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The Relationship of European Banking and Financial Elites in a Historical Approach*

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The economic crisis that erupted in 2007 and its consequences inspired this book. According to observations, mistrust of the financial sector emerged during and after the crisis, which later intensified. In this context, the issue of the responsibility of financial elites arose, the study of which had not received sufficient attention among economists and economic historians in previous decades. The authors assume that not only does the regulatory structure of financial markets and financial organisations determine the course of action of the financial elite, but to some extent, the financial elite also influence the development of the regulatory structure. According to *Edward Kane,* financial innovation plays a key role in the ongoing conflict of interest between the financial regulatory authority and regulated entities (institutions and individuals). In his view, financial innovations are more commonly used to circumvent the existing regulatory framework. Therefore, innovation plays a key role in the continuous renewal of regulation (it is sufficient to substantiate this claim by considering the current role and impact of FinTech). However, the relationship between regulatory and regulated is more complex. On the one hand, on the regulatory side, for example, there is not necessarily a need to operate in a stricter regulatory environment. In several cases, a less stringent regulatory environment is seen as more effective in reducing arbitrage. On the other hand, regulated entities also have an impact on the regulatory environment, for example through lobbying, where the role of financial elites also cannot be regarded as marginal. The book discusses the direction of actions of the financial

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elite in various national economies. Thus, the United Kingdom, France and Italy are highlighted during significant eras (e.g. periods of economic crisis, revolution).

The first study deals with the nature of financial crises. Similarities can be observed between financial crises, regardless of their location or circumstances. *Charles Kindleberger* identified stages that were valid for all crises: improper lending practices, the formation of certain bubbles (lending, real estate, etc.), insufficient financial resources, crisis, withdrawal of funds, perceived mistrust. The Great Depression of 1929–1933 and the crisis that started in 2007 had radically different receptions by and consequences for existing regulation. The impact of the former affected the world's largest economies quite differently. Regulatory responses were much less uniform, and the issue of bank liability emerged distinctly in each country.

Examination of the relationship between ownership structure and profitability in the case of banks leads to interesting findings. Historically, in addition to railway companies, banks were the first companies in Europe to separate ownership and management control functions. According to the book, a strong relationship can be discovered between ownership structure and executive remuneration. At private banks (such as Morgan Grenfell, Schroder, Rothschild, or the Speyer banking house, which is also present and dominant in Hungarian banking history), the remuneration of executives (owners and senior executives alike) generally far exceeded that of "paid" (employed) executives. Nowadays, the situation has changed in part, as the private banking structure is no longer dominant. Managers in employee status are primarily the senior executives at banks, not bank owners. However, this is far from a reduction in remuneration. On the contrary, due to the significant expansion of the financial sector and the complexity of financial transactions (such as M&A transactions), remuneration has in some cases been unrealistic, or at least extraordinary. Employed managers also earned income similar to or in excess of bank owners. In other words, bankers today who risk other people's money had at least as much or higher incomes as bankers who had previously risked their own money.

The next chapter looks back at the period of the French Revolution, the political consequences of which inevitably affected the entire French economy. Traders and bankers not only faced an unfavourable outlook for the French economy (including extremely high public debt and significant inflation), they were also confronted with growing general mistrust. Nevertheless, several individuals were able to gain significant wealth and decisive influence during this period. *Jean-Conrad Hottinguer*, born in Switzerland in 1764, embarked on an outstanding career: after a job as a temporary bookkeeper in Switzerland, he started working for Le Couteulx & C. banking house in Paris, which was headed by the future president of the Banque de France. He then joined the business of another Swiss banker, *Denis Rougemont*, who acted as an agent for Swiss bankers and merchants. However, *Rougemont*'s business went bankrupt in 1792 due to speculative transactions and as a result *Hottinguer* was forced to leave Paris. He settled in London and then moved to the United States, where he remained until the end of the Jacobin dictatorship. According to some opinions, *Hottinguer* provided significant financial support to Napoleon's rise to power and while this cannot be substantiated with concrete evidence, it is certain that he provided the army with food and clothing, which proved to be a rather lucrative activity. In addition to finance, *Hottinguer* also achieved significant success in the field of commerce; establishing trade centres in two major French cities, Le Havre and Nantes. This led to French wines being successfully exported to the United States. The successful Swiss businessman was elected among the governors of the Banque de France in 1803. Then, in 1808, Napoleon endowed him with the title "Baron of the Empire" for his loyalty and services (this circumstance also reinforced the assumption that *Hottinguer* played a significant role in Napoleon's rise to power). With his death in 1844, *Hottinguer* left behind a network of entrepreneurs with a well-functioning, reliable, and stable clientèle – primarily American, Dutch, British, Swiss, and French – that included a wide range of activities, from finance to wine trading and whaling.

The third and fourth studies take us to 20th century Italy. At the end of the First World War, Italy faced crises in several areas in parallel: a fiscal crisis (public debt rose from 80 per cent of GDP to 160 per cent), a banking crisis (due to a shortage of liquidity and resources), and a currency crisis, as the Italian lira depreciated significantly during this period. The study highlights *Alberto Beneduce* as a newcomer to the financial elite, as he was nominated by the Italian government to represent Italy at the League of Nations. *Beneduce* also had close ties to the president of the Bank of Italy, so he had excellent political connections. Later, in 1920, *Beneduce* also represented Italy at the Brussels Conference, which was seen as a first attempt at post-war international cooperation. *Beneduce* was generally engaged in a wide range of activities which characterised the financial elite at the time, including creation of the first, still operational, specialised credit institution (Crediop S.p.A.) in Italy. *Beneduce* suggested that central banks should work together to preserve the stability of the financial system and currency. Here it is worth noting a domestic parallel, as the first governor of Hungary's central bank, Sándor Popovics, also supported this need and called for the establishment of an organisation within an institutionalised framework as soon as possible, in domestic and international forums.

Also worth mentioning is the Italian and Hungarian parallel in the relationship between industrial companies and banks. According to some opinions, mainly published in the second half of the 20th century, the Italian banking system served in a substitutionary function. Due to the inadequacy of market conditions, banks played the role of investors in the industrial sector due to their adequate ability to accumulate capital, within the framework of the law. However, the research presented in the study reveals that Italian industrial companies were not nearly as much the focus of banks as previously thought, and that this interest also showed significant fluctuations over time. We have seen such opinions before and recent research (such as studies by *Béla Tomka* and *Ágnes Pogány)* has yielded similar results.

The next chapter returns to France, which in terms of its financial system from the end of World War II to the 1980s is considered one of the most regulated among European financial systems. This is also due to the fact that from the 1960s the French economy was one of the most dynamically developing European economies, achieving annual economic growth of around 5 per cent for three decades. During this period, the financial elite pursued a number of strategies in the context of the regulatory environment: they sought to take advantage of the existing set of rules, while affecting changes to these rules and at the same time trying to circumvent domestic rules by extending banking activities beyond borders through financial innovation instruments. In several cases, these three tools were used together. For example, the emergence of various collective investment schemes, which were not allowed in France for a long time, can be considered a financial innovation. However, due in large part to bank lobbying, the relevant law was amended in 1963, so many such schemes appeared (Crédit Lyonnais, the most dynamically growing bank of the era, for example, introduced several such products). From the late 1960s, banks began to expand their operations abroad to avoid regulations on domestic operations. The development of international currency markets and the emergence of new financial instruments (such as swaps) played a key role in this. In order to take advantage of capital market developments and opportunities, several banks (such as Paribas) established subsidiaries abroad. Thus, there is a kind of duality with regard to French legislation at the time: on the one hand, foreign expansion and risk-taking were allowed, while on the other hand there were strict rules for domestic business. The latter lasted until the 1970s and 1980s, when regulation moved more towards economic liberalisation and deregulation.

Chapters six and seven cover capital market regulatory issues, primarily through the example of the United Kingdom, with particular reference to investor protection and public oversight. The former began to spread to a greater extent at the international level when it became more difficult to maintain trust and informal relations at the local level (especially after 1948). Prior to this, unfortunately, there was not enough emphasis on investor protection, although several circumstances could have provided good reason for it. Perhaps one of the most outrageous cases in 19th century England is attributed to *Gregor MacGregor*, who “issued” bonds for a non-existent country worth about £ 1.3 million. Nevertheless, by international standards, the level of business trust based on personal contacts, acquaintances and reputation reached an unusually high level in the UK, although not in a generalisable way, and this was the case not only in the capital, but also in rural areas (previously highlighted by *John Stuart Mill).* In this environment, financial intermediaries and advisers played a key role, among which – although the records of intermediaries are unfortunately quite incomplete due to German bombings during the Second World War – we can also find a large number of people belonging to the financial elite. This included *Charles Morrison*, who held senior positions at a number of companies, including the Hounslow & Metropolitan Railway, which expanded London's western metro network (today the Piccadilly Line). He was also a member of the North British & Mercantile Insurance board, which offered fire, water, accident and life insurance on no less than 5 continents (*Morrison*'s full entrepreneurial network is otherwise unknown).

The idea of establishing public oversight had not yet gained ground in 19th century England, but legislation (such as Act CCCX of 1845) also gave shareholders the rights and powers to gain a certain level of insight into the operation of a given credit institution, rather than extending regulatory and supervisory powers. Under the contemporary approach, the control of credit institutions was essentially the responsibility of the shareholders, and consequently the State did not intend to perform the function of the shareholders in part or in full. The financial elite were also particularly essential to this role, acting as financial intermediaries and performing significant tasks in the supervision of credit institutions.

The final two chapters of the volume present the most important international organisations consisting of central bankers and bank supervisors, and their roles. By the end of the 20th century, new supervisory methods had become necessary to effectively control the increasingly complex and international banking activity. Who was responsible for establishing these new supervisory practices at the international level? Perhaps the most important international institution in this regard was the Basel Committee on Banking Regulation and Supervisory Practices (later Basel Committee on Banking Supervision, BCBS). The institution was established in 1974, initially operating in a more informal manner, with the aim of building relationships, sharing information and getting to know each other's supervisory practices. Later, however, it was characterised by an authority-style operation, and in addition to monitoring the international financial system, it made proposals for banking supervision and formalised and raised previously unformulated knowledge to an international level. Given that supervisory practice in the early 1970s was nowhere near as uniform as it is today, common international banking supervision standards have been developed. The BCBS was almost the only institution able to formulate rules for international banking supervision. It has also played an important role in involving overseas authorities, enabling those countries (such as New Zealand) to become actively involved in international supervisory processes. The BCBS has been able to develop into a growing political force over the years, coupled with a growing role and the broadening scope of the supervisory and regulatory area itself, which has contributed gradually to the banking supervisory occupation becoming a profession.

The nine studies in this volume provide a useful and interesting overview of the activities, influence, and role of broadly defined financial elites without falling into the trap of any "conspiracy theories" that are common today. Instead, we find a social and structural analysis of financial elites, and by measuring their influence and presenting their operational directions – for example, by examining their role in institutional change – we can become familiar with their activities and influence on the banking system. In summary, the economic literature available in Hungarian has been enriched with a valuable book on banking history, which provides answers to a number of questions that had not been examined thus far.