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The Development of Credit Money

My thesis is that capitalism has developed in response to the Christian interest ban. I therefore think that the development of capitalism did not begin by chance in the Christian West.

Before I begin my story, I would like to explain why I am telling it. I believe that history is important for understanding the present. There are two things I want to make clear.

1. I am trying to show that prohibitions do not achieve their purpose if the causes of the problems are not eliminated. It is not enough to forbid something. You need to know the reason behind it and eliminate it if you want to change something. This is evident in the alcohol prohibition in the USA. That was well meant. It's purpose was to protect people from alcoholism. But produced an organized crime that was ultimately worse than alcoholism. Even a well meant prohibition produces more harm than good if the causes of the problem are not eliminated.
2. I also want to show that profit is not self-evident. We often hold profit for an ultimate economic driving force. But the idea, one can always spend less than earn, emerged from a historical coincidence. Just because credit money was born at a time when the nobility was constantly shaping new money, the class of merchants could get used to making a profit all the time. Gold and silver from America opened up a new source of money minting for the nobility just as the merchants developed the credit money. This historical coincidence led to the emergence of capitalism.

The idea that the interest ban became the obedient aid to capitalism is an historic irony. It is likely that the Catholic Church has decreed the prohibition of interest in order to protect society from the effects of monetary policy. The Catholic Church recognized at an early stage that money-useing disturbs and weakens social relations. The idea that the ban on interest created a society in which money permeates everything shows the danger of prohibitions.

In order to understand why the prohibition of interest created capitalism, we must understand the development of money from bill of exchange to modern credit money.

The story begins in the 12th century. The long-distance trade began to develop again after the dark centuries of the Middle Ages. But traveling was dangerous, because thieves and robbers drove their misery. Therefore, merchants began to use bills of exchange. These bills were introduced to the change in the shadow of the crusades. The crusades were military attacks by the Christians on the Arab world.

Through the use of bills of exchanges, merchants could avoid the transport of cash. For example, if a merchant went from Florence to Augsburg, he went to a banker in Florence and deposited as much cash as he needed for his business in Augsburg. For this deposit he received a bill of exchange. The bill of exchange contained time, place and amount of the deposit as well as the time, place and amount of the agreed payment in Augsburg. With this exchange letter in his wallet the merchant traveled - without cash - from Florence to Augsburg. In Augsburg he went to the banker named on the bill. There he received Augsburger coins for his coins paid in Florence, minus exchange rate and exchange fee.

At this time there were not only different coins in every country, but almost every city. Therefore, the money amounts always had to be converted from one type of coin to another. Without official conversion tables, a judge could not determine whether the conversion also included interest. Therefore, a judge could not recognize a breach of the interest ban in a bill of exchange.
Of course, it was very important for the borrower that his bill of exchange, was declared as valid in the court. The bill of exchange was a very strict contract. If a debtor did not pay his bill on the appointed date, he was thrown into the tower (i.e. in jail) without a judge being asked. This right of bills was applied throughout Europe. And the debtor couldn’t do anything against it. He couldn't be released out of the jail without paying his bill.

However, in order to hide interest rates, it was necessary to convert from one type of coin to another. Therefore, a bill of exchange contract always needed a change of place. What does that mean? Where does that lead us?
If, for example, a merchant needed money for a trade trip to India, he had to lend the money in Florence and pay back about a year later in Florence too after returning with his ship. In this case, the debt and the repayment amount would appear in the same coin, so an interest rate would be immediately recognizable. The amount paid out would be higher than the amount paid. Each judge would immediately recognize that bill violated the interest ban and declared the bill invalid. For this reason, the merchants were looking for a way to secure each other without violating the prohibition of interest. So our merchant, who wished to travel to India by ship, signed a bill in Florence, in which he pledged to pay back the money he received in Florence later in Augsburg. In fact, he took the money he had received and drove with the ship to India. But his bill of exchange went to Augsburg without him. The banker who got the bill, recognized that no one would come to pay this bill. He therefore sent a new bill of exchange to Florence. This bill engaged the travelling merchant for a repayment in Florence. One bill of exchange was split into two. Each of these bills included a conversion from one type of coin to another. Time, place and type of coin changed. Therefore, an interest rate was not detectable. A trick to circumvent the law should change the economy and thus the world. What was the trick?

One bill of exchange had been split into two bills, to obscure the change in the amount of money. Now the second bill of exchange, which had returned from Augsburg to Florence, had been issued without a payment of money by issuing it. This created the possibility to issue a bill of exchange without making a cash payment. This was the birth of credit money.

I will show how that went and where that led.
A merchant came to Augsburg to sell goods. The merchant from Augsburg showed him his treasures and said he would buy his goods. But he would not pay cash. He offered the merchant a bill of exchange, which he could redeem in another city. The traveling merchant accepted the change and handed over his goods. The turning point is, our merchant could repeat this as often as he wanted to. Using bills as payment, he could buy a lot more goods then he could buy with his coins from his chest. With these bills,

our merchant could buy 10 times or 100 times of goods than it would have been possible with coins. The bills were actually debts, which he himself pledged to pay later. Today, we would say he used credit levers.
The merchant made his own money, on the basis of his own capital of coins. This was the birth of credit money, long before the foundation of the Bank of England.
But how could he pay his bills? The merchant of course sold most of the goods and got bills of exchange from others. With these bills of exchange, he traveled to the market. There, all bills of exchange were calculated and balanced out. That took days. In the end, enormous amounts of demanded money had simply disappeared, because credit and debts had been reversed. After that, only the differences had to be paid in cash. In fact, most of the trade had been carried out in bills of exchange, in self-created money. The largest part of this money had disappeared again during balancing.
The truly amazing thing was that not only a few but nearly the whole class of merchants got paid off (earned) coins at the end. How was that possible? Who paid them? The miracle was possible, because also the bills of exchange of the nobility were offset here. Great merchants lent emperors and kings large sums for wars or luxury goods. Also these loans were disguised as a bill of exchange and filed here. And also these bills were repaid in a timely manner. This was possible because ships brought new gold and silver from America to Europe. This gold and silver enabled especially the Spanish kings - the largest borrowers of this time - to constantly shape new coins. With these new coins their bills were paid. This continually new created money enabled the whole class of merchants for about two centuries to accumulate more and more money, without a crisis arose. So their chests fiiled up with coins. Thus the idea could arise that making profit is something self-evident.
This was possible because there were two different types of money creation at the time, whereby the money creation of the nobility had nothing to do with the money creation of the merchants. In contrast to today, the cash money was created completely independently of the credit money.
Only this way it has been possible to earn profit for centuries without generating a crisis. Today there is no more free coinage of the nobility. Thus the original source of profit has disappeared.
Profits made today are just debts, which must be repaid by tomorrow.

Remember: I have tried to show that prohibition often fail to achieve their purpose. You have to know the causes and eliminate them if you want to change something. Remember alcohol prohibition in the USA. And I wanted to show that profit is not self-evident. I think, it is a central problem not only of economy but of society and ecology that profit is always expected. I think, we have to eliminate this idea.

From bills of exchange to book money
The secret history of banknotes and paper currency

Yesterday, I tried to explain how credit money arose and how it came to the development of capitalism. Around the 14th century, a long and secret development began, from bills of exchange to banknotes, and finally to paper currency and book money.

The new money and banking system was created by chance in England. In 1640 the English King Charles I once again needed money for a war. He wanted to mint money, but the English parliament did not allow him to do so. That time, only in England the Parliament had such a power. Parliament demanded that the king should take a loan. The King did not want that. Therefore, he confiscated the money of the merchants that they had stored in the tower. The merchants forced the king to return their money. After all, he had to take a loan from them.
After the return, the merchants decided not to leave their money in the tower. They brought it to private goldsmiths. These goldsmiths gave receipts, gold deposits, the so-called goldsmithnotes. The merchants began to use these goldsmithnotes more and more as money in local commerce. This goldsmithnotes became the ancestors of our banknotes.
The goldsmithnotes were 100% covered by gold. But only in the beginning. The more merchants used the goldsmithnotes as money, the more gold was in the vaults of the goldsmiths. The merchants did not pick up the gold. Instead they used goldsmithnotes as source of payment. This gave the goldsmiths the idea of lending some of the gold with interest to the king. So they earned twice the amount. They received a deposit fee from the merchants, for protecting the money and interest from the king for the loan of the money.
In 1667, a foreign war ship suddenly appeared on the Thames. That panicked the merchants. They presented their goldsmithnotes and wanted their gold back. The goldsmiths paid out all the gold they had. But somehow their chests were empty and they had to confess that they had given away the gold. In order not to go to jail, they offered the merchants the treasury bills (today named bonds). Treasure or treasury bill is a euphemistic name for a promissory note (a debt). Even today, we like to circumscribe debts to conceal their essence.
The merchants took the treasury bills instead of their goldsmithnotes. Eventually they had no cash, but hoped to get their money back with interest. This bankrun took place before the first bank was established. At this bankrun the idea for the foundation of the Bank of England was born. The bank's birthday was almost 30 years later in 1694. Believe it or not, the Bank of England received the privilege of issuing banknotes covered by treasury bills. In fact - this is no joke - the bank's banknote issue was linked to the amount of the public debt.
The Bank of England was founded because King William III. of Orange needed money, of course for a war. The founders of the bank promised the King a credit of 1.2 million pound sterling for a bank license. What became visible through bankrun in 1667 was now transformed into an institution.
As a reminder: in 1667 the so called goldsmithnotes were used as money. Through the bankrun, it was obvious that these goldsmithnotes were not full covered by gold, but by treasury bills (bonds).

Now Bank of England got a license to issue money in value of public debt.
The gold standard system was from the beginning an illusion, not to say fraud.
In fact, the Bank of England collected money. This was registered as common capital.
In fact, it was awarded to the king. In return, the bank got treasures and put them in the

vault. The bank was then allowed to issue banknotes in the value of the existing treasury bills.
Of course, the bank publicly declared that its notes are covered by gold, which is kept in the vault. In fact, the gold was lent and turned into treasure bills. Only a part of these treasury bills were later converted into gold on the money market.
The bank had learned from the goldsmiths that only a small portion of the issued notes would be presented to convert them into gold. The majority of the notes were used as money and were circulated. This is how the gold standard system came about. At first it was thought to cover about 1/3 of the issued banknotes by gold. Later the gold cover sank more and more until it finally disappeared.
How could this work?
Merchants needed money for trade. Banknotes fulfilled this task. Because the merchants needed more and more money in the course of the development in order to deal with the growing quantities of goods, the amount of money was also expanded. In this sense, banknotes were a good invention. Banknotes made it possible to adjust the money supply to the needs of the trade. The amount of money was no longer dependent on how much gold there was. Merchants therefore accepted banknotes soon as cash. So banknotes came in use.

However, every war gave rise to lifting the gold solution. With each war, the system became weaker. Long before Nixon abolished the gold solution in 1971, the gold standard was only an illusion.
In order to hide that the gold cover has become less and lesser, central banks were established. Of course, the Bank of England was the first central bank. To become a central bank, these banknotes are becoming state cash. This means that central bank notes no longer have to be redeemed in gold. Instead, other private banks can redeem their banknotes instead of gold in central bank notes. In England dues had actually been in force since 1834. Since then english banknotes of private banks are being covered by banknotes from central bank. Whoever wanted to redeem a private banknote was paid instead of gold, banknotes from the central bank. Paper money was paid by paper money. There was practically only gold cover in international trade.
Today, there are no more private banknotes. Now all banknotes are from central bank. But banks still make their own money, so called virtual money (also called book money). This book money is now only about 1% covered by central bank notes. This is all that remains of the gold standard.

In most countries, central banks were created during a crisis. So there is little data about these foundations because there is no reason to celebrate. As far as I know, at the beginning of the First World War, the European states finally ended the redemption in gold for international trade.
After the Second World War, the US dollar became the only gold-covered currency. However, only states or international companies could redeem their US dollars in gold. The end of the gold leveling system is known. In 1971, Richard Nixon declared the system abolished. But the idea of money being covered by gold or other permanent values such as land or real estate, continues to live.

In fact, I think a gold cover of money has never really existed and it was also never important.
In my view, the value of money depends on the coverage of goods. We all need money to buy goods. We may recall reports from the post-war period. People earned money with arms production. These incomes did not find any goods on the market, which is why the money lost its value.
Of course, there are people who have far more money than they need for their consumption. Only this rich community was able to profit from goldstandard. Precisely, this accumulation of money without reference to genuine commodity requirements is a macroeconomic problem as it leads to a lack of money among others.
So I'm sure, the value of good money must be covered by merchandise, no more, no less.