

Economic Ironies Throughout History

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Economic Ironies Throughout History

Applied Philosophical Insights
for Modern Life

Michael Szenberg and Lall Ramrattan

Foreword by Vernon L. Smith

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ECONOMIC IRONIES THROUGHOUT HISTORY

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B”H

*Dedicated to the memory of my sister, Esther, for bringing
me to these shores;*

*to the memory of my parents, Henoch for his wisdom
and my mother, Sara, for giving birth to me—twice;*

*to my children Naomi and Avi
their spouses Marc and Tova;
to my grandchildren,*

*Elki and Chaim, Batya, Chanoch, Devorah and Nachum,
Ephraim, Ayala, Jacob,*

*and to my great-grandchildren,
Chanoch and Fegila*

And to my wife, Miriam;

*And to the righteous German officer who took my immediate
family to a hiding place just days before the last transport to
Auschwitz, where most of my family perished.*

—M.S.

*To my brother the late Pt. Baldeo Persaud,
the Priest of Bath Settlement, W. C., Berbice, Guyana,
the master at whose feet I could not escape Philosophy,
and his wife, who never saw anything wrong with me, and their
children, my always forgiving companions in childhood.*

*As we say in economics, the cost of doing something is the highest
priced alternative activity that one has given up in the process.
For me, that is the time not spent with my wife, Noreena, my kids,
Devi, Shanti, Hari, and Rani, and my grandchildren, Brian and
Sabrina. I will love them forever.*

—L.R.

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Foreword

Humans write dictionaries about words that have emerged in human experience and that have found expression in language. Except for a handful of linguistic primitives, all word meaning relies on examples because we can relate them to experience in memory or imagination.

Irony is an especially complex concept in language; in desperation dictionaries try to convey its meaning by using a variety of examples. As this book demonstrates, an exploration of irony is very rich; exhibiting so many forms that it becomes a probe into the human social and cultural condition. Robbie Burns expressed it in a way that we cannot forget:

The best-laid schemes o' mice an' men
Gang aft agley,
An'lea'e us nought but grief an' pain,
For promis'd joy!

Robert Burns, *To A Mouse . . .* (1785)

The condition we refer to involves individuals choosing actions based on beliefs that may contradict expectations. In economic policy, it involves experts who take actions based on beliefs and expected outcomes that may fail to be realized, or even result in unintended harm. We might say that the beliefs that led to the action were false or not sustainable, but that does not mean that individuals will avoid repeating their errors in future such situations. Bubbles in land, homes, and other assets are commonplace in human history, but people continue to get caught up periodically in expectations of rising prices followed

by the inevitable crash. We saw those conditions play out with devastating consequences in the Great Recession, as it is called, of 2007–2009; individuals were unaware of the approaching disaster, economists and policy makers were blind-sided. Officially, we have emerged from the Great Recession, but unlike the eleven other recoveries since World War II, this one has not been marked by a rapid recovery and return to our long-run historical growth path. What went wrong that makes this case different?

In economic policy, knowing what might have been done better given hindsight may be an uncertain guide to better actions in the future because the conditions or context of decision may be very inexactly replicated. Based on careful scholarship, it was widely believed by monetary experts that the Depression was an avoidable consequence of the failure of the monetary authorities to provide adequate financial market liquidity, especially in the critical period 1930–1931. The Federal Reserve did not repeat that “blunder” in 2007 when the housing-mortgage market began its abrupt decline. The monetary authorities moved swiftly as financial markets teetered to provide generous and growing levels of “liquidity enhancement” for over a year. Yet they found this response inadequate to deal with the long-gestating household-bank insolvency crisis.

Liquidity provision having failed to stem the undertow, the Fed’s second response was a massive intervention to prevent the failure of the two or three largest banks but, concomitantly, to rescue their incumbent investors. Five years later the “recovery” remains weak, unemployment high and the largest banks continue to be reluctant to lend from still-stressed balance sheets.

A reexamination of the 1920s exposes a lot of evidence of housing-mortgage market excesses leading up to the 1929–1934 economic collapse. Looking back, this raises the question of whether the severity of the Depression was due to household-bank insolvency exacerbated by the central bank’s inadequate response. Fed intervention in the Great Recession was justified as preventing a worse outcome. Did it, however, merely stretch

the underperformance over a longer episode? After their real estate crash in the early 1990s, Japan also allowed their banks to avoid failure in the belief that growth would restore broken bank balance sheets; in fact Japan suffered two decades of weak growth with banks not lending.

These examples are part of painful shared recent experiences that remind us of the truth in the lines of Robbie Burns.

For me as an economist, our recent economic experience has been an incredible source of new learning. The substance of that learning has just appeared: Steven D. Gjerstad and Vernon L. Smith, *Rethinking Housing Bubbles: The Role of Household and Bank Balance Sheets in Modeling Economic Cycles* (June, 2014). This work illustrates the value of constantly re-evaluating what it is that we think we know and understand in the probing light of new experiences. If our understanding is not changing we are probably not learning.

I believe the ironies of history are incredible sources of learning. Enjoy this unique exploration.

Vernon L. Smith

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Preface and Acknowledgments

Some time ago my close friend, Professor Iuliana Ismailescu, castigated me for procrastinating in submitting *Economic Ironies Throughout History: Applied Philosophical Insights for Modern Life* to the publishers. The justification for my delaying tactics stemmed from the fact that due to my voracious reading, I encountered more and more ironies. Iuliana's rebuke reminded me of the illustrative case of Lord Acton. He planned to write a masterpiece on the history of liberty that he titled, "The Madonna of the Future." The work was never completed, however, because each time Lord Acton encountered new materials related to the subject, he felt compelled to redraft his findings.¹

The idea for the irony volume came to me some years ago after I had amassed many ironies from books and various other publications. Then my long-time collaborator, Lall Ramrattan, joined my conspiracy by authoring Part I. Both Lall and I think that it is high time for this publishing venture on ironies to move forward. It is not enough for an irony to read well—it must be instructive to the degree that it is compelling, and encompass witticisms and judgments. Through the power of ironies, it is possible to enhance one's wisdom. The many selected ironies address the manifold problems which beset mankind. Many of the ironies are profound and interesting, while some are outrageous. This collection should prove a treasure-house for public speakers and provide lines and stories for office meetings as well. It also is a book for entertaining reading, inspiration, and enlightenment.

Leo Tolstoy (1828–1910), who once remarked that, “One ought only to write when one leaves a piece of one’s own flesh in the inkpot each time one dips one’s pen,” would have been pleased to hear that Gustav Flaubert (1821–1880) rolled on the floor for hours until he found just the happy turn of the phrase “le mot juste.” After all, as Mark Twain (1835–1910) remarked, “The difference between the almost right word and the right word . . . is the difference between the lightning and the lightning bug.”

The various pieces contained in this volume sing their own song, will evoke learning lessons and provide points to ponder. The purpose is to lift the spirit and enlighten the mind. And of course, the reader can incorporate selected ironies in speeches and writings. In the past, I have received calls from colleagues asking me to provide them with stories which they can use in their speeches. I provided an eminent economist from Stanford with the following ironic anecdote, which was well received: The 1949 Nobel laureate William Faulkner’s early writing ventures were not welcomed by publishers due to a lack of proper punctuation of sentences. As his talents begun to be recognized, he would attach at the end of the manuscript several pages of commas, instructing the editors to add them in the proper places of the sentences. Another irony, from the musical world, has to do with Franco Corelli (1921–2003), one of the most divine tenor voices in the opera, who experienced constant stage fright. Very often, he had to be pushed onto the stage by several aides.

Here is an example of an irony from recent history. At a reception in November 1956 for foreign ambassadors, Khrushchev stated: “History is on our side. We will bury you.” Three years later at a public discussion in Moscow, with then Vice-President Richard Nixon, he remarked:

America has been in existence for 150 years and this is the level she has reached. We have existed not quite 42 years, and in another seven years we will be on the same level as America. When we catch you up, in passing you by, we will wave to you.

REALLY? As we are all aware, it is the Soviet Union which has collapsed. However, the United States continues to stand tall despite difficulties at times. There is one common, simple factor which brought the collapse of the Soviet Union, and the credit crunch to the United States, and that is misplaced application of incentives.

In the Soviet Union, production, directed by the planning authorities—with no consumer input—was based on three incentives referred to in literature as success indicators. These were Quotas, Weights, and Values.

For example, it is obvious that if production of a product, say clothing, is based on the number of items produced, the quality will be so shabby that no one would wish to purchase it. No wonder then, that when the Soviet Union disintegrated, its warehouses contained billions of dollars worth of clothing with no buyer in sight. To take another example, if chandelier production was based on weight. In one famous case, the chandelier was so heavy that it tore down the ceiling. Again, no wonder that even today Russian spacecrafts are so much heavier than American ones. Traditions die slowly.

As for the United States' financial troubles of today, the compensation to CEOs and other executives was in large measure based on the number and quantity of loans that they extended.

No wonder that given such a simple success indicator, loans were extended to people who could in no way repay them. Company executives did not consider proper risk because of previous historical bailouts. This is what we consider a classic moral hazard.

Absence of proper pricing in the Soviet Union, and absence of adequate risk as an allocative feature in the United States are equally to blame for the mismanagement of both economies. One advantage of the United States is that we have the built-in political flexibility to peacefully change things.

It is very ironic that the end result of the misplaced application of incentives in the Soviet Union led to the increased role of the market system in that country. In the United States, the

misplaced application of incentives is bringing about greater government intervention in the economy.²

We will end this section with an ironic perspective combining religion and psychology. The Kotzker Rabbi (1787–1859) once said, “There is nothing as whole as a broken heart.” How divinely wise! Reflection followed by wisdom comes as a result of a broken heart and suffering. Many decades later, psychiatrist Viktor Emil Frankl (1905–1997) an Auschwitz survivor, had this to say: “On the biological plane, as we know, pain is a meaningful watcher and warder. In the psycho-spiritual realm it has a similar function. Suffering is intended to guard man from apathy, from psychic rigor mortis. As long as we suffer we remain psychically alive. In fact, we mature in suffering, grow because of it—it makes us richer and stronger.”³ Through suffering we are transformed.

Thomas Jefferson, a president of Early America, stands out in history as emblematic of the old phrase: “do as I say, not as I do.” As a Founding Father and writer of the Declaration of Independence, he enshrined within the American zeitgeist the notion of liberty, justice, and equality. Yet, in his private life, the man who declared “all men are created equal” imparted a decidedly ironic form of equality as one of the Virginia Colony’s largest slaveholders. This is the central paradigm of irony, to say one thing and do another. History is replete with great men who have acted nobly in public, only to besmirch their legacy and honor in private. An old folktale from pre-Shogunate Japan captures this ethos with the story of a peasant, newly arrived in heaven.

The peasant was greeted by an angel who showed him a long shelf with strange-looking objects. “What is that?” he asked of the angel. “Those are ears that belonged to persons who, when they lived, heard what they ought to do but didn’t pay attention to it. When they died, their ears went to heaven, but the rest of their bodies went to hell.” Pointing to another shelf festooned with other odd articles, the peasant asked, “What are these?” “These are tongues that once belonged to people who

told others to do good, but they themselves never did as they advised others to do. When they died, their tongues came to heaven, but the rest of their bodies were sent to hell.”⁴

One needn't have a hard time fathoming how such a room would be filled in the modern age. From congressional politicians, to duplicitous bloggers to the ever-sonorous firmament of today's media, many a sensory organ may find its way to heaven as the sizeable remains migrate below. Few truly righteous individuals have existed, who acted as they preached, drinking from their own goblet in public and in private. Socrates, the archetype of a great individual, who truly lived the life in private that he espoused in public, drank hemlock from the same cup he used within his abode and outside in Athens; he died for the truth he spoke. The figures that follow in subsequent pages have occasionally had such choices to make: die for their conviction or live for their caprice. Yet their decisions would have most likely landed an organ or two on the table before the peasant, while the remnants were sent below.

Let me conclude with an irony which deals with my dissertation supervisor.

At the recommendation of Victor Fuchs, then Vice-President of the National Bureau of Economic Research, and currently Henry J. Kaiser, Jr. Professor of Economics and of Health Research and Policy, Emeritus, Stanford University, my study, *Economics of the Israeli Diamond Industry* was submitted for the 1971 Irving Fisher Award.⁵ The final selection board consisted of three Nobel Prize-winners—Maurice Allais, Milton Friedman, Paul Samuelson—and two other prominent economists—Kenneth Boulding and Egon Neuberger. You can imagine how I felt when a letter arrived informing me that my work was unanimously selected by the committee. When the dissertation “sponsor” heard about the news, he immediately called me: “Michael, I think that from now on we should work together.” I couldn't believe what I heard. Mind you, he delayed reading the dissertation for over two years and asked me not to call him since he had no time. The anguish that I experienced

at that time was indescribable, and returns whenever I remind myself of this crucial episode. Thus then, I found a way to respond in kind, citing the four words which he had repeated to me so many times: “I have no time.” He understood—he never called me again. There is one word for it, *chutzpa*. Still, when my first book, *Economics of the Israeli Diamond Industry*, was published with an introduction by Milton Friedman, I thanked my “sponsor.”

At Palgrave Macmillan, the superb and tireless editors, Leila Campoli and Sarah Lawrence have made our publishing experience an inordinately happy one. We thank them deeply for the birth of this book, their enthusiastic guidance, creative marketing ideas, and editorial sensibility. We especially appreciate their patience and professional—far-sightedness and for seeing it through to completion.

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We are blessed to have everyone's help and support.

And yes, our families once again look forward to seeing us return to normal. Well, for Lall and myself normal means to continue working on our next literary ventures; the aforementioned *Intellectual Collaborative Efforts*, and *American Book Publishing-The Reshaping of an Industry*.