Success, Luck and Overhauling the Tax System

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by Michael Edesess

Robert H. Frank is a professor of economics at Cornell University. In his new book, *Success and Luck: Good Fortune and the Myth of Meritocracy*, Frank explores the role of luck in success, in the process making some noteworthy observations. Then the book gets into its real agenda: a proposal for the overhaul of the tax system.

How much of success is due to luck?

Success requires hard work and dedication. But it can depend on luck too.

Frank argues that luck plays a larger role in success than most people are willing to acknowledge, especially most successful people.

People who are successful are often described as risk-takers. Being a risk-taker means deliberately engaging in an endeavour whose result is partially determined by chance. Therefore, successful risk-takers are by definition lucky risk-takers. Those who did not succeed may have merited the success by any other measure, but they were unlucky risk-takers.

Nevertheless, many, as Frank notes, seem uncomfortable with the possibility that success in the marketplace depends to any significant extent on luck. Frank even shows, using a valid statistical mathematical argument[1], that the more well-qualified competitors there are for a particular perk – even if the luck component in the result is small – the more likely it is that the winner will be the most lucky, not the best-qualified. Thus, the winner may be very well-qualified, but others who are equally or more well-qualified will not have won.

However, Frank believes the unwillingness to acknowledge the importance of luck may actually be helpful to success. If you believed that success is largely a matter of luck, you might be less motivated to work hard, expecting luck to play a determinative role anyway.

Parents who teach their children that luck doesn't matter, says Frank, may for that very reason be more likely to raise successful children than parents who tell their children the truth.

The "positional goods" tax bracket

From his discussion of the role of luck in success, Frank makes a not very seamless transition to another topic, one that is presumably related, but rather tenuously.

Frank notes that the average American wedding now costs more than $30,000, almost three times as much as in 1980. The median new house, he says, is now 50% larger than in 1980, even though median income has grown only slightly in real terms.

How big should a house be? How much should a wedding cost? "Orthodox economic theories assume, preposterously," says Frank, "that our answers are completely context-free. Yet all available evidence indicates that people find it impossible even to think about such questions without a suitable frame of reference."

In other words, people find it difficult to answer such questions without knowing, how big is my neighbor's house? How much did my neighbors spend on their daughter's wedding? The cost and value of such "positional goods" is a function of how I stand relative to my peer group.

How does this relate to success and luck? Frank does not state it. But presumably the value of people's "positional goods" is related to the "preening rights" they claim as a result of their successes. The visible value of the positional goods buries forever the role of luck in achieving that success.

The highly variable value of positional goods

Frank then tries to demonstrate how malleable the value of these positional goods is. When young, he was a Peace Corps volunteer in Nepal. He lived in a two-room house with no electricity or plumbing. “If I lived in that same house in the United States, my children would have been ashamed to invite friends over. Yet in Nepal it was a completely satisfactory house… If my Nepalese friends could see my house in Ithaca, New York, they’d think I’d taken leave of my senses. They’d wonder why anyone would need such a grand home. Why so many bathrooms? But most Americans don’t think that. That’s because our evaluations depend so heavily on what’s nearby.”

He notes that in New York City, multibillionaires rarely live in apartments larger than 8,000 square feet, though they could easily afford much bigger spaces. “Yet they choose not to, perhaps because New York’s high prices have made it socially acceptable for even the hyper-rich to live in more modest spaces.”

So, given that social acceptability, they actually are influenced by the cost of the apartments to buy a smaller one, since there’s so social stigma attached.

Hence, the value of positional goods is a function of the positional goods of one’s neighbors. But it is not wholly untethered from cost.

Wher does this all lead?

The point of all this is not necessarily clear during the course of reading Frank’s short book. However, it eventually becomes clear that his real point is to introduce, and argue for, a particular public policy proposal.

It is not a radical proposal – in fact a form of it was set forth by Milton Friedman as early as 1943 – but it is disruptive nonetheless.

Frank’s proposal is of a progressive consumption tax. That label tells you little about it, but the concept is very simple. Right now the income tax taxes all income, whether it is saved or consumed. The progressive consumption tax would deduct the savings from income before applying the tax. Therefore, it would tax consumption only – income earned only to be saved would be untaxed – but it would be much more steeply progressive than the current income tax.

One of the benefits of this tax, Frank claims, is that it would alleviate the “arms race” in positional goods, without anyone being the poorer for it. When all of the people who are competing for positional goods find themselves with less disposable income – remember, the tax will reduce everybody’s disposable income in a tax bracket equally – they may pay less for a home, but as a positional good it will be no less valuable. Says Frank, “Not a shred of evidence suggests that such a change would make top earners any less happy. If all mansions were a little smaller, all cars a little less expensive, all diamonds a little more modest, and all celebrations a little less costly, the standards that define ‘special’ in each case would adjust accordingly, leaving successful people just as happy as before.”

The progressive consumption tax

It seems a little odd that while the progressive consumption tax proposal is at the heart of Frank’s book – its real unifying principle – one must wait until his Appendix 2 to get the details about it. No doubt, Frank’s publisher thought that a book about a progressive consumption tax would not be as marketable as one that is at least nominally about success, luck, meritocracy and inequality.

But in Appendix 2, one does get the details about the tax – how it would be implemented, and how special cases would be handled. Like any tax proposal, it might start simple, but it has to deal with a myriad of special cases and thus becomes more complicated.

The chief benefit of such a tax, according to Frank – apart from alleviating the positional goods arms race – is that it would stimulate higher investment and lower consumption. More workers would be employed to produce investment goods and fewer to produce consumer goods. Over time, he says, higher investment would increase worker productivity, leading to higher wages and more rapid growth in national income.

These are speculative results, of course, like the implications economists draw about any policy measure for which they believe they can make predictions. However, in this, Frank is not alone among economists. Many conservative economists believe in a consumption tax, in various forms, and some advocate it in the same form as Frank’s. Frank cites not only Milton Friedman – who wrote to Frank favorably, noting his own earlier work, after Frank first floated his idea in an article in 1997 – but also a recent book, *Progressive Consumption Taxation: The X-Tax Revisited*, by two scholars at the conservative American Enterprise Institute, Alan D. Viard and Robert Carroll.

Details, yes, need to be worked out, though Frank – and perhaps Viard and Carroll, and Friedman – have much worked out. Loans taken out during a given year would be regarded as negative savings. And large expenditures on durables like houses would be spread out as consumption of housing services over many years. The tax code would become as complicated in some respects as it is now, though one hopes not nearly so much.

He does not say so, but it seems clear that Frank expects that the progressive consumption tax would net more revenue for the government. He says that at least some useful public goods would be purchased with the "additional revenue," and it could help to alleviate the underinvestment in infrastructure that plagues the United States.

The liberal/conservative divide

Underlying the book is an issue that Frank mentions explicitly near the beginning.

"How important is luck?" he asks. "Few questions more reliably divide conservatives from liberals. As conservatives correctly observe, people who amass great fortunes are almost always extremely talented and hardworking. But as liberals also rightly note, countless others have those same qualities yet never earn much."

The feeling of a liberal/conservative divide can be sensed throughout the book. We can be 99% certain that Frank is on the liberal side of that divide, even though he rarely explicitly expresses liberal views, and his tax proposal is one that is embraced by conservatives.

The divide between liberals and conservatives has become a bigger and bigger mystery. It no longer seems to be a division about political philosophy, or policy. Rather, it seems to be a tribal difference between two peoples who self-identify differently. What is the core of that self-identification, in each case? Like Justice Potter Stewart's hard-core pornography, you know it when you see it. Otherwise, it is difficult to define.

John C. Bogle, the founder of Vanguard, wrote a wonderful little book titled, *Enough*. In it, he stressed how destructive an obsession with financial success can be, and with an obsession for more and more and more of anything. Yet he noted to me in a conversation that, by contrast, the title of a popular book about Donald Trump is *Never Enough*.

The Trump view would probably now be identified with the conservative side of the divide, while the Bogle view of "enough" would be identified with the liberal side. Yet Bogle is a traditional conservative Republican, even though he voted for Clinton and Obama in the past.

How have these identifications of liberal and conservative metamorphosed to such an extent as to become unrecognizable in terms of any coherent philosophical or political positions?

This is a mystery we shall need to spend the next decades unravelling.

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[1] Similar to the proof that the more statistical tests you do, the more likely that the result with the highest significance level will be spurious.