

### Real World Graduation: Question 3

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#### Question 3

In 1979, a certain woman bought a large number of popular "collectible" dolls. It was commonly believed at that time that these dolls would increase in value over time, and as such, were considered by some to be a worthwhile investment. In fact, some were suggesting that a \$5.00 doll purchased in 1979, if kept in its original packaging, would find buyers in 1999 (20 years later) at a price of \$100.00 or more, far in excess of the effects of inflation. This means that these dolls were expected to increase in value about 16.1% per year (in so doing, their value would double every 4.47 years, and would be worth 20 times what they were purchased for at the end of 20 years). If the effects of inflation were also considered, the dolls would be expected to sell for a lot more in 1999.

However, in 1999, the woman who bought the dolls found that there was virtually no demand for them, other than their usual value as children's toys. She has been offered \$1.50 each by another collector, which will represent a considerable loss to her. What actions should be taken?

- a) The woman should sell the dolls for \$1.50 each, then sue the person who sold her the dolls in 1979 to recover the other \$98.50 each (plus whatever extra is due owing to inflation).
- b) The woman should sell the dolls for \$1.50 each, then sue the person who sold her the dolls in 1979 for \$3.50 each; that way, she at least recovers her investment.
- c) This woman will have to take the loss, but the state or federal government should pass a law prohibiting the sale of "collectible" dolls.
- d) Because collectibles always increase in value over the long run, she should hold onto them and make even more per doll than the original \$100.00 estimate. Her inability to sell them at a profit now is only a temporary setback.
- e) This was a case of questionable behavior by the original seller. This woman will have to take the loss. But, in order to prevent this from happening to other people, the state or federal government should pass a law requiring background checks and permits for anyone who manufactures or sells dolls.

### Answer to Question 3

This is a trick question. All of the provided answers are wrong.

The most important thing to remember when this woman decided to sell the dolls: every item is worth what she can get for it, nothing more and nothing less. Let's review the history of the dolls. In 1979, the woman bought them for \$5.00 each. Why were they priced at \$5.00? Because the buyer and seller agreed on the price; the seller got the most he could, and the buyer paid the least she could. They valued them equally, and the seller agreed to part with each doll in return for \$5.00. Had they not agreed on the price, the sale would not have been made.

But why did the woman pay \$5.00 each for them? She apparently bought them because she had been told they would increase in value because they were "collectibles". What is a "collectible"? It is something that people like to collect; i.e., to spend their money on, even though they may not have a practical use. Old stamps, obsolete coins, and baseball cards are items that people have collected as a hobby or because they happen to like these things, although they do not have any particular use or any value to anyone else.

There is no guarantee that anything that is bought today can be sold at any later time. A person who bought a buggy whip factory in 1898 found selling buggy whips increasingly difficult, especially after the advent Henry Ford's Model T in 1908. Buggy whips simply became obsolete as the public switched from horse-drawn carts to cars, and their value went close to zero. Likewise, there was no guarantee that anyone would place any value on the "collectible" dolls in the future. An item advertised as a "collectible" is likely to be something that will never have any value, except to the person who gets rid of them now to a person, like our woman, who falsely believed a mass-produced doll would become increasingly valuable just because a seller claimed it was "collectible".

Let's put this in more concrete economic terms. An "investment" is defined as part ownership of an enterprise that engages in acquisition and use of equipment and tools to a) develop and produce items for sale; or b) construct buildings and infrastructure, both for sale at a profit. In other words, these are "capital goods", used to produce additional goods. Paying money to obtain stock (partial ownership) in a manufacturing company, or a video game company, or a mining company are investments because they use labor, talent, and equipment to produce items for sale. Note this definition excludes raw land, old cars, the home you live in, and dolls. None of these can be used to produce anything else, and are therefore either "speculation" or "expenses".

Secondly, if the stock market only increases in value at an average rate between 7% and 10% annually over the long term, why would anyone think a mass-produced doll would increase in value at a faster rate (in this example, a claim of 16% annual increase)? Our woman believed it because she did not do the arithmetic and ask herself if the claim that dolls would have a greater investment potential than actual productive enterprises might be plausible. A good rule of thumb is that when you buy something that is not obviously an investment, like a stock, or a business, it's yours. It is highly unlikely that you will ever be able to re-sell that item for more than you paid for it (excluding the effects of inflation). So, when you buy something, make sure you have a use for it, or make sure you like it enough to part with your money permanently to get it. Again, everything you buy is priced because that is what the seller can get for it. In the future, you will sell for what you can get for it, and most items bought for personal use decline in value over time.

Answer (a) is wrong because there was no guarantee that the dolls would go up in value; it was merely wishful thinking. No one signed a contract promising to pay \$100.00 for them in the future, so the courts have nothing to enforce. In fact, even the seediest lawyer will decline the case.

Answer (b) is wrong for the same reason; keep in mind that "collectibles" as such should not be regarded as "investments". The factory that produced the dolls was an investment for its owners, but the dolls themselves are not investments.

Answer (c) is wrong because the government should not interfere with basic economic agreements; the government cannot save a person from themselves. If it were to pass a law prohibiting sale of "collectible" dolls based on a complaint from a greedy buyer, it would soon find itself prohibiting sales of nearly everything, because someone somewhere will complain about every price. Then there would not be much of an economy.

Answer (d) is wrong because "collectible" is an advertising trick that is not enforceable; I can claim this essay to be "collectible" if I want to, but that does not mean anyone will actually want to collect copies of it, or to pay for it in the future.

Answer (e) is wrong for the same reason (c) is wrong. There is nothing "questionable" about the seller's actions. The seller himself did not claim that they might be worth a lot more in the future; some other advertising or "popular fad" was at work to convince the buyer that they would. The fact that such a claim contradicts common sense does not make it "questionable". Secondly, buying and selling only by permits and regulation makes products more expensive due to the increased compliance overhead. Third, even if the seller has the permits, the buyer is not relieved of making good buying choices. The buyer can still be taken in by their own greed. It was the buyer's greed and willingness to believe in a fairy tale that led to the loss.

The important thing to remember in this example is that when you are buying something, it is worth (to you) what you are willing to pay for it. When selling, it is worth what you can get for it, which is to say, it is worth what someone else is willing to pay. If you believe that the government can or will protect you from every bad economic decision, you are asking for something that cannot be done.