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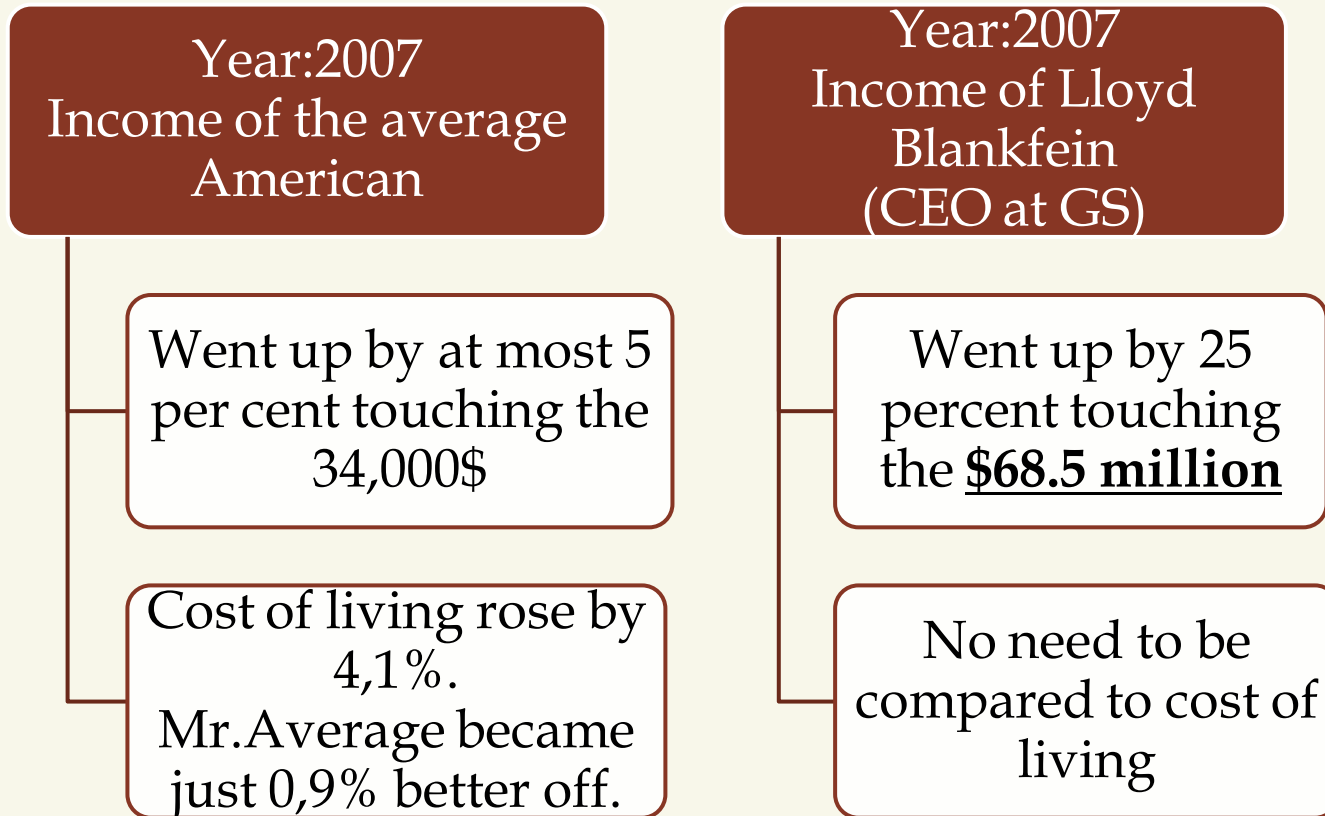
THE ASCENT OF MONEY

A FINANCIAL HISTORY *of* THE WORLD

“...[*The Ascent of Money*] shrewdly anticipates many aspects of the current financial crisis, which has toppled banks, precipitated gigantic government bailouts and upended global markets.”—Michiko Kakutani, *The New York Times*



“Bread, cash, dosh, dough, loot, lucre, moolah, readies, the wherewithal:
call it what you like, money matters.”



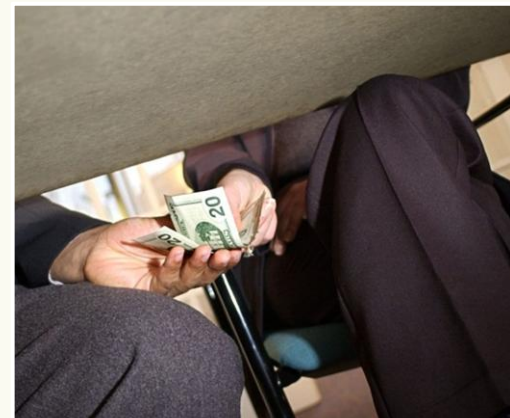
Throughout the history of Western civilization, there has been a recurrent hostility to finance and financiers, rooted in the idea that those who make their living from lending money are somehow parasitical on the 'real' economic activities of agriculture and manufacturing. This hostility has three causes:



Debtors outnumber creditors and the former have seldom felt well disposed towards the latter.



Financial crises occur frequently and thus finance seems to be something bad.



Disproportional Service by minorities that enjoyed success because of kinship and trust.

However, the evolution of credit and debt was as important as any technological innovation in the rise of civilization, from ancient Babylon to present-day Honk Kong

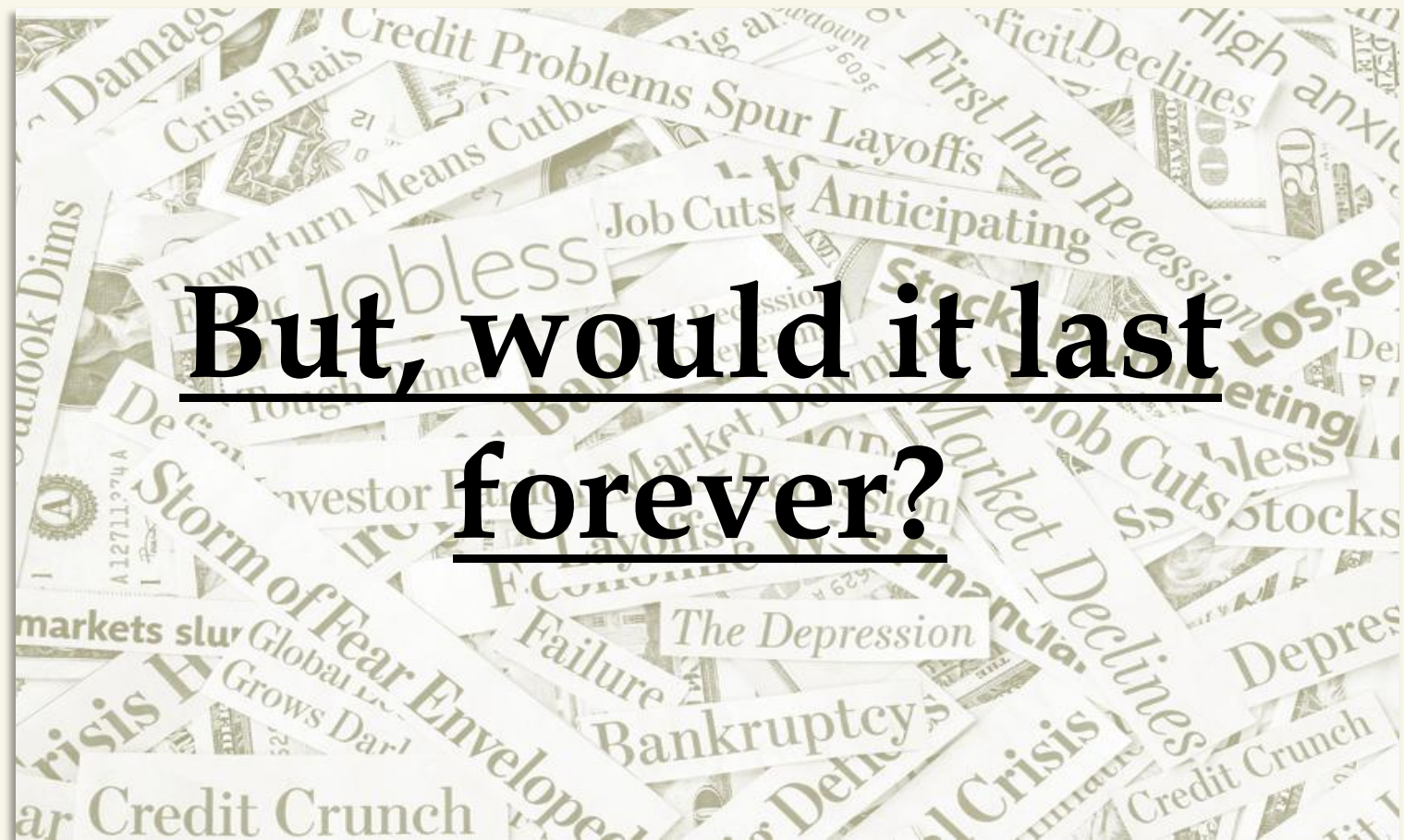
“The ascent of money has been essential to the ascent of man.”

Jacob Bronowski

Behind each great historical phenomenon there lies a financial secret. For example, the Renaissance created such a boom in the market for art and architecture because Italian bankers like the Medici made fortunes by applying Oriental mathematics to money.



At times, the ascent of money has seemed inexorable. During the 2001-2007 period planet finance started dwarfing planet earth. Finance at many countries became basic component of GDP and some “financial wonders” occurred (eg. World’s stock markets became extremely powerful, grown rate of derivatives volume, hedge funds have proliferated, bonds and real estate boom)



Loan Sharks



An old Loan shark story

Location: Northern Italy

Time: During the early thirteenth century (defunct Roman Empire)

A crucial problem: ill-suited to complex calculation numerical system (iii, iv etch)

A consequence: primitive economic life

The Contribution: A young mathematician called Leonardo of Pisa, or Fibonacci, influenced by the "Indian Method" of mathematics, introduces his path-breaking book Liber Abaci (The book of calculation)

Areas of effect

1. Decimal System
2. Concept of present value
3. Application of ds to bookkeeping, to currency conversions and to the calculation of interest
4. Explanation of fractions and Fibonacci sequence

Italian commercial centers like Fibonacci's home town of Pisa or nearby Florence proved to be fertile soil for such financial seeds. But it was above all Venice, more exposed than the others to Oriental influences, that became Europe's great lending laboratory. However, **cultural obstacles**, impeded for years the translation of Fibonacci's theories into effective financial practice. **For Christians lending money was a sin (prohibited) and Jews might legitimately lent to a Christian, though not to another Jew. Shakespeare's play The Merchant of Venice is a brilliant example of these problems but also an evergreen "lesson" about money lending.**

The Merchant of Venice synopsis

A Jewish moneylender called Shylock agrees to lend the lovelorn suitor Bassanio three thousand ducats, but on the security of Bassanio's friend, the merchant Antonio. Shylock demands a pound of flesh (Antonio's death) in case of not paying back the loan. Antonio's ships are lost. Shylock insists on his bond. The law recognizes that, but, because he is an alien, requires the loss of his gods and life for plotting death of a Christian. He escapes only by submitting to baptism.

☞ What are we taught today about money - lending from the story?

1. The power of lenders to charge extortionate interest rates when credit markets are in their infancy.
2. The importance of law courts in resolving financial disputes without recourse to violence.
3. The vulnerability of minority creditors to a backlash by hostile debtors who belong to the ethnic majority. (For in the end, of course, Shylock is thwarted).

... But ...

Why don't the Shylocks always lose out?

A modern Loan Shark story



- ☞ On Thursday, 17 August 2006, a loan shark who charged "11 million per cent" interest a year has been sentenced at Glasgow Sheriff Court to 10 months in prison.
- ☞ His name is Gerard Law and the deprived area of Glasgow was a perfect ground for him. The standard rate of interest Law charged his clients was 25% a week. His method was simple. He used his clients cash cards in return for a loan. The typical loan amount was \$50. The speed with which his clients became entirely trapped by their debts is scarcely surprising. Twenty-five per cent a week works out at over 11 million per cent compound interest a year.

Fertile Ground and G.Law's tactics

1. Vulnerable people at deprived areas (unemployed and sometimes mental subnormal)
2. Threat in case of missing a payment (reputation)
3. No mainstream financial institution
4. Law had to be rapacious and ruthless precisely because the members of his small clientele were very likely to default on their loans (high ir)

However, high rates cause financial or law deadlocks (in G.Law's case people called the police). On the other hand, generosity (low ir) wouldn't pay sharks back. So how did moneylenders learn to overcome the fundamental conflict?

☞ The answer is by growing big - and growing powerful.

The Birth of Banking



☞ Shylock was not the only one to discover the inherent weakness of moneylending. In the early 14th century finance in Italy had been dominated by the three Florentine houses of Bardi, Peruzzi and Acciaiuoli. All three were **wiped out** as a result of **defaults**.

However, the rise of the Medici illustrates the potential power of moneylenders. No other family left such an imprint on age as the Medici left on the Renaissance.

But how did Medici **gain** and **maintain** power?

The Medici Family Timeline



- ❧ Prior to the 1390s, it might legitimately be suggested that the Medici were more gangsters than bankers. Nowadays, sometimes, they are still called as the “Godfathers of The Renaissance”.
- ❧ Then came Giovanni di Bicci de Medici. It was his aim to make the Medici legitimate. In Rome, he built up his reputation as a **currency trader** (the papacy was the ideal client).

By 1420, he had established a branch of the bank in Venice, as well as Rome, Geneva, Pisa, London and Avignon. Currency trading was the bank’s main activity. However, an early form of bills of exchange was introduced (oral instruction)

➔ The real key to the Medicis' success however, was not so much size as diversification.

∞ The Medici bank was in fact multiple related partnerships, each based on a special, regularly negotiated contract. Branch managers were not employees but junior partners who were remunerated with a share of the profits.

It was this decentralization that helped the Medici bank so profitable.

Over the years, the Medici family gained tremendous power. Botticelli's Adoration of the Magi is a sample of the Medicis' will to be patrons of the art.



Adoration of the Magi, 1475 (Botticelli)

➔ The subjugation of the Florentine republic to the power of one super-rich banking family inevitably aroused opposition. Many expulsions and murders took place in order to end the Medici rule. Branch managers became more powerful and the bank depended on attracting deposits instead of foreign exchange.

❧ The End

Finally, in 1494, amid the chaos of a French invasion, the family was expelled and all its property confiscated and liquidated.

❧ The achievement

The Medici were the first bankers to make the transition from financial success to hereditary status and power. They learnt a crucial lesson: in finance small is seldom beautiful. By engaging in currency trading as well as lending, they reduced their vulnerability to defaults and spread their risks.

➔ The Italian banking system became the model for North European Nations. The seventeenth century saw the foundation of 3 distinctly novel institutions that pioneered in a different way.

- ❧ The Amsterdam Exchange Bank pioneered the system of cheques and direct debits that we take for granted today.
- ❧ The Swedish Riksbank (1656) performed the same functions as AEB but also engaged in lending and pioneered the practice of fractional reserve banking.
- ❧ The Bank of England (1694) pioneered the use of promissory note that did not bear interest. (designed to facilitate payments without the need for both parties in a transaction to have current accounts)

Conclusion



- ☞ The important point to grasp is that with the spread through the western world of
1. cashless transactions
 2. fractional reserve banking
 3. central bank monopolies on note issue

the nature of money evolved.

No longer was money understood as metal melted down into coins. Now money represented the sum total of liabilities (deposits and reserves) incurred by banks. Credit was the total of banks' assets (loans).

Financial innovation took place and set the basis for a modern monetary system, with relationships between debtors and creditors brokered by increasingly numerous institutions called BANKS.