

# A progressive consumption tax would curb positional arms races and free up finances that could plug the deficit hole. By following Darwin's theories, we could introduce a more effective economic system.

*Darwin's theory of evolution helps explain the positive role of competition in the business world but also highlights the damaging effects of competitive 'arms races' in private consumption. **Robert Frank** argues that a progressive consumption tax would correct market inefficiencies and channel resources towards more highly valued uses .*



With good reason, most contemporary economists regard Adam Smith as the founder of their discipline. But in time, I predict, a majority of my colleagues will accord that honor to Charles Darwin, the pioneering naturalist. Although Darwin had no formal training in economics, he studied the works of early economists carefully, and the plants and animals that were his focus were embroiled in competitive struggles much like the ones we see in the marketplace. His observations forged an understanding of competition that is subtly but profoundly different from Adam Smith's. Smith's celebrated invisible hand theory, which holds that unfettered markets (often) channel self-interest to serve the common good, will someday be seen as an interesting special case of Darwin's more general theory.

Consider his description of product-design improvements or cost-reducing innovations. The entrepreneurs who introduce them hope to steal sales from rivals. They often succeed spectacularly in the short term, which pressures rivals to mimic the innovations. The ultimate beneficiaries of all this churning, Smith explained, are not businesses but consumers, who enjoy ever better products at ever lower prices.

In Darwin's theory, natural selection favors traits and behaviors that promote individual reproductive success. Many of the examples he observed were closely analogous to Smith's account of product-design improvements. But Darwin also recognized that individual and group interests often conflict sharply and that in those cases individual interests generally trump.

The evolution of keen eyesight among hawks is an example of the former type. A mutation that led to slightly improved vision benefited the individual in which it first occurred. By enabling that individual to catch more prey and feed more offspring, it spread quickly. Similar mutations accreted, with the result that virtually all modern hawks have astonishingly acute vision by human standards. Like Smith's product design improvements, these mutations no longer confer relative advantage to individual hawks, but their ultimate effect was to make hawks more effective as a species.

In many other cases, however, mutations that promote individual reproductive success prove very costly to larger groups. A vivid case in point is the prodigious antlers of the bull elk. Like males of most other vertebrate species, these animals take more than one mate if they can. But if some succeed, others are left with none, making them the ultimate losers in Darwinian terms. It was thus inevitable that bulls would fight bitterly for access to females, and also inevitable that natural selection would spawn an arms race in the antlers that promoted success in those battles. But while the massive antlers of surviving bulls—which often span more than four feet and weigh more than forty pounds—help them prevail, they are a serious handicap when bulls are chased into densely wooded areas by predators.

Since it's relative antler size that matters in battle, bulls would have good reasons to favor a proposal to trim each animal's antlers by half. The outcome of every fight would be the same as before, and each bull would be far better able to escape from wolves.

In short, Darwin's understanding of competition makes clear that there can be no presumption that the process promotes the common good. Often it does but success in Darwinian terms typically depends heavily on relative performance, and attempts to occupy scarce slots atop any hierarchy inevitably provoke wasteful, mutually offsetting behavior.

It's an important point, since the modern conservative's case for minimal government rests on the presumption that competition always promotes society's welfare. Our best understanding of how competition actually works supports no such presumption.

Jockeying for position in the modern marketplace often spawns positional arms races that are just as costly as the ones that Darwin studied. If you're one of several qualified applicants seeking the same investment-banking job, for example, it's in your interest to look good during your interview. But looking good is an inherently relative concept. If others show up wearing £500 suits, you'll be more likely to make a favorable first impression if you show up in one costing £1200. That the resulting positional arms race is wasteful follows from the fact that job applicants are no more likely to get the positions they seek if all spend £1200 on suits. Rising income inequality in recent decades has exacerbated these positional arms races and surely there are more productive ways to spend these extra pounds.

There is, of course, waste in government as well. But in scale and scope, it pales in comparison with the private sector waste associated with positional arms races, whether it is living in a large house or having your children attend good schools. Private waste is also far easier to curb than government waste. Much of it in fact could be eliminated by a few relatively simple changes in our tax code.

The single most productive change would be to scrap the existing progressive income tax in favor of a more steeply progressive tax on consumption. A progressive consumption tax is different from a sales or value-added tax. People would report their incomes just as they do now. They'd also report their annual savings, much as they do now for tax-exempt retirement accounts. Their tax would be based on their "taxable consumption," which is just the difference between their income and their annual savings, less a standard deduction—say, £20,000 for a family of four. Rates on additional expenditures would start low and rise gradually with taxable consumption.

This tax would lead the biggest spenders to save more and spend less on larger mansions and more lavish coming-of-age parties, which would boost investment and economic growth. It would also shift the frames of reference that influence consumers just below them. So they, too, would spend less on housing and celebrations, which would reduce the pressures facing those further down. In short, the tax would attenuate the expenditure cascade that has made it so much more expensive for middle-income families to achieve basic life goals. By curbing positional arms races, a progressive consumption tax would essentially create new wealth out of thin air. The money saved could support a host of genuine improvements in people's lives.

Revenue from a progressive consumption tax could also help resolve the vexing question of what to do about deficits. Although deficit reduction is a task best postponed until the economy emerges from the recession, we can't allow debt to keep growing relative to national income forever. At some point, we must rein it in. But as anyone familiar with the numbers knows, budgets cannot be balanced without new revenues. Yet [all six Republicans](#) appointed to the recently created congressional super-committee charged with resolving the "debt crisis" have signed a formal pledge never to vote for any tax increase under any circumstances. An economic train wreck looms. A progressive consumption tax could avert this crisis.

In the current climate, there is little likelihood that this tax will be implemented soon, but if the tax were passed now and scheduled for gradual phase-in once the economy returned to full employment, that would kill two birds with one stone. It would reassure deficit hawks that we're committed to putting our fiscal house in order, and it would encourage an immediate burst of private spending by people eager to avoid the tax, all without the government having to spend an extra penny.

Darwin's simple insight reveals that the modern economy is not only far less efficient than Adam Smith's modern disciples think it is, but also that it would be relatively easy to improve matters. That simple truth will someday be self-evident. But until then, the wasteful aspects of the competitive process will continue to impose enormous costs on everyone.

*This essay is adapted from Robert Frank's most recent book [The Darwin Economy](#) (Princeton University Press, September 2011).*

*Robert Frank will be speaking at the LSE on **The Darwin Economy: liberty, competition, and the common good**, on Thursday, 10 November. Event details can be found on the [LSE Events page](#).*