

The Ascent of Money: A financial history of the world

Reviewed by Richard W. Rahn

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How much money do you have? It is most often considered an impolite question and therefore seldom asked, but nevertheless many people want to know this about others.

Much of recorded history is the story of people trying to acquire money to become rich. Many have become rich by creating goods and services desired by their fellow men. Over the past several hundred years, one of the best ways of becoming rich has been to provide banking and other financial services to individuals, business people and governments. Because banking and finance largely involve intangibles, there is not only the potential for great wealth creation and accumulation, but also the great potential for fraud and/or incompetence, leading to much hardship.

The acclaimed British historian, Niall Ferguson, who now teaches at Harvard, has produced perhaps the best single, relatively short book of 360 pages that has ever been written on the history of finance. Ferguson is a fine historian, who not only writes exceptionally well, but also has a considerable and detailed understanding of economics and finance. Ferguson finished *The Ascent of Money* about a year ago, before the whole global recession had unfolded, yet he clearly understood what was happening and why. Note: The book has also been turned into a documentary by the BBC.

The ability to borrow, and the resulting creation of debt, financial instruments and financial markets, has enabled mankind to put savings into more productive uses than those obvious or available to the individual saver and, as a result, created a rapid rate of productivity growth and wealth creation. Once it was understood that borrowing could lead to creation of additional wealth, many took a solid idea and corrupted it either by taking borrowed money and investing it in things that could not or did not cover the principal and interest cost of the investment or by using borrowed money for current consumption. Disaster predictably followed.

In 1717, John Law, a renegade Scotsman, convinced the French rulers to create a public bank to issue paper money as a way of dealing with France's debt and to reflate the French economy (sounds familiar). The stimulus package did not work, and after a series of machinations, including a government-sponsored monopoly development company in Mississippi, the French had issued so much paper that it resulted in the first modern day inflationary meltdown. Despite detailed historical records for the last 700 years of one financial disaster after another, due to excessive borrowing, the US

Congress and the Obama administration as well as the UK and many other governments seemed to have learned nothing.

Ferguson chronicles, not only the infamous 'bubbles' – Tulip, South Sea, and others – but also the long power struggles between the money lenders and the borrowers. "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 in the 1340s as a result of defaults by two of their principle clients, King Edward III of England and King Robert of Naples."

While this illustrates the potential weakness of money lenders, particularly when lending to the state, the rise of the Medici illustrates the opposite. Giovanni de Medici took over a small corrupt banking family enterprise and turned it into a legitimate international bank with offices in Florence, Venice, Rome, Geneva, London and Avignon by the time he retired in 1420. The Medici bank not only engaged in lending, but also currency trading and created a major 'bills of exchange' business as a way of financing trade during the middle ages. Two members of the Medici family became popes, two became queens of France and three became dukes. As a result of their wealth and influence, the power of the Medici often rivalled and even exceeded that of the Church and the royals in the countries in which they operated.

It was the Italian banking system that served as the model and forerunner for the rise, a couple of centuries later, of the innovative Dutch, English and Swedish banks, which in turn led to the development of the modern central banks. Politicians, including those in power today, have always found it easier to borrow than to tax. Central banks issue bonds backed by their government and the number of bond holders tends to be small, yet politically powerful. In the UK in 1822, "the interest on the national debt ... amounted to roughly half of public spending," yet there were probably fewer than 250,000 bond holders. In a period of stable money – the gold standard – this amounted to an enormous shift of wealth from the poor and middle classes to the wealthy, which caused considerable resentment and political unrest.

With the collapse of the gold standard during WWI and the resulting inflations in Europe (and to a lesser extent in the US), the formerly prosperous bond holders became the new victims. Ferguson manages, in a most entertaining but precisely accurate manner, to trace the cause of the global ups and downs in financial markets, the inflations and deflations and the cowardice, incompetence and arrogance of our financial and political leaders up to this past year.

Those in each generation, whether in the private sector or government, think they are smarter than all the previous ones and that they have new-found ways to get around the basic laws of economics. Some have believed that the innovative use of quantitative tools and the power of the microchip could make them infallible, but the collapse of Long Term Capital Management as well as the failure of those who argued that Fannie Mae, Freddie Mac and the big investment banks could get by perfectly well with miniscule reserves etc, have again proven that there is no free lunch.

One of the many lessons to be learned from Niall Ferguson's *The Ascent of Money* is that those who now tell us that the record expansion of government debt in the US and UK 'can be handled' and will not result in a new disaster, are almost certainly wrong.

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