

By Alec Feinberg
Based On Chapter 2, From the book
The Truth of the Modern Recession - Root Causes and Reliable Solutions

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The Growing Problem of Division of Wealth and Why it Contributes to Job Loss, Tight Money, and is Hurting our Economy

2.2: Understanding Economic Hoarding and the Velocity of Money

First we will use an analogy to understand our notion that hoarding could cause tight money, then later substantiate the issue for this recession with facts (since some economists actually might disagree with this premise). Initially, we'll look at an extreme analogy and then refine it. For the moment, consider that someone invents a way to attract rain with a new breakthrough device called a magnetic "rainometer" that has the ability to gather rain to one region of the world. What will happen? Somehow the magnetic rainometer doesn't allow evaporation back into the atmosphere for the rest of the world. As one might expect with this evil device, very soon a drought will be created everywhere else. In this situation, world governments would have to mix hydrogen and oxygen to create moisture. However, such moisture or rain created by world leaders would soon be futile, as it would again be collected by the magnetic rainometer. Now the inventor can control the water flow, its price, and the valve to turn it on or off anywhere in the world.

This is simply an analogy to help illustrate a problem; we have theorized that we are in the midst of an economic drought. It is logical to believe that the wealthy have created a kind of magnetic "moneyometer." We prefer shopping at Wal-Mart to buy low-priced items; we enjoy supporting high-salaried celebrities by going to their movies or sports events; we mainly buy Microsoft's computer products, and so forth. The government will mix ink with paper and create bailout after bailout. However, like the rainometer, their effort will be futile; the bailout money will eventually be collected by the magnetic "moneyometer." The wealthy have the economic "moneyometer" to attract our dollars and hoard them. The government actually has the combat weapon: it's called taxes. However, we have also surmised that the government doesn't have a reasonable tax structure to help keep money in circulation.

We currently have a theory, that this magnetic "moneyometer" makes our system problematic, because not enough U.S. dollars go back into circulation during a recession. Banks are reluctant to lend money. Our economic engine is sputtering along now. It is inefficient, and the flow of its fuel, namely money, is having problems circulating through our engine to all parts of our economy. We have poor economic reliability and performance, which also leads to job losses.

Money hoarding is a bit more complex than just the accumulation of wealth. It is related to the lack of circulation of dollars through our economic engine, as we have noted. Eduard Daladier, the Prime Minister of France, said the following during a London Conference in 1934:

In our economic system, money has the same function as blood for the body of human beings. In order to fulfill all the different functions of life, circulation of the blood must be ensured without interruption. With money it is the same—it necessarily needs to circulate in order to realize full employment.

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And herein is the major problem with our now global economy. Accumulation of great wealth can be devastating, especially in the time of a recession, principally when a small portion of the population (< 5%) apparently earns most of our revenues according to Figure 1.1. A person having great wealth can choose what to do with his money. This choice affects the manner and speed with which dollars enter back into proper circulation. Most individuals and corporations that accumulate great assets think more about preserving their funds than investing. In reality, they can simply live off of their savings. Investing can lead to helping money circulate and stimulating job creation and retention. (We discuss job-friendly investing in Chapter 8). It is no sin to save money, but hoarding (as we define below) is another matter.

In a time of a recession, individual bank savings and money market accounts (see Chapter 3 on money market accounts) end up effectively as “mattress accounts.” A mattress account is a common analogy referring to money stuffed away in a mattress—hoarded and out of circulation.

This is because many banks and money markets hoard cash so money doesn't circulate. Banks are very reluctant to take even minimal risks on loans in a recession (see Chapter 3). Money markets primarily invest in banks (see Chapter 3). This is our first piece of evidence.

Remark 2.1: According to *Forbes* (February 2009)—“Bank excess reserves (unloaned dollars) went from \$2 billion in August 2008 to \$267 billion in October 2008. As of the middle of January 2009, they had mushroomed to \$843 billion.”¹

It is hard to blame banks for being reluctant to lend when, for instance, the housing crisis hit a record high in quarter one of 2009.

Remark 2.2: “According to the *Associated Press*, mortgage delinquencies hit a record high in quarter one of 2009 where 12 percent of homeowners were behind on their mortgage payments or in foreclosure as the housing crisis spread to borrowers with good credit. And the wave of foreclosures isn't expected to crest until the end of next year, the Mortgage Bankers Association said Thursday.”²

Therefore, we see that the housing crisis is one root cause of tight money, as it creates an atmosphere for bank hoarding. However, there are other aspects to hoarding that need to be investigated to realize the primary root of our problems. Remember, we are seeking a reliable economy and real root causes and solutions, not quick fixes. Let's look more at some hoarding facts.

A good measure of our money supply is provided by a quantity in economics called **M1**. This is currency in circulation plus deposits (checking deposits, officially called demand deposits, and other deposits that work like checking deposits). The other

¹ www.forbes.com/2009/02/03/banking-federal-reserve-business-wall-street-0203_loans.html

² www.sfgate.com/cgi-bin/article.cgi?f=/n/a/2009/05/28/financial/f070037D89.DTL

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key quantity is **M2**. This is M1 plus savings deposits, time deposits less than \$100,000, and money market deposit accounts for individuals.

Remark 2.3: “It would appear the institutions and individuals are hoarding cash and cash equivalents. The percent change for M1 over the last 3 months (June 2008 to September 2008) has spiked to 19.5%. The six and twelve month percentage change is 11.4% and 6.4% respectively. Clearly this hoarding behavior is quite sudden and recent. M2 for example isn’t increasing nearly as fast at 6.8%, 4.0% and 6.2% over the last three, six and twelve months.”³

Remark 2.4: “Paulson is desperately throwing our money at banks in a futile attempt to convince them to lend. Instead, those banks are either hoarding the cash or acquiring more assets. In other words: Paulson is

helping the banks that were ‘too big to fail’ grow even bigger with taxpayer backing. Swell.”⁴

Therefore it becomes difficult to seek capital preservation for wealthy individuals through banks or money markets without hoarding. Great wealth frequently promotes hoarding that increases dramatically in a recession. Accumulation of great wealth creates an economic medical condition that, like an overweight person who is prone to blood clots and lack of circulation, dramatically affects all the vital functions of our economy. This lack of circulation, the slowing of the “velocity of money,” is a key factor of our economic reliability’s lifeblood.

Table 2.2 Key Definitions of Economic Hoarding

Hoarding Concept	Definition
Storage	The portion of accumulated wealth that is taken out of proper economic circulation.
Velocity (speed)	A decrease in the speed or velocity of money back into our economy typically equates to a hoarding effect. Other main factors that affect velocity are job growth or loss and quantity of goods and services (Gross Domestic Product)
Storage vs. Velocity	Hoarding is inversely proportional to velocity of money.

³ [Money Stock Measures](http://www.federalreserve.gov/releases/h6/current), www.federalreserve.gov/releases/h6/current). See also www.istockanalyst.com/article/viewarticle/articleid/2741143

⁴ *American Commentator*, Michelle Malkin, December 3, 2008

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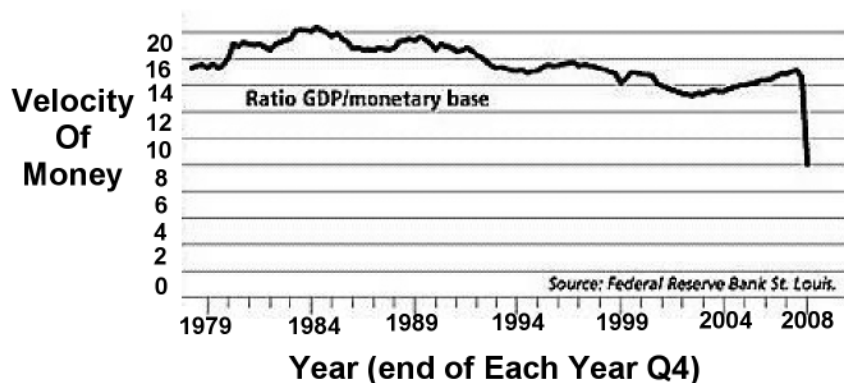
Table 2.2 defines two key definitions of economic hoarding. The storage concept is familiar to most people. It is the portion of accumulated wealth that is taken out of proper economic circulation. The velocity definition is somewhat more helpful as a measure of the speed for which money exchanges hands, similar to circulation of blood in our body. Another interesting aspect of the velocity of money is that it is somewhat useful as an indicator of consumer confidence.

Remark 2.5: “The velocity of money is probably closely linked to the confidence in the economy. If the confidence of the economy goes down so does typically also the velocity of money. Even if I have money to spend, I am less confident in the future of the economy. So it is rational for me to hold back a little even if the government should send me a check. I’ll just stash it away.”⁵

A more mathematical definition for the velocity of money is the average speed with which a dollar is spent given a certain amount of money, say, in a period of a month. The loss or decline of money circulation equates to degrees of hoarding. Velocity of money is a key economic factor. Higher velocity values reflect a relatively more free-spending society, with each dollar cycling through the economy more quickly. Lower values, on the other hand, indicate a relatively “stingy” society, in which each dollar circulates through the economy more slowly. Velocity of Money (V) is calculated as the Nominal Gross Domestic Product (NGDP) divided by the monetary base—money supply (M), or for those who like equations, a simple form is

$$V=NGDP/M$$

The importance of the velocity of money is clearly demonstrated in figure 2.1, which shows its rate of decline over the past 30 years.⁶



⁵ www.wilmott.com/blogs/collector/index.cfm/2009/2/15/The-Velocity-of-Money-and-Time-Stamped-Money, *The Velocity of Money and Time Stamped Money*, By : Espen Haug

⁶ www.fivecentnickel.com/2009/03/19/velocity-the-speed-of-money/

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Figure 2.1 Velocity of money over a number of years (Data from the Federal Reserve Bank).

More information is provided in this chapter. A number of chapters provide information on the division of wealth providing factual information of this key problem and lack of circulation of money. This is a major root cause of our Modern Recession that is totally ignored.