Murphy Answers Questions II
Guest: Robert P. Murphy
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WOODS: All right, Bob, so another year, another Nobel Prize announcement, and once again Murphy is snubbed. Can you try and make sense of the Nobel Prize winners for us? You were speculating that there was, if not a contradiction, then something kind of funny about Eugene Fama and Robert Shiller both getting it, but maybe it's not so much. Is it like a Myrdal and Hayek situation? Who are these people and is there any reason we should be pleased with this?

MURPHY: Well it's a great question. I think they're snubbing me just because I'm kind of young. They wouldn't want the older guys to feel bad; the upstart kid gets it.

WOODS: That's how I took it.

MURPHY: Yeah, so I give them that. I just hope I don't get hit by a bus before my work is appreciated.

So as far as the Nobel, what's funny here is this is another area where the Austrians seem to have a broader historical context. Because I'm pretty sure the way Paul Krugman handled this was to make a joke about, "Yeah, in economics it seems like the Nobel Prize goes to people who not only have different theories, but, in the same year for the same award, where they contradict each other." Of course, that's what Austrians have been saying since 1974, is what you were alluding to [by mentioning Myrdal and Hayek]. As far as this year's award, it's funny. There's a lot of free-market people who are saying they got it right this time. I love Fama. I've been waiting years for Fama to get it, and of course, guys like you and I are biased, because we liked the Austrians. Fama is prototypical Chicago School in this respect.

As far as what's the apparent contradiction, just for your listeners who don't really know: Eugene Fama is considered arguably the father of what's called the efficient markets hypothesis. Loosely speaking, that means that at any moment asset prices reflect all publicly available information. You can't beat the market. It's silly to put your money with a fund manager who's picking stocks based on some mechanism that he uses or someone who follows technical analysis and looks at the charts and says, "It's a head and shoulders [pattern], and that means the market's going to go down tomorrow, so I'm going to sell and get out in time." So all that kind of stuff that the wizards think that they can do, and that's why you should give your money to them and pay them huge management fees—the claim is that Fama kind of blew that all up by saying, "No, the market's efficient." People have heard that there's a random walk in terms of stock prices, so this is where all that comes from.

Fama's not the first guy in human history to remark on this stuff, but if you had to pick somebody who's the founder of this idea, it would be him. And so then Shiller, who also shared the prize and then also Lars Hansen did—Hansen got it more for his econometric work on studying asset prices and things like that, and I'm not really totally familiar with his work; I can't comment much on it. But Shiller, his work again, the layman can take it away saying that Shiller was documenting ways in which the market in general and financial markets in particular are not completely efficient or rational in the sense that neoclassical economists use those terms.

So this is the sense in which it's odd. On one hand it's almost as if the Nobel Committee is saying, and again it's not really the Nobel Prize [TW note: We explain this below], but Fama is being awarded for his work in

showing how the stock market is efficient. You can't beat the market and so on. Don't even try. And then Shiller's being awarded in the same year, sharing the same prize, for his work in showing all the ways in which Fama is wrong. And so that's the irony, and people can hash that out as to whether that's a fair statement or not. Some people have made this analogy: "Well, suppose Isaac Newton and Albert Einstein happened to be alive at the same time. Would it be so crazy for them both to win the Nobel Prize in physics for their work in understanding the behavior of matter and energy when there's a sense in which Einstein overturned Newton?" So that's the analogy some people are making, and we can speculate on that.

But as far as whether it is a good thing, all I will say is this. Clearly the efficient markets hypothesis—that strain of thought—has been used by a lot of economists when discussing the housing boom years and so on, to even come close to denying that there was a housing bubble. So not merely saying, "Well, how could anyone have known that in real time?" At Mises.org I have an article called "Bursting Fama's Bubble" that came out a few years ago, where he was saying that I don't even know what you mean by the word "bubble," because to have operational meaning people would have to know it in real time. And if you knew that there was a stock market bubble in progress or a housing bubble, you would short the market, and that would end the bubble. So they're using these kind of like quick, glib arguments to prove that bubbles are basically impossible. At least in any practical sense. And that's just silly, as anyone familiar with the Austrian School would recognize.

WOODS: And that's why I think it's not a good thing for Fama to get this. Because I think the efficient markets hypothesis almost comes off as a caricature of free-market belief. That the market is so efficient, in his kind of way of speaking, that you can't possibly have a bubble, because the market would have taken it into account. By the way, can you elaborate on one small subtlety in your remark? You said, "It's not really the Nobel Prize." Not everybody knows what you mean by that.

MURPHY: You're right, Tom. The reason I even said that is because whenever I refer casually to the Nobel Prize in economics with no quotation marks or any caveats like that, you'll get people in the comments who jump all over you and say, "No, no, no. Alfred Nobel did not set up the prize in economic sciences. That was instituted later by the Swedish Central Bank, and it's the Nobel Memorial Award in Economic Sciences," or something like that. They bring it out at the same time when the other genuine Nobel Awards are given, but actually the economists who win it are not receiving something that was endowed by Alfred Nobel. And that's interesting in and of itself, because as Austrians have said, it's the mainstream economists who have this pining. They want to be like the physicists. They want to be real scientists, so this is kind of another example of that.

WOODS: All right. I have a question that I want clarified, because I think a lot of people are confused about it. So I'm going to ask it on behalf of the general public. And that is a question that is answered in a basic economics course you would take in college. It deals with the subject of a strong dollar, a weak dollar, and exports. We hear it said that we shouldn't want a strong dollar. You want to have a weak dollar, and you want a situation in which exports from your country are favored. And that comes about by manipulating the money and all that. Can you sort out exactly what that's all about, and how it can be that in the long run you can in fact boost your exports by manipulating your currency? Or is this only some kind of short-run effect? And if so, give us an example of how that works.

MURPHY: Okay, that's a great question. So the very short-term, narrow perspective where these people are coming from involves saying, look, when foreigners are trying to decide whether they want to buy things domestically in their own currency, or they want to, from their point of view, import it from the United States—so from our point of view it's exports. They've got to look at the prices, and of course, they can't just look at the price that's on the sticker in their country and our country, because they're using a different currency.

So if people in France, let's say, are thinking about buying wine there, they'll see how many euros it is, and

then they'll look at a similar bottle of wine that's available in the United States that'll be quoted in dollars. So for them to be able to compare the two to say which is cheaper, obviously they need to know what the dollar-euro exchange rate is. And so that's the sense in which, if you held everything else equal and then all of a sudden the dollar weakened against the euro, well, then the people who hold euros now can buy more with their euros in goods that are priced in dollars. And so, other things equal, as the dollar weakened, they would be able to buy wine from the United States more cheaply than wine from France, and so you would see more exports of wine to France.

The problem with that, though, is, why did the dollar weaken? If the dollar weakened because Bernanke just announced we're going to increase the rate of creation of the U.S. dollar, other things aren't going to remain equal. That's going to push up the dollar price of goods in the United States. And so it's going to be a wash in the long run. This is a simple, crude thought experiment: if they doubled the quantity of dollars, roughly speaking, you'd say, okay, the dollar-euro exchange rate will get cut in half, and so people holding euros can now buy twice as much stuff, but then everything in the United States quoted in dollar bills is now twice as expensive when you're looking at the sticker.

So I'm simplifying there, but I'm just trying to get you to see the insight that depreciating your currency is not a method of promoting exports in the long run. If you think about it, there's a sense where in the long run a country pays for its imports with its exports and vice versa, and so it's not that you're going to fool foreigners into buying more of your stuff than they really wanted to in the long run. Certainly not by debasing your currency. That's not the path to prosperity.

WOODS: So, in other words, eventually the market figures out, "Wait a minute. No fundamentals have changed. It's just that one country manipulated its money, and then prices will wind up adjusting so that there will be no benefit that you could get from being in one currency as opposed to another." Am I right?

MURPHY: Right. I think that's the way to deal with the primitive, naïve argument that all we need to do is weaken the dollar, and that's how we're going to promote exports. So there are complications that come with that: strictly speaking, it's not just goods in the sense of finished products for consumers to use. There's also financial assets. And so if people around the world wanted to invest in U.S. assets, then we could afford to have a trade deficit which would not weaken our currency, and so there's various complications like that. But yeah, the way you just summarized it, I think that's the first thing you've got to realize when somebody says just very naively, "Oh, we don't want to have the dollar be too strong, because then we won't be able to export anything." You have to ask yourself, why is the dollar so strong? And certainly in the long run, if the U.S. for example were on genuine commodity money, it's true that, the currency, if you quoted it in terms of that commodity money, would presumably appreciate year after year against all the fiat currencies of the world, but that wouldn't spell disaster. Once people got used to that new equilibrium, the prices of goods in the United States quoted in that commodity money would probably gently fall over time—what some people refer to as good deflation. So again, there would be a wash there. Yeah, the other people holding fiat currencies, whatever we were quoting it in, it would get weaker and weaker—but then by the same token, the sticker prices here would gently fall to counteract that.

WOODS: Well, let's talk a minute about China, because we always hear China's manipulating its currency to benefit its export sector. Is it doing so? And secondly, given what we've just said that at least in the naïve version you can see how eventually there'll be an adjustment, and there won't be any long-run benefit to doing this—in order to have a strategy like this wouldn't you have to be constantly debasing your currency? Debasing it, debasing it, and eventually the market's going to anticipate a further debasement and adjust prices ahead of it. Wouldn't any alleged benefit coming from this sort of strategy exhaust itself?

MURPHY: That's a great question, and I'm glad I sort of hedged myself there and said it gets a little bit more complicated when you bring in financial assets. With China, there are two things going on: they're creating money in the yuan, and they're using that to go into the currency markets to trade their currencies against

dollars and then use the dollars to buy U.S. Treasuries, which would be bonds issued by the U.S. federal government. If you think about it from one perspective in terms of the international trade flows in accounting, in a sense the reason the United States is able to consistently buy more goods from China than China buys from the United States is that China is also mopping up more of our financial assets than vice versa. And so that's where the gap is filled. So the balance of trade or the balance of payments always does balance when you include financial assets.

So back to your question: Is China deliberately weakening its own currency? Because if you think about it, why would it weaken their currency? Because for them to do that, for them to consistently buy more financial assets from the U.S. than vice versa, that means they have to go into the currency markets with their currency and buy dollars with it. So that makes the dollar stronger against their currency than it would be if they stopped doing that. And so it's funny, people simultaneously are worried that China might try to threaten us by not buying more of our debt. They have us over a barrel if they ever threatened in an international standoff to save the U.S. You know what? We're going to stop financing your federal government's deficit if you don't play ball with us in terms of foreign policy.

So on the one hand people are mad at China at that, and on the other hand, the same people often complain that China is deliberately weakening its currency in order to promote its exports. But those are two sides of the same coin. The way they are allegedly weakening their currency by not letting their currency strengthen against the dollar is that they go into the currency markets in order to buy U.S. dollars, so they can keep sopping up our government's debt. So, I don't know exactly what's in their heads. I think part of it is they saw what happened in the Asian financial crisis in the late 1990s, and they said, "We don't want to be vulnerable in that kind of situation. So we want to have an ability to assure investors around the world that our currency is as strong as the dollar. So we want to build up dollar reserves, so that if for some reason there ever were a run on Asian currencies, people would trust us, because we've got all these dollar reserves and we can support the strength of our currency." Again I don't know exactly what's in their head.

I think at this point, they're almost wishing they could get out of the dollar, because they see what Bernanke's been doing. But they don't want to cause a panic. So whatever the actual situation is, the Chinese government cannot continue to sop up U.S. government debt, without at the same time providing the mechanism by which the United States can continue to run a trade deficit with them, which only works because they are holding the U.S. dollar artificially strong against their own currency. So those things all are interrelated, and it's just odd that a lot of neocons and other people simultaneously complain about two things that have to go together.

WOODS: What about from the point of view of the average American consumer? Is there a sense in which the average American consumer is benefitted or harmed by the Chinese manipulation of its currency?

MURPHY: Well for sure I would say everybody on planet earth is ultimately harmed when a particular government creates money and makes it easier for the United States government to run deficits and so on. So that's what's happening. I think certainly the Chinese government and its associated monetary institutions and central bank are setting their people up for an Austrian boom-bust cycle in what they've been doing. And then it's particularly egregious in that what they're doing with that new money is to lower interest rates with the United States government, and make it easier for the United States government to spend more money than they take in in taxes. So that's certainly not good for the average earthling, I would think.

As far as the direct issue of the impact to American consumers: let's say there's some foreign government that for whatever reason taxes its own people in order to subsidize exports from its own country. And so effectively they're lowering the price to U.S. consumers by making their own people defray some of the costs of the goods they're sending to the U.S consumer. So in that narrow respect, it's good. American consumers are helped if some foreign government stupidly wants to tax its own people in order to give us

stuff at a better price. If some foreign government wanted to make it completely free and just completely subsidize their exports, so they were sending us stuff across the ocean for nothing anf we were getting free TVs, obviously that makes us better off. Yeah, our industry would adjust to that new situation, but there's a *prima facie* sense in which we're getting stuff for free that's obviously making us wealthier.

WOODS: I really just want to exhaust this subject. Why are exports so important? Why is there this fixation with stimulating exports through monetary manipulation? Why are exports the key to prosperity? Is it simply that the exports sector happens to be politically powerful? Why exports?

MURPHY: There are two ways of answering that. One is in terms of the economists and the analysts who are pushing it on paper. What's the rationale they're giving? And then the other angle involves what's going on politically in the real world. So I think you're right that politically, in terms of Public Choice economics, the way you would answer is to say the classic thing, "Why are there tariffs? Why are there any kind of favors given to exporters or to people who are producing domestically, and you want to keep out cheap foreign imports?" And the answer there, which I think is basically correct, is just the issue of concentrated benefits and dispersed costs. So politically, it's easy for the government to favor exporters at the expense of importers or just the general public, because the exporters clearly benefit. They can contribute to the campaigns and so on, and they know what's going on. Whereas the average person, it's hard for him to understand exactly why everything he buys is a little bit more expensive.

As far as the economics—like, if you asked somebody who's a genuine proponent of this why, somebody like Paul Krugman or something—I think it just goes back the Keynesian mindset that they're all about: "What do you do when the economy's in the slumps, in the doldrums?" You want to stimulate spending. So if you think about it, net exports in terms of the standard equation that you probably learn in introductory macroeconomics, if you took that in college, is Y = C + I + G + net exports. GDP is the sum of all the spending in the economy. That's the way Keynesians look at it. That's why Keynesians or the analysis of a newspaper article writer who's talking about the economy will say consumer spending is down. Business investment is down. Businessmen are very afraid of the future here. What are we going to do? We need the government to come in and run a big deficit.

By the same token the fourth element in that is foreigners on net buy more of our stuff than we buy of theirs—that's what net exports are. And so in terms of all the different spending streams that add up to GDP, the total spending in the economy, foreigners buying our stuff is one element of it. So I think that's partly why today's economists with their Keynesian mindset often come back to that and stress exports. I don't think there's any real reason in the grand scheme that if you understand why you don't need to encourage consumers to go consume more. That "Oh gee, the way you fix the economy is to get people to go to the mall and blow their paycheck." If you can see what's wrong with that mentality then by the same token you can see why there's no reason why the government ought to be encouraging the export sector to the detriment of every other sector.

WOODS: Let me ask you just a yes or no question here. Is this why some people have said that there's a link between Keynesianism and mercantilism and why Keynes even said that the mercantilists have been unjustly maligned and they actually had some decent ideas? Are you able to give a simple answer to that?

MURPHY: Yes.

WOODS: Good. Let me switch gears entirely. Robots. I want to ask you about robots. And what I mean is, we all know that the invention of the train was a net benefit for society, because now the market is much wider. You can have a much broader array of goods, because they can be transported to all different marketplaces now. And you have a bigger potential set of consumers who can consume them. And you can be infinitely more efficient and all these other things. All the people who instead used to carry freight on horseback, or whatever—all those people are now freed up to produce other things. We couldn't have had

those other things before, because these people were stuck carrying stuff on their backs instead of working on producing widgets and all the things they can produce now.

So we see that technological advances and labor saving devices do not destroy jobs. They create new ones. These are great. But the scenario that you sometimes see that people propose just for the sake of argument is, suppose one day we get to a point where robots can basically do everything and then nobody has any jobs. This seems to be the ultimate direction where capitalism is heading, and yet in that scenario, yeah, okay somebody's got to repair or create the robots. But you could build robots to do that. So in other words, is there a robot endgame where it actually turns out that technological advance is a net minus, because it takes so many jobs away from us? Where is the fallacy in that?

MURPHY: Well, one way of seeing it is to say, forget that question. Let's just pretend we started new, and we're sitting around just talking to our friends saying, imagine just a complete almost utopia. Like people who are into science fiction and whatnot. Just imagine a world that's just wonderful, and it's gorgeous. And it's almost just heaven on earth. What would that look like? And they would probably say, well everyone just lounges around reading philosophy all day and watching movies and hanging out with their friends and then machines and robots do all the work. That's what paradise would be. And nobody ever has to toil, or you have to work one hour per year. And all the material benefits of our infrastructure in these robots just cranking these things out, and we go and explore the stars and so on.

We have ships that are taking us around, and we're just explorers. And we don't really work. It's just all about what we're doing with our leisure, but our leisure is not merely lounging around. It's doing all sorts of really exciting things and exploring the universe. I think that's what a lot of people, particularly those that are attracted to science fiction, would describe as a future universe that was wonderful, and too bad we can't live there. And so that's one way of explaining: so then why would you be afraid of robots becoming so productive that there's less and less for people do? That's the one way to look at it.

Now it's true you can come up with scenarios like: "Wouldn't some person who doesn't own any robots—wouldn't that person be at a disadvantage, because now he can't even sell his labor since the robots can do everything he can do?" Conceivably that could happen, but also if the world is that fantastically wealthy where the people who were lucky enough to have gotten on the investments, and they own the robots, and that's why they're the ones in charge of everything—I mean they could certainly donate to charity as a worst-case scenario. So I don't think there's any sense in which if you're worried about the fate of humanity that making us much more productive and expanding our ability to give charity to people who for whatever reason get left behind as the economy progresses—I can't see how that's going to be a problem, or that if you had to choose, you would rather stymie that technological innovation.

WOODS: It's just hard, I think, to see where people's purchasing power comes from in a case like that. I mean, it could be that the robots mean that we can produce an awful lot of stuff, but where do I get the wherewithal to buy the stuff from?

MURPHY: Well, let me just take it to the extreme. In the extreme, which is the alleged nightmare scenario where you earn basically one penny per hour, because the robots are so efficient, that's the only way to make it worthwhile for an employer to hire you. Otherwise they'll hire the robots. Just think that through. Somebody owns the robots, first of all, right? They're generating all this output. Somebody is the wonder of that, so clearly some humans are benefitting. And then one way of seeing it is, okay, land factors would clearly be very useful and valuable in that setting, in capital goods. And so, maybe you just own one acre of land that's fairly productive and that was handed down to you from your great-grandfather at a time back when human labor was remunerative, and that's what you own. And you get so much just from that. So the entrepreneurs who hire robots to come in and till the soil and so on—they don't need you to go pick crops, because that's useless. That's crazy. Nobody would use human beings anymore to pick crops. That's obsolete. But you own just that one acre. From today's standards owning one acre's not a very big deal, but

in that future time the machines are so productive that that one acre of land actually gives you more consumption than right now Bill Gates can afford.