TAXES and regulation will occupy center stage in the presidential contest.

One debate, for example, will focus on whether tax cuts for the wealthiest families should expire as scheduled at year-end — an issue that could gain traction now that Mitt Romney, the possible Republican nominee, has disclosed that he and his wife paid an effective federal rate of just 13.9 percent on their huge 2010 income. And on the regulation side, there will be attempts to repeal rules like the recently adopted Environmental Protection Agency standards that limit highly toxic mercury emissions.
Surveys indicate that most voters now favor higher taxes on the rich. But many wealthy people are determined to hang on to their tax cuts, and because recent changes in campaign finance law have greatly increased their political leverage, they may prevail. If so, however, it could prove a hollow victory.

Beyond some point, there seems to be little gain in satisfaction from bolstering your private spending. When mansions grow to 15,000 square feet from 10,000, for instance, the primary effect is merely to raise the bar that defines an adequate home among the superwealthy.

By contrast, higher spending on many forms of public consumption would produce clear gains in satisfaction for the wealthy. It’s reasonable to assume, for example, that driving on well-maintained roads is safer and less stressful than driving on pothole-ridden ones.

But that raises an obvious question: If wealthy taxpayers would be happier to drive slightly less expensive vehicles on better roads, why are so many of them vehemently opposed to the higher taxes needed for improved infrastructure?

One possible explanation is that they suffer from a simple cognitive illusion when they think about how higher taxes would affect them.

If you pay higher taxes, you obviously have less money to spend on what you want. So the prospect of a tax increase naturally inclines people to think that they’ll be less able to satisfy their desires.

But once incomes rise beyond a modest absolute threshold, many of the things that people want are what economists call positional goods. These may be things that are inherently in
short supply, like gorgeous waterfront property; or things whose value depends heavily on context, like precious stones or sure-footed sports cars. Because positional goods are in short supply, they go to the highest bidders. The tendency to overlook that fact distorts how people think about the effects of higher taxes.

The cognitive illusion occurs because most financial setbacks that people experience in life stem from events that affect them alone. They may suffer health emergencies, for instance, or problems at work. Marriages may fail, jewelry may be stolen, and floods may damage homes. In each case, the effect is to limit the ability to bid for positional goods.

Because an overwhelming majority of financial setbacks occur for such idiosyncratic reasons, it’s natural to think that the income decline from higher taxes would have similar effects. But a tax increase is different. It affects all participants in the bidding for positional goods. And because it leaves everyone with less to spend, it has essentially no effect on the outcomes of those contests. The same paintings and the same marina slips end up in the same hands as before.

Context shapes demand not just for the wealthy, but also for consumers further down the income scale. As Adam Smith observed more than two centuries ago, for example, a linen shirt is not, strictly speaking, a necessity of life. The wealthiest ancient Greeks, for example, lived satisfying lives without any linen at all. But Smith noted that in 18th-century Scotland, even the lowliest laborer couldn’t appear in public without shame unless he owned a linen shirt, “the want of which would be supposed to denote that disgraceful degree of poverty, which, it is presumed, nobody can well fall into without extreme bad conduct.”
If what people feel they need depends on what others spend, the same cognitive illusion that affects wealthy Americans’ attitudes toward taxes creates a more general bias against government. Opponents of workplace safety regulation, for example, often denounce the lower wages made necessary by its cost. For families already struggling to make ends meet, that objection resonates.

But safety regulation requires an across-the-board decline in wages, which is much less painful than one that occurs in isolation. Once absolute incomes exceed a certain threshold, lower wages are easily tolerated when they don’t entail relative disadvantage. Additional safety, bought collectively, entails a less onerous sacrifice than it does when an individual buys it for himself.

The tax and regulatory issues in the coming election are clearly important. Millions of workers will retire over the next two decades, so spending cuts alone can’t eliminate deficits. We need additional revenue, too. And as population density increases, we can’t prevent dangerous environmental spillovers without intelligent regulation.

It would be one thing if lobbying against taxes and regulation brought wealthy Americans a world more to their liking. But if their goal is to buy a home with a more spectacular view, for example, they will be disappointed. There are only so many such homes to go around, and they’ll be bought by the very same people as before, since everyone will be bidding more.

So when the anti-tax wealthy make campaign contributions, they are buying only the deeper potholes and dirtier air that inevitably result when tax revenue is low.

Robert H. Frank is an economics professor at the Johnson
Graduate School of Management at Cornell University.