

VI. Banking, Credit, and Finance in Late-Medieval Europe, 1250 - 1500

A. Week 10: The Medieval Church, Loans, and the Usury Doctrine

Revised: 13 November 2013

The Medieval Usury Doctrine 1

- (1) **Definition of Usury:**
- **the absolute prohibition against charging or accepting any interest or any other fixed return on a loan**
- - exacting any payment above the principal of the loan
- (2) **How important is the usury doctrine?**
- **Charles Kindleberger:** 'usury belongs less to economic history than to the history of ideas'
- (3) **My Objective: to prove Kindleberger wrong**
- -a) **deep influence on medieval & early-modern society, economic, social, political philosophies: to the French Revolution (1789)**
- - b) **shaped evolution of European financial institutions**

The Medieval Usury Doctrine 2

- (4) **Returns on Invested Capital:** what was accepted as **LICIT:** legal & morally acceptable:
- a) **profit:** legitimate return on invested *equity capital*: i.e., capital whose ownership is retained by the investor – making him a part or co-owner of the enterprise
- - i.e., **equity investor entitled to a share of the profits** of the enterprise
- - this return is **residual and thus variable** (not fixed)

The Medieval Usury Doctrine 3

- (4) **Returns on Invested Capital:**
- b) **rent**: legitimate return on capital invested in land whose ownership is also retained by the investor
- - this return is, however, fixed, non-variable: annual return specified by a contract.
- c) **interest (usury)**: an illegitimate and sinful return on capital invested in a loan: i.e., as a fixed, predetermined return over and above the amount of the principal

The Medieval Usury Doctrine 4

- (5) **The Usury Doctrine:** the crucial ecclesiastical provisions (in the medieval Catholic Church) on why interest was a sin (mortal sin)
- a) **the usury prohibitions applied ONLY to a loan contract:** as defined in Roman Law , by the **Justinian Code** (compiled 528-42 CE).
- b) **as a *mutuum*:** literally, ‘**what is mine becomes thine**’: with the **legal transfer of ownership** of the capital in the loan contract from the lender to the borrower –
- **principle applies to loans to the present day.**

The Medieval Usury Doctrine 5

- c) **thus, borrowers entitled to all fruits derived from that loan,**
- - i.e., **any returns or gains** from the subsequent investment of the capital provided in & by a loan contract **belong solely to the borrower:** as the **new owner** of the capital:
- - **lender has no rights** to those investment returns
- - hence any payment of interest is **theft: from the borrower**
- d) ***transfer of ownership of the capital*** is what distinguishes a loan and interest payments from all other forms of invested capital
- e) **usury or interest: also defined as a fixed and pre-determined return** or payment on capital in a loan: but note that the same is true of **land rents.**

The Medieval Usury Doctrine 6

- (5) **Usury in Judaism**
- a) **Old Testament: especially the five books of the Pentateuch**
- - **prohibitions against usury** (interest) as strong as in later Christianity: maintained in medieval Rabbinical Judaism
- - **exceptions:** legitimate to charge alien peoples interest: but same true in Christianity
- - **Ezekiel 18.13:** 'He who hath given forth upon usury and taken increase: shall he live? He shall not live – he shall surely die.'
- - **Bishop St Ambrose of Milan (339-397 CE):** 'If someone takes usury, he commits violent robbery (*rapina*), and he shall not live'
- a virtual repetition of Ezekiel 18.13.
- **repeated in later codifications of canon law** on usury

The Medieval Usury Doctrine 7

- 6) **Usury in Islam: death of Muhammad in 632 CE - Koran (Qu'ran):** similarly forbade all interest: **usury = *ribâ***, meaning 'excess': many Koranic texts similar to later Christian texts
- **Sura 2 - Al-Baqara (MADINA) : Verse 276:**
- 'Allâh will destroy Ribâ [usury] and will give increase for Sadaqât [deeds of charity, alms, etc.] And Allâh likes not the disbelievers, sinners'
- 7) **Hinduism:** similar bans on usury (as interest)

The Medieval Usury Doctrine 9

- (8) **Evolution of the Usury Doctrine in early Christianity: as a sin**
- a) **New Testament: Luke 6.35:** ‘Lend freely, hoping nothing [to gain] thereby.’
- b) **Council of Nicea: 325 CE:** **usury ban applied only to the clergy:** as a sin against charity
- c) **Church Councils under Charlemagne: 768 – 814 CE:** **extended the usury ban to the laity:**

The Medieval Usury Doctrine 9

- 9) **But Church required secular governments to enforce the usury bans**, as follows:
- a) **usury as any sum exacted/paid above the principal in a loan:**
- b **Canon Law: Gratian's *Decretum*, ca. 1140:**
- - based in part on decrees of Second Lateran Council of 1139

The Medieval Usury Doctrine 10

- (10) **The revival and spread of the anti-Usury campaign: as a MORTAL SIN**
- a) **Third Lateran Council: of 1179:**
- - **punishment of excommunication imposed on all unrepentant usurers** (esp. those who did not make financial restitution of ill gotten gains)
- b) **Fourth Lateran Council: of 1215: Anti-Semitism**
- - **since non-Christians were not bound by the usury doctrine**, Lateran IV excoriated all Jews (and other non Christians) who charged interest (though licensed to do so)
- c) **Pope Gregory IX: Decretales of 1234: summarized usury ban punishments** to be enforced by secular courts

The Medieval Usury Doctrine 10

- (11) **The Mendicant Preaching Orders: anti-Usury campaign**
- **Franciscans (1209) and Dominicans (1215): the Friars**
- **- major force in the anti-usury campaign from early 13th century:**
- **- popular mass preaching:** friars spread the gospel and anti-usury campaign amongst the mass of the people, poor especially: **inciting hatred against all usurers – and Jews** (and also Italian bankers known as Lombards)-
- **- Dominicans became** the more hostile of the two to usury
- **- Product of Lateran IV:** which required all laity to attend church at least one a year (Eucharist) + confession
- **- Significance of concept of Purgatory:** both certainty of punishment but the hope of escaping Hell

The Medieval Usury Doctrine 11

- (10) **The Scholastic Usury Doctrines: the ‘Schoolmen’:**
- - **St Albertus Magnus (1206-80) and St. Thomas Aquinas (1225-1274)**
- a) **influenced by both Aristotle and Canon Law:**
- **they provided final foundations of usury doctrine:** as a sin against **Natural Law** and thus a mortal sin against God Himself.
- -b) **Concept of usury as ‘Theft of Time’**, which belongs to God alone: i.e., because usury (interest) calculated by time: per annum rates
- - **question: why is rent** also not such a ‘theft’ from God
- since rents are fixed by time??

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- c) **Aristotle (translated into Latin in 1240s & 1260s):**
- i) **The Sterility of Money:** that money serves one purpose only, as a medium of exchange, and cannot in itself 'fructify' and be the source of additional value, which value comes only from the labour and enterprise of those using borrowed money: hence usury as 'theft'
- ii) **The Concept of Natural Law:** as ordained by God's Will
- d) **The Justinian Code: loan contract as a *mutuum*:** so that ownership of the capital is transferred to the borrower: hence usury as 'theft'

Aristotle on Usury: 'Politics'

- **The most hated sort [of money-making], and with the greatest reason, is usury**, which makes a gain out of money itself, and not from the natural use of it. For money was intended to be used in exchange, but not to increase at interest.
- **And this term usury [τόκος]**, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Whereof of all modes of making money **this is the most unnatural.**

St. Thomas Aquinas on Usury: 1

- **St. Thomas Aquinas (1225-1274): concept of 'fungibles' in a loan contract**
- - (1) **fungibles**: commodities replaced by any other **identical commodity**: non-differentiated: e.g., paper clips (or sheaves of wheat, flagons of wine & oil)
- **coins**: of each silver or gold denomination: fungibles, so that one coin replaced by another
- (2) **'consumption in use fungibles'**: any such fungible commodities (wine, oil, coins) are necessarily **consumed in their use** and can be replaced only by an exact or close replica: but **not** by the same object

St. Thomas Aquinas on usury: 2

- (3) **non-fungibles:**
- **-commodities with individual defining characteristics that are also not consumed in their use:** such as a piece of land, a house, a barn, a horse, ox, donkey, etc.
- **- Aquinas: a loan of a fungible is to be repaid in the exact same amount (quantity) of other but the same identical replacement (replica) commodity,**
- **a non-fungible is to be returned, as the very same commodity:** for which a rent may be charged for the use of that commodity
- **- this concept has the same intellectual foundation as the 'transfer of ownership'** concept, which applies only to a *mutuum* – but to **property rentals** (in which ownership is not transferred)

Dilbert on Fungibles



USURY and the Medieval Economy

- **Economic Considerations in the Scholastic usury doctrines:**
- 1) **The fruition of the doctrine: that usury was a mortal sin against Natural Law:** not just against charity and commutative justice: **but against God**
- 2) **Problem: Scholastic treatises came at height of the Commercial Revolution: in the 13th century**
- - thus, **if most loans were being made for profit-seeking commercial/business reasons**, and not for charitable reasons – to help neighbours in distress,
- **why was usury so sinful for commercial loans?**

USURY and Medieval Economy - 2

- **Economic Considerations in the Scholastic usury doctrines:**
- **3) Answers to that question: Church doctrines could not afford to distinguish** between charitable and investment loans
- – **who could tell the purpose?** – without undermining the integrity of the doctrine:
- - **usury is ANY amount of interest charge on ANY loan that is defined as a mutuum)**
- - **'excessive usury'**: akin to being opposed to **excessive** murders:
- **4) Other reasons: Papacy had ulterior motives in the usury bans:**
- e.g., **to lower the rate of interest (if not get free loans):**
- - **I do not support any such ill formulated theories:** especially when we realize that the true impact of usury laws was the reverse: to raise interest rates. **WHY?**

Exceptions to the Usury Doctrine?

- **Extrinsic Titles**: supposed exceptions
- - these are not really 'exceptions' to allow interest, but to permit legitimate compensation **in accordance with commutative justice**: equality in exchange
- 1) **Poena (Mora)**: penalty for late payment
- 2) **Damnums Emergens**: compensation for any financial loss or damage that the lender suffered after making the loan
- - because he now lacked the capital of funds necessary: to replace destroyed or stolen property

Exceptions to Usury Doctrine - 2?

- 3) **Lucrum cessans**: foregone gains: a disputed title:
- a) **opportunity cost for the lender**: in forgoing **potential gains** that he could have made from legitimate investments
- b) **Cardinal Hostiensis (Henry of Susa)**: ca. 1270: see text on next slide
- c) **Aquinas**: **rejected this title**, as did all other Scholastics: on grounds that
 - (i) **it implied that money was not sterile**, but productive & fruitful
 - (ii) **that lucrum cessans also meant a fixed, pre-determined rate of interest.**

Lucrum Cessans

- **Cardinal Hostiensis (Henry of Susa): ca. 1270**
- If some merchant, who is accustomed to pursue trade and the commerce of fairs, and there profit from, has, out of charity to me, who needs it badly, lent money with which he would have done business, I remain obliged to his *interesse*, provided that nothing is done in fraud of usury... and provided that the said merchant will not have been accustomed to give his money in such a way to usury.
- - **first (or very early) use of the term interest:** *interesse*:
- medieval Latin substantive from: *quod interest*: 'that which remains'.

Usury and coinage debasements?

- **Did Coinage Debasements provide grounds for other 'exceptions'?**
- 1) **problem of coinage debasement is obvious:** loans made in 'good' coin and repaid in debased, 'bad' coin meant **that the lender suffered a loss** in being repaid his capital (principal sum) with a diminished real value.
- 2) **Did medieval canon lawyers and scholastics recognize this problem?**
 - - **most did not**, though certainly some did (see the detailed online lecture notes – if you are interested)
- 3) **Justinian Digest of Roman Law 46.3.99:** medieval gloss: a creditor cannot be compelled to accept coins in another form, if he is to suffer loss by it;

Usury and coinage debasements?

- 4) **Azo (1220): medieval glossator**: the same money (*moneta*) or measure (*mensura*) is owed that existed at the time of the contract
- - that depended, however, on specifying actual coins in a contract
- -5) **but if a loan is specified only in terms of nominal money-of-account, the amount to be repaid is exactly the same amount**, in nominal terms, despite any intervening inflation (though some canonists disagreed)
- 6) **thus an unresolved problem**: see the lecture notes for further information

The Usury Bans: Hindrances to Growth (1)

- (1) **The Usury Bans**: serious impediment, but not a major barrier to economic growth: did not prevent the development of the financial sector
- a) **ecclesiastical & secular prosecutions**: did occur, but chiefly limited to 'notorious usurers': mostly merchants, bankers
- - still: **increased risks** of confiscation, fines, etc.
- -b) **various means of evasion**: but how effective?

Means of Evading Usury

- 2) **Means of Evasion: most common method:**
- a) **stipulate a sum to be repaid that was greater than the amount that was actually lent** and recorded in the loan contract: e.g., lend £80 but specify £100 as the loan.
- b) **implicit agreement to make late payments:** to claim the right of compensation in *poena (mora)*
- 3) **problem with such evasions:**
- a) **agreements could be contested** in court as **fraudulent**
- b) **evasions of usury bans raised transaction costs**

The Usury Bans: Hindrances to Economic Growth 2a

- 4) **Social, religious, moral problems: risks of excommunication and ultimate damnation**
- a) **very few non-believers (almost no atheists): most feared punishment in Purgatory or even perpetual, in Hell**
- i) **incentive to purchase ‘passports to salvation’:**
- - i.e., to make charitable bequests (and restitution of usurious gains);
- ii) **but misallocations of capital – economic cost**

The Usury Bans: Hindrances to Economic Growth 2b

- b) **fear of social opprobrium (contempt of society):**
- - **thus raised the costs of lending**, as compensation for both risks of confiscation or prosecution, but more for the attendant loss of social prestige, social contacts
- c) **Usury bans: thus restricted the supply of money available for lending:**
- - **and thus drove up interest rates** above potential market rates-
- - **rather than providing cheaper loans, the usury bans ended up increasing the cost of lending**

Lawrence Stone on Elizabethan England

- **Money will never become freely or cheaply available in a society which nourishes a strong moral prejudice against the taking of any interest at all** – as distinct from objection to the taking of extortionate interest. If usury on any terms, however reasonable, is thought to be a discreditable business, men will tend to shun it, and the few who practise it will demand a high return for being generally regarded as moral lepers.
- **Note: Stone is discussing England after 1571**, when the Parliament of Elizabeth I had made interest legal up to 10% (so that 'usury' was $> 10\%$ [more: next term])

B. Credit in the Late Medieval Economy: Lending

- (1) **Positive significance of the usury ban was the way in which it promoted financial innovations:** to supply credit, to circumvent those usury bans
- **which in turn promoted economic growth:** to be seen in this topic
- (2) **Importance of credit in the medieval economy: to provide the economy with both of its necessary ingredients** to function well
 - - **a lubricant:** in form of paper substitutes for coined money
 - - **a fuel:** in the form of both working and fixed capital
 - - **no economy can function without credit:** including medieval
- (3) **Credit: as standard of deferred payment:** 4th function of money
 - - future payment for goods acquired in the present

Credit in Late Medieval Economy 2

- (4) **Chief forms of supplying credit: in lending**
- a) **sales contract with future payment:** most common form of credit – but also subject to the usury bans
- b) **Loan contracts: the *mutuum*** - already discussed
- c) **notarized bonds:** promises to pay a certain sum, to named persons, at a future dates – written and authenticated by notaries
- - **English *recognizances*** (see lecture notes): formal bonds that enjoyed the protection of English royal courts – and sheriffs – unlike most other forms of credit

Credit in Late Medieval Economy 3

- d) **bills (letters) obligatory**: informal, non-notarized promissory notes (holograph instruments): not protected by royal courts
- - **1285: Parliamentary protection for bills in Law Merchant Courts**, involving financial relations with foreign merchants
- - **1335: Edward III's Statute of the Staples**: expanded powers of Law Merchant courts in English towns (civic mayor's courts)

C. Medieval Investment Contracts

- (1) **Partnership Contracts: for Trade**
- a) **compagnia**: a partnership of ancient (Greco-Roman) origins: Italian *con pane* (breaking bread together)
- i) **merchants (& families) pool capital together** as partners in land-based enterprise
- ii) **profits and losses shared in proportion** to each partner's capital investment (equity)
- iii) **but unlimited liability still prevailed**: each and every partner was totally liable for all debts obligations
- iv) **death of withdrawal ended partnership**: to be reconstituted by the survivors (with new partners)

Medieval Investment Contracts 2

- (1) **Partnership Contracts: for Trade**
- b) **Commenda Contract**: uniquely for maritime trade (Mediterranean)
- - Italian contracts (*Collegantia* – in Venice; *Societas maris* – in Genoa) were derived from Arabic *qirad* contracts
- - for one maritime venture only
- - (i) **unilateral commenda (collegantia)**:
- - one single investor **A** put up all the capital, but had no further role in the venture: passive investor
- - **seafaring merchant B** conducted the entire commercial venture
- - **profits split: 75% for the investor; 25% for the merchant**

Medieval Investment Contracts 3

- ii) **bilateral commenda:**
- - **silent partner put up 2/3 of the capital**, and the merchant put up the other 1/3 of the capital
- - **50:50 split of the profits** (but same principle as in other contract)
- c) **risk sharing and limited liability:**
- - **investor: bore the sole risk of the loss of the capital:** he was repaid only if the venture succeeded, and ship returned to port: **seafaring partner not responsible**
- - **but investor's liability was limited** to his capital investment: not liable for debts

Medieval Investment Contracts 4

- 2) **Rentes: Perpetual Rents and Life Annuities**
- a) **Census (Cens, Censo, Rente):** Perpetual rent on land (discussed earlier: Italian agriculture)
- - **originally meant an annual money payment, as rent for land:** quit of all other obligations (hence the term: quit-rent)
- - **in Italian (& other Mediterranean) agriculture:** an urban investor supplies a free (non-communal) peasant with a lump sum of capital

Medieval Investment Contracts 5

- - **in return the peasant pays the investor a fixed annual sum of money** – as rent on the land
- -if peasant defaults, investor can seize the land
- - **otherwise the investor can never get his money back from the peasant in whom he invests:**
- - **can regain his capital (or part) only by selling his claim to a third party**
- - **since this was not a loan, not subject to the usury ban** – in any event, the Church regarded this contract as related to a land-rental contract

Medieval Investment Contracts 6

- b) **The *Rente* in medieval public finance**
- - a logical extension of land-based *census*
- - i) **first undertaken in northern French towns in 1220s:** direct reaction to the new anti-usury campaign conducted by the Dominicans
- - **fear of eternal damnation led many merchants to provide town gov'ts with funds, not with loans, but by buying *rentes***
- -ii) **merchant purchased an urban gov't *rente* for a fixed sum of money in return for fixed annual payments:**

Medieval Investment Contracts 7

- iii) **two types of rentes: for public finance**
- - **life rentes:** for the duration of the investor's life only
- - **perpetual, inheritable rentes:** passed on to survivors, or sold to third parties, who collected annual payments (hence our term: annuities)
- iv) **the investor could never reclaim his capital from the town,** but the town could choose to redeem the rentes at par value at some later date.
- v) **Town governments financed these rentes – annual payments & redemptions – by levying taxes on consumption:**
- **excise taxes** on alcohol, bread, meat, fish, cloth, etc.

Medieval Investment Contracts 8

- c) **the Church's reaction to the *rente* contract**
- - **initial hostility to these *rentes*** as a devious attempt to circumvent the usury doctrine
- - **Pope Innocent IV, c. 1251: ruled that:**
- - **because there was no stipulated repayment (not at behest of investor), there was no loan**
- - if there was no loan (*mutuum*), there was no usury
- - **but papal edict decreed that the annual payments had to come from the products of land** (hence nature of urban excise taxes, as explained)
- - **doubts still remained:** raised at Council of Constance in 1414-18: **resolved by papal bulls in 1425, 1452, 1455**

Italian Public Debt: Forced Loans

- **Florence, Milan, Venice, Siena & other Italian towns:** resorted instead to forced loans from the 13th century
- -1) **wealthier elite of the towns: forced to buy shares of the public debt**, known as the *monte* (Florence & Venice: mountain of debt): originally loans with specified redemption dates
- -2) **paid 5% annually for what** became perpetual debts
- - 3) **secondary markets in public debt claims:** arose from 1320s: when towns ceased redeeming the term debts
- - **markets thus allowed merchants to regain** some of their capital – though often market sales were at discount
- - 4) **prestanze (Florence), prestiti (Venice):** transferable debt claims to be sold and bought in financial markets

Religious Reaction to Forced Loans

- -1) **Reaction of Dominicans & Franciscans:**
- **generally hostile**, but grudging acceptance
- **because loans were forced** (individual volition a key to the usury doctrine),
- **levied in lieu of taxes**, to defend the state
- 2) **Problem arose with secondary markets:**
- how could interest earned on **transferred *monte*** shares be justified??
- **1404 Treatise by Lorenzo Ridolfi** – compared to *rentes*: to justify interest on the public debt

D. Italian Contributions to Late-Medieval Banking Institutions

- 1) **Italians: from Genoa, Lombardy (Milan), Tuscany (Florence), Venice:**
 - - created Europe's fundamental banking institutions, with major innovations in finance
 - - explains Italian dominance of medieval trade
- 2) **twin roots of medieval banking:**
 - a) **deposit and transfer banking:** from money-changing
 - b) **bills of exchange, or foreign exchange banking:** devised by merchants engaged in international trade

Italians: Deposit & Transfer Banks

- 1) **Deposit and Transfer Banking: money-changing**
 - **ancient origins: Greece** in 3rd century BCE; **Rome**
 - **revived in 12th century Genoa** (1180s)
- 2) **money-changers:** always provided foundations
 - - a) **exchanged foreign coins** for domestic coins
 - - b) **purchased foreign bullion** for the prince's mints
 - - c) **necessarily had to provide security** (protection) for the inventory of precious metals
 - - d) **encouraged others to leave moneys, bullion, valuables, etc with them for safe-keeping – on deposit**, which they then lent to other merchants

Quentin Massys: The Banker and His Wife (d. Antwerp: c. 1530)



Italians: Deposit & Transfer Banks 2

- 3) **money-changers as deposit bankers:**
 - - a) **could safely lend** out some portion of deposits
 - -b) **developed fractional reserve system:** a 1:3 ratio permits entire system to expand the money supply by the reciprocal: i.e., three-fold
- 4) **moneta di banco: book account transfers:**
 - **merchants instructed their banker to transfer sums** – in payment – to the deposit account of another merchant to whom such payment is made
- 5) **evolved into cheques** (Arabic origin)

BOOK ACCOUNT TRANSFERS:

Moneta di Banco

in Italian Deposit and Transfer Banking

Merchant A instructs his banker to debit his account by 100 florins and to credit those 100 florins to the bank account of merchant B:

written transfer payment without using any coined money

Deposit Account of Merchant A:

CREDITS	DEBITS	BALANCE
1500 florins		1500 florins
	100 florins	1400 florins

Deposit Account of Merchant B:

CREDITS	DEBITS	BALANCE
1000 florins		1000 florins
100 florins		1100 florins

Italians: Deposit & Transfer Banks 3

- 6) **Diffusion of Deposit Banking in northern medieval Europe**
- a) **The Low Countries:**
 - - **Italians introduced deposit banking from the 1330s**, but soon overtaken by native Flemings (all of whom were money changers)
 - - **Burgundian Netherlands in 15th century:**
 - - **Philip the Good's monetary unification & reform of 1433-35:** severe restrictions placed on money changers as bankers (fearing that they were affecting the money supply)
 - - **by 1480s: deposit bankers banned** – until the 16th century
- b) **England:** no deposit banking until the mid 17th century
 - - **Reason: no money changers** -- because money changing was an official Royal monopoly until the 1640s (see: 2nd term)

The Italian Bill of Exchange - 1

- 1) **Bills of Exchange: unique Italian innovation**
- – **from 1290s:** with no known antecedents
- - **NO relation to Arabic *suftaja* contract:** which involved only one currency (gold dinars)
- - **most important financial innovation in European economic history:** to present day
- 2) **European Origins: from ‘lettres de foire’:**
- **in the Champagne Fairs – 13th century:**
instrumentum ex causa cambii: also Italian

The Italian Bill of Exchange - 2

- 3) **bills of exchange: payments in two different currencies, in two different (and distant) lands,**
- - a) **with four parties: two principals in A and two agents in B** (principal:agent functions)
- - b) **two principals in A send a letter instructing two agents in B** to make and receive payment on their behalf:
- - c) **the bill stipulates that the currency lent or provided in city A be converted into the local currency used in city B, for payment, at stipulated exchange rate**
- - d) **these bills thus obviated need to ship precious metals between towns** (in international trade & finance)

The Italian Bill of Exchange - 3

- 4) **Dual functions: loans & transfers:**
- a) **loan contract:** -
- -i) **by which one merchant lent a sum to another:** to be repaid via agents in another city, in a foreign currency, at a future date (*usance*: about three months)
- - ii) **the lender (*datore*) instructs his agent abroad to purchase a second 'return' bill – *recambium* – to remit the proceeds to him**
- - iii) **chief purpose: to finance international trade:**
- - e.g., to finance the export of spices from Venice to Bruges or London, and from Bruges (or London) to finance the export of woollen cloths to Italy

The Italian Bill of Exchange - 4

- b) **transfer or remittance instrument:**
- - using the same contract, in same form,
- - **to send funds abroad** for either deposit or repayment of financial obligations abroad,
- - again: **without shipping any precious metals** between cities
- - **as just noted to remit funds from city B back to the lender in city A (from loan contract).**

The Italian Bill of Exchange - 5

- c) **the role of the two principals in city A** (Bruges)
- i) **the lender, remitter, 'giver' (*datore, rimettente*):** provides the funds to the borrower, in Flemish pounds groot, and receives a copy of the bill in return (for £55 0s 0d groot Flemish received)
- ii) **the borrower or 'taker' (*prenditore, traente*):**
- **he sells the lender a bill of exchange** for this amount received, and 'draws' it (for payment) on a corresponding bank in Barcelona: **on the payer**

The Italian Bill of Exchange - 6

- d) **the role of the two agents in city B (Barcelona)**
- i) **payee (*beneficario*):** receives a copy of the bill from his principal, the lender in A (*datore*), and presents the bill to the other agent, the payer, **for ‘acceptance’:** for later payment at the stipulated exchange rate in bill.
- ii) **payer (*pagatore*) or acceptor:** on whom the bill is ‘drawn’ for payment
- - **agrees to ‘accept’ the bill, when presented for payment (by the payee) → acceptance bills**
- - **on date of maturity, the payer pays payee the sum of £312 10s 0d of Barcelona (in this bill)**

BILL OF EXCHANGE OR ACCEPTANCE BILL

- as developed by Italian merchants engaged in long-distance trade (from late 13th century)

PRINCIPAL - AGENT RELATIONSHIPS

(1) **PRINCIPAL A: in home city**

- lends money or sells goods on credit to

(2) **PRINCIPAL B: in home city**

- borrows the money or buys the goods from Principal A
- sells a Bill of Exchange to Principal A, and in so doing
- 'draws' the bill for payment on Agent B, in a foreign city, where he maintains a bank deposit account

(3) **AGENT A: in the foreign city**

- receives a copy of the bill from his Principal (A)
- presents the bill for 'acceptance' to Agent B, and thus obtains his agreement to honour the bill on the stipulated date of maturity

(4) **AGENT B: in the foreign city**

- having received a copy of the bill from his Principal (B), agrees to accept the bill for payment, when the bill is presented to him
- pays or 'honours' the bill when Agent A presents the bill for redemption (payment) on the stipulated date of maturity

NOTE: AGENT A, on collecting the bill, will arrange to have a return bill drawn on PRINCIPAL B, who will then pay PRINCIPAL A, on that bill's date of maturity.

Bill of Exchange and Usury - 1

- 5) **The De Roover thesis: usury & bill of exchange**
- a) **bills were devised to circumvent the usury ban:**
- - **by 'disguising' the interest rate** in the stipulated exchange rate in the bill (higher than 'manual' rates)
- b) **But the Church was not fooled:** declared fictitious bills known as 'dry exchange' (cambio secco) to be usury, when the exchange rates on the two bills – the cambium and recambium – were fixed ahead of time
- -c) **a genuine bill of exchange always involved some risk:** that exchange rates would become adverse before the **return bill of exchange** was drawn to remit the funds back to the original lender

Bill of Exchange and Usury - 2

- d) **canon lawyers: stated that true bills of exchange were purchase contracts:** by which one merchant acquired claims to funds in a foreign bank account.
- e) **Medieval bills held to maturity: usury ban prevented merchants from selling bills before maturity, necessarily at DISCOUNT**
- f) **importance: circulation bills of exchange increased the income velocity of money, not its aggregate supply**

Bills of Exchange, warfare, and international trade

- 6) **Warfare, Insecurity & Bullionism:** for the origins of the bill of exchange: my thesis
- -a) **widespread warfare from the 1290s:** encouraged the much wider diffusion of the Italian bills of exchange
- - b) **defensive reaction to far greater insecurity** in international trade: by land & sea – brigandage & piracy
- - c) **reaction also to the almost universal imposition of bullionist laws,** especially those preventing bullion exports-
- - **as noted bills of exchange obviated bullion shipments:** such bills transacted international financial trade (& finance) without transporting any precious metals: left free to circulate in the local economy
- - **lower cost mechanism to finance international trade**

Tavener to Elizabeth I on the 'origins' of Bills of Exchange: 1570

- 'marchauntes naturall exchaunge was first **divised** and used by the trewe dealing marchauntes immediately after that princes did inhibit the cariadge of gould and silver out of their Realmes'
- - **an opinion**: with no historical evidence
- Richard Tawney & Eileen Power, eds., *Tudor Economic Documents*, vol. III, no. iii.5, p. 362.

Bills of Exchange: Northern Europe 1

- -1) **Italian commercial predominance in northern Europe:** → Italians dominated in bills of exchange transactions
- a) **papal tax collection & banking:** major advantage for Italian merchants
- b) **problems:** bill collections were difficult to enforce in law courts, because they lacked any official standing
- c) **Italian commercial networks:** well organized network of fellow Italians, with close family connections, provided trust and financial security
- d) **Law Merchant courts:** see earlier notes

Bills of Exchange: Northern Europe 2

- 2) **The German Hanseatic League:**
- - **did use similar bills** from the 1290s
- - **after more formal organization of the League, in 1370s**, its Diets placed more & more restrictions on their use (see trade lectures)
- **in response to claims of fraud** – and fears of financial instability
- 3) **England: Parliamentary bans on bills of exchange**
- - on grounds that they promoted usury and fraud
- - that their use impeded the import of precious metals

Did Credit Instruments compensate for medieval coin scarcities? (1)

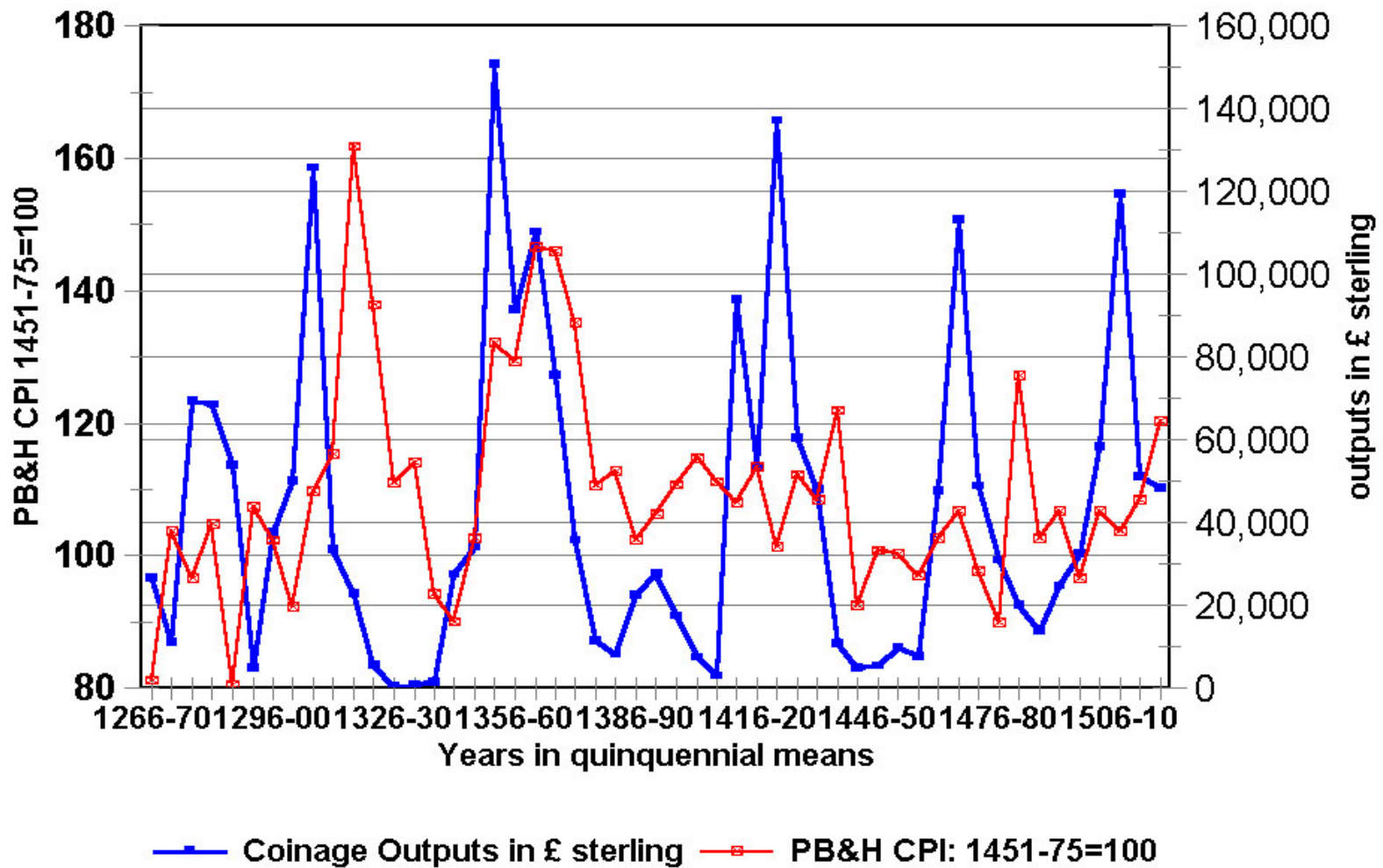
- **Contrary to a majority opinion on this issue, I do not believe that they did so compensate:**
- **1) They were all introduced and diffused before the late 14th century 'bullion famines'**
- **2) They were not negotiable (because of the usury bans):** could not expand the money supply (but did increase the income velocity)
- **3) Government restrictions on use of credit increased:** because of both the **usury bans** and because of **bullionist legislation**

Did Credit Instruments compensate for medieval coin scarcities? (2)

- 4) **lack of court protection for most credit transactions:**
- **restricted their use to small coterie of merchants** (chiefly Italian) who knew & trusted each other
- 5) **very few people had bank accounts and access to these financial instruments:** Peter Spufford – fewer than 10% of adults in Bruges did so
- 6) **Credit instruments were tied to, not yet divorced from, coinage:** so that credit expanded or contracted with coin supplies
- - as shown earlier: **deflation (from monetary contraction) → fear of lending → curbed credit supplies → liquidity crises**

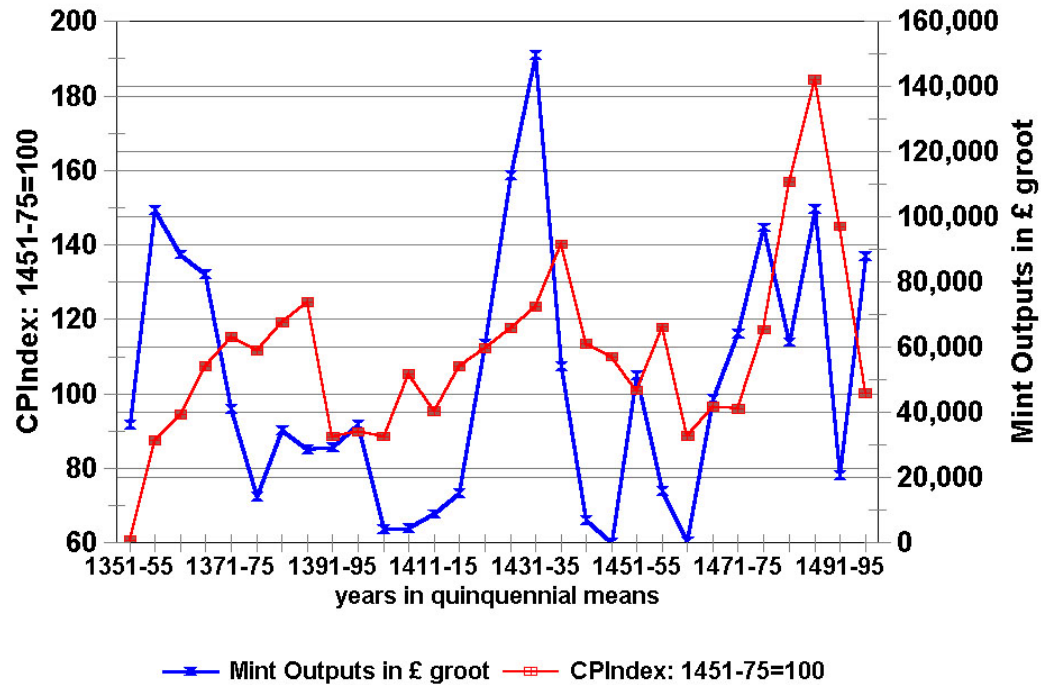
Coinage and Prices in England

Mint Outputs and CPI, 1264-1520



Coinage and Prices in Low Countries

Mint Outputs in £ gr & CPI, 1351-1500



Economic Costs of Deflation

The Economic Burdens of Periodic Deflations

- 1) **increased the burden of factor costs:** rising real costs for interest (capital), rent (land), wages (labour)
- - **the problem of institutional long term 'wage stickiness'** previously discussed
- - **land-rents and interest payments based on fixed term, non-changeable contracts**
- 2) **monetary deflations discouraged borrowing and increased hoarding:** both of which further contracted money supplies and price levels
- 3) **were coinage debasements an effective remedy?**
NO (or almost never)