ECONOMIC SCENE

# Doctoral Thesis Says Rich People Spend More on Conspicuous Things

**By ALAN B. KRUEGER**

Published: January 6, 2005

LONG before Thorstein Veblen coined the term "conspicuous consumption," economists from Adam Smith to Karl Marx had argued that people choose to buy some goods because of what those goods reveal about their standing in society, not because of any intrinsic enjoyment they get from the purchase.

Yet conspicuous consumption remained mainly a theoretical curiosity for more than a century, with little empirical content or support. Now, Ori Heffetz, a doctoral student in economics at Princeton University, has developed the first broad-gauged index of product visibility. Sure enough, he finds in his thesis that conspicuous items make up a greater share of the consumption budget in wealthier families.

The idea of conspicuous consumption is intuitive. A Timex watch, for example, tells time about as well as a Rolex, but the particular watch you wear tells a lot about your purchasing power and personality. A major motivation for buying an extravagant watch is to signal to others that the consumer has "made it," a point not lost on advertisers.

In Veblen's view, the wealthy engage in conspicuous consumption to advertise their wealth. If true, such behavior can set off a wasteful rat race, in which people buy expensive products they don't particularly like only to "keep up with the Joneses" and signal their lofty status. Because conspicuous consumption makes others feel less successful, some economists have argued that society would be better off if a high tax rate were applied to goods that are the object of conspicuous consumption.

It is unclear, however, whether conspicuous consumption is a motivation underlying the purchase of many products or just a few. Furthermore, products that are conspicuous may nonetheless be consumed for their intrinsic value, not their curb appeal.

To determine whether conspicuous consumption is a rarity deserving little attention or central to understanding what people buy, it is necessary to have a measure of the extent to which a good is conspicuous.

Mr. Heffetz measured the visibility of various products by conducting a telephone survey of 243 randomly chosen individuals last summer. He first requested that respondents "imagine that you meet a new person who lives in a household similar to yours." Then, for each of 29 types of products, which together account for most of consumer spending, he asked them to imagine that the household spent more than average on that product. "Would you notice this about them, and if so, for how long would you have to have known them to notice it?"

Responses were assigned a score of one to five, ranging from never to almost immediately. The index of visibility, or "vindex," is the average score for how long it would take to notice that the consumer spent more than average on a product.

The logic is simple: visibility is a cultural as well as a physical property. If neighbors talk about their expenditures on some goods, then they are more conspicuous than otherwise. The more conspicuous a product, the sooner it is noticed.

The visibility ranking that resulted from the survey is quite sensible. Cigarettes, clothing, cars and jewelry are the most visible products, while underwear, home insurance, life insurance and car insurance are the least.

An implication of the theory of conspicuous consumption is that families spend relatively more on conspicuous goods as their incomes rise. Economists classify goods as "necessities" if their share of the budget falls as income rises, and as "luxuries" if their share of the budget rises as income rises. Are more visible goods more likely to be luxuries, as the theory predicts?

To answer this question, Mr. Heffetz estimated the relationship between the amount spent on each of 29 products and a household's income, using data on 3,924 households from the 1997 Consumer Expenditure Survey, conducted by the Bureau of Labor Statistics. The "income elasticity of demand," defined as the percentage change in consumption for a 1 percent increase in income, summarizes the degree to which a good is a luxury or a necessity. A good is a luxury if a 1 percent increase in income is associated with more than a 1 percent increase in consumption of that good.

Mr. Heffetz's analysis indicates that the higher the visibility of a good, the more likely it is to be a luxury item. For example, spending on cars and jewelry, two highly visible items, rises as a share of a household's budget as its income rises, while spending on home utilities, an inconspicuous category, falls as a share of the budget as income rises.

The relationship is far from perfect, however. Cigarette consumption is greater among lower-income households than among higher-income ones, yet cigarettes are the most noticeable product of all, according to the findings of the study. Formally, the index of visibility accounts for 12 percent of the way in which income relates to consumption across products. Interestingly, the effect of visibility on consumption applies only to the richest half of families, for whom the visibility index accounts for 20 percent of the way additional income is spent on various products.

For those in the bottom half, product visibility has no detectable effect on how income affects the pattern of consumption.

Although conspicuous consumption is expected to apply mainly to the rich, this finding would come as a surprise even to Thorstein Veblen, who claimed, "No class of society, not even the most abjectly poor, forgoes all customary conspicuous consumption."

Mr. Heffetz said he recently found support for another of Veblen's pet theories, though: the notion of "vicarious consumption," meaning the satisfaction someone derives from giving a conspicuous gift or throwing a lavish party. Christmas gifts are 40 percent more visible than the average consumer purchase, Mr. Heffetz calculated.

Why give conspicuous presents? One reason is that gift givers wish to signal that they can afford to be generous. A conspicuous gift transmits that signal to a wider audience than an inconspicuous one.

So before you return one of those loud ties, that gaudy pair of earrings or other conspicuous holiday gifts, recognize the impact of flaunting the gift on your reputation -- and on your benefactor's reputation as well.