MULTI DIMENSION IMPACT ACCOUNTING (MDIA)

The Value Dynamic of Money

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Love of Money

'For the love of money is the root of all evil: which while some coveted after, they have erred from the faith, and pierced themselves through with many sorrows.' ...
King James Bible, 1 Timothy 6:10

Note that it is the 'love of money' and not money itself that is the root of all evil. I think that it is fair to say that this idea is even more relevant in our modern enviro-socio-economic system today than it was when these words were written.

But worse, money itself has been corrupted in very important and dangerous ways.

Money is one of the most important parts of our modern world, and yet it is also one of the least understood. Whether or not this is by design on the part of the leaders in the system is a matter for consideration, but not, perhaps at this time and in this article.

What is the 'Purpose' of Money

When I was a student of economics some 50 years ago, I remember being taught that money was 'a medium of exchange' and a 'store of value'. I argued as a student that this was only partially true and is far less true today.

> *I see banking and financial services as being very much like a lubricant in an automobile. The lubricant is essential to keep the vehicle running, but it is the motor and the gas that gives the vehicle the power it needs. Financial innovations move wealth around but they do not create additional real wealth.*

In the modern enviro-socio-economic system money is now not only the essential lubricant, but is also used as a measure that purports to give an indication of value. Perhaps more than anything money has become a device for the creation of apparent value where no real value has been created.

> *In 1948 my parents bought the house we were living in as sitting tenants for 700 pounds (then about $2,000). Recently this house sold for 480,000 pounds. Same house. Same location. But the pound (money measure) is different.*

And another case of money and value making no sense:

> *I bought a house in 1976 for $59,000. Two years ago this same house sold for $850,000. Same house, same place … but different money.*

Money as a Measurement is a Failure

Money has neither substance nor reality. It has become a fiction that sustains itself on top of a massive amount of ignorance and misinformation. It has none of the characteristics of a sound unit of measure.

> *The unit of measure for length is clearly defined by the International Standards Organization (ISO) and though length may be called different things, they all refer to the same physical entity. A kilometer and a mile have a fixed relationship to each other … and the physical distance does not change when these two measures are switched.*

The International Standards Organization (ISO) does not have a definition for money. Money as the unit of measure for wealth or value does not have any of the rigor used by the ISO for a physical measure. The relationships between the moneys of different countries changes all the time. As we have already seen, the relationship between a physical item and its value measured in money terms changes over time and very significantly

For most of history there were efforts to ensure that the value of money was not debased over time. This is one of the reasons for the so called 'gold standard' where the value of money was defined by reference to an ounce of gold. In that era, paper currency could be exchanged for physical gold held by the issuing organization as 'backing' for the currency. The last vestiges of that system were swept away when Richard Nixon was President of the United States more than 40 years ago.

Market Price and Value are not the Same

There are significant myths surrounding the idea of a market. For many items supply and demand and a market will result in a price for the buy-sell transaction. In my experience this system works better than when an organization like a government tries to set prices. The Soviet Government could not make an economy work on top of this type of price control, and when it was used in the USA after the 'oil shock' of 1973 it did not work either.

But market price only works when there is no asymmetry between buyers and sellers, and recent years it seems that every possible market is now subject to gaming where people with more knowledge are able to make transactions at prices that favor themselves. Managing misinformation in the modern economy has become big business.

There is a view that a market price of something is the same as the value of something. This is rarely the case. A human life has a value, but the ideas that this value can be determined by some sort of market mechanism is obscene.

Value, however, does have an impact on price. Buyers do not buy when a product or service has a price that exceeds the perceived value (in money terms) of the item. One of the reasons why healthcare is such a profitable sector in the United States is that sick people perceive that the value of medical interventions are very valuable, and healthcare suppliers are therefore able to price their services at a level that usually is extremely profitable. This business model ends up being bad for society … rich people can afford the high prices and poor people die.

Amazing improvements in the cost effectiveness of modern medicine is obscured because price is more correlated with perceived value than a reflection of cost.

It was almost 30 years ago that I first wrote something to the effect that the biggest cost in the modern US economy was profit. The cost to a consumer, is what a consumer pays … that is the price, and the price is cost plus profit.

Alternatives to National (and Regional) Currencies

The money centric establishment does not want to see significant changes to the status quo. National currencies like the US dollar and regional currencies like the EURO are in the mainstream and Central Banks like the Federal Reserve Bank together with law-makers and the established banking system want this to continue.

In spite the impediments, alternative currency systems do exist and they compliment the established national level currencies very well. In Switzerland there is a unit of currency called the WIR that has been in circulation since the 1930s in parallel with the Swizz Franc. It represents maybe as much as 20% of Swiss GDP. The WIR seems to help the economy by being somewhat counter-cyclical. There are several hundred very small alternative currency initiatives in the United States … such as Berkshares in Massachusetts. Typically these initiatives encourage local purchases at local businesses. It may be argued that many of the big business incentive programs like Frequent Flyer Miles are an embryonic form of alternative currency.

Alternative Metrics

We cannot make sense of the modern enviro-socio-economic system until we have ways to measure not only tangible 'stuff' that we buy and profit flows that we anticipate, but also those very important things that go into producing quality of life and impact on the environment that we have taken for granted until very recently.

The good news is that there is a rapidly growing body of research into what goes into quality of life and how the environment and the global eco-system works. The bad news is that most of this is complicated and not easy to understand and up to now there is no way for quality of life and the state of the planet to be accounted for and reported on in an easily understandable manner.

Corporate profits, prices on the capital markets and GDP growth are metrics that are easy to talk about. No easy metrics are available for what is happening to quality of life, and no easy metrics are available for the state of the planet. Financial analysts look at the future prospects for a company and convert that to a present value that justifies the price of the company's shares. There is no easy methodology to compute the present value of environmental disaster that might possibly have massive impact in the future.

The genius of conventional money profit double entry accounting is that it is amazingly simple and immensely powerful. It is at the center of even the most sophisticated corporate management information system. A key characteristic of money profit accounting is that there is a common language that enables big complex organizations to summarize their performance very succinctly and also to drill down to very specific elements in the complexity. There is, however, nothing like it to account for what is going on with quality of life and what is going on with the condition of the planet. This has to change.

There is a lot of initiatives trying to work out how this can be done. My view of these initiatives is that they are all incremental improvements on the status quo, and accordingly will not make much of a difference. In particular, they assume that better corporate performance will result in better impact on people and planet … and assumption that may have been valid through much of the last century, but has not been valid for perhaps the last 40 years. What I want to see is a data architecture that will enable accounting and accountability for every component of the complex enviro-socio-economic system … the profits of organizations, the quality of life of people, the impact on the planet … and the state of place … and the role of product and process in this system .. and the role of knowledge, governance, institutions, organizations, infrastructure, society and culture on all of this.

Effective metrics … scorekeeping … has to be easy to understand. The game may be complex and sophisticated, but keeping score has to be simple.

Dinosaurs are extinct. Are people next?

What is Money and What is a Security?

There used to be (in the United States) paper 'Bank Notes' which were issued by a bank to facilitate trade. They were more convenient than metal coin, which would have been the alternative. There was backing for these notes in the form of metal coin in the vaults of the bank. The banks realized early on that since the notes were required for commercial transactions, they could issue more paper bank notes than the metal currency or coin backing them because there would never be a case when holders of bank notes would call for repayment of the note in coin.

The banks also applied the same logic to money deposited in the bank by depositors. The money deposited could be used by the bank for income generation through investment and loans. Again the assumption was that depositors would not call for their money and a proportion of that money could be safely used without any problem.

From time to time these assumptions were wrong. People wanted their bank notes to be redeemed in coin or depositors wanted to withdraw their money from their accounts … and in some cases the bank could not meet these demands. Then there was a 'run on the bank' and in the past both bank, bank note holders and depositors were ruined.

This was very much the banking model in the 19th century, but something very similar but on a grander scale and much more sophisticated took place with the banking crisis of 2007/8. During the 20th century many important safeguards were introduced including the creation of the Federal Reserve System in 1913 as a Central Bank and issuer of bank notes, now called 'Federal Reserve Notes', the introduction of a system of deposit insurance 1933 and other regulation of the banking system. In recent years in spite the near disaster of 2007/8 there are pressures to roll back the regulation of the banking system because unregulated banking is very profitable no matter how much damage banking does to the society.

Where does Wealth come from?

Most wealthy bankers probably think that they have earned their wealth by their work as bankers. The reality is that the wealth of bankers was earned in some other sector of the economy and merely transferred from that sector into the banking sector by the machinations of the banking institutions and the money system of which they are a part.

This is not obvious … in fact it is downright confusing … when money is both the measure of the wealth, the substance of the wealth and a part of the mechanism that is used to facilitate the creation of wealth.

To a great extent money wealth is a mirage.

> *Consider how wealth is represented on the balance sheet of a business. A business balance sheet has three components: the assets, the liabilities and the owner's equity. Assets less liabilities equals the owner's equity. The owner's equity is a manifestation of the owner's wealth. In a big company, the owner's equity may be split into many shares (stocks) which are owned by many rather than a single person, and these shares may be traded on a stock market. Better yet, they may be traded at a price that is higher than the book value of the shares according to the balance sheet.*

Increasingly the value of share in a company as traded on a stock exchange are significantly higher than the underlying net assets of the company or book value as shown on the balance sheet. About 30 years ago the value of shares at market prices was some 30% higher than the book value. In recent years this has increased to around 75%.

The reason for this is that real assets that are on the balance sheet have become parts of processes that are extremely profitable. Technology has enable productivity, and this has resulted in higher production for less labor, better quality for less labor and in the end higher profits for a lower payroll. In turn higher profits means more optimistic investors and high stock prices and in turn again more wealth for owners.

There is no wealth for workers on the balance sheet … rather there is less wealth for workers because higher productivity leads to lower payroll and a society increasingly stressed by the continuous growth of income inequality.

The wealth of the world's wealthiest is based on ownership of something, rather than the work they have done and the income generated from the work. Investors drive stock prices in anticipation of the future, and assign value based on a multiplier of future performance. The ownership wealth at a moment in time may be many times what the real economy has produced in real wealth. This is one of many manifestations of growing wealth for owners and reduced wealth for everyone else.

> *The story of Mo Ibrahim in Africa is interesting. He was able to build out a mobile phone network (Celtel) in Africa that represented a considerable real physical investment. It was profitable and the future looked good. Ibrahim sold out to a bigger company at a price that made Ibrahim a billionaire and very much more than the book value of the company. The problem with this is that the new investor has to raise prices substantially in order to get the same return on investment than Celtel was getting on its smaller balance sheet. Net net this is a win for Ibrahim and a huge loss for the people who are the customers of the network.*

Another way of looking at this is to consider this from the perspective of various capitals. If we think of financial capital as being the owner's equity in a company, then this is the same as the net assets (assets less liabilities of the company) plus of minus the difference between the book value and the market value. As Centel invested to build out a cellular telephone network, there was both an increase in the financial capital as the earning potential of the network grew, but also increases in physical capital that benefited both the company and the society, and social capital as people now had access to an important tool for communications. In turn human capital also was increased as lives improves and communication resulted in more knowledge capital.

Markets and Money

The idea that a market enables the discovery of something's true value is widely held, but, in my view is entirely wrong and a very dangerous idea. There are assumptions that the market is perfectly efficient which it never is, and that all the parties have complete and valid information, which never happens. But it is even worse than this.

The value of money itself is also a function of a market situation. Markets respond to supply and demand … but the money system itself allows for creation of supply in all sorts of ways that are convenient without much of a basis in anything that touches tangible reality.

The balance sheets of the world's central banks, which includes the Federal Reserve Bank of the United States, expanded by about three times in the aftermath of the financial system meltdown of 2007/8. In other words, a supply of money was conjured out of thin air to ensure that the wealth of the owners of the banking and financial institutions would not vanish.

Table of Contents