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‘The first prediction of the positional model is that people will work too many hours’



Interview with Robert H. Frank

Robert H. Frank is the Henrietta Johnson Louis Professor Emeritus of Management and Professor Emeritus of Economics at the Samuel Curtis Johnson Graduate School of Management. For more than a decade, his "Economic View" column appeared monthly in The New York Times. He received his BS in mathematics from Georgia Tech and then taught math and science for two years as a Peace Corps Volunteer in rural Nepal. He holds an MA in statistics and a PhD in economics, both from the University of California at Berkeley. Frank's books have been translated into 23 languages. Frank is a co-recipient of the 2004 Leontief Prize for Advancing the Frontiers of Economic Thought. He was awarded the Johnson School's Stephen Russell Distinguished Teaching Award in 2004, 2010, 2012, and 2017, and Apple Distinguished Teaching Award in 2005.

You are often referred to as one of the founders of behavioral economics. Two other behavioral economists, Daniel Kahneman and Richard Thaler, have received the Nobel Prize in Economics for their analysis of irrational behavior. How does your approach differ from that of Kahneman/Tversky and Thaler?

I taught what I believe to have been the first course in behavioral economics to an undergraduate student population at Cornell in 1983. I called it "Departures from Rational Choice," and it had two parts on the reading list: "Departures from Rational Choice *with* Regret" and "Departures from Rational Choice *without* Regret." The first part included the kind of work associated with Thaler, Tversky, Kahneman, and others who specialize in the frailties of human reasoning. The second part was an attempt to explain what I saw as the Homo Oeconomicus model's more important shortcoming, which was rooted in my own understanding of rudimentary biological principles. My basic point in this second part of the course was that central features of evolved human preferences give rise to profoundly wasteful collective action problems.

What are examples of "Departures from Rational Choice without Regret"?

One is to leave a tip in a restaurant you'll never visit again. You tip because you have a considered preference to do right by the waiter who served you. Or let's say a person finds an envelope with 10 000 € inside of it and the owner's name and address written clearly on the outside. The finder could keep it with no penalty, and the Darwinian model predicts

that he would do so. That model says that an organism with more resources will leave more surviving offspring. Taking the Darwinian approach into account, over time, the type that would return the money should go extinct and the type that wouldn't return the money should take over. But clearly, that hasn't happened, so there must be an advantage for those who don't cheat even when cheating can't be detected and punished. In any case, most people who leave a tip in a restaurant they'll never visit again or who return an envelope with money in it do not appear to regret their behavior once economists tell them it doesn't match their model's predictions. That's why I called that section "departures from rational choice without regret." But on reflection, I don't really want to call honest behavior irrational. So in that sense, I feel my course title was poorly chosen.

In my classes, I don't introduce your work as behavioral economics, I tell my students that we operate with a different paradigm, namely, evolutionary economics. Do you feel comfortable with the classification of your work as evolutionary economics?

When I taught my behavioral economics course in 1983, I thought I was going to be a participant in good standing in the behavioral economics movement, because I thought of this emerging field as one that tried to offer a richer account of how people actually behave, in contrast to the account of behavior that we see in traditional economics textbooks. And psychology provides some of the basis for that, as in the work of Thaler, Kahneman, and Tversky. But I also hoped that behavioral economics would ultimately include the work of Darwin, perhaps even a more broadly interdisciplinary effort that would include sociology, anthropology, and other fields that would help us answer questions we care about. But to this day, people think of behavioral economics as primarily a field at the intersection of economics and psychology. There are indications, however, that the field is gradually broadening.

One strand of your research emphasizes the advantages that individuals can have when they allow themselves to be guided by emotions. Your 1988 book "Passions within Reason" has become a classic reference on this topic. A second strand of your work emphasizes the importance of relative position and the inefficiency of inequality. Your first book on this topic was "Choosing the Right Pond" in 1985. Which of the two strands of your work seems more important to you: the work on the role of emotions or the work on status competition?

The work on the role of emotions was probably the most exciting work I ever got involved in. It was intellectually more satisfying despite the clear recognition that the work on positional competition has more sweeping policy implications.

In this interview, I'd like to focus on your work on positional goods. What is the central idea here?

Humans often care about their relative position rather than just their absolute position. In our evolutionary past, having higher rank meant better access to food and mates, among other advantages. This drive for relative position continues today, causing people to strive for more, even when they have enough. While this drive is understandable, it often leads to waste. The unique thing about humans is our ability to create rules and institutions that curb this waste. For example, we pass laws like safety regulations or mandatory school start dates, which help mitigate waste caused by positional competition.

The Easterlin paradox is a popular concept among my students because it discusses the intriguing question of whether money buys happiness. How does your perspective on status competition relate to this?

What we see in the Easterlin paradox is that people who have relatively high incomes enjoy greater life satisfaction than people with relatively low incomes. Yet when you increase everyone's income, average life satisfaction doesn't go up.

The Easterlin paradox is what Darwin's view of competition would lead us to predict. If that doesn't seem obvious, let's do a thought experiment in which you must move to one of two new worlds. In the first, your absolute income would be 50 percent higher than your current income but you'd be among the bottom 10 percent of earners. In the second, your absolute income would be 25 percent higher than your current income but you'd be in the top 10 percent of earners. Which world would you choose?

If I'm honest, I'd pick the second world ...

We see that there are advantages to being in the top part of a group that are quite valuable to people and they're not irrational to care about them. According to Darwin, the human nervous system wasn't forged to make us happy. It was forged to help us survive and project copies of our genes into the next round. We were programmed not to feel contented but rather to feel anxious and want to do better.

An obvious question that follows from the Easterlin paradox is whether one thinks that an increase in average real incomes in rich countries like the United States or Germany would be helpful or even necessary to increase average life satisfaction. What is your view on this?

I think it's a good question, especially with the climate issue coming into sharper focus and powerful movements like the anti-growth movement gaining more popularity. But I see many problems with it.

One stems from work by the Harvard economist Benjamin Friedman, who found that the lion's share of social justice measures historically was adopted during periods of above-average economic growth. His explanation was that if you wanted to get taxpayers to help others in need during periods of static incomes, that would require them to make do with less for themselves, which would trigger loss aversion. Loss aversion is of course one of the big findings in behavioral economics. People hate having to make do with less. In contrast, when incomes are growing rapidly, we can pay for improving social justice without requiring taxpayers to cut back on their own consumption.

So you are not an anti-growther?

No, in my view, the effort to limit growth *per se* is just fantastically wrong-headed, because it's only growth in certain things that are even harmful to climate concerns. If my wife takes piano lessons, the money she pays her teacher goes into GDP. No harm results from that. If more people can afford to do that and they do it, or if they hire a landscaper to plant flowers and trees, that's all to the good. But if they burn more fossil fuels, that's bad. And we have policies that can discourage people from doing things that are harmful.

But higher GDP growth comes with an opportunity cost: you can't simultaneously reduce working hours and fully capitalize on hourly labor productivity growth. Productivity gains could be either directed entirely toward GDP growth, used to reduce working hours, or allocated between the two. What is your perspective on this trade-off?

Yes, if you're saying, you're going to get more, but not as much more as you would have gotten because we're going to use some of it to help these people who need it, then it's much easier to get support for that.

Many years ago, there was an interesting paper in which Landers et al. (1996) asked associates in large law firms which option they would prefer: a 10 percent pay cut and 10 percent fewer hours to work, or their current package? And people said that if everybody took the 10 percent pay cut and had 10 percent fewer hours, they would strongly prefer that. Right, but just me? No way. If you work less than the others, you're less likely to get promoted. It's a competitive world. And the first prediction of the positional model is that people will work too many hours. Top lawyers don't need additional income to be able to pay their piano teacher. It's just a question of holding their place in the competitive line.

Neoclassical economists view the choice between consumption and leisure as a matter of individual preference. However, if positional externalities play a significant role, especially in highly unequal societies with individualized bargaining over wages and working hours, doesn't this push people toward excessive consumption and insufficient leisure?

Without question. In fact, the only way we've gotten increases in leisure time historically has been through some form of collective action. If you want to think about regulations as data, all the world's religions have a day when you're not supposed to work. In more modern times, overtime laws say that if you employ the worker beyond a certain number of hours in the week, you have to pay a 50 percent wage premium. That's a strong disincentive for the employer not to ask you to work more than 40 hours a week.

In terms of vacation time, the countries of Europe seem more sensitive to this issue than the US has been. In the US, there are fewer weeks of vacation time typically offered to the worker. But unlike Europeans, Americans also have the option of not taking their vacation time. And in competitive environments, many people take that option. That shouldn't be understood to mean that they're happy about forgoing vacation time. It may mean only that unless they refrain from taking as much vacation as they're entitled to, they'll be less likely to make it onto the next rung of the job ladder.

Don't your points suggest that the anti-growth movement isn't entirely misguided? Isn't the real issue not productivity growth itself, but how it is used?

I fully support laws that increase national holidays or mandate "use it or lose it" vacation policies. However, I disagree with the anti-growth movement if it advocates producing less as a general principle of the good – that, to me, is misguided.

Is real GDP even a meaningful measure of material living standards when considering positional goods? For example, if smartphones like the iPhone are status goods, isn't the focus less on which technical features you get for your money than on the cost of owning a socially acceptable model?

Well, GDP is in fact exceedingly hard to measure. You can always find issues that plague the measurement of any quality assessment. There was once an iPhone app called "I Am Rich." Its price was \$1000, and the seller consciously emphasized that its product does absolutely nothing, making it an effective way to signal how wealthy you are. Others would see the app's ruby icon on your iPhone screen, leading them to say, "That guy's got so much money that he's willing to pay \$1000 for an app that does nothing." The I Am Rich app was in the end an effective signal not of wealth but of stupidity. Almost nobody bought it, and it was dropped from the app store in mere weeks. Buyers apparently care more about intrinsic product quality than some critics seem to think.

If I buy a new smartphone, I'll choose the higher-end model if the extra features matter enough to me. If some bureaucrat then tells me we're overestimating GDP growth because he thinks I don't really care about those features, I'll complain.

Maybe the iPhone isn't the best example, but with cars, it's clearer that real GDP increases because people drive bigger cars. The real reason for this is a positional competition, where people buy bigger cars to feel safer, retaliating against others who do the same. This creates not just a measurement issue, but a conceptual problem with using GDP.

That's indeed a much stronger example of your point. And I have long argued that the best intervention in this example would be a tax on vehicles based on weight. Why should such a tax be viewed as controversial?

My concern is that you treat the existing infrastructure and poor quality of public transport as given while addressing positional externalities through the tax system. Shouldn't the solution be for the government to reduce car-centric infrastructure and invest in public transport?

I agree that proposals to change the playing field also ought to be on the table. And I think it would in fact have been better to have invested much more in public transit decades earlier. But is your argument that taxing vehicles by weight will reduce the incentive to make those investments now?

No, it is rather a question of how much political capital can we mobilize to make any changes.

Well, if a significant portion of our efforts are spent on getting vehicle taxes enacted, that can indeed limit the political capital and energy available to push for other important initiatives, like building more subways or investing in public transportation infrastructure. So, yes, there are trade-offs of exactly the sort you describe.

Another concern with the emphasis on GDP may be that people work in what they perceive in "bullshit jobs." According to the late radical anthropologist David Graeber, such jobs are the reflection of neo-feudalism. If it is true that many jobs could be abolished without replacement, what would be your theoretical explanation for this? Do we need imperfect competition or a theory of neo-feudalism?

It's not the result of imperfect competition. It's the expected result of positional competition itself. One of the most striking examples is the construction of a fiber optic cable from Chicago to New York, costing hundreds of millions of dollars. This cable, which reduced signal transmission time by just 3 milliseconds compared to the old route, facilitated arbitrage between commodity market hubs. The faster transmission offered no real value beyond enormous windfall profit gains to the cable entrepreneurs. The same people could have contributed to projects that actually benefited society instead of performing a task that served no meaningful purpose.

What do you see as the main obstacles to shorter work hours, and what policies would be necessary to overcome them?

I believe a steeply progressive consumption tax would be one of the most effective ways not only to lessen the need to overwork for advancement but also to narrow the long-term income gap.

Can you briefly explain how a progressive consumption tax works and its expected economic benefits?

For people whose annual consumption exceeds a high threshold, let's say a million dollars, we can be confident that the marginal dollar spent is for something whose positionality is

almost certainly very high. Under a progressive consumption tax, you would report your income to the tax authorities as you do now. Probably it would be better to simplify that a lot, as has often been proposed but never done. Then you would document your annual addition to your stock of savings, as many already do for tax-exempt retirement accounts. The difference between those numbers – your income minus your addition to your net savings – is your annual consumption spending, and that amount minus a big standard deduction is what you would pay tax on. Rates would start low, keeping the tax for low- and middle-income people as low or lower than the current income tax, but then the rates can go steeply upward beyond a high consumption threshold.

You favor the progressive consumption tax because it avoids making judgments about which kinds of goods should be taxed?

If you took positional externalities as a concept seriously, and if you had unlimited detailed information about everything in the world, you would tax every purchase in proportion to how positional it was. Of course, there won't ever be enough information to do that. The attraction to me of the progressive consumption tax is that it requires no judgments at all about what's positional. Making such judgments is a bad business for congressional committees to be in.

Maybe I have a more "European," or "statist" attitude here? I would argue that not only important positional goods such as education, housing, and transport but also the pension system should be provided by the state and that working hours should be regulated by collective bargaining agreements so that positional externalities do not arise in the first place. Take them out of the domain of monetary arms races in the first place, rather than try and alleviate them ex post through taxation.

I once had a discussion about a related question with an American friend who'd spent several years working in Australia. He said that Australians mostly seemed happier than people he knew in the US and he was always curious why. And he finally thought it was just a simple consequence of the fact that the people in the US were worried about three things: How am I going to send my kids to college? What am I going to do if I get sick? And how am I going to retire? He said those three things are completely off the table as items to worry about in Australia, where education is financed collectively, healthcare coverage is universal, and the retirement system is a fairly generous transfer to retirees. Your position strongly aligns with his.

It is a difficult balance to strike between individual freedom and collective reason ...

I think the libertarians and I share a visceral dislike of being told what to do. But despite my support for many policies that most libertarians oppose, I still think of myself as a libertarian because I embrace John Stuart Mill's harm principle: People should be permitted to do whatever they please as long as they don't cause undue harm to others.

In the end, much comes down to how we think about what constitutes harm to others. What about spending a million dollars for your daughter's wedding reception? Does the state have any role in making it harder for you to do that? I think it does. You almost surely don't intend to harm others by making that expenditure. You acquired the income lawfully. But your expenditure would nonetheless alter the norms that govern expenditures for celebrating special occasions. The Indian government eventually adopted laws to regulate how much was spent on funerals, because to honor the dead in a satisfactory way had been growing steadily more expensive. Of course you could say, well, just then

don't spend it. But how is that an acceptable option for somebody who wants to honor the person they've just lost?

Thank you very much for being available for this interview!

This interview was conducted by Till van Treeck at the FMM conference in Berlin in October 2024.

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