Challenging the Libertarian Mind

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In a book that uses Darwinian insights alongside Adam Smith to change our thinking on economics, Robert H. Frank sets out to convince libertarians that more taxes can mean more growth and more freedom. Can he succeed?

Reviewed: Robert H. Frank, *The Darwin Economy: Liberty, Competition, and the Common Good*, Princeton University Press, 2011, 240 p., $26.95.

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In *The Darwin Economy. Liberty, Competition, and the Common Good* Robert H. Frank practices what he preaches. Starting with just a handful of simple basic principles, he is not only able to offer new insights on some of society's most pressing problems, but also to propose (at least to some) contrarian solutions for them. Frank arrives at his analyses and his solutions not by exploring the properties of mathematical models but by cogent informal reasoning.

A professor of economics at Cornell University, Frank is well-known for his use of micro-economic principles and tools to shed light on political-economic issues. This has resulted not only in several academic papers and books, but also in monthly "Economic Scene" columns in *The New York Times*. Frank also co-authored a textbook *Principles of Economics* with Ben S.

Bernanke. In *The Economic Naturalist* (2007) Frank advocated a “less-is-more” approach to the teaching of economics. Instead of the algebra and calculus needed to understand mathematical models in economics, students were encouraged learn to use just a few informally stated and basic economic principles to understand phenomena in the real world. The goal was to acquire a deeper and more lasting understanding of what it is to think like an economist. Underlying this “less-is-more” approach is Frank’s belief that most of the insights produced by economic theory follow from the application of just a few basic principles, and that formal models are not needed to see that (and how) the insights follow from the principles.

Another example of this “less-is-more” approach, Frank’s latest book. *The Darwin Economy*, has been advertised as bringing home the message that eventually not Adam Smith but Charles Darwin will be hailed as the principal founding father of economics. Most of the book is in fact devoted to combating Tea Party-type U.S. libertarians, who see raising taxes as an intolerable infringement upon basic individual rights. Frank sets out to show that their view is not only unproductive and paralyzing, but also fundamentally misguided. In true “less-is-more” fashion, he does so through a remarkable use of informal economic reasoning, with just a few principles to start with.

A Wasteful Arms Race

One such principle, perhaps the most central in the book, is that people tend to care more about their relative than absolute position. No matter how well they do in absolute terms, people are not happy if their peers do better. This tendency to orient oneself with respect to how one is doing relative to others is particularly strong and wasteful in so-called winner-take-all markets. In such markets the top seed person earns much more (in terms of material wealth, but also of social status) than the numbers two and three, who might be only slightly worse than the number one. Many are tempted to join the market and compete for the number one position, especially if it entails considerable prestige and wealth, but a lot of energy is expanded in vain: no matter how hard they strive to be number one, only one attains the desired top position. Much waste could be avoided if people put their efforts into other activities and markets. But even if people see through this and realize that it would be in the interest of all to de-escalate, they will not be in a position to curb this process if they act alone. If they decrease their efforts, they can be certain that they will not be the number one; other than that, nothing will change. Only by organizing some sort of coordinated or collective action can the arms race be de-escalated. The introduction of a substantive tax might do the trick, for example. Here, Frank briefly repeats what he argued elsewhere (for example in *The Winner-Take-All Society*, 1995), namely that a progressive income tax should be replaced by more steeply progressive consumption tax.

The Darwin Economy introduces a new spin on this approach. People in winner-take-all markets who devote all their energy and effort to becoming the number one inflict indirect harm on others (another way of putting it, as noted by Frank, is to say that it creates negative externalities). They do not harm others directly by stealing from them or by committing violence to them, but indirectly by making it more costly for them to become the number one. Frank wants to convince others, notably libertarians, that such forms of indirect harm should be taken as seriously as direct forms. Both forms should be subject to Mill's principle, Frank argues, which states that it is permissible to restrain an individual's freedom of action only when there is no less intrusive way to prevent undue harm to others. As we just saw, the only way to prevent undue indirect harm from being done to others in winner-take-all markets is to commit all participants to collective action, for example in the form of taxes. Conjoined with Mill's principle, the concept of indirect harm (the argument that indirect harm can be as detrimental to people as direct harm) provides sufficient reason for Frank to plead for introducing taxes in winner-take-all markets. An additional reason for doing so (implying that it is possible here to kill two birds with one stone) is that the money thus generated represents badly needed revenues for governments looking to reduce deficits.

Although Frank also has a few things to say to political leftists (e.g., about their mistaken assumption that the main source of market failures is limited competitiveness), his main opponents in this book are libertarians. Frank is well aware that his plea will make them shudder, and that they will particularly resist taking indirect harm as seriously as direct harm. Libertarians are likely to respond that it should be left to the discretion of people themselves whether they want to compete for the number one position in winner-take-all markets, or how much effort they want to put into it. Voluntary coordinated action to curb arms races is fine; but imposition of taxes by the state is unacceptable: to libertarians, it is tantamount to an infringement upon individual rights, coercion, or even outright theft.

In the section called “A Mindless Slogan Contest” Frank shows how little patience he has for libertarian objections. Libertarians feel individuals who have earned their own money in a decent and honest way are entitled to keep all of it. Frank explains that this moral argument is based on a false premise, namely that the money people earn through hard work is a consequence of their efforts alone. That is clearly not the case: it is also a consequence of an infrastructure made possible by made by others. Frank also points out that success and failure depend much more on chance factors than people like to think—especially when they are successful. Additionally, in winner-take-all markets using the latest technology, equally highly (or perhaps even more) talented people who have not made it to the absolute top earn much less than the number one. Finally, there is absolutely no evidence that higher taxes on top incomes inhibit economic growth. To the contrary, higher taxes on hedge fund managers are likely to stimulate economic growth, for example, if only because the best brains would be attracted to other non-winner-take-all markets.

Are There Rational Libertarians?

Debunking libertarian arguments is not enough for Frank. He sets out to convert some of their proponents, especially the rational libertarians who endorse basic libertarian principles (safeguarding the freedom and rights of individuals, except when it can cause harm to others) but who are open to revise their anti-government sentiments provided good arguments are offered.

I do not think that Frank is successful in this part of his argumentation. He in effect assumes that a rational libertarian is willing to reconsider what rights and freedoms to define, and that in this process such libertarian is prepared to take on board consequentialist considerations and understand costs more broadly than just the infringement upon the negative freedom and property rights of individuals. Yet, accepting these assumptions would turn rational libertarians into a rather mystical species quite remote from actual libertarians. As Frank recognizes, the frame of mind of a libertarian is deontological. A libertarian starts with the presupposition that individual persons have inalienable rights that should be respected no matter what. A libertarian understands Mill's principle as saying that compromising the exercise of these rights is legitimate only if unlimited exercise of the individual violates the (exercise of) the rights by others. Recognizing other sorts of (indirect) harms or costs that could legitimize compromising the exercise of individual rights is simply not part of his mind set.

That Frank might not persuade libertarians does not imply that the arguments he puts on the table are not forceful. But what he really shows, I think, is the steep price we have to pay if we accept libertarian principles without being prepared to go beyond them. He points at various negative externalities that would result from this and shows that we can all be better off by relaxing libertarian principles, the benefits of such position clearly outweighing the costs. This shows that his frame of mind, not surprisingly for an economist, is clearly consequentialist.

Frank relies heavily on Coase's (1960) insight that negative externalities like noise or smoke are purely reciprocal phenomena. The farmer who complains about the smoke produced by the new-built factory next door has a point. But so has the factory owner when he complains about the extra costs he has to incur to reduce pollution. Coase's ground-breaking insight was that it is not obvious that the factory-owner (as the "perpetrator") would have to incur all costs. If the farmer and factory-owner are willing to negotiate with each other, and if they can do so at negligible cost, they both have an incentive to agree on an efficient solution. Frank proposes to take Coase's insight as a model for how a rational libertarian should ideally find out about what rights to define: libertarians should only treat outcomes which completely free people would agree on as rights. Frank makes clear that the integrality of the costs and benefits such free people deem relevant should go into this hypothetical agreement.

Frank apparently believes that a rational libertarian would find this model fully congenial. I very much doubt it. Again the problem is that Coase's framework is clearly consequentialist, whereas the libertarian's framework surely is deontological. Frank might be right that libertarians often refer approvingly to Coase's work, and his hope is that a rational libertarian is willing to follow Coase's reasoning to its logical end. I think it more likely that a libertarian will stick to his guns, which basically means making basic freedoms and property rights sacrosanct, and say: so much the worse for Coase.

Frank's discussion of Coase's celebrated insight is excellent. Frank shows an acute awareness of the fact that Coase never believed that contracting costs (or transaction costs) are negligible in actual negotiations, for example. This is why "Coase's theorem" is modeling an ideal hypothetical situation. Along the way (not surprisingly for an author who is so much concerned with the effective and proper teaching of economic principles) we are offered many insights stemming from pure economic reasoning. Frank simply cannot stop making us economically more literate. Here, he is at his best. He thus explains why a nonzero level of pollution could be optimal, why auctioning off seats in overbooked flights can be in the interest of all, and why, even though willingness to pay depends heavily on ability to pay, rational policy should be based on willingness to pay nonetheless. One can complain that auctioning off seats in overbooked flights is immoral, for it clearly favors the rich over the poor. It is true that the result of the auction might be that rich people, who can afford to pay a high price, continue their travel uninterrupted, while poor people, who cannot afford paying a high price, will be left waiting for the next flight. But Frank argues that we should not forget that no one forces poor people to accept the deal they are offered: to get some cash payment (or some other compensation) for relinquishing their seat instead of refusing this and keeping their seats. By accepting the deal poor people reveal that they apparently prefer serving other pressing needs than taking the flight. So both rich and poor people benefit from the auctioning arrangement. Frank adds to this that if it is the immorality or unfairness of the distributional consequences that we are concerned about, we can always choose to independently implement redistributions.

From Smith to Darwin?

Although the bulk of the book is about defending against libertarians the introduction of additional taxes, the book has been marketed as claiming that within the next century Charles Darwin will replace Adam Smith as the intellectual founder of economics. Frank predicts that the significance of wasteful arms races will come to supplant Adam Smith's rosier vision of the invisible hand in free markets. One can object that we do not need Darwin to recognize this. Economists and others have long (and independently of Darwin) realized that the pursuit of individual interests need not lead to socially optimal outcomes (Nash equilibria need not be Pareto efficient, for example) and that collective action might be required to prevent this from happening. One can also object that, although Darwin, with his notion of sexual selection, draws our attention to these problems, they are not Darwin's main message. Perhaps Darwin's greatest insight was similar to that of Smith's: that a socially optimal order, which has all the appearances of being designed by a benevolent creator, can result from the blind force of natural selection.

These objections should not hide the fact that Frank uses Darwin in other ways. He is careful not to argue that people care about relative position because relative performance is all that matters in natural selection. He does not suggest that from the fact that relative performance is all that matters in natural selection it inevitably follows that all that people care about is relative rather than absolute position. It would be mistaking ultimate causes for proximate ones. What ultimately counts as success in biological evolution for an individual is to pass more genes to the next generation than its competitors; but it does not imply that an individual's ultimate goal must be to pass more genes to the next generation than its competitors. Pursuing other, more mundane goals may be a better strategy to have superior reproductive success. Frank (1988) himself showed that people who are emotionally committed to cooperation might be reproductively more successful than opportunists. Nor does the necessity of having superior reproductive success imply that all the goods that people value are positional goods (i.e., goods for which relative position or performance is more important than absolute position). Thus leisure is not likely to be a positional good, Frank argues. The reason is that in ancient times, when the human nervous system evolved, famines were a recurrent phenomenon. Individuals who made additional investments to outperform others in terms of leisure were more likely to have starved than those that were more frugal in this respect. By contrast, individuals that made extra investments to achieve high rank in income distribution were likely to be reproductively more successful than others, as higher income meant a higher chance to be fed. Income is therefore more likely to be a positional good than leisure.

What is interesting is that Darwinian thinking is used here to determine what sorts of goods are likely to be positional. The underlying presupposition here is that *homo sapiens* is an evolved species and that our evolutionary history left its traces in our current biological and behavioral characteristics. Note that this is an altogether different use of Darwin than in what is supposedly the main message of the book: individual pursuit of self-interest may lead to inefficient social outcomes (called "Darwin's wedge"). Yet another (albeit implicit) use of Darwinian thinking is made when Frank argues that regulations are data. Here he challenges libertarians to explain why regulation is such a widespread phenomenon over time and across cultures. If all regulation were bad, why is it so prevalent? Although he does not spell this out, Frank's suggestion is clearly that there must be a good reason for something as ubiquitous as regulation, otherwise it would not have evolved in the first place. Frank himself links this with the Smithian "no-cash-on-the-table-principle." Friedrich Hayek would have said that with his views on the spontaneous evolution of social order, Smith was a Darwinian-before-Darwin. This is indeed where Adam Smith's invisible hand and one—if not the—central message of Darwin seem to converge.

Frank has written a book that is both rich in substance and content and simple in terms of the principles used and arguments developed. Even though he might not succeed in converting libertarians, he at least has given them a lot of food for thought.

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