

FINANCIAL MARKET 'DESIGN'

*Addressing structural
flaws to improve lives*

Catherine Macaulay

How did we go from this...



Dutch East India Company Directors, 1682

...to this



Wall Street 2008

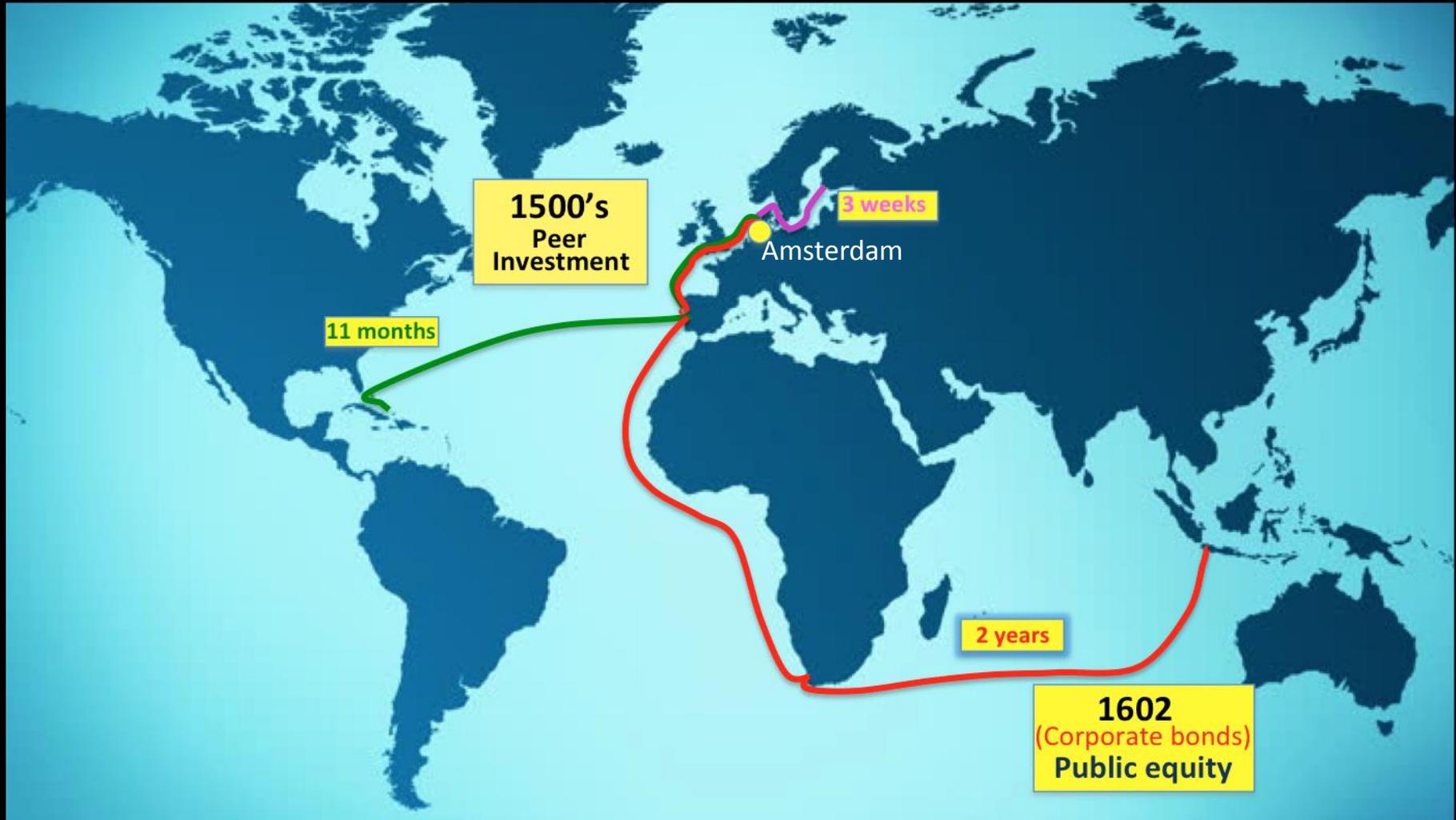
“the stock market is the **key player** in the **game of economic growth** ...

...stock prices are **not only a leading indicator** of economic activity, they are a **major cause** of it...

...**6 percent** of the change in GDP results from changes in **market value** of stocks and homes.”

Alan Greenspan (2013) CNBC interview

DUTCH TRADE: *financing the new frontier*



DUTCH TRADE: *financing the new frontier*

1. Raise funds from the public



2. For a 10 year loan period



The Breach of Contract

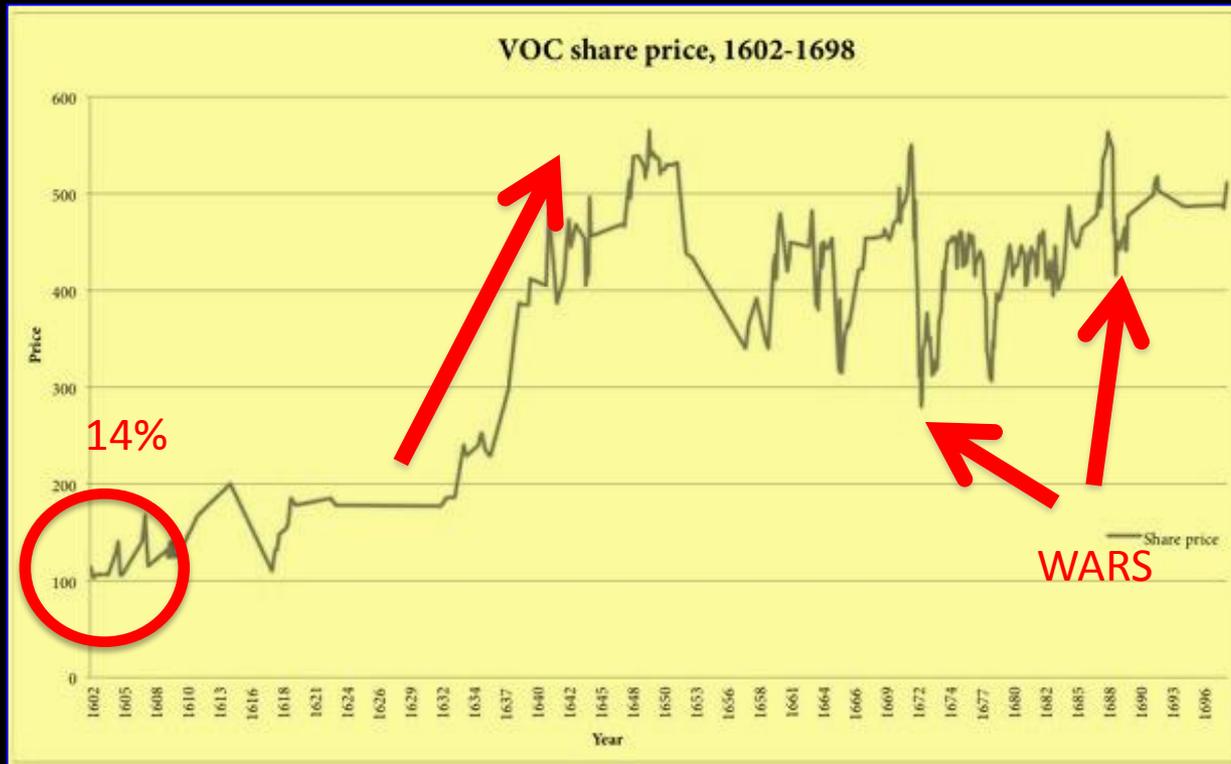
- **What happened:**
 - **No spare cash** for dividends
 - Feared that the audit would **expose** cash position
 - Bonds were rolled over **without** an audit
 - In **breach of contract**
- **Directors were forced to take out loans to run the company**



Dutch East India Company Ships

What happened on the market?

- *Ideal* for trading



- Dividends ONLY averaged 3.7% in the first century

What was the company's position?

- The 10 year bonds became **perpetual bonds with dividends, or fixed equity**
 - Dividends were just an **added burden**
- Company debt averaged **11 million guilders** from 1622-1700.

CANDY INDUSTRY

VS

CANDY TRADING MARKET

- ✓ Productive transactions
- ✓ Creates new capital

- Non-productive transactions
- Transfers of ownership



- INCLUDED in GDP

- EXCLUDED from GDP

Our focus on the trading market

- “...the **key player** in the game of economic growth...
- ...stock prices are not only a **leading indicator** of economic activity, they are a **major cause** of it...
- ...**6%** of the change in GDP results from changes in **market value of stocks.**’



Prioritizing the Stock Market

‘The Fed is not credible with the markets at this point.’

Larry Summers, 2017

‘...no institution in our capitalist society is as venerable as the stock market.’

Joseph Stiglitz, 2013

What has the stock market done for us?

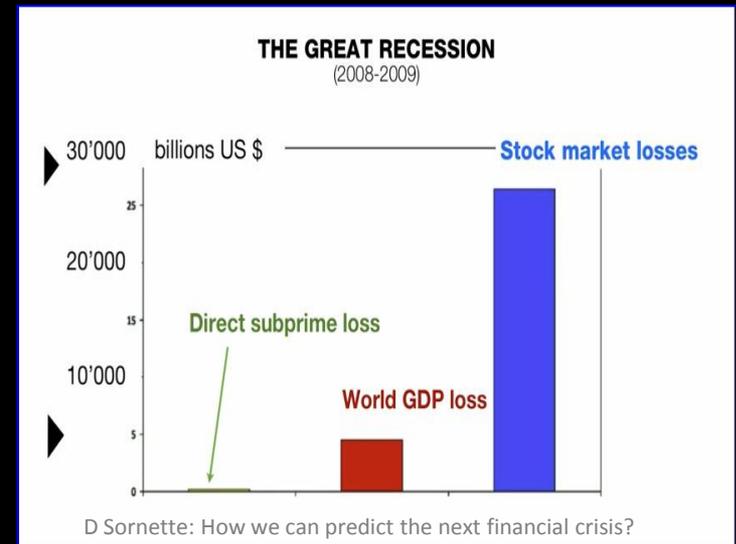
Crashed every 14.8 years since the South Sea Bubble

1721 The Mississippi co Bubble	1896 US Panic	1987 Black Monday crash
1769 Bengal Bubble	1901 limited New York Stock Exchange crash	1997 Asian Financial Crisis
1792 US Panic	1907 US Bankers Panic	2000 dotcom bubble
1847 British financial markets crash	1910-11 large US investment firms failure	2008 Financial Crisis
1882 Paris Bourse crash	1910 Shanghai Rubber Stock Market Crisis	2010 Flash Crash
1893 US Panic	1929 Wall Street Crash	2015 China stock market crash
1873 Panic and Vienna Stock Exchange crash		

... and we are still debating why...

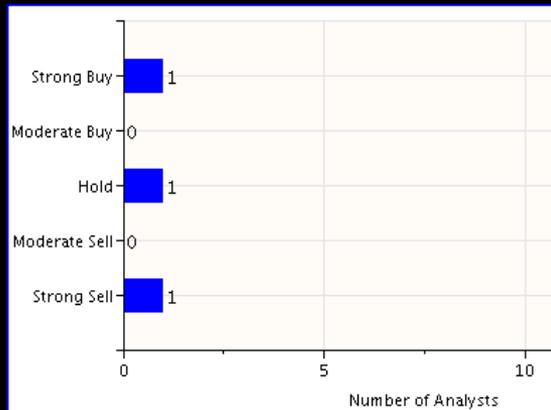
Causes of the 2008 crash:

- Greed
- Cheap credit
- Derivatives
- Fraud
- Cronyism
- Unbridled risk-taking
- De-regulation
- Short termism
- Complexity
- Fragmentation and the 'silo effect'
- Ratings agencies
- A lack of 'transparency'
- Repeal of Glass Steagall Act
- Social contagion
- Herd behaviour
- Predatory lending practises
- Believing some activities are too big to fail.
- Inadequate competition
- Market 'self-regulation'
- Ending the gold standard
- Asymmetric information
- Failure to understand risk
- Flawed corporate incentives
- Quantitative economics
- 'Ridiculous calculations'
- Supressed innovation

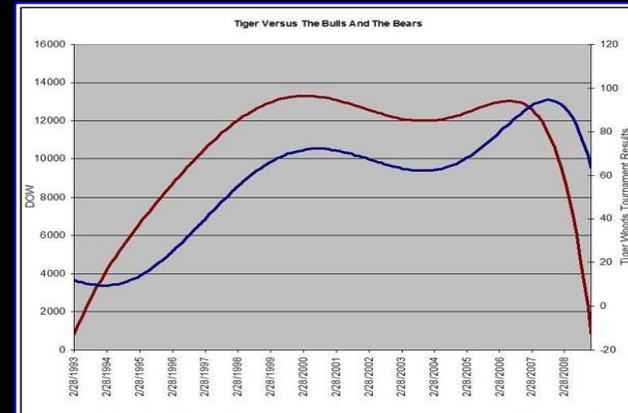


What has the stock market done for us?

1. Confused us on 'value'
2. Eluded forecasting and correlation



Analysts have opposing views



'Tiger Woods' Bears and Bulls Index'

3. Increased inequality

“\$2 trillion was transferred to corporate executives through stock options and to entrepreneurs of newly-floated companies in the 1982-2005 bull market.”

1688

‘never give anyone advice to buy or sell shares because it can turn out badly;

‘take every gain without remorse about missed profits or hope for persistence of good luck’

‘profits are ‘carbuncle stones, then coals, then diamonds...then tears’

‘to win in this game requires **patience and money** since the values are so little constant.’

Uncertainties Misconceptions Conundrums

- ⊘ Market Value relates to **Book Value**.
- ⊘ The stock market provides *capital to enterprise*.
- ⊘ Equity is good as it is **not debt**.
- ⊘ The corporate model is the **pinnacle** organisational structure.
- ⊘ Shareholders '*own the company*'.
- ⊘ The stock market is a good place to direct **pension savings**.
- ⊘ The stock market is an **economic indicator**.



What can we do about the stock market?

- Nothing can turn the stock market into a **productive market** without **eliminating the trading** which defines it.
- A **secondary market** is, by definition, a market of **non-investment transactions** that are not included in **GDP**
- What would happen if we just stopped venerating the trading market?

Economies without a predominant stock market

1. The Dutch Golden Age

1540-1672

- **Beginning:** 6 decades before the stock market opened in 1602
- **Ended:** 'when prominent capitalists chose finance over enterprise' *Dutch historian, Oscar Gelderblom.*



Mercator's projection

The yacht



Compound microscope



The concept of the atlas



The still life genre

Economies without a predominant stock market

2. Germany

- **First common share:**
traded in 1820
- **German pension funds**
65% bonds and 14%
equities
- **0.02% of German firms**
are publicly listed.

Privately owned companies:

Bosch	Steinway and Sons,
Miele	Staedtler
Karcher	Birkenstock
Blanco	Hamburg Sud shipping
Leica	Hella automotive
Stihl	Erco lighting
Dorma	Boehringer Ingelheim
Häfele	pharmaceuticals

Unemployment: 3.9%

Federal budget surplus since 2014.

To Do List: THEORY

Clarify terms

- Market
- Investment
- Finance
- Stocks

Dispute beliefs

- ✘ Buying shares adds capital to a company.
- ✘ Buying shares is good for the economy.
- ✘ Holding shares for a while is 'investment' not 'speculation'.
- ✘ Shareholders 'own the company'.
- ✘ Holding equity implies ownership.
- ✘ The stock market is a leading economic indicator.



To Do List: PRACTICAL

1. Develop primary capital markets
2. Direct pension funds into **productive** activity.
3. Central Banks responsible only for '*price stability*' and the '*Real*' Economy.
4. Stop stock markets incentives.
5. Re-consider '*privatising*' essential services.
6. Bring back Economic Geography
7. **Demote** media stock market reports



Pre-Galileo Logic



THE STOCK MARKET

Volatility

Inequality

Agency issues

Economic stagnation



THE
ECONOMY

Economics for better lives

THE ECONOMY

Jobs
Training
Innovation
Productivity
Community
Environment



STOCK
MARKETS