Second Life is virtual world with real economy

By Adam Pasick

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LONDON (Reuters) - Philip Rosedale and his team at Linden Lab have almost godlike powers in Second Life, the virtual world they created, powers that Alan Greenspan could only have dreamed of when he chaired the U.S. central bank.

But they have much the same job managing its economy.

Second Life is an online, 3D world with a thriving business sector and a currency that can be exchanged for U.S. dollars, effectively making it a real currency in its own right. Up to 135.5 million Linden dollars, worth about $500,000, changes hands every day among its 900,000 registered users.

Residents of Second Life can buy and sell virtual real estate and items ranging from houses to jewelry to airplanes. Everything in the world has been built by its users using simple 3D design and scripting tools.

Presiding over it all is Rosedale and his brainchild, San Francisco-based Linden Lab, which has the ability to create new land, pump in or siphon off money and even banish residents.

With the Second Life economy growing by a red-hot 10 to 15 percent a month, roughly in line with its overall population, Linden Lab is keen to avoid the hyperinflation that has often tainted both real economies and virtual ones.

"Our goal is in general to keep the exchange rate as close to constant as possible, which is the typical global economic policy concern that most countries have," Rosedale said in a telephone interview. Just like a real-world central bank, sometimes Linden Lab has to take money out of the economy, and sometimes it has to put it back in.

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Not all virtual world economies are designed for stability. Some go out of their way to create imbalances that will make game play more exciting.

"I don't want a perfect economy, because they're boring. Economies that are fun to play -- that's the first thing I think about" said Sam Wilson, a game designer who was trained as an economist and is now working on a Cartoon Network game in South Korea, in a phone interview. "The guys at Linden have struck an even balance."

VIRTUAL ECON 101

Linden's policies are broadly in line with standard economic dictums about inflation.

"What they're doing is monetary policy, there's no question about it. All the standard theories of micro- and macroeconomics absolutely apply," said Indiana University professor Edward Castronova in a phone interview. He is the author of "Synthetic Worlds: The Business and Culture of Online Games," and has studied virtual economies extensively.

"Our basic understanding ... is there's inflation when there's more money than there is trade," he said.

So far, growth in the Second Life economy has been vibrant, partly due to the ingenuity of its residents.

"People are coming with clever ideas and competing to come up with compelling products," Rosedale said. "Something like a pair of sunglasses or a watch, something interactive, those types of items are subject to intense competition in the marketplace, so those items are becoming more interesting and the prices are going up."

CENTRAL BANK TOOLKIT

So what's in the Linden Lab economic toolkit?

-- Stipends, weekly payments made to premium account holders, the primary source of new money introduced into the economy. Raising and lowering these directly affects the overall money supply. Currently, premium account holders paying a $9.95 per month subscription receive a weekly stipend of 400 Linden dollars ($1.46) weekly stipend.

-- Buying and selling currency on the Lindex. Selling Linden dollars "has the weird side effect of making money for Linden Lab, so it's very important we do all this stuff transparently, because you could argue we're conflicted in that sense," Rosedale said.

-- Introducing new "sinks" to remove money from the economy, such as increasing the fees for certain activities.

Crucially, the Linden economic team is lacking the lever that central banks use most: the ability to raise and lower interest rates. If you've forgotten your Econ 101, raising interest rates causes consumers to borrow less, reducing the money supply; lowering them causes the opposite.

But that is likely to change soon, Rosedale said.

"We don't lend money, but we'll probably start doing that. We could loan money, set up a federal banking rate, where we lend money to individuals or banks at 3 percent. Then we'd have the traditional control the (U.S.) federal government has," he said.

In addition to real-world central-banking tools, the creators of Second Life also have
special powers conferred on all Second Life residents. Even former Federal Reserve chairman Alan Greenspan might envy the ability to fly.

(To read more about Second Life, where Reuters has opened a virtual news bureau, visit http://secondlife.reuters.com)