

FINANCIAL INNOVATION AND GLOBAL ECONOMIC WELFARE: PAST, PRESENT AND FUTURE



Robert C. Merton

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Winner of the Alfred Nobel Memorial Prize in Economic Sciences in 1997

Monday, 17 October 2016
10.30am – 12pm
Nanyang Auditorium

Chairman: Hong Ru, Division of Banking and Finance

Abstract

Nearly 60 years ago, Nobel laureate Robert Solow's fundamental work on the determinants of long-run economic growth concluded that it was technological progress, not high rates of saving or population growth that accounts for the vast bulk of growth. Subsequent research pioneered by Nobel laureate Douglas North found that having well-functioning financial and legal institutions are a strong predictor of the subsequent leaders in economic development of their times. In essence, without the means for transforming technological innovation ideas into broad implementation in the economy, the growth benefits of technological progress will not be realized.

For the past four decades, financial innovation has been a central force generally improving the global financial system with considerable economic benefit having accrued from those changes. The scientific breakthroughs in finance in this period both shaped, and were shaped by, the extraordinary innovations in finance practice that expanded opportunities for risk sharing, lowering transaction costs and reducing information and agency costs. However, as a consequence of the financial crisis of 2008-9, strong concerns were raised about financial innovation carrying with it increases in risks, particularly from mismatches between innovation and the infrastructure necessary to support it.

Through historical examples, we demonstrate how crisis can induce implementation of financial innovations, which not only address the challenges of the crisis but also provide permanent benefits to the economy. These examples illustrate how financial innovation can materially impact the real economy, both in terms of efficiency gains and environmental sustainability. We examine financial innovation in the present in response to global aging demographics and major expansion in GDP in Asia. We then explore the growth opportunities and challenges for the financial-service industry from financial and technological innovation in the impending future. A case is presented that trust will be the innovation-implementation global business model in the future.

About the Speaker

Robert C. Merton is the School of Management Distinguished Professor of Finance at the MIT Sloan School of Management and University Professor Emeritus at Harvard University. He was the George Fisher Baker Professor of Business Administration (1988–98) and the John and Natty McArthur University Professor (1998–2010) at Harvard Business School. After receiving a Ph.D. in Economics from MIT in 1970, Merton served on the finance faculty of MIT's Sloan School of Management until 1988 at which time he was J.C. Penney Professor of Management. He is currently Resident Scientist at Dimensional Holdings, Inc., where he is the creator of Target Retirement Solution, a global integrated retirement-funding solution system.

He has received the Alfred Nobel Memorial Prize in Economic Sciences in 1997 for a new method to determine the value of derivatives. He is past president of the American Finance Association, a member of the National Academy of Sciences, and a Fellow of the American Academy of Arts and Sciences.

He has also been recognized for translating finance science into practice. He received the inaugural Financial Engineer of the Year Award from the International Association for Quantitative Finance (formerly International Association of Financial Engineers), which also elected him a Senior Fellow. He received the 2011 CME Group Melamed-Arditti Innovation Award, and the 2013 WFE Award for Excellence from World Federation of Exchanges. A Distinguished Fellow of the Institute for Quantitative Research in Finance ('Q Group') and a Fellow of the Financial Management Association, Merton received the Nicholas Molodovsky Award from the CFA Institute. He is a member of the Halls of Fame of the Fixed Income Analyst Society, Risk, and Derivative Strategy magazines. Merton received Risk's Lifetime Achievement Award for contributions to the field of risk management.

Merton's research focuses on finance theory, including lifecycle and retirement finance, optimal portfolio selection, capital asset pricing, pricing of derivative securities, credit risk, loan guarantees, financial innovation, the dynamics of institutional change, and improving the methods of measuring and managing macro-financial risk.

Merton received a B.S. in Engineering Mathematics from Columbia University, a M.S. in Applied Mathematics from California Institute of Technology and a Ph.D. in Economics from Massachusetts Institute of Technology and holds honorary degrees from fourteen universities.

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