Money: a history

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This is the third in a series of comments from Helen Schofield on the history of money. The first is here, and the second here. Today I offer what Helen describes as her fifth and sixth instalments. The series will end tomorrow.

Institutions / Agencies

Whilst I've explained that "Lombard" style quasi-banks or agencies have been around in Europe since the 13th century and 9th century in Arab parts of the world to lubricate trade between countries I didn't expand on the nature of goldsmith banks in England. These were fractional reserve banking operations. They got going in England towards the middle of the 17th century. Originally engaged in gold-smithing operations making jewelry, serving utensils and cutlery, even crowns and diadems, etc. they had to keep the precious materials they worked with safe in vaults. (Note whereas gold-smithing had been a trade Jewish people had specialised in the Jews had been expelled from England at the end of the 13th century by Edward 1st. It was Oliver Cromwell who allowed them to return in 1657 which meant the gold-smiths in England were predominantly English.)

Over time they made these vaults available to wealthy members of the public who wanted to store valuable assets such as coinage and tallies, etc. Of course they charged a fee for this storage and provided a receipt itemising what they were storing. At some point the proverbial light bulb went on in their head that since many customers kept their valuable items in storage for years especially coins and tallies they could actually utilize them to make money on them. Of course, the fact they were doing this was not a complete secret to many of their customers since they were paying interest to their customers to "bank" coins and tallies with them!

The one institution that was missing, and common knowledge throughout much of the 17th century that this was so, was something that would create a currency that was more readily available and stable than the specie coinage of gold and silver. This was the big conundrum because it ran up against the issue of trust both for domestic and foreign trade purposes. If governments or events threatened the value of specie coinage then at least some value or indeed possibly all could be salvaged by selling it as bullion, usually in other countries.

As Christine Desan points out in her “Making Money” book this conundrum was somewhat alleviated by the large amounts of gold and especially silver flooding into Europe from the New World. However, economic historians argue that not a lot of the benefit of this inflow went to England and there were two outcomes. Most of the inflow got recycled to the East for the import of commodities and although Spain benefitted the most it was already a trade deficit country because it didn’t produce much of what other countries wanted. The consequence was countries like the UK had to produce commodities and goods for export whilst Spain never bothered and lived briefly “high on the hog” till the New World flow of gold and silver started to dwindle not least because the English navy came to dominate the seas.

The conundrum of how to achieve a better functioning English currency was resolved as Christine Desan argues very much by accident and as we will see The Stop of the Exchequer played a powerful role in this that also has parallels with the cause of the GFC in 2007/2008. But first before we get to “The Big Stop” we need to know about the financial instruments available in the 17th century.

Financial Instruments

This section is concerned with the main financial instruments being used during the 17th century in the run-up to The Stop of The Exchequer in 1672. I’ve already mentioned the English especially the merchant class were familiar with the Bill of Exchange which was also used domestically as well as for foreign trade (the domestic use eventually evolved into the cheque).

The tally stick is another financial instrument. Although of ancient origin they were first introduced into England by Henry I around 1100. In 1660 when Charles II first came into power under the Restoration he decided his income awarded by Parliament was inadequate and started selling tally sticks to the gold-smith bankers at a discount. The bankers set up a secondary market to on-sell the tallies at a profit. In this way Charles II avoided accusations of usury by selling the tallies with an interest rate attached. This manoeuvre, however, paved the way for the introduction of the Treasury issuing a financial instrument that paid interest. Enter George Downing!

In May 1667 Downing was made secretary to the Commissioners of the Treasury and he took part in the management and reform of the Treasury. It was Downing who was responsible for promoting the idea of Treasury Orders which paid 6% interest. These were the forerunners of what we now know as Treasury bonds or gilts. The way Downing implemented the Treasury Orders was to have each order assigned a number. The amount loaned by the purchaser on the order was unlimited except by a particular hypothecated tax revenue stream expected. So for example, in Milevsky’s book he quotes what is called The Eleven Month Tax. There was no set redemption date on the

Treasury Order the principal plus 6% interest was redeemable when the tax revenue came into the Exchequer and payout was determined by what number you had on your Treasury Order the lower your number the earlier you got the money. There was no restriction on trading the Treasury Orders to others.

Finally, as already mentioned, the gold-smith bankers were issuing receipts including paying interest on coinage and tallies and possible other valuables left in their safe keeping. Working on the principle of fractional reserve banking the gold-smith bankers began using some of their customers’ coinage and tallies from their vaults to buy Treasury Orders. As Milevsky says in his book little did they know they were buying their own murder weapons.