

Seminar - Economic History
Geography of international credit and commercial
interest rates in Premodern Europe - Li Ling-Fan

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1 What is the main question raised in the paper?

In theory, the interest rate implied in the difference between short-term and long-term exchange is the interest rate in the destination city. That is, no matter which city issued the bill, only the destination city will determine the implied interest rate. However, the author finds a discrepancy between interest rate in Paris according to London and Amsterdam. Does this reflect the different liquidity between the two markets?

2 Why should we care about it?

Nowadays we are living in a sophisticated financial market. Firms could issue bonds to raise capital and consumers could manage the wealth throughout the credit market. It is therefore important to understand the origin of the credit market in Europe. We could have a better understanding of the relationship between interest rate and exchange rate, the political power of the cities and the commercial activities. It helps us to pin down trade routes and major historical financial events in Europe. Most of all, we could understand the reason behind the discrepancy in interest rates, which identifies problems in different credit market.

3 What is the author's answer?

The author makes three points in her conclusion.

1. Italian cities remained powerful and dominant in the international credit market until 17th century, but after 17th century, the international financial and exchange gravity gradually moved toward northwestern Europe.

2. The commercial interest rates were at a similar level in 17th, 18th and 19th century. The financial innovations and institutional changes resulted in reducing cost of capital and increasing credit market efficiency.

3. The shadow interest rate in 18th century Amsterdam was close to those paid by the public debt. The risk premium only existed when financial crises occurred.

4 How did the author get there?

Because there was no public available interest rates until the nineteenth century. Economic historians could only "estimate" the interest rate based on the bills of exchange. The author proposes two ways to calculate interest rates.

1.

$$r_j^i = \frac{(E_{ij}^L - E_{ij}^S)}{E_{ij}^S} * \frac{365}{N}$$

where E_{ij}^S and E_{ij}^L are the short- and long-term exchange rates drawn from city i on city j, respectively; N is the number of days difference in maturity between these two exchange rates. Therefore, r_j^i is the shadow interest rate in city j according to city i.

2. The profit from exchange and re-exchange

We still need further explanation in the seminar to pin down the method the author used. Anyway, the author used the data on International Institute of Social History and Castaing, J., 'The Course of Exchange' to compare the shadow interest rates with respect to different cities.