Taking part in order of appearance:

Robert Frank  
Economics professor at Cornell University and author of *Principles of Economics* and *The Darwin Economy*

Samuel Brittan  
Audience member, from the Financial Times

Brian Micklethwait  
Audience member, used to work for the Libertarian Alliance

Paul Ormerod  
Audience member

John Ashworth  
Audience member, Ex-director of the LSE

Joe Parker  
Audience member, from the School of Political Sciences at Queen Mary

Lord Glasman  
Audience member, from London Metropolitan University
MASON: (Audience applause) Good evening and welcome to the London School of Economics. I’m Paul Mason, and in this edition of Analysis I’ll be speaking to the economist Professor Robert Frank about the startling claim in his new book that Charles Darwin is a better guide to economic reality than Adam Smith. Robert Frank is an economics professor at Cornell University. His books have focused on the way status and emotion affect our economic choices, and on the way competition can produce increasingly winner takes all confrontations. He’s also co-author, with Federal Reserve Chairman Ben Bernanke, of the textbook Principles of Economics. If only we had all read that before things went wrong. Robert Frank, anybody who has read your book comes away with this startling image of the bull elk and its big, wide antlers. Explain what you’re getting at there. What do you mean by that metaphor, that analysis?

FRANK: The evolution of antlers in the bull elk I think is a nice instance of a trait that evolved for the reproductive advantage of individual animals, but whose ultimate presence ended up being a handicap for a larger group of the same animal. So if you think about the bull elk, they’re - like males in other vertebrate species - determined to take more than one mate if they can. The if they can qualifier is important - it means if some take more than one mate, others don’t get any - so naturally males will take any step they possibly can to increase their odds of landing a mate. They fought with one another. The antlers were an effective bit of weaponry in those battles, and so a mutation that coded for larger ones was very quickly selected. The antlers on the modern animals now span four feet or more; they weigh forty pounds. Imagine an appendage of that size on your head. If you’re chased into a wooded area by wolves, you’re easily surrounded and killed. If you were an elk and could put your hoof on the red button at the count of three and say all antlers get cut back by half, you’d want to do that because you’d be more mobile, you’d be better able to escape from wolves who had chased you into the woods, but each fight that you were engaged in would be resolved exactly as before since it’s relative antler size that matters. So it’s not that that’s a threat to the species of elk. It’s not that the antlers keep growing forever. There are limits on that, of course. There’s no animal with forty feet across antlers. He wouldn’t be a very effective competitor for mates. He’d never get his nose off the turf. There’s an equilibrium. The point is that the equilibrium isn’t good from the perspective of bulls as a group. I emphasise not from the perspective of the species - as biologists are quick to point out, there are superfluous males in all sexually reproducing species, we don’t need so many males, a few will do - but I’m just trying to think about this from the point of view of the bulls themselves.

MASON: So let’s be clear then. What is the four foot wide elk antler in the room here in modern capitalism? What are the distortions that the market has produced?
FRANK: I think a really fruitful example is the whole question of how much safety the market gives workers and the like, and here I think the first thing that got me thinking about the conflict between individual and group interests here was a vivid example offered by Tom Schelling. He noted that hockey players, if they were given a choice, would always skate without helmets. But then he noted if they took a vote on the manner in a secret ballot, they would vote often unanimously for a rule requiring themselves to wear helmets. So what’s going on, guys, he wants to know. If helmets are so great, why don’t you just wear them? Why do you need a rule? And I think his explanation really got at this Darwinian notion that what is in the individual interest in competitive situations when rank is really what matters isn’t necessarily what’s in the group’s interest.

MASON: One obvious difference with the way Smith describes competition and the model you are adopting from Darwin describes competition is that in Smith the actors are rational. The rationality of the actor in Smith is that which prevents theoretically the four foot wide elk antlers ever being created.

FRANK: No, no, I think that the precise point is that the individuals are rational. Rational individuals have the communication skills, the cognitive skills to say look, this is not the best outcome attainable for us. So it’s not irrational what the individuals are doing. It’s just that individual rationality doesn’t coincide with collective rationality.

MASON: What is lacking in Smith?

FRANK: I’m one of Smith’s biggest fans. My target is not Smith himself, but really the modern caricature of Smith as put forward by the free market enthusiasts who are his biggest disciples, particularly in the US. I think what we’ll decide in time is that the invisible hand story is really just an interesting special case of Darwin’s more general view of the competitive process. What Darwin’s great insight was that sometimes individual interests coincide with group interests, but often they don’t. Whenever there’s a conflict, it’s individual interests that tend to trump - often to the great cost of larger groups. I think the key thing in the case of the antlers, why that was inefficient, was that the traits were evolving not for elk to compete against the environment but for elk to compete against their own kind. And when you see the business world, much of the competition in the business world - and among consumers, for that matter - is against our own kind. If there were nothing you could do about that, then well and good, we’ll take the benefits of competition where we find them and suffer the waste when it occurs; but there are often gentle changes and incentives we can usher into the picture that will guide resources away from the wasteful activities.

MASON: I think anybody who’s met a top investment banker - I may be generalising here - but when you meet them, they often do have this Smithian model in their minds of a justification of what they are doing; so in pursuing my own self-interest, I am pursuing the good of all. Now if they had your theory, how would investment bankers have fought in the run-up to the catastrophic loss of Bear Stearns and Lehman Brothers?
FRANK: I think it is true that they have a lot of very self-serving rhetoric. To my ear, they sound much like the social Darwinists of the 19th century. They think anything that survives and prospers in the marketplace is to be celebrated morally: it’s good, we want to encourage more of that and less of whatever doesn’t survive. But I don’t think it was fair really to think of Darwin as a social Darwinist at all. He was really a very humane man by most accounts I’ve read. He saw that competitive imperatives led animals to do things that were brutal in terms of the well-being of other members of the groups: the alpha lion, the first thing he does is murder the cubs sired by the previous alpha male. So I don’t think he thought that whatever survives in nature was to be morally celebrated. I think if you want to read Darwin as a theory of morality, it points you to the conflict between individual and group, and sometimes what benefits the individual puts a much bigger cost on the group - nowhere more than in the financial services industry, by the way. We’ve sent the best and brightest of our students to that industry where they’re fighting over bits of the pie, not creating any new pie. There are only so many deals to be struck and they’re going to get struck whether we send 10 per cent of our best and brightest to that industry or one half of one per cent.

MASON: So …

FRANK: We’re not sending the right number to that industry.

MASON: Okay, so what do you do? What’s the policy outcome of the theory you put forward?

FRANK: I try to attack the libertarian rhetoric in its own terms. I assume markets are competitive, I assume people are rational. Neither of those things is strictly true, of course - the behavioural economists have been making hay for decades on the fact that people are not rational much of the time. Amos Tversky, who died in the mid-90s - one of the founders, he was a social psychologist - he liked to say, “My colleagues, they study artificial intelligence. Me, I study natural stupidity.” (laughter) He could point to situation after situation where people had all the information they needed and they still got it wrong. But I’m not going to go there. I’m going to tell the Right Wing, yes people are rational. And they’re not that irrational. People make mistakes, but for the most part they’ve got goals; and when they have experience, they know how to achieve them. Markets are competitive. They’re well informed or they can become informed. So I agree on all those things. The only thing I add is that they’re an assumption - that rank matters; that we’re not competing over absolute amounts, we’re competing over rankings. And that was Darwin’s insight: it’s not how fast you are, it’s whether you’re faster than the runner you’re competing against that matters. And whenever you’re in that last situation, you get actions by one side that are offset precisely by defensive actions by the other side. If you’re a merchant, you want a sign that people will see. What must a sign be like in order to be seen by people driving by? It must stand out from the visual field. It’s not how big it is; it’s whether it’s bigger than the other signs. It’s not how bright it is; it’s does it have more wattage than the other signs? And so the equilibrium amount of signs gets huge and then we get a visual blight that sometimes we decide hey we can do better than that with a few zoning laws. So a zoning law would be an example of a policy …
MASON: *(over)* Okay so zoning law is one. What else? I mean you’re talking here to libertarian America. They don’t like zoning laws. What else don’t they like? Tax?

FRANK: *(over)* They don’t like them, they don’t like them. They don’t like regulation, they don’t like taxes. Safety regulation is one where I think they’ve got an especially powerful, rhetorical set of arguments to offer. They’ll say of course workers can get higher wages if they take riskier jobs. The firms don’t have to invest in so much expensive safety equipment, so the firm can afford to pay more. The worker can be careful, and I’m willing to be careful and take the higher wage in compensation for the extra risk. My response to that, based on this Darwinian perspective, is that if the contract involved only the parties to it directly, I would say fine, do what you like, but it doesn’t involve just them. If I’m a worker, I’ve got lots of motives for getting more income, but one important one is I want to send my kids to the best possible school I can. The good schools are located in the neighbourhoods where the houses are more expensive. So if I want to send my kids to a school of average quality if I’m in the middle of the earnings distribution, what must I do? I must outbid 50 per cent of all families who are trying to do the same thing. One way I can get a leg up doing that is to sell my safety for a higher wage, so that puts me ahead in the bidding. But then you can do the same. It’s like the hockey players. They’re not going to sit idly by. You sell your safety, I sell my safety. We’ve each bid for houses in better school districts. At the end of the day, we succeed only in bidding up the price of those houses. Half the kids go to bottom half schools same as before. That’s wasteful.

MASON: I think I’ve worked out what you’re trying to do. You’re trying to convince the American Right to accept regulation and taxation on its own terms aren’t you?

FRANK: Yes.

MASON: You’re not saying information is asymmetric, so it can never work. You’re accepting the basic principle not just of Adam Smith but of Ayn Rand maybe, but you’re drawing a different conclusion.

FRANK: Right.

MASON: Has anybody from the American Right accepted this conclusion?

FRANK: I’ve been surprised by the friendly reception I’ve gotten from the Right actually, especially to some of the tax proposals I advanced. I had expected more pushback. I think the Right is not used to being challenged in its own terms. They’re used to being told that’s not fair or you need to be more empathetic or more mindful of the need to regulate monopoly - to which they say fairness, that’s a fuzzy notion; or monopoly, there isn’t any effective monopoly anymore. So I think they’re puzzled when they hear an argument couched in their own terms and they don’t seem quite sure what to respond to it.
MASON: Just explain to us again what the specific tax proposal, the key policy is.

FRANK: Yeah, the key recommendation is to scrap the income tax altogether; in its place adopt a steeply progressive tax on consumption expenditures. And the way that works is if I think a salary’s too high, my proposal is to tax the amount people spend out of that salary. So here’s the claim. If you’re spending four million pounds a year, you’re in a high bracket, let’s say the marginal tax rate is 100 per cent on the next pound you consume. So you’re thinking about adding a two million pound addition to your mansion. That’s going to cost you four million pounds now: two million for the addition, two million for the tax. People think the rich don’t respond to prices, but they do. The rich would scale back their additions if they were confronted with that. They’d say let’s put some of that money into the tax sheltered account, build a mansion addition half as big as the one we were planning. That way it’ll end up costing us the same. And here’s the magic step: others would do likewise and so the new smaller additions that we’d all build would serve us just as well as the bigger ones. It’s relative size that matters in those cases. If you think that’s not true, then you would quarrel with this claim I’m making, but I want to see what evidence you would offer to try and persuade a sceptic that that’s not true. I think it’s plainly true that beyond some point it’s really relative size that matters.

MASON: We’ll come back to some of these specific tax proposals, but I want to hear from the audience now. Samuel Brittan from the FT.

BRITTAN: I want to know what your method, if any, is for people on this side of the Atlantic. Going through your book, I see you annihilating people like the Tea Party, the night watchman state, the ghost of Ayn Rand and all sorts of things like that. There’s hardly anyone this side of the Atlantic who holds any of these almost idiotic laissez-faire positions, although quite a lot of us believe in a sensible market. Now what is the message of your book for this side of the Atlantic or is it just a spectator sport that we should watch?
FRANK: *(laughs)* I think we’ve seen an increase in income inequality on this side of the Atlantic that’s followed in the wake of the one we’ve seen in the US. In the US it’s gone much further than it’s gone here; and in the UK it will proceed further, I predict, mainly because of market forces. Market forces now amplify the reach of the most talented performers in each domain and makes their actual value in competitive terms greater than it used to be. And that in turn has spawned an enormously inefficient pattern of expenditure escalation. So if you think about the rich, they spend more on coming of age parties for their kids, they build bigger mansions. Not because they’re bad people, but because they have more money. That’s what everybody does when they get more money: they build bigger and buy better. When the rich build bigger, the middle class doesn’t seem annoyed by that - they like the pictures of the mansions, they will tune into the TV shows about the life stories of the rich and famous to see them - but there’s a group just below the rich that’s very heavily influenced by what the rich build. They travel in the same social circles. Maybe now the near rich need a ballroom in their house too because now we have our daughter’s wedding at home, not in a hotel or club. They build bigger. Then the near near rich build bigger and it cascades all the way down. What that means is that the median earner in order to send his kids to a median quality school must spend a whole lot more than before just to achieve that basic goal even though the median real wage is no bigger than it was thirty years ago. And that’s a huge burden for the people in the middle. American weddings now on average cost $28,000 a piece. In 1980, in inflation adjusted terms, $11,000. Does anybody imagine that the people who were getting married in 1980 were happier because their weddings … were less happy because their weddings cost so much less? There was a standard for weddings. They met it, they were happy or not when they got married in both of those years. The extra expenditures were mutually offsetting. They just raised the bar that defined how big a party you had to have to suitably mark that special occasion.

MASON: Robert, you’re up against here not just a theory but a culture, aren’t you? The modern world doesn’t like that. It just doesn’t like tax. It doesn’t like the collective solution to these problems. I mean you are fighting a losing battle, certainly in the USA.

FRANK: Yeah, I really intended the book to be a sort of primer for grown-ups about the idea of taxes. I mean our Libertarian Right - you don’t have them, but I bet you have people like them here.

MASON: We do.

FRANK: In April, which is tax time in the US, they’ll get up on the stump in high dudgeon and say all taxation is theft. Do you have people who make such statements here?

MASON: Is there anybody in the audience who does believe that, and let’s give them their due. Sir? Wait a minute, please, give us your name and speak into the microphone if you don’t mind.
MICKLETHWAIT: My name is Brian Micklethwait and I used to work for the Libertarian Alliance, and I am a libertarian of exactly the kind Sam Brittan despises. It’s mutual. (laughter) And although I have not written a publication called *Taxation Is Theft*, I have published one and I admired it very much. It compared taxation to robbery and made many very good points about the violent nature of both processes.

FRANK: Here is the point I would make in response to the claim that all taxation is theft. The alternative is what, voluntary taxation? If we had a country with voluntary taxation, here’s what I predict would happen. I predict there wouldn’t be much tax revenue before long. There wouldn’t be much of a government you could fund with the little tax revenue that you’d have. You couldn’t maintain an army. You would be invaded in due course by a country that had an army financed with mandatory taxes that it levied on its citizens and then you would pay mandatory taxes to that government. (laughter)

MASON: I think, Professor Frank, you might be describing Greece there. (laughter)

FRANK: Nobody likes taxes, but adults know you have to pay taxes. That’s the price of a civilised society.

ORMEROD: Paul Ormerod. So the logic of your argument there is we only need to raise taxes for an army to defend ourselves?

FRANK: If you want to think that’s all government should do, we can argue that. That doesn’t seem like …

ORMEROD: (over) That was your argument - if we didn’t have an army, we’d be invaded. If we raised …

FRANK: (over) Well I’d say if all taxation is theft, we wouldn’t have an army.

ORMEROD: (over) If we raised taxes to defend ourselves, like the English did you know at the time of the civil war. You know we’ve got a long tradition of this historically.

FRANK: So maybe the libertarians will get up on the stump and say now all taxation in excess of what we need to support an army is theft. And I can have the same argument; we’ll extend it. It won’t be the fact that we can’t have an army that’ll be the reason that that doesn’t make sense. It’ll be other reasons.

MASON: In the book, you make a plea for the importance of context to economics and you ask … I think you’ve asked other economists, some of the distinguished ones I think you’ve worked with, why modern economics is so hostile to context; why it claims for itself this high ground of mathematical purity. What did they answer?
FRANK: I’m still struggling with that question. This to me is the big issue in the sociology of knowledge in the areas I’ve worked in. The standard economic models - I assume the ones that are taught here at LSE as well - completely ignore the role of context in shaping demand. So the utility a consumer gets from his house, it depends only on the absolute qualities of the house. That’s so transparently not a correct way to think about that issue. I lived for two years in Nepal, the poorest country on the Earth. I was a Peace Corps volunteer many years ago there. I lived in a two-room house. It had no plumbing, it had no electricity, the roof leaked when it rained hard. None of you would want your friends to know where you lived here in the UK if you lived in a house like that, but at no moment did I ever feel ashamed of living in that house. I was proud to entertain guests in it. It was a nice house compared to the houses that my fellow high school teachers lived in in that context. And to think that context doesn’t matter for your evaluations of things and what you feel you need is just … that’s a notion that describes a world that’s nothing like the world we live in. So I’ve not yet ever heard of a cogent response to my question: why is it economists are loathe to incorporate context into their models of demand?

MASON: Let’s have a few more questions. What about the Darwinians? Are there any biologists or Darwinian scholars here?

ASHWORTH: My name’s John Ashworth and I used to be director here. Modern evolutionary biologists have been much exercised by the appearance of altruistic behaviour, particularly in social animals like ourselves, and Bill Hamilton, a PhD student here many years ago, did some very elegant mathematics which accounted for how this could evolve. And I was wondering whether you’ve tried to apply those thoughts and particularly Hamiltonian mathematics to an economic situation?

FRANK: Yeah in fact one avenue, the one I explored, was in a situation where no-one can tell whether I’ve cheated or not and I’m dealing in one shot games with non-kin, why would it ever pay me to evolve as a trustworthy person? And the argument I pressed on that issue was that the moral emotions have telltale traces that they leave upon the face and the voice, and if there’s something about me that enables you to tell I’m a trustworthy person, yes there’ll be a cost to me, I won’t cheat you even though I could without any probability of being caught, but because you can forecast accurately that I won’t do that, I’m a very valuable employee for you to hire in situations that require trust. So yeah there’s a lot of interesting work I think being done along those lines and it’s again all about the conflict between individual interest and group interest. Cheating is in the individual’s interest in many cases. It’s not in the interest of the group that everyone cheat.

MASON: Sir?
PARKER: Hello Professor Frank. I’m Joe Parker from the School of Political Sciences at Queen Mary. I think a lot of biologists wouldn’t be too surprised to hear what you’ve said today because a lot of us have been trying to find the morals or the altruism in evolutionary biology for about 150 years now. Normally these attempts founder because whenever we find anything that looks like altruism it turns out to be a case of the organism doing something that has a marginal self-interest or a sufficient possibility of payback at some point in the future. So with that in mind and bearing in mind that selection for presumably companies or individuals occurs across a whole range of equilibria - not just the antlers but the ability to digest a certain type of grass or coat colour or anything else - isn’t it the case that any attempt to impose modifications, whether it’s regulation or taxes, would simply be interfering with a selective organism’s ability to simultaneously optimise across a wide range of variables?

FRANK: It would and that’s precisely the goal of the intervention. Again …

PARKER: (over) Sorry, but that presumes that you’ve got you know sufficiently good knowledge of what interventions to pick.

FRANK: Yeah and that’s why I urge regulators to be humble. If I were a Conservative, I would worry that regulators wouldn’t be humble; that they would read my book and say oh collective interests are different from individual interests, let’s regulate everything. I wouldn’t want to see that happen. If the ultimate effect of that book were to stimulate people to form coercive governments that tried to micromanage everybody’s behaviour, I would be deeply disappointed that I’d written the book in the end. I would not want to see that happen.

MASON: I’m seeing Maurice Glasman here in the audience.

GLASMAN: Yeah, I’m from London Metropolitan University. I’m interested in the competition between systems within the Darwinian system and I wonder to what extent you think that the social market economy in Germany, which has the vocational training that’s binding on all companies, that has the worker representation on boards - I mean you could describe it in terms of liberty, competition and the common good - is something distinctive from Anglo American capitalism, and how it could be that the social market economy could triumph over the Anglo American model, particularly at a time when it seems to me that the conclusion that many people (including in the Financial Times) are drawing is that Germans should just spend their savings?
FRANK: *(laughs)* I think the Germans have done some interesting things to try to lean against what individuals would find it most attractive on their own to do - to behave in ways that as a collective they might find more advantageous. I mean I remember being surprised when I lived for a bit in Berlin, you couldn’t shop after … you could only shop one Saturday a month. I’ve got a liquor store owner friend in Ithaca. They’ve been allowed to stay open on Sunday now for the last year. That wasn’t possible before. I asked him about that and he said, yeah, he has to come in on Sunday now. He doesn’t sell any more than before, but if he doesn’t open on Sunday then he’ll gradually lose customers to other shops. So basically because I’m getting a tiny little gain by being able to buy wine on Sunday - which I don’t need to do, or there could be one shop in town that is open on Sunday on a rotating basis - but all the shop owners now, they’ve lost their Sunday with their family, and that’s just a reflection of the fact that if we can do it as individuals then we have to do it. If we can sell our safety, we have to sell our safety. If we can work the extra hour, we have to work the extra hour or we can’t bid effectively for the house in the good school district. And so I see in Germany they make you take vacation. If you don’t take your generous allotment of vacation, you lose it forever. In the US you get one week of vacation to start with. It’s barbaric I think if you compare that system to the German system. So, yeah, I think let different national systems experiment with this whole issue of what’s in the collective interest and maybe some will find useful ways of realising the collectively best pathway.

MASON: I should say anybody who feels traumatised by the issues raised by hearing about a place where there are no wine shops open on a Sunday afternoon, we have a helpline you can ring later. *(laughter)* It just remains for me to thank you, the audience, the London School of Economics, and Professor Robert Frank, and bid you all a safe passage as you go out into the maelstrom that is the Euro sovereign debt crisis. Thank you. *(Applause)*