The Debt Delusion
Evolution and Management of Financial Risk

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Universal Publishers
Boca Raton, Florida
"The Debt Delusion"

Evolution and Management of Financial Risk

Preface - Capitalism or Debtism?

“Debt is the slavery of the free.”
- Publius Syrus, Sententiae, c 50BC

Quite a few years ago, not long before I left the Royal Australian Navy, I was told to have my eyes tested, following a flippant suggestion that an instructor's writing on the blackboard was illegible. He was serious. I was found to have myopia (short-sight) and issued with spectacles. When I first wore those spectacles, I thought a veil had been lifted from my eyes. I could see the distance clearly. Up until that time I believed that everyone else viewed the world in the same way that I did.

On that day I discovered that one's perspective of the world can be changed simply by viewing things in a different way. Now, much later in life, I find myself with a concept of financial management which seems to be out of perspective with what many companies are viewing in the new millennium.

My involvement with Australasian companies, and study of international companies, has led me to believe that modern management places an inordinate emphasis on technology and day to day supervision, at the expense of longer term policy and strategy.

My concept is that corporate policy and leadership structure needs to be improved so that technology can be more directed. I do not consider myself an expert in general management, but I am well qualified to
demonstrate my management concept in the financial area. Maybe this book will change the perspective of some company directors, senior managers, business owners and financial officers by demonstrating a different view of financial management.

Although I find the corporate level of debt extraordinarily high in the twenty-first century, this view is not shared by the vast majority of executives and Company Directors who have grown up in a culture where debt has been made a virtue. My boyhood occurred when the memory of the 1930s depression was still very strong in the minds of many Australians, who blamed the economic collapse on undisciplined borrowing.

The accepted wisdom passed to me in my youth was that one should save the money from gainful employment to purchase the products of new technology, and to borrow only for large capital purchases such as a home or maybe a car. This thinking is terribly old fashioned to those raised to believe in the instant gratification achieved by buying everything on credit. In business it is unthinkable by most modern managers to keep debt to a minimum. The larger the business, the larger the debt.

The twentieth century world’s dominant mercantile culture that has survived into the twenty-first century has been the unrestrained capitalism of the United States of America which had its origins in Renaissance Europe. European culture had developed from an ancient Roman imperial structure through the expansion to monopoly of the Christian church. A series of invasions from the east, and the Muslim south then stimulated the Renaissance western culture away from Church bureaucracy to swiftly adapt new technology into a mercantile civilization. Diverse ethnic groups ensured competitive improvement of technology through warfare, then, after the Reformation, growth of capitalism.

The word *capital*, had the Medieval meaning “the
principal sum as distinct from interest”, from even earlier times when the church forbade the lending of money for interest or usury. In the age-old mercantile practice of adjusting to bureaucratic guidelines, an article of value could be nominally purchased and then sold back at a higher value to disguise the nature of the morally prohibited loan. Thus the principal sum as capital became blurred.

By the time of Tudor England it became impossible to distinguish between the lending of valuable items, and the lending of money. Following the religious Reformation, when lending of money was allowed to attract interest, capital came to be recognised as ”that part of wealth set aside for future production”. The activity whereby joint-stock companies used subscribed capital for productive purposes became known as capitalism. The banking system was then expanded to allow acceptance of deposits from unutilised capital to on-lend for productive purposes.

In the twenty-first century financial world, mercantile technology has allowed the banking system to control commerce. The term capitalism is practically indistinguishable from corporate productivity. In particular, the computer has allowed capitalistic speculation to an unprecedented degree. Unfortunately, as has often been the case in western civilization, the new technology has outstretched sound financial policy and strategy.

In the 1990s, the capitalist goal of wealth at any cost became so dominant that individuals and companies had sought to excuse their lack of morals and ethics as economic rationalism. Some have called this development economic Darwinism, alluding to Charles Darwin’s theories of evolution in which only the fittest of the species survived. I am more inclined to see the quest for unlimited financial dominance as a natural development of warfare.

It is my philosophy that modern unbridled capitalism has evolved from practices employed in war
throughout the ages into a socially acceptable form of
civilised corporate combat. Capitalism had its origins
in Europe, where the ancient Roman *equites* or
knights transformed themselves from a military class
into the monetary entrepreneurs of the Roman
Empire. Brilliant generals and weapon technology
were still of prime importance to success in warfare,
but money became the backbone of war.

In modern peacetime, the warrior of yesteryear
became the corporate merchant, in hierarchical
organizations similar in structure to armies of the past
led by generals and kings. Nineteenth century
corporate monopoly barons of America, curbed to a
minor degree by social legislation, had formed modern
multi-national corporations which sought to escape
any social control. These corporations then fought
monetary battles with large and small competitors, as
well as with governments, with the goal of total
dominance, comparable in many ways with the
aggressive armies of history.

As democracy burgeoned in government, so did the
concept of socialism tend to further blunt the sharp
dge of capitalism. In the late twentieth century, past
social limitations on capitalism were abandoned in the
United States, making money the sole arbiter of
success. The US Republican Party in particular
embraced the concept of unrestrained capitalism.

As modern corporations have discovered, a
successful army needs to employ, not only the latest
technology, but proper planning and structure. The
military analogy can be applied to modern commercial
organisations, where planning, structure and
technology is already in place.

I believe that corporate financial management in
smaller companies can be greatly improved by
recognising that age-old war policy and strategies,
which can be transformed into innovative financial
technology and tactics.

Small companies must recognise that successful
competition with multinational corporations calls for financial operations that need to have a degree of military precision. Key to success in the economic warfare of the twenty-first century is the successful financial management of debt.

Debt is currently the vital fuel of the modern version of capitalism. Unfortunately at times, the amount of fuel sometimes floods the business engine.

One illustration of this phenomenon is the apparent paradox of stock markets falling every time there is news of a strong economy. A strong economy should be good for business and the stock market, were it not that the economy is so dependent on debt.

News of a strong economy now indicates that debt might be harder to obtain and service, so debt reliant stocks become less attractive. Reliance on low priced debt now clouds the strong business atmosphere. This apparent paradox supports the theory that the basis of business in the third millennium is not capital, but debt. Such is the delusion of debt.

As a conservative, I would suggest that the current business culture is really "debtism - an economic system totally dependent on private, public or corporate debt". I doubt that politicians will allow such a term to become popular or even reach the general public. The public mantra “that debt should not be allowed to control economics” would not be possible if the public knew the total size of consumer, corporate and public debt. “Debtism” just doesn't have the same ring as "capitalism", "communism" or "consumerism".

The modern business culture has led owners of public corporations, through representative Boards of Directors, into increased reliance on financial managers who promote the belief that innovative financial instruments and technology produce the best business productivity.

It is my belief that much of the world's mercantile activity has become dependent on debt and speculation, instigated by corporate warriors without
sufficient guidance by owner/shareholders. More often than not, the modern financial warriors dictate the course of business battles, not the corporate governors and generals.

I should be quick to point out that I am not disapproving of simple debt as a capitalistic concept, but am very critical of the high level of, and reliance on, debt that has become the modern business model. I will demonstrate that the concept of debt has been part of western civilization for recorded history, but that high levels of debt have caused such traumatic crises that debt itself has often been outlawed for long periods.

In following chapters I shall show the policy principles of war which have endured through history from the oriental civilization where mental stimulus was long admired. I shall then demonstrate the financial weapons which have evolved from western civilization's predilection towards improvement of technology under the stimulus of war. The blend of the oriental and occidental principles, with modern technology can be used to manage the corporate risk brought about by the high level, and rising price, of debt.

My studies have shown that civilizations throughout history have used debt, abused debt, revolted and warred over debt, and have forbidden debt. I believe that the history of debt and money throughout the book might lead readers to at least question the level of debt that corporations are carrying.

I hope that this discussion of debt enlightens at least some companies in the twenty-first century so that they avoid the normal consequence of collapse.

**Will Slatyer**

2008
# Evolution and Management of Financial Risk

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CHAPTER 1

An Early History of Debt

“Those who cannot remember the past, are condemned to repeat it.”
- George Santayana (1863-1952)

The economy of the twenty-first century is based on debt, which has expanded exponentially through banks and governments. Every day in the modern media, bankers and financiers extol the virtues of the “new economy” where innovative financial instruments can be managed through the internet to produce great profits with minimum risk. The general public is told that the government will take care of any twenty-first century “new economy” monetary risk. In general, banks make huge profits from debt so it is to their advantage to delude the public about risk. Or are the banks simply deluding themselves? History over millennia suggests that governments and bankers have a poor record of managing economies based on debt. There is every reason to fear today that the current debt explosion will have the same dire consequences that it has had many times in the past.

I have always thought that to explain a concept, one should begin at the beginning. We can learn from
wise men of past ages who have provided evidence of the patterns that can now be called group psychology. Extensive reading has led me to believe that there are not too many original ideas, simply new ways of implementing earlier philosophies using new technology.

Debt is probably older than recorded history, and evidently existed before the coming of coined money. The law of debt bondage probably has its origins in the Babylonian Code of Hammurabi from around 1750BC, and remained in various forms well into the nineteenth century AD. In ancient times interest was rarely charged on advances of precious metals by the temple or wealthy landowners for pressing needs. However, if one did not pay the loan back as agreed, interest was charged at very high rates for loans of this kind. The word “interest” refers to the compensation under Roman law which was due to the debtor who had defaulted i.e. compensation.

For the purposes of modern monetary management, debt had its origins with the invention of coined money. The Lydians might have been the first to mint standard small gold ingots, which as coins came to the attentions of the Persians following their conquest of Lydia in 547BC. In 493BC an edict of Emperor Darius I introduced silver coinage into the Persian Empire, including Babylonia. With government manipulation of money that the circulation of coinage made possible, private banking flourished on a large scale in Babylonia.

Although private banks took over many functions initially performed by the religious temples and royal treasuries, they could not usurp the power of the priests and court. The Persian court in Persopolis dictated the monetary policy of the Empire in the manner of a modern central bank, by inadvertently determining the amount of money in circulation. At Persopolis and other royal treasuries, wealth was
amassed by state hoarding, and currency withdrawn into the vaults.

Without coins to pay the heavy taxes, the people were forced to mortgage themselves to private banks to fulfil their obligations. The increased demand for loans, and the decreased supply of currency led to soaring interest rates. From 20% in Babylonia before the Persian conquest, rates increased to 40-50% by the end of the fifth century BC. Failure to repay interest or loans led to debt bondage of the debtor and/or his family.

The Babylonian practice of charging interest was apparently learned by the people of Judah, exiled to Babylon centuries before. The practice was heavily criticized by the Jewish religious leaders of Babylon, and the Hebrew contempt for the merchants of Babylon is reflected in the Biblical Old Testament proscription of usury.

Many commercial practices of the Persians were adopted by the ancient Greeks, even though they were natural military enemies. The rise of commerce and a money economy in Greece saw evolution of banking away from temple mints, most probably through resident aliens. Passion, the most famous of ancient Greek bankers, was originally a slave, thought to be of Persian birth.

The debt of landowners grew to be disruptive of the nascent democracy in Athens. In 594BC Solon created laws which forgave the hopeless indebtedness of the lower classes, by outlawing debt-bondage. The law however made no provision with regard to the rate of interest charged. Ten percent was a low rate between friends, and small loans of a risky nature were likely to incur 33 1/3%.

“It is better to pay a creditor than give to a friend.”
- Aristotle, The Nichomachean Ethics IX c 340BC
The history of debt continued with the political and social struggles of ancient Rome. Credit was the great weapon of the aristocracy against the lower class, through cruel laws which empowered acts against the person and property of the debtor. From time to time, public anger from the swollen ranks of unhappy debtors forced the magistrates to take measures to stifle revolt. Abolition of debt had to be legislated by the government at regular intervals through the centuries. Laws were introduced to outlaw high interest rates or usury. Debt itself was not outlawed.

Laws restricting lending and usury were often ignored, sometimes by using non-Roman citizens as intermediaries. Roman politicians were often able to repay debt by providing lucrative appointments to their creditors, and thus opportunities to profit at other citizens’ expense. Prior to Rome's Civil Wars, 1% per month interest on debt appears to have been normal practice, but during the Civil War, 24% and even 48% did not seem excessive to the contemporaries of Cicero.

The popularity of Julius Caesar owed much to his debt decrees. Money hoarded or used for payment of the armies of Caesar and Pompey around 49BC, caused a shortage of money in circulation. As in earlier times, debtors were at the mercy of creditors. Caesar outlawed hoarding and compelled creditors to accept whatever land or other property was offered to them as repayment, at pre-war prices. Neither lenders nor borrowers were satisfied, and violence followed. Caesar on his return to Italy cancelled all interest due on debts since the beginning of the Civil War. Mass popularity followed, because even the property owning creditors were forced to admit that payment most probably would not have been received in any event. That popularity of the imperator assisted the birth of the Roman Empire. The Roman economy was saved.
Religion has never been far from money. The ancient Greek Oracle at Delphi not only dispensed wisdom from the gods, but in the fifth century BC, minted silver coins which allowed donated temple wealth to facilitate trade.

As important to modern commerce as religion itself, was the conversion of the Roman Emperor Constantine to Christianity in 313AD, and the rise to power of the Catholic Church of Rome. The Roman Empire collapsed a century after Constantine, but the Church powered on into a Holy Roman Empire.

Another legacy that ancient imperial Rome gave to modern day commerce was Roman law, codified around 450BC, modified under Justinian 528-534AD. The system of international law under Roman law which applied in disputes between Romans and foreigners, laid the basis for civilized international trade. The commercial rule of law spread throughout the Holy Roman Empire in Europe after Charlemagne.

“\textit{If thou wilt lend this money, lend it not} \\
\textit{As to thy friends - for when did friendship take} \\
\textit{A breed of barren metal of his friend?} \\
\textit{But lend it rather to thine enemy.”} \\
- St Thomas Aquinas c.1225-74

\textbf{Debt in the Middle Ages}

As only the effective government in Europe after the collapse of the Roman Empire, the Church of Rome added Canon Law to Roman Law. It was Canon Law which governed the expansion of debt in medieval times. Canon Law forbade \textit{usury}, which did not simply mean a high rate of interest, but all and every form of interest on debt. The early church followed the principles of Aristotle in treating money as a "barren
metal" which cannot naturally breed. Lending money for gain was unnatural, and thus was condemned as *usury*.

The Crusades which have been romantically recorded as religious battles to regain the Holy City of Jerusalem from the Muslim invaders also had a great economic effect on Europe. The holy war call to arms from Pope Urban II in 1095 was also a call to those who could not be pilgrims, to finance the religious battles. Travelling pilgrims and armies needed gold and silver to buy supplies on their long journey through foreign lands. This example of the age-old confluence of religion, war and money, depleted European treasuries.

The first practical international bank, the organisation of Poor Fellow-Soldiers of Christ and of the Temple of Solomon, popularly known as the Knights Templar was a product of the Crusades. As a Papal favorite, the Templars were given huge donations by the rich of Europe to conduct their activities in the Holy Land. As well, travelers to the Crusades could deposit money at Temples in Europe, and receive funds on their arrival in the Holy Land. Deposits of government funds were made by countries in capital city Temples because of their reputation for honesty and safety.

The continent of Europe, with settled order and increasing commerce, chafed under enforced religious unselfishness that was thought to stifle trade. Throughout history merchants have sought *loop-holes* though which profitable business could be conducted preferably without direct violation of law. Shortage of precious metals could not be allowed to restrict trade, of which debt had long been an integral part. The Church, often dependant upon powerful mercantile figures for money, was forced to tolerate evasions of the prohibition of *usury*.

In the 12th century, the buyer on credit was
allowed to pay more (on final settlement) for his article than the buyer who paid cash. The formal bill of exchange (Medieval Latin - document - bulla) was born as a debt instrument. A bill of exchange was an instrument whereby a trade debt in one place was transferred to another, thereby avoiding the necessity of transferring cash from place to place. The bill of exchange was excluded from the usury category because additional payment (interest or discounted advance) could be termed compensation for theoretically transporting money from one place to another.

Another important exception to Roman Canon Law was to perpetuate hatred for the race that already had been vilified by the Church for crucifying Christ. The Church allowed Jews to lend money at interest.

The age-old hatred towards those collecting a debt was thus attracted to the one racial sector able to lend. Jews were not Christians, and therefore not bound by Canon Law. Jews in Italy were barred from all trade guilds and were only allowed two positions, that of money lending and the selling of used clothing.

In fact, it appears that the Jews themselves indulgently interpreted their own religious beliefs to allow the lending of money at interest. The Christians had based their usury ban on the Biblical Old Testament which had Hebrew origins in the Talmud. In Hebrew law, an indulgent perception of usury meant that one could lend at usury to a racial alien or one not of the Jewish faith. Hebrews could not lend to other Hebrews at interest. In early Palestine, loans with interest had been allowed to gentiles and Samaritans, and the practice had spread to Europe.

The other major Middle East religion, Islam or Mohammedism, has never been as tolerant towards lending or interest as Judaism or Christianity. The Holy Koran explicitly forbids usury. Islamic banks in medieval times, and today, must follow the principles
of "Shari’a" which involves capital participation - sharing risk - rather than loans at interest. This is in fact true capitalism. Unfortunately, in the twentieth century Islamic banking has apparently adopted lease and instalment loopholes that allow similar profits to their secular counterparts.

Around 1100 King Henry I introduced "tallies" to England to replenish the treasury depleted of gold and silver for the Crusades. A tally was a wooden stick with a value carved and printed, which could be split in half. One half remained in treasury and the other half could be given to soldiers, armourers and farmers for the supply of goods and services. At tax-time taxpayers paid half of the wood, which had to tally with the other half in treasury.

Tallies or government stock (Anglo-Saxon - stoc - small piece of wood) provided a domestic money supply related to taxes. Tallies also could be bought and sold privately, initially by Jewish moneylenders, and later as stock on the Stock Exchange in England for over 700 years. As debt of the English King, stock was acceptable only within the English realm. Gold and silver was still needed for international trade.

The Jews had a monopoly of nearly all credit transactions in England from the time of the Norman Conquest, and enjoyed royal favours in exchange for heavy taxes. The need to borrow, as the economy moved from barter to money, placed the Jew in an untenable position. The money lender was officially protected from prosecution as a usurer, but, as in Italy, reviled by those who needed to borrow, for the very religion that allowed the profession of money lending.

Henry III plundered the Jews by taking a third of their property in 1230. Many Jews left England in the 1250s and those remaining were attacked by the barons in the 1260s civil war. In obeisance to the 1274 Council of Lyon, Edward I ordered that Jews no
longer practice usury in England. Following pressure from the Church, Jews were banished from England c.1290 and their position as money lenders, particularly to the Crown, was taken over by the Italian merchant houses of Lombard.

The northern Italian cities had profited from the Crusades (1096-1291) by providing sea transport and trade. As well, Italian merchants had learned Arab accounting techniques which allowed expansion of business. Venice, Genoa, Pisa, Naples, Florence and Milan all flourished. The northern Italian city states formed the Lombard League to maintain some independence from the Holy Roman Empire, so could afford to ignore Church prohibition of usury.

The Lombard banking houses, largely from the Tuscan provincial city states of Pisa, Florence, Lucca and Sienna, evaded the formal charge of usury by granting gratuitous loans to which was added a sum, nominally the cost of repeatedly lending for payment if the debt was overdue. Trade routes ran into central and southern Europe - over the Alps into Switzerland and South Germany, down the Rhine to Flanders, the economic capital of the North. The concept of debt in the form of Bills of Exchange, flourished in the northern Italian cities, then spread to Antwerp, and by trade routes to the rest of Europe.

"If thou wilt lend this money, lend it not
As to thy friends, - for when did friendship take
A breed for barren metal of his friend?
But lend it rather to thine enemy:
Who if he break, thou might with better face
Exact the penalty."

- William Shakespeare, Merchant of Venice c.1596
Usury in the Renaissance

The Lombard financiers were ostensibly Christian but are thought to have had strong Jewish connections from those unfortunates expelled from England, France (14th century) and Germany (1350s). When rulers and their cronies became too indebted to their lenders, a method of cancelling indebtedness was to expel those lenders. In hindsight one can see that the expulsion of Jews from indebted countries was more economic than religious. Lombard lenders, as Christians, were like modern bankers, simply at risk of default.

One of the main reasons for borrowing by European royalty was the high cost of standing armies and/or specialized mercenaries at a time when the nation/state was evolving from the city/state. The high risk of default by princes and barons meant interest rates as high as 45%.

Wars were fought by major and minor princes to obtain booty for debt repayment, as much as for reasons of power and religion. The world's first bank crashes appear to have occurred from 1298 when the great Siennese banking house of Buonsignore failed. By 1346, following the battle of Crecy, the last three great Italian financiers collapsed, not the least because of default on loans by the defeated English King Edward III.

The establishment in the 15th century of "montes pietatis", as charitable institutions which lent to the poor at interest, basically finished the Roman church's control over European finance. Institutions called "montes profanis" then were founded based on the charitable model of subscription of capital for interest gain, but without the pious objective.

Among the Lombard bankers the House of the Medici was pre-eminent - the most powerful financial institution in all of 15th-century Europe. Giovanni di Bicci de’ Medici, who had managed a bank in Rome 20
before moving to Florence, established the Medici bank in 1397. After the death of Cosimo de Medici in 1464, the Medici bank went downhill until it collapsed in 1494, a victim of depression, internal strife and French aggression.

Intensive Semitic persecution in Spain culminated in 1492 in the forced expulsion of that country’s large and long-established Jewish population. They sold their houses, their landed estates, and their cattle for very small prices, to save themselves. The King did not allow Jews to carry silver and gold, so that they were compelled to exchange their silver and gold for cloth, skins and other merchandise. Only Jews who had converted to Christianity were allowed to remain, and those suspected of continuing to practice Judaism faced persecution in the Spanish Inquisition.

Charles I ascension to the throne of Spain in 1516 and election as Holy Roman Emperor Charles V in 1519, marked the beginning of the great era of prosperity and Spanish hegemony over much of Europe. Unfortunately for Charles, Spanish dominance involved recurrent warfare by the largest European standing army and a newly developed navy.

Despite large revenues from the Low Countries (Netherlands) and the Indies, Spain’s expenses exceeded income. Some precious metals had started to flow from South America after 1493. The Spanish state resorted to crisis finance - lengthening loan maturities, reducing interest rates, raising the price of gold and declaring itself bankrupt. Whether or not the religious Reformation was also a factor in the change of the royal attitude to usury is debatable, but there is no doubt that Europe needed a capital market. In 1543 Charles V approved lending at interest in the Holy Roman Empire.

When Charles abdicated his various lands in 1555–56, Philip II (1556–98) succeeded to all his father’s dominions except Germany. Philip on his
accession also inherited an unfinished war with France and a debt of some 20 million ducats. Philip’s governments, both in Madrid and in Brussels, had to declare a moratorium on their debts, or rather a forcible lowering of the very high rates of interest on government loans and a rescheduling of the repayments of short-term loans.

It was the first of three such moratoriums in Philip II’s reign—the other two were declared in 1575 and 1596—and set the tone for the remainder of Habsburg rule in Spain. There was growing disparity between imperial policies and the financial resources at the regime’s disposal to carry out these policies.

For the rest of the 16th century this disparity between income and expenditure was still largely masked by the fluctuating, but generally increasing, shipments of silver from the New World. These shipments inspired both the king, and his German and Genoese creditors, with the perennial hope of new treasure to pay off ever growing debts.

However the expenses of the Spanish armies and navies continued to swallow up more than the stream of American silver. The loss in 1588 of the Spanish Armada of about 70 ships and 13,000 men precipitated another debt crisis.

**Reformation Credit Expansion**

Changes in trade patterns, innovation in cargo sailing vessels, and encouragement of foreign merchants, had already moved the European centre of commerce from northern Italy to the Netherlands. During the early 16th century, the Bourse (Exchange) at Antwerp dominated Europe’s transactions in Bills of Exchange. Holy Emperor Charles V raised much of his needed funds by borrowing through the Antwerp exchange. The merchant, Jacob Fugger, Brothers and Sons, was the Spanish Crown’s largest creditor.

The short term capital market which had
developed in Antwerp and Amsterdam adopted the legal right of endorsed assigned bills of exchange around 1537. A bill of exchange allowed, for example, the purchase of goods in London, with the final payment to be made in a foreign currency in another country, say in Amsterdam. The practice arose whereby smaller merchants maintained deposits with larger firms upon which they could draw bills of exchange. Large merchants, such as the Fuggers, wealthy from mining and foreign exchange, became the deposit bankers for smaller merchants.

Eventually deposit banking developed out of this merchant practice, no doubt assisted by the fourth Spanish bankruptcy in 1607 which badly damaged the Fuggers. The Bank of Amsterdam was established in 1609 under the guarantee of the city to provide commercial advances but not sovereign loans. The first public European bank, Banco de Rialto had been opened by the decree of the Venice senate in 1587, also in consequence of the frequent insolvency of private investment banks.

The religious Protestant Reformation had a strong influence in the development of mercantilism in the Netherlands and England. The theory of personal and property freedom under a simple and strong government was embraced by both the merchant and ruling classes at a time when the Holy Roman Empire was vulnerable. Religion and money were still entwined. The theologian, Jean Calvin of Geneva, rejected the long standing religious views on usury, and endorsed the idea of secular property rights. The rapid spread of Protestantism might have been as much for the reason that "it was good for business", as for religious principle.

London Lord Mayor Sir Richard Gresham was impressed by the Antwerp Bourse and in 1568 established the Royal Exchange in Lombard Street, the area where the 14th century Italian financiers had
been obliged to reside. Where the merchants gathered, could be found the exchanging goldsmiths, stockjobbers and foreign exchange brokers.

It is thought that gold exported to Amsterdam in response to speculative demand, provided the increased money supply that made possible “Tulipmania” in 1637 Holland. A number of upstanding citizens went into debt to buy overvalued tulips. The value of the tulips collapsed but the debts stood.

By the time of the first Dutch War (1651-54), English goldsmiths had modelled their activities on the Bank of Amsterdam. Indeed much of England's goldsmiths' deposits were still banked with the Bank of Amsterdam. After Charles II restoration to the throne of England in 1660, goldsmiths began to use the Government Exchequer for their short term deposits.

Following a secret treaty with Louis XIV of France, Charles II cloaked an attempt to return England to Roman Catholicism and arbitrary government, by waging another war with the Protestant Dutch in 1672. To finance the war, Charles expropriated the goldsmiths' deposits from the Government Exchequer. This marked the start of the English National Debt, which gave impetus to moves to form a central bank. In 1694 the protestant King William III was in need of funds to prosecute the war with France. The Charter of Incorporation of the Company of the Bank of England was signed on July 27, 1694.

The Bank of England was allowed to issue notes against £1,200,000 which it advanced to the Government. Although the Bank's notes were not at first legal tender, 1694 marks the commencement of the general acceptance of paper money by the public. It should be noted that paper money is still simply a form of government debt.

The beginning of the 18th century appears also to