

Many items and commodities once considered valuable are now free, and many commodities that were once free and taken for granted are growing increasingly expensive. Yet another sign that the paradigms, they are a changin'.

How's Free?

By Clark Winter

On August 1, media baron Rupert Murdoch completed what many considered the crowning deal of his career – a \$5.6 billion takeover of venerable Dow Jones & Co. Murdoch has promised to leave the company's flagship newspaper *The Wall Street Journal's* editorial operations alone, but one change that is already rumored to be in the works is a decision to end the Journal's on-line subscription service and to substitute a free news service for it. Why would Murdoch sacrifice the roughly \$65 million that the Journal's on-line business generates? Because a free service could increase readership as much as 10 times according to some estimates, and that huge increase would more than compensate Murdoch in increased advertising revenue from the Journal's online users.

Now, consider this: According to The Earth Policy Institute, the price of water, which many people used to consume for free, is suddenly soaring all around the world. Over the past five years, municipal water rates have increased by an average of 27 percent in the United States, 32 percent in the United Kingdom, 45 percent in Australia, 50 percent in South Africa, and 58 percent in Canada. In Tunisia, the price of irrigation water increased fourfold over a decade. Why should water, so necessary to life that many governments give it away for nothing as a basic human right, suddenly have a rising price tag on it?

What is going on here is a revaluation of goods and services that may be unprecedented in human history. It is a process that has already created tremendous opportunity in a limited number of areas, but which will create much more in the years to come. It will also create

danger for companies, as they make the decision about who will pay for their goods.

Why is the move toward a shifting price paradigm happening? Three factors influence the change. First, there's China. Even as Chinese wages rise, China's hundreds of millions of unemployed still need jobs, a factor which will depress wages and the cost of goods for at least another decade. Consumers all over the world will continue to benefit from the flood of low-cost Chinese goods for the foreseeable future. Second, there is technology. There seems to be no end in sight for Moore's law, defined by Intel co-founder Gordon Moore in 1965 as a doubling of semiconductor device density every 24 months. As our society becomes one of devices driven by computer chips, the cost of what was once thought of as impossibly expensive merchandise drops and drops and drops to the point where \$5 cell phones, \$100 computers and inexpensive home entertainment centers are just over the horizon. Finally, there are the consumers. While the technological and monetary gains of the past thirty years have lifted nearly two billion people out of poverty, nearly three billion still remain dependent upon incomes of under \$500 per year. That additional \$1.5 trillion of purchasing power is now becoming a target of eager manufacturers, who see that purchasing power as just a base for large and rapid increases once the poor become working consumers. For those who doubt that idea, remember that most of America's prosperity in the 1990s was caused by a drop of just two percent in unemployment, with most of the newly hired coming from the bottom of the economic pile, not the top. Companies such as Wal-Mart and Home Depot made their fortunes—and fortunes for their shareholders—by catering to the needs of newly empowered homemakers and not the spending habits of the rich.

This trifecta of supply and demand, while it has surely kept the global economy on an upward trend, has some problems. First and foremost, companies can't give their goods and services away for nothing. Milton Friedman said there was no free lunch, and no one has yet proved him wrong. Somebody has to pay for all those spiffy new services, so manufacturers and service providers have turned to advertising to offset their costs. What companies give away for free to attract customers they recoup in fees for access to their customers by non-competing companies. Companies will spend more than \$451 billion on ads this year, a six percent rise from the year before. There is absolutely no indication that advertising spending is about to level off.

But now, the other side of the coin. As consumerism grows around the world, it brings with it rising demand for all sorts of things, including such basics as food, clean air and water. While there is no such thing as profligacy in air consumption, there is in water and food. A shift from farming to manufacturing is not a shift of water usage, because while people move off the farms and into cities to take up manufacturing jobs, more water is needed, not less, to grow more food for the rising caloric intakes of city dwellers, for the goods that they manufacture, for the appliances that keep city dwellers, their dishes and their clothes clean, and for the air that must be scrubbed to make it breathable. Given that the amount of water on planet Earth is fixed, more demand inevitably

means higher prices. Conservation can slow the growth of prices, but it cannot stop it. What is true for water is equally true for food – prices have been steadily rising in nearly all agricultural commodities, as we run out of arable land and demand shows no signs of relenting – and for air, as countries impose taxes to curb pollution. We might not see it exactly that way – New York Mayor Michael Bloomberg's congestion pricing plan, which emulates London's – is a pollution tax in the form of a consumption tax.

For manufacturers and distributors of goods or services, the shift in the definition of what has value and what is now free has all sorts of social implications. The move to free has had a salutary effect on urban crime: why would you bother to steal something that has no resale value? Steve Jobs and not William Bratton may go down in history as the greatest of crime fighters by making the iPod a device not worth stealing (you need a computer to upload and download music, and stealing someone else's music is stealing their personal tastes, with all the limitations implied in the word "taste"), but what will that do to an economy that is based upon the value of goods? Why accumulate if your hard-earned money is going toward the purchase of an item that will be obsolete within six months? These are the new existential questions of the age, but they will come with huge price tags, and garner huge fortunes for those smart enough to figure them out. ■

Clark Winter has a long history in investment management, at Morgan Guaranty Trust/JPMorgan, where he opened offices in Spain and Mexico, as CEO of Global Asset Management (now part of UBS), and as founder and president of Winter Capital International, an independent advisory firm that is now a subsidiary of the Citigroup Private Bank. He has written for *Forbes* and other publications and is the author of "**The Either/Or Investor**," a book to be published in January, 2008. Copyright © 2007 by Clark Winter