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A Crusoe Economy

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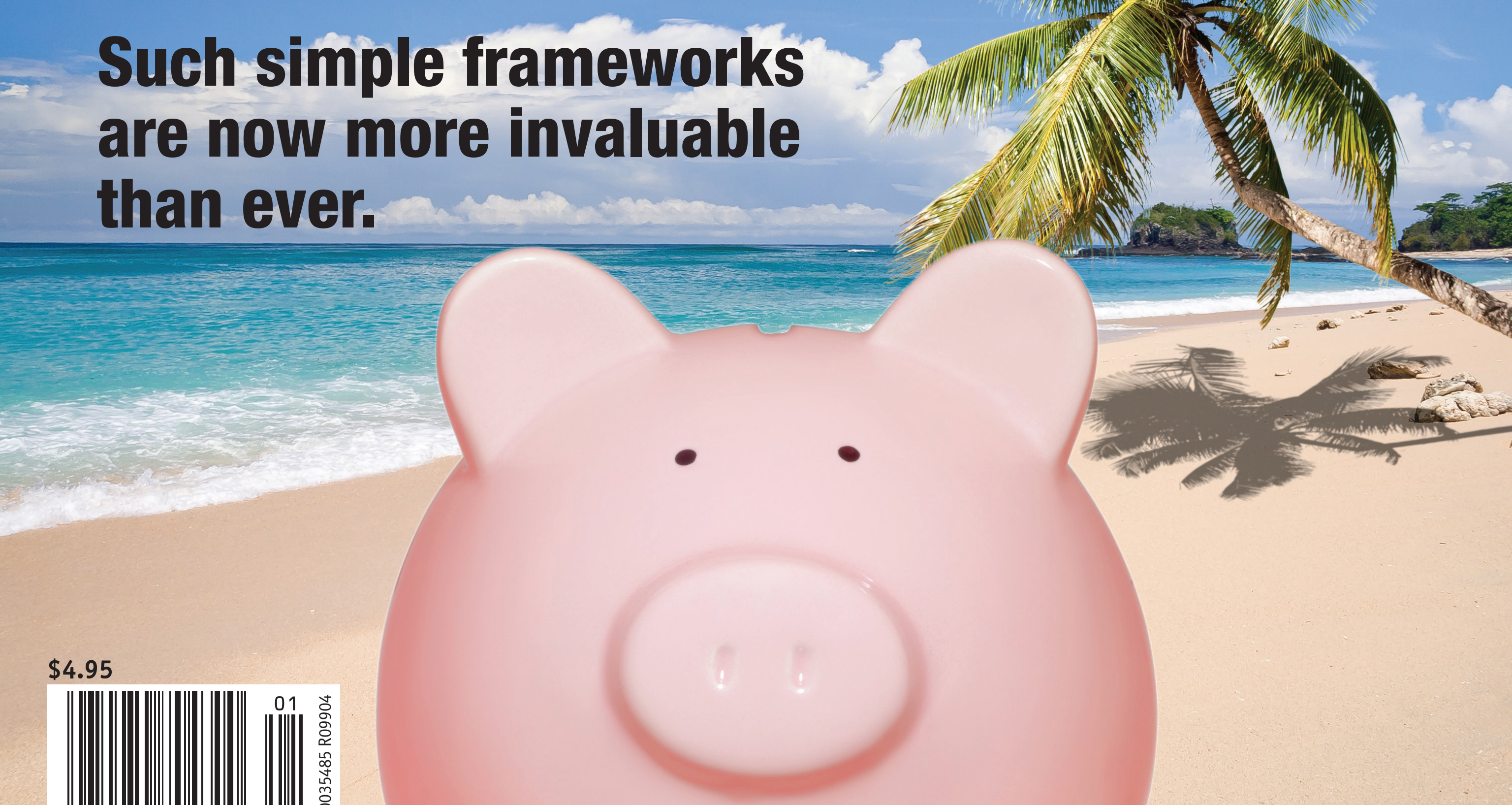

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A Crusoe Economy

Brian Chang

When commentators today talk about "Crusoe Economics", in fact, what they are referring to is the seldom-used analytical framework sometimes employed by economists to reduce complex market concepts down to basic first principles. As originally envisioned, the framework examines a hypothetical Robinson Crusoe stranded on a desert island with only a single friend, Friday, as his companion. The analysis then distills the complexities of a modern economy down to basic elementary truths, emulating a simple closed economic system with only two individuals under conditions of resource scarcity.

While originally created as an educational tool for the teaching of core economic principles to the uninitiated, it has today become a euphemism for debunking popularized economic fallacies and a rebuttal to the increasingly pervasive and misguided policies of modern-day governments. In today's new world of "muddle-through" economics where policymakers bounce unwittingly from one failed policy experiment to the next, such simple frameworks are now more invaluable than ever.

Let us begin our analysis with one of the most pervasive and deeply-damaging fallacies that currently exists in modern-day economics: the erroneous belief, held by the majority of policymakers and government economists, that consumer spending is the primary engine of economic growth. This profoundly damaging viewpoint is reflected in virtually all forms of public discourse and policy discussion concerning efforts by governments and central banks to either increase economic growth or support the economy during times of recession.

These erroneous views are reflected most perniciously in the continued advocacy of the idea that the root cause of present-recessions is insufficient "aggregate-demand" by consumers. In the world of government policy-makers and mainstream analysts, it is always and everywhere consumer spending that stimulates economic growth, and a lack thereof is the root cause of recessions. According to widespread present-day economic doctrine, every dollar spent by the consumer is in fact income for the businessman, which in turn becomes wages to the employee to be spent repeatedly throughout the economy, thus setting in motion a virtuous cycle of economic growth based entirely on the initial spending by the original consumer. Recessions must therefore be fought through the lowering of interest rates to stimulate borrowing and spending, and the curse of savings must be combated through inflation so to incentivize "hoarders" to unleash their stockpiles of cash into the broad economy.

And yet the problems inherent in the above fallacy are easily made clear through a simple illustration which has nonetheless befuddled the average government economist of the day. Turning our attention back to our hypothetical "Crusoe Economy", imagine a fictitious Robinson Crusoe suddenly stranded on a desert island and forced to turn immediately to the critical task of survival. Let us assume that he has found a nearby stream to quench his initial thirst for water, and must now turn his attention towards food, finding that he is able to catch only two fish per day through laborious and painstaking work. Crusoe finds that he must wade waist-deep into the ocean and stand completely motionless for hours on end in the unrelenting sun, hoping to snare the odd fish that happens to swim close enough to be caught by hand.

The work is tedious and difficult, and he soon devises that he will improve his means through the creation of a net, which he estimates will take him five days to complete. But Crusoe, of course, does not have the time to dedicate five straight days to making this net, for in the meantime he will surely starve to death. Instead, he decides that for five straight days he will bear the hardship of consuming only one fish per day and keep the other fish in a small nearby pond to eat at a later time. At the end of five days, while he has indeed grown weary with hunger, he now has a stockpile of five fishes to consume over the next five days while he toils away constructing his net. Fortuitously, at the end of the 10th day, Crusoe is suddenly able to use his newly constructed net to catch 20 fish per day and is now able to gorge on fish for days on end to at last satisfy his unrelenting hunger.

It should be obvious, however, that while Crusoe was indeed ultimately able to increase his consumption from two fish per day to 20 fish per day, he did so only through the initial act of under-consumption. In choosing to forgo the consumption of two fish per day in order to keep one for the future, Crusoe chose to save and invest so that he might increase his productive capacity, which only at the end of the long and drawn-out process allowed for a final increase in consumption to 20 fish per day. What this simple example illustrates is that an increase in consumption does not magically appear out of thin air with the wave of the hand by some altruistic central banker. It requires savings to fund increased productivity, which only then creates a sustainable increase in consumption. Government economists have it precisely backwards in that they continuously enact policies to increase consumer spending before any savings or increases in productivity has taken place at all.

The problem is made clearer if we now introduce Crusoe's lone companion, Friday, into the mix, who being native to the island, enjoys a vastly different set of skills than that of his friend. Friday, it turns out, has not the temperament to fish, but is instead more apt at climbing trees to collect stockpiles of coconuts. After some time, reviewing his own situation, Crusoe realizes that he cannot hope to consume all 20 fish each day, and even after having set aside some quantity of fish for a rainy day he finds that he still has a large surplus which will over time go to waste. Seeing Friday's skill at collecting coconuts and wishing to introduce these into his diet, Crusoe decides each day to offer Friday five fish for one coconut, which Friday gladly accepts, since he has in fact a surplus of coconuts while not the means to acquire fish.

What was not obvious from our original example of a lone Robinson Crusoe catching fish for his own consumption is now readily apparent with the introduction of Friday as an additional economic agent. Absent the introduction of the concept of money, we see now that Crusoe pays for coconuts with fish—he pays for consumption with production. Obviously, Crusoe would never have been able to acquire the coconuts from Friday had he not first produced fish and, likewise, without first producing coconuts, Friday would have no means by which to acquire the fish in return.

Modern-day economics has become obfuscated with the construct of money which, while originally introduced into exchange economies for measures of convenience and efficiency, has as a side-effect come to hopelessly confuse the fact that people do not actually pay money for goods. Rather, they pay for goods with other goods; money is the common medium of exchange. These examples serve to illustrate just how far present-day economists have been led astray from basic economic fundamentals once increasing complexities are introduced into the system by way of artificial financial and monetary engineering.

It is a fundamental economic truism that society must ultimately pay for consumption with production, and in order to increase consumption in any sustained and permanent way, society must also increase its productive capacity, which requires savings followed by investment. Deliberate government policies to incentivize its citizens to go further into debt for the sake of consumption-based economic stimulation is an inherently flawed and backwards policy that, over time, erodes the real wealth of society. Under-consumption and savings happen first and increases to spending happens last.

The failure to understand this basic concept is to decry the growth of savings by individuals as economically harmful, since by its very definition, an increase in savings by society requires a corresponding decrease in consumption-based stimulus. The belief that savings is somehow damaging to society despite being beneficial when undertaken on an individual basis is what mainstream economists today refer to as the "Paradox of Thrift". The problem with the Paradox of Thrift, however, is that there simply is no paradox. It is merely a name given by modern-day Keynesian economists to a phenomenon which contradicts their confused models that consumption, not savings and investment, is the ultimate engine of economic growth. Instead of considering the possibility that their models are in fact incorrect, and that savings and investment are beneficial for both individuals and society as a whole, they simply label the phenomenon as a curious "paradox" and move on to other stimulus-inducing measures that detract from future production and standards of living.

As Henry Hazlitt noted in 1946 in his book *Economics in One Lesson* with a warning still as relevant to investors today as it was over 70 years ago: “Elementary illustrations like this are sometimes ridiculed as Crusoe Economics. Unfortunately, they are ridiculed most by those who most need them, who fail to understand the particular principle illustrated even in this simple form, or who lose track of that principle completely when they come to examine the bewildering complications of a great modern economic society.”

Brian Chang is the author of the finance blog Crusoe Economics (https://crusoeeconomics.com). He resides in Vancouver and can be contacted by email at info@crusoeeconomics.com or on twitter @CrusoeEconomics.