Mediating the Mercantile Machinations of the Market’s Middle Men

An attempt at evaluating the role of financial market institutions in our economy

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On my choice of topic

The supplementary material we received emphasizes the need for transparency, ie. the showcasing of process and progression. In this spirit, it would prefer us to first outline how we chanced upon the topic of our presentation. I must confess a certain skepticism towards such displays, as they often seem to value form over substance, the appearance of effort over actual insights gained. I, for one, cannot clearly communicate how or when the subject of participants in the financial markets first piqued my interest. It did, however, prove itself to be far better suited for the presentation exam than other ideas I was considering. Some, I discarded simply due to a dearth of literature (especially lack of empirical verification — econometrics is a young discipline still in it's infancy). Some, like my idea of structuring a presentation around the saying "There's no such thing as a free lunch", simply didn't lend themselves to a more nuanced inquiry, and yet other topics are simply *too* complex. I was forced to leave the Gold Standard to the people who have a better understanding of what they're doing.

It is fair to say, I think, that the sujet of market economies is simplified to an almost laughable degree in our political education. Indeed, true to the name of the class, we concern ourselves almost solely with mapping political conflicts and debate in which economics is occasionally cited as a marginal phenomenon. This in itself is nothing to take offense at, were it not for the fact that this divorce from economical reasoning is then presented as economical orthodoxy, a view that might be shared by mainline political discourse, but assuredly not by policymaking circles, let alone actual economists, whatever their convictions may be. It would not be unfair to assume the average student leaves high school with a degree of economic literacy that amounts to the vague sense that business cycles are a concept thought up by Messrs. Keynes and Friedman, one of whom had some vague reservations on fiscal policy. To make matters worse, political education clings to topicality the way a bureaucrat clings to their clipboard, perhaps hoping to conceal unpleasant complexity with a generously applied varnish of "current affairs", effectively sacrificing solid fundamentals and needed historical context for the appearance of being up to date (never mind the absurdity of discussing, say, Eurobonds in 2023, without mentioning the European debt crisis even once).

But naturally, I find myself in the same predicament. I am operating under comparable constraints and find myself both fascinated and frustrated by the sheer complexity of the numerous and intricate mechanisms by which financial intermediaries operate. Struggling to understand and make sense of it all, I'm forced to confront my own limitations, the fact that I could never truly grasp the entirety of this subject, that there would always be more to learn and more to consider.

So I must acknowledge the nature of this work as, simply, a snapshot, a timid attempt to cast light on a topic whose omission from the curriculum, while understandable, is still one that fills me with regret.

Background

A nation may be said to be tangibly wealthy when it has abundant natural resources, an advantageous position in the world's economy, or copious amounts of various goods. The wealth of a nation shall provide for its people's future wants and necessities, fulfilling these desires through its diverse offerings. Sometimes, this wealth yields directly consumable goods and services, but more often it elevates human effort and intelligence, thus providing the means for producing them. The intangible wealth of a nation, however, is immeasurable, for it encompasses the skill, knowledge, and character of its population, as well as the intricate framework of laws, customs, and social interactions that foster cooperation and community.

Elements of a nation's wealth maybe claimed as property, whether by the government or by private entities such as individuals or corporations (Locke, 1689). Some intangible assets, such as patents and copyrights, are also able to be appropriated. In capitalist societies, the majority of appropriable wealth is held by private individuals, with capital markets, where such property is traded, being a hallmark (Hayek, 1944). Yet, in a society devoid of slavery, the trading of 'human capital' is limited and restricted (Marx, 1867).

An individual may possess great wealth without claiming ownership of any assets that contribute the appropriable national wealth. Instead, their wealth may be accounted for in the form of currency and coinage, bank deposits, bonds, stocks, mutual funds, insurance policies, and pension rights. These are simply pieces of paper, representing claims against other individuals, companies, institutions, or even governments. In calculating an individual's net worth, one must subtract the claims held against them from the value of their total assets. When the net worth of all economic units within a nation are combined, the paper claims and obligations cancel each other out. Ultimately, if the valuations are accurate and the census is complete, what remains is the true value of the nation's wealth.

If the central government is excluded from the calculation, private net worth — the cumulative net worth of individuals, institutions, and subsidiary governments, considered part of the 'private' sector due to their limited borrowing capabilities — will not only include the national-wealth assets they possess, but also their claims against the central government. These claims take the form of currency, deposits in the central bank, and Treasury obligations with interest. Should the debts of the central government surpass the value of its tangible assets, private net worth will surpass national wealth. However, in determining their net worth, private individuals may account for taxes they expect to pay in the future to fulfill the government's debts. Some economists hold the belief that this subtraction is absolute, therefore public debt does not factor into aggregate private wealth (Barro, 1974), while others maintain that the offset is not complete (Tobin, 1980).

The financial system allows for the creation and exchange for paper contracts and claims, allowing for a more efficient market. Private net worth would at first only seem to be made up of components of national wealth, predominantly in the form of tangible assets, and obligations to the government, but is in fact made up of a labyrinthine web of debts and claims.

In this context, the distinction between outside and inside assets is a useful one, with outside money referring to the monetary debt of the government and its central bank, and inside money encompassing private deposit obligations of banks and other depository institutions. The definition of which deposit obligations are considered ‘money’ varies.

In the ecosystem of financial transactions, inside assets and debts cancel each other out, allowing individuals and businesses to improve their financial standing through borrowing and pledging property as security. Capital markets, including financial and property markets, are integral to this delicate balance, with money markets serving as a hub for the exchange of short-term debts for outside money.

Financial institutions play a crucial role in the economy, primarily engaging in the trade of financial assets. Their balance sheets are mostly comprised of paper, with only a small amount of physical property. The owners’ equity, or reserve fund, is minimal compared to the obligations of the enterprise.

Methodology

This work is mainly structured as a literature review. I make no claim to originality, I’m merely attempting to understand the current state of the field. Knowledge production in financial economics required me to model complex issues. Presenting my results required me to laboriously produce a large volume of redundant content.

In the beginning I mostly drew on Diamond’s and Dybvig’s famous *Journal of Political Economy* article, “Bank Runs, Deposit Insurance, and Liquidity.”, as well as some of Bernanke’s historical works. While I could’ve considered a great many more sources, including some works of popular economics, I instead chose to more deeply engage with a smaller number of especially renowned papers, and did not read any books about the 2008 financial crisis featured on the NYT Best Seller list.

In the implementation of my presentation, the exciting possibilities offered by the use of visual or audio-visual presentation methods caught my eye. The use of diagrams and charts is an invaluable help when giving a talk on economic policy, allowing me to better illustrate numerical data. Moving elements such as illustrative cartoon clips as well as self-created animations and graphics allowed me to present processes in an approachable, friendly, yet comprehensible way.

To make full use of the virtually limitless possibilities afforded to me by modern Microsoft PowerPoint™-like software, I turned to Microsoft PowerPoint™, a software package that allows the user to create a multimedia slide presentation. Microsoft PowerPoint™ combines a high degree of flexibility in design and numerous ways to animate and embed video. As the amount of citations I had to deal with was minimal compared to standard academic workloads, I decided to forego literature management software (e.g. Elsevier’s Mendeley). I also deliberately forewent analog forms of presentation such as the normally preferred poster, since these do not allow the medially diverse content preparation workflow Microsoft PowerPoint™ provides.

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Subject to Change

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