

The Virtue of Thrift

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The title of this article is intended to be a rebuttal to the concept of the “paradox of thrift”. Unfortunately, I could not find a term that is the opposite of paradox, so the title is not quite the play on words I wanted. With that out of the way, let’s get to a substantive discussion of this bogus concept.

The principle behind the so-called “paradox of thrift” is that, while saving money on an individual level may be good for the individual, everyone in society saving money at the same time will crash the economy. The reasoning behind this is that if everyone saves, there will be no consumption/demand for goods/services.

I suppose there is one theoretical situation where this could be true, and I will get to that later. For all practical purposes though, this is a bogus concern. If this were just a theory, solely discussed/debated by academics, it would not be that important to debunk. The problem is, this theory is influencing a lot of macroeconomic policy decisions and so it needs to be argued against as much as humanly possible.

So, why is this theory wrong? Let’s start by revisiting exactly what “savings” represent. Once this is well defined, it should be clear why it is virtually impossible to have “too much savings”, at least on a practical level. To best understand this, imagine a human being stranded alone on an island.

This individual starts out with absolutely nothing in terms of savings. Of course, this is a bad situation as this person will be living a very hand to mouth existence. Every day will be a battle to survive. While some people may find this liberating/exciting and a great form of adventure, I would suggest that is a romanticized view portrayed by authors and Hollywood. In reality, most people want to have some kind of fallback plan in case some disaster strikes.

So, say this individual has a green thumb and is able to plant and grow a small garden quickly enough to stay alive. This is purely hypothetical, but say that this individual has two options. One, growing enough food each day for just that day. That is, doing the bare minimum to survive and repeat the process the next day.

Option two is that it will take a lot of extra work/time when starting out, but the individual can lay a foundation to grow several days’ worth of food in one day. Or, the individual could continue to grow the same one day supply, but not consume all of it every day. He/she may feel a little hungry/malnourished, but the goal is to store up some of the food that was not consumed for the future. In either of these situations, the plants/food that goes beyond the single day requirements can be considered savings.

So right away, it should be clear that “the more savings the better” (assuming the individual can store it in a way it won’t spoil). After all, what if the individual gets injured or gets sick and can no longer grow food every day? The individual would have to rely on these savings to survive.

As one does not know how often they may get sick/injured in advance, having a supply of food “just in case” creates a safety net.

Back to the one situation where someone COULD have too much savings. Say that this individual has a week of food in storage and suffers a tragic accident and dies. Now you could say that this week’s supply of food was a “waste” because there is no one left to consume it. Of course, that would not be true in our actual society because it could be left to other people.

Still, this same situation could occur if the Mayans are right and the world ends later on in 2012. Any food/supplies humanity has saved up could be considered a “waste” if the human race is wiped off the Earth. It should be clear that this is a very theoretical situation and if it were to happen, there would be no one around left to lament the wasted supplies anyway.

Now say that there is an event similar to what killed the dinosaurs and some meteor prevents us from growing plants for several years. Wouldn’t society be better off if we had a great deal of food/savings stored up to get us through this time? Yes, these are both exaggerated examples, but they should underscore the importance of savings.

In reality, it is not as cut and dried as this as there is always a tension between saving for the future and enjoying the present. That is, on an individual level, people have to decide how much to save because you “can’t take it with you”. Then again, there are some people who may find it more enjoyable to save up wealth/security for their family members after they are gone rather than enjoying it themselves. That is fine, the purpose of this article is to show that everyone saving is not a bad thing.

On a macro scale, can you think of any time in history when our entire society has saved up so much that we had “too many” supplies? Even in wealthy countries there are still homeless/hungry people, so there are still people that could use the supplies. There are logistical issues about transporting/distributing the food, but the point remains that we as a society have NEVER reached the point of “saving too much”.

Also, it is impossible to reach a point of 100% savings as people will still need the basic necessities to survive. Going back to the stranded individual, they cannot save everything forever. Even if they were to go several days without eating to store up some supplies, the intention is to use the supplies later on.

So, even if everyone WANTED to save 100% of their income, they would still have to spend money on food/housing/water etc. As there would still be demand for food/basic necessities, there would still be jobs/wealth creation for people growing this food. This can get lost in the shuffle sometimes with our complex economy and so many people producing things that are for entertainment/luxury purposes.

It is just important to remember that the reason we can spend so much of our income on luxury/entertainment items is because we feel we have enough in storage/have access to the basic necessities that we can “splurge” a little with our excess income. Think about it. If tomorrow your home was destroyed by a natural disaster and all your retirement account and savings accounts all went down to zero, would you consider yourself in a better situation?

The answer (should be at least) an emphatic NO! Well, if the “paradox of thrift” were true, it would mean that society would be better off if no one had savings for retirement than if everyone were to have savings for retirement.

If you doubt that this bogus logic is truly affecting our economic policy right now, think about the Fed’s near zero/zero interest rate policy. The idea behind this is that we want to discourage people from putting money into the bank and rather spend it all right away to “stimulate” the economy. If it were really true that this is the best way to “stimulate” the economy, why not abolish all the penalties on withdrawals from retirement accounts?

While I hate to bring this up as I’m afraid to give the government any ideas, do you think that would be good thing if we encouraged everyone to spend everything they have already saved up in the past to boost the economy right now? Sure, we may be able to create some jobs in the short term by using up everyone’s savings. What happens when all the savings are gone though? Now those jobs disappear and now society as a whole has no savings to fall back on if there is some terrible unforeseen event.

Taking this through to its logical conclusion, if it is not a good idea to force people to spend all their past savings, why is it a good idea to encourage people to spend all the money that they could be saving right now?

This is a topic with many threads running through it so you could also read the articles on inflation, minimum wage, the gold standard, and social security to see a bigger picture of the economy.

For a complete discussion of how all these subjects intertwine, check out Anti Social: Rebooting Capitalism and the American Dream, available at www.rebootingamericandream.com!