Foreword

Most of modern economics relies on the assumption that economic actors are 'maximizers' (i.e., households maximize utility and firms maximize profit). This assumption has proved fruitful because it permits a systematic study of the interactions between economic agents through well-developed models. Despite the success of this approach, it is largely absent from existing intermediate teaching materials. *Money, Financial Intermediation and Governance* addresses this void by continually exploiting the assumption that economic actors are 'maximizers' to deepen our understanding of how financial services, and the organizations that govern them, influence economic performance.

Maximizing agents have an incentive to economize on resources to facilitate transactions. A well-developed monetary system, for example, expands consumption possibilities by minimizing the costs of bartering for goods and services (that is, opportunities that households forgo to find consumption bundles that satisfy a 'double coincidence of wants'). Likewise, a well-developed capital market expands firms' production possibilities by facilitating trades between 'idea-rich' entrepreneurs and 'resource-rich' financiers.

But while maximizing-behavior provides the incentive to economize on transactions costs, it is also at the heart of an impediment to economic activity; the problem of credibly committing against narrowly egoistic actions. To see this problem, consider the difficulty that societies experience in establishing and maintaining efficient systems of money. As maximizers, monetary authorities want to expand consumption possibilities beyond those that barter makes available. They can do that by issuing money. However, for money to be used, the monetary authority must be able to commit not to inflate away its value. Successful monetary authorities must adopt a type of organization or governance that constrains them enough to eliminate the temptation to inflate.

The problem of credible commitment also says a lot about how systems of financial intermediation should be (and are) organized. Idea-rich entrepreneurs and resource-rich financiers enjoy considerable prospects for mutually beneficial trade. But entrepreneurs have an incentive to be too optimistic about the future performance of their projects and misuse borrowed capital after the fact. Likewise, narrowly egoistic financiers have an

Dino Falaschetti and Michael J. Orlando - 9781845428709
Downloaded from Elgar Online at 02/19/2018 11:32:46PM
via free access

incentive to expropriate the product of entrepreneurs' sunk investments. Well-developed systems of financial intermediation and corporate governance help maximizers credibly commit against such actions, and thus expand general economic opportunities.

Money, Financial Intermediation and Governance is both rigorous in its treatment of the material and accessible. By avoiding shortcuts it challenges the reader to think seriously about deep economic incentives. At the same time, it provides the guidance necessary to master these important ideas. This is a great book for readers who want to learn and, more importantly, to think.

Antoine Martin

Dino Falaschetti and Michael J. Orlando - 9781845428709
Downloaded from Elgar Online at 02/19/2018 11:32:46PM
via free access