

Lecture 4: Development of Banking in Medieval Europe

- Monetary transaction in the medieval Europe
- Banking in Northern Italy
- Money Lending Business and Christianity
- Birth of Banking in 16C

Monetary transaction in the medieval Europe

- Problems in Pisa in 13C, Counting Money
 - Northern Italy in the 13C, a land subdivided into multiple feuding city-states, the many remnants of the defunct Roman Empire
 - a numerical system (i, ii, iii, iv. . .) singularly ill-suited to complex mathematical calculation, or commerce.
 - merchants also had to contend with seven different forms of coinage in circulation.

Underdevelopment of Financial System

- Underdevelopment of Financial System causing problem in the medieval Europe
 - By comparison, economic life in the Eastern world in the Abbasid caliphate or in Sung China was far more advanced, just as it had been in the time of Charlemagne.
- Enter Leonardo of Pisa, or Fibonacci:
 - ▣ Fibonacci, the son of a Pisan customs official based in now Bejaia in Algeria.

Pisa, Florence, and Venice, Italy



Leonardo of Pisa, or Fibonacci

- Fibonacci's path-breaking book *Liber Abaci* :
 - ▣ *Liber Abaci*, 'The Book of Calculation', published in 1202, introduced the 'Indian method' of mathematics, a combination of an Indian and Arab insights, revolutionize the way Europeans counted.
 - ▣ the Fibonacci sequence of numbers (0, 1, 1, 2, 3, 5, 8, 13, 21; . . .), in which each successive number is the sum the previous two, and the ratio between a number and its immediate antecedent tends towards a 'golden mean' (around at 1.68).

Fibonacci's *Liber Abaci*

- Also included are:
 - ▣ the concept of present value
 - ▣ Most important of all, introduction of Hindu-Arabic numerals, i.e., decimal number system.
- He also showed how it could be applied to commercial bookkeeping, to currency conversions and, crucially, to the calculation of interest.

Pisa, Florence, and Venice

- Pisa, Florence, and Venice as center of financial development
 - ▣ Significantly, the examples in Fibonacci's book are made more vivid expressed in terms of commodities like hides, peppers, cheese, oil and spices.
 - ▣ The first significant application of mathematics to making money and, in particular, to lending money.
 - ▣ Italian commercial centers like Fibonacci's home town of Pisa, or nearby Florence, or Venice proved to be fertile soil for such financial seeds

Venice, Italy as banking center

- Venice became Europe's great lending laboratory.
 - ▣ Due to its location, more exposed than the others to Oriental influences
- Jewish money lender, as loan shark
 - ▣ Shakespeare's play *The Merchant of Venice*:
 - ▣ the Jewish moneylender Shylock agrees to lend the lovelorn suitor Bassanio three thousand ducats, but on the security of Bassanio's friend, the merchant Antonio.

Venice, Italy as banking center

- Story of *The Merchant of Venice*, continued:
 - ▣ As Shylock, says, although Antonio is a ‘good’ man , meaning not that he is especially virtuous, but that his credit is ‘sufficient’. However, Shylock also points out that A lending money to merchants (or their friends) is risky, so demanded, as a security, literally a pound of flesh of Antonio, in effect Antonio’s death, if he cannot fulfill his obligations.
- Why this bizarre story?
 - ▣ The answer is of course that Shylock is one of the many moneylenders in history to have belonged to an ethnic minority, the Jew. They are money sharks.

Money lender as loan sharks?

- Jews as money lender at Shakespeare's time
 - Jews had been providing commercial credit in Venice for nearly a century.
 - They did their business in front of the building once known as the Banco Rosso, (sitting behind their tables and on their benches, their *banci*), located in a cramped ghetto some distance away from the center of the city.

Money lending and Christians

- Money lending and Christians
 - For Christians, lending money at interest was a sin, so a taboo.
 - Usurers, people who lent money at interest, had been excommunicated by the Catholic church, esp. the Franciscan and Dominican orders detested money lending at an interest.
 - Christian usurers had to make restitution to the Church before they could be buried on hallowed ground.

Jews as money lenders in ghetto

- Money lending in Jewish communality
 - ▣ Money lending to non-Jews by Jews, so by Jews to non-Jews accepted as way to avoid sins, which they did in Spain.
 - ▣ Jews had been were forced to adopt Christianity by a decree of 1497 or expelled from Spain in 1492. So they sought refuge in the Ottoman Empire.
- The Jewish presence in Venice
 - ▣ From Constantinople and other Ottoman ports they then established trading relationships with Venice, dating back from 1509, seeking refuge from the War of the League of Cambrai.

Jews as money lenders in ghetto

- Jews as money lenders in ghetto
 - ▣ At first the city's government was reluctant to accept the refugees, but it soon became apparent that they might prove a useful source of money and financial services, since they could be taxed as well as borrowed from.
 - ▣ In 1516 the Venetian authorities designated a special area of the city for Jews on the site of an old iron foundry (which became known as the ghetto nuovo (getto literally means casting)).

Jews as money lenders in ghetto

- Jews as money lenders in ghetto
 - confined every night and on Christian holidays. Those who stayed in Venice for more than two weeks were supposed to wear a yellow O on their backs or a yellow (later scarlet) hat or turban. Residence was limited to a stipulated period on the basis of condotte (charters) renewed every five years.
 - A similar arrangement was reached in 1541, with some Jews from Romania, who were accorded the right to live in another enclave, the *ghetto vecchio*.
 - By 1590 there were around 2500 Jews in Venice. Throughout the sixteenth century, the position of the Venetian Jews remained conditional and vulnerable.

Jews as money lenders in ghetto

- Jews as money lender, as social outcasts
 - In 1537, when war broke out between Venice and the Ottoman Empire, the Venetian Senate ordered the sequestration of the property of 'Turks, Jews and other Turkish subjects.
 - Another war from 1570 to 1573 led to the arrest of all Jews and the seizure of their property, though freed and had their assets returned after the war.
 - The repetition of similar events occurred during 16C. Jews were considered to be outcast doing sinful business, restricted in doing money business, threats of confiscation or expulsion.

The nature of money lending in 16C Italy

- The nature of money lending revealed in in 16C Italy
 - The story of Shylock, though fictional is not entirely removed from Venetian reality, and illustrates three important points about early modern money-lending:
 - 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.

Money Lending and anti-Semitism

- Money Lending and anti-Semitism
 - ▣ The Merchant of Venice raises profound questions about economics as well as anti-Semitism.
 - ▣ Shylock is a loan shark, a primitive money-lending, taking on like the poor or the desperate. They have been always, thriving all over the world
 - ▣ Interest rates often rise hundred or thousand percent per year. Examples: payday loans, emergency loans, card loans, etc.

Inherent conflict in Money lending Business

- Inherent conflict in Money lending Business
 - Fundamental problem of creditor:
 - if they were too generous, they made no money;
 - if they were too hard, like loan sharks, people eventually called in the police
 - the problem is all the more acute when the creditor is a foreigner?

Loan sharking and Creditor Problem

- Loan sharking dilemma
 - Loan sharking is crime, punishable harshly, charging insanely high interest, using ruthlessly violent forces to collect payments.
 - But why do they exist?
- Creditor Problem
 - In the 14C, finance in Italy had been dominated by the three Florentine houses of Bardi, Peruzzi, and Acciaiuoli, all wiped out in the 1340s as a result of defaults by two of their principal clients, King Edward III of England and King Robert of Naples.

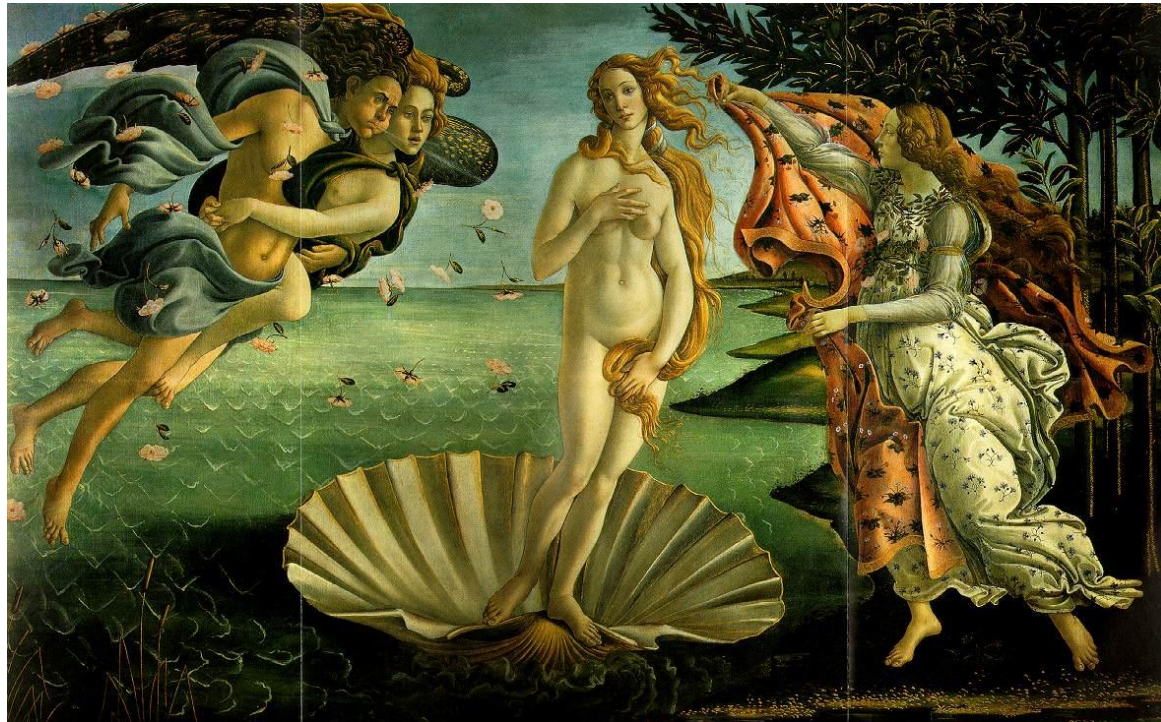
Emergence of Banking in Italy

- Creditor or Banker's Problem
 - One solution growing big, and growing powerful.
- Medici Banking
 - The Medici family or The **House of Medici** or **Famiglia de' Medici** of Florence: 13C-18C

The Birth of Banking

- The Medici family or The **House of Medici** or **Famiglia de' Medici** of Florence: 13C-18C
 - a political dynasty, banking family and later royal house
 - The Medici family was connected to most other elite families of the time through strategic marriages, partnerships, or employment,
 - as a result of which the Medici family had a position of centrality in the social network: several families had systematic access to the rest of the elite families only through the Medici, perhaps similar to banking relationships.

Medici sponsoring artists like Sandro Botticelli



The Birth of Banking

- The Medici family, at height in 15-16C
 - ▣ left indelible marks on the Renaissance.
 - ▣ two Medici became popes (Leo IX and Clement VII);
 - ▣ two became queens of France (Catherine and Marie); three became dukes (of Florence, Nemours and Tuscany)
 - ▣ Niccolo Machiavelli, who wrote their history. *The Prince*, dedicated to Lorenzo the Magnificent
 - ▣ supported the arts and sciences, that ran the gamut of genius from Michelangelo to Galileo.
 - ▣ their dazzling architectural legacy

The Birth of Banking

- The Medici family, how they became powerful?
 - ▣ They were foreign exchange dealers: members of the Arte de Cambio (the Moneychangers' Guild), though started in wool business.
 - ▣ They became known as bankers (*banchieri*) because, like the Jews of Venice, they did their business literally seated at benches behind tables in the street.
 - ▣ Prior to the 1390s, the Medici were more gangsters than bankers: a small-time clan, notable more for low violence than for high finance, many sentenced to death.

The Birth of Banking

- Giovanni di Medici , a currency trader.
 - ▣ From 1385 and on, Giovanni, a currency trader.
- Giovanni and his 'banking' business
 - ▣ so that any long-distance trade or tax payment was complicated by the need to convert from one currency to another.
 - ▣ The Medici transformed to moneylender in Florence doing most of their business with the papacy of the Vatican.

The Medici in the Republic of Florence

- The success of Medici
 - Medici family made money mostly in currency conversion, a lucrative business, given the number of different currencies flowing in and out of the Vatican's coffers at a time when multiple systems of coinage, some gold, some silver, some base metal.
- The Medici family, significant in politics
 - ▣ Giovanni di Bicci de' Medici, Cosimo de' Medici (*Pater Patriae*), Piero I de' Medici (*Piero the Gouty*), Lorenzo I de' Medici (*Lorenzo the Magnificent*), Piero II de' Medici (*Piero the Unfortunate*), Cardinal Giovanni de' Medici

The Medici in the Republic of Florence

- Medici and 'banking' business
 - ▣ Giovanni returned to his native Florence in 1397 to expand business
 - ▣ passed on the business to his eldest son Cosimo in 1420, when the branches of Medici banks in Venice, Rome, Geneva, Pisa, London and Avignon.
 - ▣ also acquired interests in two Florence wool factories.
- Medici Introduced the bills of exchange (*cambium per literas*) , very important development in the course of the Middle Ages as a way of financing trade.

The rise and fall of Medici

- The rise and fall of Medici
 - ▣ The subjugation of the Florentine republic to the power of one if super-rich banking, family inevitably aroused opposition.
 - ▣ Between October 1433 and September 1434 Cosimo and many of his supporters were exiled from Florence to Venice. In 1478 Lorenzo's brother Giuliano was murdered.
 - ▣ The bank itself suffered as a result of Lorenzo's neglect of business in favour of politics.

The rise and fall of Medici

- The rise and fall of Medici
 - ▣ In 1494, amid the chaos of a French invasion, the family was expelled and all its property confiscated and liquidated.
 - ▣ Blaming the Medici for the town's misfortunes, the Dominican preacher Girolamo Savonarola was ensued by a mob invasion of the Medici palace and burned most of the bank's records.

The essence of the Medici banking business

- *Bill of Exchange* the essence of the Medici banking business.
 - ▣ If one merchant owed another a sum that could not be paid in cash until the conclusion of a transaction some months hence, the creditor could draw a bill on the debtor and either use the bill as a means of payment in its own right or obtain cash for it at a discount from a banker willing to act as broker.
 - ▣ Whereas the charging of interest was condemned as usury by the Church, there was nothing to prevent a shrewd trader making profits on such transactions.

The essence of the Medici banking business

- *Banking* of the Medici banks.
 - ▣ Deposits or shares: no cheques; instructions given orally, and written in the bank's books. There was no interest; depositors were given *discrezione* (in proportion to the annual profits of the firm) to compensate them for risking their money.
 - ▣ The *libro segreto*, literally the secret book, of Giovanni sheds fascinating light on the family's rise a story of meticulous bookkeeping.

The essence of the Medici banking business

- *Banking* of the Medici banks.
 - The Medici used early form of balance sheets, though did not systematically use the double-entry method, though it was known in Genoa as early as the 1340
 - The real key to the Medicis' success, however, was not so much size as diversification.
 - Whereas earlier Italian banks had been monolithic structures, easily brought down by one defaulting debtor, the Medici bank was in fact multiple related partnerships, each based on a special, regularly renegotiated contract.

The Medici in the Republic of Florence

- *Banking* of the Medici banks.
 - ▣ Branch managers were not employees but junior partners who were remunerated with a share of the profits. Rate of return of ranged in the range of 30-36 percent.
 - ▣ In essence, the *innovative banking skill of bills of exchange* coupled with meticulous bookkeeping, diversified banking, profit sharing was the key to the success.
 - ▣ By the time Pius II became pope in 1458, Cosimo de' Medici effectively was the Florentine state. He is King in everything but name.

Adoration of the Magi of 1475 (Botticelli)

- Cosimo the Elder, his two sons Piero (in red) and Giovanni (in white). Also in the picture are Lorenzo (in a pale blue robe) and, clasping his sword, Giuliano



The rise and fall of Medici

- ▣ Medici (the Younger) was summoned back to Florence and in 1569 was created Grand Duke of Tuscany. The ducal line endured for more than two hundred years, until 1743.
- ▣ the Medici, a Success Story of Financier
 - ▣ the Medici were the first bankers to make the transition from financial success to hereditary status and power.

The rise and fall of Medici

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