

The New York Times

July 12, 2009

ECONOMIC VIEW

The Invisible Hand, Trumped by Darwin?

By ROBERT H. FRANK

IF asked to identify the intellectual founder of their discipline, most economists today would probably cite Adam Smith. But that will change. Economists' forecasts generally aren't worth much, but I'll offer one that even my youngest colleagues won't survive to refute: If we posed the same question 100 years from now, most economists would instead cite [Charles Darwin](#).



Darwin, renowned for the theory of evolution, was a naturalist, not an economist, and his view of the competitive

struggle was different from Smith's in subtle but profound ways. Growing evidence suggests that Darwin's view tracks economic reality much more closely.

Smith is celebrated for his "invisible hand" theory, which holds that when greedy people trade for their own advantage in unfettered private markets, they will often be led, as if by an invisible hand, to produce the greatest good for all. The invisible hand remains a powerful narrative, but after the recent economic wreckage, skepticism about it has grown. My prediction is that it will eventually be supplanted by a version of Darwin's more general narrative — one that grants the invisible hand its due, but also strips it of the sweeping powers that many now ascribe to it.

Smith's basic idea was that business owners seeking to lure customers away from rivals have powerful incentives to introduce improved product designs and cost-saving innovations. These moves bolster innovators' profits in the short term. But rivals respond by adopting the same innovations, and the resulting competition gradually drives down prices and profits. In the end, Smith argued, consumers reap all the gains.

The central theme of Darwin's narrative was that competition favors traits and behavior according to how they affect the success of individuals, not species or other groups. As in Smith's account, traits that enhance individual fitness

sometimes promote group interests. For example, a mutation for keener eyesight in hawks benefits not only any individual hawk that bears it, but also makes hawks more likely to prosper as a species.

In other cases, however, traits that help individuals are harmful to larger groups. For instance, a mutation for larger antlers served the reproductive interests of an individual male elk, because it helped him prevail in battles with other males for access to mates. But as this mutation spread, it started an arms race that made life more hazardous for male elk over all. The antlers of male elk can now span five feet or more. And despite their utility in battle, they often become a fatal handicap when predators pursue males into dense woods.

In Darwin's framework, then, Adam Smith's invisible hand survives as an interesting special case. Competition, to be sure, sometimes guides individual behavior in ways that benefit society as a whole. But not always.

Individual and group interests are almost always in conflict when rewards to individuals depend on relative performance, as in the antlers arms race. In the marketplace, such reward structures are the rule, not the exception. The income of investment managers, for example, depends mainly on the amount of money they manage, which in turn depends largely on their funds' relative performance.

Relative performance affects many other rewards in contemporary life. For example, it determines which parents can send their children to good public schools. Because such schools are typically in more expensive neighborhoods, parents who want to send their children to them must outbid others for houses in those neighborhoods.

In cases like these, relative incentive structures undermine the invisible hand. To make their funds more attractive to investors, money managers create complex securities that impose serious, if often well-camouflaged, risks on society. But when all managers take such steps, they are mutually offsetting. No one benefits, yet the risk of financial crises rises sharply.

Similarly, to earn extra money for houses in better school districts, parents often work longer hours or accept jobs entailing greater safety risks. Such steps may seem compelling to an individual family, but when all families take them, they serve only to bid up housing prices. As before, only half of all children will attend top-half schools.

It's the same with athletes who take anabolic steroids. Individual athletes who take them may perform better in absolute terms. But these drugs also entail serious long-term health risks, and when everyone takes them, no one gains an edge.

If male elk could vote to scale back their antlers by half, they would have compelling reasons for doing so, because only relative antler size matters. Of course, they have no means to enact such regulations.

But humans can and do. By calling our attention to the conflict between individual and group interest, Darwin has identified the rationale for much of the regulation we observe in modern societies — including steroid bans in sports, safety and hours regulation in the workplace, product safety standards and the myriad restrictions typically imposed on the financial sector.

Ideas have consequences. The uncritical celebration of the invisible hand by Smith's disciples has undermined regulatory efforts to reconcile conflicts between individual and collective interests in recent decades, causing considerable harm to us all. If, as Darwin suggested, many important aspects of life are graded on the curve, his insights may help us avoid stumbling down that grim path once again.

The competitive forces that mold business behavior are like the forces of natural selection that molded elk. In each case, we see instances of socially benign conduct. But in neither can we safely presume that individual and social interests coincide.

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