.

At one level, the recent upgrades in what we buy might seem a benign symptom of the fact that we are more productive, and hence richer, than ever before. Our cars are not only faster and more luxuriously appointed, but also safer and more reliable. And although social critics may lampoon the frills of modern appliances, which of these critics would trade their current appliances for the ones they owned 20 years ago? Although we seem to concede that money does not always buy happiness, most of us remain steadfast in our belief that having more of it would be a good thing.

But there is also a dark side to our current spending patterns. Whereas those at the top of the economic totem pole have done spectacularly well, the median American family has gained virtually no ground at all during the past two decades, and those in the bottom fifth have actually suffered earnings losses of more than 10 percent in real terms. Similar changes have occurred in Britain, and this pattern has begun spreading. With static or declining incomes, middle- and low-income families have thus had to finance their higher spending through lower savings and sharply rising debt. In the process, our personal savings rate has fallen steadily and is now significantly lower than that of any other major industrial nation. Personal bankruptcy filings are at an all-time high.

Even among those who can easily afford today's luxury offerings, there has been a price to pay. All of us – rich and poor alike, but especially the rich – are spending more time at the office and taking shorter vacations; we are spending less time with our families and friends; and we have less time for sleep, exercise, travel, reading and other activities that help maintain body and soul. Because of the decline in our savings rate, our economic growth rate has slowed, and a rising number of families feel apprehensive about their ability to maintain their living standards during retirement. At a time when our spending on luxury goods is growing four times as fast as overall spending, our highways, bridges, water supply systems and other parts of our public infrastructure are deteriorating, placing lives in danger. Our parks and streets are becoming dirtier and more congested. Poverty and drug abuse are on the rise, and violent crime,

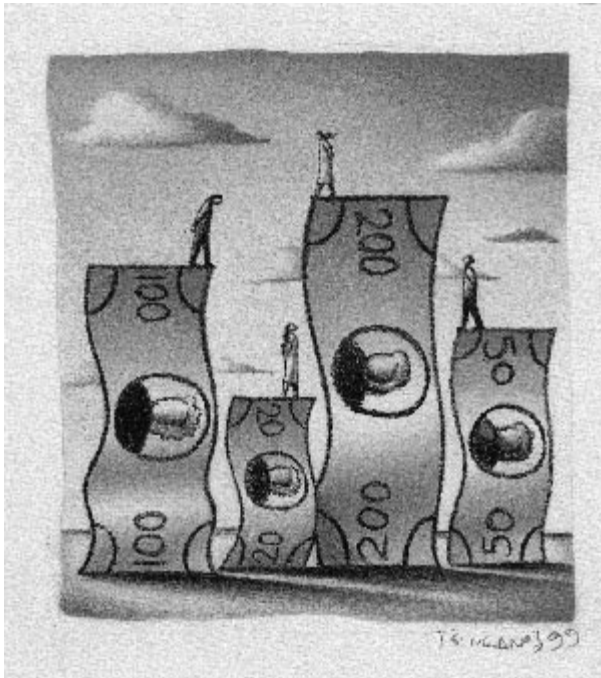
though down from its recent historical peaks in some cities, continues at high levels. A growing percentage of middle- and upper-income families seek refuge behind the walls of gated residential communities.

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We have long grown accustomed to hearing social critics carp about how much better society as a whole would be if we could manage to spend our money a little differently. And indeed, common sense seems to confirm that at least some of the spending by the superrich could be put to better uses. The barstools aboard the late Aristotle Onassis's yacht, the Christina, were covered with the buttery soft – and jarringly expensive – foreskin of the sperm whale penis. The vessel's faucets were of solid gold and at the flip of a switch its swimming pool could be covered by a retractable, mosaic-tiled dance floor.

The Christina was just one salvo in Onassis's costly battle to outdo his rival shipping magnate, Stavros Niarchos, whose own yacht, the 375-foot Atlantis, was designed by an architect whose explicit instructions were to make it 50 feet longer than the Onassis vessel. Can anyone doubt that it would have been better to build each boat a little smaller and use the money thus saved to provide school lunches for hungry children?

Yet only the lunatic fringe would empower our government to confiscate money from anyone bureaucrats may feel is spending it unwisely. As conservatives are correct to remind us, the very incentives that led people like Onassis and Niarchos to accumulate such vast wealth have also resulted in millions of new jobs and dramatically improved levels of overall prosperity. If our high and rising living standard rests on the continued willingness of the rich to work hard and take risks, what does it really matter if they sometimes spend their money in frivolous ways?



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our stocks of material goods produce virtually no measurable gains in our well-being. Bigger houses and faster cars, it seems, don't make us any happier. But other studies identify a variety of categories in which extra spending would promote longer, healthier and happier lives for all. For example, we could expect such improvements if we spent more to alleviate traffic congestion or spent more time with our families and friends or provided cleaner air and drinking water for our cities.

The more novel and provocative element of my claim is that we can actually achieve such changes without having to compromise other important values. We will not need to empower bureaucratic commissions to make judgments about which specific forms of consumption are wasteful. Nor will we need to engage in painful acts of self-denial. Nor will we need to risk crippling the incentives that lead talented and industrious people to create new wealth. Rather, I will suggest a simple revision of our existing spending incentives that will make it possible for each of us to pursue our respective vision of the good life more fully and effectively, no matter what (within reason) those visions might be.

On its face, this may seem a preposterous claim. If better living conditions were so easily achieved, why haven't we already achieved them? If we would be happier working shorter hours and spending more time with our families, even though that would mean living in smaller houses and buying less expensive cars, why don't we just do it?

Over the past several years, the so-called voluntary simplicity movement has spawned dozens of popular self-help books that urge us to scale back, telling us we will be happier if we adopt simpler, less harried lifestyles. The brisk sales of these books suggest that their authors have struck a resonant chord. Their upbeat message is that more comfortable, stress-free living patterns are ours for the taking. All we need do is control our appetites.

Skeptics can be forgiven, however, if they find this a naïvely optimistic view. If we would really be happier with simpler lifestyles, it seems a safe bet that we wouldn't need self-help manuals to discover this. It would have been part of our shared cultural wisdom all along.

The fact that we are working more hours and buying more goods than ever before has led champions of the status quo to conclude that our current spending patterns, for all their apparent shortcomings, must reveal what we truly value most. Sure, it would be nice to have both bigger houses and more time for our families; but when forced to choose, we seem to opt overwhelmingly for the former. This is a powerful rejoinder, and social reformers are destined to continue losing their debates with defenders of the status quo until they can come up with a persuasive response to it.

Yet the plain truth, as even the most ardent free-marketeers have known all along, is that the choices of rational, well-informed people do not always add up to a whole that meets their approval. One of the clearest examples involves activities that pollute. The fact that millions of motorists voluntarily drive to work in Los Angeles does not mean that they approve of the resulting smog that enshrouds their city. On the contrary, smog tends to be excessive in many cities because any individual who endured the inconvenience of car pooling or riding the bus would end up breathing essentially the same dirty air as if he drove.

Making these sacrifices might be worth it if everyone else also made them, for then we would get significantly cleaner air. But individuals can control only their own choices, not the choices of others.

The incentives we confront as individual consumers are often problematic in precisely analogous ways. As a 17-year-old Detroit high-school senior, Terrell Garner saved his earnings from a part-time job for several months to be able to buy an \$875 pair of alligator shoes to wear to his senior prom. Many social critics would object that he did so because he was duped by sophisticated marketing tactics. Yet so brisk is the demand for these shoes that the Detroit retailers who sell them see no reason to bother advertising. Garner's choice is more plausibly understood if we assume that he perceived correctly that these shoes would create just the impact he wanted: "Once I stepped in the door [at the prom], it was like 'Pow!'" he said, describing the "shoes' mythical, almost explosive appeal."

This appeal would not exist except for the fact that his shoes stood out relative to the shoes worn by others. Garner had no reason to feel concerned that the combined effect of his and others' purchase decisions made it considerably more expensive for someone to stand out from the crowd. But as he moves on to higher paying jobs, he will discover that the cost of achieving similar impact from a new pair of shoes will rise accordingly. A Detroit attorney, Thomas Marshall, for example, now owns 10 pairs of alligator shoes, including a pair that cost him \$3,000; and Cecil Fielder, the baseball player, reportedly owns several hundred pairs in 26 different colors.

The irony is that if, within each social group, everyone were to spend a little less on shoes, the people who stand out from the crowd now would continue to do so. And because that outcome would free resources to spend in other ways, people would have good reasons to prefer it. Each individual, however, can choose only the amount that he spends on shoes, not the amounts spent by others. Similarly, Onassis and Niarchos might not have minded if both their yachts had been a little shorter; but each could choose only his own yacht's length, not the other's.

Adam Smith's celebrated invisible hand – the claim that society as a whole does best when individuals pursue their own interests in the open marketplace – rests on the assumption that each person's choices have no negative consequences for others. Yet even the most ordinary spending choices frequently do have negative consequences for others, just as the presence of a preschooler with the chicken-pox has negative consequences for others. If I buy a 6,000-pound sport utility vehicle, I increase the likelihood of others dying in a traffic accident; and in the process, I create an incentive for them to buy heavier vehicles than they otherwise would have chosen. If I buy a custom-tailored suit for my job interview, I reduce the likelihood that others will land the same job; and in the process, I create an incentive for them to spend more than they had planned on their own interview suits. When I stay an extra hour at the office each day, I increase my chances for promotion; but in the process, I reduce the promotion prospects of others and thereby create an incentive for them to work longer hours than they otherwise would have chosen. In situations like these, individual spending decisions are the seeds of a contagious process.

Situations like these are by no means exceptional. H.L. Mencken once defined a

wealthy man as one who earns \$100 a year more than his wife's sister's husband, and considerable evidence confirms the wisdom of his observation. People who earn \$40,000 a year may be happy or sad, but they are far more likely to be satisfied with their material standard of living if their associates earn \$35,000 rather than \$60,000.

As a young man fresh out of college, I served as a Peace Corps volunteer in rural Nepal. My one-room house had no electricity, no heat, no indoor toilet, no running water. The local diet offered little variety and virtually no meat. Yet, although my living conditions in Nepal were a bit startling at first, the most salient feature of my experience was how quickly they came to seem normal. Within a matter of weeks, I lost all sense of impoverishment. Indeed, my \$40 monthly stipend was more than most others had in my village, and with it I experienced a feeling of prosperity that I have recaptured only in recent years.

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But even though I felt completely satisfied with my living conditions there, I would experience a crushing sense of poverty if I were to live in the United States or any other prosperous country under those same

conditions. Not a day would pass in which I would not be keenly aware of the extent to which my circumstances fell short of community standards. Things I did not feel I needed in Nepal I would feel I needed here.

The poor are not the only ones who experience pressure to spend more when community consumption standards rise. It is natural for people at all income levels to experience new desires in the presence of others who spend more than they do. And even apart from any changes in what we consciously desire, our individual spending decisions are often influenced by the fact that our menu of available choices is so strongly shaped by what others spend.

The real significance of offerings like the \$5,000 Viking-Frontgate Professional Grill is that their presence makes buying a \$1,000 unit seem almost frugal. As more people buy these up-market grills, the frame of reference that defines what the rest of us consider an acceptable outdoor grill will inevitably continue to shift. I could easily spend \$1,000 on a new grill tomorrow, and few people would notice that I had done anything strange. More troubling still is the possibility that, with ready opportunities to spend five times that amount and more, I might fail to notice anything strange about spending \$1,000 to replace my \$90 gas grill.

In short, both the things we feel we need and the things available for us to buy depend largely – beyond some point, almost entirely – on the things that others choose to buy. When people at the top spend more, others just below them will inevitably spend more also, and so on all the way down the economic ladder. As this happens, simpler versions of products that once served perfectly well often fall by the wayside.

This diagnosis of why our current spending patterns are problematic suggests the possibility, at least in principle, of reducing the speed of the consumption

treadmill, thereby freeing resources that can be put to various uses that would make more of a difference in our lives. My case for change rests not at all on the social critic's claim that luxury consumption is self-indulgent or decadent, but rather on detailed and persuasive scientific evidence that if we adopt a simple change in the incentives we face, all of us can expect to live longer, healthier and more satisfying lives.

Yet it would be a mistake not to acknowledge that the case for changing our current consumption patterns entails a moral dimension as well. In our rush to balance federal, state and local government budgets, we have slashed funding not only for bridge and highway maintenance but also for hospitals that serve the poor, the Head Start program, the school lunch program, drug rehabilitation programs, homeless shelters and a host of other low-overhead programs that make life more bearable for our neediest citizens. These programs are being cut not because they do not work, not because they destroy incentives, but because we say we cannot afford them.

The average taxpayer's annual contribution to Head Start and other programs for needy citizens is small – far less than many upper-middle-class couples spend on wine for a single dinner party. As by far the richest country in human history, we should be doing more, not less, to provide better opportunities for others less fortunate. And as we shall see, the only cost required to take these steps is a small and temporary across-the-board reduction in the rate of growth of material goods consumption by middle- and upper-income families. In the face of this truly negligible cost, our current policies become all the more difficult to defend.

Again, however, my aim is not to scold but to describe a striking new set of possibilities. In the fact that our current consumption patterns entail a substantial measure of waste lies the seeds of a golden opportunity. By a simple and easily achieved rearrangement of our current consumption incentives, we can effectively enrich ourselves by literally trillions of dollars a year. Seldom in our history have moral imperatives and naked self-interest been so closely aligned.

DOES MONEY BUY HAPPINESS?

Many regard it as self-evident that we would have done better to have spent our money differently. Yet the mere fact that there are useful things we could have bought does not, by itself, imply that we have chosen poorly. An alternative interpretation – one strongly favored by defenders of the status quo – is that the pleasures of additional material goods are more than enough to compensate for the sacrifices the goods make necessary in other areas. Life is full of trade-offs, these defenders say, and the people whose own money is at stake are in the best possible position to resolve them.

If the defenders of the status quo are correct, we should expect to find some indications that further accumulations of material goods continue to provide significant increments in satisfaction, even after countries achieve levels of affluence like those currently enjoyed in the United States. But the scientific literature provides no support for this position. Once a threshold level of affluence is reached, the average level of human well-being in a country is almost completely independent of its stock of material goods.

The sources of human satisfaction have been a subject of discussion and debate through the ages. Does happiness spring from wealth and power, romantic love and steadily improving golf scores? Or do the sources of true and lasting happiness lie, as many insist, beyond the self in helping others or in religious devotion?



Philosophers have even questioned whether happiness, in and of itself, is an important human goal. Robert Nozick asks us to imagine an opportunity to hook up to an "experience machine" capable of simulating any experience we might desire. This machine could "make you think and feel that you were writing a great novel, making a friend or reading an interesting book. All the time you would be floating in a tank, with electrodes attached to your brain." You could choose from a huge library of the experiences that have been found satisfying by people from all walks of life. You would even be free to program in intervals during which the machine would shut down, allowing you to reconsider and adjust your mix of experiences.

While the machine is in action, however, the experiences it delivers will constitute perfect virtual reality. Subjectively, you will experience them exactly as if they were actually happening. Given this opportunity, Nozick's question is, should you plug in?

He concedes the powerful attractions of doing so. Yet no matter how pleasurable the experiences you might imagine, he argues, there are even more compelling reasons for refusing the offer: "We want to be a certain way, to be a certain sort of person." Someone floating in a tank is an indeterminate blob. There is no answer to the question of what a person is like who has long been in the tank. Is he courageous, kind, intelligent, witty, loving? It's not merely that it's difficult to tell; there's no way he is. Plugging into the machine is "a kind of suicide."

Nozick's vivid thought experiment drives home the point that feeling happy is hardly the only important goal in life. Given the multitude of competing conceptions of the good life, perhaps the most we can hope for in our social institutions is that they grant the widest possible latitude to forge lives that suit us.

How are we to evaluate the extent to which an economy succeeds at this task? In the context of modern democracies in which fundamental political liberties have been assured, the approach most often taken by economists is simply to measure the aggregate value of the economy's goods and services. The presumption is that the economy that serves up the largest per-capita national income is the one that best serves the interests of its citizens.

Critics lambaste national income as a measure of human welfare, noting that it ignores the value of work performed within the family. For instance, if a man

marries his accountant, national income goes down even though the amount of accounting services she performs remains the same. Critics also complain that national income rises when sophisticated advertising campaigns manipulate us to buy goods and services we don't really need.

Does that mean we would be better off if we entrusted government with the decision of what goods to produce? The unhappy experience of collectively managed economies provides little support for that alternative.

If happiness could actually be measured, most economists would predict that people in rich countries would be happier, on the average, than people in poor countries and that, in an environment in which incomes are rising over time, people should be happier today, on the average, than they were in earlier times.

Unlike economists, psychologists and other behavioral scientists have few preconceptions about the extent to which free-market transactions promote human satisfaction. Whereas economists simply assume that money buys satisfaction (because having more of it broadens one's options), psychologists try to measure individual differences in satisfaction and then investigate how these differences are related to differences in income and other factors.

If other things are equal, people who experience a greater balance of positive emotions over negative emotions will tend to experience higher levels of subjective well-being. Yet the relationship between the balance of emotions that

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someone experiences and her overall level of subjective well-being is by no means simple.

Although it might seem natural to think that a person must be either in a good mood or in a bad mood at any moment in time, in fact it is possible for people to experience both strong positive and strong negative emotions simultaneously. Indeed, neuroscientists now recognize that positive and negative feelings are governed by two largely independent sets of neural circuitry and that emotions in the two classes are not strongly correlated with one another.

The stereotypically happy person is someone who experiences frequent and intense levels of positive affect and infrequent and mild levels of negative affect. By contrast, the stereotypically unhappy person is someone for whom frequent and intense levels of negative affect are coupled with infrequent and mild levels of positive affect. People who experience high levels of both positive and negative affect are often described as volatile or highly emotional, while those with low levels on both scales are called phlegmatic.

Psychologists measure life satisfaction in various ways. By far the most popular approach has been simply to ask people how happy or satisfied they are. For example, people may be asked to respond, on a numerical scale, to a question like, "All things considered, how satisfied are you with your life as a whole these days?" Or, "Thinking of your life as a whole, would you consider yourself (a) very happy; (b) fairly happy; or (c) not happy."

More recently, neuroscientists have also used brain-wave data to assess positive

and negative affect. Subjects with relatively greater electrical activity in the left prefrontal region of the brain are likely to indicate strong agreement with statements like the previous ones, while those with relatively greater electrical activity in the right prefrontal region are much more likely to disagree with these statements. The left prefrontal region of the brain is rich in receptors for the neurotransmitter dopamine, higher concentrations of which have been independently shown to be correlated with positive affect.

Observed consistency is, if anything, even more powerful for the brain-wave measures. In a sample consisting mostly of American college students, the neuropsychologist Richard Davidson found that people who registered high positive affect on one occasion (as measured by a high level of electrical activity in the left prefrontal regions of their brains) tended to register similarly high levels one month later. Davidson observed similar stability among subjects showing high levels of negative affect. (Davidson notes with interest that, on both occasions, the brain waves of one particular individual in his sample, a Tibetan monk who was in the United States for a brief visit registered dramatically higher positive affect levels than any other subject.)

Ratings derived from interviews with mental-health professionals are highly correlated with self-reported subjective well-being. People who describe themselves as happy are able to recall more positive events from recent experience, and fewer negative events. And the various measures of subjective well-being also respond to good and bad life experiences, and to therapy, in the expected ways. Someone who has experienced the recent death of a loved one, for example, is likely to exhibit sharply reduced subjective well-being, irrespective of the measure chosen.

In short, it seems that what the psychologists call subjective well-being is a real phenomenon. The various empirical measures of it have high consistency, reliability and validity.

Turn now to an assessment of the relationship between subjective well-being and income. Throughout the industrialized world, average incomes have been growing sharply for the past several hundred years, and the amount and quality of the goods and services we consume have increased accordingly. Are we significantly happier on that account?

One of the central findings in the large scientific literature on subjective well-being is that once income levels surpass a minimal absolute threshold, average satisfaction levels within a given country tend to be highly stable over time, even in the face of significant economic growth. For example, although per capita income was 39 percent higher in real terms in 1991 than in 1972 in the United States, the proportion of people who considered themselves very happy actually declined slightly over the period.

Of course, other factors affect satisfaction levels besides income and the material goods it commands. Perhaps a large income effect on happiness during the period shown was offset by some other negative effects. Yet average satisfaction levels are also found to be unresponsive to changes in average income levels in other countries and during other time periods.

The average satisfaction level reported by survey respondents in Japan remained

essentially unchanged between 1958 and 1986, a particularly striking finding in view of the fact that per-capita income rose more than five-fold during that period. In automobile and appliance ownership, Japan in the late 1950's was essentially no different from many developing countries today.

Yet the data do not allow us to conclude that people are equally satisfied no matter how poor they might be. On the contrary, most careful studies find a clear relationship over time between subjective well-being and absolute income at extremely low levels of absolute income. Thus, in a country in which most people lack minimally adequate shelter and nutrition, across-the-board increases in income appear, not surprisingly, to yield significant and lasting improvements in subjective well-being. In the same vein, average satisfaction levels are significantly lower in extremely poor countries than in rich ones.

Our concern here is with how differences in consumption affect citizens' well-being in countries that have already achieved a measure of affluence. And for such countries, average satisfaction levels are not significantly correlated over time with income.

EXCELLENT, RELATIVELY SPEAKING

If in fact we could all live better lives by simply changing our spending patterns, why haven't we done that? Many people are aware that we might be better off if all saved more and all spent less on houses and cars. But that choice is simply not an item on any individual's menu. A family can choose the amount it spends on its own house, but it cannot choose the amounts that others spend.

In this observation lies a key to understanding why the things we buy are so often not the things that best promote our own interests. The orthodox models that underlie Adam Smith's invisible hand take the primary economic determinant of a person's sense of well-being to be his absolute standard of living. But as virtually everyone has long been aware, it is relative living standards that often prove more important. And as we shall see, when satisfaction depends on relative living standards, all bets regarding the efficacy of the invisible hand are off.

Having been raised as an only child, I have always observed the sibling rivalries among my own children with great interest. On returning from a friend's house, my 8-year-old son immediately asks "Where's Chris?" if his 11-year-old brother is nowhere in sight. When Chris is at his violin lesson or at the orthodontist's office, we have no problem. But let him be at a movie, and the next thing we'll hear is Hayden's angry shout of "That's not fair!" – the inevitable prelude to an anguished outburst about the injustice of life.

As children grow older, their complaints become more muted, but their concerns about unequal outcomes never truly disappear. And even if we could, would we really want to stifle these concerns completely? Despite all the pain and suffering that spring from unequal outcomes, real or imagined, it is hard to see how someone stripped of these concerns could function effectively in the world as we know it. A child who didn't care how her own serving of ice cream compared with her brother's would be unlikely to achieve the station in life that her talents and abilities might otherwise command.

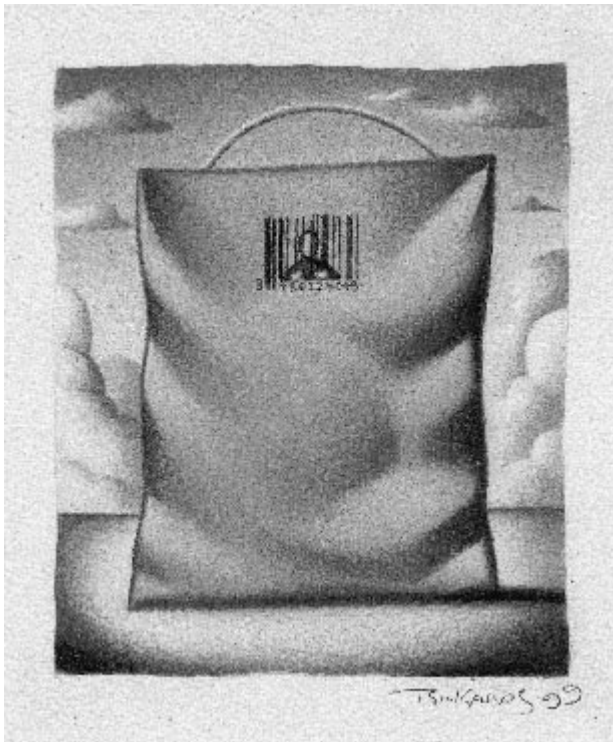
Study after careful study shows that, beyond some point, the average happiness level within a country is almost completely unaffected by increases in its average income level. Thus, average satisfaction levels register virtually no change even when average incomes grow manyfold.

But both in what we say and what we do, we give every indication that our incomes are a matter of enormous concern. When psychologists ask what change in our circumstances would most improve the quality of our lives, our most frequent response is "more money." And indeed, if this were not so, why would first-year associates work 80-hour weeks in New York law companies? Why would oilfield firemen risk their lives and health? Why would the Tobacco Institute's expert witnesses humiliate themselves by making preposterous claims on the witness stand? The short answer seems to be that getting more money does make people happier, if by getting more money we mean moving forward in relative terms.

When psychologists examine how subjective well-being varies with income within a country at a moment in time, the consistent finding is that richer people are, on the average, more satisfied with their lives than their poorer contemporaries. Note the striking contrast between this relationship and the evidence that average satisfaction levels remain constant as average per capita incomes rose manyfold over time within a country.

Measures of subjective well-being are not the only evidence that people care strongly about relative income. David Neumark and Andrew Postlewaite investigate how individual labor supply decisions depend on the incomes of important reference group members. The idea is that if someone cares strongly about how her income compares with the incomes of others, an increase in others' incomes will cause her to become more likely to seek employment or more likely to work longer hours if she is already employed. Unfortunately,

researchers seldom have reliable data about the individuals whom people care most about.



Neumark and Postlewaite cleverly finesse this problem by asking whether a woman's decision about work outside the home depends on her sister's economic circumstances. According to economic orthodoxy, it would not. But the researchers find that women are 16 to 25 percent more likely to work if their sisters' husbands earn more than their own husbands.

Additional evidence for the strength of concerns about relative position comes from an elegant experiment known as the "ultimatum bargaining game." The game is played by two

players, Proposer and Responder. It begins with Proposer being given a sum of money (say, \$100) that he must then propose how to divide between himself and Responder. Responder then has two options: (1) he can accept, whereupon each party gets the amount proposed; or (2) he can refuse, whereupon each party gets zero, and the \$100 goes back to the experimenter.

If both players cared only about their own absolute incomes, as assumed by economic orthodoxy, Proposer should propose \$99 for himself and \$1 for Responder (only whole-dollar amounts are allowed). And Responder should then accept this one-sided offer because getting \$1 is better than getting nothing.

Yet this almost never happens. In one typical study in which the amount to be divided was \$10, the average amount offered by Proposer was \$4.71, and in more than 80 percent of all cases Proposer offered exactly \$5. When Responders in this same study were asked to report the minimum amounts they would accept, their average response was \$2.59. Most people seem predisposed to reject offers whose terms they find "unfair."

As in the laboratory, so in life. Concerns about relative position appear to account for a longstanding anomaly in the distribution of pay among workers within companies. According to economic orthodoxy, workers will be paid in strict accordance with the value of what they produce. The wage structure within most companies, however, seems far more egalitarian. Many companies follow strict salary formulas based on experience, education and length of tenure within the company, despite large and visible differences in the productivity of workers.

Here is a simple thought experiment. Among your co-workers of roughly similar rank, job title and seniority, try to envision the two most productive individuals and also the three who are least productive. Now suppose that either the top two or the bottom three were to disappear suddenly. Which group's absence would most reduce the total value of what gets produced in your group? Most people answer without hesitation that the disappearance of the top two would hurt most. On the basis of this answer, economic orthodoxy would predict that the combined salaries of the top two individuals would be greater than the combined salaries of the bottom three. Yet in most groups the reverse is true.

The apparent anomaly can be explained if we assume that, other factors being the same, workers prefer to work in companies in which they do not earn less than most of their co-workers. But if people are free to associate with whomever they please, why don't the lesser-ranked members of groups leave to form new groups in which they would no longer be near the bottom?

Some workers undoubtedly do precisely that. And yet we also observe many stable heterogeneous groups. What holds them together?

The apparent answer is that their low-ranked members receive extra compensation. If they were to leave, they would gain by no longer having to endure low status. By the same token, however, the top-ranked members would lose. They would no longer enjoy high status. If their gains from having high relative pay are larger than the costs borne by members with low relative pay, it does not make sense for the group to disband. Everyone can do better if the top-ranked workers induce their lesser-ranked colleagues to remain by sharing some of their pay with them. For the privilege of occupying top-ranked positions

in those companies, they will have to work for less than the value of what they produce.

Even simple laboratory manipulations of relative position can have profound implications for market exchange. In one experiment, for example, researchers awarded half of their subjects stars on the basis of their performance on a transparently meaningless quiz. After these awards, subjects were given objects of known value and allowed to exchange these objects with one another for cash. The subjects who received stars consistently received better terms – that is, they bought at lower prices and sold at higher prices – when they exchanged goods with subjects who did not receive stars.

Preventing unequal outcomes to assuage concerns about relative position is a recipe for economic failure.

Further evidence that interpersonal comparisons are important comes from studies of markets for collectibles. In purely functional terms, a coin with a slight flaw is a perfect substitute for one that comes from the mint in perfect condition. As the market for rare coins attests, however, perfect substitutes are not

always valued equally. The prices of flawed coins are often millions of times higher than those for otherwise identical coins that were minted in large quantities.

This finding is not merely the same as having documented the orthodox relationship in which the price people are willing to pay for a good is inversely related to the quantity they consume. If rarity per se truly didn't matter, the observed premium for flawed coins would be akin to finding that color-blind people are willing to pay much more for red toasters than for green ones.

Whatever positive consequences may flow from our concerns about relative position, it is clear that they are also the source of a great deal of misery. Some societies have attempted to avoid the unhappiness that results from unequal outcomes by trying to prevent unequal outcomes. Hence the Marxian distributional maxim: From each according to his ability, to each according to his need. Yet, as the collapse of the economies of the former Soviet Union has shown, preventing unequal outcomes to assuage concerns about relative position is a sure recipe for economic failure.

The explosive progress of the industrial economies of the West has been in no small measure the result of a generally shared cultural understanding that concerns about relative standing are not legitimate. This is not to say that people in the capitalist economies never experience a twinge of envy or resentment when an acquaintance succeeds on a spectacular scale. It is just that such feelings have never been seen as a legitimate basis for restricting the options of others.

Setting aside the question of whether it was ever sensible to stifle innovation in the name of equality, most observers recognize that this is no longer feasible. In the increasingly competitive global economy, those who are not rewarded will not take the necessary steps to innovate and those who fail to innovate will not survive. What is not generally recognized, however, is that the other extreme – complete intolerance of concerns about relative position – has itself proved a costly error, and not just in social terms, but in economic terms as well.

LUXURY WITHOUT APOLOGY

Excessive environmental pollution is caused by an incentive gap virtually identical to the one that gives rise to excessive conspicuous consumption. And once we understand the link between these two problems, we can use the lessons in the environmental domain to help craft better solutions to the problem of conspicuous consumption.

Consider an individual weighing the decision of whether to drive to work or take the bus. This person has no reason to believe that his decision will have any measurable impact on air quality in his city. If driving to work is considerably cheaper, or more convenient, he will drive. But when millions of motorists simultaneously reach the same conclusion on this basis, the impact on air quality is far from negligible.

Note the virtually identical incentive gap in the job seeker's decision about whether to buy a custom-tailored suit. His natural focus is on whether the suit will increase his odds of landing the job he wants by enough to compensate for its extra cost. If the contest for the job is likely to be close, it will be worth it for him to spring for the better suit. This is problematic because when other job seekers simultaneously reach the same conclusion, the extra expenditures go for naught.

Our first attempts to solve the problem of excessive pollution were much like our first attempts to solve the problem of excessive conspicuous consumption.

The Clean Water Act of 1971, for example, established a deadline by which each producer had to remove 90 percent of its base-year emissions of toxic wastes flowing into the nation's rivers. By issuing an across-the-board prohibition on specific acts of pollution, this law was essentially like the early sumptuary laws, which issued across-the-board prohibitions on specific forms of consumption. And the problems with both approaches are strikingly similar.

One wasteful aspect of the sumptuary laws was the indiscriminate way they required cutbacks in consumption, even from those with a passionate attachment to the forbidden product. The original Clean Water Act was wasteful in an exactly parallel way. Whereas the goal of an intelligent environmental policy is to achieve a reduction in pollution at the lowest possible cost, the Clean Water Act required the same 90 percent cutback from producers for whom curtailment was costly as from others for whom curtailment was cheap.

Trying to micromanage individual companies' pollution-abatement efforts generally results in wasteful outcomes, a lesson that has at last been absorbed by environmental policy analysts. Instead of requiring equal cutbacks on the part of each company, they now focus on policies that reduce a concern's incentive to pollute by taxing it on the basis of how much it pollutes. This provides each company with an incentive to cut back its pollution in the most cost-effective way it can.

In a hypothetical world with only a single conspicuous-consumption good – say, cars – the analogy between luxury taxes and pollution taxes would be virtually exact. The problem in each case is that we have too much of something in the

absence of collective action – too much conspicuous consumption good in one case, too much pollution in the other. Each problem exists because of an incentive gap. Both conspicuous consumption and activities that pollute are more attractive to individuals than they are to society as a whole.

With a tax on the luxury good, people would have an incentive to spend less of their incomes on it – just as, with a tax on pollution, companies have an incentive to pollute less. Note that in both cases, the tax tends to distribute the burden of adjustment in a fair and efficient manner. Just as a pollution tax concentrates pollution abatement in the hands of those who can accomplish it most cheaply, so a luxury tax concentrates the reduction in conspicuous consumption in the hands of consumers best equipped to adjust. Those who don't care much about cars will find that their best bet is to scale back their automobile expenditures significantly. And those for whom such cutbacks would be most painful will elect to pay the tax to continue to pursue their passion.

However, there is not just one conspicuous good but many. If we taxed bright silks, people would simply move to gold buttons, just as the medieval Europeans did. To complicate matters further, what is a conspicuous-consumption good for one may not be for others. And to attempt to use the political process to classify specific goods as luxuries is to invite a free-for-all. Fortunately, however, we can attack the problem without having to settle such questions on a case-by-case basis.

THE PROGRESSIVE CONSUMPTION TAX

Because we ignore the fact that our own spending influences the definition of an acceptable living standard, private consumption seems more attractive to us as individuals than to society as a whole. The simplest solution is to make those forms less attractive by taxing them with a single levy on the total amount that families spend each year.

Here's how a progressive consumption tax would work if the first \$7,500 per person were exempt from tax. With a total deduction of \$30,000 per year, a family of four whose income was less than \$30,000 (plus the amount it saved) would owe no tax. It could purchase basic necessities – defined not by legislators but by its own members – tax-free. Once the family's total consumption passed the taxable threshold, it would then begin to pay tax on each additional dollar of consumption, at a progressive rate. The tax on families with positive taxable consumption might begin at 20 percent and then gradually escalate.

There is reason to believe that even the wealthiest people would respond to such tax signals. For example, in Manhattan, where real estate prices are several times higher than in most other American cities, the wealthy buy much smaller houses than their counterparts elsewhere. Whereas even a 5,000-square-foot brownstone is expansive by the standards of the wealthy residents of the Upper East Side, people with similar incomes in Los Angeles often buy 10,000- or even 15,000-square-foot houses.

Yet an American chief executive needs a 15,000-square-foot mansion only because others of his station in life have houses that large. To have a lesser dwelling would risk social embarrassment or raise questions about the health of

his business. Yet if all chief executives were to build smaller houses, no one would be embarrassed in the least. Indeed, many chief executives might even prefer to have smaller houses.

Just as high real estate prices lead the wealthy to buy smaller houses, a steeply progressive consumption tax could lead them to spend less on automobiles. The erstwhile Ferrari driver, for example, might turn instead to the Porsche 911 Turbo, which currently sells for "only" \$105,000. The 911 is even faster than the Ferrari, and it is also more surefooted. Its only real drawback, from the perspective of the ultrarich, is that its bargain-basement price has made it an almost common sight in the circular driveways of many neighborhoods. Under a progressive consumption tax, the Porsche would acquire precisely the rarefied status of today's exotic cars, which was all that kept it from being attractive to Ferrari buyers in the first place.

If a progressive consumption tax affected only the spending decisions of the superrich, its benefits would be minimal. But such a tax would have much broader impact. Indeed, it would produce a cascade of similar savings all the way down the consumption pyramid. If we continue for several more decades on our current trajectory, the replacement for today's Ferrari 456 GT will sell not for \$207,000 but for more than \$400,000. Those who are content to drive the \$105,000 Porsche 911 Turbo today will move up to a car something like the Ferrari 456 GT. Likewise, those who drive the \$72,000 Porsche Carrera today will move up to a car like the 911 Turbo. The current drivers of the \$45,000 Porsche Boxster will trade up to a car like the Carrera.

If we take no action, these upgrades will inexorably occur, as will others like them in other domains. A future version of the Patek Philippe Calibre '89 wristwatch, for example, will command twice its current price of \$2.7 million. And tomorrow's Hermes Kelly alligator handbag will cost not \$14,000 but \$28,000.

By contrast, with a phased introduction of the progressive consumption tax, the amount of resources devoted to producing these goods can be held near their current levels. The point is not to put companies like Ferrari and Patek Philippe out of business, but simply to slow the rate at which additional resources are devoted to making all products – not just theirs – more opulent.

All incentives are relative, and because the progressive consumption tax makes it more costly in relative terms to engage in conspicuous consumption, it also makes it less costly to engage in inconspicuous consumption. For example, because the tax would mean that an additional dollar of cash wages would buy less, employers have an incentive to rearrange their compensation packages to emphasize untaxed quality-of-life benefits – an extra week of vacation, a more private space at work.

Because the amount of additional goods people can buy by working longer hours would decline under a progressive consumption tax, they would have an incentive to work fewer hours and spend more time with family and friends or just reading a good book.

The catch? There is none. The extraordinary beauty of the progressive consumption tax is its ability to generate extra resources almost literally out of

thin air. It is a win-win move, even for the people on whom the tax falls most heavily.

So why don't we already have a progressive consumption tax? Such a tax faces a critical political hurdle – namely, the belief that imposing sharply higher tax rates on the nation's most wealthy and productive citizens is a surefire way to cripple the economy. Although this belief is most deeply entrenched among conservatives, it has also won widespread acceptance among liberals. Indeed, it is no exaggeration to call this the single most influential belief driving economic policy in the late 20th century. It was responsible, for example, for the dramatic reductions in the tax rates on top earners in both Britain and the United States during the Thatcher and Reagan administrations.

It is natural that voters find tax increases distasteful, and the belief that they will harm the economy has provided politicians with an irresistible opportunity to denounce them. Indeed, the risk inherent in proposing even a modest tax increase cannot have escaped the attention of any politician with a pulse.

On the best available evidence, however, a steeply progressive consumption tax would not cripple the economy; it would actually invigorate it. Yet it is what people believe about reality, rather than reality itself, that governs public policy decisions. And as long as the fundamental premise of trickle-down economics remains an entrenched part of the received wisdom, the adoption of a steeply progressive consumption tax will remain a long shot.