Economics on Gilligan's Island

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Famed economist Henry Hazlitt wrote the economics classic, Economics in One Lesson: The Shortest and Surest Way to Understand Basic Economics. The book is quite popular and has sold well over one million copies. While the content is brilliant, what makes it distinctive is the simple clarity he uses to explain complex economic concepts.

We try our best to follow in Hazlitt?s footsteps and explain economics without the complexity and jargon so often used by trained economists. One of our techniques is to bring an economic concept to its most basic level so that it?s easily understood by all readers. While at 720Global, we produced an animated video, *The Animated Virtuous Cycle*,which allows a ten-year-old to understand the complex economic topic of productivity.

In this paper, we lead with a few instances where we have taken Hazlitt?s approach to better explain economic concepts. Following those excerpts, we use Gilligan?s Island as a means of illustrating productivity and its importance for the health of an economy and the prosperity of its people.

As a refinement of our recent article, Productivity: What it is and Why it Matters, we hope this approach allows more readers to grasp the importance of productivity growth. Falling productivity growth helps to explain the link between many of the mounting economic and social troubles we face. Equally important, from an investor?s perspective, productivity growth is the driver of current and future cash flows for almost every investment imaginable.

If you want to skip to our simple primer on productivity, go to the section entitled ?Gilligan?s Island?.

Greetings From Stiltsville

The following excerpt came from our article, Greetings From Stiltsville: Deficit Spending is not a Free Lunch. We created the fictitious island of Stiltsville to demonstrate why GDP is a poor measure of economic growth.

Imagine an island called Stiltsville, where a person?s value is based solely on their height. In order to increase their value, people living on the island used to wear platform shoes. A person wearing six-inch platform shoes would suddenly be more valuable than a person of similar height who wore normal footwear. Eventually, platform shoes were replaced by stilts, three-foot stilts were be replaced by six-foot stilts, and so on. People eventually rose to be the height of giraffes. The main point is that, on an island where height is valued above all else, people will try to game the situation to their advantage by increasing their height by any means available.

People from other lands would look at the people of Stiltsville and recognize their obsession with height greatly distorts their perception of value. They would also likely conclude that distorted perceptions result in actual distortions in productivity, because:

- *People waste time and money thinking about how to increase their height, and*
- *Walking around in platform shoes or stilts does not necessarily increase a person?s productivity, and instead most likely impairs it*

Now imagine a world in which the health of an economy is perceived to be based on one metric; Gross Domestic Product *(GDP).* GDP is simply the total amount of spending in an economy. GDP, as currently measured, does not distinguish between ?good? spending and ?bad? spending. GDP does not distinguish between consumption spending and investment spending. GDP also does not distinguish whether spending is generated by existing wealth, by going into debt temporarily, or by going into debt permanently. **In this world, every dollar spent on education or new means of production, is counted the same as every dollar spent on epic bachelor parties and video games.**

This world, the world of GDP accounting, is the world we live in. More spending today than occurred yesterday is considered economic growth. Growth, regardless of how it happens or at what cost, is highly sought after by politicians, economists and central bankers.

The Fallacy of Macroeconomics

In our RIA Pro article, The Fallacy of Macroeconomics, we show why the current mindset governing what constitutes economic growth is deeply flawed. In this article, we swapped Stiltsville for Glenn Villeneuve, a real person living off the grid in a remote part of Alaska.

To help you appreciate the benefit of creating value through production, we elicit the National Geographic Channel?s *Life Below Zero*. The documentary tracks the lives of several people that live largely independent, ?off-the-grid?, in the wilds of Alaska. Of particular interest is Glenn Villeneuve, who does not appear to rely on help from the outside world, nor many of the innovations of modern society, including electricity and power tools. Assessing Glenn?s daily activities, we better illustrate the measurement of a personal economy. While this example does not represent the norm, it does provide a microcosm of a simple economy to allow us to contrast the circumstances of Villeneuve with the fallacy of an economic perspective focused on consumption.

A typical day for Glenn involves some of the following activities in which he produces goods: hunting, trapping, fishing, sourcing water, and chopping lumber. Other parts of his day are spent consuming prior production such as eating, drinking, sleeping, and warming up by a fire. The first set of activities involves productive endeavors that add economic value. The second set of activities involves consuming the value he created. Note that there is also an intermediate stage in which the value he created is stored (saved) for future consumption.

Throughout the show, Glenn consistently extols efficiency or the benefits of using the least amount of energy and the most amount of ingenuity to add value to his camp. After watching an episode or two, a viewer quickly realizes that without this supply side mindset Glenn would quickly exhaust his resources and become a victim of the harsh Alaskan climate.

Most of our days are quite different than Glenn?s, but nevertheless they are filled with similar pursuits. We sit at a desk providing legal services, picking grapes from a vine, building houses and millions of others jobs in which we create value. While most of us do not ?eat what we kill? and consume the value we create directly, we earn the value in the form of currency. As a store of that value, currency then affords us a medium of exchange for something we need or want when it suits us.

Just as portrayed in Glenn?s example, the harder we work and the more innovative and productive we are, the more value we create. It is in this straightforward incentive that the prosperity of a populace grows and scarcity is diminished.

The Fed?s Mandate to Pick your Pocket

In a recent article entitled, The Fed?s Mandate to Pick your Pocket, we used the analogy of three people stranded on a deserted island to explain inflation.

?*Inflation is everywhere and always a monetary phenomenon*.? ? Milton Friedman

This oft-cited quote from the renowned American economist Milton Friedman suggests something important about inflation. What he implies is that inflation is a function of money, but what *exactly* does that mean?

To better appreciate this thought, let?s use a simple example of three people stranded on a deserted island. One person has two bottles of water, and she is willing to sell one of the bottles to the highest bidder. Of the two desperate bidders, one finds a lonely one-dollar bill in his pocket and is the highest bidder. But just before the transaction is completed, the other person finds a twenty-dollar bill buried in his backpack. Suddenly, the bottle of water that was about to sell for one-dollar now sells for twenty dollars. Nothing about the bottle of water changed. What changed was the money available among the people on the island.

As we discussed in *What Turkey Can Teach Us About Gold*, most people think inflation is caused by rising prices, but rising prices are only a symptom of inflation. As the deserted island example illustrates, inflation is caused by too much money sloshing around the economy in relation to goods and services. **What we experience is goods and services going up in price, but inflation is actually the value of our money going down**.

Gilligan's Island

Having traveled to Stiltsville, The Brooks Range of Alaska and a deserted island, we now bring you to Gilligan?s Island. This widely popular 1960?s television sitcom portrayed the island home of seven castaways. Despite the comic ventures of the half-witted first mate, Gilligan, and the rest of the castaways, the setting provides a nice canvas to illustrate how a nation?s prosperity can only permanently grow with the help of productivity.

As we stated in, Productivity: What it is and Why it Matters, *?Economic growth is a direct function of productivity which measures the amount of leverage an economy can generate from its two primary inputs, labor and capital. Without productivity, an economy is solely reliant on the two inputs. Due to the limited nature of both labor and capital, they cannot be depended upon to produce durable economic growth over long periods of time.?*

Given the three factors that create prosperity - labor, capital, and productivity - we discuss how the three elements of economic growth can be employed on Gilligan?s Island and the benefits and drawbacks of each. We greatly simplify this analysis by assuming that the only product the castaways produce are coconuts. Further, the coconuts can be sold to Robinson Crusoe Island (RC Island), and as a result the castaways on Gilligan?s Island can buy whatever goods they desire.

Labor

While there are many facets to labor such as education, training, work ethic and incentives, the biggest factor is demographics. Demographics describe the composition of a population. On Gilligan?s Island, all seven inhabitants, even the socialite Mrs. Howell, are capable of picking coconuts for long hours each day. Given this construct, there are two ways the island can increase its economic production; work more hours and/or have babies.

If each person were to increase their daily workload by two more hours, they would pick more coconuts and exchange them for more money and other goods. This would certainly make them more prosperous. However, picking hours are limited by what is physically possible and the number of hours of daylight. At some point, their ability to work more reaches a limit.

The other way to increase the island?s economic activity is to have babies that will eventually work. If, for instance, the population were to double to 14, then we might assume the coconut production would also eventually double and therefore economic activity would double. That is true, but the level of activity and prosperity per person would remain the same.

In both examples, there is a limit to the number of people that can fit on the island and the number of hours that can be worked. While additional hours and babies can increase economic activity and prosperity, both have a definitive maximum.

Capital

?*Capital includes natural, man-made and financial resources*.? The capital in our example is coconut trees and coconuts. In our most basic example, the only other potential source of capital is borrowing money from RC island.

Thurston Howell III, the once prominent millionaire, has devised a way to buy more stuff than is possible through daily coconut picking activities. He approaches RC island and asks to borrow money. RC island agrees and lends the Islanders money which is then spent.

Now, in addition to what they can buy from their coconut sales, they have the additional purchasing power of debt. This method makes Gilligan?s Island seemingly more prosperous, but only temporarily. In the future, they will not be able to borrow any more money and must use their income from coconut sales to pay back the debt. The buying power gained from the debt will be paid back in the future plus interest. Credit can raise the level of consumption, but it is temporary and limited.

Productivity

Fortunately, Gilligan?s Island has the Professor. The resident genius realized the ultimate bounds of borrowing, working more hours and having babies. All three tactics could certainly provide more but were limited and flawed. He knew that capital, either saved or borrowed, and a little ingenuity could be used to permanently increase the number of coconuts they pick without requiring more hours of work or more people.

The Professor suggested they cut one month?s intake of caviar to buy ladders. The ladders allow them to get up and down the trees quicker and produce more coconuts in less time. Also, he suggested they borrow money to buy genetically modified coconut trees that produce five times as many coconuts as the trees currently on the island. By doing so, each trip up the tree would yield five more coconuts than before. The debt would have to be paid back with interest, but the extra revenue would more than offset the extra expense. They could also use their savings or debt to buy tools that could be used to make many different products from the coconuts. These products would generate more revenue per coconut.

This illustration demonstrates how productivity acts as leverage to get more out of labor and capital and expand the prosperity of an island and, for that matter, a nation.

Summary

The concepts presented here are grossly simplified, but they apply to our modern, multifaceted economy every bit as much as they do to Gilligan?s Island. As a nation, we can keeping gaming GDP growth with largely unproductive debt or we can save and invest more. It is easier to borrow and spend, but it offers only a short-term means of raising consumption. It is not a permanent, long-term solution. Saving and investing comes with a temporary, short-term cost but the long - term benefits more than outweigh that sacrifice.

This lesson applies to the economy and the generation of demand for the products and services that drive the revenue and profits available to investors. It also applies to the value of individual investments themselves. With this precious of understanding of productivity and its value we should be asking if the companies we invest in are using capital to wisely invest in their future or are they using it for other less-productive purposes? This is not a binary question in most cases as most companies do both, however we all but guarantee that, over the long run, companies focused on investments where productivity growth trumps short-term profits will benefit at the expense of companies focused elsewhere.

For related research on this important concept we recommend reading *The Death of the Virtuous Cycle* and watching our short video *The Animated Virtuous Cycle*.