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Conspicuous Consumption? Yes, but It's Not Crazy

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There's no denying the over-the-top flavor of much high-end consumption these days. A Reinast toothbrush, of solid titanium, sells for $4,200 even though it may not get your teeth any cleaner than a $2 toothbrush from Walgreens. Then there's the Greubel Forsey Double Tourbillon 30° Technique, a platinum wristwatch that sells for scores of thousands of dollars. Its intricate mechanical works may be a masterpiece of traditional engineering, but for that, you might keep your day-to-day appointments just as well with a $40 Timex.

Buyers of these products have plenty of money, of course. But are they different from the rest of us in other ways? It's an important

question. Because income growth in recent decades has been so heavily concentrated at the very top, luxury markets have become the biggest drivers of economic activity around the world. To understand these markets, we must first understand the motives of the customers they serve, and it's here that many analysts have stumbled.

One common claim is that the wealthy routinely violate the economist's law of demand. A bedrock principle of economic rationality, this law holds that as the price of a good rises, consumers buy less of it. Many analysts, however, portray the rich as people who lust after what are known as "Veblen goods" — commodities whose sales actually increase when their prices rise.

The term was inspired by the economist Thorstein Veblen, who interpreted much consumption by the rich as an attempt to signal their great wealth to others. In his view, the lavish summer mansions of 19th-century industrialists in Newport, R.I., were valued less for their own sake than for the fact that they marked their owners as people of wealth and power.

Yet wealth-signaling is probably less important than Veblen thought. Rich people buy luxury goods for many reasons, but even those seeking to display their wealth can almost always find efficient ways of doing so. Why buy a gratuitously expensive good when you can signal your riches just as effectively with an equally expensive good that you actually like? To be sure, billionaires are often willing to spend enormous sums for beautiful things that can't be duplicated at low cost. But almost none of them would want to buy more of something simply because its price had risen.

If they were merely chasing Veblen goods, the rich would be easily exploited by the purveyors of luxury items. Yet the markets for these goods are among the most bitterly contested, and not just because the stakes are so high. Thousands of wine producers spend small fortunes trying to achieve 96-point Robert Parker ratings, but very few get them.

The disruptions that have occurred in the luxury car market also cast doubt on the Veblen-goods concept. Throughout the 1980s, for example, BMW and Mercedes-Benz were leaders in the market for sedans costing up to about $70,000. But wealthy motorists eventually found more choices when respected reviewers assured them that the Toyota brand Lexus offered a better car in many respects.

If BMW and Mercedes sedans had been Veblen goods, their producers could have responded to the Lexus challenge by simply raising their prices. In fact, they have managed to prosper by getting costs under control and making their cars much more appealing.

The rich, of course, are willing to spend more, often a lot more, for products that deliver quality improvements they value. But few of them want to throw money away. In that respect, they're like middle-income Americans, many of whom don't feel especially prosperous these days. Yet relative both to current world standards and to living standards of the past, middle-income Americans are incredibly wealthy. And when viewed from the perspective of those standards, much of their current consumption is strikingly similar to that of

today's rich.

Each day, for instance, many of us consume espresso brews priced at what would be almost a week's wages in other parts of the world. We'd be offended if someone described these purchases as attempts to display our wealth. And we'd be puzzled if someone said we'd buy even more lattes if our favorite cafe were to raise its prices. The coffee just tastes better, we'd say, and we're willing to pay a premium for that.

Luxury markets are already important, and with inequality poised to grow further, these markets will become ever more so. Those who fail to understand them cannot hope to understand what drives the world economy.

That goal will remain elusive until we recognize that the wealthy are essentially similar to the rest of us. They just have a lot more money.

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