Smart for one, dumb for all


Economist Robert H. Frank has written a stimulating book that integrates research from psychology, evolutionary biology, and economics to address the raging "luxury fever" that is needlessly consuming precious resources in "overdeveloped" economies. Frank documents how luxury consumption in western industrialized countries has been rising at an astronomical rate even though recent psychological research shows that there is scant correlation between this consumption and levels of stated life satisfaction.

Why, then, are some wrist watches selling for $20,000, huge houses of 10,000 square feet or more being built, and myriad forms of conspicuous individual consumption rapidly increasing, even as social spending on education, infrastructure, the environment, and other things that would raise the average level of life satisfaction in society is decreasing? Frank describes how this perverse "luxury fever" occurs when individuals pursue their strong individual incentives to increase their relative position in society by consuming more than their peers. But when everyone behaves in this way, relative consumption (and perceived life satisfaction) remain constant, while absolute consumption (and related negative impacts on natural resource use, the environment, and education spending) soars.

Luxury fever is one of a class of phenomena known by various names in different disciplines: negative externalities (Pigou 1940), social traps (Cross and Guyer 1980, Costanza 1987), social dilemmas (Ostrom et al. 1999), the prisoner’s dilemma (Axelrod 1984), and the tragedy of the commons (Hardin 1968). Frank cleverly labels these phenomena as situations that are "smart for one, but dumb for all." Once one begins to look, clear examples of these situations can be found everywhere, in such phenomena as drug addiction, pesticide overuse, arms races, environmental pollution, and high fashion. Although these phenomena have been recognized by economists, they have largely been relegated to the status of interesting but relatively minor anomalies. But Frank clearly points out just how pervasive, important, and wasteful they are and how eliminating them can save literally billions of dollars while actually improving human welfare. The "invisible hand" of the market cannot be relied on to solve these problems, Frank notes, because "far from being a principle that applies in most circumstances, the invisible hand is valid only in the special case in which each individual's rewards are completely independent of the choices made by others. In the rivalrous world we live in, precious few examples spring to mind" (p. 271).

After describing current trends in luxury consumption in often shocking detail, Frank looks at the psychological research on the determinants of life satisfaction and combines that research with research on human evolution. Individual humans have clearly evolved to respond much more strongly to relative position in a group than to absolute position. As in all animal species, the competition to survive and reproduce rewards individuals that are relatively more successful at finding mates and raising offspring than their peers. In humans and many other mammals, mate selection by females is influenced by the relative status of males, because male status is often correlated with the success of their offspring. But these evolutionary processes, Frank points out, can be smart for one but dumb for all. For example, the relative size of a male elk's antlers determine his mating success. But although the relative sizes of antlers in the population have remained constant, the absolute sizes have increased, in a kind of "arms race." The problem with this strategy is, of course, that big antlers hinder the male's movements and make them easier targets for predators. Likewise, individual humans get caught in the same kind of trap by pursuing their (perfectly rational) individual incentives to increase their relative status. The net effect is no change in relative status—but huge increases in wasteful consumption, with its related costs.

Frank's solution to luxury fever is a strongly progressive consumption tax. A simple one-line amendment in the US tax code would exempt all savings from income taxation. With this modification, the income tax would tax only consumption, obviating the need to specify which consumption was "luxury consumption," and (because of its steep progressivity) it would do so without adversely affecting the poor. This consumption tax would have the effect of increasing the costs of conspicuous consumption for indi-