Novel Economics

Reviewed by David R. Henderson

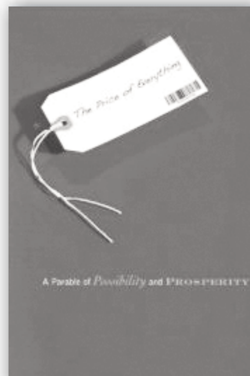
THE PRICE OF EVERYTHING: A Parable of Possibility and Prosperity
By Russell Roberts
203 pages; Princeton University Press, 2008

Have you ever wanted to give a friend a book that explains the main virtues of economic freedom in a dramatic way that is accessible to a broad audience? Russell Roberts's latest novel, *The Price of Everything*, is the book you want.

That's right: I said "latest novel." Roberts, an economics professor at George Mason University, has written two other novels, both of which teach economics lessons. His first, *The Choice*, is a kind of *It's a Wonderful Life* applied to free trade. His second, *The Invisible Heart*, is a highly plausible love story between two high-school teachers: a male economics teacher and a female English teacher.

In my review of *The Invisible Heart*, I pointed out a problem with the book as a novel: the conversation is one-sided. I stated in my review: "I don't know how to fix that when one person understands economics and the other doesn't, and the author's goal is to get across some important ideas in economics. But maybe Roberts will figure that out when he writes his next novel."

Roberts has partially figured it out. This time, although the conversation is still one-sided, it is less so. His new twist is to have the person who knows and teaches economics be an older woman, the fictional provost of Stanford University, Ruth Lieber. Maybe I shouldn't find this more acceptable than a male know-it-all, but I do. Dramatically, it works better. Part of the reason is that she often has a more gentle way than Roberts's previous male characters of communicating life's economics lessons.



The other protagonist in the novel is Stanford undergrad Ramon Fernandez, a tennis star whose mother had escaped with him from Cuba by boat. When Lieber meets him, she has an explicit agenda, and it's one that, as an economics professor, I share: she wants to convince Ramon that free markets are humane and will accomplish so much of what he, and humans in general, want to accomplish. Lieber may also have a hidden agenda, and Roberts keeps us wondering about that all through the novel. The way he plays that tension is masterful.

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Another way Roberts handles the one-sided-conversation problem is by alternating between Lieber teaching an economics class that Ramon's girlfriend, Amy, attends and Lieber having conversations with Ramon. In one class, Lieber tells the students why no one knows how to make a pencil. Her explanation is based on Leonard Read's classic 1958 monograph "I, Pencil." The gist is that the pencil is made through an extensive division of labor, not just across industries but also across borders, and there is no central organizer, no central planner, who makes this happen. Instead, it is an example of people acting and coordinating their actions based on prices. Lieber goes beyond Read, pointing out that "the greatest migration in human history, the movement of the Chinese from the farms to the cities" — which has created new demands for pencils, bicycles, and other items — has happened without a shortage in either pencils or bicycles.

There are other nice touches. One of my favorites is Lieber's story of a family friend who put 20 years of his life into producing a medical device that made him rich. Lieber makes clear that the way you get rich in a free market is by producing something people really want. Why did they want this medical device? Because it blasted the plaque from people's arteries, making open-heart surgery unnecessary. In the previous year, the device had helped about 4,000 people. But then the man found out that he had liver cancer and a life expectancy of only a few months. He was distraught. His children were grown and he had hardly ever been around; his wife had left him. I don't want to give away the story — it surprised me and I want you to have the same surprise. But what happened next was a wonderful, loving, and totally believable way of helping the man see just how important his life had been.

Another of my favorite passages reminded me of something that happened in the early 1990s in my economics class. We were discussing the economics of information, and the main point I wanted to get across is that information is scarce and often valuable. Therefore, I said, the hostility that many people have toward those who make money on the basis of information that only they have is no more justified than hostility toward those who make money on steel or cars or steak. So-called inside traders, I said, are making money from information, but so am I. I'm here because I'm paid to be here, and I am paid to be here because I have information to impart that the school deems valuable enough to pay me for. So, I am making my

David R. Henderson is a research fellow with the Hoover Institution and an associate professor of economics at the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, Calif. He is the editor of *The Concise Encyclopedia of Economics* (Liberty Fund, 2008.)

money on inside information every bit as much as an inside trader does. "Do you mean, professor, that you're not teaching us because you love us?" joked a student. The class laughed, and I saw my chance to extend the joke and teach an economics lesson in the process. "I do love you," I said, "but love isn't enough to get me here. I have to be paid, too." Ruth Lieber tells a similar story.

One issue that always comes up in discussions of economic freedom is the high degree of income inequality that economic freedom can lead to. In *The Price of Everything,* Ruth and Ramon have that discussion. Ruth makes the point that a high degree of inequality is completely consistent with everyone doing well and improving his or her situation. She makes an important distinction, using a variant of a statement that Roberts used in a March 2006 online debate held by the *Wall Street Journal.* Lieber says, "I think most people care about getting ahead, not about whether they're getting ahead of others."

Roberts is definitely progressing as a romantic novelist. See if this passage about Ramon and Amy sitting looking at birds increases your pulse:

> Amy's body temperature had been on the rise for the last few minutes. Without any conscious effort on her part, the slightest tinge of pink rose to where her cheekbones were closest to the skin, in that perfect curve below her eyes. Her upper lip dampened, glistening ever so lightly in the sunlight holding the remains of the day. As the hawk flew on, and the shorebirds returned to their still life, Ramon's gaze returned to Amy's face. Whether it was the change in color or the moistening of her upper lip or some other cause — Ramon could not explain it any more than he could explain the impulse of the shorebirds to defend their young so ably — Ramon took Amy in his arms and kissed her.

But I don't want to downplay the good economics that Roberts and his character Lieber get across in a punchy way. To answer Ramon's objection that increases in productivity destroy jobs, for example, Lieber states, "In 1900, America had 30 million jobs. A century later, we had over 130 million." Roberts even has a nice statement about economics professors who are passionate about teaching and not so excited about writing seldom-read scholarly articles, a statement that I, a passionate economics teacher, appreciated. Lieber, speaking to Ramon after her career has ended, says:

> I spent the early part of my career writing scholarly papers for scholarly journals that a handful of scholars found interesting. But in the classroom, I taught thousands of students over the years about the complexity of the world.

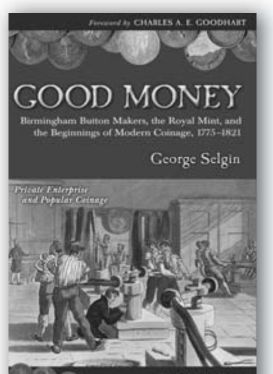
Happily, if the Amazon rankings and the number of people listening to Roberts's *EconTalk* podcasts are indicators, Russ Roberts is teaching tens of thousands of people that, in Lieber's words, "not everything glorious that we observe in the world around us is the result of someone's intention. There is wonder in the world that we humans create without any of us fully understanding it."

A Chronicle of Coinage

Reviewed by George Leef

GOOD MONEY: Birmingham Button Makers, the Royal Mint, and the Beginnings of Modern Coinage, 1775–1821
By George Selgin
345 pages; Independent Institute and University of Michigan Press, 2008

"I am good copper/Value me as you please." That was the inscription on a coin made by a Connecticut blacksmith named John Higley, circa 1737. The coin was not "official" money — it wasn't legal tender. Nevertheless, it circulated in trade. In colonial America, coinage by the Royal Mint in England was too scarce to serve the needs of commerce, so artisans and businessmen stepped in to supply money.



Those are among the facts in an article by Brian Summers entitled "Private Coinage in America," published in the July 1976 issue of *The Freeman.* Having read the article, I was aware that free-market money is not just a theoretical notion for laissez faire purists to play around with, but an historical reality. For that reason, the story told by University of Georgia economics professor George Selgin in his new book *Good Money* was not a surprise to me, but for most readers it probably would be, because it describes Britain's experience with private coinage during the Industrial Revolution. As was the case in the colonies, the Crown proved to be inadequate to the task of supplying money. Selgin's meticulous research explains why that was the case, how private enterprise ameliorated the problem, and finally how the government reasserted its monopoly to put an end to the nation's free market money episode.

PRIVATE MONEY PROBLEMS? *Good Money* has an intriguing origin. While reading a book by the 19th century British economist William Stanley Jevons, Selgin came across a passage in which Jevons took issue with Herbert Spencer's argument that the production of money could be entrusted to the free market. Jevons wrote that in his view, "there is nothing less fit to be left to the action of competition than money," and added that the nation's experience with privately minted coins in the late 18th century "amply confirmed" his opinion. Selgin wanted to know just what that experience was and proceeded to investigate. He writes, "What I dis-

George Leef is vice president for research of the John W. Pope Center for Higher Education Policy.

covered amazed me, not the least because, instead of confirming Jevons's position, it did just the opposite."

That sentence hooked me.

Among other great changes it brought, the Industrial Revolution led to a huge increase in the need for money. In pre-industrial England, relatively few workers were paid money wages. As industrialization increased, however, more and more workers left feudal agriculture for manufacturing employment and business owners had to pay them in money. But because there was a shortage of small coins, factory owners needed to devote a substantial amount of time and effort to coming up with the money necessary to meet their payrolls. Furthermore, much of the money they were able to acquire was questionable because many coins were badly worn, had been clipped (i.e., some of the metal had been sheared away), or were counterfeit. It was not good for morale when some workers were paid in coins that they feared might be rejected.

The Royal Mint was indifferent to the situation. Its job was to coin money for the upper classes to use — mostly gold. It wasn't averse to silver, but no silver had been coined for decades prior to 1775. The reason for that is a favorite of economics professors: Gresham's Law. The government's official rate for silver was well below the market price for the metal elsewhere in Europe, so silver flowed out of the country. Selgin performs a valuable service in explaining the true meaning of Gresham's Law. It is not that, as most people have heard, "bad money drives out good," but rather that when government artificially overvalues one kind of money relative to another, people will tend to spend the overvalued and horde or export the undervalued. Just think about the disappearance of U.S. silver dimes and quarters after the introduction of clad coins in 1965; officially, silver and clad coins were of equal value, but as soon as people began to realize that the silver was worth much more, they stopped using silver as money.

COPPER What about copper coins for small transactions? The Royal Mint had not bothered coining copper for years, for several reasons. Small change was regarded as "unworthy" of the highbrow mint, because copper supposedly was merely money for the common folk. Selgin relates an anonymous verse from 1739 that captures the attitude:

> 'Tis gold buys Votes, or they'd
> have swarmed 'ere now,
> *Copper* serves only for the meaner
> Sort of People;
> *Copper* never goes at Court.
> And since one shilling can full
> Twelve Pence weigh,
> Silver is better in *Germany.*
> 'Tis true the Vulgar seek it, What
> of that?
> They are not Statesmen — let the
> Vulgar wait.

Thus, the famous British upper-class snobbery combined with Gresham's Law to help produce an acute shortage of small coins in an economy desperate for them. There was another reason, too: occasionally the mint had coined some copper, but those coins were overvalued relative to their metallic value and were so poorly made that counterfeiting was easy. Selgin explains, "The mint thus found itself inadvertently boosting the output of spurious copper coins whenever it tried to add to the quantity (and improve the average quality) of genuine ones."

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In 1761, copper was discovered on Anglesey Island, off the coast of Wales. Commercial mining began in 1768. The owners initially produced mainly copper sheathing for the hulls of Royal Navy ships. Mining operations grew apace and within a few years over 1,000 miners were employed there. Owner Thomas Williams faced the problem discussed above — how to come up with enough coins to pay his men.

Williams at first approached the government with a plan to collaborate in the production of new copper coins, but the Crown was not interested. He then secured the services of a master engraver and began producing his own coins, called Druids, to pay his workers. They were (and still are) regarded as exquisite coins, but their more important feature was that they were accepted as payment by the workers and then in trade by merchants. Soon the coins were circulating on the mainland. Williams shrewdly facilitated the demand for his product by stamping on them that they were promises to pay and setting up redemption offices in London and Liverpool. People's confidence in the new money grew rapidly; they knew they were getting "good copper."

So great was the success of the Druids that Williams soon opened another mint in Birmingham and employed experts to improve efficiency. Private enterprise brought high technology of the day to the business of making money while the government continued using old-fashioned methods.

Several years later, industrialist John Wilkinson contracted with Williams to produce coins for him. But whereas the Druids were made to the official mint standard of 23 pence per pound of copper, Wilkinson attempted to overvalue his coins, calling them pence but putting only half as much copper in each as the Druids. That bit of knavery failed — Wilkinson's workers refused to accept the light coins at the value assigned to them. Selgin drives the point home, writing, "Wilkinson had inadvertently discovered an important difference between commercial and regal coins: that while the Royal Mint could take advantage of its copper coins' limited legal tender status to make them as light as it wished, commercial coins could be lightened only subject to the public's approval, without which they would not circulate."

CHOICE OF CURRENCY In time, Birmingham became the center of a substantial coinage industry. Why Birmingham rather than London or some other city? It was because, Selgin discovered, Birmingham was the most accommodating city for new business enterprises. It was a town of free trade, a contemporary writer noted, and not encumbered with "corporate and chartered dignities, honours, immunities, privileges, and annoyances." It was the Hong Kong of its day.

During the period, there were many different coins produced by many firms. But instead of leading to confusion and disrupting commerce, businesses and workers adapted without difficulty. Almost 200 years before Hayek's advocacy of choice in currency, the British were enjoying the benefits of a regime of choice.

The story, alas, has an unhappy ending. By 1812, Royal Mint officials and their political allies were pressing for a bill to outlaw the private coinage. Arguing against it was James Maitland, the Earl of Lauderdale. He denounced the bill, contending that the suppression of private coinage would "create confusion and distress in the country, by destroying the means of carrying on the retail trade, it being only through the medium of small change…that the retail trade of the country can at present be carried on." What did that matter to politicians and mint officials? Lauderdale's counsel was ignored and in 1813 Parliament passed the Local Tokens Act to outlaw private coinage. Lauderdale was quickly proven right. The economy was thrown into a tailspin, yet the government dithered for three years before starting to supply more small coinage itself. The only good Selgin finds in this sorry episode is that the Royal Mint learned from the private minters and eventually was able to meet the monetary needs of the British economy.

In conclusion, Selgin argues that the history of private coinage shows that we should "ponder governments' role in money through the same wary eyes economists tend to cast upon other government ventures." Just so. We can speculate that the history of both Britain and the United States would have been more prosperous and peaceful if we had stayed with private coinage and bank notes rather than allowing the government to create a money monopoly for itself.

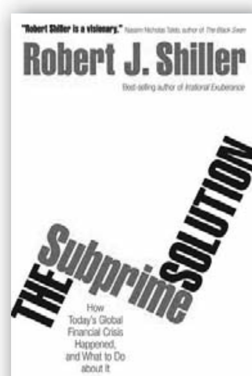
Not only is *Good Money* very thought provoking, it is also beautifully written and embellished with several glossy pages of illustrations of the coins, people, and buildings central to the story. Whether you use good money or bad, buy this wonderful book. **R**

Learning to Live with Bubbles

Reviewed by William A. Niskanen

THE SUBPRIME SOLUTION: How Today's Global Financial Crisis Happened, and What to Do about It
By Robert J. Shiller
178 pages; Princeton University Press, 2008

Compared with most economists, Yale University's Robert Shiller writes unusually well and he addresses issues of broad popular concern. Unfortunately, in his latest book, *The Subprime Solution*, he has almost nothing to say about the presumed topic. He does not describe the characteristics of subprime mortgages, the public policies that promoted the rapid expansion of their use and later authorized their securitization, or the reasons why subprime mortgages are unusually risky to both borrowers and lenders. Instead, the book is really about bubbles generally — his explanation of the subprime bubble and his proposed solutions are common to bubbles in any other market.



For instance, on the cause of the subprime bubble, Shiller writes: "The subprime crisis was essentially psychological in origin, as are all bubbles. … [I]t was caused by failure to anticipate quite obvious risks — by 'irrational exuberance' at the prospects for profits." He acknowledges, "The interpretation of the bubble that I have just offered is not the conventional wisdom. Other factors are widely cited as the cause of the housing boom. I argue here that, to a large extent, these other factors were themselves substantially a product of the bubble, and not exogenous factors that caused the bubble." Among the other factors that Shiller asserts were products of the subprime bubble were the Fed's low interest rate policy for several years following the 2001 recession and "the lack of urgency among regulators in doing their job."

As an example of Shiller's perspective on bubbles, he also attributes the rapid increase in oil prices to "speculative enthusiasm" rather than to any change in demand or supply conditions. Schiller singles out Alan Greenspan for criticism because "he never seemed to embrace the view that a good part of what drives people's thinking is purely social in nature. … He does not seem to respect research approaches from the fields of psychology or sociology." In this case, neither does this reviewer. The primary problem of Schiller's explanation of the subprime and other bubbles is that he provides a theory of bubbles but no evidence, a theory that has not been tested and may not be testable.

PROPOSALS Shiller regards bubbles as basically exogenous, rather like a dangerous storm, conditions that cannot be reduced, delayed, or averted by prior changes in policy. This leads him to conclude by recommending two types of policy changes to reduce the impact of any type of bubble: *ex post* assistance to some of the people harmed by the collapse of a bubble, and several new types of *ex ante* financial instruments and insurance for all of us.

He makes the case for substantial bailouts to some of those harmed by the collapse of a bubble in the name of social or economic justice. He writes, "The purpose of the bailouts should *not* be to maintain high values in the housing market, the stock market, or any other speculative market. The essential purpose is to maintain a sense of social justice. As such the bailouts should focus intensely on preventing distress among

William A. Niskanen is chairman emeritus of the Cato Institute and chairman of *Regulation's* editorial review board.

people of modest means." And, "We have to be willing to spend money on securing economic justice. That means allocating resources to determining — to the extent possible — who among mortgage borrowers were misled and mistreated, and then focusing the bailouts on them." These recommendations (on successive pages) leave some doubt about who would be eligible for bailouts — "people of modest means" or "mortgage borrowers who were misled and mistreated" — and he does not seem to be concerned about any moral hazard effects by members of those groups.

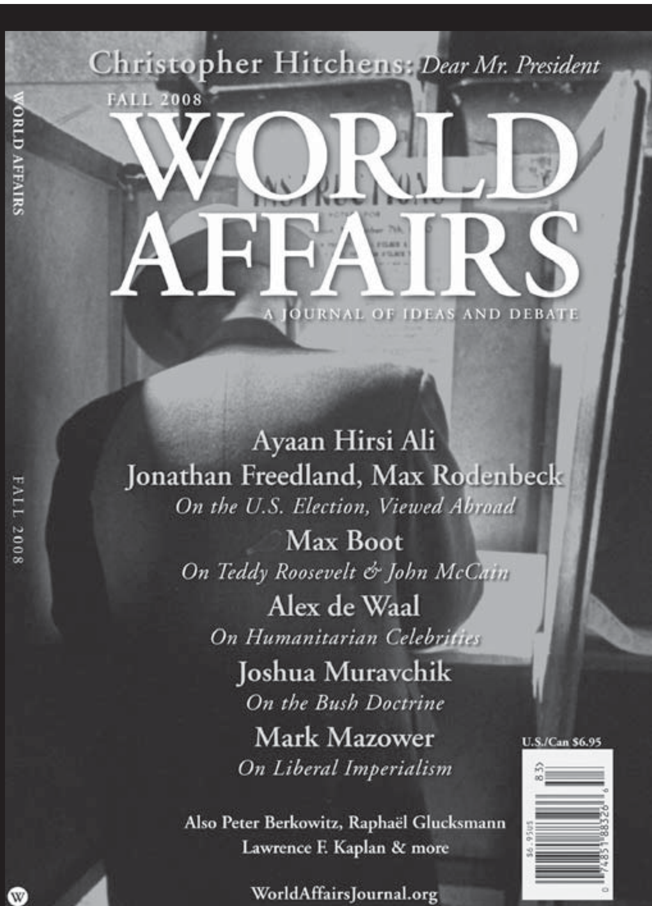
Shiller makes the case for improvements in the information infrastructure and financial markets in the name of financial democracy. His recommendations (taken from his own summaries) include:

- Promote comprehensive financial advice for everyone through institutions that will make sure that all individuals, not just the most wealthy, receive such advice.
- Create a financial product safety commission.
- Establish standardized default-option financial plans that operate well when people are inattentive and fail to act.
- Improve the disclosure of information that is relevant to people's financial and economic lives.
- Subsidize the development of large private databases on both individuals and all firms. The databases would be governed by protocols that allow the information to be used to develop risk-management contracts, but at the same time assure privacy.
- Establish an inflation-based unit of account.

This is an ambitious agenda. But it raises questions about whether most people would understand, value, and use the additional information, and about civil liberties issues.

Finally, Shiller's most creative proposals are to establish several new types of financial and insurance instruments. The proposals that would have the greatest effect on the housing market would be to establish a liquid market in real estate futures by city, continuous workout mortgages, and home equity insurance. Livelihood insurance would broaden disability insurance to include economic risks as well as medical risks.

Shiller has thought carefully about the structure of his proposals, to eliminate any significant moral hazard effects. The proposals' value is that they would reduce the costs of risk-reducing behavior without reducing the underlying risks. The proposals merit serious attention, but they should not shift attention away from efforts to reduce the underlying risks; we need not accept the view that bubbles cannot be averted. And one wonders why private firms have not already offered most of these financial instruments and insurance policies. R



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