

CHAPTER 1 Minutes of the Heavenly Court: Soul of David Ricardo

INITIAL TRIAL

DATE: September 11, 1823

MAGISTRATE: Please state pertinent biographical detail.

DEFENDANT: I was born in 1772 and given the name David Ricardo. My mother, peace be upon her, named me after King David, writer of psalms, sweet singer of Israel. She—

MAGISTRATE: Mr. Ricardo. Less lyricism. More facts. Occupation?

DEFENDANT: I was chiefly a financier, then later a politician.

MAGISTRATE: Speak up, Mr. Ricardo. Your occupation will not be held against you. What do you consider your most important achievement while you were alive?

DEFENDANT: My theory of comparative advantage. Outlined in my 1817 book, *On the Principles of Political Economy and Taxation*, the theory showed how nations benefit from free trade. In addition, as a member of the British Parliament, I spoke numerous times on the dangers of protectionism and the benefits of free trade.

MAGISTRATE: Were your views heeded?

DEFENDANT: Not yet, but in time I believe—

MAGISTRATE: That will be all, Mr. Ricardo. You are sentenced to a period of wandering until further evidence is brought to the attention of this court.

REQUEST FOR RETRIAL

DATE: December 18, 1846

MAGISTRATE: Mr. Ricardo. You have requested this hearing to put forward additional evidence you believe relevant to your case.

DEFENDANT: Yes. I am happy to report that down below, my native country of England has abolished the Corn Laws that protected British farmers from foreign competition. I request that the court consider reopening my case.

MAGISTRATE: Request dismissed. It is too early to tell if this change is temporary or permanent. In addition, do not virtually

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all nations outside of Britain still practice extensive trade restrictions?

DEFENDANT: Yes, but—

MAGISTRATE: That will be all, Mr. Ricardo.

REQUEST FOR TOUCHING DOWN**DATE: July 13, 1960**

MAGISTRATE: Mr. Ricardo. You have requested an opportunity to intervene in human affairs to remove your status as a wanderer. What evidence justifies your request?

DEFENDANT: I believe the United States is about to embark on a policy of protectionism that will destroy the American economy. I request one evening on Earth to help put America on the path of freer trade and prosperity.

MAGISTRATE: Request granted. You realize, Mr. Ricardo, that a wanderer is allowed only one period of touching down during the probationary period.

DEFENDANT: Yes, sir. I feel confident that—

MAGISTRATE: That will be all, Mr. Ricardo. Good luck. And Godspeed.

CHAPTER

The Challenge of Foreign Competition

“When our factory opened, a worker made \$50 per week, and over at Willie’s Appliance Store, a Stellar television cost \$250. So it took a worker five weeks of work to earn a television. Today, the average worker in that factory makes \$100 per week and Willie gets \$200 for a Stellar television—two weeks of work to earn a television. That’s how I measure our success—how many hours it takes one of you to earn one of our products. That number has been falling since the first year of operation.”

That was Ed Johnson talking back in 1959, a year before I touched down. Ed’s the chief executive officer of Stellar Television Company. Their headquarters are in Star, Illinois, the destination for my one night back on Earth. If you had been dead for 137 years and had one evening back on Earth, you probably wouldn’t head for a town of 100,000 people in Illinois. But Ed Johnson and Star hold the key to my future and America’s. I thought you’d like to get to know Ed and his company before I touched down.

Ed was speaking at the annual company picnic, held every year in Johnson Park. They named the park for his father, who started the company. Ed always has a great time. He brings the family, tears his pants sliding into second in the softball game, and eats a lot of fried chicken and potato salad. Ed gets along fine with the workers—he worked in the factory in high school before heading off to study engineering. Stellar has three other factories around the state, but the one in Star’s the biggest. In a good month, the 5,000 workers in Star make 80,000 televisions.

As you can tell from Ed’s speech, Ed is pretty proud of his company. But walking home from the picnic, his wife Martha sensed something was wrong. She waited until their two children ran up ahead and out of earshot.

“What’s bothering you, dear?”

“Foreign competition. Japanese televisions are coming into America. I almost had to lay off workers this month. And I may have to lower wages and break the streak I talked about this afternoon.”

“Oh, honey, you’re teasing. People know that ‘Made in Japan’ means junk. No one is going to buy a Japanese television.”

“Some are buying them now.”

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The next morning, after a restless night, Ed drove into Chicago and took a plane to Washington. He met with his congressman, Frank Bates. He asked for a limit on imports of Japanese televisions. Eliminating foreign competition would keep the jobs and wages of his workers safe.

“Well now, Ed, I just don’t know. You’ve been good to me, always helping out with the campaign, and I appreciate that. But this kind of bill is tricky. People want a level playing field. Competition is the American way of life. Playing tough with the Japanese isn’t going to look good.”

“That’s nonsense, Frank. We invented the television. The Japanese stole it from us. Now they’re stealing our jobs. If good jobs go to Japan, what will we replace them with? What will happen to Star? And what will happen to the companies around Chicago that supply us? If Stellar Television closes, the trouble doesn’t end in Star, it just begins there! We can’t let the Japanese get ahead. They’ll get all the future inventions in electronics if our television industry disappears.”

“I hear what you’re saying, Ed. Hey, I fought in the Pacific. Listen, Ed. There’s serious talk of me making a real run at the White House. I don’t need some trade bill around my neck. Let me get in the White House, and then I can help.”

“How are you going to run for president if people in your home district are having trouble making ends meet? A bill like this can put you in the White House. You just have to explain it right. Buying American will make America rich again.”

“It sounds better when you put it that way. Let me think it over.”

Frank Bates thought it over and decided to sponsor a bill banning foreign televisions. Every month another 80,000 televisions came off the line at Stellar Television, and every month there was more talk of Congressman Bates becoming President Bates someday. His trade bill banning imports of televisions passed. He started speaking about a plan to keep out all foreign products entirely, to pass on the benefits to other industries, not just televisions. That plan became the centerpiece of his presidential campaign. Ed Johnson did a lot of traveling and speaking for Frank Bates, defending protectionism.

By the summer of 1960, Frank Bates was even money to get his party’s nomination. He asked Ed to make one of his nominating speeches at the convention. Ed hesitated, but Frank explained that his staff would write the speech for him. Ed would talk about the glory of America and the importance of protecting basic American industries from foreign competition. He’d explain how Frank’s economic policies would lead to prosperity for all, just as it had for Stellar’s workers and the citizens of Star. It didn’t seem too difficult. Ed said yes.

The night before his plane was due to leave for the convention in Los Angeles, Ed Johnson tossed and turned in bed, unable to sleep. He had practiced his speech. His wife and kids were healthy and asleep on a July

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night in Illinois. His workers had never fared better. Stellar televisions were selling for \$300, but his workers earned up to \$200 a week, working only a week and a half to earn a television. The plant was at full capacity, and there had been talk of expanding. What was bothering Ed Johnson?

At 2:00 A.M. Ed headed downstairs for a glass of milk and a piece of chocolate cake. He went back upstairs to the den, talking to himself. He walked over to the hi-fi, put on Frank Sinatra's *Only the Lonely*, and placed the needle on the mournful "One for My Baby."

"Never did like government," he muttered. "I admit that quota bill sure has been good for Stellar Television. But I'm worried about a bill that would limit all foreign imports. Televisions are different. Electronics are the future of America. But all products? Maybe it won't turn out so well."

That was my cue. So while Ed was pacing the room, I got the Magistrate to approve my request to come back to Earth for a night. Then I popped into the leather armchair in the corner. Ed didn't see me at first; he was too busy digging a trench in the carpet. When I finally caught his eye, he came to a full stop and gave out a snort of breath. His words of greeting were a nervous staccato.

"Whoa, my friend, who the hell are you?"

I had not heard much profanity from Ed Johnson in all the years I had observed him. Arriving unannounced in a man's den at two in the morning will jar even the most peaceful spirit.

"My name is David, but you can call me Dave. I'm—"

"Look here, Dave," said Ed gently, "are you hungry? There's fried chicken downstairs. How about a piece?"

Ed had taken me for a beggar of some kind, looking for a warm place to stay and a meal. No call to the authorities. Just an offer of help.

"Thank you kindly, Mr. Johnson. I wish I could accept your offer, I truly do. Where I come from, we don't get hungry."

"Plenty to eat where you come from, then?" asked Ed in a nervous voice. The temperature had fallen in the room and Ed began checking the windows while he was talking, looking for a draft.

"The windows are all fine, Mr. Johnson. That draft you're feeling is my doing, I'm afraid. It's a natural consequence when a wanderer touches down."

"A wanderer?"

"Yes. Mr. Johnson, have you ever seen *It's a Wonderful Life*?"

"Of course. See it every Christmas. One of my favorite movies."

"You remember Clarence in that film?"

"Sure. Clarence was George Bailey's guardian angel. Great how he got his wings in the end. Now, Dave, let's head downstairs. I'm sure there's something in the icebox to interest you."

"I'm afraid it doesn't quite work that way."

“What doesn’t work what way?”

“Getting the wings. Mr. Capra was merely being fanciful.”

“Is that so?” Ed reached for the telephone on his desk. “Why won’t this phone work?” Ed asked, speaking to himself.

“Probably my doing, though I daresay I can’t explain it. More in your line of work, I would venture. Electricity, televisions—”

“Listen, Mr. David whatever-your-last-name-is—”

“Ricardo.”

“Listen, Mr. Ricardo, if you’ve cut my phone line, I am going to lose my sense of humor—”

“Calm down, Mr. Johnson. Remember in *It’s a Wonderful Life* how Clarence proves he’s an angel? I just have to do something similar for you.”

“Why don’t you tell me why I’m eating milk and chocolate cake?”

“Not too difficult. When you were a boy, you used to go downstairs with your father on the pretext of making sure the lights were out. He would give you a glass of milk and a piece of chocolate cake. You and Steven have continued the ritual, but tonight, it is too late for Steven.”

Ed sat down. I’d gotten his attention.

“Parlor tricks are so demeaning, Ed. May I call you Ed? I know you very well, far better than one who would know about the scar on your knee from that nasty fall as a child. Such knowledge does not establish my unearthly origins—a man with enough nerve and gumption could uncover such a detail. No, Ed, my ear is more finely tuned than you can imagine. I know of your dreams for your son Steven and how you yearn to see your daughter Susan safe and secure. I, too, had such dreams for my children. I know your uneasiness at the thought of your alliance with Mr. Bates. You tossed and turned in bed tonight because of guilt, wasn’t it? Guilt at knowing you had turned to others for help, that you sought unfair advantage for your company . . . ”

Ed Johnson’s gaze had softened, and I knew I had struck home.

“Patience, Ed. You’ll have real cause for guilt before the night is through. But you will have a chance for redemption that few men are given.”

“I am at your service.”

“We are going to travel in time. I am going to show you what will become of America if Frank Bates fails in his bid for the presidency. If Frank Bates becomes president of the United States, America will become increasingly protectionist. Instead, I am going to show you the America of increasingly free trade. Perhaps when you see such a world, you will no longer support Frank Bates, and you will throw away that speech on your night table.”

“I’m ready, Mr. Ricardo.”

“Call me Dave.”

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“You don’t have relatives in Cuba by any chance?”

“Cuba? I don’t think so. Most of my relatives remain in England.”

“The phrase ‘Babaloo’ doesn’t mean anything to you, then?”

“Ah, I catch the allusion. Very good, Ed. But I am afraid that is another Ricardo. No relation.”

On that note, we soared into the future.

CHAPTER

5

The Roundabout Way to Wealth

I chose the year 2005 to play it safe. That would give Ed enough of a taste of a world where Americans were free to trade with foreigners.

“Where are we?” asked Ed.

“My friend, we are in the parking lot of a movie theater in your hometown of Star, Illinois, in the year 2005.”

“Why would a movie theater need such a large parking lot?”

“There are 16 theaters here, and they need a lot of space.”

“Sixteen theaters! What happened to the Bijou?”

“The Bijou, downtown? I’m afraid it was torn down in the name of something called ‘urban renewal.’ ”

“That’s too bad. Can we see the Stellar Television factory?”

“I’m afraid it’s gone, Ed.”

“Gone!” cried Ed, leaning against a Honda Accord for emotional support.

“I’m afraid so. In fact, this multiplex—the modern name for a collection of theaters—stands on the very spot where your plant once stood.”

“I’ll be damned, why—”

“Ed, watch your language. You may get your wish.”

“Sorry. Is anyone making televisions in the United States anymore?”

“They are. In fact, they’re doing it with lower labor and raw material costs than you did in your best year.”

“Must be Motorola. They always gave me a good fight.”

“Motorola made its last television in 1974.”

“Then who is it?”

“I’ll show you. We’ll have to leave Star for a bit. But that shouldn’t be any problem for the people Upstairs.”

“Where are we now, Dave?”

“Rahway, New Jersey.”

“Where’s the television factory?”

“You’re looking at it.”

“But the sign says ‘Merck and Co., Inc., A Pharmaceutical Company.’ Doesn’t that mean they make drugs?”

“Indeed they do, Ed. They send some of those drugs to Japan. In return, Japan sends America televisions. There are two ways to make a

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television set—the direct way, and the roundabout way. The direct way is to build a factory like yours in Star and combine raw materials with people and machines to produce televisions. With the roundabout way of making televisions, you make televisions by making something else, such as drugs, and trading the drugs for televisions. Japan's drug industry isn't able to efficiently create and supply all of Japan's demand for drugs, so Japan imports drugs and exports televisions. What you see appears to be a drug manufacturer. But they also produce televisions for Americans to enjoy by exporting some of their production."

"But Merck doesn't send drugs to Japan for televisions. They send drugs to Japan for money."

"That is how matters appear. But Merck accepts Japanese currency for their drugs only because some American wants to use that currency to buy something from Japan such as televisions. If no one wanted to buy Japanese products, then Merck would have to use that currency as wallpaper. They wouldn't sell drugs to Japan."

"Couldn't they exchange the yen for dollars at a bank?"

"They can, as matters turn out. But matters turn out that way only because someone with dollars wants to buy something made in Japan and needs yen to do it. Otherwise, no one would give up dollars for yen, and the bank would not be in the business of currency exchange. You see Americans buying televisions and giving the Japanese dollars. And Japanese buying drugs with yen. But actually, Americans are swapping drugs for televisions. The currencies merely facilitate the transaction."

Ed looked at me warily.

"What happens when Japan increases its supply of domestically produced drugs?"

"Maybe they will, or maybe they won't. Japan can't make everything. Well, they can, but they can't make everything equally well. Like every nation, their resources are limited. By their resources, I don't mean just raw materials; I mean their people, and the number of hours in a day, and how hard people wish to work. It's impossible for Japan to make everything better than anyone else in the world. And even if they could, it wouldn't be wise for them to do so."

"Why not?"

"Even if they could, they would do even better by specializing in a few things rather than trying to do everything. Take yourself. I know you won the typing contest at Star High your senior year. Set the all-time record, didn't you?"

"I did."

"Yet as president of Stellar Television, don't you have your own secretary?"

"Of course."

"But you are a better typist than she is. Why did you hire her?"

“Because my time is better spent running the plant.”

“Exactly. Your time is scarce. So even though you type much more quickly than Miss Evers, it would be foolish for you to do the typing. The same is true of Japan. As a nation, they specialize in producing televisions and import drugs even though they could train their television engineers to be chemists. America, in turn, wants both life-saving drugs and televisions. It produces both in the most efficient way possible: by making drugs, keeping some for domestic consumption, and sending the rest to Japan for televisions.”

“Does this insight have a name?”

“It does, but it is not so catchy: ‘The Theory of Comparative Advantage.’ A British economist figured it out.”

“Who was that economist, Dave?”

“I cannot say I remember, Ed. At any rate, you and I will give it a different name: ‘The Roundabout Way to Wealth.’ The idea is that even if a nation is relatively poor at doing everything, there are some things it does relatively well. And a nation that is really good at many things should still specialize in producing some items and import the rest.”

“I don’t understand.”

“Neither do most students. A numerical example might help, but it also might put you to sleep, and we have a long night ahead of us. And that numerical example leads some students to think that the theory applies only when there are two goods or two countries in the world. Let me try to cut to the essence of it. Time is the ultimate scarce resource. You should use your time wisely. Trying to do everything for yourself is actually expensive—it means taking time away from those things you do relatively well. So you hire Miss Evers to do your typing, even though you’re a better typist than she is. The same is true for nations. Even though the United States excels at television production, devoting scarce resources to televisions means having less of something else. So as good as Americans are at making televisions, Americans are even better at making pharmaceuticals. The United States has a comparative advantage in pharmaceuticals, even though it might take less labor to produce a television in the United States than it does in Japan.”

“But, Ed. If it takes less labor to produce a television in the United States than it does in Japan, isn’t it inefficient to have the Japanese make televisions instead of Americans?”

“No, because people don’t care just about televisions. They care about other things as well. The real cost of making televisions in America isn’t the labor that is devoted to the task but rather what that labor could have produced instead. Making televisions means making less of something else. Suppose America is a little better than Japan at making televisions, but a lot better at making pharmaceuticals. Then making televisions in America is expensive—it means giving up a lot of pharmaceutical production.

Better to let the Japanese make televisions, just like you gave up typing to concentrate on managing your factory. Or maybe a better way to say it is like this—better to make lots of pharmaceuticals and use some of them to make televisions the roundabout way—by swapping some of them for televisions. That way you get more televisions than you would have by trying to make them directly.”

“And I guess Japan is doing the same thing. They’re getting richer by making televisions and swapping them for drugs rather than trying to make drugs for themselves.”

“That’s right. The whole idea of trading with another nation is the same idea as trading with people in your own country. It’s a way to let people use their skills together. Trade looks like competition. But it’s really a form of cooperation. Japan makes televisions for Americans, and in return Americans make pharmaceuticals for the Japanese. By trading with others, you leverage your skills in a way you could never do if you tried to do everything for yourself. Trade is the way to get the most out of your skills and your scarce time—for both sides of the deal.”

“But how do you know the roundabout way is cheaper? It’s just a theory. The government stands back and lets Motorola and Stellar go out of business—”

“Motorola is still in business, Ed.”

“But you said—”

“I said they stopped making televisions.”

“OK, they stopped making televisions. So America makes televisions in the roundabout way. But Americans are sending money to Japan. Lots of money, I bet. Wouldn’t it be better for the United States if that money stayed in America? That way, Americans have the money instead of the Japanese. With more money, we’re richer. Isn’t that better than sharing the money with foreigners?”

“It depends, Ed. The wealth of a society isn’t measured by how many pieces of paper its citizens hold. If America does not trade with Japan, Americans have more pieces of paper. But do they have more goods and services and the leisure to enjoy them? Unless the Japanese send televisions to America out of the goodness of their hearts, then America has no Japanese televisions. Without Japanese televisions, America must make those televisions domestically. Making those televisions domestically requires people and raw materials. But the roundabout way of making televisions by making drugs and swapping them for televisions produces televisions more cheaply.”

“The theory sounds pretty good, but how about some evidence? You claim that Merck can make televisions more cheaply using the roundabout way than I did with an old-fashioned television factory. Prove to me that televisions have gotten cheaper—and without using some fancy theory.”

“Take it easy, Ed. Calm down. Back in 1960, how many hours did one of your workers have to work in order to earn enough money to buy a television set?”

“About two weeks.”

“Today the average American can earn a TV in less than a day.”

“You’re kidding! But what about the quality? If you’re going to compare a 1960s television to one made in 2005, you’ve got to compare televisions of the same quality. If those televisions are made in Japan, they couldn’t be very good.”

“I’ll let you be the judge of that. Let’s go back to Illinois and take a look.”

“I suppose Willie’s Appliance Store is gone.”

“I’m afraid so. Replaced by a juice bar, a phenomenon we can explore later. But don’t worry, you can still buy a television in Star.”

Back in Star, I took Ed to a Circuit City to look at the televisions of the year 2005.

He was overwhelmed by the array of shapes and sizes. We went over to a 20-inch color model.

“Ha!” said Ed. “\$100! That’s not such a bargain. That’s not much less than my TVs. You said the average worker could buy one of these in less than a day.”

“The average worker can. Wages are a lot higher now than they were in 1960. That’s why it’s useful to think about how many days of work it takes a worker to earn a television—it gets rid of the effects of inflation on both wages and televisions.”

“Less than a day. Amazing. And the sharpness of the picture is astounding.”

“And unlike the older sets you are used to, Ed, these new models hardly ever break. And they all come with a remote control.”

I also reminded Ed that unlike 1960, in 2005 color televisions were the rule rather than a rarity. Then I took him to look at the big screens. He stood in silence gazing at a 42-inch plasma TV.

“Where’s the rest of it?” he asked quietly.

“That’s the whole thing. I know. It’s only 4 inches deep. They’ve figured out how to make them a lot thinner than they could in your day.”

“And a lot bigger,” Ed said, shaking his head. “How much does it cost?”

“It’s \$1400. The average American worker can earn one in about two weeks—just over 11 days. About what it took a worker in 1960 to earn a 20-inch TV. Not quite the same, is it?”

“I’m impressed, Dave. But as nice as these new televisions are, Dave, I can’t believe America can’t compete and make a product that’s just as good. What happened to good old American know-how?”

“It’s still functioning. It just got redirected to other more productive areas. It’s like your typing skills—how could you give up typing when you were the best typist in the building? It was too costly for you to be your

own typist. The gains to the factory from your superlative typing are less than the gains to the factory from your time spent managing it. It is the same with televisions. America could easily make the best televisions in the world.”

“Then why don’t we?”

“Because the resources it would take to make the best televisions are better spent making the best drugs and swapping them for televisions that other countries make.”

“Maybe you’re right, but how do you know? Who makes the decision not to specialize in televisions and to specialize in drugs instead? How do you know it’s the right decision?”

“No one person makes that decision. That is what is hard to understand, but really rather beautiful. If some American could make the same quality television as the Japanese but at a lower cost, that person could become fabulously wealthy. Evidently, a better American-made television would cost more to make than the current Japanese televisions.”

“How do you know?”

“If it could be done, someone would have the incentive to make such a television and become wealthy. To make such a television, you would have to pull engineers and manufacturing know-how out of other industries, such as aerospace, computers, and pharmaceuticals. The talent is better used in those industries.”

“How do you know?”

“If it were not true, a television manufacturer could outbid those industries for the talent. Of course, a television manufacturer can always outbid those industries for the talent by paying a higher wage. But we do not see such a phenomenon occurring. Evidently, the wage necessary to draw skilled labor out of other industries and into televisions is so large, an American television cannot be sold at a price that is competitive with the Japanese price. It reminds me how people confuse international trade with the Olympics, Ed.”

“The Olympics? How could trade be like the Olympics?”

“In the 1970s and the 1980s, the East Germans and the Cubans dominated the Summer Olympics, despite their small populations. Some Americans clamored for a better Olympic team. Of course America could win the gold medal in every Olympic event if it wanted to. America could mobilize a larger portion of her resources for training facilities and make sure that the best sprinters, high jumpers, and gymnasts pursued their craft full-time. A committee of experts could select the best potential athletes and pay them enough to get them to give up their best alternative job. Do you think that would work?”

“I don’t see why not.”

“I think it would work. America could win every gold medal that way. But would it be worth it?”

“Not necessarily. But what’s that have to do with trade?”

“It’s an example of the seen and the unseen and how what is seen doesn’t capture the whole story. America would have some glory. That would be seen and apparent. What would go unseen are the activities and opportunities that were sacrificed to have the glory. It wouldn’t be worth it. It wasn’t worth it for East Germany or Cuba. Oh, the athletes involved lived pretty well. It was worth it for them. But while they were winning gold medals, the people of Havana and East Berlin were living in poverty and squalor. The free market would never have produced such outcomes. It took an authoritarian government to make a colossal blunder like that. A lesser, but similar, mistake would be to insist that America at least win the gold medal in the 100-meter dash because Americans have always won the 100-meter dash. Should America insist on making the best televisions in the world simply because it always has? If televisions can be made at a lower cost by the roundabout way, then America is better off producing them the roundabout way.”