

# The Emergence of Financial Innovations and Institutions During Turbulent Times: The Case of Medieval Florence

## Abstract

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Medieval Florence, a city-state which has significant importance in the economic history of the world, is also an interesting case when it comes to financial development. This city state, had a prominent place in the production of wool in the medieval world. But later on in the mids of the 14th century, its wool industry began to decline. The city-state was also an important actor in financial networks of Europe. As some kind of financialization process was suggested by authors such as Marks(1960) and Arrighi (2010) as an explanation to the deindustrialization of the city-state; the institutional and political economic landscape of the time may also be effective in the financial development of Florence. Innovative financial institutions were developed in line with the needs of the city-state which also reflect its cultural traits.

**Keywords:** *Financialization, financial institutions, financial innovations, institutional change.*

## Çalkantılı Zamanlarda Finansal Yeniliklerin ve Kurumların Yükselişi: Ortaçağ Floransa'sı Vakası

### Öz

Dünya iktisadi tarihinde çok bir önemli şehir devleti olan Ortaçağ Floransa'sı, finansal gelişme ile ilgili de ilginç bir vaka örneğidir. Floransa,Ortaçağ'da yünlü üretiminde de çok önemli bir yere sahip bulunmaktadır. Ancak, 14. Yüzyılın ortalarından itibaren, yünlü sanayisi ile ilgili gerileme emareleri gözlenmektedir. Floransa, aynı zamanda, Avrupa finansal ağlarında önemli bir aktör konumundadır. Yünlü sanayinin gerilemesi bağlamında bir tür finansallaşma süreci, Marks (1960) ve Arrighi (2010) gibi bazı yazarlar tarafından açıklayıcı olarak önerilmekle birlikte, zamanının kurumsal ve ekonomi-politik yapısı da Floransa'nın finansal alandaki ilerlemesinin arkasındaki neden olabilir. Bir takım yeni finansal kurumlar, şehrin ihtiyaçları doğrultusunda geliştirilmiştir. Bu kurumlar ve uygulamalarda şehrin kültürel özelliklerinin izleri de görülmektedir.

**Anahtar Kelimeler:** *Finansallaşma, finansal kurumlar, finansal yenilikler, kurumsal değişim.*

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## 1. Introduction

Italian city-states occupy an important place in world economic history. Among those cities, Florence comes to prominence with her wool industry, her consequent financial development, and being home to Renaissance. Florence's acquiring of raw materials of textile from England, France, Spain and then processing them into clothes and selling them to world market is well-known. Florence, reaching a significant production capacity in the manufacturing of wool clothes and velvet was unrivaled in terms of quality. In the second half of the 15th century, Florence was producing more than 25 thousand drapes (approximately 850 thousand meters) of cloth. But the situation began to change with the discovery of the New World and emergence of rivals such as Venice in the 16th century. (İnalçık,2000:287). Besides her wool industry, Florence was an important figure in financial advancements of the time. Florence innovatively produced important financial institutions during the 14th and the 15th centuries in order to meet the needs of the time. In this study, we try to investigate some of the financial institutions and innovations that were put in place in Florence during the 14th and 15th centuries and in the context of financialization of the city state. In the next section we briefly discuss the rise and decline of the wool industry of Florence. In the third and fourth sections we give a picture of innovatory financial institutions in the general outline of the 14th and 15th centuries. The final section concludes.

## 2. Industrialisation and the Wool Industry

At first, Florence used to process fabric bought from the Northern countries or re-process processed Northern fabric and sell them in the Mediterranean. In time, this activity left its place to the manufacturing of Florentine high quality fabric (San Martino). The medium and low quality (garbo) fabric production also continued. In 1321, sectors contributing the most to the revenues of the city were wool and silk industries. And the wool industry accounted for %40 of employment in the first half of the century (1427). But the industry began to decline in the end of the 16th century, with number of wool shops dropping from 152 in 1561 to less than 50 in 1620 (Goldthwaite,2009). Wool production also showed a 72 percent decline between 1373 and 1437 (Padgett and McLean,2011:11).

It is understood that Florence had an important share from the Ottoman market. Ottoman interests led to favourment of Florence by way of granting trade privileges. The Ottoman State gave the Florentines permission to establish trade colonies in Pera, İstanbul (İnalçık,2000:283,284). The revenue Florentine merchants acquired from Florentine fabrics which the Ottoman state had given a purchasing guarantee amounted to 600 000 ducats. The Levant trade of the Florentine merchant did not consist only of Florentine clothes to the Ottoman market. They also acquired Iranian silk from one of its important destinations, Bursa; then re-process and re-export them (İnalçık,1996:210). This was one of the most important source of earnings in Florentine wool trade. Large profits were made from the barter of wool and silk. These profits, led Florentine merchants to import wool and products from England, France and Spain; and direct them to Levant trade after processing (İnalçık,1996:149). The importance of the wool industry for Florence can be understood from the anxious words of an anonymous chronicler who was concerned about the possible case that the shipment of wool being ceased by a naval blockade due to war with Milan: "*if wool doesn't get here, there is no work in Florence, ...the poor will die of hunger*" (Najemy,2006:190). And Milan did actually strain wool trade of Florence, only to be rescued by the death of the ruler of Milan, Giangaleazzo Visconti in 1402 and the peace of 1405 (Brucker,1983:80,81). It is true that silk industry progressed as wool industry declined in Florence. Nevertheless, in 1427 number of firms in silk trade was only one fourth of the number of firms in wool trade. Silk industry continued to develop in the 16th century, number of looms rising from one thousand to two thousand. However, silk industry never ensured Florence the market she had earned from wool trade (Goldthwaite,2009). Also, according to the 1427 census, silk industry stands lower than then receded wool industry in its share of employment (Padgett and McLean,2011:12), and at the end of the 16th century, Florence was no longer a center in luxury clothing and silks. Cities such as Segovia, Cordoba, Toledo and Venice began to show more vitality (Braudel, 1994:518). Table.1 shows data on the performance of Florentine wool industry over time:

Table 1: Wool Industry of Florence 1373-1619

	(a)	(b)	(d)	(e)	(f)	(g)	(h)
	Production	Gross Value	Net Value of Production	Daily	Value of Production		Value of
Year	(Bolts)	of Production in Florins		Wage	In one work year (260 days)	Population	Per Capita
		(scudi)	(livre)	(soldi)			Production
1373	30000	1050000	2142000	10	16477	60000	0.27
1381-82	19000	679250	1467180	10	11286	55000	0.21
1391-95	13000	455000	1037400	10	7980	60000	0.13
1425-30	11000	437662	1050389	10	8080	40000	0.2
1488	17000	471075	1639341	10	12610	42000	0.3
1526	18000-24000	600000	2520000	10	19385	70000	0.28
1553-54	---	470000	2115000	13	12515	60000	0.21
1558-59	---	540000	2430000	13	14379	60000	0.24
1560-61	---	945000	2252500	13	25163	60000	0.42
1570-71	---	927000	4171500	16	20055	60000	0.33
1591-1605	13437	850000	3825000	20	14712	65000	0.23
1619	10717	500000	2250000	20	8654	75000	0.12
	<b>Source:</b> Goldthwaite, 2009:278						

Some authors interpret the decline of the wool industry in the context of financialization. Marks(1960,146), noting the importance of finance in Florence, mentions the possibility that finance-orientedness of Florence during the 15th century may have impeded its industrial development. Similarly, Arrighi (2010:102,103), links this decline in the wool industry to a deeper reason. To him “*deindustrialization of Florence*” was a result of a tendency present in the working dynamics of capitalism itself:

“[T]his drastic curtailment of industrial production in Florence.... was the expression of the strictly capitalist logic of action that guided Florentine business enterprise. [T]he intensification of competitive pressures throughout the trading system ... provoked a major reallocation of capital from the purchase, processing, and sale of commodities to more flexible forms of investment, that is, primarily to the financing of domestic and foreign public debts.”

Arrighi(2000) calls this capitalist mechanic as

“*systemic cycles of accumulation*” where a financial growth phase follows a growth in real economic activity, trade and manufacturing. This transformation usually occurs before a dominant power in the capitalistic world order loses its place to another rival.

However, Goldthwaite (1980:52,53) notes that while the wool industry was “*strong*” until 1600; there was a decline in Florence’s “*international banking and commerce*” in the 16th century. Although this information seems to contradict with the financialization hypothesis, it is important to bear in mind that banking and finance are not synonymous phenomena. Also, this might further indicate that capital is allocated between financial and real investments, thus a substitution relationship between real and financial uses of capital. Elsewhere, the author mentions a decrease in production in wool industry after the Ciompi revolt(1378), reaching its low in the 1390s, and recovery in the 15th century (Goldthwaite,2009). In fact there seems to be a business cycle pattern in wool industry between 14th and 16th centuries as

Table.1 also indicates.

We now turn to other aspects of financialization in Florence and investigate some of the specific financial institutions of the city-state in historical context.

### 3. Disruption in the General Economic Environment

Florence, the Italian Peninsula and Europe, passed through a period of crisis in the 14th century. This was a crisis that swept throughout the Medieval Europe. The foremost of the causes of this crisis were the Black Death, the great drought of 1315-1317 and consequent wars. The plague spread from Asia to Europe in 1348. It effected nearly everywhere in the region tracing the trade routes. The epidemic destroyed about one third to half of the population of the country it had visited, repeating every 10-15 years, caused massive human losses and continued throughout the 14th century. As a result demographic situation returned to its levels in the previous century. These human losses, made labor expensive and caused some land to be out of agricultural production by distorting the land-labor ratio (Cameron and Neal,2003:73).

In this environment, Florence experienced difficulties in the 1340s, bankruptcies of Bardi and Peruzzi and later the Black Death in 1348, had affected her economy, around forty thousand people died during the Black Death in Florence, followed by the 1378 Ciompi Revolt and 1375 war with the Papacy (Brucker,1983:55,79). Considering Florence's population was around ninety five thousand in 1330 (De Long and Shleifer,1993:679), this means that Florence lost almost half of her population to the epidemic. Brucker (1983:55) notes the city had lost a third of its market with this nearly %50 loss of her population. One effect of the plague could be the rise of the capital labour ratio throughout the effected areas. Brucker (1983:56) for instance mentions that some entrepreneurs became enriched with "legacies" after the plague. This rising capital-labour ratio might also be one factor behind the capitalist development of the region.

Facing this loss of man-power, efforts to revitalize the economy through a kind of incentive system

were initiated. The records of 1424 through 1431 indicate the struggle of Florence to draw capital and labour to herself. For instance, tax exemption for twenty five years, was granted to farmers in 1424 who had emmigrated from Florence, if they returned and tilled the land. Tax exemption and a debt moratorium was provided to returning silk workers in 1429. Later, in 1431 tax exemption was enlarged to include all residents of the contado whether they farmed or not. More interesting was a proposal dated 1431 to allow Jews to work in money markets of Florence, from which they were banned before (Brucker,1983:82,83,86). These were regulations to attract both skilled (silk workers and financiers) and unskilled labor alike to the region again.

Climate was one of the sources of crisis at the time. In the 14th century, climate was very rough in Europe. Grain and fruit could not be grown and the Baltic sea was frozen. Floods rendered agriculture nearly impossible in the Low Countries. Undernourishedness made masses prone to the plague, and this may have caused number of deaths to be higher. The decline in the population because of the plague resulted in two things: The demand for grain in the cities falled down as wages rose, thus causing the wage-price ratio to rise. Later, constraints on wages were implemented and this caused social unrest. Revolutions and wars burst throughout Europe. In the second half of the 14th century, in 1378, wool workers temporarily seized control of Florence. Similar events happened in other regions of Europe. Feudal lords, although being strong, could not contain worker movements and social explosions. Production and exports were lower in the beginning of the 15th century than their levels in the beginning of the 14th century (Cameron and Neal,2003:75).

#### 3.1. War Economy

It would be appropriate to mention some of the important historical events that have been effective in setting up the stage for 15th century institutional sturctures. The 14th century was a difficult era for Europe. As Wallerstein(2012:39) notes, The Hundred Years War (1335-1345), forced kingdoms to conduct a "war economy" thus increasing the need for tax revenues. But it is possible that this war environment also led kingdoms to be more dependent on external finance, especially on finan-

ce from wealthy city states (see Arrighi,2000). But city-states themselves were not the exemption when it came to war-time needs. At first, the method of financing the government debt was through compulsory debts in Florence which dated back to 13th century. But in the following decades also with the effect of wars (Florence was at war with Milan in 1423; with Lucca in 1432, with the Aragonese in 1453-1457), this method did not suffice, and voluntary debt started to be used with higher interest payments. During the Medici era, a “*financial elite*” held much of this voluntary debt. (Fra-tianni and Spinelli,2006:266; Molho,1995:115; Najemy,2006:190). One might also refer to Spufford(2014) and Pezzolo(2007) on the relationship between war making and the development of financial institutions of the Italian city-states. The mercenary system of war-making also seems effective in the rise of the elite as financiers of city’s war-time fiscal needs (Marks,1960). Resorting to voluntary debt was a natural policy for the medieval states because their sources of income were not elastic enough to finance rapidly rising expenses, especially in times of war. But these voluntary loans were then paid from taxes. When these loans and their interest were paid by the *gabella*<sup>1</sup> (indirect taxes) distributional issues also emerged; because this meant a transfer of income from the less wealthy to creditors. The Ciompis for example tried to tackle this issue in Florence by trying to control interest rates (Molho,1995:107).

Fiscal needs of the state led to innovations like the Dowry Fund, (Monte delle doti) in Florence. Established in 1425 with the initiation of the city state itself, this fund not only provided a kind of insurance for marriages but also a source of funds for the state. (Molho:1995; Kirshner and Molho,1978). Alongside, the 1427 catasto was implemented, helping the process of tax assessment. But some authors such as Elio Conti, argue that the catasto lost its importance during the Medicean era. In fact, before Cosimo de Medici’s return and the Medician takeover, recourse to pre 1427 forms of tax assessment had been approved in Flo-

rence. Also rigorous account keeping of state incomes and expenses initiated by Lionardo Becanugi, the superintendent of Camera del Comune came to a halt in 1433 (Molho,1995). Molho (1995) concludes that even if transformation of the city-state under the Medici era to a more patrimonialistic type could be accounted for; this tendency had begun before the Medicean take over. “*A new regime had been born because of the crises of the age*”. According to him, wars and political instability led to a change in the governmental apparatus in Florence. The author counts several important years (1343, 1348, 1378, 1382, 1433, 1434, 1494, 1498, 1515, 1527, 1531) as historical junctures in Florentine institutional change. Arrighi (2000) also mentions the consolidation of power in the upper classes that happened after the 1378 Ciompi Revolt. As Najemy(2006) notes, developments that took place between 1380s and 1430s were effective on the change of the Florentine institutional setting from “*guild republicanism*” to “*elite leadership*”. War was an important part of these developments. The only peaceful part from 1390 to 1454 was the time between 1414-1423. Other than that the period was characterized with Florence being at war. For instance, during the Visconti war in 1395, 1.619.819 florins of debt was taken. Nearly one tenth of this amount, 130 thousand florins came from the Alberti brothers and 25 thousand florins came from the Spinelli brothers, 14 thousand florins from Forese Salviati, 13 thousand from Vanni Castellani, 12 thousand from Alessandro Alessandri, 10 thousand from Filippo di Lionardo Strozzi and 9500 from Francesca di Palla Strozzi. Meaning that the ratio of the debt provided by these names accounted for approximately %17 of the total. Later in 1401 the Medici contribution amounted to 200 thousand florins. The patronage system started to be a more effective tool in “*power*” relations, than formal bureaucratic forms in the beginnings of the 15th century in Florence (Najemy,2006).

#### 4. Banking, Financial Innovations and Institutions in Florence

During the course of economic development in medieval Italian city-states, trade and finance progressed in accordance with each other and financial transactions played a complementary role to trade. Thus, international trade itself have been effective in emergence of financial products; the

<sup>1</sup> Kirshner(2015:206), mentions the *gabella* over the Pisan example as a contract tax. Sakellariou(2011:315), gives an example of the *gabelle* being imposed on “consumption and retail sale of wine in Neopolitan tavernas and inns.” The term ‘*gabella*’ is said to be coming from the arabic word ‘*qabāla*’ (see. Watt,2013:131).

nature of long distance trade sometimes necessitated it as in the use of orders of payment, cheques and bills of exchange instead of moving large sums of gold and silver across countries. However, in the 14th century, bills of exchange started to be used as instruments of credit alongside their original trade-related use. Bills of exchange transformed into financial products playing sometimes the role of a deposit instrument providing interest income, or sometimes a financial product that was kept as an instrument of speculation. In the 15th century, financial activities began to drift apart from commercial activity when bills of exchange began to be used for these purposes, financial transactions well exceeding the level of commodity transfers began to be made, in a sense, the financial sector started to drift apart from the real sector. Florence, for a considerable period, “*dominated this international money market...in which the bill [of exchange] was the principle instrument*” (Goldthwaite,2009).

Furthermore, during times of war, a different kind of economy emerged between rulers and international bankers. In those times, the cash demand of rulers peaked, on the other hand, war itself caused very high risks in commercial activities and caused markets to shrink. At these times, capital in cities such as Florence enters into a tendency to move towards war making rulers (Kohn,1999:13). For example the finance machine of Florence, gave loans to 2nd and 3rd Edward who embarked in the conquests in Europe and England. The king of England owed 900 thousand florins to the Bardi, and 500 thousand florins to Peruzzi (Braudel,2004).

In addition to these developments, some financial institutions were developed in Florence during the era under consideration. Those institutions both reflected the cultural and political aspects of the Florentine city-state, but also they must be understood in the general context of international political landscape the city had found itself in. The *Catato*, the *Monte Commune* and the *Monte Delli Dotti* are the most profound of these institutions.

Two of the most prominent financial developments of the time were the speculative uses bills of exchange and “*the institutionalisation of the debt*” to use Pezzolo(2007)’s term as *Montes*. Although having been practiced in the Middle East

well before, use of bills of exchange goes back to 13th century in Italy. These bills also containing interest began to be used more widely with the expansion of “*multi-branched companies*” in various regions of Europe. With bills of exchange being widely adopted and the practice being established, they also began to be used as speculative instruments of financial investment. The institutionalising of government debt was a procedure during which “*temporary loans*” the cities have acquired became “*permanent*” in the institution of *Monte*. In this practice, Venice was the principal “*innovator*” in 1262. In 1343-1345 the institution of ‘*Monte*’ was adopted by Florence (Spufford,2014). Venice and Genoa were ahead of Florence in the field of financial innovations (Fратиани and Spinelli, 2006:258). But Florence’s banking mechanism was the “*first*” to gain international hold. Florence was the “*most innovative*” when it came to financial institutions. But Genoa was ahead in terms of innovation of financial instruments (Fратиани, 2009:254,271). The *Monte Comune* bonds were being traded in the market. But these bonds which were issued with a price of 100 florins did not display a good performance. The price of *Monte Comune* bonds fell as low as 11,5 florins in 1491. *Monte delli Dotti*, on the other hand gained more demand (Fратиани, 2009:267,268). Pezzolo (2007:4,6) notes on the extent of Florentine bond market and its diffusion among various parts of the society: “*bonds circulated throughout almost all social environments, from the great merchants to the humble artisans*”. Also as the author further notes, beginning in the 15th century, several other bonds such as the bonds associated with *Monte dei depositi*, *Monte di Pisa*, *Monte dei cinque interi*, *Monte dei Prestanzoni* and *Monte Comune Nuevissimo* were traded alongside the *Monte Comune* bonds. There are also records of share transfer of companies such as the *Bardi* in Florence in 1310, indicating the presence of transactions in private shares along with government (*Monte*) bonds (Spufford,2014).

Fратиани and Spinelli (2006:272,274) mention that the “*marketability of debt instruments*” is among the financial innovations of the time. The fact that *Monte Comune* bonds were traded in the market shows that in Florence this market was present (although the first example was Genoa’s *San Giorgio*’s practice of “*swap of debt for equity*”. It is noteworthy that Florence’s *Monte delli Dot-*

ti was also a social security programme. This, as the authors note is an important innovation which had similar principles with social security systems of today.

#### 4.1.The Catasto

Implementation of a catasto to assess the compulsory loans and taxes more equitably was negotiated in as early as 1422. An interesting argument during those debates was that taxes that are based on real estate and property encouraged people to invest more on financial instruments and mobile property. But this argument was opposed from the point that taxing financial instruments would reduce credit and thus adversely affect the lives of the people. At the end, the catasto did not pass and its initiation delayed until 1427 (Najemy,2006). Political institutions are thought to be effective in the formation of economic institutions and the distribution of resources (See. Acemoglu et.al.,2004). Implementation of the catasto, shows the effect of inclusive political institutions producing inclusive economic institutions to use Acemoglu and Robinson (2012)'s terms. The fact that Florence, being a republic (although not a perfect one) must be kept in mind when interpreting the development of the Catasto.

Some tax figures show the effects of the Catasto: For instance, before the Catasto, Niccolo de Uzzano was being assessed around 16 florins, whereas after the implementation of the Catasto this amount rose to 250 florins as Cavalcanti notes. According to the 1427 Catasto numbers, the private wealth in the city amounted to 10 million florins. Palla Strozzi came first in the value of taxable wealth with 101 422 florins; Giovanni de Medici came second with an amount of seventy nine thousand florins and above mentioned Niccolo de Uzzano had 46 000 thousand florins of taxable assets. And the city had a population of approximately ten thousand households (Najemy,2006:257-260). This data indicate a per household taxable wealth of ten thousand florins, under the assumption of perfect equality<sup>2</sup>.

<sup>2</sup> Meanwhile, in the early 15th century the population of Damascus was thought to be around 100000 people, but this figure seems to be a bit exaggerated. Ottoman census estimates the population of Damascus to be around 57000 people in

#### 4.2.The Monte Comune

The degree of financialization in Florence could be drawn from the initiation of the Monte Comune. Monte Comune, was a device where its shares represented public debt and a claim on its interest. The institution was initiated as early as 1345. And catasto records show the wide use of the Monte by the Florentines, as a matter of fact, “almost all citizens had some Monte holdings in respect of past loans, forced or otherwise” (Marks,1960:127,128). Monte Comune and Monte delli Dotti, or the Dowry Fund, represent the innovative and adaptive character of Florentine system with regards to financial institutions.

#### 4.3.The Monte delli Dotti

Dating back to the winter of 1425 (Kirshner and Molho:1987), the Monte Delli Dotti is an interesting example of a financial innovation reflecting the effect of culture on institutions. The Monte Delli Dotti, or the Dowry Fund aimed to provide dowries for daughters of contributing Florentine families. In Florentine social structure, the daughter needed to have a socially acceptable amount of dowry to get married. “Without a generous endowment the average Florentine maiden could not hope to win a husband.” But this institution was also an indirect source of public debt. Fathers put money on the Monte Delli Dotti but, if their daughter died or became nuns before the maturity of their fund, half of the fund had to be left to the Monte Delli Dotti, the growth of one's investment in the Monte Delli Dotti was tied to an interest rate. In the beginning of the 15th century this interest rate was 5 percent but later through the 1470s it declined to 3,25 per cent. But the weakening economy of Florence in the 15th century must be taken into account while interpreting this data. On the other hand, the lowest rate the interest on the Monte Commune ever fell was 12 percent (Marks,1960:128-132).

1520-1530 (Lapidus,1984:79). In around 1500, the population of Florence was about 55 thousand people (De Long and Shleifer, 1993:679); whereas, the population of Bursa was 6351 people in 1520-1530 a city where Florentines bought silk from, whereas Istanbul had 16 326 households in 1478 (Inalcik,1994:225,257).

## 5. Conclusion

Some of the financial institutions that were put in place in Florence all date after wool industry's decline: The Monte Commune, initiated in 1345, the Catasto in 1427, the Monte delli Dotti in 1425 and the use of bills of exchange as credit and speculative instruments in the 14th and 15th centuries. There is a pronounced decline in the wool industry from the third quarter of the 14th century. Although silk industry developed, it was never an important sector as the wool industry. In this respect, the period after the second half of the 14th century can be seen as a period of deindustrialization following Arrighi (2000,2010) and partial financialization with some important financial institutions emerging in Florence. But the backstory of this partial financialisation is different than today's financialisation process. Because in part, these institutions seem to be the result of government's need for financial resources in the worsening economic, social and international climate of the time: wars, plagues and unrests. There are numerous arguments in the literature on the relationship between wars and financial-institutional developments in the region. These institutions both reflected the culture, as in the case of the Monte delli Dotti; and the domestic and international political economy of the 14th-15th centuries; as in the transformation of the republic and the growing need of finance both in Florence and in other kingdoms, such as England. The institutions that were mentioned in this study, also show the importance of culture and history being effective in the structure of institutional developments in a small-open economy.

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