The New Asset Economy

by
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Pleasure and Pain Calculus

The British philosopher Jeremy Bentham was the founder of the philosophical school of utilitarianism, which had a profound influence on the science of economics during its formative years. In the view of the utilitarians, men are pleasure and pain calculators; and in this "felicific calculus," money is the measuring rod comparing alternative possibilities.

The flow through the markets of goods, services, and factors constitute the real economy. The acquisitions made in these markets are what matters in the utilitarian view, since only real objects can cause pleasures and pains. The counterflows of money that also passes through the markets are in this scheme of things merely what allows us to avoid the so-called "double coincidence of wants," the necessity to find someone who has what we want and wants what we have. Such cumbersome processes are avoided when money is used as a means of exchange, and, consequently, money facilitate the development of the highly complex networks of specialization in production and distribution embodied in the industrial system.

Within a monetized market economy, identification of counterparties becomes an institutionalized and in most ordinary cases highly predictable matter. Thus, although many links often are inserted into the economic chains spun between primary producers and final consumers, low transaction costs at each link nevertheless make it far superior and more economical that any other alternative methods.

The Veil of Money

Many of the classical and early neoclassical writers saw the importance of money in this vein, primarily connecting it to the functional convenience it gave to the economic flows. The true origin of economic value was to be found in the real economy and money mainly served by making exchange and specialization more efficient. Thus, though the "veil of money" – as they called it – sometimes might cloud the perception of the real economy, it didn't affect it very much.

This view is perhaps best reflected in a famous statement by John Stuart Mill: "There cannot be intrinsically a more insignificant thing in the economy of society, than money; except in the character of a contrivance of sparing time and labour."

Money was also the measuring rod used to express the results of pleasure-pain calculi. Again, it was viewed in an inert role that left the fundamental mechanisms of the real economy untouched except for the help its impartial measures offered men in rationally choosing the most advantageous path toward an optimal pleasure-pain balance.

Half a century after Mill, Marshall was still more or less in line with this view when he declared: "…money is the center around which economic science clusters...because in this world of ours it is the one convenient means of measuring human motive on a large scale." Although pleasures and pains in Marshall's more mundane world became 'satisfactions and sacrifices,' men were still busily occupied by double-entry bookkeeping over these balances.

This was the state of affairs when Thorstein Veblen published his first major opus, *The Theory of the Leisure Class*. Veblen's forte was that he mastered a much broader view than most of his contemporary establishment economists, as he was fully up-to-date with the developments in other social sciences of his day. This led him to put emphasis on, firstly, the Darwinist implication that economic institutions should be viewed as the products of accumulative social changes. Secondly, the necessity to incorporate the behavioral aspect offered by the psychological science when analyzing man's economic relations.

When man habitually uses money in exchanges, and compares everything in terms of money values, a psychological effect arises that changes behavioral attitudes and habits. Money no longer is just a convenience, facilitating exchange and production, but turns into an economic goal of its own. It no longer just measures pleasures and pains, but in itself might also be the origin of these. This turns money into an object shaping our social norms, causing its mere possession to serve as a sign of personal accomplishment and status. Mastery over money must therefore be shown at all times by "conspicuous consumption" – a term coined by Veblen.

When money acts as a powerful driver of men's motives, the functional operations of an exchange economy can also be seen from an opposite perspective. Goods and services are not merely produced in response to demands arising from primary utility needs, but to fulfill the money motive of the individuals in control of the production side of the economy. This perspective brings the asymmetric tendencies of the economy into focus, as it creates an incentive for the production controllers not just to be passive responders to incidental demand shifts, but to try and influence demand shifts toward patterns that best serves their money motives.

Meanwhile, the conspicuous consumption connected to money's status role creates another consequence in conflict with the neoclassical market theory. Goods and services in their real economic role as objects that satisfy functional needs have diminishing rates of utility. But this might not be so when they are acquired to serve as status symbols.

For instance, many of the executives exposed in the recent spate of corporate asset raiding scandals have been linked to lifestyles of an almost pathological extravagance. Part of this extravagance requires that they maintain lavish abodes and garages stuffed with high priced luxury cars in New York, London, the Riviera, and where else the displayers of conspicuous consumption congregate. However, as humans they still can only sleep in one bedroom at a time and, likewise, only be driven around by their uniformed drivers in one car at a time. Obviously, the functional utility value of each extra mansion and each extra car diminishes sharply, pretty much as it would do for everyone else. But seen as objects of conspicuous consumption, the status and role-play value of extra units of luxury items does not similarly diminish, but may even increase.

The Measure of Growth

The traditional definition of money is that it is as a medium of exchange (its transactional use) and a store of wealth. However, these two functions parted company in recent decades. Base money – whether it is bills stuffed in boxes under the bed or held as balances on transactional bank accounts – earns no or negligible interests, but remains the transactional media used in exchange. Contrary to this, liquid financial assets – often called near-money – earns incomes either as interest or capital gains, but won't be accepted in the local supermarket as payments. They have to be converted into transactional money first, either coins and notes, or a balance on a bank account accessible by sliding a debit card through the supermarket's card terminal.

The growing role of near-money, not only as the preferred store of wealth but also as a component of the economic patterns in general, is most visible in the US economy. Here transactional money (M2) grew 3 times from 1980 to 2000, somewhat less than the 3.5 times gain in nominal GDP, while liquid financial assets rose more than 5 times. Other developed economies, such as Canada, the UK, and Germany show similar trends, though to a lesser degree.

Modern economic theory remains focused on the real economy. When growth variables such as the GDP expand, it is interpreted as the result of changes in the real economy, for instance higher physical factor productivity, leaving money relegated to its old role of the numerator that measures the growth.

The Growing Role of Near-money

However, recent growth patterns put questions to the minimal role that economic theory still assigns to money. In the real economy, each exchange making up the economic flows involves the opposite movements of two equal values. The value of the goods and services that the seller sells must represent an equal value to the sum of money that the buyers pay, not only in the minds of the two individuals engaged in an exchange, but also in the accounting that our statistical capture of variable aggregates and their growth changes over time is based on.

This is not only the case with exchanges of goods and services, exchanges of liquid financial assets also involves such opposite flows intermediated by money. This means that when rising stock of wealth are reflected in rising transactional volumes of near-money, this impacts the size of the GDP. The implication is that we cannot be sure that registered growth in the GDP originates in the real economy. Seen in isolation, it might just as well reflect changes in stocks and derived transactional volumes of liquid financial assets.

A key facet of recent changes is that issuing near-money, both in the public and private sectors, increasingly financial expenditures. If debt is not liquid when issued, it is quickly securitized into liquid forms, or in other words, near-money. Similarly, a corporate CEO might for instance be paid mainly with stock options. If we assume that there is a rising surplus to collateralize this stock expansion, the dilution effect on the market value of already existing stocks will be negligible. Thus, an issue of near-money will have paid for an added expenditure – the higher remuneration of the CEO.

In some cases, the corporate profit growth, which collateralizes near-money expansion, might result from offshoring some of the corporation's manufacturing operations. Besides depressing local wages this also expands the country's trade imbalance. In the next step, it requires the government to run a budget deficit.

In the new asset based economy, the rising relative size of incomes derived from the expanding stock of liquid financial assets means that other income groups are being crowded out. As a measure of this, the incomes of the bottom four quintiles of US households fell from being 57 percent of national income in 1980 to just below half in 2000. This falling share includes large groups of wage-earners that have seen no growth at all in inflation adjusted dollars incomes during this period. On the other hand, the incomes of the top quintile, among which the holding of liquid financial assets are overwhelmingly concentrated, rose from being 43 percent to slightly over half of total national income.

The real sector of the advanced economies has been in decline for some time, partly due to the offshoring wave in manufacturing that in recent years has been followed by a similar trend in service industries. This point to the conclusion that GDP growth in the new asset based economy increasingly are lifted by the financial sector, fuelling growth in incomes and wealth holdings at the top, and not by the stagnating real sector of the economy upon which ordinary households mostly depends for their incomes.