

ARTICLES

Creative Destruction versus Robert Frank's Progressive Consumption Tax

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Keywords: creative destruction, positional good, capital structure, progressive tax, consumption tax

<https://doi.org/10.35297/001c.115888>

Quarterly Journal of Austrian Economics

Vol. 27, Issue 1, 2024

Joseph Schumpeter, like Ludwig von Mises, thought of capitalism as a process that often, over time, turned luxuries into necessities. Schumpeter warned that assessments that ignored this process, which he termed creative destruction, would misconstrue the social results that arise from capitalism in practice. This article exposes the applicability of this warning to the analyses of positional-good consumption presented by Robert Frank which led him to conclude that a steeply progressive tax on consumption would constitute a free-lunch, bringing in “trillions of dollars” without the loss of “anything of enduring value.”

Creative destruction is the essential fact about capitalism. . . . As long as this is not recognized, the investigator does a meaningless job. As soon as it is recognized, his outlook on capitalist practice and its social results changes considerably.

—Joseph Schumpeter (1950, 83–84)

Ignoring Schumpeter’s warning not to ignore the process of creative destruction in assessing capitalism’s merits, Robert Frank has argued for nearly four decades that expenditures on luxury/positional goods in capitalist societies is so inefficient and wasteful that state intervention to curtail them should be pursued. Preceding Schumpeter by several decades, Ludwig von Mises (also ignored by Frank) understood the process Schumpeter was talking about but did not describe it in identical terms.¹ Instead, Mises discusses it as a process which begins with innovative new products hitting the market

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The authors would like to thank Kathryn McClure, Nathan Snow, Sean Tommasi, and Daniella Bassi for help in editing and copyediting this article.

¹ Whether Austrian economists consider Schumpeter an Austrian school economist depends on the context of inquiry. For example, Don Lavoie (2015, 5), in his inquiry into the calculation debate, properly categorizes Schumpeter’s thinking as neoclassical rather than Austrian. In our article, on the other hand, Schumpeter is considered an Austrian because his ideas about creative destruction dovetail with those of Mises regarding capitalism’s record of advancing prosperity via luxury-to-necessity transformations.

as high-priced luxuries. Over time, entrepreneurial competition and further innovation transform such luxuries into lower-priced goods, eventually turning them into commonplace necessities.

Rebutting the argument that the wealth of society would be advanced if the production of luxury goods were curtailed via the nationalizing credit (empowering the state to deny credit to producers of luxuries), Ludwig von Mises (1960, 112) emphasizes capitalism's inimitable history of transforming luxuries affordable by few into commonplace necessities of the many: "Every innovation enters into life [under capitalism] as the 'luxury' of a small number of wealthy individuals, but once industry and the consumers have learned to adopt new ways, it becomes one of the obvious 'necessities' of the masses." Affirming Mises and Schumpeter, Deirdre McCloskey (2010, 78–85) emphasizes that creative destruction, over the past several centuries, has been a "win-win-win-win-win-lose" process in stark contrast to the zero-sum, "win-lose," popularizations that are common in static and ahistorical narratives purported to be characteristic of capitalism.

Giving no apparent thought to creative destruction, Robert Frank (1999, 279) modeled luxury consumption as a zero-sum arms race, advancing the idea that expenditures on luxury goods constitute a market failure so wasteful and inefficient that a steeply progressive tax can be imposed costlessly: "The progressive consumption tax is, on the best available evidence, a compellingly good idea—one that will free up literally trillions of dollars each year to spend in ways that will create lasting improvements in the quality of our lives. This is money for nothing, in the sense that we can get it without having to sacrifice anything of enduring value." Our critique of Robert Frank's proposal to cure "luxury fever" via progressive taxation of consumption expenditure, unlike other critiques,² focuses on Schumpeterian creative destruction—a process which Mises had discussed prior to Schumpeter but in other terms—as often turning luxuries into necessities (see footnote 1).

This article discusses Frank's tax proposal and his crucial error of ignoring creative destruction, provides an Austrian school rejoinder to Frank's (2006) assertion that a progressive consumption tax will accelerate economic growth, and examines the irony of Frank's apt application of Coasian thought to the issue of public interracial handholding in Atlanta during the 1960s versus his ineptness in thinking like Coase about luxuries.

² There are many alternative lines of criticism that might apply, but these are beyond the scope of this article. For example, an anonymous referee suggested this intriguing alternative line of criticism, tracing to Adam Smith, that might be applicable to Frank's tax: Since people crave status, "high taxes on consumption, inheritances, and so on tend to induce people to seek status inefficiently. If I can't leave Junior the family fortune, I can invest in the social networks and hand-shaking I would need to do to get him into one of the ivies. . . . [One] can argue with some justification that taxes on 'luxury fever' would most likely shift status-seeking to less-productive margins."

Robert Frank's Proposal to Progressively Tax Consumption

Since 1985, in high-profile academic articles and a series of books, Robert Frank has championed the view that the consequence of status seeking under capitalism is excessive, wasteful, and inefficient levels of expenditure on luxury/positional goods.³ He reasons as follows: When wealthy people purchase high-priced luxuries and positional goods, many other members of the same capitalist society unable to afford those luxuries will suffer serious harm as a result of their further decline in social status. Frank (1999, 272–73) leaves no doubt as to how serious he believes this harm is: “Ordinary spending is often precisely analogous to activities that generate pollution. When some job seekers buy custom-tailored interview suits, they harm other job seekers in the same way that motorists harm others when they disconnect the catalytic converters on their cars. Yet in each case, the rational individual response to market incentives is to take these harmful actions. And we have no reason to believe that the stresses people experience in trying to keep up with escalating community consumption standards are any less damaging to their health and longevity than the soot and ozone in the air they breathe.” Believing the harm severe and ubiquitous, Frank proposes the imposition of a steeply progressive tax on consumption expenditures.

Specifically, Frank (1999, 215) recommends the following marginal tax rates on “taxable consumption”: 20% for the \$0 to \$39,999 range; 22% for \$40,000 to \$49,999; 24% for \$50,000 to \$59,999; 26% for \$60,000 to \$69,999; 28% for \$70,000 to \$79,999; 30% for \$80,000 to \$89,999; 32% for \$90,000 to \$99,999; 34% for \$100,000 to \$129,999; 38% for \$130,000 to \$159,999; 42% for \$160,000 to \$189,000; 46% for \$190,000 to \$219,000; 50% for \$220,000 to \$249,000; 60% for \$250,000 to \$499,999; and 70% for \$500,000 to \$999,999.⁴ Frank’s rationales for the steep progressivity here are that (1) it is “essentially a luxury tax, but without the devastating cost of having to define and tax specific luxury goods on and case by case basis” (1999, 214) and (2) “if a progressive consumption tax is to curb the waste that springs from excessive spending on conspicuous consumption, its rates at the highest levels must be sufficiently steep to provide meaningful incentives for the people atop the consumption pyramid” Frank (1999, 216).⁵

3 Robert Frank uses a variety of terms (positional good, luxury, conspicuous-consumption good) in his discussions of consumption goods that confer social distinction on their users. The term “positional good” traces to Fred Hirsch (1976). For an insightful history of this term as defined in various ways by scholars from Hirsch to Frank, see Michael Schneider (2007).

4 Frank (1999, 214) defines “taxable consumption” as “income minus \$30,000 minus its savings minus its tax.” Frank’s is not a tax on particular luxury goods; again, it is a progressive tax on consumption expenditure whose aim is to curtail consumption of luxury goods. Frank (2006) sensibly eschews the targeting of particular luxuries because the political “quibbling over what should be taxed” would be “enormously wasteful” and targeting particular luxuries would inject “an inescapable element of arbitrariness and capriciousness into our public debate.” Because Frank’s tax proposal has never been implemented, no evidentiary assessment of it exists. There is a vast literature on other types of consumption taxes, beyond the scope of this article to review, which has led to some very interesting debates over the growth and welfare of taxes and transfers. For example, see Andreas Bergh’s (2006a) critique of Peter Lindert’s book (2004), which sparked a reply from Lindert (2006), which inspired a reply by Bergh (2006b).

5 In an earlier publication, Frank (1985b) recommends a “simple tax on positional good expenditures,” but does not spell out the details as he does later (1999, 215).

Ignoring Creative Destruction: Frank's Critical Error

Robert Frank's proposal for a progressive consumption tax is the result of a static analysis that ignores creative destruction—the process that Schumpeter highlights as having advanced capitalism more dynamically than socialism. We find no reference to “creative destruction” in publications by Frank (1985a, 1985b, 1988, 1999, 2005, 2006, 2007, 2011) that make the case for taxation to reduce expenditures on luxury/positional goods as a way to avoid what he sees as the dire consequences of individual status seeking under free-market capitalism. Throughout his career, Frank has steadfastly⁶ professed that the unconstrained consumption choices of individuals living under capitalism would lead to excessive, wasteful, and inefficient levels of expenditure on luxury/positional goods.

This raises the question of the applicability of Schumpeter's warning—that without consideration of creative destruction it will prove a “meaningless job” to investigate the practice of capitalism and its “social results”—to Frank's investigation of status-driven consumption in a free-market economy. The history of Henry Ford and his Model T suggests the prescience of Schumpeter's warning in the epigraph. In 1909, the Model T sold for \$850 (*Encyclopedia of Detroit*, s.v. “Model T,” accessed March 21, 2024, <https://detroithistorical.org/learn/encyclopedia-of-detroit/model-t>). What if, in response to its high price and the fact that rarely, if ever, was a Model T purchased by anyone who was not wealthy in 1909, Ford's Model T had been subjected to a positional-good consumption tax in order to discourage Ford and other budding automobile entrepreneurs from wasting time in a rat race of hard work producing luxury transportation few could afford?⁷

Ford's Model T offers a great example of creative destruction, which, as Schumpeter explained, is a process that plays out over time in ways that are revolutionary and of great benefit to human well-being. By 1924, as a result of scale economies and Henry's hard work, it had fallen in price to about \$260, with nearly half the households in the United States owning one! The Model T was transformed—by rising demand, mass production, and competition—from a consumption good whose high price put it out of reach for most into one whose modest price put it within reach of the majority.

6 Steven Landsburg's (1999) review of Frank's book *Luxury Fever* concludes that the book is “an infuriating mix of clever argument, befuddled reasoning, genuine insights, inconsistent assumptions, and well-turned phrases” (289). Consequently, Landsburg offers a tongue-in-cheek compliment: “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” (286).

7 Layard (2005, 228), building upon Frank's body of publications, argues that advocates of progressive income taxes have nothing to apologize for and that such taxes spare workers from having to participate in a “rat race” in which too many hours are worked and not enough are devoted to leisure. Frank (1985b, 115) argues not only for consumption taxes but (like Layard) for income taxes as well: “If consumption externalities are as important as they appear to be, then supply siders have got matters turned completely around when they insist that income and consumption taxes introduce serious distortions into the labor-leisure choice. When relative standing is important, such taxes serve, on the contrary, to mitigate an already present distortion in that choice.”

In one of his discussions of creative destruction, Schumpeter (1950, 67) highlights the evolution of the production and pricing of nylon stockings. Initially affordable only for queens, they eventually (again, via scale economies) became cheap enough for the factory girls to purchase.⁸

Electric lighting is no great boon to anyone who has money enough to buy a sufficient number of candles and to pay servants to attend to them. It is the cheap cloth, the cheap cotton and rayon fabric, boots, motorcars, and so on that are the typical achievements of capitalist production, and not as a rule improvement that would mean much to the rich man. Queen Elizabeth owned silk stockings. The capitalist achievement does not typically consist in providing more silk stockings for queens but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort. Joseph Schumpeter.

Like Schumpeter, Friedrich A. Hayek (1978, 43–44) explains capitalism as a dynamic and transformative process:

If we, in the wealthier countries, today can provide facilities and conveniences for most which not long ago would have been physically impossible to produce in such quantities, this is in large measure the direct consequence of the fact that they were first made for a few. All the conveniences of a comfortable home, of our means of transportation and communication, of entertainment and enjoyment, we could produce at first only in limited quantities; but it was in doing this that we gradually learned to make them or similar things at a much smaller outlay of resources and thus became able to supply them to the great majority. A large part of the expenditure of the rich, though not intended for that end, thus serves to defray the cost of experimentation with the new things that, as a result, can later be made available to the poor.

This insight of Hayek's, like Schumpeter's nylon-stocking example, challenges criticisms of the ability of the rich to gain social status from purchasing products that, when they initially hit the market, the poor cannot afford. If initial expenditures by the rich on such goods allow for entrepreneurial experiments that lead to production economies in which the poor can afford those goods, then the immediate negative status externality experienced by the poor that Frank worries about will be overwhelmed by the positive

⁸ Setting up this quote, Schumpeter (1950, 67) makes the point that “the capitalist engine is first and last an engine of mass production which unavoidably means also production for the masses.” For this reason, Schumpeter was not at all surprised, contra Frank, that although “in money terms” relative shares of national income had remained “substantially constant over the last hundred years,” relative shares “in real terms” had changed “substantially in favor of lower income groups.”

externalities that the expenditures of the rich eventually confer. Friedrich A. Hayek (1978, 51) concludes this line of thinking with a general warning against envious policies that handicap the rich but, in the end, handicap all: “We have only to remember that to prevent progress at the top would soon prevent it all the way down, in order to see that this result is really the last thing we want.” The evolution of the smartphone provides a key contemporary example of how creative destruction, and the hard work of the entrepreneurs who incite it,⁹ greatly increased the well-being of the masses over time.¹⁰ It evolved from bulky wireless phones that required antennae. Notwithstanding their bulkiness and limited capabilities, only the few could afford these first-generation portable phones. They were also very much conspicuous-consumption goods, as exemplified in the 1987 movie *Wall Street*, in which Michael Douglas as multimillionaire Gordon Gecko glories in the display of a clunky first-generation cell phone. Still, consistent with Hayek’s insight above, purchases of such phones by the rich helped defray the entrepreneurial “cost of experimentation” so they could later “be made available to the poor.”

Furthermore, even those considered poor in America can today afford mobile phones that are far superior to those first-generation luxury phones. Today’s smartphones are pocket-size, equipped with cameras, contain applications able to translate languages, and connect to the internet, giving their owners access to people and markets across the country and around the globe. What if the government had imposed a cripplingly high tax rate on first-generation cell phones because they were classified as positional goods that lowered the relative status of those who could not afford them?¹¹

The static analyses that led Frank to call for taxation of consumption expenditures to avoid the immediate status-altering impacts that positional-good consumption can have are “meaningless” for precisely the reason that Schumpeter stressed: they ignore the potential revolutionizing process of creative destruction which has often raised the well-being of the masses.

⁹ Thinking along similar lines, Steven Landsburg (1999, 288–89), critical of Frank’s oversight of the positive externalities conferred on the masses as a result of the hard work of entrepreneurs, rhetorically asks, “Should we have had a consumption tax to discourage Thomas Edison from overworking?”

¹⁰ Dwight Lee (2005, 391–93) emphasizes “sensory adaptation” research, which indicates that we tend to grow accustomed to products over time, increasingly taking them for granted. This, as Lee (392) explains, provides an explanation for the different results between happiness surveys derived from cross-sectional versus time-series data: “The cross-sectional studies are picking up the temporary effect that a change in income has on happiness. Because the effect of greater income on happiness is temporary, the average level of happiness over the entire population does not increase as income per capita increases.” Interpreting such results in light of sensory adaptation and the enormous benefits that capitalism bestows upon those who live under it, Lee (396) argues persuasively: “Maybe they are not happier because they have adapted to what, upon reflection, anyone would recognize as a far better state of the world [a state of the world where fewer of their children die, in which they live longer and healthier lives, where jobs become more interesting and less dangerous, and where leisure time increases]. Can anyone argue, however, that it makes more sense to dismiss these improvements as of little importance?” Kashdan and Klein (2006, 418–19) offer additional criticisms of Frank’s highlighting of happiness surveys; although Frank (2006) acknowledges some of their criticisms, Frank completely neglected Lee’s article.

¹¹ Kurt Vonnegut (1961) famously imagined a “Handicapper General” in his short story about a dystopian society in which individual merit and beauty are disallowed by a law enforced by handicaps aimed at making everyone equal to the least meritorious and least beautiful in society.

Again and again under capitalism, the introduction of new products has been followed by processes of incremental improvement and production economies that drive prices down and quality and durability up. It is through these processes that most people can afford products that once only the wealthy could afford. We discussed the Model T and the mobile phone, but many other products have followed a similar path (e.g., landline telephones, radios, televisions, washing machines, electric lighting, life-saving drugs and means of medical diagnosis, painless dental work, and electronic books that can be purchased and delivered in seconds).

In making his case for steeply progressive consumption taxation, Frank (1999, 172) argues that “concerns over relative position” are so powerful that “we are confronted at almost every turn with opportunities to pursue actions that create economic distortions for which there is no reason to hope that [they] . . . will be small, and much evidence for believing that they are large.” But it is far more likely that if Frank’s proposed taxation had been imposed in 1909, it would have prevented Americans who are considered poor today from becoming what the über-rich Americans of five generations ago would consider unimaginably wealthy.

An Austrian Rejoinder to a Frank Reply

Andrew Kashdan and Daniel Klein (2006) provide, in a series of vignettes, a wide-ranging critique of Robert Frank’s works. In one of their vignettes, Kashdan and Klein (422–24) criticize Frank, as we did in the previous section, for ignoring Hayek’s insight about the positive externalities arising from upper-class expenditures on innovative new products.¹² Frank’s (2006) reply was similarly wide-ranging, offering a series of short replies to each vignette. Because Frank’s reply to the vignette on “The Upper Class and Economic Growth” is highly relevant to this article’s thesis, and because Kashdan and Klein did not reply to it, it is crucial that we do so here.

Specifically, we reply to Frank’s (2006, 446–47) unchallenged assertions, quoted below, that the imposition of a progressive consumption tax would have no negative impact on economic growth in the short run and would accelerate economic growth in the long run:

The tax would not change the total level of spending. Rather, it would shift the composition of spending in favor of investment. Innovation is hardly confined to the consumption sector. Producers of capital goods also have strong incentives to come up with useful innovations. And with the greater aggregate investment spending caused by a consumption tax, more

¹² For the reader’s convenience, we repeat here the final sentence of Hayek’s (1978, 43–44) quote: “A large part of the expenditure of the rich, though not intended for that end, thus serves to defray the cost of experimentation with the new things that, as a result, can later be made available to the poor.”

resources than before would be available for research and development. There is thus no reason to expect innovation to slow down, even in the short run. In the long run . . . higher rates of investment mean a higher rate of income growth, which means that consumption along the high-savings trajectory will eventually exceed what it would have been had we remained on the low-savings trajectory. From that point forward, there would be more expenditure on innovation in both the consumption and capital goods sectors.

Above, Frank asserts that the imposition of a progressive consumption tax would leave “total expenditure” unchanged and that, consequently, the tax would not slow economic growth “even in the short-run.” Nor, he asserts, would the tax cause any reduction in “useful” innovation; it would simply “shift” expenditures on innovation from the “consumption sector” into the “capital goods” sector of the economy. Frank thinks of capital as nonspecific (i.e., capable of being costlessly shifted in response to changes in relative prices and exogenous shocks), and he thinks that innovations in the capital-goods sector are independent of innovations in the consumption sector. In contrast, Austrian school economists emphasize that the usefulness of the heterogeneous capital goods that comprise an economy’s capital structure varies directly with changes in relative prices and exogenous shocks (e.g., Frank’s proposed consumption tax), depending on how well the universe of diverse and dispersed capital goods fit into the process by which consumers’ goods are invented, productized, manufactured, inventoried, and delivered now and in the future.

Innovations across the capital structure arise in response to changes in relative prices, consumer needs, and the circumstances of time and place confronting rivalrous entrepreneurs. Furthermore, these innovations then inspire changes in relative prices and consumer needs, which are the basis for subsequent rounds of innovation.¹³ For Austrians, “sustainable” economic growth results from either a change in the intertemporal preferences of households or from innovations in products, capital structure, or both that better align producers’ plans with consumers’ needs now and in the future.¹⁴

Recognizing the interconnection and feedback between the capital-goods and consumer-goods sectors deepens our understanding of how creative destruction causes growth, the process which Schumpeter highlights as essentially distinguishing capitalism from socialism. As a result of seeing

13 Randall Holcombe (1998, 55) provides this Austrian perspective of the entrepreneurial process that generates economic growth: “The market system produces this setting, and entrepreneurship within the market setting makes the process work. Innovations produce profit opportunities which are then seized by entrepreneurs, and these entrepreneurial activities create more profit opportunities.”

14 For Austrian analyses of sustainable economic growth inspired by these changes, see Roger Garrison (2001, 61–67 on intertemporal preference changes, 57–61 on innovation). See Garrison (2001, 67–83) for an Austrian exposition of unsustainable growth caused by excessive credit expansion which dis-coordinates the structure of heterogeneous capital.

this interconnection and feedback, Mises (1960, 111) understands that as “industry and the consumers have learned to adopt new ways” (i.e., as a result of successive rounds of innovation and consumer feedback), luxuries have frequently transformed over time into commonplace necessities.

The luxury consumption of the well-to-do plays a dynamic role that makes it one of the most powerful propulsive forces of economics progress. . . . Think, for instance, of our clothing, the lighting equipment and bathroom fixtures in our apartments, the automobile and tourism. Economic history shows how yesterday's luxury has become today's necessity. . . . Critics of the capitalist social order, if they plan to improve the conditions of the masses, should hesitate to make any reference to luxury consumption, since so far no one has succeeded in invalidating the assertions of theorists and the experience of practical men that only capitalist management warrants the highest conceivable productivity.

Mises's insight here, that the capitalist process which turns luxuries into necessities is crucial to the well-being of the masses, expresses what Robert Frank disregards in his proposal to curtail luxury consumption via progressive taxation of consumption expenditures. Blind to this, Frank sees a problem that Americans have never had and never will have as long as they continue to benefit from the creative destruction that depends on information and cooperation that only market transactions can provide.

Those we should feel sorry for are those who live in countries where most people live on less than \$5.50 a day and can seldom buy even what they don't consider a luxury.¹⁵ In America, as in other market-based economies, a steady stream of luxuries have largely been taken for granted by a large and growing majority of people as a result of the process that converts luxuries into widely affordable (albeit still luxurious) necessities. It is difficult to know if free-market processes are creating luxuries more or less rapidly than they are creating necessities by improving products and selling them at lower prices. What is *not* difficult to know is that Frank's steeply progressive consumption tax would reduce, for the wealthy and non-wealthy alike, the number of luxuries produced via the expansion of national wealth. Yet Frank believes that without his tax, the stress many consumers would experience in trying to

¹⁵ See World Bank (2018). Of course, simple reminders alone of miserable living standards are insufficient to impart adequate understanding of the processes and causes of such misery. We agree with John Nye (2002, 4) in this: “Of course, even with the reminder of other people's misery, the small differences that seem close to us of them appear large enough to block our vision of the bigger picture.” This is why articles like Nye's, and ours, are needed. As Adam Smith (1979, 137) observed (in the context of discussing an earthquake in China), the power of man's narrow-minded self-love is exceeded by the power of his “inner spectator,” who aligns man's thoughts and conduct with the bigger picture via “reason, principle and conscience.”

keep up with escalating community consumption standards would damage their health and longevity as much as the soot and ozone in the air they breathe. (Recall Frank 1999, 272–73.)

To be consistent and objective, Frank should also consider the advantage of not imposing taxes on luxuries such as Ford's 1909 Model T automobile. The tax structure of the early 1900s did not impose extra taxes on luxuries and thereby artificially discourage Henry Ford from converting the Model T from an expensive luxury into what was within a decade or so seen as an increasingly common and necessary means of transportation. Fortunately for billions of people since 1925, other automobile producers began competing with Ford and each other. This led to the production of a huge number of increasingly luxurious automobiles that, for the most part as time passed, ceased to be considered luxuries and instead became routine, convenient, and comfortable ways to get around.

Of course, regarding automobiles, people eventually began complaining about the real pollution discharged by the huge numbers of cars in congested cities. Fortunately, though, the pollution that came out of the tailpipes of cars left the streets immensely cleaner than the pollution that came out of the “tailpipes” of horses in such cities. Also, when it comes to reducing pollution coming out of tail pipes, it is far easier to do it by adjusting car tailpipes than by adjusting horse tailpipes. Because of the sheer popularity of cars, the public eventually wanted automobile manufacturers to adjust tailpipes to reduce pollution, which may have occurred sooner because of encouragement from the federal government. But circumspection is a given for a government that also tries to reduce global warming by requiring gasoline to contain ethanol, which even Al Gore said did not help the environment (“Al Gore: Votes, Not Science, Led Me to Back Corn Ethanol,” NBC News, November 22, 2010, <https://www.nbcnews.com/id/wbna40317079>).

To bolster our discussion of the dramatic fall in prices of Model T automobiles in the early twentieth century, consider the extraordinary rise in automobile quality, safety, and durability¹⁶ over the past four decades that resulted from competition among producers of “luxury” lines. It is this process that has given rise, over time, to mass production of less expensive “luxury” models with features providing far greater utility, safety, and durability. In particular, consider the Lexus line of automobiles, which traces to an initiative, beginning in the 1980s, by the Toyota Motor Corporation

¹⁶ In 1977, the average vehicle age in the United States was 6.4 years, rising steadily to 8.24 in 1995 and then 11.9 in 2021. See Hu and Young (1999) for 1977 through 1995. For 2021, see “How Long Do Cars Last?,” CapitalOne Auto Navigator, May 10, 2022, <https://www.capitalone.com/cars/learn/finding-the-right-car/how-long-do-cars-last/1512>. Also see Dexter Ford, “As Cars Are Kept Longer, 200,000 Is the New 100,000,” *New York Times*, March 16, 2012. Clearly, automobile durability has risen significantly. This is important because it suggests that Frank's proposed progressive taxation of the consumption expenditures in a year (e.g., the entire purchase price of a vehicle in the year it is purchased) would be much more distortionary than it would have been in 1977 when automobiles were much less durable.

aimed specifically at producing “luxury” models capable of profitably competing for the attention of consumers demanding luxurious automobiles (“How Long Does a Lexus Last? Mystery Solved!,” Way, accessed March 21, 2024, <https://www.way.com/blog/how-long-do-lexus-last/>). The genesis of this line traces to two initial models, the Lexus LS, launched by the Lexus division in 1989 (“History,” Lexus Newsroom, Toyota Motor Sales, U.S.A., accessed March 7, 2024, <https://pressroom.lexus.com/history/>).

In 1989, the Lexus LS had a base price of \$35,000, which, adjusting for inflation, is just north of \$82,000 in 2023 dollars. In 1989, the Lexus ES 250 had a base price of \$22,000, which, adjusting for inflation, exceeds \$51,000. Both models were successful, and in 1991 the ES 250 was the biggest seller in an expanding line of Lexus models. Now, the two best-selling 2024 models are the Lexus RX and Lexus NX, whose base prices, as listed by the *Kelley Blue Book* (2023), are \$40,305 and \$36,490. Although both models, adjusted for inflation, are far less expensive than either the 1989 Lexus LS or ES 250, both models are expected to last longer and offer features that enhance consumer utility in ways that were inconceivable in 1989.

Thinking about how the production of luxury automobiles has led to the mass production of automobiles loaded with “luxurious” features (e.g., safety, comfort, reliability, and durability) at increasingly affordable prices facilitates deeper Austrian insight into Schumpeter’s emphasis on creative destruction and Mises’s emphasis on luxury-to-necessity transformations as key drivers of economic growth.¹⁷ From an Austrian perspective, Frank’s tax will likely result in capital consumption and distortionary capital reshuffling away from a structure¹⁸ which aims at the creation of consumption goods of greater durability, reliability, and safety because such goods tend, at any point in time, to have higher prices.¹⁹ Consumer purchases of such goods can be understood as a form of saving and investing; the payment of a premium for

17 David Gordon (2009), in an insightful review of Robert Frank (2009) (a book in which Frank again makes a pitch for the imposition of a progressive tax on consumption expenditure), catches Frank in a fundamental inconsistency pertaining to the kind of “luxurious” features we are emphasizing. On the one hand, Frank makes himself appear reasonable by admitting that quality improvements are a source of value, but then, in advocating for the progressive taxation of consumption, he ignores product quality: “Frank does not grasp that he has here refuted his main reason for a consumption tax. By assuming that people want certain goods only because others want them, he ignores the likelihood that people consider the consumption Frank deems wasteful to be genuine quality improvements.” For insightful critical reviews on other books by Robert Frank published by the Mises Institute, see David Gordon (2000, 2012).

18 This article’s critique of Robert Frank’s progressive consumption-expenditure tax complements Rothbard’s (1970, 807–13) critique of the idea that either a “general sales tax” or taxation of a “specific industry” can enhance growth prospects. Like Rothbard, we draw attention to tax distortions of the capital structure arising from decreased demands for the products of higher-order firms.

19 Austrian school thought emphasizes that for any explanation of economic growth to be “relevant,” it “should characterize capital goods by their place in the structure of production as conceived by entrepreneurs” (Ritenour 2023, 151). From this perspective, Ritenour (67–68) explains, in parallel to our discussion in the text, that changes in market demand for consumer goods will set off a process by which capital goods that become obsolete in prevailing uses are either “reincorporated” elsewhere in the capital structure or are “scrapped.” Ergo, Robert Frank’s explanation of economic growth is seen as irrelevant beyond the blackboard, blind to both capital consumption (scrapping) and the costly capital restructuring that would attend his progressive tax on consumption—which would reduce market demand for goods of higher quality (e.g., greater durability, reliability, and safety).

a more durable and reliable consumption good is a choice to make a greater sacrifice today in order to obtain a longer stream of future consumption services.

Lacking Austrian perspective, Frank's overaggregated "consumption" and "saving" categories are completely independent of product durability and reliability. According to Frank's Keynesian categorization, spending \$80,000 on a "luxury" automobile that is expected to last eighteen years is no different from spending \$80,000 on a 154-day luxury cruise around the world. Following this Keynesian line of thought, taxing either of these as "consumption" has the same implications for consequent changes in saving, capital investment, and economic growth. From an Austrian perspective,²⁰ focusing, as Frank does, on overly aggregated measures of consumption, saving, and investment is understood to be a fundamentally unreliable approach that conceals the mechanisms of change (e.g., the relative prices of consumption goods and capital goods across the structure of capital) which are at work allocating and reallocating resources toward more highly valued usages around the economy and across time.²¹

Frank's Deep Understanding of Coase's Framework Is Ironic

Robert Frank's misplaced enthusiasm for imposing a steeply progressive consumption tax was the result of his complete oversight of the dynamic process of creative destruction. Ironically, this was despite the fact that he realized that the dynamic application of the Coasian prescription to an interesting social problem depended on making use of foreseeable changes in public attitudes that would bear on the costs and benefits of public policy.

When analyzing the question of the appropriate public policy regarding the prohibition of public interracial handholding in Atlanta, Georgia during the mid-1960s, Frank insightfully explains the correct application of Coasian thinking about the problem of social cost. Frank's (2011, 95–97) deep understanding of the Coase framework is clear from this (necessarily lengthy) excerpted quotation:

In that environment, there were few who would benefit from having the right in question [to engage in interracial handholding] and many who would be offended by the exercise of it. The apparent implication is that the option with the

²⁰ The importance of consumption durability in Austrian economics traces to William Stanley Jevons (1965, 231), as noted by Roger Garrison (2001, 48) in his seminal work *Time and Money: The Macroeconomics of the Capital Structure*. Although Garrison emphasizes that "in some applications" explicit consideration of "durable consumption goods" might be required, because Garrison's focus was on the disruption of the heterogeneous capital structure caused by excessive credit expansion, his analysis abstracted away from a full structure-of-investment triangle as presented by Jevons. To understand the negative growth implications of Robert Frank's proposed tax on the production of consumption goods, and Mises's opposition to interventions by the state that would curtail the production and consumption of luxuries, the durability of consumption goods is a clear and important consideration, as we emphasize above.

²¹ Here we note that Frank's discussion of macroeconomic aggregates, like Keynes's, is subject to the same criticism that Hayek (1995, 128) made in 1931: "Mr. Keynes's aggregates conceal the most fundamental mechanisms of change."

best consequences overall would be to prohibit interracial handholding. . . . The Coase framework thus seems to say that if it had been practical for the affected parties to negotiate, they'd have agreed to implement the ban on interracial handholding and carried out the indicated compensation payments. . . . But before rejecting Coase's framework, those who share my view that a prohibition on interracial handholding would be wrong should consider the possibility that the framework was simply applied incorrectly in the example. As described, the analysis completely ignores the fact that people adapt over time in dramatically different ways to different forms of real or imagined injuries. The cumulative amount that white residents of Atlanta in the 1960s would have been willing to pay to avoid the sight of interracial handholding probably did outweigh the cumulative amount that the small number of interracial couples would have been willing to pay for the right to hold hands. But as interracial relationships have become more common during the intervening years, attitudes have changed dramatically, and in ways that were completely predictable at the time. . . . Activities that cause harm to others are inherently reciprocal. If interracial handholding occurs, some may feel injured. If interracial handholding is prohibited, others will surely be injured. The Coase framework says the best response in such cases is the one that minimizes total harm. Proper application of that framework requires an assessment not just of the injuries different parties feel, or claim to feel, in the current moment but also of their capacities to avoid those injuries and to adapt over time. In short, the Coase framework, properly applied would never have ruled against interracial handholding in the first place.

Frank correctly emphasizes the reciprocal nature of the problem of social cost and the "proper" application that "the Coase framework" demands by considering not just static costs and benefits but, in addition, the predictable adaptations over time that alter costs and benefits.

Unfortunately, Frank's thinking about the consumption of luxury/positional goods considers neither the reciprocal nature of the problem nor the foreseeable future adaptations. Instead, his thinking about the status-driven externalities arising from expenditures on luxury goods is one-sided, like the Pigouvian analyses of environmental externalities that, notwithstanding Coase's seminal publication, remain common in contemporary economics

textbooks.²² What Coase most objects to is that Pigou takes a one-sided, rather than reciprocal, view of the problem of social cost. Coase sees what Pigou does not: in the real world of positive transaction costs, the imposition of a penalty on a factory in accordance with the reduction in the value of adjoining properties would create a moral hazard that could, to the detriment of society, bankrupt the factory. Coase correctly recognizes that not only is the land adjoining the factory a source of value to the members of society, but the output of the factory is valuable too. Without considering the trade-off between the value of the output of the factory and the value of the adjoining land, an economically efficient use of the resources available to society cannot be ensured.

Coase (1960, 42) points out that although it is certainly true that a smoke-emitting factory imposes a negative externality on the people living in the neighborhood, it is equally true that with a Pigouvian tax on the factory, people moving into the vicinity of the factory impose a negative externality on the factory: “Without the tax [on the smoke-emitting factory], there may be too much smoke and too few people in the vicinity of the factory; but with the tax there may be too little smoke and too many people in the vicinity of the factory. There is no reason to suppose that one of these results is necessarily better.” Like Pigou, Frank takes a one-sided view of an externality in arguing for a tax on a “polluter” without considering the social value of the actions and dynamic processes that “polluters” precipitate. Frank’s proposal for imposing a tax on conspicuous consumption assumes away any consideration of the creative-destruction revolutions that so often, as Mises observed, transform luxuries into necessities.

Conclusions

The bad economist pursues a small present good, which will be followed by a great evil to come, while the true economist pursues a great good to come—at the risk of a small present evil.

—Frédéric Bastiat (2015, 1)

Robert Frank’s analysis of social-status competition and positional-good externalities is an example of the type that Frédéric Bastiat (2015) correctly sees as “bad.” Because it is clear from Frank’s discussion of interracial handholding that he understands that a proper application of the Coase framework depends both on short-run and long-run considerations, his shortsightedness about luxury consumption is ironic. The progressive consumption tax on consumption expenditure that he proffers as a

²² McClure and Watts (2016) analyze the continued practice among economics textbook authors of presenting students with one-sided, Pigouvian analyses of externalities.

“compellingly good idea” and as “money for nothing” is nothing of the sort. Instead, it reveals his blindness to the dynamic process of creative destruction, the process that Schumpeter considered capitalism’s defining feature.

Such oversight over so many decades by such a high-profile, insightful, and prolific scholar as Robert Frank lends credence to the pessimism about capitalism’s survival that Schumpeter maintained from 1942 until his death in 1950. Schumpeter was rightly worried that the wealth arising from capitalism would give rise to a class of intellectuals whose nonsense could inspire counterproductive policies that might appeal to the ignorant majority. As Schumpeter (1950, 145; his italics) says of the electorate, “Like Louis XV, they feel *après nous le déluge* [after us the flood].”

Hayek, like Schumpeter and Bastiat, also worries about the shortsightedness of economists. Having witnessed the plethora of anti-capitalist policies imposed by government during the Great Depression, F. A. Hayek (2009, 409) stresses that overemphasizing the short run was not only “a betrayal of the main duty of the economist” but also “a grave menace to our civilization.” Rebuking the Keynesian policies of the 1930s, Hayek (410) concludes:

Mr. Keynes finds his views anticipated by the mercantilist writers and gifted amateurs: concern with the surface phenomena has always marked the first stage of the scientific approach to our subject. But it is alarming to see that after all we have once gone through the process of developing a systematic account of those forces which in the long run determine price and production, we are now called upon to scrap it, in order to replace it by the short-sighted philosophy of the business man raised to the dignity of a science. Are we not even told that, “since in the long run we are all dead”, policy should be guided entirely by short-run considerations? I fear that these believers in the principle of *après nous le déluge* may get what they have bargained for sooner than they wish.

In advocating progressive taxation of consumption on the basis of static analyses of status externalities, Robert Frank shows his lack of knowledge regarding the history of how economic growth has unfolded under capitalism—namely, via a dynamic process of creative destruction that, again and again, has transformed what were initially luxuries into what over time became necessities. History matters, as do incentives and as do both long-run and short-run processes.

The “next big thing” is less likely to inspire creative destruction if Frank’s steeply progressive taxation of luxuries is put into place. The dynamic process by which the practice of capitalism has transformed goods such as automobiles and washing machines from luxuries into necessities is too

important to human thriving to allow it to be crippled by a steeply progressive consumption tax arising from academic disregard for Schumpeter's warning not to ignore creative destruction.

Submitted: July 27, 2023 CST, Accepted: February 13, 2024 CST



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