Economy, Money, Government

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EECS GIST

Objective:
What is economy?
What is money?
What do we expect with money?
There is no real money today.
Inequality gets worsened over time since the start of fake money.
Booms and busts are the product of fake money.
As the results, ordinary working people suffer.
A money seeking society is the result of fake money.
Bitcoin is an effort to make a real money for the global economy.

Economy

The economy is the total of all activities related to production and consumption of limited resources by a group of participants. (Investopedia)

Economy is to live well.

There are human beings with limited resources.
Human beings have limited life span.
They are born, grow and die.
There are limited resources such as land and water for them to use.
They want to make a peaceful living out of what they have.
To live well, they need to utilize the resource efficiently and productively.

To stay alive, each one needs to have food to eat, cloths to wear, and shelter to sleep.
A person spends their limited **time and energy** for food, clothes, and shelters.

They transact with each other for making food and shelters.
Someone grows crops such as rice and wheat.
Others raise pigs and cows.
Others make milk and bread.
Others catch fish.
Others are good at building shelters.
Others are good at making nets.
They exchange these goods and services.

This way of division of labors and transacting goods and services with each other is more efficient than each one does them all alone.

Money

To make transactions more convenient, humans have invented “money.”

Money is a medium of exchange.
With money, people can overcome “coincident of wants,” the inefficiency of a barter system. For example, let us suppose: Bill wants fish but has no wheat. Adam wants wheat but has no fish. No transaction can occur between Bill and Adam.

Money is a measure of value.
One can determine how much dear a good is to him/her. For Bill, a fish is worth 5 unit of money. If there is a seller who wants to sell fish at 5 unit of money.

Money is standard of deterred payment. Bill lends Adam 5 heads of sheep today. Adam shall pay back with 7 heads of sheep a year later. With money, the following is possible way of settling a debt: Bill lend Adam 5 heads of sheep today which is worth 5 unit of money, and Adam shall pay back with 7 unit of money.

We can see from above, with the use of money, the real value of debts may change due to inflation and deflation. It is important to have a money that shall not be devalued.

- ✧ Inflation is the decline of the purchasing power of a unit of money over time.
- ✧ Deflation is the rise of the purchasing power of a unit of money over time.

Money acts as a store of value. For this, money must be able to be reliably saved, stored, and retrieved. The value of money needs to remain stable over time.

A person grows older and they have less energy.
But they still want to survive.
They seek to have a way to keep themselves alive.
One way is to keep the land and animals.
But this is very difficult.
With money, it can be done.

Gold Standard
Gold has been used as money for thousands of years.
Gold is scarce.
No counterfeit is possible.
It does not get deteriorated.
Its value is stable.
It is compact.
It can be made into gold coins.

Summary

- ✧ Money has been used in economy.
- ✧ It serves medium of exchange, measure of value, standard of deferred payment, and store of value.
- ✧ It shall be free from counterfeits and deterioration.
- ✧ It shall have intrinsic value offering stability of exchange value.
- ✧ Gold has been used as money.

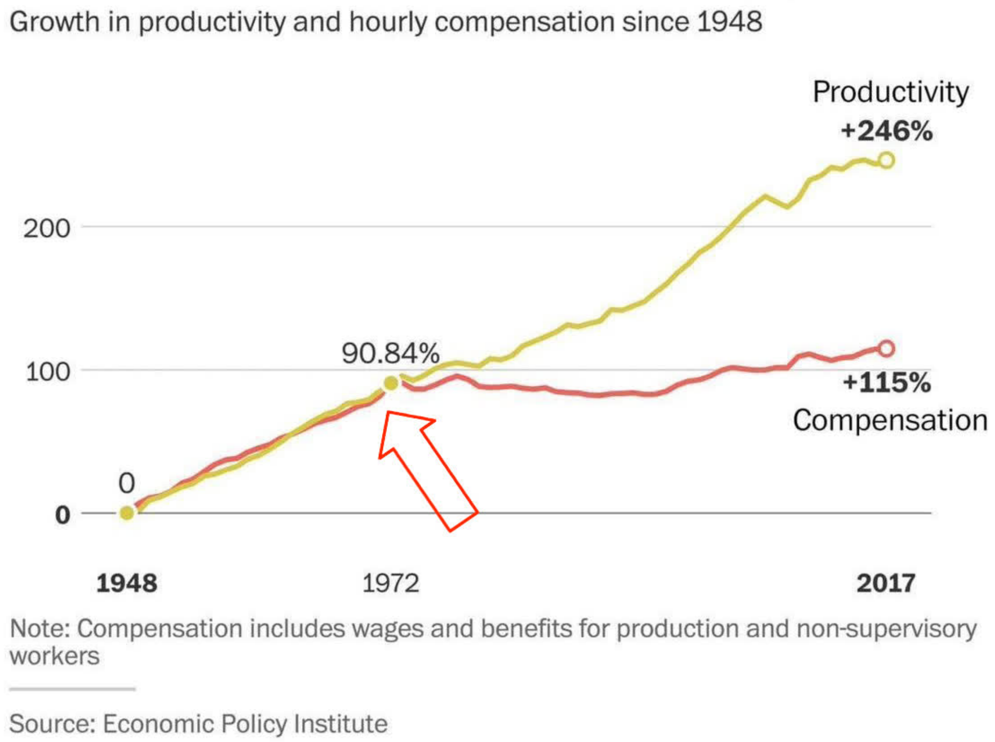
Kinds of Money

- ✧ Commodity: shells, sheep, cow, gold and silver coins are examples.
- ✧ Representative: tokens, coins, paper money can be used to exchange for gold and silver.
- ✧ Fiat currency is a money by government decree.
  - ■ For example, "One ounce of gold is 35 USD" (The Gold Standard, Bretton Woods, 1944).
  - ■ After Nixon Shock 1971, the USD is backed by nothing.

US dollars served as money up until the Nixon shock 1971.

- ✧ Nixon Shock (1971). Richard Nixon, the 37th President of US, ended the gold standard in 1971.
- ✧ With growing world economy (esp. German and Japan), the US share of economic output has shrunken and the trade deficit has grown.
- ✧ Wealth (USD) has flown outside the US and US had become no longer able to back the US dollars with the reserve gold.
- ✧ US Dollars since Nixon Shock are fiat currency which the central bank of the US (the Fed) can create more than the gold reserve of the US.

There are many reports that wealth inequality has worsened since the Nixon shock.



The Federal Reserve System

The Federal Reserve System (FED) is the central banking system of the United States of America, created on December 23, 1913, with the enactment of the Federal Reserve Act. It has seven board of governors, Federal Reserve Board(FRB), which are appointed by the US President. The FED has twelve regional Federal Reserve Banks. The twelve presidents of FRBs and the seven Governors form the Federal Open Market Committee which sets the monetary policy. FOMC meets regularly, four times a year.

FED chair is the chair of the FED board of governors. FED Chairs

- Jerome Powell
- Janet Yellen
- Ben Bernanke

Federal Reserve Notes (FRNs) are the US Dollars.
See Understanding How the Federal Reserve Creates Money.

They are fiat currencies. Fiat means a decree or an order.

These are currencies backed by sovereign bonds. For example, US Dollars are backed by sovereign bonds of the United States. But bonds are debts, i.e., IOUs (I owe you).

The U.S. Congress established three key objectives for monetary policy in the Federal Reserve Act:

1. maximizing employment
2. stabilizing prices, and
3. moderating long-term interest rates.[13]

The first two objectives are sometimes referred to as the Federal Reserve's dual mandate.[14]

Its duties have expanded over the years, and currently also include

4. supervising and regulating banks,
5. maintaining the stability of the financial system, and
6. providing financial services to depository institutions, the U.S. government, and foreign official institutions.[15]

It has a mixed structure of private and government. While the amount of money supply is determined by the FED, the United States Department of the Treasury, an entity outside of the central bank, prints the currency used.[23]

The federal government sets the salaries of the board's seven governors, and it receives all the system's annual profits, after dividends on member banks' capital investments are paid, and an account surplus is maintained.

In 2015, the Federal Reserve earned a net income of $100.2 billion and transferred $97.7 billion to the U.S. Treasury.[24]

Although an instrument of the US Government, the Federal Reserve System considers itself "an independent central bank because its monetary policy decisions do not have to be approved by the President or anyone else in the executive or legislative branches of government, it does not receive funding appropriated by Congress, and the terms of the members of the board of governors span multiple presidential and congressional terms."[25]

(See the Federal Reserve System, Wikipedia)

Financial Crisis, FED, and LSAPs

Chairman Bernanke's College Lecture Series: The Federal Reserve and the Financial Crisis

You can watch the videos, and download the lecture notes and the scripts.

Part 1: Origins and Mission of FED
Part 2: The Federal Reserve after World War II
Part 3: The Federal Reserve's Response to the Financial Crisis
Part 4: The Aftermath of the Crisis

Financial Crisis 07 ~ 08

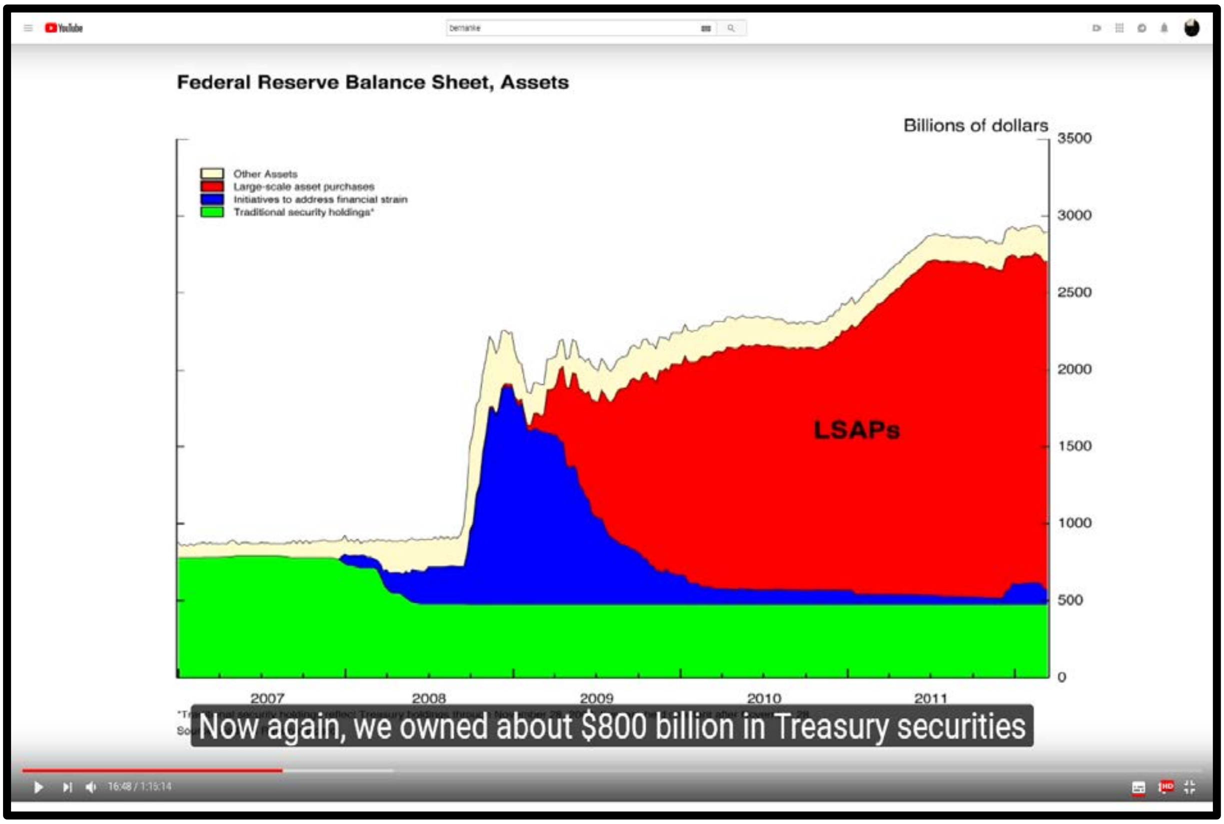
Financial panic means "you cannot withdraw your money."

- Pre 2007: Banks went loose in lending out risky loans. A strip club dancer got 5 mortgage loans. Banks mixed good loans with bad loans, and made AAA bonds.
- May 19, 2005: Michael Burry, the hero of The Big Short, closed a Credit Default Swap deal again subprime mortgage bonds with Deutsche Bank ($60 million).
- 2006: housing price peaked and mortgage loan delinquency started to rise.
- April 4, 2007: A real estate investment trust, called New Century, filed for bankruptcy.
- August 6, 2007: American Home Mortgage filed bankruptcy.
- Sept. 14, 2007: A bank run occurs at Norther Rock, a British bank.
- Panic spreads: Everyone holds on to their cash. They will not lend them out. Cash disappears. You cannot withdraw your money.
- Defaults occur one after the other.
- Sept. 18, 2007: FED stepped in as the lender of last resort, and started to lower interest rate from 5.25%.
- To Sept, 2008: Panic continued. Stock market tumbled. Bank run on money market occurred. Bankruptcy of Lehman Brothers (Sept 15, 2008).
- Fed saves AIG, Goldman Sachs, and Morgan Stanley.
- These banks are too big to fail. If government leave them fail, it will encounter chain defaults and avalanche of bankruptcies.
- Sept. 18, 2008: Bernanke requested a $700 billion fund to acquire toxic mortgages. "if we don't do this, we may not have an economy on Monday."

One of the most dramatic policy FED has adopted during this crisis is LSAP.

Large Scale Asset Purchases (QE) by FED
FED purchase US bonds and mortgage backed securities in open market operations. To lower the mortgage interest rate, FED started to purchase these securities. These bonds offer a fixed rate of interests. The yield of these bonds drops if the price of bonds goes up. FED’s purchase of these assets raises the price of these assets, and lowers the long term interest rate (mortgage interest rate). This helps the home owners to re-finance their home mortgage.

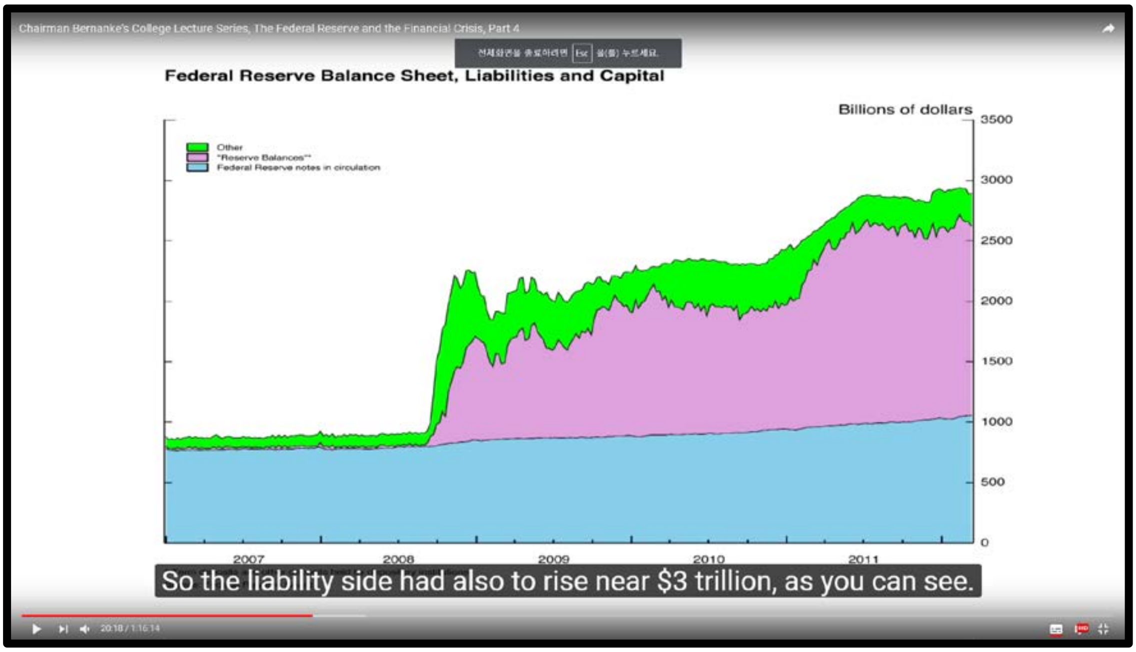
- Control long-term supplies of securities
- Raising the price of these assets
- Lowering the long term interest rate.



How did they pay for LSAPs?

Watch Part 3 of Benanke's lecture.

… the liability side had also to rise near $3 trillion… But as a literal fact, the Fed is not printing money to acquire these securities. The amount of currency in circulation has not been affected by these activities. What has been affected is the purple area. Those are the accounts that banks, commercial bank, holds with the FED. They are part of what's called the monetary base. But again, they are not – they certainly aren't cash.
Watch for yourself right here.



Causes of Financial Crisis

- Bank's predatory lending
- Government's guaranteed loans
- Moral hazard of bankers and home owners

Results of Financial Crisis

- Money injection into society created bubble.
- Rich got richer; they've got bailout; they did not get punished.
- Greater inequalities

1 percent vs. 99 percent. Data analysis from 1920 to 2015, the money made from monetary policy by central banks go to hike the price of assets but not to wages.

Monetary policy and the top one percent:

Evidence from a century of modern economic history

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April 2019

Abstract

This paper examines the distributional implications of monetary policy from a long-run perspective with data spanning a century of modern economic history in 12 advanced economies between 1920 and 2015. We employ two complementary empirical methodologies for estimating the dynamic responses of the top 1% income share to a monetary policy shock: vector auto-regressions and local projections. We notably exploit the implications of the macroeconomic policy trilemma to identify exogenous variations in monetary conditions. The obtained results indicate that expansionary monetary policy strongly increases the share of national income held by the top one percent. Our findings also suggest that this effect is arguably driven by higher asset prices, and holds irrespective of the state of the economy.

JEL Codes: D63, E62, E64

Keywords: Monetary policy, Income inequality, Local projections, Panel VAR

Reforming Wall Street

Wall Street cannot continue to be an island unto itself, gambling trillions in risky financial decisions while expecting the public to bail it out.

It is time to break up the largest financial institutions in the country.

The six largest financial institutions in this country today hold assets equal to about 60% of the nation's gross domestic product. These six banks issue more than two thirds of all credit cards and over 35% of all mortgages. They control 95% of all derivatives and hold more than 40% of all bank deposits in the United States. We must break up too-big-to-fail financial institutions. Those institutions received a $700 billion bailout from the US taxpayer, and more than $16 trillion in virtually zero interest loans from the Federal Reserve. Despite that, financial institutions made over$152 billion in profit in 2014 – the most profitable year on record, and three of the four largest financial institutions are 80% bigger today than they were before we bailed them out. Our banking system must be part of the productive, job-creating economy. The Federal Reserve, a government entity which serves as the engine of the banking industry, must eliminate its internal conflicts of interest, provide stricter oversight, and insist that the banks serve the economy in a way that works for everyone, not just a few.

The Evolution of Trust

Scientific American **318, 38 - 41 (2018)**

Published online: 19 December 2017

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Natalie Smolenski

- Banks and governments have in many ways failed to broker trust for the global economy, especially in the past few decades. Ordinary people have grown wary of centralized power and are seeking alternatives.
- Bitcoin—and blockchain technology in general—allows the brokering of trust to be shifted toward machines and away from human intermediaries such as bankers. This technology could design exploitation out of the system instead of punishing it later.
- Blockchains lend themselves both to human emancipation and to an unprecedented degree of surveillance and control. How they end up being used depends on how the software handles digital identity.

I am the 1%. Let's talk.

- Con:
  - FED, TARPs, LSAPs.
  - Gov. deficit spending
  - Socialism
  - Regulations
- Pro:
  - Small government
  - Free market capitalism
  - Entrepreneurship
  - Making money means creating jobs with new goods and services.
- If he did not pay the tax, he could have re-invested and made more jobs.
- It is the Government (the Fed) who created the bubble.

Peter Schiff at Occupy Wall Street "I am the 1%. Let's Talk"

조회수 1,265,631회 2.9만 2천 공유 저장

Economy, Currency, Government

- People want an *ever improving state of self* and economic position compared to what they have enjoyed in previous years.

- **Government aims to provide** what people want.
  Food and house
  Energy and water
  Safer environment
  Less work but improved life style with leisure
  Equal opportunity for limited resources
  Improved education for children

- Results:
  Politicians need to get re-elected.
  They make promises which can only be fulfilled by money creation.
  Money is poured into the society.
  Debt is growing.
  Government guarantees growth.
  More people live off of government guarantees.
  Asset price is soaring.
  Working people belongs longer to the middle class.
  More people find themselves in money trading.
  Less people work in the areas of producing goods and services.
  Entrepreneurship is reduced.
  Inequality grows.
  What result is the society in which honest work is less valued.

Today there are many issues which make us to think!

- Today, currency is not money.
  1. USD does not have any internal value (No more gold standard).
  2. Currency is created by banks when someone takes out a loan or government issues bonds (I.O.U.), or by increasing an electronic balance to the commercial banks at the whim of FED.
- With frequent financial crises, trust to government has been greatly tarnished.
  - People are grown wary of budget deficit and currency expansion.
- Issues around bitcoin are
  1. Decentralization
  2. Reforming Wall Street
  3. Reducing inequality
  4. Honest money
  5. Global asset and currency

Should we go back to the gold standard?

Could Bitcoin be a solution to these problems?

What do you think is the reason that the Bitcoin price getting higher and higher?