

Conservation of money

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The current dominant theory of economics is Adam Smith's theory. He thought that supply and demand will reach a balance status due to invisible hand of market. The basic assumption is that all players in economics are rational. Thus, they can make a complete rational decision for demand and supply to reach economical equilibrium. However, this theory has severe problems. For examples: this theory cannot explain why economic bubbles occur in all economical history. Economic bubbles occurred several times in world history. When economic bubbles burst, the whole country suffers from a short or long period of economic depression. The whole economic system suffers from a detrimental impact. They are all due to irrational investors. General equilibrium theory means that equilibrium prices for goods exist and that all prices are at equilibrium. This theory was proposed by French economist Leon Walras. This kind of market equilibrium is called Pareto efficient. These economic bubbles point out that the great equilibrium of economics theory has a severe defect.

Here, I will propose a new theory for the general demand-supply market. I will apply the theory of energy conservation from physics law. This is called conservation of money. In order to prevent inflation, the total money (currency) in the whole market should be conserved. The central bank of any bank will tend to maintain the stable amount of currency in the domestic market. Thus, the total amount of money is unchanged. When the money is spent to certain market such as stock market, there will be winners and losers. Winners are the first people to enter the stock market by buying stocks with low price. And, the losers are the last people to enter the stock market by buying stocks with high price. Because of the conservation of money, the stock market won't rise even higher without extra money entering the stock market. Thus, this stock market with maximal currency will be turned downhill. Then, these losers need to sell out their stocks by high price and they lose money. However, the winners also sold out the stocks with high price and they get the extra money. In a simple sentence, some earn the money and some lose the money. Winners get money from the losers because of the conservation of money.

This new simple theory can explain the happening of economic bubbles. The

wicked winners buy in certain “potential stocks”. For example: internet.com stock. Then, they advocate that these kinds of stocks are very potential and have a lot of profits in the future. They can use media or advertisement to attract other foolish followers. Then, many poor fools will believe their words and start to buy in these “potential stocks” such as internet.com stocks. When the stock market starts to go higher and higher, it will reach a plateau because of the conservation of money. There no extra money for this stock market for buying in these “potential stocks”. Then, the stock market will “bankrupt”. The stock market will go downhill. Then, an economic bubble will burst up. This new simple but powerful theory can fix the defect of Adam Smith’s demand-supply theory and Leon Walras’s general equilibrium theory. It can successfully explain the economic bubbles. In addition, there is a key point in this theory. There is information asymmetry. These wicked winners have more information about these “potential stocks”. They know much better than those poor fools. In addition, they can control the opinions of the mainstream media and advertisement. That is the reason they can control the stock market. They can also use economical psychological effect to attract these poor fools to buy in these “potential stocks”. Then, they will get high profits from these poor losers. As for the foreign exchange market, the wicked winner could be the risky investors and the poor foolish losers can be the government. There is money conservation: some win, some lose.

There is another variant of this money conservation theory. There could be a short term of extra money from other countries to enter the domestic market. For example: the Great Depression of America. After the World War I in Europe, many European thought that Europe was not safe and they started to invest the American stock market. Because of the excessive hot money, their behaviors let Americans think American stock market will go higher forever. Then, these poor fools followed and bought in some “potential stocks”. However, the excessive hot money is only short termed. These hot money went back to Europe soon because European could not invest American stock market for too long time. When the excessive hot money was withdrawn from USA market, the USA stock market started to go downhill. This is the “bankrupt” of USA stock market, and Great Depression occurs. Although there are other reasons contributing to USA Great Depression, excessive short term money still plays an important role. This theory pointed out that short term excessive hot money is the cause the burst of economic bubbles. This theory is useful and powerful. The continuity equation for conservation of money can be expressed as:

$$\frac{\partial \rho}{\partial t} + \nabla \cdot \mathbf{J} = 0$$