The history of the mainstream rejection of interdependent preferences

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Abstract

The notion of interdependent preferences has a long history in economic thought. It can be found in the works of authors such as Hume, Rae, Genovesi, Smith, Marx and Mill among others. In the 20th century, the idea became more widespread mainly through the works of Veblen and Duesenberry. Recently, an increasing number of theorists are interested in issues like reference income, relative consumption and positional goods which are all based on the concept of interdependent preferences. However, such preferences were never part of the corpus of orthodox theory. For instance, although Pareto and Marshall were aware of their existence, they rejected their incorporation into economic theory. There were various reasons for this rejection. The structure of mainstream economic methodology might be one reason. Another reason had to do with the theoretical implications of adopting interdependent preferences. The paper discusses the main historical aspects of this idea in relation to the mainstream resistance to incorporate it in orthodox economic theory.

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The History of Mainstream Rejection of Interdependent Preferences

1. Introduction

The concept of interdependent preferences, and its closely related notion of positional goods, are present in the works of a substantial number of eminent thinkers in the history of economic thought. One can even find the basis of the above ideas in the theories of 18th century authors such as A. Genovesi and D. Hume and also in a great number of classical economists such as Smith, Ricardo, Marx, Senior, Mill and many others, who discuss these issues in sympathetic terms. In addition, it plays a central role in the contributions of many very well-known post-marginalist economists such as T. Veblen, A.C. Pigou and J. Duesenberry. In the last few years, there is a renewed interest in the idea especially in many macroeconomic and labour papers and also in the relatively modern research area of subjective well-being. Many theorists in the above fields have found that the incorporation of interdependent preferences can help explain a variety of economic phenomena such as wage rigidity, savings patterns and the Easterlin paradox (see Bruni, 2004; Drakopoulos, forthcoming).

In spite of the above, it is still not accepted by the majority of mainstream economists who continue to assume independent individual preferences. There are a number of reasons for this attitude which have mainly to do with the methodological foundations of orthodox economics. More specifically, the notion of interdependent preferences was deliberately ignored by the founders of modern mainstream economics such as V. Pareto and A. Marshall. Pareto thought that interpersonal preferences were not part of his definition of “logical action” in economics and that their analysis belongs to sociology and not to economics. Marshall was aware of status-driven consumption but he condemned such expenditures, believing that they were rooted in personal vanity and created envy in others. Thus, Marshall’s and Pareto’s negative stance towards incorporating the idea of interpersonal preferences can be seen as an important reason why such preferences did not become part of the corpus of subsequent mainstream analysis and also of mainstream welfare economics. Orthodox reactions towards the work of J. Duesenberry on consumption theory, which is based on the idea of interdependent preferences, is a more modern representative example of this stance. It seems that the mainstream methodological preconception against incorporating psychological and sociological elements in economic theory and also the methodological prevalence of economic agents characterized by selfish behaviour, were two crucial reasons for the negative mainstream attitude.

The paper will start with a review of the presence of interdependent preferences in the history of economic ideas[1]. Namely, it will argue that the idea was present in the works of many pre-classical and classical economists. The next section will show that this presence continued in the work of theorists such as Veblen and Pigou who explored the analytical consequences of such preferences. The fourth section of the paper will discuss how Pareto’s and Marshall’s negative stance, contributed to the abandonment of such preferences from subsequent mainstream economic

[1] As in most cases of history of ideas based discussion, the problem of using contemporary terms retrospectively holds. The modern terms of interdependent preferences and of positional goods that are the main terms used in this paper, are conceived in a broad sense to reflect the general notion that individual preferences are constantly influenced by the preferences and actions of other individuals.

theorizing. The following section will discuss the mainstream attitude towards the work of Duesenberry as the main example of the continuation of mainstream disregard and also of the possible reasons for this. The sixth section will provide a brief discussion of the more recent developments on this matter. Finally, a concluding section will close the paper.

2. Interdependent Preferences and Positional Goods in Pre-Classical and Classical Thought

The general idea that individual preferences are influenced by the preferences and actions of other individuals is based on the social nature of human beings. In fact, one can argue that the social nature of humans implies the behavioural importance of interdependent preferences and also of positional goods. Clearly, the social dimension of human nature is not a novel idea since it was first analyzed and emphasized by ancient thinkers and especially by Aristotle (for a review see Schneider 2007). In modern times, the Neapolitan Antonio Genovesi (1713-68) is one of the first authors whose social and economic thinking is characterized by an emphasis on the sociality of human nature. As Genovesi puts it in an indicative statement:

> "We are created in such a way as to be touched necessarily, by a musical sympathy, by pleasure and internal satisfaction, as soon, as we meet another man no human being not even the most cruel and hardened can enjoy pleasures in which no one else participates" (Genovesi, 1766, quoted in Bruni, 2007, p.31).

Furthermore, human sociality is seen as the main function of society given that for Genovesi the chief advantage of society is not to be found in its production of material goods, but in the enjoyment of social relationships (Bruni, 2007, p.31).

Writing in the same period, Sir James Steuart's economic work can also be seen as having grasped the basis of interdependent preferences and positional goods. As he writes: "the moment a person begins to live by his industry, let his livelihood be ever so poor, he immediately forms little objects of ambition, compares his situation with that of his fellows who are a degree above him, and considers a shade more of ease, ….. as an advancement, not of his happiness only, but also of his rank" (Steuart, 1767, p. 272). Furthermore, he seems to have anticipated the well-known concept of 'conspicuous consumption'.

> "Those, however, who are systematically luxurious, that is, from a formed taste and confirmed habit, are but few, in comparison of those who becomes so from levity, vanity, and the imitation of others. The last are those who principally support and extend the system; but they are not the most incorrigible. Were it not for imitation, every age would seek after, and be satisfied with the gratification of natural desires" (Steuart ,1767, p. 244 also p. 61).

D. Hume was well aware of the importance of the social aspect of human behaviour. As he states: "The passions are so contagious, that they pass with the greatest facility from one person to another, and produce correspondent movements in all human breasts" (Hume, 1736, p. 605). Similar to this, is Hume's strong objection to the universal assumption of self-interest which implies autonomous and thus non-interdependence of individual preferences:

> "So far from thinking that men have no affection for anything beyond themselves, I am of opinion, that though it be rare to meet with one, who

loves any single person better than himself; yet ‘tis rare to meet with one in whom all the kind affections taken together, do not overbalance all the selfishness” (Hume, 1736, p.487).

The idea that preferences are influenced by the preferences of other individuals can also be found in many classical economists. Adam Smith recognized that individuals engage in social comparisons. Apart from the natural human motives, such as the "love of life", the "dread of dissolution", the "desire of the continuance and perpetuity of the species", etc. (Smith, 1759, p. 77, ft), he also included "the love of distinction" (1759, p. 50). The basis of this motive is the human "vanity which is always founded upon the belief of our being the object of attention and approbation" (1759, p. 50), and is "natural to man" (1759, p. 182). The idea of comparison of our income to a class or group of individuals is also present in his thought (In modern terms, this idea is known as “keeping up with the Jones’s”). In Smith’s words:

“The desire of becoming the proper objects of this respect, of deserving and obtaining this credit and rank among our equals, is, perhaps, the strongest of all our desires, and our anxiety to obtain the advantages of fortune is accordingly much more excited and irritated by this desire, than by that of supplying all the necessities and conveniencies of the body, which are always very easily supplied" (Smith, 1759, pp. 212-3).

Adam Smith’s contemporary, John Rae was also well-aware of the power of consumption imitation. Rae’s ideas on the subject are quite similar with the ones expressed subsequently by T. Veblen, although it is not clear if Veblen was aware of Rae’s work (see Edgell and Tilman, 1991). As Rae states:

“Their [i.e. individuals] consumption is regulated, to a great degree, by the influence of the imitative propensity. We may form a near guess whether a person is in the custom of drinking wine, or tea, or coffee, or smoking tobacco, from knowing the habits of his associates…[and] ….. Their consumption is also greatly regulated by the passion of vanity" (Rae , 1834, pp. 293-4).

Rae also discusses further the idea of conspicuous consumption (influenced to a large extent by Adam Smith)[2]. He attributed such behavior to the selfishness and vanity of individuals: "It is not, indeed, to be disputed, that the rarity and costliness of the liquors, and other similar commodities consumed by an individual, may heighten greatly the absolute pleasure he derives from them. This arises from a trait in the character of man, which we have every day opportunities of observing. The attention is always roused in a greater degree by an object, when it excites more than one faculty" (Rae, 1834, p. 268). Similarly, Rae seems to have distinguished between mere luxuries and what were to become known subsequently as 'Giffen goods'. The demand for such goods falls if there is a considerable drop in their price: "Were pearls, or lace, to be got for one tenth of the labor that must now be given for them, they would go completely out of fashion" (Rae, 1834, pp. 270, 292).

A. Cournot has a very similar approach to Rae's observation that a fall in the price of some luxury goods will certainly reduce their demand. Cournot admitted that:

"There are, in fact, some objects of whim and luxury which are only desirable on account of their rarity and of the high price which is the consequence thereof. If any one should succeed in carrying out cheaply the crystallization of carbon, and in producing for one franc the diamond which to-day is worth a thousand, it would not be astonishing if diamonds

[2] For a discussion of the concept of conspicuous consumption in economic thought, see Mayhew, 2002.

> should cease to be used in sets of jewellery, and should disappear as articles of commerce. In this case a great fall in price would almost annihilate the demand" (Cournot 1927, p. 38).

R. Whately argued (1832, p. 51) that the level of consumption and of the consumption pattern is socially determined. The notion of interpersonal preferences is present when he argues that "an individual man is called luxurious, in comparison with other men, of the same community and in the same walk of life with himself" (Whately, 1832, p. 53). Similarly, M. Longfield advances the argument that "the wages of the labourer depend upon the expense of his maintenance and usual style of his living, instead of his expenses and his mode of living depending pretty much upon his wage" (Longfield, 1834, p. 203).

Nassau Senior in his *Outline of the Science of Political Economy* drew attention to what he called "the desire for distinction". Having discussed the desire for variety, and having attributed to it the diminishing utility to be gained from each additional unit of a particular commodity consumed, Senior unequivocally declared it to be less powerful than the desire for distinction:

> "But strong as is the desire for variety, it is weak compared with the desire for distinction: a feeling which, if we consider its universality and its constancy, that it affects all men and at all times, that it comes with us from the cradle, and never leaves us till we go to the grave, may be pronounced to be the most powerful of human passions. The most obvious source of distinction is the possession of superior wealth" (Senior, 1836, p. 12).

Senior makes clear that the main effect of the motive for distinction is to influence the rate of demand and utility of special goods of high exchange value, such as diamonds (Senior, 1836, p. 13).

One can maintain that Marx had also conceived the idea of relative income and consumption and in general, of the concept of positional goods. Hence the quotation "let a palace arise beside the little house, and it shrinks from a little house to a hut" (Marx, 1849, p. 216). Furthermore, there are other passages where the notion of rising immiseration in spite of the rising real wages is also present (see also Hollander, 1984, p. 146).

J. S. Mill points out that once a basic standard of living has been achieved, the concern about social status becomes extremely strong. The subsequent notion of positional goods is present in the following passage:

> "When once the means of living have been obtained, the far greater part of the remaining labour and effort which takes place on earth, has for its object to acquire the respect or favourable regard of mankind; to be looked up to, or at all events, not to be looked down upon by them" (Mill 1874, p. 411).

Finally, by the end of the 19th century, Henry Cunynghame provided the first attempt to illustrate diagrammatically the effect of incorporating dependence of one individual's demand for a good on that of others, in his 1892 article entitled *Some Improvements in Simple Geometrical Methods of Treating Exchange Value, Monopoly, and Rent*. In introducing this new diagram, Cunynghame observed:

> "… almost the whole value of strawberries in March, to those who like this tasteless mode of ostentation, is the fact that others cannot get them. As my landlady once remarked, 'Surely, sir, you would not like anything so common and cheap as a fresh herring?'. The demand for diamonds, rubies, and sapphires is another example of this. As the number increases, not only does the price go down, but the very pleasure of those who already have them is decreased by their becoming common" (Cunynghame 1892, p. 37).

Cunynghame's diagram showed a consumer surplus curve lying below the commodity demand curve, but shifting upwards for every reduction in the quantity supplied.

Thus, as our previous discussion indicated, interpersonal comparisons and positional goods were concepts which were present in the economic thought of the 18th and especially 19th centuries. It has to be noted that for most of the authors discussed, the above ideas were not part of a systematic theory of individual economic behaviour. To a large extent this was due to their adherence to a cost of production theory of value. This implies that a full theory of individual preferences was not a necessary part for the construction of economic theories. A more systematic discussion of these ideas, however, became apparent with a shift towards a more subjective approach to the theory of value which took place in the last decades of the 19th century. But before we proceed to this theme, let us see first the more systematic discussion of interdependent preferences in the works of T. Veblen and A.C. Pigou.

3. Veblen and Pigou

Interdependent preferences and positional goods are central ideas in Thorstein Veblen's main work. A substantial analysis of these concepts and of their impact can be found in his *The Theory of the Leisure Class* (1899). These concepts played such a fundamental role in his analysis that they were conceived as the foundation of a private property society. In the following statement Veblen combines many aspects of the previous discussion. Namely, he links consumption and wealth imitation, private property and the nature and effect of positional goods:

> “The motive that lies at the root of ownership is emulation; and the same motive of emulation continues active in the further development of the institution to which it has given rise and in the development of all those features of the social structure which the institution of ownership touches. The possession of wealth confers honour; it is an invidious distinction. Nothing equally cogent can be said for the consumption of goods, nor for any other conceivable incentive to acquisition, and especially not for any incentive to the accumulation of wealth. … the end sought by accumulation is to rank high in comparison with the rest of the community in point of pecuniary strength. So long as the comparison is distinctly unfavourable to himself, the normal, average individual will live in chronic dissatisfaction with his present lot; and when he has reached what may be called the normal pecuniary standard of the community, or of his class in the community, this chronic dissatisfaction will give place to a restless straining to place a wider and ever-widening pecuniary interval between himself and this average standard” (Veblen 1899, pp. 25-6, 31-2).

Veblen’s famous term, “conspicuous consumption”, is obviously related to the above. In particular, conspicuous consumption is the consumption of luxuries that is observed by others, sometimes by these others participating in it. Conspicuous consumption is not confined to the “rich”, or to the leisure class in Veblen’s terminology. Other social classes might also engage in such activity, even the lower classes. As he states:

> “[n]o class of society, not even the most abjectly poor, foregoes all customary conspicuous consumption. … There is no class and no country that has yielded so abjectly before the pressure of physical want as to deny themselves all gratification of this higher or spiritual need” (Veblen 1899, p. 85).

It is clear that in Veblen's theoretical analysis, the idea of interpersonal comparisons of income, consumption and wealth are extremely important factors for economic and social relationships.

Although Veblen's ideas as a whole were not very influential for the emerging corpus of mainstream theory, the notion of interpersonal preferences was not uncommon among leading economists at the time. This can be seen in the work of A.C. Pigou whose ideas were in the centre of mainstream economics of that period. Pigou devotes considerable space to the concepts of interdependent preferences and positional goods. He is clearly influenced by Pareto's differentiation between the terms 'ophelimity' and 'utility', which we will examine in the next section. In his words:

> "The curve of the private marginal demand prices lies above the curve of collective marginal demand prices if an addition to the consumption of one consumer diminishes the ophelimity associated with a given consumption by other consumers … The curve of the private marginal demand prices lies below the curve of collective marginal demand prices if an addition to the consumption of one consumer increases the ophelimity associated with a given consumption by other consumers" (Pigou 1910, p. 361).

The inequality between *private* and *collective* demand prices depends on the emergence of a social element to individuals' states of consciousness because some or all consumers of a particular product derive utility from their direct consumption as well as consumption by third-parties (see also Mclure, 2009). This is closely linked to his previous analysis in his *'Some remarks on utility'* (Pigou, 1903) where he introduces the argument $K\{a,b\}$ as an element within the individual's utility function of a specific commodity. More specifically, $U = f(\ldots, K\{a,b\})$, where $K\{a,b\}$ is a 'complex expression' in which the elements *a, is* the quantity of A possessed by the individual's first neighbour and b is the 'distance' from an individual to his/her first neighbour. If the consumption of good A by neighbours has no effect on the ophelimity enjoyed by an individual from his/her consumption of good A, the 'distance' *b* is zero and thus the value of the complex expression is zero. However, when the consumption of good A by neighbours influences the ophelimity that an individual enjoys from his/her consumption of good A, the 'distance' in each of the elements *b* is non-zero and the value of the complex expression is non-zero. Pigou is clearly influenced by Cunynghame (1892), that people who like a tasteless mode of ostentation receive diminished pleasure from some commodities when they become more 'common' (for an extensive discussion, see Mclure, 2009).

4. Pareto, Marshall and the Rejection

As was seen in the previous sections, the concepts of interdependent preferences and positional goods were part of the economic thinking of a great number of influential theorists. However, the marginalist emphasis on the subjective theory of value required a systematic model of individual economic decision-making. Thus the issue of the nature of preferences had to be addressed. Vilfredo Pareto was the first major economist who provided the rational for the irrelevance of interdependent preferences for economic analysis and thus contributed to their rejection from mainstream economics.

The basis of Pareto's approach to preferences are the distinct concepts of ophelimity and utility. For Pareto, the term utility has a general character while the term ophelimity is more specialized to the purposes of economics. Economic man is conceived as a rational being in the sense of means-ends relationship. This rationality can be achieved through trial and error process. Economic man responds only to forces ophelimity (Pareto 1896, p. 12). In this conceptual framework, individual preferences are independent. Although Pareto admits that man's character presents other characteristics too, these are studied by other sciences. Once an individual's preferences are influenced by interaction with the actions and ideas of third-parties, action is considered with respect to utility and not ophelimity (McLure, 2009). In a subsequent article, Pareto (1918) is more specific about the two scientific domains, in the sense that when the 'economic part' of the economic phenomena dominates, analysis should primarily be based on economic theory; and when the 'sociological part' of the economic phenomena dominates, analysis should primarily be based on sociology (see also McLure, 2009).

It is evident that Pareto's rejection of interdependent preferences had a methodological motive. Pareto was extremely influenced by the prevailing positivist scientific philosophy, a basic characteristic of which, was the exclusion of all 'metaphysical' and 'non-scientific' elements from economics. Pareto's methodological ideal of economics was that it should be a mathematical science, part of the natural sciences such as physiology and chemistry (Pareto, 1896, p.21). This implies that economics should be freed from any sociological or psychological ideas which hamper the application of the positivist methodology (for an extensive discussion, see Seligman, 1969;

Drakopoulos, 1997). Pareto's model of rational economic man outlined above, excludes social influences such as interpersonal preferences.

Alfred Marshall's influence on the formation of modern mainstream microeconomics is widely recognized. Marshall was aware of consumption for the purposes of status, but he condemned such behaviour basically on ethical grounds:

> "There is some misuse of wealth in all ranks of society. And though, speaking generally, we may say that every increase in the wealth of the working classes adds to the fullness and nobility of human life, because it is used chiefly in the satisfaction of real wants; yet even among the artisans in England, and perhaps still more in new countries, there are signs of the growth of that unwholesome desire for wealth as a means of display which has been the chief bane of the well-to-do classes in every civilized country. Laws against luxury have been futile; but it would be a gain if the moral sentiment of the community could induce people to avoid all sorts of display of individual wealth. There are indeed true and worthy pleasures to be got from wisely ordered magnificence: but they are at their best when free from any taint of personal vanity on the one side and envy on the other." (Marshall, 1890, book III, ch. VI).

Thus, Marshall effectively refused to consider further status-driven consumption. Moreover, he was reluctant to discuss the general case of interpersonal effects on demand mainly because it would have called into question the fundamental assumption of the standard theory, that aggregate demand could be derived from the simple addition of individual demand schedules (Mason, 1995). Although a number of authors such as Cunynghame (1892) and Foley (1893) clearly pointed this lack concerning status driven consumption, Marshall effectively ignored these criticisms and did not analyse the issue further in subsequent editions of his *Principles* (see also Mason, 1995).

In general, Pareto and Marshall, two extremely dominant figures for the formation of mainstream economics, had a negative attitude towards incorporating interdependent preferences in economic analysis. Pareto's extremely influential methodological ideas against including sociological and psychological elements in economics, and Marshall's explicit refusal to accept their role, seem to be important reasons for the mainstream rejection. Thus, by the first decades of the 20th century, the idea of interdependent preferences had been effectively marginalized from mainstream economic analysis although it had a constant presence in the earlier history of economic thought.

5. J. Duesenberry and the Reappearance of Interdependent Preferences

The next major analytical use of the concept of interdependent preferences appeared in James Duesenberry's main book published in 1949. One can view Duesenberry's work as a continuation of Veblen's, given that there are many common points concerning income and consumption comparisons, and also of the role of the demonstration effect (see McCormick, 1983). In particular, Duesenberry is known as the proponent of the relative consumption hypothesis, the basic idea of which was that "any particular consumer will be influenced by consumption of people with whom he has social contacts" (Duesenberry, 1949, p. 48). This idea (labeled as the demonstration effect) questioned the established mainstream view that absolute levels of income only determine patterns of consumer demand

(Duesenberry, 1949, p. 27). Duesenberry proceeded further to analyze the basis of such behaviour. As he writes:

> "We can maintain then that the frequency and strength of impulses to increase expenditure depends on frequency of contact with goods superior to those habitually consumed. This effect need not depend at all on considerations of emulation or 'conspicuous consumption'" (Duesenberry 1949, p. 27-28).

Duesenberry's consumption approach shows how levels of expenditure could be increased not by changes in income or prices, but by following the consumption expenditures of others with whom the individual had contacts (Duesenberry, 1949, p. 29). This implies serious consequences for a number of important theoretical issues like the pattern of savings and growth as Duesenberry himself intended. In this framework, savings rates depend on the position of income distribution and not exclusively on the income level, as in a traditional savings function.

However, much in the same way as the previous approaches on interdependent preferences, Duesenberry's ideas never gained popularity among mainstream theorists. As was discussed previously, this was partly due to the established orthodox conceptual framework which was hostile to interpersonal preferences. However, there appeared some new forms of reaction which were more specific. One type of reaction against the inclusion of such preferences was to diminish their theoretical importance.[3] Robert Clower's stance a few years after Duesenberry's publication, is indicative:

[3] Many theorists have shown that interdependent preferences and demonstration effects have significant theoretical importance and produce different results and policy implications. See also the discussion in the following sections, and for a relatively early paper pointing out the differences, Pollak, 1976).

“Interdependent preferences analysis differs but little from ordinary consumption theory; hence, while one sometimes gets different and slightly more general results in “interdependent” as compared with “independent” preference analysis, it is only in this very limited and practically unimportant sense that the two kinds of theory may be said to be at variance with one another” (Clower, 1951, p.178).

The position of Modigliani and Brumberg towards interdependent preferences, and more specifically towards their specific expression in Duesenberry’s analysis, was somewhat different from Clower’s. Although, initially, Modigliani (1949) embraced this idea in his own research concerning relative income effects on consumption, he was much more critical later on arguing that it contained unnecessary social and psychological elements. Instead, they claimed that their (Modigliani and Brumberg’s) new interpretation of consumption theory was sounder and much simpler (Modigliani and Brumberg, 1954, p.424; Mason, 2000).

In the same period, Milton Friedman attacked Duesenberry’s formulations by claiming that permanent income rather than relative income was the basis of consumer behaviour. Although Friedman acknowledged some merit in Duesenberry’s concept of relative income, he argued that it was basically only a biased index of relative permanent income status. Furthermore, Friedman believed that his approach was superior, since it owed nothing to sociology or to psychology in contrast to Duesenberry’s which was full of subjective elements (Friedman, 1957; Mason, 2000).

Thus, interpersonal preferences were once again excluded from the mainstream corpus of economic theory. One basic reason for this, as is inferred from Modigliani, Brumberg and Friedman, is that Duesenberry’s analysis poses some fundamental questions regarding the cultural influences on economic decisions and the endogeneity of preferences, issues which were not popular for orthodox theorists. Thus, it seems that allegedly simpler and more "economic" explanations of consumption patterns offered by Modigliani, Brumberg and Friedman were preferred to Duesenberry's sophisticated approach (see also Harbaugh, 1996; Cowling, 2006). Another important reason for the lack of acceptance of his ideas was the serious problems that they posed for the conventional demand theory which assumes that individual consumption behaviour was independent of the consumption of others. First, the inclusion of 'demonstration effects' in standard consumption theory would have made demand and consumption measurement far more complex[4]. Furthermore, during the same period, Samuelson's (1947) revealed preference theory was gaining wide acceptance as a more 'scientific' approach based on observed behaviour than the traditional utility approach. However, many theorists suspected that the standard approach to individual demand functions based on revealed preference theory would be problematic if we take into account interdependent preferences (for an extensive discussion, see Holländer, 2001).

6. Recent Developments

For many years after its analytical treatment in the work of Duesenberry, the concept of interdependent preferences was again effectively ignored by the mainstream corpus of economic theory. According to R. Frank

[4] It has been argued that Duesenberry's sociological interpretations of consumption posed a recognizable threat to purely econometric treatments of consumer demand and of consumption patterns (Mason, 2000, pp. 561-62).

the rejection of Duesenberry's relative income hypothesis "seems yet another testament to the power of a priori beliefs held by most economists" (Frank, 1985a, p. 111). The notion was utilized though, by a few notable economists like Harvey Leibenstein, (1950) where the interdependence of individual preference functions is called the "bandwagon effect", by Tibor Scitovsky (1962) who attacked the mainstream notion of consumer sovereignty and thus of independent preferences, by J.K. Galbraith (1969) who built on many of Veblen's insights into consumer interdependence, conspicuous consumption and competitive emulation, and by Fred Hirsch (1976) who introduced the concept of positional consumption and positional goods. Furthermore, non-mainstream schools such as the Institutionalist, Behavioural and Post-Keynesian schools also continued to pay attention to the idea (for an extensive review, see Drakopoulos, forthcoming). However, the vast majority of mainstream economists still treated individual preferences as independent.

In the last two decades though, the research potential of interpersonal preferences has started to be realized by an increasing number of economists and thus it has begun to re-appear in some economic literature. There is an increasing use of ideas such as reference income, target income, relative consumption, positional goods and social status which are all based on the concept of interdependent preferences (for a recent review, see Truyts, 2010). The subfields of macro and labour economics are indicative examples. In particular, the idea that unions and workers compare income or wages with others has been expressed in a plethora of terms such as relative wage, fair wage, aspiration wage, comparison or target wage [see for instance, Frank (1984), Akerlof and Yellen (1990), Clark and Oswald (1996), Charness and

Grosskopf (2001)]. Furthermore, in the last two decades the notion of comparison income has also entered the job satisfaction literature and more recently the quite fashionable subfield of happiness research, mainly in formulations examining the relationship between income and happiness level (e.g. Clark and Oswald, 1996, Frey and Stutzer, 2002; Drakopoulos, 2008). In spite of the above, the concept with its specific expression of comparison income or interdependent utilities, is still not accepted by the economics orthodoxy.

One can argue that there are some apparent reasons for the continuous mainstream resistance towards interdependent preferences. One of these reasons might have to do with their serious theoretical consequences. A number of authors have shown that that the full incorporation of interdependent preferences, and of the related concept of the comparison or relative income, in economic theory, would cast considerable doubts on many well-established and important theoretical results. Namely, optimal taxation, economic growth and income distribution theories might need serious rethinking towards more progressive taxation and more emphasis on more equal income distribution (for reviews, see Dugger, 1985; Postlewaite, 1998; Clark, Frijters, and Shields 2008, and for the implications of interdependent preferences for general equilibrium, see Ackerman, 1997).

Another reason for the rejection of interdependent preferences has to do with the orthodox conception that economic agents are characterized by selfish preferences. In fact, self-interest was one of the cornerstones of the traditional model of individual economic behaviour (economic man). This is certainly still the case for many modern standard formulations. As R. Frank observes: “To many economists, the notion of consumers being strongly influenced by demonstration effects must have seemed troublingly inconsistent with the reasoned pursuit of self-interest, if not completely irrational” (Frank, 1985b, p.146). Mainstream resistance to question self-interested behaviour is still very strong in spite of abundant research indicating otherwise (see for instance, Andreoni, 1995). The assumption is so embedded in mainstream theorizing that as Rabin points out “A remarkable amount of energy has been devoted to giving self-interested explanations for laboratory behaviour that seems to be a departure from self-interest” (Rabbin, 2002, p.667).

Finally, another reason which is closely linked to the above is that mainstream economists are still extremely reluctant to consider psychological and sociological aspects of human behaviour in their economic analysis. Concepts such as social status, positional goods, rank concerns and consumer conformism which are all based on interdependent preferences, are thought by many mainstream theorists as not belonging to the realm of economic analysis. The ‘economic’ approach to human behaviour is seen as extremely successful and superior compared to other social sciences. Gary Becker’s definition of the economic approach is indicative of this attitude: “The combined assumptions of maximizing behaviour, market equilibrium and stable preferences, used relentlessly and unflinchingly, form the heart of the economic approach … provides a valuable unified framework for understanding all human behavior” (Becker, 1976, p.5). Although Becker’s statement was made more than three decades ago, most mainstream economists still adhere to it (see also Rabin, 2002).[5]

7. Concluding Comments

The notion of interdependent preferences and positional goods has had a long presence in the history of economic ideas. Our discussion showed that it was present in the works of many 18th and 19th centuries authors like A. Genovesi, D. Hume, J. Rae, A. Smith, K. Marx and J. S. Mill among others. It was also seen that the idea played an important role in the works of T. Veblen and A.C. Pigou. By the turn of the 20th century however, V. Pareto's and A. Marshall's negative stances did not favour its further incorporation in mainstream economics. The main reason for this was the gradual establishment of methodological ideas which were clearly against the inclusion of sociological and psychological elements in economics. This was deemed to be essential for the drive of establishing a 'positive' economic science. After, WWII the concept of interpersonal preferences regained some momentum mainly in the work of J. Duesenberry on consumption theory. However, Duesenberry's approach was also ignored in favour of allegedly more 'simple' and 'sound' consumption theories.

In the last two decades, there seems to be a renewed interest in the notion by some labour economists and also by theorists in the relatively new subfield of the economics of subjective well-being, mainly because of its research potential towards analysing and explaining numerous contemporary

[5] It has to be noted here that in the last decade there is a rise in the interest in psychology by mainstream economists. This is basically due to the impact of the "New Behavioural Economics" which seems to have a greater influence than the "Old Behavioural Economics" (for an extensive discussion, see Sent, 2004).

economic issues. Still, however, mainstream economists are not willing to abandon the notion of agents characterized by independent preferences.

Our discussion indicated that there are some basic reasons which might account for the continuous resistance to incorporate interdependent preferences in mainstream economic theory. The traditional refusal to accept the role of psychological and sociological dimensions of economic behaviour might be seen as an important reason. This is connected to the standard conception of economic agents as selfish utility maximizers which implies independent preferences. Clearly, this is due to the methodological foundations of mainstream economics which can be traced to the emergence of the marginalist school. The other reason was the serious problems that interdependent preferences posed for the conventional aggregate demand theory. Many contemporary mainstream theorists have realized that many well established theoretical results might need serious rethinking if preferences are not independent. Thus, our discussion of the history of interdependent preferences indicates that the old methodological mainstream preconceptions concerning human behaviour and ‘positive’ economics, are still extremely strong.

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