Financial systems, risk management, and entrepreneurship: historical perspectives

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Abstract

Economic historians find that the most successful economies of history tend to be ones that early in their modern histories developed sophisticated financial systems that subsequently sustained their development and growth. Financial economists are finding the same association of financial development and growth across a wider range of countries and levels of economic development in recent decades. This essay argues that more sophisticated financial systems not only mobilize more capital and allocate capital more efficiently than do less developed systems. By offering more sophisticated methods of managing and reducing risks than primitive financial systems, modern financial systems, perhaps paradoxically, also promote higher levels of risk taking and entrepreneurship.

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1. Introduction

Evidence building at a rapid rate indicates that financial development plays a leading role in economic growth and in accounting for the relative performance of the world’s national economies. The evidence challenges older interpretations, still held to by some, that financial development is mostly a passive response to the needs of economies that began to grow more rapidly for other reasons, such as the exploitation of international trading opportunities—the globalization of trade—and technological breakthroughs in production—the industrial revolution. Instead of being a passive response to changes arising in non-financial sectors of economies, financial development now appears to an active, instigating cause of economic growth and modernization.
Some of the evidence for the enhanced importance of financial factors in economic development comes from my own field of research, economic history. Economic historians have demonstrated that “financial revolutions,” a vivid term used to connote bursts of financial innovation leading to the establishment of modern, articulated financial systems, often occurred before the leading economies of modern history became leading economies (Sylla, 2002). Other evidence stressing the primacy of financial factors in economic growth comes from the work of financial economists in analyzing large cross-country data sets pertaining to recent decades. These economists find that countries having more developed banking systems and more developed securities markets—two key components of modern financial systems—tend to grow faster and perform better on other measures than countries with less developed financial systems (Demirgüç-Kunt and Levine, 2001). Moreover, by means of careful modeling and painstaking econometric estimation, these financial economists argue that good finance is a cause, not merely a result, of better economic performance.

In this paper, I summarize some of the evidence for the importance of financial development in modern economic history. I also consider theoretical arguments about why good finance matters, which typically involve the advantages of good financial systems in mobilizing capital and allocating it efficiently among competing uses, and I extend these arguments in a new direction, to encompass the ways in which modern financial systems facilitate risk management. Economic historians have not paid much attention to the risk management facilities offered by modern financial systems. I argue here that understanding the implications of financial systems’ risk management facilities can have a large payoff. It can help us to understand how financial systems promote higher levels of risk taking and entrepreneurship.

I proceed as follows.

First, I want to emphasize the key importance of modern financial systems in creating our world as we know it today, a world of great economic inequalities between the rich and the poor countries.

Second, I want to describe in institutional terms just what I mean by a modern financial system. The rich countries have such systems, and the poorer countries do not. But the poorer countries, assisted by the rich countries and international institutions such as the World Bank and the International Monetary Fund, are trying to create modern financial systems. In our era of history, this is one of the most important items of the agenda of global economic development.

Third, I want to discuss why modern financial systems are so crucial to economic growth and modernization. In addition to the standard economic reasons—namely, the ways in which good financial systems promote efficient resource allocation—I explore a less standard reason—the ways in which modern financial systems promote economic growth by promoting more efficient allocations of risk, that is, the ways in which such systems facilitate more efficient risk management.

2. How rich are the rich countries?

I begin by drawing attention to the position of today’s leading national economies in the world economy during the past five centuries. Table 1, based on the research of the
economic historian Maddison (2001), provides a convenient summary. It shows for seven of today’s rich countries the real GDP per capita (one index of economic growth and development) of that country relative to the world average GDP per capita at various years starting with 1500. In 1500, late-renaissance Italy was the richest economy, with a per capita product about twice the world average. Italy was followed by The Netherlands, France, the United Kingdom (Great Britain), and Germany, all of which had per capita products 500 years ago that were a fifth to a third higher than the world average. Japan and the United States in 1500 were countries with per capita product levels below the world average. The USA, of course, did not yet exist in 1500, but there were people living in the territory that became the USA in 1776, and it is possible to estimate roughly what the standard of living was relative to the world average.

Compare 1500 with 1998, five centuries later. The USA, the poorest of the seven countries in 1500, became the richest, with a GDP per capita almost five times the world average. And that world average includes the USA, which is a very large economy. If we remove the USA from the rest of the world and compare it to the rest, we would find that its real GDP per capita was about six times the average of the rest of the world.

In the context of the entire table, it is apparent that the world today is a much more unequal world than the world of 500 years ago. Then, Italy was the richest of the seven economies with a real GDP per capita twice the world average. Now the USA is the richest of the seven, with a real GDP per capita five to six times the average.

Another result from the table is the changing locus of economic leadership. By 1600, the leading economy was no longer Italy, but The Netherlands, called then the Dutch Republic or the United Provinces. The Netherlands remained the leading economy until the early-19th century. Then the UK—Great Britain essentially—succeeded The Netherlands as the economic leader. UK leadership lasted until the late-19th century when the USA passed it. By 1913, the USA (as Table 1 indicates) was the leading economy in terms of real GDP per capita, and it has remained the leader from then to now.

Japan hovered around the world average until the middle of the 20th century. But that is not the entire story told by the table. Note that Japan increased its GDP per capita relative to

Table 1
Real GDP per capita relative to world average, selected countries, 1500–1998 (world average = 100 at each date)

<table>
<thead>
<tr>
<th>Date</th>
<th>Country</th>
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<tbody>
<tr>
<td></td>
<td>Italy</td>
</tr>
<tr>
<td>1500</td>
<td>195</td>
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<tr>
<td>1600</td>
<td>185</td>
</tr>
<tr>
<td>1700</td>
<td>179</td>
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<td>1820</td>
<td>167</td>
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<td>1870</td>
<td>173</td>
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<tr>
<td>1913</td>
<td>170</td>
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<tr>
<td>1950</td>
<td>166</td>
</tr>
<tr>
<td>1973</td>
<td>259</td>
</tr>
<tr>
<td>1998</td>
<td>311</td>
</tr>
</tbody>
</table>

Source: Derived from Maddison (2001).
the world average from 1870 to 1913, a period when countries considerably richer than Japan—The Netherlands and the UK—declined relative to the world average. Japan clearly was growing considerably faster than The Netherlands and the UK in that period, which historians call the Meiji era.

Note also the remarkable leap of Japan after 1950, when it transformed itself from an economy with a GDP per capita about equal to the rest of the world to one with a level of per capita real product second only to the USA among the seven leading economies. When we realize that the world average per capita product was itself increasing through the 20th century, Japan’s growth is all the more remarkable. From these facts—maybe we should call them “stylized facts” since the data are incomplete and subject to revision—one can easily grasp why economic historians are so fascinated by Japan. It made the transition from being a relatively poor country to being one of the richest countries in roughly a century.

3. Why are the rich countries so rich?

Why did the countries in Table 1 become so much richer relative to the rest of the world than they were 500 or even 300 years ago? Undoubtedly, there are many reasons. During most of the 20th century, economic historians contended that the so-called industrial revolution—the advent and development of modern manufacturing technologies and the factory system of large-scale production—was the main reason. Great Britain was the leader of this development, and we can see its rise in Table 1. The industrial revolution spread from Britain to the other countries in the table, that is, to Western Europe, the USA, and Japan.

I have come to believe that there are good reasons for doubting the contention that the industrial revolution and its diffusion from Britain to a number of other countries are main reasons why the inequality between the rich and the poor countries of the world has increased so much. The first industrial revolution did not arise in Britain until the late-18th century. It therefore cannot account for why Italy was twice as rich as the rest of the world in 1500. It cannot account for why The Netherlands in 1700 had just about the same high per capita product relative to the world as it does today.

Moreover, modern industrial technologies are now known to, and available to, most of the countries of the world, and they have been for a long time. Yet, the world became increasingly unequal during that period, judging by Table 1. If most countries have not industrialized or modernized their economies, it is not because they lack access to the great technological changes that arose from the industrial revolution.

I and other economic historians, doubting the traditional industrial revolution explanation of these world economic trends, have searched for better explanations. In general, we argue that institutions and institutional changes, not breakthroughs in manufacturing technologies, account for long-term trends such as those described in Table 1. That is, we think today’s rich countries are rich because they developed institutions more favorable to economic growth than did other, poorer countries. Some examples of such institutions are good government, the protection of property rights, and effective legal systems. Such institutions usually develop slowly over long periods of history. These institutions are
much more difficult to transfer from one country to another than are industrial technolo-
gies. Hence, institutions and institutional differences among countries may offer more
insights than industrial technologies into why great income gaps among nations emerged
and why they have persisted.

My own work stresses the importance of financial institutions, namely the appearance of
modern financial systems. It is well known among economic historians that medieval and
renaissance Italy achieved a higher development of financial institutions than any other
part of the world. Indeed, the English word “bank” comes from the Italian “banco,” which
means “small table,” or “desk,” or “counter.” An Italian long ago placed his “banco” in
the town square, receiving deposits of money from some, making loans to others, and
recording the transactions in his account books on top of the “banco.” He became therefore
a “banchiere” or, in English, a banker.

But banks are only one component of a modern financial system, although certainly an
important one. I argue that a modern financial system has a number of key components. They are given as follows:

- Stable public finances and markets for government debt securities.
- Stable money and money markets.
- Sound banks and banking systems.
- An effective central bank.
- Efficient securities markets for business firms’ debts (bonds) and equities (stocks).
- Sound insurance companies and insurance markets.
- Corporations with limited liability to facilitate equity share issuance and ownership.

The leading economies of modern economic history—The Netherlands, the UK, the
USA, and Japan are notable examples—developed such financial systems very early in
their modern economic histories. They did this before they became leading economies. The
early development of modern financial systems was a key reason why their economies
subsequently developed so rapidly, far outpacing those of other countries where “financial
revolutions,” the term economic historians often use to describe the initial appearance of
modern financial systems, did not occur.

Space constraints will not allow me to describe ways in which the various key
components of a modern financial system interact with one another, and reinforce one
another, in modern economies. From our own experiences with the financial system, we
will quickly realize some of them, and with a little more time we would think of still more.
We pay our taxes, we receive services from our governments, and we invest in government
securities. We spend our yen and dollar incomes, and we keep most of our money in banks.
Sometimes we invest, directly or indirectly, in corporate bonds and stocks. We borrow
money to buy our houses and to make other purchases. We insure our houses, our cars, and
our lives against the risks of adverse events. And we expect the Bank of Japan and the
Federal Reserve, two examples of modern central banks, to oversee our financial systems
and prevent or alleviate financial crises.

We should also want to think about the great advantages an economy with such a
financial system has over one that does not have it. Many places in the world still do not
have such modern financial systems. We might also think about the bad consequences
that come when one or more of the components of such modern financial systems
encounter serious problems. If, for example, the banking system becomes burdened with a lot of non-performing loans, as happened in Japan during the 1990s, or if the stock market encounters a major deflation of values, as occurred in Japan after 1990, and the United States after 1999, the consequences for the rest of the financial system and for the economy are not good. We are aware, even painfully aware, of the problems that from time to time can beset even good financial systems. But not everyone has an appreciation of the importance of well-functioning financial systems. Too often we take them for granted. We do not appreciate how rare they are in history, and the large advantages they conferred on economies that have had them. The key findings of financial historians can help us overcome our limited perspectives on the importance of financial systems.

In The Netherlands, the financial revolution occurred in the late-16th and early-17th centuries. The Dutch at that time established in some form each of the key components of a modern financial system. For example, a market in public debt grew to help the Dutch finance their wars of independence from Spain. The Bank of Amsterdam, something of a central bank, appeared in 1609, and what was the world’s first common stock, the standardized, tradable equity shares of the Dutch East India Company, appeared at the same time. The value of the Dutch currency, the guilder, was stabilized, and banking and insurance facilities grew. After this Dutch financial revolution occurred, The Netherlands economy had what historians variously describe as its “golden age” its “embarrassment of riches,” and it became “the first modern economy” (t’Hart et al., 1997; de Vries and van der Woude, 1997). In that period, Dutch merchants and ships appeared throughout the world, in New Amsterdam, which later under the English became New York, and even in Japan. And the Dutch Republic established a colonial empire that included today’s Indonesia among other colonies.

In Britain, the financial revolution came a century later. For example, the Bank of England was founded in 1694, and a modern market for public debt and equity securities appeared around 1720. This era also featured the stabilization of the pound sterling currency and the advent of the first insurance companies. After the British financial revolution, the British had the first industrial revolution, aided in no small part by the prior appearance of a modern British financial system having all of the key components I have identified (Dickson, 1967).

In the USA, the financial revolution was compressed into the years 1789–1795, when the first government under the new Constitution was established. In that brief period, the new government’s finances were stabilized and active public debt markets appeared. The US dollar was invented in 1791. A banking system emerged, and the Bank of the United States (an early version of the Federal Reserve System) was founded as a central bank with interstate branches in 1791. Efficient securities markets were established (the New York Stock Exchange traces its origins to 1792), and insurance companies and markets emerged. Much of this financial development was the doing of a brilliant finance minister and US founding father, Alexander Hamilton, the first Secretary of the Treasury. After the financial revolution, the USA expanded geographically and its economy took off into modern economic growth, as Table 1 indicates. The USA subsequently had an industrial revolution and a transportation revolution, which generations of US historians identified as the causes of economic modernization. What these historians did not appreciate was that much of the
industrial, transportation and other investments were financed by the modern financial system that first emerged during the years 1789–1795 when Hamilton was finance minister. The modern financial system appeared so quickly at the beginning of the country’s history that historians took it for granted instead of appreciating, as we are now beginning to do, what a rare advantage it had then conferred on the United States (Sylla, 1998, 2002; Wright, 2002a,b).

In Japan, the financial revolution occurred in the early-Meiji era, the 1870s and 1880s. The Meiji government’s finances were stabilized and public debt markets appeared to trade the bonds the government issued to replace Samurai rice stipends. Modern securities markets were founded—the Tokyo and Osaka stock exchanges appeared in 1878. The yen came in as a new currency. New banks including the Yokohama Specie Bank were founded, and a modern banking system emerged. The Bank of Japan appeared in 1882, and insurance companies and markets also appeared around that time. As in the USA, a lot of the credit for this can be given to a brilliant Meiji era finance minister, Masayoshi Matsukata who, like Hamilton in the USA, studied best-practice finance around the world and then implemented the key components of a modern financial system in Japan. And like the USA, after Matsukata did his work, the economy of Japan began to grow rapidly, more rapidly (as Table 1 indicates) than the world economy, which itself was growing rapidly in the Meiji era (Sylla, 1999, 2002; Suto and James, 1999; Rousseau, 1999). Japan, which had been a rather isolated country during the Tokugawa period, quickly became a major player in the world economy and on the world political stage.

This brief account of how modern financial systems first appeared in four countries, and of the stimulating economic effects that such systems introduced to those countries, provides evidence that financial development often tended to precede economic modernization, and that modern economic growth may well have been “finance led.” These are some of the key lessons of financial history that I have gleaned from my study of and work in financial history.

4. How do financial systems promote economic development?

Why is good finance so important to an economy? Why do countries that have effective modern financial systems prosper so much relative to those that do not? What exactly are the sources of the differential advantages that arise in economies that have good financial systems?

We economists have some well-accepted answers to these questions. On the most general level, the financial resources of an economy—its financial capital—are scarce resources, and the more efficiently these resources are mobilized and allocated to investments that yield the highest returns, the better that economy will perform in terms of its growth and development. One of the main purposes of a financial system is to promote the efficient allocation of capital. But that is not the only function of a financial system. Financial economists have identified several basic functions of a financial system (Merton and Bodie, 1995). They include:

- Providing ways of making payments to facilitate trade.
• Providing ways of pooling capital resources and subdividing of public and private debts as well as shares of enterprises into units attractive to investors.
• Providing ways to transfer economic resources through time, across geographical boundaries, and among economic sectors and industries.
• Providing price information to coordinate decentralized decision-making in an economy.
• Providing ways of dealing with incentive problems caused by what economists term "asymmetric information," that is, when some actors in the economy have more information than do others, and when "principal-agent problems" arise, for example, when managers of enterprises are different from the owners of enterprises, and may have different interests than owners do.
• Providing ways of managing risks.

There is a correspondence of sorts between this functional view of a financial system and the key institutional components of a financial system that I described earlier. Stable money facilitates making payments and is a form of holding wealth. A variety of institutions such as governments, banks, and companies pool financial resources, provide goods and services, and create bonds and shares attractive to investors. Money markets and securities markets give liquidity to financial instruments such as bills, notes, bonds, and shares, and they both produce and use price information to coordinate decision-making. And the insurance companies and markets that I mentioned earlier provide products and services that help us to manage risks.

5. Risk management and entrepreneurship

I want to focus in the rest of the essay on the risk management facilities provided by financial systems. In the work of financial historians facilities financial systems provide for managing risks are rather neglected in comparison with their functions of mobilizing and allocating capital.

Providing insurance is only one of a several ways that a modern financial system helps us in managing risks. Economists identify three broad categories of risk management (Mason, 1995). They are hedging, diversification, and insurance. Modern financial systems provide all of them. We need to have an understanding of each form of risk management, the benefits it confers to the economic actors that use it, and the overall economic effects of the provision of risk management services.

Hedging is one way of eliminating a risk exposure. To illustrate it, imagine a pre-modern economy made up of rice farmers and rice consumers who meet and trade with each other in markets for rice. It takes time to produce rice. The risk faced by the farmer is that the price of rice after it is produced will be different from what was expected. The risk faced by the consumer is the same, a price that differs from what the consumer expected. If there is no financial system providing risk management services, the farmer and the consumer will just have to live with these risks. Suppose, however, that the financial system provides a futures market for rice, in which participants buy and sell standardized futures contracts calling for them to trade rice at a specified price at some future date. In that market,
producers and consumers of rice come together, use all the information available to them, and establish a consensus about what the price of rice will be in, say, 6 months. Then the farmer effectively can sell now the rice he plans to grow during the next 6 months. The farmer has eliminated price risk, and can plan rice production accordingly. The same holds for the consumer, who can plan consumption accordingly. Instead of being uncertain about the price she will have to pay for rice in 6 months, she uses the futures market to eliminate that uncertainty.

That is how hedging in futures markets eliminates price risk for individual producers and consumers. It does not, however, eliminate the overall risk that the price of rice in 6 months will be different from what the consensus now thinks it will be then. Maybe a typhoon will destroy part of the crop just before it is harvested, resulting in a higher price. Or maybe the weather will be better than expected, resulting in a large crop and low prices. Either of these unexpected events could cause the price of rice in 6 months to be different. Nonetheless, the farmer who sold, and the consumer who purchased, a futures contract for rice eliminated their risk of the price they would receive or pay. The fact that modern financial systems give rise to such futures markets indicates that a lot of producers and consumers are risk averse. They use futures markets to eliminate the risks they face, and the fact that they do indicates that this hedging of price risk is a valuable risk management service of the financial system.

**Diversification** is a second broad way that financial systems provide risk management services. How does it reduce risk? If an investor holds an equity stake in only one enterprise, as is common in pre-modern economies, the investment return to that equity holding, and hence the value of the holding, will vary from year to year with whatever idiosyncratic factors affect that enterprise. But a modern financial system provides a host of equity securities in which investors can invest their capital. By holding a portfolio of made up of the securities of enterprises having uncorrelated or less-than-perfectly correlated idiosyncratic risks of what the return this year will be for each individual security, most or all of the idiosyncratic risk of variable returns can be eliminated. This is one of the most basic results of modern finance theory. A diversified portfolio of securities can provide the same return as an individual security, but with much less risk in the form of the variability of that return.

A modern financial system, of course, goes much farther than this in providing opportunities for shedding risk through diversification. It provides not only equity securities, but also a host of other financial assets—bonds, bills, notes, bank deposits, and mortgage loans, for example—all of varying degrees of risk. All of this allows investors rather easily to minimize the risk of achieving whatever financial returns they desire, given their attitudes toward risk and return. The vast proliferation of financial instruments, institutions, and markets we see in modern financial systems, along with the substantial resources we devote to them, all testify to the value of the risk management services they provide. Great as these services are, some argue that they could be made far more extensive to cover a wide range of risks that remain uncovered by current risk management institutions (Shiller, 2003).

**Insurance** is a third form of risk management provided by a modern financial system. From experience, we know that every year some cars will be involved in accidents, that some airplanes will crash, that some ships will sink, that some houses will burn down, that some people will become ill, and that some will die. But each of us does not know that our
car will have an accident, that our airline will have a crash, that we ourselves will become ill or die, and so on. These are risks we all bear day to day, week by week, month by month, and year by year, throughout our earthly existence. Insurance companies, however, can predict fairly accurately how many of these adverse events will occur each year, and so they can offer us contracts that insure us against the adverse consequences of these risks. In effect, the insurance company pools together the risks of a large number of individuals, and offers individuals and firms insurance against such adverse consequences. The more extensive are the forms of insurance available to us, and the more competitive are the markets for insurance, the greater is the likelihood that we can manage the risks that are a part of our existence. Modern financial systems provide such insurance services. They help us to manage our risks.

This account of risk management and financial systems leads me to a fundamental question. If modern financial systems provide us with a wide variety of ways in which to manage our risks, why is that good for our economic growth? Earlier in the article, I provided a number of pieces of historical evidence indicating that countries developing modern financial systems early in their histories subsequently grew faster, developed more, and became much richer on average than the far greater number of countries that failed to do so and hence remain relatively poor. Economists and economic historians, I included, have often contended that the modern financial systems of the rich countries—The Netherlands, the UK, the USA, and Japan were the ones I discussed here—benefited in economic development and growth from their financial systems. The financial systems of those nations mobilized more capital than did less developed financial systems in other countries, and then they also allocated the capital that was mobilized more efficiently.

This is certainly part of the answer to the question of why some countries are far richer than others. But I am not sure that the mobilization and efficient allocation of capital are the main contributions of modern financial systems to economic growth. The risk management facilities afforded us by our financial systems, which are just beginning to be discussed by economic and financial historians (although financial economists have discussed them for some time), are equally if not more important parts of the contribution of financial systems to economic modernization.

Why? I think the answer has to relate the facilities for managing risks offered by modern financial systems to their possible impacts on the amount of entrepreneurial activity we might expect to see in economies with and without such facilities. One of the pre-eminent economists of the first half of the 20th century, Joseph Schumpeter, was largely correct, I think, when he argued that the driving force of economic development was entrepreneurship. Most economists listened to Schumpeter, and then proceeded to ignore his insight regarding the importance of entrepreneurial innovation. Entrepreneurship did not seem to be tractable in the contexts of the economists’ mathematically rigorous economic theories and models. Entrepreneurship was important, economist could agree, but it seemed to involve more sociology and psychology than economics. Therefore, economists pretty much left entrepreneurship as a field of study to sociologists and social psychologists.

But just who is this entrepreneur, one of two key actors in Schumpeter’s analysis of economic development? The entrepreneur is the “idea person,” the visionary who innovates in various unexpected ways, and in doing so changes the world and drives
economic development. For Schumpeter, “Development . . . is . . . defined by the carrying out of new combinations,” that he famously went on to characterize as follows:

This concept covers the following five cases: (1) The introduction of a new good . . . or of a new quality of good. (2) The introduction of a new method of production . . . (3) The opening of a new market . . . (4) The conquest of a new source of supply of raw materials or half-manufactured goods . . . (5) The carrying out of the new organization of any industry, like the creation of a monopoly position . . . or the breaking up of a monopoly position. (Schumpeter, 1934, p. 66)

The other key actor in Schumpeter’s model is, of course, the banker, the person who provides the entrepreneur with the financing to implement his or her visionary ideas. I would generalize Schumpeter’s banker by saying it is a shorthand term for the entire financial system. The entrepreneur and the banker are risk takers, and entrepreneurial innovation financed by bankers is all about taking risks, often large risks, that may have only limited probabilities of succeeding. Such risks will not be taken if there are no entrepreneurs, or if entrepreneurs are timid. Much the same can be said if there are no bankers, or only timid ones. In that case, there will not be much development. The economic world will stay much the same year after year, century after century, as it did for much of recorded history. But all that changed in recent centuries, at least in a few countries such as those contained in Table 1. These countries developed good financial systems early in their modern histories, an entrepreneurial achievement in itself, and also one that subsequently fostered and sustained the higher levels of non-financial entrepreneurship characterized by Schumpeter in the quotation above. Good finance helped to institutionalize entrepreneurship, and the countries that had it raced ahead of the pack.

If entrepreneurship and its financing are essentially about risk-taking, how does that relate to my discussion of the role of modern financial systems in promoting better risk management? I arrive at a seemingly paradoxical conclusion. Because modern financial systems enable economic actors to reduce and better manage their economic and financial risks, they promote a higher level of risk-taking, that is, they promote a higher level of entrepreneurship. By being able better to manage many of our risks through the facilities for hedging, diversification, and insurance afforded by modern financial systems, we tend to take more risks. As a result of having higher levels of entrepreneurship induced at least in part by our modern financial systems, we as individuals, along with the rich economies in which we live, tend as a consequence to prosper, grow, and develop more rapidly than do people and economies whose financial systems provide fewer opportunities for sophisticated risk management. If my reasoning here has a modicum of validity, the risk management facilities provided by our modern financial systems are not simply a minor byproduct of economic and financial development. They are at the very core of entrepreneurship and economic development.

6. Conclusion

The hypothesis developed here that modern financial systems, by offering a wide variety, although hardly a complete menu, of ways to manage risks, tend to encourage risk taking
and entrepreneurship is just that, a hypothesis. It requires further refinement, as well as systematic investigation and testing. Advancing the hypothesis is just a first step, and I hope that others will join in exploring its ramifications, both in history and our contemporary world. Some day it may not even seem paradoxical that by helping economic agents to reduce and manage their risks, financial systems promote higher levels of risk taking and entrepreneurship. Perhaps we shall come to think of that as obvious.

References


