Veblen’s theory of the leisure class revisited: implications for optimal income taxation

Thomas Aronsson · Olof Johansson-Stenman

Abstract  Several previous studies have demonstrated the importance of relative consumption comparisons for public policy. Yet, almost all of them have ignored the role of leisure for status comparisons. Inspired by Veblen (The theory of the leisure class. Macmillan, New York, 1899), this paper assumes that people care about their relative consumption and that leisure has a displaying role in making relative consumption more visible, based on a two-type model of optimal income taxation. While increased importance of relative consumption typically implies higher marginal income tax rates, in line with previous research, the effect of leisure-induced consumption visibility is to make the income tax more regressive in terms of ability.

JEL Classification  D62, H21, H23, H41

Closely related to the requirement that the gentleman must consume freely and of the right kind of goods, there is the requirement that he must know how to consume them in a seemly manner. His life of leisure must be conducted in due form…  Veblen (1899, Chap. 4)
1 Introduction

The Theory of the Leisure Class by Veblen (1899) remains the classic reference to the idea of “conspicuous consumption,” according to which individuals signal wealth—or status more generally—via their consumption behavior. Today, a substantial body of empirical evidence suggests that people care about their relative consumption, i.e., their consumption relative to that of others—a possible indication of status seeking—and hence not just about their absolute consumption as in conventional economic theory.¹ There is also a rapidly growing literature showing how public policy ought to respond to the externalities and distributional challenges that relative consumption concerns give rise to.² Yet, and somewhat paradoxically given the title and content of Veblen’s book, almost the entire literature dealing with optimal tax and expenditure responses to relative consumption comparisons has ignored the role of leisure in such comparisons.

In the present paper, we consider optimal redistributive income taxation and, in line with the ideas of Veblen (1899), assume that leisure has a displaying role in making relative consumption more visible. There are at least two aspects of such consumption visibility. First, the utility gain to an individual with higher relative consumption may increase with his/her own use of leisure. This is so because it takes time to be able to consume in a seemly manner. Second, the positional consumption externality that each individual imposes on others may increase with the time he/she spends on leisure. Intuitively, people will have a hard time noticing a person’s new BMW if he/she works all the time. We discuss both of these aspects below, and show that only the latter directly affects the policy rules for marginal income taxation.

As far as we know, Aronsson and Johansson-Stenman (forthcoming) constitutes the only previous study on optimal policy responses to relative consumption concerns where leisure plays a role for relative social comparisons. In that study, individuals derive utility from their own consumption and use of leisure, respectively, relative to the consumption and use of leisure by other people. We shall return to their results below. In the present paper, though, we do not assume that individuals care about their own use of leisure relative to that of other people; instead, their own and others’ use of leisure will matter in the sense of making their own and others’ private consumption more visible. We believe that this approach is closer in spirit to the ideas put forward

---

¹ This empirical evidence includes happiness research (e.g., Easterlin 2001; Blanchflower and Oswald 2004; Ferrer-i-Carbonell 2005; Luttmer 2005; Clark and Senik 2010), questionnaire-based experiments (e.g., Johansson-Stenman et al. 2002; Solnick and Hemenway 2005; Carlsson et al. 2007; Corazzini et al. 2012), and, more recently, brain science (Fliessbach et al. 2007; Dohmen et al. 2011). See Samuelson (2004) and Rayo and Becker (2007) for evolutionary models consistent with relative consumption concerns. Stevenson and Wolfers 2008 constitute a recent exception in the happiness literature, claiming that the role of relative income is overstated.

² Earlier studies dealing with public policies in economies where agents have positional preferences address a variety of issues such as optimal taxation, public good provision, social insurance, growth, environmental externalities, and stabilization policy; see, e.g., Boskin and Sheshinski (1978), Layard (1980), Oswald (1983), Frank (1985, 2005, 2008), Ng (1987), Corneo and Jeanne (1997, 2001), Brekke and Howarth (2002), Abel (2005), Blumkin and Sadka (2007), Aronsson and Johansson-Stenman (2008, 2010), Wendner and Goulder (2008), Kanbur and Tuomala (2010), and Wendner (2010, 2011). Clark et al. (2008) provide a good overview of both the empirical evidence and economic implications of relative consumption concerns.