What I Just Learned in Second Grade

February 2011

We have a second grader. Trying to be a good dad, I volunteer teach his class basic economics. A not-for-profit entity called Junior Achievement organizes volunteers to teach economics to kids from elementary through high school. I have taught economics before to inner city high school kids…a thankless and enormous challenge. This is my first time with the little tykes.

Junior Achievement makes the job pretty easy if you can get the students' attention. The syllabus is already developed for each grade. Just the other day, I taught one of the sections to these wide-eyed wee ones. The subject was the difference between wants and needs.

I was surprised to find out that this lesson suggested we only have three needs: food, clothing and shelter. Everything else is wants. Of course these three needs are the basics, something simple second graders might understand, but it occurred to me that our economy actually has a whole lot more needs.

The needs of food, clothing and shelter were appropriate for thousands of years, when mankind was in hunter-gatherer and farming periods. But once we started to make the transition from a rural agrarian to an urban production based economy, our list of needs had to expand.

An urban area needs more ***rules*** (***government***) to keep order amongst a growing mass of disparate people. It needs rules of engagement for both living and commerce. Getting to and from work requires more ***transportation***. You're no longer working in the front or the back 40. We need ***communications*** systems to coordinate a more complex and interconnected world. And we can't live without ***energy*** to power the factories, the transportation and communications systems, and the homes with an ever-increasing number of appliances.

Needs increased as we moved from an agrarian to a production-based economy. Add to food, clothing and shelter, government, transportation, communications and energy. There is no way for the urban production economy to operate without meeting these new needs.

So long as there are abundant resources, the farm-to-factory transition can create a virtuous growth cycle. Labor moves from farm-to-factory for higher wages. Those higher wages inspire more consumption for basic, as well as new needs, and then maybe for a few luxuries (wants). Workers don't consume government but they have to pay for it via taxes. Police and firemen don't work for free. More consumption creates more demand, which requires more labor, which creates more demand and on and on and on, so long as there are abundant resources to support the process.

The U.S. was blessed with immense and vast natural resources, which inspired immigration, the import of human resources. On the other hand, China has abundant human resources but has to import more natural resources. Over time, the combination of natural and human resources in a production-based system can turn an Emerging Market into a Developed Market. But what really separates the two? Might it be each country's ability to fully cover its citizens' needs?

That seems about right. America is developed. We have adequate food, clothing, shelter, government (no laughing here), transportation, communications and energy. In emerging China, all these needs are not nearly as adequately dispersed within or available to their entire population.

It seems China has ample runway for that farm-to-factory virtuous cycle to continue, so long as they can access the needed natural resources. But the less obvious is what should a developed, mature America do? We have already been through our own farm-to-factory virtuous cycle. Our needs seem met to such a degree that our economy has become more and more driven by our wants.

We want a bigger and nicer house. We want nicer furniture. We want an extra house for vacations. We want newer and fancier cars, washing machines, refrigerators, sneakers, clothes, handbags, espresso makers, bicycles, cameras, TVs, and on and on. We already have this stuff, but we want the newer stuff, the "better" stuff, and more stuff. And so for the past couple of decades we have gone out and gotten more stuff to fulfill our growing list of wants, which seem now more like needs.

But here's the rub…An economy driven by ever growing wants may be destroying capital. The utility value of that $50,000 BMW is no different from the $20,000 Civic. They both get you from one place to another in the same time. So in a way, purchasing the BMW destroyed $30,000 of capital. The daily utility of those $150 Nikes is no different than those $25 Keds. The $400 Kenmore washes clothes just as well as the $1,200 LG. You can make the same analysis with a lot of our stuff. Certainly some people can afford to destroy capital, but as a country, as an overall society, we can't.

The law of diminishing returns shows up as our wants become needs. Our first car increased our personal productivity far more than subsequent ones. Subsequent cars just maintain that increased productivity we captured in the first purchase. Similarly, our first appliances were much more productivity-enabling than their replacements. Going from washing clothes by hand to using a machine provided a great leap in personal productivity. The second and subsequent washing machines only maintained our existing productivity. We can apply this same rule to a lot of the stuff we already have.

And what about the optimum house size? Is capital being destroyed when we purchase a bigger one?

The destruction of capital must have its own unintended consequence. There is no action without reaction. It seems that this reaction can be seen in lower wages, higher debt, unproductive activity or a bit of all the above. Median wages have gone almost nowhere over the last 20 years. During this same period we have accumulated Mt. Everest-sized government debt. And now we have this monster fascination with Facebook, a focus on me, me, me and not on work, work, work.

This same law of diminishing returns also applies to government spending. Building the interstate highway system created significantly more value than maintaining it does. Building out all infrastructure is much more economically stimulating than maintaining it. Like the first car or first washing machine, the first optimal and adequate infrastructure produces the greatest economic value. Further investment is either a destruction of capital, building bridges to nowhere, or a marginal use of capital in maintaining that which we already have. So what should we do when most all our infrastructure needs are adequately met?

It would seem that so long as there is ample available capital, we will happily embrace more and more wants. And the more capital available, the more wants become needs. As you've heard from the Armchair before, ***there is nothing like prosperity to numb the mind of self-discipline***.

What would we do if we still had self-discipline? Well for one we would stop turning wants into needs. Think of the recent efforts to increase home ownership, minimum wage, the percentage of college graduates and the number of people covered by health insurance. Are these needs or are they wants we are trying to turn into needs?

We don't need increased home ownership; we need adequate housing, which we already have. We don't need the minimum wage; we need an economic environment that creates decent paying jobs without having to borrow trillions to sustain mandated wage minimums. We don't need a greater percentage of college graduates; we need more people with an insatiable desire to learn and the practical skills to apply what they learn, which should feed economic growth. And when we enormously outspend every country in the world on health care, we don't need universal health coverage; we need care more people can afford. Every time we turn a want into a need, we destroy capital, which drags, rather than stimulates, our economy.

Maybe if we cleared the intoxicating fog of prosperity, we could better focus on supplying needs to those countries currently going through their own farm-to-factory virtuous cycle. Food, clothing, shelter, government, transportation, communications and energy – which on this list are things we can export to the Emerging Markets? Is it not obvious that food and energy are the natural places we can create more economic value for ourselves?

America is the "Saudi Arabia" of agriculture, yet we are currently diverting a huge amount of our land to the production of ethanol. Studies have shown we likely release more carbon in the production of ethanol than we save by replacing gasoline, while at the same time we drive up food costs. Emerging Markets need more food. They will pay us real money for it. We'd be much better off getting paid for something we actually produce than borrowing more money to support our growing list of wants…that prosperity has convinced us we need.

America also has prolific resources of coal, oil and natural gas, yet it seems Washington loves to keep its heel on the neck of these industries. Emerging Markets need these resources. You want shovel ready jobs that don't require us to borrow money to create? Free our energy resource industries from their statutory shackles.

But since prosperity has numbed our mind of self-discipline, leadership, media and voters seem dead set on continuing the process of turning wants into needs. Given the black hole of government spending and our super nova exploding government debt, one would think we might finally figure out that ***America can no longer afford to be liberal***. It reminds me of something I heard a few years ago that won't leave my mind…Common sense really isn't so common.

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