Overview of New Economic Systems

By Eman M. Elshaikh

We're used to credit cards now, but the very idea of credit, interest, and banking were pretty radical innovations in our economic history—and they led to the emergence of capitalism in Europe.

Introduction

A character in Shakespeare's *Hamlet* gave his son some stern advice when he said: "Neither a borrower nor a lender be." His words reflected the idea that lending money was immoral, at least in his own society in England. But if you look at the economic history of the world in Era 5 (when *Hamlet* was written), people didn't really follow that advice. By Shakespeare's time, lending money had become incredibly common, especially in England, but also in other parts of the world! It enabled many major economic, social and political transformations. It was part of a broader pattern of economic change that completely reshaped production and distribution around the world; formed new networks; created a middle class; and also contributed to the rise of nation-states and capitalism.

Innovations in finance

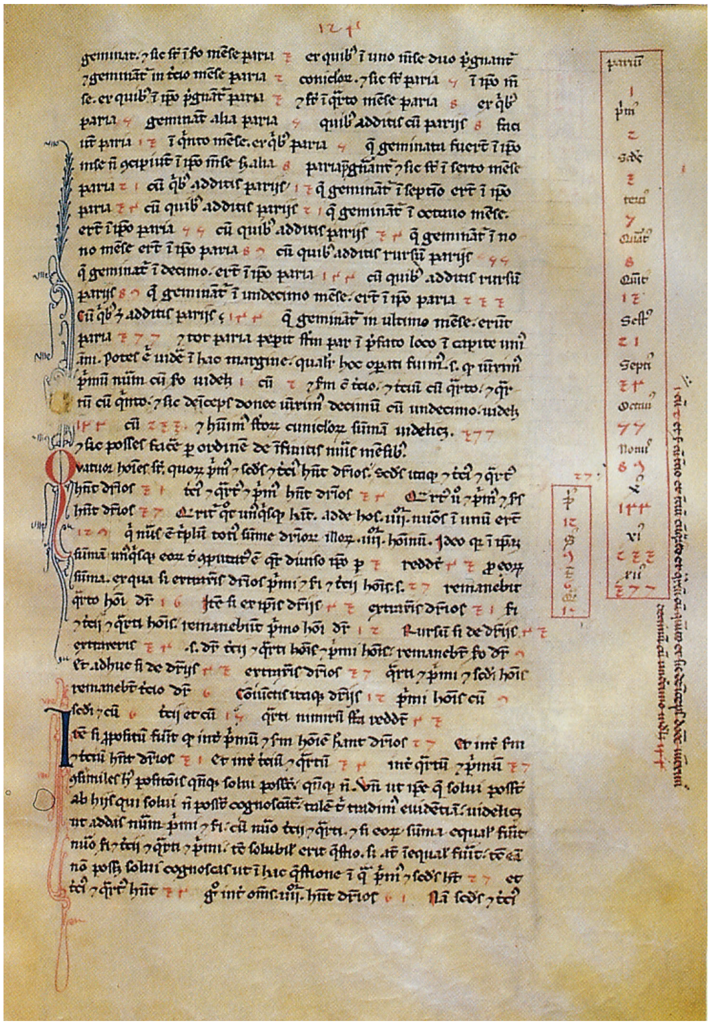
In order to understand these changes, we're going to need to step back to a moment in history when credit wasn't so widespread. But first, let's define it. Credit is an agreement between a borrower and a lender that a loan will be repaid later. In many cases, the agreement includes interest. Interest is what the borrower must repay in addition to the value of the initial loan. There are some ancient examples of credit and interest. Archaeologists have discovered ancient Mesopotamian tablets from the second millennium BCE that have financial contracts carved into them describing an amount of barley that must be paid back.

Mesopotamian tablet from c. 1780 BCE with a contract for a loan of barley carved in cuneiform.
By the Metropolitan Museum of Art, public domain.

So why did a Shakespearean character say it was so wrong 3,600 years later? Why was it not commonly used? First, charging interest was banned by the Christian Church and by other religious institutions. So non-Christian groups, who were often were excluded from economic opportunities, tended to be the only ones who did it. Becoming money-lenders only increased discrimination against them. In fact, another of Shakespeare's play, *The Merchant of Venice*, features a Jewish money-lender named Shylock as its central villain, reflecting an antisemitic stereotype.

Fibonacci's Liber Abaci

Even if we set aside the moral issues around credit and interest, people just didn't really know how to use these technologies. They were used in parts of Asia but had not reached Europe yet. Leonardo of Pisa, also known as Fibonacci (c. 1175-1250), wrote a book called *Liber Abaci*, that changed all of that. He had traveled far and wide, gathering mathematical knowledge that had originated in the Middle East and India. His book introduced Europe to fractions and decimals as well as the Hindu-Arabic numeral system (1,2,3, etc.). These worked a lot better than Roman numerals, which don't even have a zero symbol. Think about it—without the Hindu-Arabic system, a phone number like 867-5309 would barely fit on a sticky-note because it would look like this: VIII VI VII - V III *NULLA* IX. Fibonacci's book also contained important ideas that helped solve existing economic problems, like putting a price on merchandise, converting currency, calculating profits and interest rates, and predicting investment returns.



A page from the Liber Abaci. *Public domain.*

The first modern banks

The ideas Fibonacci adapted from the work of Muslim and Hindu scholars energized the already lively economic activity in Florence and Venice. These cities were part of vast trade networks, and it was in cities where the first modern banks emerged. Today, banks seem to be on every corner, but only a few centuries ago, the concept of an institution that manages money and offers loans was brand new.

Partly based on technologies from south and southwest Asia, banks developed new ways to deal with money, such as the bill of exchange (sometimes called a promissory note) meaning the bank fulfills the buyer's promise to pay the seller. Bills of exchange helped people give money to each other without exchanging cash and without having the money immediately at hand. These bills could also be sold or transferred to others and were safer to transport across long distances. If they sound familiar, it's because they're related to modern-day checks.

Fun fact: the English word for check came from the third century Persian word *čak*, which became the Arabic word *sakk* during the Abbasid Caliphate!

International currency exchange

So, for a while, the Mediterranean was a financial hotspot. But power eventually shifted from the Mediterranean to Northern Europe. Dutch, British and Swedish banks adapted foreign technologies to their own economic systems. They also developed new financial technologies, like exchanging currencies and using a standard currency for debits and transfers. Trade got more efficient, because now you could move money without having to use coins or bills of exchange.

Bonds

Around this time, banks started to manage money on much larger scales, including dealing with government debt. For example, when the English government needed money to finance a war with France, the Bank of England sold bonds to its customers. Bonds were basically loans to the government, which individuals could give through a bank, and the government promised to pay back the loan plus interest at a later date.

Sealing of the Bank of England Charter (1694), by Lady Jane Lindsay, 1905. Public domain.

Colonialism and the rise of joint-stock companies

These financial technologies revolutionized the way many nations dealt with trade, war, and especially colonial expansion. Still, international trade was risky and costly. To send a fleet of ships across the ocean, and pay and feed a crew, was financial gamble few individuals could take. During the Age of Exploration, a successful voyage promised merchants great profits. But if the ships sank or if nothing useful was found, you lost all your money. If only there were a way to *share* that risk with others…

Joint-stock companies were the answer. Ownership of a joint-stock company was shared by several investors—they simply split initial costs and shared the profits. High-risk, high-profit business ventures became more common.

Yes, they could still fail, but joint-stock companies minimized individual losses. The company basically became a *separate thing* so that no one person took on a huge burden. Soon, stock markets emerged, making it easy to buy and sell shares in a company. For better or for worse, a much larger segment of the population were now traders.

Empires as businesses

Strictly speaking, joint-stock companies were not new, since we know they were used in the Song Dynasty in China around 1000 CE. They were also around in a different form in the Muslim world. But in the sixteenth and seventeenth centuries, the joint-stock model really took off on a more international scale, starting in Europe.

Imperialism as a private business may sound strange, but joint-stock companies were often able to fund colonizing projects better than governments. Running an empire was not cheap, since travel and administration costs really added up. So when it came to building overseas empires, joint-stock companies were key. Among the wealthiest were the British East India Company and the Dutch East India Company. These were companies, *not governments*, yet they performed colonial administration in India on behalf of the British and the Dutch.

As Europeans gained access to spices and other goods from around the globe, consumer demand increased dramatically—and a quick walk through your grocery story will show the demand never went away. Things like sugar, pepper and coffee had been too expensive to import into Europe. But under European imperialism, they were valuable commodities as *raw materials*, which were then turned into highly profitable finished goods.

A painting by the Flemish artist Andries van Eertvelt depicting ships returning from an early Dutch trading expedition to the East Indies in 1599, with the city of Amsterdam visible on the right. Public domain.

A global competition

European countries, which wanted to control resources across the globe, began to see other nations as competition. Many European countries promoted mercantilist policies. Mercantilism is an economic philosophy in which a government uses its economy to expand political power, prohibiting free trade. The goal is to sell more than you buy to make your country wealthier and more self-sufficient.

These economic policies made imperialists hungry for more colonies for a couple of reasons. First, new land was a source of raw materials needed to make all the stuff that had become so marketable. Second, the colonies were new places for Europeans to sell their finished goods. But it didn't go both ways; colonial and indigenous inhabitants were not able to trade with other countries.

The rise of the middle class

Business was booming, at least for Europeans. In a world that used to be just a few rich people and a whole lot of poor people, middle classes began to emerge, particularly in Europe. This had a lot to do with the rise of the merchant class, which was able to generate wealth through trade. As the middle classes gained power, they also started talking to each other and trying to gain more political power. Enlightenment ideas were swirling around, and more people felt a sense of national belonging, which only grew as national wealth grew. All this led to a new social and political environment during the seventeenth and early eighteenth centuries.

Capitalism and the free market

In this context, a new economic system started to emerge: capitalism. You've probably heard of it. Capitalism, in the most basic terms, is a system where a country's economy is controlled by private companies—as opposed to by the government or by laborers. European economies did not immediately take this form, since under mercantilist policies the government controlled much of the economy. But over time, some European governments adopted a *laissez-faire* ("let it be") approach. They just left it to private companies to buy and sell without too much government intervention. So what did this shift look like on the ground? As trade expanded, some joint-stock companies and individuals acted as capitalists. They hired people who had been peasants, but who now became wage laborers, which means they had to sell their labor in order to survive. They also bought their tools, farms, mines and buildings. By putting those things together with labor, these capitalists were able to produce things on a large scale, and then sell them for a profit; a profit they didn't have to share with their workers.

Conclusion

It's impossible to overstate the dramatic effects of these economic changes. Credit was not new, but it got a major reboot in Era 5. Financial innovations like joint-stock companies directly contributed to the expansion of colonial systems. The other big reboot was production and distribution, with production of goods concentrated in the European colonies, but their distribution going to both Europe and the colonies. Goods, money and people flowed through new networks, completely reorganizing communities into nations with distinct classes. And those classes and nations—particularly in Europe—eventually adopted a capitalist economy that would completely change production and distribution *globally*.

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Eman M. Elshaikh

The author of this article is Eman M. Elshaikh. She is a writer, researcher, and teacher who has taught K-12 and undergraduates in the United States and in the Middle East and written for many different audiences. She teaches writing at the University of Chicago, where she also completed her master's in social sciences and is currently pursuing her PhD. She was previously a World History Fellow at Khan Academy, where she worked closely with the College Board to develop curriculum for AP World History.

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