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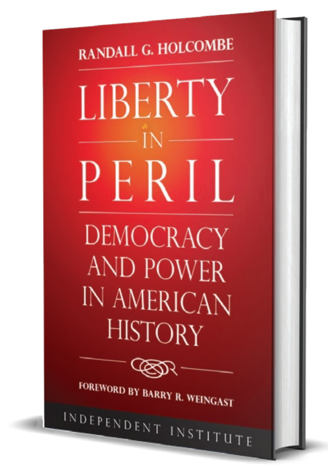

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REVIEW ESSAY

Everything Is Coming Up Roses, Isn't It?

STEVEN E. LANDSBURG

If your memory extends back as far as the 1970s, you won't need a book to tell you that American living standards have risen dramatically over the past generation. But if your memory is short, you should have a look at W. Michael Cox and Richard Alm's *Myths of Rich and Poor* (New York: Basic Books, 1999). It is a superb book, filled with facts and logic and clarity and wit, fun to read and impeccably argued, an encyclopedia of progress.

But is it really necessary? To remind yourself how much wealthier we've gotten in the past few decades, you don't need Cox and Alm; all you have to do is pick up a twenty-five-year-old mail-order catalogue, correct the prices for inflation (in other words, roughly triple them), and then ask yourself whether you'd rather buy those goods at those prices or today's goods at today's prices. I guarantee that if you carry out that experiment, you'll be *stunned* at how much the world has improved in the past few decades.

Think about what health care was like twenty-five years ago, or communications, or home entertainment. Heart transplants were rare, the Internet was not even a fantasy, and only the wealthy few had VCRs. Of course the world has gotten better, and that's obvious to everyone. Right?

Certainly it's obvious to my parents, who are awed by the $250 stereo system I take for granted—the one that holds sixty CDs, remembers what type of music is on each one, and will play, for example, all the jazz tracks in random order. But just when

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my parents' astonishment has me convinced that Cox and Alm's book is unnecessary, along comes Robert Frank, with his new book *Luxury Fever* (New York: Free Press, 1999) and his genuinely risible claim that the median American family has gained *no ground* in the past two decades. No ground! Can he be serious? Would Frank really be willing to return to the living standards of 1979? Does he want to sacrifice his personal computer, his microwave oven, his video camera, and his CD collection? Does he want to give up ibuprofen, disposable contact lenses, and effective antacids?

Reading Frank's book made me understand that we really need Cox and Alm's book after all. I'd have thought the wealth explosion was evident to anyone with open eyes, but if an economist of Frank's stature is blind to it, others probably are, too. In a world where memories are short, it's nice to have a collection of incontrovertible reminders of what the past was really like.

On the other hand, why should anyone care about aggregate wealth statistics? So what if the average American is wealthier now than a generation ago? Well, you might respond that wealth is somehow related to happiness. As to the exact nature of that relationship, Cox and Alm declare their agnosticism up front. (It is, however, a qualified agnosticism: "We don't know whether economic progress brings happiness, but we strongly suspect that the absence of it brings misery.") But that still doesn't explain why anyone should care about how the average American is doing. What you probably care most about is how *you're* doing—and that's not something you can learn from a book. The only thing you can learn from Cox and Alm is how your neighbors are doing—and why should you care about that?

Poor Me, You're Richer

Frank has an answer. He believes—and this brings us to the central theme of his book—that it's more fun to be rich when your neighbors are poor. If Frank is right, then you should view Cox and Alm's glad tidings with dismay. If, on the other hand, you view general economic progress as good news, then you are a living repudiation of Frank's position.[1]

Here's another test of Frank's hypothesis: When was the last time you heard a politician say "Vote for me! I've been in office for four years and times are really bad!" It's true that you wouldn't support a politician who has held back your own progress, but presumably you already *know* something about your own progress, and you've already accounted for that in your voting behavior. By advertising that he's held everyone *else* back, the politician can only make himself more attractive to you. The fact that no politician campaigns that way is evidence against Frank's story.

1. A subtle distinction deserves mention here. If Frank is right, you might want to root for *future* economic progress, because the fun of getting richer outweighs the pain of seeing everyone else get richer too. But—still assuming Frank is right—you'll always be dismayed to learn of *past* economic progress, because you already know about your own good fortune, and you can only be sorry to learn that your neighbors have shared it.

But it's hard to refute Frank's story decisively, because his story keeps changing. First he says we want to *consume* more than our neighbors; then before long he says we want to *earn more income* than our neighbors. Those are different things, but Frank flits from one to the other as if they were the same.

As for why we care about relative consumption (or relative income) in the first place, Frank is equally slippery. Are we psychologically hard-wired to care about relative position for its own sake? Or do we care about relative position because it helps us compete for goods—such as mates—that are distributed outside the economic marketplace? Either hypothesis could be the germ of a respectable theory, and each of them probably contains an element of truth, but they are surely distinct hypotheses, with distinct implications; and it's not always clear which one Frank has in mind.

Frank is at his most incoherent when he asks the question of "Why now?" That is, "Why should we believe that the struggle for relative position is a more powerful determinant of economic behavior now than in the past?" As far as I can piece together his argument, it seems to go as follows: Concern for relative position kicks in only above a certain threshold level of income; rising income inequality has thrust a record number of Americans above that threshold; therefore, concern for relative position has become a more potent economic force.

And what is the magic threshold? Frank never tells us, leaving himself free to change it at will. When it serves his purposes, he suggests that he himself crossed the threshold somewhere between his days as a Peace Corps volunteer and his appointment as a Cornell assistant professor. When it serves another of his purposes, he suggests that you don't cross the threshold until long after you've made your first million.

In any event, "rising income inequality" makes an awfully precarious foundation for Frank's story. He wants to pin increasing inequality on the rise of "winner-take-all markets," made possible by technological advances that allow a single competitor (for example, Amazon.com) to serve the entire world, so that Jeff Bezos (Amazon's founder) ends up with $9 billion while hundreds of small bookstore owners end up bankrupt.

But, contrary to Frank's suggestion, the proliferation of winner-take-all markets need not imply a widening gap between the rich and the poor. The same technology that fosters the winner-take-all environment simultaneously fosters the advent of entirely new markets, as it becomes newly possible to reach critical masses of consumers who share offbeat tastes. Very few people share my passion for knives designed by the artist Gil Hibben, so until recently I relied on serendipitous finds at knife shows and flea markets. Today a network of on-line dealers will find me any Hibben knife I'm looking for. Indeed, no matter how idiosyncratic your desires, somebody stands ready to fulfill them on the Internet. So even if each individual market is winner-take-all, the great proliferation of markets has made it possible for everyone to be a winner. As Frank himself has forcefully insisted elsewhere, it's all a matter of finding the right pond.

To summarize: Frank's hypothesis is that people care about consuming more than their neighbors—or maybe about earning more than their neighbors—and this desire kicks in when one becomes an assistant professor, or perhaps a multimillionaire, and it is becoming more important because of limited opportunities to succeed in a world where opportunities are less limited than ever before.

Although he keeps changing his story, Frank is at least steadfast about its moral: Concern for relative position leads to wasteful "arms races" with everyone trying to get ahead of everyone else, even though we'd all be better off if only we could all agree to kick back and relax a little more. In Frank's vision of the world, we all work hard to afford 4,000-square-foot houses, even though we'd all be happier working less and living in 3,000-square-foot houses.

What Should Be Done?

If we'd all be happier that way, why don't we all just work less? Because none of us wants to live in a smaller house than our neighbors. Therefore, we can't get to the most desirable outcome without some kind of collective action.

If Frank's assumptions about preferences (which he justifies with references to survey data that I find pretty unconvincing) are right, then his conclusion—that people work too hard—does follow. The problem is that every time Frank wants to draw a new conclusion, he changes his assumptions about preferences, so it becomes very hard to tell whether his various conclusions fit together into a coherent whole.

For example, he is eager to convince us that because of the consumption arms race, people not only work too hard, they also don't save enough. But that conclusion doesn't follow. People who enjoy conspicuous consumption in the present are likely to enjoy conspicuous consumption in the future, and they know that future consumption requires current saving.

Although Frank never explicitly acknowledges this gap in his argument, there is some evidence that he is aware of it, because he chooses this moment to throw in another new assumption: that people systematically undersave because they just don't understand (or just don't think about) the magic of compound interest. He "proves" this assertion by observing that if only people saved more in the present, they'd be wealthier in the future; because they don't save more in the present, they must not be thinking about the future. In other words—and I'm paraphrasing here—people who live in houses are making great mistakes, because if only they lived on park benches, they'd be able to retire rich. I find that argument unconvincing.

In fact, I could offer a lot of anecdotal evidence to the contrary. Graduate students generally live pretty meager existences, even when they are studying subjects (such as economics) that are likely to make them employable at high incomes after graduation. Why don't they borrow against those high future incomes to start living better now? To me, it looks very much as though they are making mistakes. But unlike Frank, I am unwilling to build an entire theory around my presumption that if I fail to understand someone's behavior, it must be because the other guy is stupid.

But all of that is beside the main point: Whether or not people undersave is an argument that has absolutely nothing to do with conspicuous consumption or inefficient "arms races," because arms races can be fought equally well on the battlefield of present consumption or of future consumption. And when Frank's arms-race theory fails to yield his desired conclusion about undersaving, he rescues his argument by simply pulling a new assumption out of his hat and then declaring the theory a success.

Moreover, it's not even clear that this new and ad hoc assumption saves the day. Remember that much of Frank's argument relies on the spread of "winner-take-all" markets, which usually lead to overinvestment in skill acquisition, which is a form of oversaving, not undersaving. By jumping from one set of assumptions to another, Frank deflects attention from the full implications of his theory.

Now, as it happens, other researchers *have* made the effort to tell precise, coherent stories about jockeying for relative position and to enumerate their consequences. My favorite example is a paper by Hal Cole, George Mailath, and Andrew Postlewaite ("Social Norms, Savings Behavior and Growth," *Journal of Political Economy* 100 [1992]:1092–1125). Cole, Mailath, and Postlewaite (henceforth CMP) hypothesize that people care about their relative positions in the wealth distribution because a high relative position allows you to attract a better mate. Then, rather than just assert various consequences of their hypothesis à la Frank, they actually work out in detail what life would be like in such a world. And one thing they find is that the competition for mates drives most people to save *too much*. Young people oversave in an attempt to improve their own prospects, and old people oversave in an attempt to improve their children's prospects. If everyone could agree to save a little less, we'd all be better off: Our relative mating-game scores would be unchanged, but we'd all have more money to spend. And yet, although this "oversaving" is costly to any given generation, it enriches future generations.

That outcome is exactly the opposite of what Frank wants us to believe is the necessary consequence of jockeying for relative position. It turns out that when you make Frank-like assumptions, take them seriously, and don't keep adjusting them in the middle of the argument, you don't get the conclusions he wants you to get.

When people compete by saving, the rich have a head start. So the CMP theory suggests that income inequality should grow over time. But if inequality becomes so great that people lose all hope of changing their relative positions, then the incentive to oversave disappears, and the inequality could begin to shrink. Again, these developments are very different from Frank's speculations about the nature of income inequality—but unlike Frank, CMP actually prove their assertions in a rigorous context where the assumptions are nailed down.

Whereas Frank's conclusions about overwork, undersaving, and income inequality are all suspiciously divorced from his assumptions, his policy proposal—a highly graduated consumption tax—seems entirely divorced from logic. His idea seems to be that conspicuous consumption is an "arms race," arms races are bad things, and the way to discourage consumption is to tax it. The "highly graduated" part comes from the assumption that the wealthier you are, the more likely you are to be involved in an arms race.

Okay, let's sort out this argument. In a society where people are jockeying for relative position, there are two possible justifications for a consumption tax. First, a consumption tax can discourage overwork and thereby make everyone happier. Second, insofar as people care only about relative position, and insofar as the tax leaves everyone's relative position unchanged, it's a means of generating tax revenue at no cost to the taxpayers. Those are separate arguments, and Frank doesn't do a very good job of delineating them, so let me try to separate the issues.

First, if overwork is driven entirely by a desire for conspicuous consumption, then a consumption tax does exactly nothing to discourage overwork. If the prospect of outspending my neighbor is worth an extra hour in the salt mine, then I'll put in an extra hour in the salt mine to outspend my neighbor—regardless of whether I'm outspending him by a dollar or (because of a 99 percent consumption tax) outspending him by a penny.

Second, if people care about *both* absolute and relative position, then a consumption tax can indeed discourage work (if absolute consumption matters, then I might be willing to work an extra hour to outspend you by a dollar, but not to outspend you by a penny). But it doesn't follow that people are happier. After all, if people are getting involved in arms races, it's entirely likely that they enjoy not just the prospect of winning, but the competition itself. So it's by no means clear that you'd want to discourage such competition.[2]

Third, even if you could somehow discourage people from overworking to jockey for relative position, they'd find some *other* way to jockey for relative position (or at least they might, depending on why they were jockeying for relative position in the first place—once again, the vagueness of the assumptions leaves us floundering), and the alternative competition could be even more socially wasteful than overwork.

Fourth, Frank is so concerned about the "negative externalities" of overwork (the unhappiness you cause your neighbors when you pull ahead of them) that he forgets about the positive externalities. My guess is that the most productive members of society—the ones Frank wants to tax most heavily—are precisely those who

2. When I say that people might enjoy competition for its own sake, am I just making an arbitrary and unsupportable assumption? Sure. But it's no more or less arbitrary and unsupportable than Frank's assumptions about preferences. Once you start postulating that "people are just wired" to care about relative position, you might just as well postulate that "people are just wired" to enjoy *competing* for relative position, so ameliorating that competition could make people *less* happy, which is exactly the opposite of what Frank wants us to believe.

contribute most to the quality of everybody else's lives. Should we have had a consumption tax to discourage Thomas Edison from overworking?

True, Frank does make a pretense of worrying about disincentive effects in the labor market (the discussion seems a bit surreal, however; I thought the whole *point* was to create disincentive effects in the labor market). But in doing so, he completely fails to account for the *external* benefits of work—by working, you generate ideas that others can copy, and those ideas make everyone more productive. I strongly suspect, though I cannot prove, that those external effects are most significant among precisely the high-income earners whom Frank sees as the nexus of the overwork problem.

Conclusion

The inadequacies of Frank's book are particularly frustrating because it has so much going for it. It is well written, full of interesting facts and tidbits, and it contains plenty of thought-provoking arguments, though they fail to cohere into a whole.

For example, I love Frank's observation that, if people care about relative status in the workplace, then highly productive workers view their less productive colleagues as a blessing and less productive workers view their highly productive colleagues as a curse; therefore the least productive must be overpaid (otherwise they wouldn't stick around) and the most productive must be underpaid (because they're already receiving a part of their income in the form of status). I love that observation because it's a clear, convincing, logical, and surprising consequence of a carefully stated assumption. It's also, I think, self-evidently wrong. At least in my own experience, hiring decisions tend to revolve around the question "Will this person improve our average quality?" I have never heard anybody argue for a job candidate on the grounds that he'll make the rest of us look better.

Like George Bernard Shaw's *Intelligent Woman's Guide to Socialism*, Frank's *Luxury Fever* is an infuriating mix of clever argument, befuddled reasoning, genuine insights, inconsistent assumptions, and well-turned phrases. I'm inclined to add it to the reading list for my freshman honors students, with an assignment for each student to identify and illuminate at least one lapse in logic.

The students will write those papers on laptop computers, shifting text from one paragraph to another at will (I am old enough to have developed considerable skill with physical scissors and paste), while heating their dinners in microwave ovens and listening to digitally reproduced music downloaded from the Internet. When I tell them how things were in the old days, they will listen with tolerant fascination, as I did when my father talked about the days before refrigerators. If they want to know more, I'll enthusiastically point them toward Cox and Alm's *Myths of Rich and Poor.*