

# History of Finance

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## □ Course Descriptions & Objectives

- This course is intended to provide students with a solid background to understand historical developments of financial institutions and financial markets.

## □ Readings

- Niall Ferguson, *The Ascent of Money: A Financial History of World*, Penguin USA, 2008.
- Kindleberger, C. *Manias, Panics, and Crashes: A History of Financial Crises*, John Wiley and Sons, 2005.

# Course Overview

- Part I: Money and Banking
  - ▣ Origin and Development of Money and Banking
- Part II: Bond Markets
  - ▣ Origin and Development of Bond Trading
- Part III: Stock Market
  - ▣ Origin and Development of Stock and Stock Exchanges
- Part IV: Central Banking
  - ▣ Origin and Development of Central Banking

# Lecture1: Ascent of Money, an Overview

- Introduction and Overview
- Why Money or Finance?
- Attitudes to Money
- Financial phenomena to be explored
- Money versus Moneyless Society

# Why Money or Finance?

- Introduction and Overview
- Money in different names
  - ▣ cash, currency, riches, finance, wealth, income
- Meaning of money, Relevance of money in daily life
  - ▣ What is money? Does money matter?
- Attitudes to Money
  - Measure of success, the root of all evil, the shackles of labor, a mountain of silver?

# Money and Income Gaps

## □ Income Gaps

- In 2007, the income of the average American, was just under \$34,000, while the CEO of Goldman Sachs, earned \$73.7 million.
- Goldman Sachs's total assets for the time passed the \$1 trillion mark, it's net revenues of \$46 billion' which exceeded the entire gross domestic product (GDP) of more than a hundred countries, like Croatia, Serbia, Slovenia, Bolivia, Ecuador, Guatemala, Angola, Syria

# Money (or Finance) on larger scale

- In 2006 the measured economic output of the entire world was around \$48.6 trillion.
- The total market capitalization of the world's stock markets was \$50.6 trillion.
- The total value of domestic and international bonds was \$67.9 trillion.
- Every day \$3.1 trillion changed hands on foreign exchange markets, every month \$5.8 trillion changed hands on global stock markets.

# Money (or Finance) on larger scale

- The volume of leveraged buyouts surged to \$75 billion, volume of 'securitized asset', asset-backed securities and collateralized debt obligations above \$3 trillion.
- The volume of derivatives contracts such as interest rate swaps or credit default swaps (CDS), traded 'over-the-counter' over \$400 trillion.

# Collapse of finance in 2008

- Bear Stearns:
  - rescued from collapse by J P Morgan, Countrywide: taken over by Bank of America, Merrill Lynch: suffered the same fate, Lehman Brothers: bankrupt had gone bust.
- Citigroup:
  - had lost \$18.7 billion, wiping out most of its earnings since 2005 , while Merrill Lynch had lost \$35.8 billion, wiping out its earnings since 1996.



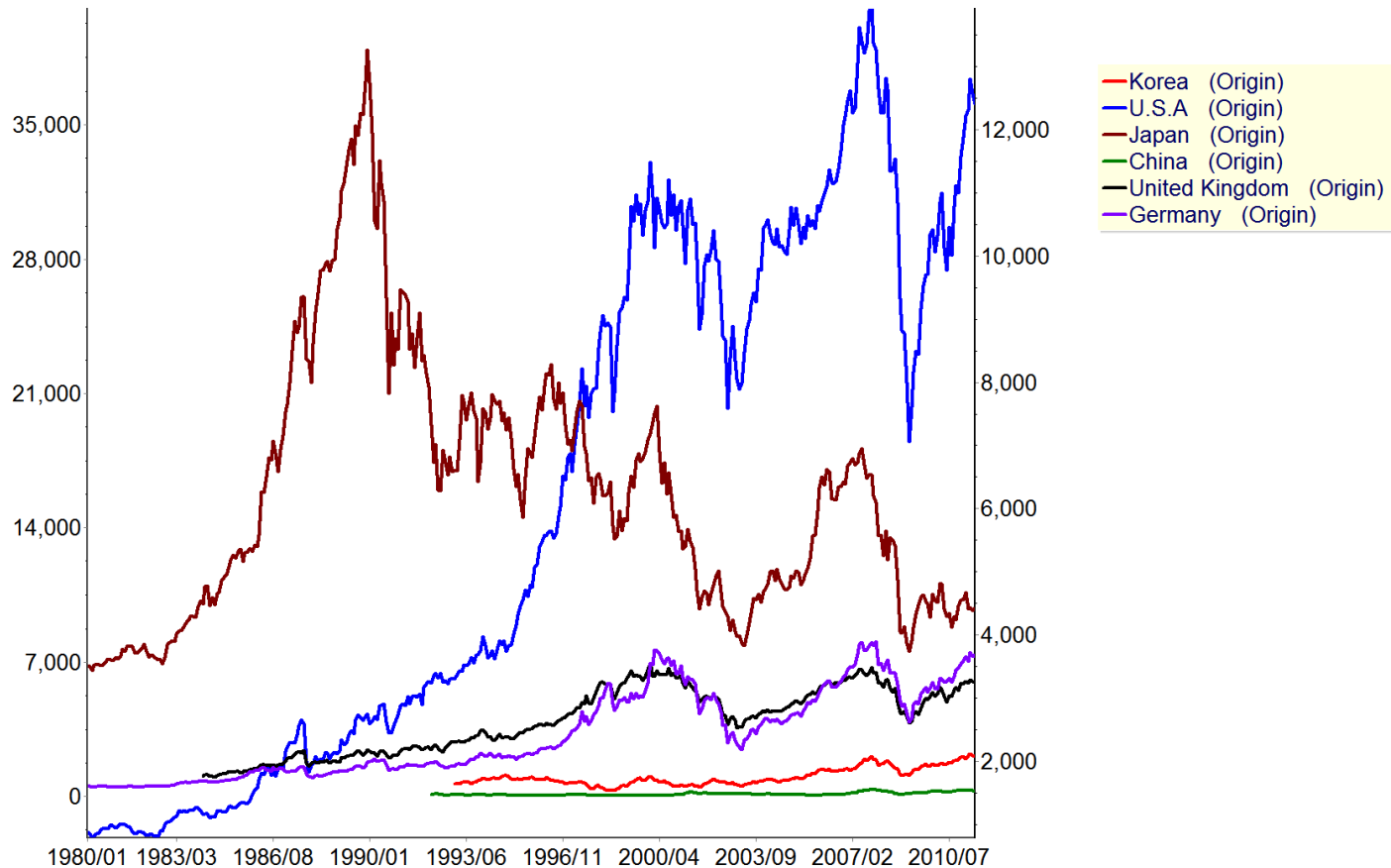
# Collapse of finance in 2008

- Goldman Sachs and Morgan Stanley:
  - ▣ had both been forced to convert themselves from investment banks into bank holding companies.
- Banking Troubles in sum;
  - ▣ All the surviving banks had accepted capital injections from the US Treasury under the TARP
  - ▣ Despite government assistance, their share prices plummeted, forced nationalization for some of them.
  - ▣ By February 2009, shares in Citigroup, for example, had fallen from \$55 in June 2007 to \$1.49.

# Historical stock prices

KOSPI 1980.1.4=100

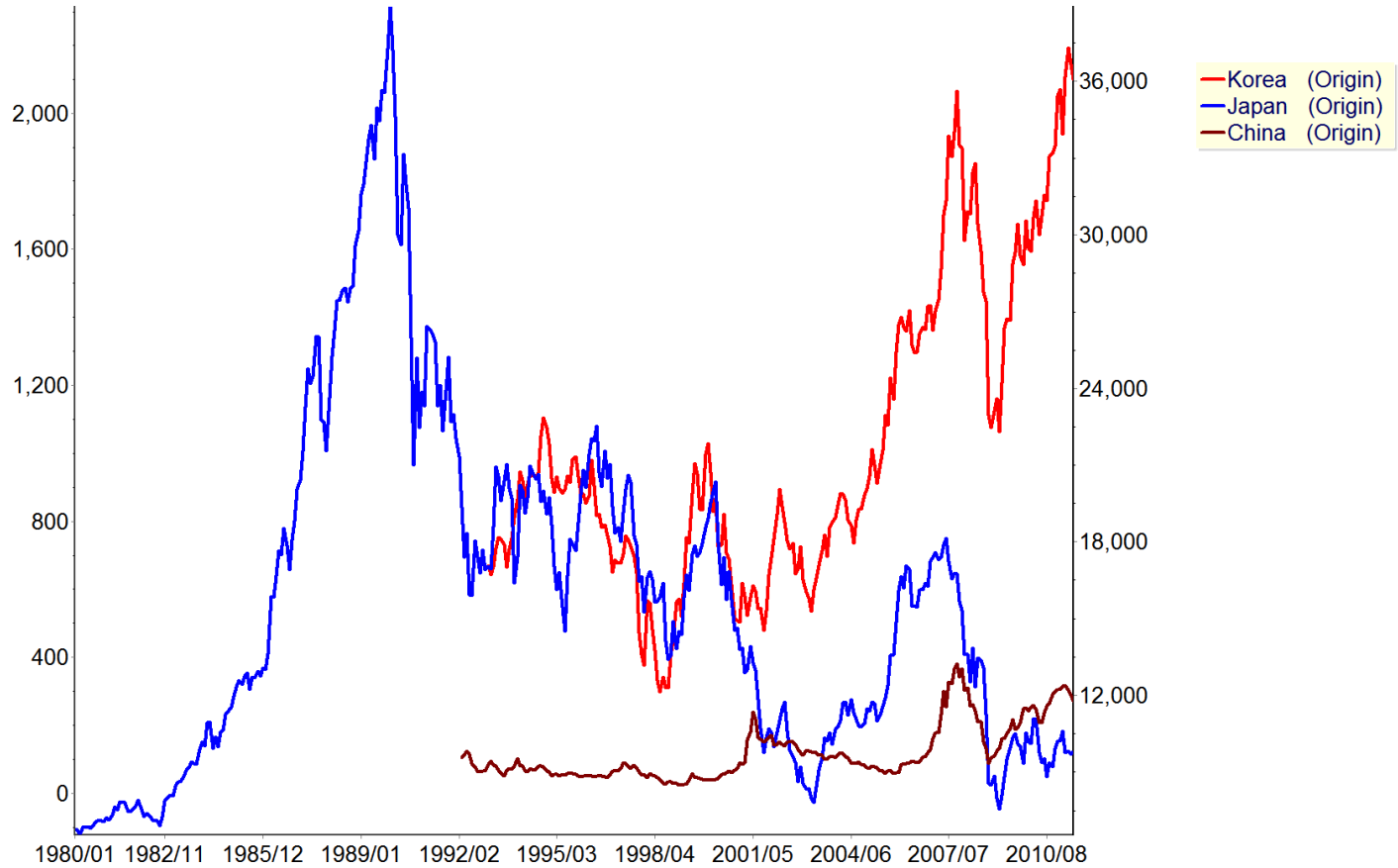
Dow Jones Indus. 1896.5.26=4



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KOSPI 1980.1.4=100

Nikkei 225 1949.5.16=176.21



# Hostility towards finance and financiers

- A recurrent hostility to finance and financiers:
  - ▣ those who make their living from lending money are somehow parasitical on the 'real' economic activities of agriculture and manufacturing.
  - ▣ this attitude, throughout the history of Western civilization or in other culture, derived from religious or philosophical biases.

# Three causes for Hostility towards finance

- 1. debtors outnumber creditors,
- 2. finance appear to be a cause of poverty rather than prosperity, volatility rather than stability,
- 3. financial services in countries all over the world were disproportionately provided by members of ethnic or religious minorities
  - ▣ they had been excluded from land ownership or public office but enjoyed success in finance, for example, Jews

# Money and History

## □ Money and History

- Behind each great historical phenomenon there lies a financial secret, though may not appear to be evident
- Rise and Fall of Empires like, Roman, Chinese, Spanish, Dutch, French, British empires or the dominance of America
- Financial Innovations like modern banking, gold standards, or financial crises like great depression, subprime fiasco

# Money and progress

- History and the evolution of credit and debt
  - ▣ The evolution of credit and debt as important as any technological innovation in the rise of civilization. For example,
    - Banks and the bond market provided the material basis for the splendors of the Italian Renaissance.
    - Corporate finance was the indispensable foundation of both the Dutch and British empires,
    - The triumph of the United States in the twentieth century was inseparable from advances in insurance, mortgage finance and consumer credit.

# Money and National Failures

- The financial problems of the French monarchy led to the French Revolution
  - ▣ The problem caused by a Scots named Law, a convicted murderer , who had wrecked the French financial system, by unleashing the first stock market bubble and bust.
- A self-destructive cycle of defaults and devaluations ruined Argentina 1980s.
- Subprime fiasco of America in 2008-2009.



# Six financial phenomena to be explored

- 1. How so many American and European banks came to have such highly leveraged balance sheets, in other words how they ended up owing and lending so much more money than their underlying capital bases.
- 2. How a whole range of different kinds of debt, including mortgage debt as well as credit card debt, came to be ‘securitized’, that is bundled together and then sliced up into different kinds of bond-like securities.

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- 3. How the monetary policies of central banks came to be focused on a very narrow definition of inflation, ignoring the potential hazards of bubbles in stock prices and later real estate prices;
- 4. How the insurance industry, led by the giant American firm **AI**G, branched out of traditional risk coverage into the market for derivatives, effectively selling protection against highly uncertain financial risks;

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- 5. Why politicians on both sides of the Atlantic sought to increase the percentage of households that owned their own homes, using a variety of inducements to widen the mortgage market;
- And 6. What persuaded Asian governments, and particularly that of the People's Republic of China, that they should help to finance the US current account deficit by accumulating trillions of dollars in international reserves.

# Money society vs Moneyless society

- Money society: Negative views of money, 'Filthy money'
- Friedrich Engels and Karl Marx declared:
  - *money is merely an instrument of capitalist exploitation, replacing human relationships with the callous 'cash nexus.'*
- Marx, in Capital, viewed money
  - *as commoditized labor, the surplus generated by honest toil, appropriated and then 'reified' in order to satisfy the capitalist class's insatiable lust for accumulation.*

# Is moneyless society happier?

- *The life of a hunter-gatherer* is indeed, as Thomas Hobbes said of the state of nature, ‘solitary, poor, nasty, brutish, and short’.
- Instead of trade or saving, they raid.
  - ▣ Episode of the Nukak, primitive tribe of Amazon in Ecuador. 60 per cent of male deaths were due to violence.
- Episode of the most sophisticated society in South America, the Inca Empire, was also moneyless.