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Cover: A 1900 political cartoon celebrates President William McKinley's signing of the Gold Standard Act, explicitly making gold the only commodity exchangeable for U.S. paper money.

In This Issue

Edward Stringham, President

The American Institute for Economic Research has an amazing history that has helped a lot of people and we are working hard to continue on and leverage its past success. In my opinion, economics—and the public's knowledge about economics—is a key determinant of the fate of human progress and flourishing around the globe. Yet too often, important political economic decisions are left to people with little understanding of, or even an antipathy to, economics and markets. A recent case in point is Elizabeth Warren's baby, the Consumer Financial Protection Bureau, which was filled with bureaucrats who basically had to pass a litmus test of being against Wall Street and banking in general. The president recently referred to this agency as a "total disaster," stating that "financial institutions have been devastated and unable to properly serve the public," and I think he is right. Rather than placing blind faith in bureaucrats and politicians, we need to recognize the potential burdens of regulations and cost of red tape to society.

One economist who highlighted the economic cost of government programs was Frédéric Bastiat (1801–1850). Bastiat helped popularize and extend many of the ideas of Adam Smith and was very influential on E.C. Harwood's friend Henry Hazlitt, who elaborated Bastiat's idea of "the broken-window fallacy." This theory describes how one can look at a boy breaking a window and praise him because the act creates a job for a glazer and the glazer subsequently buys a suit and the tailor goes on to buy groceries, etc., and that creates so many jobs. But that is only the seen. The unseen loss is that the owner of the broken window could not spend his money on a suit, groceries, or whatever. Going around breaking all windows would "create" a ton of jobs but ones that did not need creating if we simply preserved our windows. Today the general public routinely looks at government spending money and thinks about all of the jobs created. But the unseen is that each time the government spends a dollar, we have one fewer dollar to spend or invest over the long run. AIER is pleased to expand its program offerings with the Bastiat Society. Read more about it on pages 10-11. We will be expanding chapters around the country to bring together businesspeople who want to learn more about economics.

Also, check out some summaries of work by our in-house researchers and longtime affiliated scholars. William Luther and Thomas Hogan are dynamic young economists who studied and later taught at the American Institute for Economic Research in the 2000s. Luther and Hogan's Professor Lawrence White has been a longtime teacher in AIER's summer programs and is also in this issue. Advancing economic understanding in society is a long-term project but one of utmost importance. In 1978, E.C. Harwood stressed that improved economic understanding could help bring about "a civilization that will foster in every possible way the development of individual men to their maximum capacities and the firm establishment of a good society."

Edward Peter Stringham

The Real Innovation of the Sharing Economy

By Max Gulker

The so-called sharing economy has been the topic of much discussion in recent years, but there is still confusion over what it includes, what makes it different, and the importance of these differences. This article seeks to clarify these questions by evaluating the characteristics of online platforms commonly associated with the sharing economy. The frequent platitudes about the sharing economy changing "perceptions of ownership" and "creating global communities" tend to obscure what is truly important about these platforms, and the term "sharing economy" itself can be misleading. But the online, peer-to-peer matching of buyers and sellers does have important implications for buying and selling goods and services.

The website Investopedia provides a definition of the sharing economy that broadly captures most people's understanding: "A sharing economy is an economic model in which individuals are able to borrow or rent assets owned by someone else. The sharing economy model is most likely to be used when the price of a particular asset is high and the asset is not fully utilized all the time." This article will consider three features commonly found in that and other definitions:

Peer-to-peer matching: platforms allow individual buyers and sellers to find each other, rather than one side of the market being a large firm

Use of idle resources: goods or services involve the use of a physical asset or someone's time that would otherwise be underutilized

No change in ownership: people pay for access to a good or service rather than ownership

Peer-to-Peer Matching

The internet has drastically reduced search and information costs in many areas, perhaps nowhere as importantly as the efficient matching of buyers and sellers. While we used to think of sellers as established businesses with full-time workers, the rise of peer-to-peer matching platforms has blurred this definition. These platforms have significantly lowered entry costs in many industries. By avoiding traditionally high costs associated with search, advertising, communication, and payment, individuals seeking supplementary income in their spare time can often compete with established firms.

The platforms most commonly associated with the sharing economy are Uber and Lyft (rides), Airbnb (lodging), and TaskRabbit (other services). They are all peer-to-peer in that they connect individual consumers to individual service providers. Interestingly, platforms enabling the sale of pre-owned or custom-made goods, such as eBay and Etsy, predate widespread use of the term "sharing economy" and are only sometimes included in the discussion. I argue below that this rests on a false distinction. The only type of platform sometimes included in discussions of the sharing economy that is not peer-to-peer is rental services such as Zipcar or Citi Bike. Their inclusion as an example of the sharing economy might be the consequence of successful branding, as these services are often labeled "car sharing" or "bike sharing." In reality, these are simply rental agencies rendered more efficient by information technology.

It is peer-to-peer matching technology that truly separates platforms commonly or sometimes associated with the sharing economy from their pre-internet counterparts.

Use of Idle Resources

The car owner making extra money at night as an Uber driver and the homeowner renting out her second bedroom on Airbnb have become ubiquitous archetypes of how the sharing economy has changed the world. The entry of these individuals into the car-service and lodging markets is made possible by the peer-to-peer technology discussed above. Presumably drivers could have started their own part-time car services before Uber, but the cost of finding customers and advertising would have been too high. This is a highly important development in many industries. Putting people's time and capital assets to more productive use unambiguously increases overall economic well-being (though, much like free trade, it also causes disruptions for some traditionally employed in these industries).

The use of "spare" or "idle" resources characterizes many but not all of the service providers in these industries. In a 2015 study, Jonathan Hall of Uber Technologies and economist Alan Krueger report that 57 percent of Uber drivers work 1 to 15 hours per week, 29 percent work 16 to 34 hours, 9 percent work 35 to 49 hours, and 5 percent work over 50 hours. In all likelihood, well over half of Uber drivers have a different primary source of income, though a small number do use it as a full-time job. However, many people rely on these platforms as a source of income even if not their largest source. A 2016 Pew Research Center study reported that 56 percent of workers on sharing-economy platforms characterized the income as "essential or important" while 42 percent said it was "nice to have."

When assessing the importance of these new uses of "idle" resources, some overly excited commentators disregard the "no free lunch" rule of economics. One must remember that entering these markets still involves costs, even if a car would otherwise be sitting in a garage or a room would be empty. Renting a room in one's home on Airbnb, for instance, involves a certain level of required upkeep, the sacrifice of privacy, and the risk of letting someone relatively unknown into one's home. Costs similar to these likely explain why, as described below, some platforms involving more actual sharing have failed.

Access, not Ownership

Many observers have failed to notice how little sharing actually happens in the mainstream "sharing economy." Terms such as "collaborative consumption" and "access rather than ownership" are thrown around, but seem largely to describe a vision that has not come to fruition. Starting around 10 years ago, many peer-to-peer sites sprung up that aimed to facilitate the actual sharing of goods in neighborhoods. The power drill became the classic example, with many noting the wastefulness, at least in theory, of everyone owning separate drills when they are so rarely used. However, of seven startups in this space between 2007 and 2010, only one, NeighborGoods, still existed in 2015, with about 10,000 active users.

Observers have made a tempting but incorrect logical leap by connecting this idea to Uber and Airbnb, where we all "share" the car or room. However, they are simply describing a long-standing business model where an entrepreneur uses capital assets to provide a service. This type of sharing describes traditional taxis or hotels just as much as it describes these new platforms. When one excludes cases where "access rather than ownership" describes a service industry both before and after the new technology, one is left only with platforms that do not have the peer-to-peer hallmark typically associated with the sharing economy.

Internet-based platforms have connected individuals to each other for almost two decades. The real innovation at the heart of what's been named the "sharing economy" is the realization that such peer-to-peer matching can transform markets for services such as transportation, lodging, and general errands. Those who carelessly speculate that these platforms will change the role of private property will inevitably be disappointed—the so-called sharing economy is another way that free market forces have evolved to put that property to its best use.

Deposit Insurance Is Not Fair

Thomas L. Hogan and William J. Luther

Many economists have argued that government mortgage programs and low-interest-rate policies caused the 2008 financial crisis. We maintain that government deposit insurance, provided in the United States by the Federal Deposit Insurance Corporation (or FDIC), may have also been a contributing factor. By failing to price risk fairly, the FDIC encourages banks to increase their risk- taking activities.

Although most people assume that FDIC insurance prevents bank failures, the expected net effect of government deposit insurance on bank failures is, at best, unclear. On the one hand, deposit insurance discourages bank runs. If depositors know their money is insured by the government, then they have no reason to run on a bank. As such, we should expect fewer run-generated bank failures and panics under a government deposit-insurance regime. On the other hand, deposit insurance poses a moral-hazard problem. If bankers know that insured depositors are unlikely to withdraw funds from risky banks, they can boost their returns by taking on additional risk without fear that customers will move their savings to more prudent banks. Thus, deposit insurance might increase the number of risky banks and bank failures.

In theory, the problem of moral hazard can be offset if the government sets deposit-insurance premiums exactly equal to the bank's cost of risk—that is, the actuarially fair rate for deposit insurance. If the rate assessed for insurance is too low, then banks are likely to increase their risk-taking activities. If the rate is too high, then banks will constrain credit, resulting in less economic activity than is desirable. In other words, the actuarially fair rate provides the perfect balance of risk minimization and economic-production maximization.

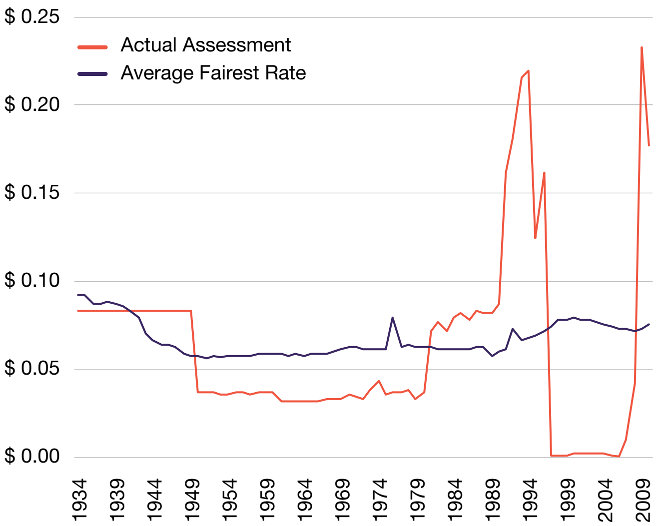
In practice, the actual cost of FDIC insurance has differed markedly from most estimates of the actuarially fair rate. This is not surprising considering how the FDIC manages its Deposit Insurance Fund (DIF). Rather than operating as a true insurance program, the DIF is treated like a rainy-day fund. The FDIC assesses member banks with an annual fee, and these funds accumulate over time in the DIF. When a bank fails, the DIF is depleted in order to repay insured depositors. Then, assessment rates are raised on the remaining banks to replenish the fund. In other words, the FDIC's assessment rates are based on actual historical losses. Actuarially fair insurance, in contrast, sets rates according to expected future losses.

In figure 1, we present the actual assessment rate in each year between 1934 and 2010 alongside the actuarially "fairest" rate in each year. Over the history of the program, the average annual rate of DIF losses is roughly 0.05 percent—that is, $0.05 cents per $100 in deposits. After including annual expenses, the average fairest rate ranges from 0.06 to 0.09 percent per year. Actual rates were less than the average fairest rate from 1934 to 1941, 1950 to 1980, and again from 1997 to 2008. Recall that when the price of insurance is lower than the actuarially fair rate, banks have an incentive to take excessive risk. For example, an actuarially fair rate would have been high in 2006 with risk building up in the banking system, but the actual assessment rate was only $0.0005, the lowest rate in FDIC history!

The FDIC has also erred in the opposite direction. From 1942 to 1949, 1981 to 1996, and again from 2009 to 2010, actual rates exceeded the average fairest rate. Recall that when the price of insurance is higher than the actuarially fair rate, banks overpay for insurance. Resources that could have been marshaled to fund useful banking services will instead be devoted to providing insurance, making depositors worse off.

Figure 1

Actual annual assessment and fairest rates, 1934–2010



Our rough comparisons of actual assessment rates and the actuarially fairest rates are consistent with the bulk of historical studies on deposit insurance. Studies of the FDIC find that higher levels of deposit insurance are associated with higher rates of bank failures and that the moral hazard created by deposit insurance may have contributed to the savings-and-loan crisis of the 1980s and the recent financial crisis of 2008. More generally, studies of deposit-insurance systems around the world find that "the relationship between deposit insurance and bank fragility is economically large" and "countries with an explicit deposit insurance scheme were particularly at risk." Unlike the United States, most developed nations have partly or fully privatized deposit-insurance systems that are associated with few failures and crises.

Despite the widespread belief that government deposit insurance reduces the number of bank failures, the consensus view emerging from the academic literature is that higher levels of deposit insurance and more government involvement in the deposit-insurance system are associated with higher probabilities of bank failures and financial crises. These higher rates of failures and crises occur in part because government deposit insurance is not fairly priced according to actual levels of bank risk. To prevent the next crisis, we should look to private alternatives to government deposit insurance.

Business Cycle Research at AIER

Robert Hughes

Since its founding in 1933, AIER has conducted research on the U.S. economy with an emphasis on business cycles, money, credit, and prices. A seminal work by Col. E.C. Harwood, Cause and Control of the Business Cycle (1932), was one of the catalysts for the creation of AIER, and established the foundation for decades of useful, practical research.

In 1950, AIER began to follow a set of economic indicators that had been shown to anticipate peaks and troughs in business cycles. Acknowledging the work done by the National Bureau of Economic Research, AIER began tracking these indicators as part of an ongoing research program.

In Investment Bulletin, June 5, 1950, we wrote
The National Bureau of Economic Research has just published an interesting booklet Statistical Indicators of Cyclical Revivals and Recessions. Although this report is preliminary and no doubt will be modified as research continues, the Bureau describes several economic series, the fluctuations of which lead or lag general business-cycle changes.

Later, in Investment Bulletin, July 3, 1950, we wrote
In the June 5 Investment Bulletin, mention was made of a study by the National Bureau of Economic Research of statistical series that lead, coincide with, and lag general business-cycle changes. In these bulletins, we shall periodically review the changes in those series.

Over the years, AIER created its own set of leading, coincident, and lagging indicators, and they continue to be the cornerstone of AIER's business cycle research program. Research at AIER is based on sound economic theory and backed by empirical analysis. The combination of theory and empirical study remains the foundation of our Business-Cycle Conditions model.

In simple terms, our model is a set of economic indicators combined in a diffusion index that anticipates turning points in a business cycle. Since its introduction more than 50 years ago, our Business-Cycle Conditions model has achieved a positive track record of identifying turning points in the business cycle, predicting 8 of the last 10 recession with an average lead of about five months while trailing the truning point in just two recessions by an average of 2.5 months (see table).

However, like any other complex system, the economy changes over time. As a result, our model must be reviewed and updated. Among the many forces that can lead to changes in an economy are improved technologies, demographic or political shifts, policy changes, new regulations, new trade pacts, and changing personal preferences. It is not hard to recall a wide range of major changes in all those areas over the course of the past few business cycles.

The latest update to the BCC model was released in 2016 based on work done over the course of 2015. The update included several enhancements. In broad terms, three areas of the model underwent review and enhancement. First were the individual economic indicators in the model. Of the 24 indicators, 12 are leading (they reach peak and trough ahead of a turning point in the broader economy), 6 are coincident (they reach peak and trough at roughly the same time as the broader economy), and 6 are lagging (they reach peak and trough after a turning point in the broader economy). After statistically testing the individual indicators for predictive ability, we determined that five leading indicators, one coincident indicator, and two lagging indicators were no longer effective. We replaced a total of 8, or one-third, of the 24 indicators in the model.

In selecting new indicators, AIER reviewed the most popular and well-known business cycle theories, such as endogenous business cycle theory, real business cycle theory, and Keynesian theory, as well our own work in business cycle theory. Studying those business cycle theories and past recessions, we established 12 economic categories for potential business cycle indicators: consumer spending; housing; business investment; international trade; government spending and fiscal policy; monetary policy, money, banking, and credit; prices and inflation; capital markets; the business sector—corporations and small businesses; labor, wages, hours, demographics, and immigration; manufacturing and trade (including production, utilization, sales, orders, and inventories); and consumer and business sentiment.

Next, we conducted statistical testing to quantitatively verify how well each measure performed in relation to historical business cycles. Our tests covered two periods: 1950–2014 and 1983–2014. The primary reason for using not just the longer period is to balance the benefit of the

AIER estimate of business cycle turns

Peak NBER date (announcement date)	AIER estimate (lead [−]* or lag [+]*)
July 1953	June 1953 [−1]
August 1957	January 1957 [−7]
April 1960	February 1960 [−2]
December 1969	August 1969 [−4]
November 1973	November 1973 [0]
January 1980 (June 1980)	July 1979 [−6]
July 1981 (January 1982)	October 1981 [+3]
July 1990 (April 1991)	January 1990 [−6]
March 2001 (November 2001)	May 2001 [+2]
December 2007 (December 2008)	April 2007 [−8]

Sources: National Bureau of Economic Research, AIER

Trough NBER date (announcement date)	AIER estimate (lead [−]* or lag [+]*)
May 1954	June 1954 [+1]
April 1958	June 1958 [+2]
February 1961	May 1961 [+3]
November 1970	March 1972 [+16]
March 1975	June 1975 [+3]
July 1980 (July 1981)	September 1980 [+2]
November 1982 (July 1983)	April 1982 [−7]
March 1991 (December 1992)	June 1991 [+3]
November 2001 (July 2003)	March 2002 [+4]
June 2009 (September 2010)	October 2009 [+4]

*Months from business cycle peak or trough

larger number of cycles with the cost associated with the fact that business cycle behavior appears to have changed in recent decades. (See our research brief "The Changing Nature of Recessions": https://www.aier.org/research/changing-nature-recessions-0.)

In addition to the statistical testing, the chosen series had to have timely, complete, and statistically adequate data from a reliable source. We evaluated the series according to both their behavior and the relevance and validity of the underlying macroeconomic theory.

The current leading indicators are

1. Real debit balances in margin account: outstanding balances at broker/dealer margin accounts, adjusted for inflation. Sources: New York Stock Exchange, Bureau of Labor Statistics

2. Treasury yield spread: the difference between the 10-year and the 1-year Treasury note yields. Source: Federal Reserve Board

3. Real retail sales: sales at retail and food-service establishments, adjusted for inflation. Sources: Bureau of Labor Statistics, Census Bureau

4. Real new orders for consumer goods: manufacturers' new orders for consumer goods and materials, adjusted for inflation. Source: The Conference Board

5. Real new orders for core capital goods: manufacturers' new orders for nondefense capital goods excluding aircraft, adjusted for inflation. Source: Census Bureau, BLS

6. New-housing permits: permits issued for construction of new private housing units. Source: Census Bureau

7. Manufacturing and trade sales-to-inventories ratio: manufacturing and trade sales divided by inventories. Trade includes wholesale trade and retail trade. Source: Bureau of Economic Analysis

8. Heavy-truck unit sales: sales of trucks weighing more than 14,000 lbs. Source: Bureau of Economic Analysis

9. Real common-stock prices: S&P 500 price index, adjusted for inflation. Sources: Bureau of Labor Statistics, Standard & Poor's

10. Average workweek in manufacturing: average weekly hours of manufacturing workers, both production and nonsupervisory. Source: Bureau of Labor Statistics

11. Initial claims for unemployment insurance: first-time claims for state unemployment insurance. Source: Department of Labor

12. Consumer sentiment: University of Michigan Survey of Consumers Index of Consumer Expectations. Source: University of Michigan

Bastiat Society Pro

Through the Bastiat Society program, AIER is expanding its reach into communities around the world. The program's network has grown to nearly 30 chapters in over a dozen countries where thousands of regular people meet to discuss issues which are central to AIER's mission and philosophy. Furthermore, our attendees and members connect with each other, become mentors, build meaningful relationships and bring our ideas to their friends and colleagues.

The program, primarily made up of local business leaders, is set to coordinate over 140 panel discussions, lectures, conferences, and debates in 2018.

Fittingly, this program is named after Claude Frédéric Bastiat (d.1850), who, like AIER's founder Colonel E.C. Harwood, was largely self-taught. While working in his family's mercantile and trade business, Bastiat became consumed with economics, trade, history, and political philosophy at a very young age. By age 40, Bastiat became a prolific writer and statesman whose words ring true today.

The Bastiat Society program aims to continue both men's legacies by providing a space where the average business person can gain a deeper understanding of classical liberal ideas and free market economics.

Focusing on economic freedom, sound money, individual liberty, and responsible governance, attendees learn what it means to be a principled business person. They also have the chance to connect with an international network of free market advocates, scholars, and think-tank leaders.

Above: Tom Palmer, of Atlas Network, introduces Frédéric Bastiat to attendees in Sri Lanka.

Left: Leaders from the South Carolina Policy Council and the South Carolina Coastal Conservation League discuss land-use policy in Charleston, South Carolina.

Below: Members in Wichita listen to Ben Rast, co-founder of the Bastiat Society.

gram

Moreover, we believe the Bastiat Society's network serves as a critical link between scholarship, policy, and the business community.

The Bastiat Society Program's mission is to provide individuals the tools they need to promote freedom and defend markets. Knowing we cannot do this through research alone, this program empowers regular business people to take the lead and discuss classical liberalism with their peers, employees, and even customers. As Bastiat famously stated, "The worst thing that can happen to a good cause is, not to be skillfully attacked, but to be ineptly defended."

Time to End the Fed's Credit-Allocation Policies

Lawrence H. White

Professor of Economics, George Mason University

In 2007, at the initiative of Chairman Ben Bernanke and New York Federal Reserve Bank President Timothy Geithner, the Federal Reserve System began a set of unprecedented credit-allocation policies that have been wasteful, morally hazardous, studded with favoritism, and in some cases of dubious legality. Many of the ad hoc lending programs have been wound down, but the Fed continues to hold the $1.7 trillion in mortgage-backed securities (MBS) it bought to prop up their prices and thereby subsidize their holders. Whether these new policies helped to lessen the financial crisis during 2007–10 can be debated. But today the emergency is over. No rationale remains for the Fed to pursue policies that distort the allocation of credit. That's the job of Congress.

The Government Accountability Office in 2011 enumerated 20 new Fed credit-allocation initiatives since 2007. Most had narrow groups of privileged beneficiaries: special dollar swap lines favored foreign banks doing US dollar business, special "lending facilities" favored the 20-some "primary dealers" who buy and sell bonds at the New York Fed trading desk, special lending programs favored money market mutual funds and issuers of commercial paper, and two programs favored holders of mortgage-backed securities (MBS). The New York Fed created a novel (and legally dubious) special-purpose subsidiary, Maiden Lane LLC, to buy $30 billion in dodgy assets from the balance sheet of the failed investment bank Bear Stearns, and thereby to enrich Bear's purchaser JPMorgan Chase, as well as Bear's shareholders, bondholders, and counterparties. Similar favors (via creation of Maiden Lane II and III) went to AIG and its counterparties, which especially meant Goldman Sachs. The Fed made special non-recourse lending commitments to two well-connected and faltering banks, Citigroup and Bank of America. The Fed's Agency Mortgage-Backed Securities Purchase Program favored holders of Fannie Mae and Freddie Mac IOUs. These special lending programs have mostly been discontinued, while Maiden Lane's asset holdings have fallen to $1.7 billion.

But three large initiatives keep going. Under "Operation Twist," the Fed sold short-term bonds from its portfolio and replaced them with long-term bonds. The intervention aimed to reallocate credit toward long-term bonds, raising their prices and reducing their yields. The intended beneficiaries were financial institutions holding long-term mortgages and MBS (which are bundles of long-term mortgages), and new mortgage borrowers (by lowering 30-year interest rates). Under "Quantitative Easing 1," the Fed bought $1.25 trillion of MBS. Under QE 3, the Fed bought hundreds of billions more of MBS at the rate of $40 billion per month. The Fed's balance sheet today remains twisted toward long-term securities, and in particular the Fed continues to hold $1.7 trillion in MBS. All three programs allocated credit away from other lenders and borrowers toward the banks and other financial firms that were holding MBS when the price-support operation began.

Government programs that divert credit away from the most productive uses, as evaluated by the marketplace, are inherently wasteful, even if policy makers have the best of intentions. It is easy to see the beneficiaries, and easy to see why the beneficiaries would lobby for such programs. Less obvious, but not less real, are the losers, namely all those potential users of funds who suffer by having credit diverted away from them. Resources are also wasted in the rent-seeking game of lobbying for preferential allocations—for example, by banks expanding merely to become so big or so connected that the authorities will consider them "too big to fail." The implicit bailout guarantees come at taxpayer expense.

Financial markets generate prices and allocate resources based on the decentralized judgments of millions of market investors, who are staking their own funds, about the most promising avenues for investment. When Federal Reserve officials alter the allocation of credit, risking not their own but taxpayer funds, they substitute their own judgments for the wisdom of the market. Having no unique knowledge lacked by market participants, Fed officials cannot improve on a competitive market's allocation of funds even if that is their sincere aim. To prop up insolvent financial firms is to makes investments that prudent market participants shun. Bailouts and below-market-rate loans throw good money after bad, and create moral hazard (reduce the incentive of financial firms to invest prudently).

The Fed should not try to divert loanable funds to any particular firm or any subset of financial markets, but (so long as it exists) should only judge the scarcity of money in the economy as a whole. Assuming we have a central bank, its least disruptive policy option is to provide more money to the economy as a whole when money is too scarce (to support the current level of nominal spending), and less money when too abundant. It can do this without playing favorites by not lending to particular banks or buying favored private securities, but by expanding and contracting the quantity of money through purchases and sales of Treasury securities only.

The Fed's decisions about how many securities to purchase represent monetary policy, because (other things equal) they alter the amount of money held by the public. But the Fed's decision to purchase and hold mortgage-backed rather than Treasury securities, holding constant the dollar volume of purchases, does not qualify as monetary policy because it does not alter the amount of money.

The QE programs could have expanded the quantity of money held by the public, but the Fed deliberately combined QE with interest on reserves—paying banks not to lend out the excess dollar reserves that the Fed was creating—in order to negate that potential impact. The path in M2 has been steady since 2007 even while QE programs made the quantity of the Fed's own monetary liabilities (the "monetary base") skyrocket.

If the combination of the Fed's continued large MBS holdings with interest on reserves is not a monetary policy, what is it? It is a fiscal policy. The Fed in effect borrows funds from the commercial banks, paying interest on reserves at a favorable rate (initially 0.25 percent, now 0.75) slightly above the prevailing rate on short-term Treasury bills, and spends the borrowings in pursuit of a policy goal, higher MBS prices.

A fiscal policy of wasteful subsidies, under our Constitution, traditionally originates with the Congress, not with a federal agency that has no Congressional mandate to subsidize. It is past time to normalize the Fed's asset portfolio and restrict it to Treasury securities. Conceivably the Fed could buy a basket of private stocks and bonds, as the Swiss National Bank does, but there are severe practical problems with designing and implementing an unbiased basket that avoids distorting the allocation of credit.

Lady Pecunia at the Punching Office: Two Poems on Early Modern Monetary Reform

Sarah Skwire , Liberty Fund, Inc. and **Steve Horwitz**, St. Lawrence University

The rowdy commercial culture of seventeenth-century London provides fertile ground for an exploration of economic sophistication among early moderns. Two economically focused poems, Richard Barnfield's "The Encomium of Lady Pecunia: Or, the Praise of Money" (1598) and the broadside ballad "Rare News for the Female Sex: Or, Good Luck at Last" (1695/6), offer the opportunity to consider high-cultural and popular-cultural debates about monetary reform at either end of the seventeenth century and to evaluate them for their contribution to a fuller picture of economic thought in the period.

A complete Elizabethan struck Silver Sixpence.
https://finds.org.uk/database/artefacts/record/id/460321

Written at the end of Elizabeth I's reign and filled with references to her, "The Encomium of the Lady Pecunia" provides a faux-mythical history of money, in the form of the anthropomorphized Lady Pecunia. Barnfield lists her powers and fine qualities, as well as exploring how she helps people at every level of society. The poem is interested in general in money and in those who use it. However, it is also interested in particular in money during the reign of Elizabeth I, and most specifically in the reassessing and recalling of old coinage and minting of new coins that was done early in her reign.

Elizabeth's monetary reforms were hardly unproblematic. It is hard to say how the recoinage would have affected the "man in the street." If people could accurately assay the real value of the debased coins, they would only accept them at a discount. To the extent that this was done, being forced to trade in old coins for new would not have involved much loss. If they were unable to determine whether their coins were full-bodied or not, the case would have been different.

The other complication here is the gold-silver relationship, which is tied up with Gresham's law. When all the silver was recoined, the treasury did not make the proper adjustment in the official exchange rate between silver and gold. The result was that silver was overvalued, and people found it more profitable to melt silver coins down or ship them abroad and profit from the arbitrage. This problem plagued Elizabeth's whole reign and continued even after the Great Recoinage Act of 1696 because the Treasury did not set the government's exchange rate equal to the market rate. The result is Gresham's law: the undervalued coin (gold) drives out the overvalued one (silver) when the exchange rate is fixed by law.

The goal of the recoinage, however, was to solve the immediate, highly visible problem of debasement. At this, the act seems to have been a success, albeit a temporary one. Barnfield's poem emphasizes the stability of English money after the Elizabethan recoinage and praises Elizabeth I as the monarch who accomplished that.

> But faire Pecunia, (most divinely bred)
> For sundrie shapes, doth Proteus selfe surpasse;
> In one Lande, she is suited all in Lead;
> And in another she is clad in Brasse:
> But still within the Coast of Albion
> She ever puts, her best Apparell on.
>
> Silver and Golde, and nothing else is currant,
> In Englands, in faire Englands happy Land:
> All baser sorts of metals, have no Warrant.
> —*Barnfield 1598, lines 163–71*

Later in the poem Barnfield returns to his praise of Elizabeth and provides a sophisticated capsulated poetic argument about the literal and literary origins of money.

The tyme was once, when faire Pecunia, here
Did basely goe attired all in Leather:
But since her raigne, she never did appeare
But richly clad; in Golde, or Silver either:
—Barnfield 1598, lines 199–202

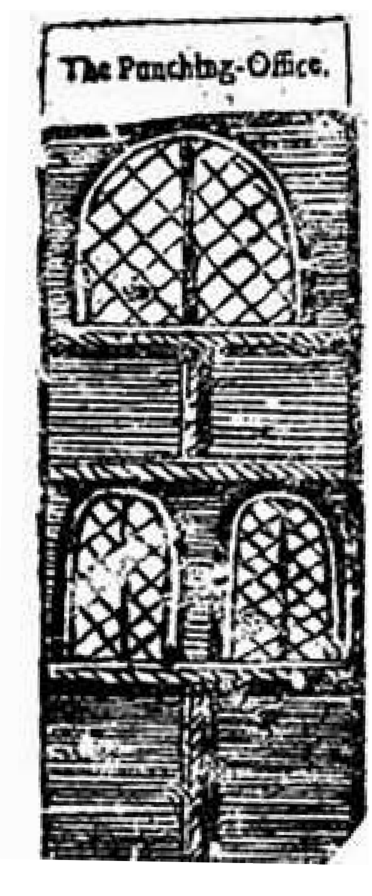
Barnfield's image of Pecunia wearing leather in older times is all but incomprehensible now. However, the root of the word "Pecunia" is *pecus*, which means a herd of cattle. (The Latin word *capitale*, and the modern words "capital" and "cattle," are similarly connected.) By putting that set of puns next to the common story told of the origins of money, which is that it began as a convenient way to "shorthand" the amount of a commodity—often cattle—that one owned so that it wasn't necessary to bring the physical commodity to market, we begin to reach a little clarity on Barnfield's joke. Pecunia, in the old days, wore leather because she was—more or less literally—made up of cows. In Barnfield's more economically sophisticated times, she appears in the more sophisticated silver and gold.

What is interesting about this joke is that it is not just linguistically complex. It is economically complex. Barnfield was not writing only for his own amusement. He must have assumed that a certain number of people who read his work would get the joke. That suggests that Barnfield had some confidence in a reasonably widespread cultural awareness not only of Latin, but also of economic history.

The broadside ballad "Rare News for the Female Sex: Or, Good Luck at Last" (1695/6), a response to the Great Recoinage Act of 1696, is a raunchier but similarly economically sophisticated poem. The conceit of "Rare News" is that the ballad maker has passed a group of women who have heard about the Recoinage Act and are celebrating because they must "all be puncht this year" (Anonymous 1695/6, line 8). This is another all-but-incomprehensible early modern sexual pun. The author is referencing the part of the Recoinage Act that specified that when coins were recalled and reassessed they were required to have holes punched into their centers to indicate that the coin was of full value.

The broadside's author could not resist the sexual joke suggested by all that punching of holes. He imagines a group of women celebrating because—instead of their virginal, intact, and "unpunched" state being taken as proof of their value—they now are all required, like coins, to be "punched" to prove their worth. The pun is more sophisticated than it might seem. Punching through a coin does not diminish the amount of metal in the coin. Thus, it does not negatively affect the coin's value. Nothing is taken away. This preservation of a coin's value by means of penetration is in direct opposition to the usual early modern idea about how a woman's value is preserved. The women in the broadside, in other words, are thrilled not only because the government requires them to be "punched." They are thrilled because they can be "punched" without the usual attendant scorn and diminution of value.

The Great Recoinage Act is a complicated piece of economic policy. That broadside writers understood it, made jokes about it, and anticipated that their audience—literate and illiterate—would get those jokes is another piece of evidence for early modern economic sophistication. A complicated grasp of economic theory is not necessary here. Indeed, the existence of such theories is not even necessary. What is necessary is for money use to have penetrated so far into a culture that it is part of the daily considerations and calculations of a majority of the populace. The public has always understood enough to know when their money is being debased. It should be unsurprising that they would have a sophisticated-enough understanding of the issues surrounding recoinage to be a receptive audience for these two pieces of literature. The evidence given here seems to suggest that this sophisticated response to economic events was already occurring between 1560 and 1696.



The Encomion of Lady Pecunia:
or the Praise of Money.
By Richard Barnfeild, 1598

Alumni News

Recent news from AIER Summer Fellowship alumni

Ben Powell (2000–02 Summer Fellowship program) was elected to AIER's Board of Trustees during their most recent Annual meeting in October 2017. Ben states: "AIER played an important role in my development as an economist while I was a graduate student. Historically, it has also played an important role in educating the American public about the importance of sound money, private property, and the free enterprise system. I look forward to doing what I can to help President Stringham reinvigorate AIER in its mission."

Bo Bo Nge (2003 Summer Fellowship program) is currently the Deputy Governor of Central Bank of Myanmar. Bo Bo was recently a featured guest at the Parami Institute of Liberal Arts and Sciences, Yangon, Myanmar. His presentation was entitled "The Financial Sector, the Economy and the Society." In addition, Bo Bo is currently pursuing a Ph.D. in financial and management studies at University of London's School of Oriental and African Studies.

Alexandru Roman (2010-11 Summer Fellowship program) is an Associate Professor with the Jack H. Brown College of Business and Public Administration at California State University, San Bernardino. He is the Director of the Research Institute for Public Management and Governance. He also serves as the Editor of the Journal of Public Procurement and Managing Editor of the International Journal of Organization Theory and Behavior. Dr. Roman has recently established an accredited and internationally recognized Management Certificate in Public Procurement (MCPP). He currently is developing a Master's in Public Procurement and Contract Management, expected to launch in 2020.

Crista (Jensen) Court (2012 and 2013 Summer Fellowship programs) is currently (since 2016) an Assistant Scientist in the Food & Resource Economics Department at the University of Florida (UF), Institute of Food & Agricultural Sciences (IFAS). She serves as Assistant Director of the UF Economic Impact Analysis Program, which conducts sponsored projects for industry organizations and government agencies encompassing a wide range of activities and industries. She also holds affiliate faculty status with the UF Water Institute, the UF/IFAS Institute for Sustainable Food Systems, and the Regional Research Institute at West Virginia University. Her research interests include regional economic modeling, the energy-water nexus, environmental accounting, and connections in human and natural systems.

ALUMNI PROFILE

Hedieh Shadmani

AIER Summer Fellow 2011

"AIER's Summer Fellowship was an unparalleled learning and growing experience which enlightened both my short- and long-term career aspirations.

The two-week program of fruitful lectures, workshops, and conversations on a wide range of areas in economics gave me the opportunity to have a better understanding of the abstract theories I learned from the textbooks and helped me think critically and advance my analytical skills.

Among many takeaway lessons, I really enjoyed talking and interacting with the professors and mentors at the AIER in an explicitly informal setting. I had the chance to learn from their experience and ask their insights on what it takes to be a successful researcher and teacher.

Now, when I look back over the past few years, I realize that my love of becoming a university professor was first sparked in Great Barrington. I feel so blessed that I got the chance to participate in the program."

Hedieh Shadmani is currently an Assistant Professor of Economics at Fairfield University. She received a B.S. degree in Statistics from Allameh Tabatabai University in Iran in 2005, a M.A. degree in Economic Development and Planning from Alzahra University in Iran in 2008, and a Ph.D. in Economics from Kansas State University in 2015.

AIER **Events**

AIER Winter Program with Missouri University of Science and Technology

January 3–14, 2018 — AIER Campus, Great Barrington, MA
This program is an on-campus component of the Applied Economic Research course that AIER pioneered four years ago.

2018 Arizona Freedom Summit

February 2–3, 2018 — **Sandra Day O'Connor**, ASU College of Law, Phoenix, AZ
Ed Stringham, AIER President presents "The Fable of the Leeches."
Do markets depend on government contract enforcement and government rules against fraud?

LibertyCon

March 2–4, 2018 — Wardman Park, Washington D.C.
Visit AIER as a supporter of the Students for Liberty annual conference, a place for liberty lovers of all ages to meet, plan, learn, and have fun.

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I followed Colonel Harwood for many years and one thing that came through in all of his writing was that he was a great patriot and a strong believer in an honest currency. Having been in the investment business for 48 years, I think Colonel Harwood's teaching is needed even more now than it has ever been. He had a great impact on my thinking.

—**Arnold Van Den Berg**, Longtime AIER Member

AIER members understand the importance of AIER's mission and want others to understand too.

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FROM THE ARCHIVES

Gilder Holds Court, 1982

In this photograph (l–r): George Gilder, Fred Harwood, Larry Pratt, and Ernie Welker

Photo courtesy of Fred Harwood