The End of Finance
by Massimo Amato and Luca Fantacci

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With great ambition, *The End of Finance* argues that the widespread issuance of financial claims that are tradable and sometimes irredeemable has introduced a systemic risk to modern capitalist economies. Authored by Italian economic historians Massimo Amato and Luca Fantacci, the book is divided into three parts, the first two of which could be read stand-alone. The third part provides policy recommendations following the authors' arguments presented in parts one and two.

The first part presents a study of the nature of finance. A striking feature of the recent global financial crisis is the geographical distance between borrowers and lenders. Mortgage backed securities issued in the United States along with Irish bank bonds and Greek government bonds were owned and traded by Belgian dentists and Japanese housewives. When the crisis struck and these borrowers defaulted, finding all the lenders was an extremely difficult task. Negotiating with them was another story altogether.

Amato and Fantacci argue that the anonymity of modern finance has weakened the link between finance and its purpose or *end*, a contract between known borrowers and lenders, used to support the exchange of goods, services and investment in productive assets. Relating to a specific trade or investment, loans should have some fixed maturity, or *end*.

Renegotiations of loan contracts can be useful for both firms and borrowers and is a key justification for bank lending. Banks provide households and firms with deposit services and also lending services. A bank manager who has worked with a customer over a number of years can work with borrowers during difficult periods to keep them in their homes or keep their businesses alive. They can share the 'burdens of adjustment' (p.32). In the words of Amato and Fantacci, 'credit is not essentially a thing but a relationship' (p.29).

The authors observe the prevalence of irredeemable, tradable debt contracts, and argue that this trend has introduced systemic risk to modern capitalist economies. When a bank lends to a firm, fundamental economic considerations are paramount. When a trader buys a bond, the liquidity of the bond is what matters.

Liquid financial markets work great in good times, lowering borrowing costs for firms and households. In bad times, not only do these loans and claims lose some fundamental value, their liquidity disappears. The fall in liquidity amplifies the consequences of the underlying recession. In the economics literature, this process is known as a *liquidity crisis*. The authors go so far as to say that the recent financial crisis was a 'crisis of liquidity' (p.26) and argue that such a crisis could lead to the end of modern capitalist systems.

Part two presents a short history of the development of the modern global financial system. It contains concise and valuable descriptions of important episodes including the gold standard era, the Bretton Woods system and the European Payments Union. This history however is littered with omissions, terminological errors and flawed logic.

The authors describe how the post war Bretton Woods system relied upon the use of the US dollar to settle payments in

international trade. Interestingly, chapter seven of part two describes the accidental nature of these arrangements (p.142). The influential British economist John Maynard Keynes suggested at the time that international trade should be settled in a clearinghouse by some unit of account designed precisely for this purpose. Amato and Fantacci, supportive of this view, do not reveal that important currencies including Bank of England pounds were initially used solely for clearing accounts between banks exactly in this way before proliferating in public use. The distinction between money and clearinghouse units is not as great as the authors imagine.

Frustratingly, the authors consistently use the term 'equilibrium' to describe a situation where all debts are repaid. This definition is not always congruous with the standard economic definition, that prices are consistent with supply being equal to demand. It is also not clear theoretically why it is a goal to be aspired to. Singapore achieved rapid development largely supported by sustained borrowing in international capital markets. It may be perfectly sensible and consistent with economic equilibrium for ageing baby-boomer western countries to invest large amounts of wealth in developing nations. By redefining equilibrium, the authors can argue that the current importance of the US dollar in international trade has prevented equilibrium in international trade (for example p.95).

Perhaps the movement towards decentralized finance is destabilizing, but *The End of Finance* offers no clear explanation why. In some important new economic models of financial crises, this decentralization of lenders is a stabilizing force during recessions. Stated more clearly in reverse, when a borrower has a credit relationship with only one lender, then not only is the lender

exposed to the risk of the firm defaulting, but the borrower faces the risk of the lender failing. If the lender goes bankrupt, the borrower will face the expensive task of building a new credit relationship with a new lender. Maintaining many lending relationships may be stabilizing from this perspective.

Recent evidence suggests that the decentralized bond market has mitigated the effects of bank failures on productive firms: as banks have contracted their balance sheets and decreased loan issuance, other lenders – including insurance companies and managed funds – have increased their purchases of corporate bonds.

Policymakers should not tear down Chesterton's fence without understanding why it stands. Modern finance theory can largely explain why contractual relationships have taken their current form. Moreover, these fields have failed to find significant destabilizing effects of the dissolution of financial contracting, or the use of debt contracts designed to be traded in liquid markets. *The End of Finance* presents a challenging analysis of the modern financial system, one that at times imposes a high degree of importance on arbitrary events and historical accidents. The evidence suggests that in reality, these accidents suffer from a survivorship bias; like an evolutionary process, accidents only persist if they are consistent with economic incentives.

I recommend that readers look elsewhere for a clear, accessible perspective on the fragility of the modern financial system. Familiar and unfamiliar readers alike will find greater benefit from a work that first seeks to explain the economic motivations of the current financial system; one that clearly explains why the contracts that we observe are likely to proliferate. This would provide a more

solid foundation for discussions about financial vulnerabilities, and the potential need for regulatory intervention.

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