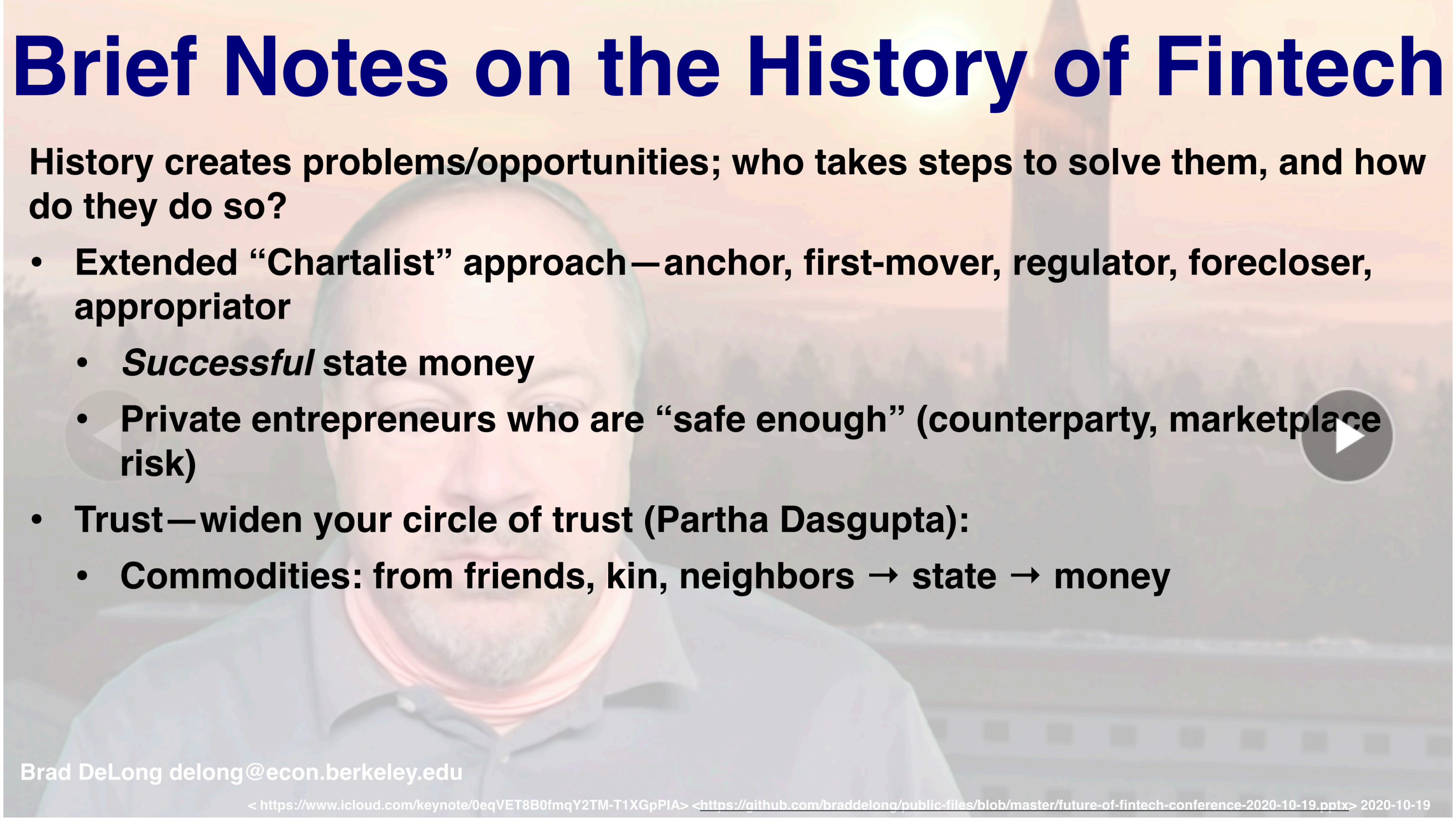
Grasping Reality by Brad DeLong

Brief Notes on the History of Fintech

Comment on: **Stephen Quinn & William Roberds**: *On the Evolution of Payments Systems*



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The focus of good work in economic history is always this: History creates problems and opportunities for economic actors. They then have to respond. What is most interesting is how they respond, and what the unintended consequences are. The master move of economics is always that the market combines individual actions to produce something that nobody expected or necessarily wanted: that is what we expect out of our narratives, and that is what we have gotten so far in this session.

What we have heard is a chartalist-plus approach, an approach that I think that is broadly correct. The state and its payments are the foundation on which private entrepreneurs seek to gain wealth and advantage. The state with its payments and taxing flows is the anchor of their positions. The state is much more than just a very large organization that keeps itself functioning by collecting and then distributing a huge amount of wealth. Moving in the slipstream of the state's operations can gain you an awful lot of thick-market and trust benefits.

The state is also a first mover—or maybe a last mover. When it innovates (or adopts and adapts others' innovations), it solidifies the market by setting what the expectational equilibrium will be. It is also a regulator and the adjudicator. It has people who ultimately can say what you can and cannot do. In the old days they carried spears and now it is people with guns, but ultimately they can say 'this is your wealth, and this is not'.

In that role, the state is a foreclosure of potential options that private sector entities might want to undertake. It is also often an appropriator of things that private sector entities wish to do. The state inherently has sources of advantage the private sector does not. The South Sea Company's business model was a sound one: 'We are going to take the many untradeable issues of British national debt created since the Glorious Revolution, consolidate them, and then sell them and trade them in a thick market. We will then capture all of the thick-market marketability edges as our profit, and we will divide it among the founding shareholders. And you can buy now and get in on the ground floor, for we are already trading on a when-issued basis."

It was a wonderful business model. But ultimately it was the big player, the Bank of England, that successfully executed that business model. It was not the South Sea Company. Isaac Newton is supposed to have famously said that he could calculate the motions of heavenly bodies, but not the madness of crowds. But he ought to have been able to calculate the motion of a very large, better-positioned state actor, better placed to execute a now-public and potentially very profitable business plan.

We have successful state money. We then have private entrepreneurs, trying to do as they do and find things that reap the benefits of successful state money. The payments flows, assets, and liabilities created by these entrepreneurs have to be cheaper than and also have to be safe enough to be attractive for those who would otherwise use state money. And in placid times they are. They always are. Until they aren't. And then they stop being safe enough, things get very fraught.

Perhaps the key insight is that economies are always impelled to seek find ways to widen circles of trust. This is an insight I stole from economist Partha Dasgupta. You can deepen your individual division of labor, but your own ability to produce things as limited. Thus you face a world in which there are lots of commodities that you need that you cannot produce, and for which you must trade. Trade starts out with gift exchange or commodity exchange, but only with those who trust. Your division of labor is limited to your friends, your neighbors, and your family. I would not trust some of my neighbors. I definitely would not trust some of my family, when it comes to engaging in reciprocal but not contemporaneously balanced trade.

But things become easier with some kind of state institutio, like a temple, or the treasury of the Great King. Those institutions have permanence and credibility. You can deal with them. In fact, you have to deal with them: They are already collecting tithes and taxes from you, and you might as well piggyback as much as you can of your trade on those flows..

And then you have the invention of money! These little things made of precious metal that the Great King will accept in payment for taxes. He will also crucify anyone who counterfeits them, or adulterates them. And all of a sudden your circle of trust for commodity exchange has widened. Now your circle of commodity is made up of everyone who can show you the money. This is a great and wonderful thing.

But counterfeiting, adulteration, clipping, plus carrying large chests of coins around is difficult and costly. I winced when I watched the heist movie, The Italian Job, as the posse dropped a chest of gold down four stories into the getaway motorboat. I know enough about physics to know that that chest would have smashed the bottom of any boat, and promptly gone to the bottom of the Venetian lagoon.

People move from coins of gold or silver with the picture of the Great King on them to bullion,, to bullion being kept somewhere in someone's basement, to bullion that is not earmarked for you but is the fractional-reserve backing for ledger entries, to trust that the transactions of a large organization that has money coming in and going out are sufficient liquidity backing for the This is the dance that we always do over time. We see it going in payments from money to merchant credit, to bills of exchange, to deposit banks, to large state actors. Those as anchors seem to work well.

But those large anchor organizations need to be only semi-state actors. There needs to be efficient insulation of financial regulation from the fiscal needs of the state. The health of the financial system must be prioritized over the fact that the state can use this to get a little bit more seigniorage. And the state always pushes this margin.

Thus the organizations that succeed in the long run are those that are somehow sufficiently insulated from the fiscal needs of the state to prioritize the financial system: state-like enough to be concerned with the public interest rather than simply at some point taking the money and running. But they need to be non-state enough to prioritize the convenience of bankers over the goals of the high politicians.

And underneath this all there is always regulatory arbitrage by private entities. Their liabilities are, also, safe enough until they are not. And this is going to make the state nervous. If someone shows up and is large enough to actually begin taking on a state-like role, the central bank is going to get very nervous about who is the boss here and how will a crisis be handled.

Thus the state is in tension: regulator and anchor, first mover and validator. And we also need to be thinking of the state as closer of some. Maybe it forecloses some private options because they are too risky. Maybe because they are too profitable, and it wants to skim the cream itself. Maybe because these options upset the current balance of forces within the state. The state is going to seek to grab much of the thick-market benefits of being the hub.

We began with trust in commodity exchange at the start. Then we moved to trust in payments that make trust in commodity exchange not a problem. And finally we move to trust in long-term financing. This topic is, potentially, very fraught as we go forward now in this era of ' secular stagnation. Today it seems that is not so much saving as rather risk bearing capacity and entrepreneurial vision that are the places in which the economy feels constrained, rather than in the creation of liquidity, or even in the flows of savings.

So let me stop there by saying, as Barry Eichengreen did at the start: What is our financial future? Ant Financial? VISA? FacebookPay? Or ????.

1400 words

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