The Evolutionary Chain of International Financial Centers

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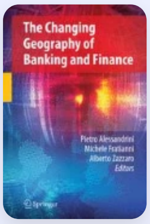

The Changing Geography of Banking and Finance

Michele Fratianni

Abstract

Financial products are unstandardized and subject to a great deal of uncertainty. They tend to concentrate geographically because of the reduction in information costs resulting from close contacts. Concentration leads to economies of scale and encourages external economies. Great financial centers enjoy a high degree of persistence but are not immune from decline and eventual demise. Yet, their achievements are passed along in an evolutionary manner. In revisiting the historical record of seven international financial centers—Florence, Venice, Genoa, Antwerp, Amsterdam, London and New York—the paper finds evidence of a long evolutionary chain of banking and finance. As to the present and the future, the forces of integration are likely to give an additional boost to the persistence of international financial centers.

Notes

1. The Medici family exerted "informal" hegemony from 1434 to 1494 and then

more formally from 1512 to 1526; after 1530, their power became absolute.

2. To Florentine bankers one must add those from Lucca (e.g., Riccardi), Pistoia (Ammannati), and Siena (Bonsignori).

3. Hunt (p. 160) reports creditors' recovery rates of 36 percent for the Peruzzi and 46 percent for the Bardi.

4. De Roover (p. 202) calculates that up to 1435 more than half of total earnings generated by the vast Medici network came from the Rome branch.

5. The heyday of banking in Florence, despite a resurgence of sorts in the following century, was over. The decline of the banking industry, it should be noted, preceded the decline of the great Florentine industry, wool, by approximately a century. After 1600, wool output in Florence fell drastically, following a competitive shift in favor of the Low Countries and England (Goldthwaite 1980, p. 52).

6. Interest payments were delayed in 1444, 1449, 1450, 1454 through 1459, and after 1467; back payments were canceled in 1483 and 1489; and interest was paid only in part from 1488 to 1492 (Conti, pp. 31–5, 57, 362–63). For the taxpayer-investor, *Monte Comune* turned out to be a financial disaster (Conti, Fig. 2).

7. For early banking in Venice, see Mueller (1997, chapter 1). It should be pointed out that the first public bank was the *Taula de Canvi*, established in Barcelona in 1401. However, the *Taula*was not as purely a payments bank as the *Banco di Rialto*inasmuch as it lent heavily to the city.

8. At the Piacenza fairs, according to Braudel (1992, p. 168), "…the capital of the Italian cities was all drained towards Genoa. And a multitude of small

investors, Genoese and others, entrusted their savings to the bankers for modest returns."

9. These arrangements start in 1566.

10. It should be noted that short-term interest rates were higher than long-term interest rate

11. What follows draws from Fratianni and Spinelli (2006).

12. The account of Ehrenberg on pages 244–5, although incomplete, is consistent with this reasoning. A much better explanation of the *ricorsa* bills is given by de Roover (1948, pp. 61–2).

13. The Fuggers, having barely survived the royal bankruptcies of 1575 and 1607, were dealt a final blow with the bankruptcy of 1626 (Ehrenberg, pp. 130–32).

14. Amsterdam had the largest share of the capital (50 percent) and the highest representation in the board (eight directors); Rotterdam followed with 25 percent of the capital and four directors; Delft, Enkhuizen, Hoorn and Middelburg had 6.25 percent of the capital and one director each. A 17th director was added, on a rotating basis, from one of the five smaller cities to prevent Amsterdam from having veto power on decisions; read Neal (2005, p. 167).

15. Dividends averaged 16.5 percent of stock par value for the first half of the 17th century (Neal 2005, p. 171).

16. Initial price of shares was 3,000 guilders.

17. The archival material on options and futures is rather thin; see Gelderblom and Jonker (2005, pp. 199–200).

18. The restrictions were defined by the Bubble Act of June 1720 (Dickson, p. 148). On management running up share prices of the South Sea Company, see Dickson (pp. 141–45) and Neal (1990, p. 109).

19. See Neal (1990, Table 4.1 and Fig. 4.4) for the data on the explosion of bank notes issued by Banque Royale and on the Mississippi bubble.

20. Further boost to the power of the Bank had come in 1707, when Parliament gave the Bank the monopoly on joint-stock banking in England and made its notes legal tender; and in1715, when the Bank began managing the national debt, thus re-enforcing its role as the fiscal agent of the state.

21. With an acceptance, a party, typically a merchant banker, guarantees the payment of the bill should the drawer default. Bills of exchange, we recall, were early medieval instruments used to finance international trade.

22. Baring Brothers of London learned the business of foreign lending through its association with Hope & Co. of Amsterdam; see Cassis (2006, p. 20).

23. For Jefferson's quotations on money and banking, see http://etext.virginia.edu/jefferson/quotations/jeff1325.htm

24. Sylla (2005, p. 306) shows the price histories from 1790 to 1820 of three Federal government securities, the Bank of the United States, the Bank of New York, the Manhattan Company, and the New York Insurance Company.

25. There is some controversy about the effective start of the NYSE. For some, including Downing (p. 284), the Exchange began with the Buttonwood

Agreement of 1792 signed by 24 New York merchants, securities dealers, brokers, and auctioneers. For others, NYSE starts with the formal charter of 1817; on this, see Sylla (2005, pp. 307–9).

26. Cassis (p. 120) mentions that the restrictive standards, coupled with fixed commissions, generated rents to the Exchange's owners. They also encouraged the rise of rival exchanges.

27. The data are from the World Federation of Exchanges, *Focus*, July 2007; see http://www.world-exchanges.org.

28. Howard Curtis Reed (1981) ranks international financial centers for much of the 20th century using hierarchical cluster analysis and stepwise multiple discriminant analysis. London and New York are always at the top. In banking, London prevails over New York; see Table 2.2. In finance, New York was higher than London in 1955 but falls behind London in 1965, 1975 and 1980; see Table 2.4 in Reed.

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