UCLAECONOMICS

Official Newsletter of UCLA's Undergraduate Economics Department

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Volume 9 | Issue 1 | Fall 2020

Published by the Undergraduate Economics Society:
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Professor Mosche Buchinksy Named 2020 Econometric Society Fellow

Moshe Buchinsky, an Econometrics and Labor Economics professor at UCLA, was recently named a 2020 Econometric Society Fellow. The Econometric Society is one of the most prestigious learned societies in the field of economics, with members from all over the world. The primary goal of the society is to promote studies that aim at a unification of the theoretical and empirical approach to economic problems.

Martha Bailey Awarded Russel Sage and NIH Grants

Martha Bailey, one of the department's newest faculty members has received grants for two new research projects. The first, titled "Measuring Intergenerational Mobility in the US over the 20th century" aims to quantify *national rates* of intergenerational mobility in terms of occupation, income and education. Her second project, M-CARES, aims to evaluate the role of the price of contraceptives in women's choice of contraceptive method, unintended pregnancy and her life outcomes.

It's a Bank's World: The Fed's COVID-19 Response Explained

Contributed by Katia Arami, UCLA Undergraduate Economics and International Development Student

Life has come to a halt with the onset of COVID-19 in the United States. Months of quarantining and we are just peering out of our 'Safer at Home' shelters — for those of us who are lucky enough to have one. Yet the imminent second lockdown seems to loom overhead as hospitalizations continue to rise, and is perhaps only days away. The government is alarmed, not by the rising deaths, but rather by the ongoing loss of economic activity. Their beloved GDP is shrinking right before their eyes. So how has the government responded to this economic crisis? The saner ones who have not opted for reopening the economy and letting the economically downtrodden head to their graves have pursued policies to keep the economy afloat. Today I seek to break down this response of the government.

To begin our exploration it is necessary to familiarize ourselves with the tools the government, particularly the Federal Reserve, has at hand. There are two methods of economic control by our government: fiscal and monetary. Fiscal involves the tax system and the active spending of the government in what is called expansionary policy. Monetary policy involves several mechanisms of controlling the money supply in the country, including:

- Open market transactions: transactions of securities (short-term bonds) that takes or puts money in the hands of banks
- The reserve requirement: the rate at which banks must must keep money on hand, limiting or promoting lending (generally around 10%)
- The discount rate: the interest rate which the Fed charges on its loans, expected to correlate that of the commercial banks

Through the aforementioned methods, the government can influence the economy and maintain growth, or so the hope is.

It must be noted that these do not take into account bailouts, a newly eminent economic policy through which the government refloats bankrupt companies and insolvent banks, or what some economists call "socialism for the top." Though the Fed is too embarrassed to admit that this controversial action has been added to its list of mechanisms, after the 2008 crisis it seems to be an important one. Now we wait to see if a new round of bailouts will make the public responsible for the misdemeanor of the corporations once again, but until then we must revisit the currently acknowledged tools of the government.

In March of this year, the Federal Reserve dropped a bombshell decision, they came out guns blazing, every single one of them, and all at once. What I mean to say is the Fed pulled all three levers of monetary policy in March of this year.

- They announced the purchase of at least $700 billion of Treasuries and mortgages, a continuation of quantitative easing that began in 2008 without any foreseeable end. Though it has now edged towards *trillions* since March put in the hands of the banks ($2.06 Trillion in 5 weeks)
- They lowered the reserve requirement ratio to 0%, meaning the banks can lend infinitely without any guarantee of solvency, essentially eliminating any regulation of their lending
- They dropped the interest rates to 0% overnight, allowing for banks to borrow without penalty

So how goes fiscal policy you ask? The government gave each qualifying American a measly $1,200 check while the other trillions (together totaling $2.7 Trillion thus far) went to programs distributed through (Guess who!) the banks. Programs like the Payroll Protection Program put money in the hands of the banks to distribute to small businesses to keep their employees employed and on payroll, but instead 4% of the loans accounted for 43% of the dollars (not-so-small small businesses, huh?). It should be no surprise that these corporations are the biggest customers of big banks and let's not forget, the ones who make up their portfolios in the forms of securities. Let’s expand on that.

With the economy at a virtual stand still, banks are not clueless to the gravity of the situation. They are not lending money to the average American or business owner, and this goes for both the financial and regulatory freedom they have received from monetary and fiscal policy. They are putting their money into the financial system, into securities and large corporations. Don’t be shocked that the stock market edges higher and higher as the nation hovers between 10-15% unemployment, sure to rise even higher after the Payroll Protection Program expires. The banks and the wealthy fuel the success of the financial economy while the real economy and the hoi polloi wallow in unemployment and nonexistent savings.

However, that is just the beginning of the fun for the banks. We must not forget to address the atomic bomb that the Federal Reserve dropped - the dazzling 0% reserve requirement, the nuclear weapon of monetary policy. This rate was once 20% for the first 50 years of Federal Reserve history and has been worn down to only 10% in the Fed's relatively recent history. That was until March 15th. This new move means the banks could theoretically continue to lend ad infinitum. And who is the preferred loan recipient of the banks? The corporations. In a new era of infinite liquidity, this should scare us, perhaps more than a pandemic that we could simply end within months with face coverings (… Alas).

In a report on the March 15th announcement by the Fed, Pam and Russ Martens of Wall Street on Parade reported, "One brave reporter on the Fed's press conference…, which was held by telephone, asked exactly how eliminating reserves was going to help businesses and consumers. Howard Schneider of Reuters [asked], … 'Did you get explicit agreements from [the banks] that this will go to customer finance and not something else?' Powell made it clear that the Fed had not gotten any contractual guarantees from the banks."

Now, we must remind ourselves, we never fixed the problem of 2008. The massive looming debt and irresponsibility of the banks has only increased since then. The situation is, in fact, very bizarre. Think of it like this: you give your child an allowance to buy school lunches for the year and they spend it on candy, so you again give your child the lunch money without even a slap on the wrist (this is the bailout). Then a week later you hand them your whole wallet to watch over! Mind you, a wallet with endless reserves. The Fed only assumes the appearance of having control over the economy, but in reality, virtually all of their policies put money in the hand of banks, the same ones who turned our economy belly up in 2008.

With a looming crisis and an endless cycle of debt, we have given banks the limitless credit card and asked them to refloat the economy and save the average American from poverty. If we are to respond realistically and adequately, it is high time we rethink economic policy itself. Or maybe, some more radical economists like Yanis Varoufakis would suggest, perhaps it is time to eliminate commercial banks altogether. Regardless, we await the next surge of the pandemic much like we await the next move of the unscrupulous government as it continues its fiscal hemorrhage and eyes the final unflipped switch: 'Bailout.'

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Capitalism and Inequality

Contributed by Amos Tong, UCLA Undergraduate Economics Student

We all live on a single planet, yet we live in different worlds. Depending on your income and wealth, your experience of the world can vary substantially. The existence of economic inequality in our society begs the question – how did this come about? For a short answer: capitalism thrives on inequality.

The bedrock of the modern capitalist economic system is that supply by firms and demand by consumers will agree on market price and quantity. On paper, a free market is supposed to bring perfect competition – numerous firms producing similar goods and consumers who are indifferent between them. The presence of competition means that only if the firms vie for every marginal customer can they thrive – indeed, survive. Aggregated, this would translate into a lowest possible price at the market level. This price is the equilibrium price, at which the firm's costs are equal to the firm's revenue – no profit is being made throughout the industry. If there is any profit to be reaped, new entrants to the industry will increase market supply until there is no more profit to be gained.

It only takes a glance at the state of the global economy to show how out of touch this theory has become from reality. Today, oligopolies and monopolies permeate the economic and financial systems. Massive multinational corporations extend their reach across the globe. Some technology companies, such as Apple or Microsoft, are worth more than the Gross Domestic Product of many countries. This is no surprise, since corporations exist for profit, by profit, and of profit. For profit, because all entrepreneurs are motivated by profit – this is the primary goal of any firm; by profit, because a firm can only survive and expand if it is profitable; of profit, because investors focus on profit as an indicator of the performance of a firm. Without profit, there is no production of goods and services. After all, who would want to put in so much effort to build and organize a firm if there are no rewards to be reaped? The entrepreneur might as well be a worker himself; at least he will earn some wages! This is the one aspect that economic theories failed to consider. As a result, it has dire consequences for human society.

The capitalist system allows for, and actively promotes, inequality. The advent of the Industrial Revolution gave birth to a new social class – capital owners. Prior to the Industrial Revolution, the richest men were the royal family and the aristocrats who owned land, some even owned people. However, the invention of mass production and the transformation of farmers into industrial workers allowed capital owners to control the means of production effectively. For the first time in history, a person's familial background does not factor into their eventual success definitively. Innovators and inventors were handsomely rewarded for coming up with novel solutions to optimize and streamline industrial production. The modern era of inequality had begun.

Nonetheless, the twentieth century changed the concept of inequality fundamentally as individual entrepreneurs in the United States, led by Henry Ford, reinvented the industrial process by introducing the assembly line. Workers, who relied on their specialist skills to accomplish tasks before, are now reduced to simple, menial chores. Unlike previous decades, where artisans were highly regarded and scarce in society, workers during the Industrial age are highly substitutable as their repetitive work does not require any sophisticated skill - therefore, there is a huge supply of labor. Thus, workers are disposable; if one worker does not work, there is always another worker to fill the space. With this, the worker's ability to bargain for higher wages also diminished substantially. The production line's efficiency enabled entrepreneurs to lower the cost of products and enlarge their market size as more people could now afford cheaper products. Many entrepreneurs utilized this strategy to amass more wealth, leading to an economic polarization unrivaled in scale. At one point, business magnate John D. Rockefeller alone was worth about 2% of the US Gross Domestic Product.

Fast forward to 2020, the world's wealthiest people are founders and CEOs of a different breed of corporations – tech giants. But the basic idea remains: many are self-made billionaires by producing innovative solutions to long-standing challenges. However, the nature of inequality has changed again. Unlike the Industrial Revolution (during and after), where workers were reduced to minute mechanisms along the assembly line, workers in the twenty-first century are relatively well-paid. The catch is that not all workers are well-paid. Workers in a few industries, such as technology, finance, engineering, healthcare, etc. are extremely well-paid. High-value added industries all require high education qualifications because work in those industries require expertise in specific fields. However, workers in other conventional sectors, such as manufacturing, observed stagnant real wages.

The difference between inequality then and inequality now is that instead of just a disparity between the entrepreneur and the worker, there currently exists an economic distinction among the workers. Professionals in niche industries – fin-tech, investment banking, cybersecurity, data scientist, etc. – bring home more than $100,000 annually. Contrast this with manufacturing workers who earn as low as $31,000 annually in the US. According to PewResearch.org, "[M]iddle-class incomes have grown at a slower rate than upper-tier incomes over the past five decades," and that "[T]he wealth divide among upper-income families and middle- and lower-income families is sharp and rising."

Moreover, tech giants have a completely different business model. In industrial capitalism, firms sold goods to consumers. In today's digitalized age, big tech sells consumers to products. As more and more people use the internet and become more active on social media platforms, technology companies and social media platforms collect massive quantities of data that could be sold to other companies to improve their business performance. This way, tech companies do not increase revenue solely from customer purchases and subscriptions; conventional consumer spending represents only part of the revenue sources for technology companies. What is more valuable is that these companies can track spending patterns, browsing history, clicks on a website, location history, and other valuable information for analyzing business performance. This way, the poor are essentially commoditized, unable to have any say over who controls their data, and how their data are treated. This time, capital in capitalism refers to data; the capital owners are the owners of big data – Google, Facebook, Amazon. The founders of these data-centric companies benefited from the commodifying of consumers: 4 of the 10 wealthiest people on Earth are founders of tech companies.

This points to a structural problem in capitalism; it propagates inequality at an alarming rate. But why and how do the wealthiest strata of the human population manage to increase their wealth so much more than everyone else? The answer is simple: the finance and investment industry.

The financial industry is intrinsically complex and a continually evolving sector. Since the first banks and the early stock exchanges, numerous financial products have been introduced and improved upon. The financial industry allows the rich to snowball their wealth by providing means for them to invest in government bonds and company stocks. In simple terms, the finance industry enables borrowings by firms and governments across the world. Governments promise to pay investors a premium – or interest, or coupon – for lending them money when they issue a bond. On the other hand, companies may borrow money from the market through equity or stock. When a company issues shares, it essentially sells the company's ownership to investors, who expect the share price to increase over time. The rich could put their savings to work and earn them even more money.

Even insurance companies, which market themselves as a protector of the lower class by providing financial protection for unforeseen expenditures, are investors themselves. The pool of money aggregated from those who subscribe to insurance services are then used to invest in financial products such as bonds, futures, securities, and stocks. The rise of financialization transformed industrial capitalism into a much more sophisticated version of its predecessor – financial capitalism. Financial capitalism describes "a stage of capitalism in which economic and political domination is exercised by financial institutions or financiers rather than industrial capitalists."

The effect of financialization on economic inequality is arguably worse than that of industrial capitalism. To satisfy the appetite of affluent investors, financial firms constantly innovate on financial products that are extremely risky. But with great risk, comes great returns. Thus, debt is freely bought and sold in secondary markets even though these debts are not rated by rating agencies such as Moody's. Even if they are rated, the ratings often do not reflect the actual risk of these securities. An example is collateralized debt obligation (CDO), where a group of loans, debt (such as mortgages), and other assets are pooled together and sold to investors. The idea is that if a diverse set of asset classes shares risk, then the total risk is not as high as if those risks were individually added together. Therefore, rating agencies can rate these groups of assets as "investment grade." This is the reason behind the 2007/08 Financial Crisis.

As people defaulted on their mortgages, the returns on CDOs were also affected. The financialization of capitalism meant that the economy is so intricately linked that a liquidity crisis (lack of cash by businesses and institutions) "can very quickly turn into a solvency crisis for financial institutions, a balance of payment crisis for sovereign countries and a full-blown crisis of confidence for the entire world." The poor are often hit the worst in financial crises. According to Harvard Business Review, this phenomenon is caused by the different types of assets that the wealthy and the less-wealthy own. As the rich have more disposable wealth, they tend to have a higher share of their income on stocks, whereas the poor and middle class have a higher share of wealth in housing. Therefore, housing booms will tend to benefit low- and middle-income groups more as compared to the rich. On the other hand, the wealthy have a diversified asset portfolio consisting of real estate, equity, stocks, and so on. Thus, rising asset prices only benefit the rich and not the poor. During periods of financial crisis, housing prices decrease substantially, whereas the stock market rebounds quickly, increasing economic inequality. The finance industry increases inequality in two ways. Firstly, it attracts money from wealthy investors and snowballs it; secondly, it leads to financial crises, which affects the poor disproportionately, if not adequately regulated.

It can be observed that since the Industrial Revolution, capitalism and inequality took on multiple forms, yet their underlying relationship remains unchanged. Initially, capital owners amassed enormous sums of money due to their ability to organize mass production of consumer goods while suppressing wages. Subsequently, the tech and financialization epoch transformed both capitalism and inequality. Industrial capitalism gave way to financial capitalism, aided by technological advances. The finance industry, through its complex financial products, also allows the rich to earn money as long as they are willing to take risk, endangering the livelihoods of the poor. As a result, the rate at which the rich accumulate wealth far surpasses that of the other classes, widening economic inequality. At the same time, wages between classes of workers also diverged; highly-skilled professionals observed skyrocketed wage increases while workers in sectors such as agriculture and manufacturing experienced no significant wage increases. Nonetheless, capitalism exacerbates economic inequality more and more with every passing day. It is simple, capitalism would not exist without economic inequality.

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