"Summary of article by James S. Duesenberry: A Reformulation of the Theory of Saving" in Frontier Issues in Economic Thought, Volume 2: The Consumer Society. Island Press: Washington DC, 1997. pp. 176-179

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James Duesenberry's classic work on consumption proposes a model of consumer choice based on social interdependence and habit formation, tests the model against the available macroeconomic evidence, and speculates about the implications of the model for other areas of economics. This is a summary of the third chapter of the book, in which Duesenberry formulates his model of consumer choice. Portions of the chapter dealing with macroeconomic analysis of savings have been omitted.

In the conventional economic analysis of consumer choice, changes in behavior can only be explained in terms of shifts in preferences, a subject about which economists have little to say. The alternative pursued here is to make some definite, though general, assumptions of a psychological and sociological nature in order to model the interdependence of consumer choice.

NATURE OF CONSUMPTION CHOICES

If we ask why consumers desire the things they buy, the answer on one level is obvious. Some goods and services are purchased to maintain physical comfort, others such as transportation may be necessary for work, or used to maintain social status or to provide pleasure. Nearly all purchases are made ostensibly "either to provide physical comfort or to implement the activities which make up the life of our culture." (20)

The same needs can be met by goods of higher or lower quality. There is widespread agreement about the ranking of different automobiles, houses, and other goods in terms of quality. An improvement in the standard of living often consists of satisfying the same needs with higher quality goods.

THE PROCESS OF CHOICE

Consumers do not consider a menu showing the prices of all available goods and services, and make their selections from it, as assumed by marginal utility theory. The principal choice made by consumers is to vary the quality of goods and services they purchase. Such decisions are not made simultaneously from a menu, but rather individually, as the need arises. The connection between different decisions and the budget constraint is conveyed through learning and habit formation. A consumer who spends too much on one item learns that he runs out of money before the end of the pay period, and regrets having made lower-priority purchases earlier in the period. Eventually the consumer achieves a habitual consumption pattern that leads to no regrets. When an individual's income decreases, this process is repeated until a new, lower consumption pattern becomes habitual.

THE DRIVE TOWARD HIGHER CONSUMPTION

The drive toward continual improvement in the quality of consumption goods leads people to work hard and yet save little of their income. At the same real income level, households saved more in the past than they do today. It is easy to see why consumption increases when income does; but why does consumption increase over time even at a fixed income level?

The habits that govern consumption are a compromise between the desire for higher quality goods and either the limitations of income or the desire for savings. However, each contact with higher quality goods "is a demonstration of the superiority of these goods and is a threat to the existence of the current consumption pattern." (26) If other people's consumption levels rise, each household will have more frequent contact with high quality goods, increasing the strength of the impulse to buy them; the result is an increase in spending at the expense of saving. This can be called the "demonstration effect."

THE SOCIAL SIGNIFICANCE OF CONSUMPTION

Thus far the impulse to increase expenditure has been based on the perceived superiority of higher quality goods for fulfilling existing needs. But when the pursuit of a higher standard of living becomes an end in itself, it provides an even stronger drive to increase expenditure. As the attainment of increased standards of living becomes a generally recognized social goal, individuals are socialized into recognizing its importance; a certain degree of success in reaching this goal becomes essential to the maintenance of self-esteem.

While some other societies attach prestige to the acquisition of certain completely useless objects, we gain self-esteem by buying a Buick instead of a Chevrolet. Virtually everyone has contact with people of slightly higher as well as lower status than themselves, and receives frequent reminders of the goods that provide higher status. "Our social goal of a high standard of living, then, converts the drive for self-esteem into a drive to get high quality goods." (31)

It seems quite possible that above some minimum income level, a consumer's satisfaction depends purely on a comparison of his consumption to a weighted average of other people's consumption (with the weights reflecting the degree of contact and other factors), rather than on his absolute level of expenditure.

INTERDEPENDENCE, SAVINGS AND TAXATION

How is the decision about savings affected by the social interdependence of consumer choices? The savings decision represents a choice between present and future consumption. All of the factors that make current consumption depend on relative rather than absolute expenditures are equally applicable to future consumption. Thus the entire process of choice between current and future consumption can be recast in terms of relative income. That is, the consumer cares primarily about the ratio of his own consumption and income levels to the weighted average of other people's consumption.

The result is that consumption is proportional to income, and the rate of savings is independent of the absolute level of income. If everyone else's consumption and income increase by a fixed factor, any individual consumer will be induced to increase consumption at the same rate. The rate of savings will be unchanged.

This model of interdependence in consumption would lend to changes in many areas of economic theory. For example, assume that the satisfaction of every consumer is negatively affected by the consumption of those with higher incomes, but unaffected by those with lower incomes. Under this assumption, a progressive income tax is required to achieve efficient allocation of resources, with the optimum tax rates determined by the strength of the dependence effect. Such a tax will decrease the inequality of incomes and consumption, and cause a reduction in paid work and an increase in leisure -- changes which are necessary to achieve a welfare optimum in a world of interdependence.[1]

Notes

1. Mathematical proof of these assertions is presented in a later chapter of the same book: James Duesenberry. Income, Saving and the Theory of Consumer Behavior (Cambridge: Harvard University Press, 1949), 96-102.