Forum: Economic and Social Council

Issue: Preventing the formation of economic bubbles to ensure economic stability, with an emphasis on blockchains

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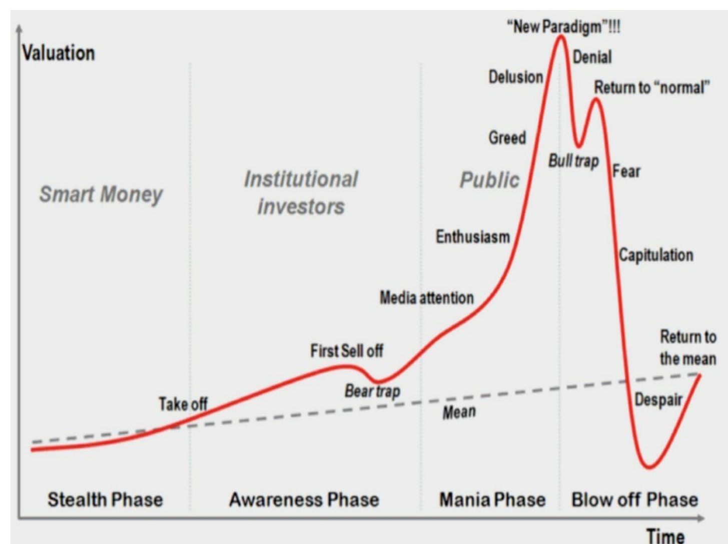
Position: President

Introduction



Peter Kugis of Stanford University explains, "A bubble is where investors buy an asset, not for its fundamental value, but because they plan to resell, at a higher price, to the next investor." An economic bubble (also referred to as a market bubble, a price bubble, or a speculative mania) is a system in which the price of an asset is not justified by the actual worth of that asset, but is instead driven by the over-exuberant behavior of investors and their implausible views about the future. In other words, a bubble is created during a period of unusually high demand, when an asset is traded at a price range that is far above its intrinsic value. A bubble eventually bursts when the high demand decreases and investors are no longer willing to pay the extremely high prices. This results in a massive sell-off, which is followed by a drop in the asset's value -severely damaging anyone who had invested in the asset and thus impacting economic stability. The issue of economic bubbles has been relevant for almost the past four centuries. The first bubble occured in the 17th century when investors were suddenly interested in importing Dutch tulips. According to Charles Mackay, one tulip was valued at "Two lasts of wheat, four lasts of rye, four fat oxen, eight fat swine, twelve fat sheep, two hogsheads of wine, four tuns of beer, two tons of butter, one thousand lbs. of cheese, a complete bed, a suit of clothes, and a silver drinking cup". This was followed by a sudden drop in interest when an infection destroyed the tulips, and the investments were lost. The most recent examples of bubbles include the Dot-Com Boom and the Housing and Credit Crisis.

Blockchain is the technology in which cryptocurrencies such as Bitcoin and Ether operate. It has been suggested that the cryptocurrencies powered by blockchains are creating the next

economic bubble. In fact, it can be argued that crypto-trade is the definition of a bubble: there is no actual product or any actual worth, and the entire trade is based on the behavior of investors. Considering that Bitcoin recently reached a market cap of 323 billion dollars, it is clear that the financial bubble of crypto trading is fastly getting larger, and thus presents risks to the global economic stability.

Definition of Key Terms

Cryptocurrency: A digital currency operating independently of a central bank.

Monetary liquidity: Extent to which a market allows assets to be bought and sold at a stable price.

Financial volatility: Statistical measure of the dispersion of returns for a given security or market index.

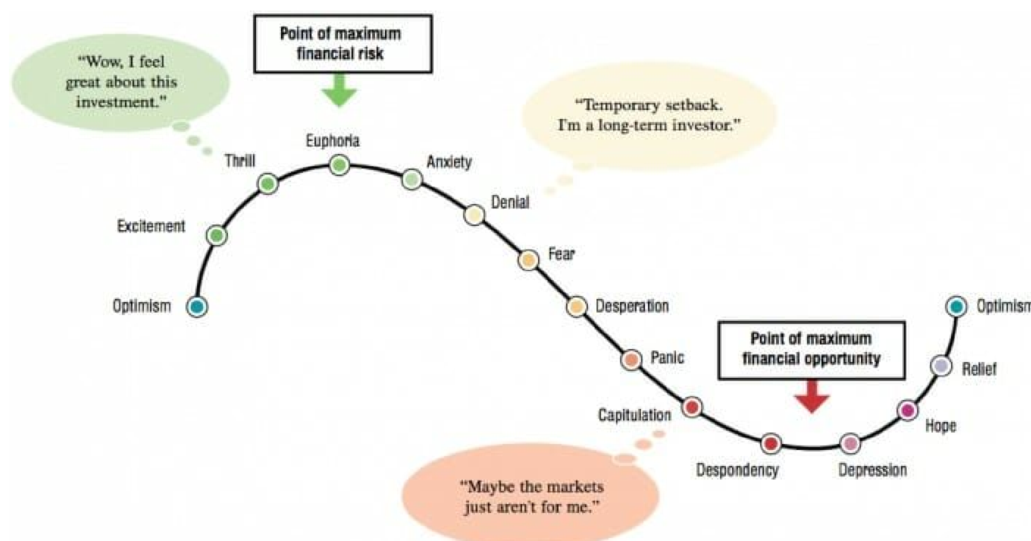
IPO: Stock market launch in which shares of a company are sold to institutional investors.

Market capitalization: Total value of all a company's shares of stock.

Economic stability: A low inflation rate and only minor fluctuations in output growth.

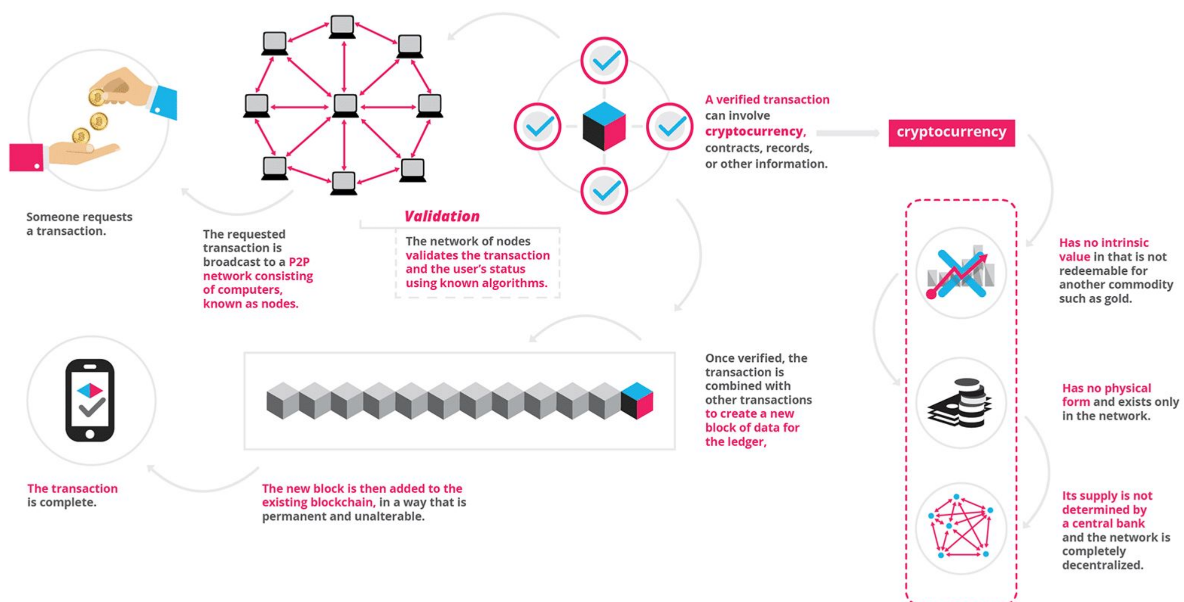
General Overview

Economist Hyman P. Minsky identified five main stages in the cycle of an economic bubble. The first stage, displacement, starts when the investors get interested in a new form of asset, due to either technological developments or historically low rates. Second step, boom is when prices begin to rise and trigger an urgent sense among investors to jump into a financial opportunity. Euphoria is the third stage of a bubble, and it is the almost-utopic period in which the prices skyrocket and any need for caution is abandoned. Profit-taking is the fourth part when some investors begin to fear that the prices will not remain at the high rates and start selling off. The final stage of any bubble is panic: the asset's worth rapidly drops and investors try to liquidate, regardless of the price at which they are able to sell. This five-stage cycle has been evident in all economic bubbles throughout history; larger the bubble, the more damage was done when it



eventually burst. It’s been seen time and time again that the repercussions of a financial bubble can be very harmful. The biggest financial crises of both the 20th and the 21st centuries were in fact somewhat caused by giant economic bubbles that burst, both of which were in the United States. After the 1920s, in which Americans experienced great economic development and invested heavily in the stock market, the boom of stocks dropped and triggered the Great Depression. In the 21st century, after US housing market rapidly inflated prices for many years, the drop in 2007 was perhaps the biggest cause of the Great Recession. Nevertheless, bubbles do have some benefits as well: they temporarily create jobs and increase wages, and they also drive innovation, typically with start-ups. However, it is a general consensus that when it comes to financial bubbles, the cons outweigh the pros.

There are many variables that cause the formation of a bubble, and most experts disagree on the main reason why the price of one specific asset is suddenly inflated. Some research suggests that it takes place without any reasonable justification, while others indicate a correlation with price coordination and other varying factors. One possible cause of bubbles regards the overall system in which financial systems operate. There is an excessive amount of monetary liquidity, which leads banks to develop reckless lending policies and thus increase leveraged speculation. Axel Weber, the former President of Deutsche Bank, explained: “the past has shown that an overly generous provision of liquidity in global financial markets in connection with a very low level of interest rates promotes the formation of asset-price bubbles.” A more sociological reasoning behind economic bubbles is the greater fool theory. People who choose to enter the bubble may not believe what they’re buying is useful but they believe (or they are told) that someone in the future will pay them more for the asset than what they paid themselves. The reasoning is that there is always a greater fool out there, but at some point, there is the last fool. Other suggested sociological reasoning includes herding behavior (assuming that most people cannot be wrong), short termism (considering the recent past and short-term future while making financial decisions) and cognitive dissonance (filtering out negative news and reinforcing ideas). Federal monetary policies and global imbalances should also be kept in mind while examining an economic bubble.



The formation of economic bubbles has rapidly increased in the 21st century. While a bubble used to be considered an extremely rare event, they have become an almost common occurrence. There are some warning signs of a financial bubble: extra tight credit, extra low volatility, rising short rates and flattering curves, elevated usage of debt, high marketing for an asset, incentives, international trade imbalances, and general complacency. The real estate market shows all of these signs, especially in the US and Canada, mostly due to extremely loose regulations. California house prices have gone up 69% since 2010, while the Canadian house market has increased by a shocking 1040%. The stock market also exhibits signs of being in a bubble. The FAANG stocks (Facebook, Amazon, Apple, Netflix, and Google) account for 30% of the S&P 500 index gain and, even though they are the biggest tech giants in the world, their stocks are inarguably overpriced. The credit and indexing industries are also believed by some to be inflating giant bubbles. One industry that symbolizes the very definition of a financial bubble is that of cryptocurrencies, which is operated by blockchains. At its most concrete level, blockchain is literally a chain of blocks -the block being the digital information stored in a public database. Blockchains verify any transaction and store the necessary information. This information is relatively secure, but is accessible by anyone on the blockchain network. The cryptocurrencies that are made possible by this technology, such as Bitcoin and Ether, are products that in a way do not even exist. It is an fueled entirely by the behavior of investors, without any actual worth. The fact that Bitcoin started out with zero value and is now being traded at 16.000 dollars, reaching a market cap of over 300 billion dollars, is an unbelievable accomplishment for the almost Ponzi-minded founders of this currency system, but represents a great risk to the global economic stability.

Timeline of Events

1637	The first bubble in history was formed when investors paid unjustified attention to imported tulips, thus raising its prices. The tulips were eventually destroyed by a virus.
1720	The South Sea Company was granted an exclusive charter by the UK government to trade in the south seas. The company took on investors by promising great riches from explorations, which proved to be a completely false claim.
1720	Similar to the South Sea Company, the Mississippi Company was authorized to explore the Mississippi River in order to find gold and silver. This was a way for the US government to eliminate their mounting debt. Demand for company shares skyrocketed, which led to the standard five cycles -ending with the bubble being burst.
1840s	New railroads sparked a technology boom for the United Kingdom, and market prices exploded. The amount of money spent on railways was at one point more than double

	what the money spent on the British military. The worth of investments began decreasing rapidly, the famous novelist Charlotte Bronte noting: “Many, very many, are by the late strange Railway System deprived almost of their daily bread.”
1926	Florida developed reputation as a tropical hotspot after World War I, and people began buying and selling land with reckless strategies. People forked over the down payments and then resold at a profit before the full balance was due. Charles Ponzi tricked out-of-state buyers into purchasing plots of land supposedly located in Jacksonville. The properties actually sat in a swamp some 65 miles away.
1929	The rising values led to an extreme interest in the US stock market. The economy started slowing down and there were mini-crashes caused by the Fed’s warning and the London Stock Exchange’s crash. Though these mini-crashes were resolved by the banks, the crumbling foundation was eventually exposed. In four days, Dow Jones lost -adjusted for inflation- 400 billion dollars in value.
1980	America was weakened by high inflation and unemployment, and that fear drove up investments to gold -a commodity which was viewed as a safe bet. This was shortly followed by a selling panic and the values rapidly dropped.
1989	The Yen was rising due to trade surplus and a loosely regulated banking system. This resulted in a boom in the Japanese real estate prices, which was followed by a 99% fall in value.
1990s	Perhaps the best example of the irrationality of economic bubbles was the Beanie Babie bubble of the 1990s. Stuffed animals made by the company Ty were pursued heavily by the media, speculators, and collectors. One toy was at one time was being sold at almost 200.000 USD. Unsurprisingly, the entire system eventually collapsed.
2000	The .com bubble (referred also as the NASDAQ bubble) took place when the revenueless networking company Sycamore Networks IPO’d with a market cap of 14 billion dollars. Investors once again extremely pursued the .com stock and day-trading became a common occurrence. 5 trillion dollars were lost in the aftermath.

2007	After years of increasing value, the US housing market peaked in its prices in 2006. The values started to decrease in 2007 -the Case-Shiller home price index reporting it as the largest price drop in history. The subsequent credit crisis was an important cause of the Great Recession.
2017-present	Bitcoin, a cryptocurrency powered by blockchain technology, reached its peak value of 19.276 dollars and a market cap of 323 billion. It's value has since dropped to 3.872 dollars. Another cryptocurrency, Ether, reached its maximum value at 1.152 and is now down to 204 dollars. Combined, these two cryptocurrencies' market caps have lost more than 300 billion dollars.

UN Involvement

The involvement of the United Nations in the issue of financial bubbles, as well as the topic of cryptocurrencies, has been extremely limited. The UN has published a few research memos and policy briefings regarding these issues, but has failed to take any concrete action. This is somewhat understandable considering the fact that all economic bubbles fall under the inner affairs of that nation, but it should be kept in mind that any bubble being burst -such as the blockchain bubble currently in the works- would have severe global impacts, and, therefore, should be prevented.

Relevant UN Documents

Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, March 2009

Evaluation of Previous Attempts to Resolve the Issue

The response of the United States government to the 2007 Housing Crisis is exemplary of all government interventions after a bubble is burst. The Federal Bank was hand-and-deck and led the banks back into safety. Some of this was done by pushing helpful regulation, while some banks that were falling apart were bailed out in order to protect the Deposit Insurance Fund. A stimulus package was also implemented by the Obama administration, so that the record unemployment would decrease. The Dodd–Frank Wall Street Reform and Consumer Protection Act was subsequently passed as a future caution, but its inarguably weak regulations ,currently, do very little to prevent another economic bubble. This situation unfortunately highlights that the formation of bubbles will always be a possibility in a capitalist system -unless of course all nations suddenly adapt to Bernie Sanders' vision of "No bank too big to fail, no executive too powerful to jail." However, this possibility could be significantly lowered by adequately addressing and at least somewhat resolving this issue.

Possible Solutions

Many economists claim that bubbles cannot be identified in advance, so they cannot be prevented from forming. In that case, the government is responsible of addressing a bubble's aftermath with monetary policies. However, almost any financial crisis traces back to insufficient government regulation, and this could not be more clear in the issue of economic bubbles. As long as there is no limit on how banks operate while giving out loans, anyone can invest in any asset they wish, even if they don't have the money to pay for it. This creates the perception that they could invest a downpayment -without being able to afford the actual amount- and then sell to the highest bidder. This perception is fueled by the aforementioned greater fool theory and is a giant cause behind the formation of bubbles. Blockchain-based cryptocurrencies -which by all indications will become the next big bubble- are also subject to very few rules and regulations. There is even an active debate on whether or not to accept Bitcoin as legal currency. The government encouraging or even allowing the idea that a currency which is not based on any actual worth could or should be considered valuable is the recipe for financial disaster. That is why an obvious solution is for the governments to intervene, yet this solution faces many challenges. First of all, the government interfering in the private sector is completely against the libertarian school of thought. The United Nations interfering in the business of federal governments to get them to interfere in their private sectors would be even more of a stretch. However, if it can be conclusively argued that economic bubbles present a global threat, the UN could employ incentives or sanctions in order to impose at least some common ground regulation; such as a cap on what could be lent by the banks for investments or rules regarding cryptocurrencies. Furthermore, the Fed could increase rates in order to decrease the availability of reckless loans.

While any issue can be addressed by raising public awareness, this could actually be key in the topic of economic bubbles. It is the public who creates the bubble by unreasonably investing in a certain asset, so if they were more knowledgeable about this process, they would presumably not as comfortably enter financial bubbles.

Notes from the Chair

The belief that history repeats itself is evident throughout this report, since every economic bubble follows the same exact pattern and every one of them ends in a financial downfall. One very good question to ask would be: why are we falling into the same exact trap over and over again? The answer can vary from insufficient government regulation to an unreasonable amount of greed that is embodied within the capitalist system, but addressing this question is key in figuring out how to break this vicious circle. Cryptocurrency trade is a perfect example of how an economic bubble is formed. That is why the emphasis on blockchains should not be overlooked, and should instead be carefully examined while writing a resolution on this issue.

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