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The Empty Wealth of Nations

by

Robert H. Frank

The barstools aboard the late Aristotle Onassis's yacht, The Christina, were covered with the buttery soft— and jarringly expensive— leather from the scrotum of the sperm whale. The vessel's faucets were of solid gold, and at the flip of a switch its swimming pool could be covered by retractable, mosaic-tiled dance floor. The Christina was just one salvo in Onassis's costly battle to outdo rival shipping magnate Stavros Niarchos, whose own yacht, the 375-foot Atlantis, was designed by an architect whose instructions were to make it 50 feet longer than the Onassis vessel. In a world in which many still lack adequate nutrition, shelter, medical care, and other necessities, such excesses remain a favorite target of social critics.

At one level, these critics obviously have a point. Yet, at another level, their contempt is naïvely self-righteous. For although the concerns driving the Greek shipping magnates were expressed in a context of spectacular wealth, they were no different from those driving the rest of us. H. L. Mencken had these concerns in mind when he quipped that a wealthy man is one who earns $100 a year more than his wife's sister's husband. The point is not that most of us envy those who have more than we do, although there is of course plenty of envy in the world. Rather, it is that our sense of well being depends strongly on social context. A person who earns $40,000 a year may be either happy or sad; but she is more likely to be satisfied with her standard of living if most of her friends earn $35,000 than if most of her friends earn $50,000.

This inescapable fact of human nature has many consequences, not all of them bad. But many of them are bad, and my focus here will be on one of these— namely, the fact that it leads us to squander literally trillions of dollars each year in the US alone, much more than enough to eliminate persistent government deficits, rebuild decaying public
infrastructure, and end the growing threat of economic insecurity. Unlike the conspicuous excesses of the super-rich, much of this waste is subtle. But it is waste nonetheless. And the good news is that there is a simple policy change that can curb it.

My claim is not that government bureaucrats know how to spend our money more wisely than we do. Rather, it is that if we had a full range of options—including the option of taking collective steps to alter our spending incentives—we would want to spend differently than we do now. Each of us, rich and poor alike, would save more, and we would buy a very different mix of goods and services.

The Positional Arms Race

Why might collective decisions about spending lead to different patterns than we get from individual decisions? Military arms races provide perhaps the clearest illustration. From each individual nation's point of view, the worst outcome is not to buy armaments while its rivals do. Yet when all spend more on weapons, no one is more secure than before. Most nations recognize the importance of maintaining military parity, and the result all too often has been a wasteful escalation of expenditures on arms. Nations would spend much less on weapons if they could make their military spending decisions collectively. And with the money thus saved, each side could then spend more on things that promote, rather than threaten, human well being.

Similar forces affect each family's decision about how much to save. Parents want to save for retirement, but they also have other important goals. For instance, they want to make sure that their children receive an education that qualifies them for the best jobs. For the typical American family, that means buying a home in the best school district it can afford. Most of us thus confront an almost irresistible opportunity to do more for our children: By saving a little less for retirement, we can purchase homes in better school districts.
From the collective vantage point, however, such moves are futile in the same way that military arms races are futile. When each family saves less in order to buy a house in a better school district, the net effect is merely to bid up the prices of those houses. Students end up at the same schools they would have attended if all families had spent less. In the process, an important goal—being able to maintain an adequate living standard in retirement—is sacrificed for essentially no gain. Yet no family, acting alone, can solve this problem, just as no nation can unilaterally stop a military arms race.

Housing is not the only expenditure that is driven by forces similar to those that govern military arms races. Spending on cars fits the same pattern, as does spending on clothing, furniture, wine, jewelry, sports equipment, and a host of other goods. Because the kinds of things we “need” depend on the kinds of things that others have, our needs grow when we find ourselves in the presence of others who have more than we do. Yet when all of us spend more, the new, higher spending level simply becomes the norm.

Some Contexts Are More Important Than Others

Of course, many factors other than material living standards affect happiness. Many poor people are joyful; and many rich people are miserable. But although the correlation between happiness and income is not large, it is positive. There is strong evidence that, within a given country at a given moment in time, people with high incomes are happier, on the average, than people with low incomes.

There is equally strong evidence, however, that average happiness levels are highly stable over time, even when average incomes grow several fold. For example, measures of subjective well-being in Japan, which has one of the world's highest per capita incomes, are no higher now than in 1955, when Japan was essentially a third-world economy.

Some scholars have concluded from this evidence that economic growth doesn't matter—that when our material standard of living improves, we quickly get used to that, and then we're really no better off than before. A careful reading of the evidence,
however, suggests that this conclusion applies only to growth in certain *kinds* of consumption. For instance, whereas a 10 percent increase in every American upper-middle-class family’s living space would produce no lasting improvement in happiness, increases in other forms of consumption appear to have both dramatic and enduring effects on well being.

Consider a thought experiment in which we compare two societies that are identical except for the fact that some force of nature has caused their incomes to be spent in different ways. For example, suppose that people in Society A have 5000 square-foot houses and a 45-minute one-way commute by car through heavy traffic each weekday morning; and that people in Society B have 4000 square-foot houses and a 15-minute daily trip to work on a nearby commuter train. The two societies are equally rich in the sense that the extra resources that were required to produce the larger houses of Society A could have been used instead to produce the shorter and less stressful commute of Society B.

In which society will people be happier? That obviously depends on whether people generally care more about having larger houses than they do about having a more pleasant journey to work. And on this point, the evidence is surprisingly clear: The typical citizen of society B will be happier than her counterpart in Society A.

It is not that the people in Society B wouldn’t be pleased to have more spacious living quarters. They would. But when *everyone* moves to a larger house, this pleasure proves fleeting. By contrast, our capacity to adapt to a lengthy commute through traffic is much more limited. Even after extended periods of adjustment, such experiences continue to produce elevated levels of cortisol, epinephrine, and other hormones associated with psychological stress.

Social interaction is another form of consumption that affects human well being in substantial and lasting ways. Whereas neuroscientists would have difficulty telling which people came from a society with larger houses, it would be much easier for them to identify who came from a society in which people spent more time with family and friends.
A society in which every family has a 4000 square-foot house can transform itself into one in which every family has a 5000 square-foot house by simply having everyone work more hours each day, more weeks each year. Instead of having six evenings a month free to get together with friends, we can cut back to only two; instead of taking five weeks of vacation each year, we can take only one; instead of coming home at 5 PM to spend time with our children, we can work until 8; instead of having time to exercise 4 times a week, we can exercise only once; instead of reading ten books a year, we can read only 2; and so on.

The point is not that such activities are always more satisfying than the things we could buy if we spent more time at work; rather, it is that people are happiest when they achieve a reasonable balance between leisure and work. A growing number of Americans appear to lack this balance. Available evidence suggests that the change in well being that results from spending more time with family and friends, from exercising, from reading, and from other extracurricular activities—pursuits that I will lump together under the term "inconspicuous consumption"—is both larger and more enduring than the change in well being that results when we all spend 10 percent more on houses, cars, and other forms of more conspicuous consumption. People with few social contacts, for example, tend to die younger and to suffer more frequently from stress-related illnesses.

Yet despite this evidence, people in the US have been working steadily longer hours—20 percent longer since 1973, according to a recent Harris Survey—and have been using their higher earnings to buy larger houses and more expensive cars. Why are we working more if we would in fact be happier with more unstructured time rather than less? And why do we adjust more easily to a change in the size of our house than to a long commute through traffic?

The neuroscientist’s attempt to answer this question begins with the observation that the human nervous system was crafted by the forces of natural selection. On this view, our brains reward us with good feelings when we take actions or experience events
that enhance our ability to survive and reproduce; and they penalize us with bad feelings whenever we become less able to achieve those goals.

Since human life began, there has been a strong positive relationship between relative wealth and the ability to survive and reproduce. Even during famines (which were frequent during early human history), there was always some food available, and those who got it tended to be those with the highest relative wealth. Similarly, the likelihood of marrying well—or even of marrying at all—has always been highest for those with the highest relative wealth. In Darwinian terms, relationships like these may be the ultimate source of our concerns about relative wealth. To the extent that these concerns spur us to work harder when we find ourselves too far down on the economic totem pole, it is easy to see how they might be adaptive.

Darwin emphasized, however, that natural selection favors traits and behaviors that benefit individuals, even when those same traits prove wasteful from the perspective of larger populations. Thus, the expansive antlers of the male elk are advantageous when it comes to doing battle with other males, even though their prodigious size makes these animals more vulnerable to predators (because, with predators, the best strategy is to flee rather than fight). Male elk would do better if all had smaller antlers. Yet a lone mutant with smaller antlers would do worse. He would be better able to escape predators, but this advantage would be outweighed by his disadvantage in the competition with other males.

A similar logic permeates our decisions about how much to save and how to allocate our time. Someone who works shorter hours must settle for a house in a lesser school district than her colleague who works longer hours. And whereas people would be little affected by an across-the-board reduction in expenditure on housing or automobiles (since the human psychological reward system is calibrated in terms of relative, rather than absolute, wealth), failure to have done as much as possible for one's children creates a lasting sense of distress.
There is a second difficulty, one that is independent of the mechanics of the human reward system. It lies in the fact that promotion decisions on the job often depend heavily on the relative number of hours someone works. Thus, an associate in a law firm who goes home at 5 PM each day instead of 8 PM not only earns less in relative terms, she is also less likely to be promoted to partner. If all the associates left work a little earlier, of course, no one’s promotion prospects would be affected. But each individual has control over only the hours that she herself works. She cannot unilaterally decree that everyone scale back.

In summary, then, the problem confronting individuals who must decide how to spend their time and money is like the one confronting nations that must decide how much to spend on armaments. Just as nations end up spending too much on weapons and too little on other things, ordinary people end up spending too much time earning money to buy private goods, and too little time doing other things. Our problem, in brief, is a surfeit of conspicuous consumption, a deficit of inconspicuous consumption.

When nations attempt to curtail military arms races, they try to negotiate agreements that specify precisely what kinds and quantities of weapons are permissible. The idea of private citizens conducting similar negotiations about how to allocate their time and money seems wildly impractical. Fortunately, however, the underlying problem can be solved without trying to micro-manage people’s spending decisions at all.

**The Solution: A Progressive Consumption Tax**

If our problem is that certain forms of private consumption currently seem more attractive to individuals than to society as a whole, the simplest solution is to make those forms less attractive by taxing them. Without raising our overall tax bill at all, a progressive consumption tax would change our incentives in precisely the desired ways.
Proposals to tax consumption raise the specter of forbidding complexity--of citizens having to save receipts for each purchase, of politicians and producers bickering over which products are to be exempt, and so on. Yet a system of progressive consumption taxation could be achieved by a simple one-line amendment to the federal tax code--namely, by making savings exempt from tax. This is so because the amount a family consumes each year is simply the difference between the amount it earns and the amount it saves. Administratively, a progressive consumption tax is thus essentially the same as our current progressive income tax. (In either case, the tax structure could, and should, be simplified further, but that is a separate issue.)

Consumption taxation has been proposed before. Its proponents have stressed that it will encourage savings, and hence stimulate economic growth. This is indeed an important benefit--more important, by far, than even the proponents of consumption taxation have realized. Yet the most significant gains from progressive consumption taxation lie elsewhere. Properly designed and implemented, such a tax will eliminate trillions of dollars of waste from the American economy.

The key to understanding how this would work is the observation that when the price of a good rises, we buy less of it. It follows that if consumption were taxed at a progressive rate, we would save more, buy less expensive houses and cars, and feel less pressure to work excessively long hours. And this, on the best available evidence, would improve the quality of our lives.

Even the wealthy respond to price signals. Thus, in Manhattan, where real estate prices are several times higher per square foot than in most other American cities, the wealthy buy much smaller houses than their counterparts elsewhere. For example, whereas even a 5,000 square-foot brownstone is expensive by the standards of the Upper East Side, the wealthy in Los Angeles often buy 10,000 or even 15,000-square foot houses. And even these houses pale in comparison with the largest dwellings in cities with relatively low real estate prices. Thus, Microsoft chairman Bill Gates is about to occupy a
50,000-square-foot residence on the shores of Lake Washington, just east of Seattle. Six years in the making, its total cost may top $100 million, including $6.5 million for the swimming pool alone.

Gates has a current net worth of nearly $20 billion. If he were to move to Manhattan he could certainly afford to build just as large a house there, even if New York prices were five times as high as Seattle’s. Yet he would almost surely not build such a house in Manhattan. Given the relatively small dwelling sizes of Manhattan’s wealthy (which, again, are a direct consequence of the high real estate prices there), a 50,000 square-foot house would just be unseemly, even for a multibillionaire.

The resources that would be saved if a progressive consumption tax were to induce wealthy and upper-middle-class families to build smaller houses are real resources. They can be put to good uses—indeed, much better uses than the ones to which they are currently being put.

An American CEO “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 CEOs were to build smaller houses, no one would be embarrassed in the least. Indeed, many CEOs might even prefer to have smaller houses. It is a nuisance, after all, to have to recruit and supervise the staff needed to maintain a mansion.

A similar logic applies to the wealthy person’s decision about which car to buy. If he is really wealthy and of sporting temperament, he will want one that handles well, accelerates rapidly, and—perhaps most important—stands out in a crowd. Under our current tax structure, he might consider the Ferrari 456GT. With its 437 horsepower, 5.5 liter, 48-valve V12 engine, it accelerates from zero to sixty in about five seconds, and its $207,000 sticker price assures that not too many others will have one.

Just as high real estate prices lead the wealthy to buy smaller houses, a steeply progressive consumption tax would lead them to spend less on automobiles. The cruxwhile
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 handles just as well. Its only real problem, from the perspective of the ultra-rich, 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.

A numerical example is instructive. Suppose we taxed additional consumption at the highest levels at a rate of 60 percent--that is, for total consumption beyond some level, an extra dollar of consumption would mean an extra 60 cents of tax. And suppose that, because a consumption tax exempts savings, the person who would have spent $207,000 on a Ferrari now decides to invest a little more in the stock market and spend a little less on his car. If he buys the Porsche, his outlay, including the consumption tax, will be $168,000. In return, he gets a car that performs just as well as the Ferrari and is now also just as rare. In terms of both his motoring pleasure and his ability to signal his wealth, he is therefore just as well off as before.

In other ways, however, both he and the rest of us are better off. For one thing, he now has $39,000 more invested in his mutual fund (the difference between $207,000 and $168,000), which will accumulate dividends and capital gains that will not be taxed until he spends them. What is more, the government acquires additional tax revenue with which it can reduce the deficit or support needed public services. The icing on the cake is that the extra money invested will increase the rate of economic growth.

If a progressive consumption tax affected only the consumption of the super-rich, these benefits would be minimal. But the tax would have much broader impact. Indeed, it would produce a cascade of similar savings all the way down the economic pyramid. Just as the Porsche would claim the top market niche once occupied by the Ferrari, cars like the
Toyota Supra, which currently sells for about $50,000, would move up to fill the second-tier spot left vacant by the Porsche. Cars like BMW’s Z3 (about $30,000) would claim the third-tier slot vacated by the Supra; Mazda’s Miata (about $20,000) would fill in for the Z3; and so on.

Given the importance of social context as a determinant of driver satisfaction, these moves would not take any lasting toll on happiness. Because the progressive consumption tax leads everyone to cut back on automobile expenditures, less expensive cars end up performing precisely the same services once performed by more expensive ones. And in each case, the difference in price represents real resource savings that can be put to good uses.

It might seem natural to worry that a tax that limits consumption might lead to recession and unemployment. This is not a serious concern, however, because money that is not spent on consumption is saved and invested. The result is that some of the people who are now employed to produce consumption goods will instead be employed to produce capital goods—which, in the long run, would enable us to produce even more consumption goods than before. (More on this point below.)

The progressive consumption tax will also change the kinds of consumption goods we produce. If the tax is sufficiently progressive, it will collect more revenue than our current system does from those at the top of the economic pyramid and less from those at the bottom. This means that carpenters will spend less of their time building mansions for the rich and more of their time building housing for others; and that fewer of our health care dollars will be spent on liposuction and tummy tucks, and more on the treatment of people who actually have illnesses.

The government knows how to stimulate the economy when recession threatens. Indeed, a central problem of recent decades has been to contain the inflationary pressures that result when demand grows more rapidly than the economy’s capacity to produce goods and services. By stimulating savings and investment, the progressive consumption tax will
increase the rate at which the economy's productive capacity grows, and thus reduce the rate of inflation.

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 wealthy on whom the tax falls most heavily.

Actually, I have overstated the case a bit. More precisely, I should have said that the progressive consumption tax is a win-win move in the long run, for in the short run there will be some transition costs.

A Painful Transition?

If you accept the proposition that human satisfaction depends not just on absolute consumption, but also on relative consumption, it follows as a matter of simple logic that the ultimate consequence of the switch to a progressive consumption tax will be an increase in total well being. It is possible, however, to accept this conclusion as a matter of logic, and yet still feel a strong visceral resistance to the switch—because, in the short run, the switch will entail having to make do with less.

Perhaps your last child has recently graduated from college and you are about to trade in the family Dodge on new Lexus coupe. Concern about relative consumption played no role in your decision. (You recognize that many other people may care about relative consumption, but you personally have never been much affected by such comparisons.) You want the Lexus simply because you appreciate quality for its own sake— the vehicle's extraordinary fit and finish, its sure handling, superior ride quality, and the solid 'thunk' its doors make on closing. (You disregard the psychologist's claim that motorists thirty years ago would have had a similar reaction to the sound of the door closing on the Dodge you now drive.) In the end, your position is that if the switch to a progressive consumption tax means you'll have to keep driving the Dodge, then you're against it.
Fair enough. There is no question but that someone who was poised to switch from a Dodge to a Lexus will feel keen disappointment if induced by a change in tax policy to postpone his plans. Indeed, the evidence on this point is so clear that it routinely motivates multimillion-dollar divorce settlements among the wealthy. The courts recognize that a sense of psychological deprivation accompanies a reduction in material living standards, even when the new standard is lavish relative to the average person’s. The fact that we know people would ultimately adjust to the new standard does not make this feeling of deprivation any less real for the time being.

In addition to whatever transitory psychological burden this adjustment entails, there will be other transition costs. For example, even though the progressive consumption tax poses no threat to full employment, it would, as noted, cause demand patterns to change. This would mean the creation of some new jobs, but it would also entail the elimination of some existing ones. And as the recent wave of American corporate downsizing has demonstrated, such transitions are often painful.

So the question is whether the long-term gains of switching to a progressive consumption tax are sufficient to outweigh the various transition costs. How long does the psychological process of adjustment to a new consumption standard take? And are there policies that can soften the transition from one job to the next, or facilitate the movement of capital from one task to another?

When we think about how we might react to a change in our lives, we generally try to think back to when some similar change actually occurred and try to remember how we felt about it. For example, in thinking about how we might react to a reduction in our level of consumption, many of us would think back to a time when our incomes fell and we were forced to cut back on our spending. Most of the time, however, people’s incomes don’t fall in tandem. As a practical matter, then, most of us would think back to how we felt when our own consumption went down while others’ consumption remained the same.
But the feelings that we associate with such episodes will be poor predictors of how we would react to the decline in consumption caused by a progressive consumption tax. This tax, after all, would induce an across-the-board reduction in consumption—a less painful experience by far than that of someone whose consumption declines unilaterally. There are experiences, however, that do provide insight into the psychological costs of adjusting to an across-the-board reduction in consumption. One such experience is to have lived temporarily in a country with a lower standard of living.

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. My decline in consumption on moving to Nepal was of course far greater than the decline that would occur in response to a progressive consumption tax. (Even if the tax caused consumption to fall by 15 percent, Americans would still consume more than the citizens of virtually all other countries.) 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.

Nothing in the psychological literature suggests that my experience was idiosyncratic. We may thus expect that the adjustment to the much smaller change produced by a progressive consumption tax would be relatively easy. It would entail costs, but they would be small and short-lived. By themselves, these costs do not constitute a persuasive argument against switching to a progressive consumption tax.

The job switching and corporate restructuring that would result from adopting the consumption tax are also real, if transitory, costs. But turnover in both labor and product markets has always been higher in the US than in Europe and Japan, and we have always considered this a price worth paying in return for the most productive and dynamic
economy in the world. We have developed a variety of institutions—such as unemployment insurance, job retraining programs, and compensation programs—to ameliorate these transitions. These institutions could be developed further if the switch to a progressive consumption tax threatened to create additional temporary dislocations.

In short, the gains from adopting a progressive consumption tax will be large and permanent, whereas the costs will be small and temporary. The case for this tax is strong even if we ignore its effects on growth in our national income. But once we take these effects into account, it becomes compelling.

Effects on Savings and Growth

Proponents of consumption taxation have long stressed that it will increase savings, and they are right. These same proponents go on to predict that the increase will be small, and that the resulting increase in growth and well being, though steady, will be small as well. The latter predictions, however, are significantly off the mark.

Switching to a consumption tax from an income tax would affect savings through several channels. Past advocates of consumption taxation have focused on two. First, the tax would put more resources in the hands of those whose savings rates were highest to begin with. (The less someone consumes, the less tax she pays, and hence the more she is able to save.) And second, a consumption tax would increase the monetary reward for saving. But, as past advocates of consumption taxes have realized, both of these effects are relatively small.

Where past predictions have gone awry is in having ignored the effect of community consumption standards on savings rates. This is by far the most important channel through which a progressive consumption tax would stimulate savings. Even though the direct effect of the tax would be to reduce our consumption only slightly, this would initiate a self-reinforcing sequence of indirect effects. Thus, when others consume less, the amount that we consume would decline still further, and our responses would then
influence others, and so on. Once these multiplier effects are taken into account, the effect on savings rates turns out to be substantial.

Higher savings rates, in turn, are the surest path to more rapid economic growth. The personal savings rate in America, which currently hovers close to 4 percent of personal income, is one of the lowest among industrial nations. Both Germans and Japanese save more than 15 percent of their incomes. Our low savings rate is an important reason for our low rate of economic growth in recent decades.

A simple numerical example illustrates the dramatic consequences of a large increase in our national savings rate. Suppose that money saved and invested generates a rate of return of 10 percent (a conservative assumption since the pre-tax rate of return on money invested in the US stock market in this century is significantly higher). Now consider two economies that are identical except for the fact that one saves 5 percent of its income and the other saves 20 percent. If per-capita income is initially $100 in each economy, this means that consumption starts out at $95 per capita in the low-savings economy, and only $80 in the high-savings economy—an initial gap of $15.

But notice how quickly things change. After one year, income in the high-savings economy is $102 per capita (the original $100 plus the 10 percent interest on the $20 saved), while income in the low-savings economy is only $100.50 (the original $100 plus the 10 percent interest on the $5 saved). Consumption in the high-savings economy rises to $81.60 after one year (80 percent of $102), compared to $95.48 in the low-savings economy (95 percent of $100.50). In just one year, then, the $15 consumption gap shrinks to $13.88.

The diagram below shows the growth paths of consumption for the two economies. Notice that it takes just 11 years for the consumption path of the high-savings economy to overtake that of the low-savings economy. Thereafter, the high-savings economy pulls away sharply from the low-savings economy. Fifty years out, for example, per-capita
consumption stands at $219 in the high-savings economy but only $121 in the low-savings economy.

There is nothing rigged about the numbers in this example. The striking contrast between the two consumption trajectories is a simple consequence of the so-called miracle of compound interest. Any society that can permanently increase its savings rate can permanently increase its rate of economic growth. And as the example illustrates, if the increase in the savings rate is large enough, the high-savings society's consumption path will actually overtake the low-savings society's in less than half a generation.

![Graph showing consumption in high and low savings economies]

Some might wonder whether having more consumption would be such a good thing in the end since, after all, people do tend to adjust quickly to changes in material
living standards. One might also worry that more consumption means more garbage and more greenhouse gases.

On the first point, the evidence suggests that although we adjust rather quickly to any stable standard of living, we seem to derive continuing satisfaction from an ongoing increase in our standard of living. Thus, a person who earns $40,000 this year is more likely to be happy if she earned $30,000 last year than if she earned $50,000. And the faster the economy is growing, the happier people seem to be.

History has taught that tax and regulatory policy can provide strong incentives to clean up the pollution that accompanies some forms of consumption. Thus, there is less smog today in the Los Angeles basin than there was 20 years ago, even though the number of vehicle miles driven has roughly doubled during the same period. If certain forms of consumption generate harmful effects—noise, garbage, toxic waste, congestion, greenhouse gases, whatever—we should simply tax them more heavily. Such taxes would not only encourage the development of cleaner technologies, they would also encourage us to shift to cleaner forms of consumption. Taking clarinet lessons doesn’t pollute; nor does planting flowers in one’s garden.

The important point is that all opportunities are greater in a rich society than in a poor one. The former Soviet Union generated more pollution than any nation on earth not because of its high rate of economic growth, but because its productivity lagged so far behind that of its rivals. A richer society has more resources for medical research, more resources for rapid transit, more time for family and friends, more time for study and exercise—and, yes, more resources for houses and automobiles.

Cash on the Table

"Cash on the table" is an economist’s metaphor for situations in which people seem to be passing up opportunities for gain. Each year, Americans leave literally trillions of dollars on the table as the result of wasteful consumption arms races. This waste can be
curbed by a disarmingly simple policy change— in essence, a one-line amendment that exempts savings from the federal income tax. Adoption of a progressive consumption tax would greatly enhance every citizen’s opportunity to pursue his or her vision of the good life. The only required sacrifice would a brief interval— incredibly brief, if one takes a historical perspective— of slightly reduced consumption.

The only intelligible reason for having stuck with our current tax system for so long is that we haven’t understood clearly how much better the alternative would be. But we now have all the evidence we could reasonably demand on this point. In the face of this evidence, the progressive consumption tax emerges as by far the most exciting economic opportunity of the modern era.