

The fundamental problem of exchange



The creation of the government bonds market was one of the earliest financial markets created. It formed ways of raising funds for the government through compulsory loans on which interest was regularly paid, which is directly comparable to modern day government bonds. It is possible to see just how prosperous the Venetian Republic was in comparison to other European countries by looking at the GDP per Capita it had. In 1500, it had a GDP of \$1100, which was far larger than other countries; the UK had a GDP of \$714, Spain \$698 and the second highest GDP per capita was Belgium with \$875.

This shows just how prosperous the Venetian Republic really was. Between 1147 and 1249, Portugal emerged from Arab rule. It did so with a significantly different political regime in comparison with that of Venice, as military aristocracy and the church became major landowners, and the interests of the church and the state became very closely linked. The fact that it was placed very well geographically meant that it was able to develop a strong empire through its unearthing of new trade routes and voyages of discovery.

The Portuguese state was willing to give Jewish merchants and scholars refuge after they were driven out of Spain, as they recognised the value they had to society through the skills they were able to bring. They were able to provide scientific development, as well as being providing valuable links in trading with the Islamic world. This allowed important networks to be built up, which increased the volume of trade that Portugal came into contact with and so built up its strength as an empire. Although Portugal was extremely

successful in its core business areas of shipping and trade, this success did not lead to successful wider development.

This can be seen when looking at figures for per capita income before the nineteenth century, which gives an estimate of the per capita income of Portugal of \$632. This is far lower than other relatively similarly dominant economies, such as Italy and Belgium, who had per capita incomes of \$1100 and \$875 respectively. The reason for this can be given by the fact that in general, agriculture and industry were the determining factors when analysing the per capita incomes, and in Portugal these industries were quite underdeveloped relative to other countries.

In comparison to Portugal, Venice was far more prosperous. Not only when looking at the per capita incomes, but also when seeing how much more developed the Venetian institutional framework was. It was formed to be favourable to merchant capitalism, which vastly strengthened its trading platform as a country, and therefore the amount of money it was able to make. Trading was only possible through solving the fundamental problem of exchange. Over time, ways of solving the problem became more sophisticated; from using boycotts and networks of trust, to legal frameworks and courts of law.

We have been able to become more affluent as economies due to the advantages that trade brings us, as can be seen looking at examples of economies from hundreds of years ago that first experienced the prosperity that trade brought. We have also been able to see the importance that

institutions hold in nurturing and maintaining an environment that is favourable to trade, namely in Venice.

References: 'The Fundamental Problem of Exchange: A research agenda in Historical Institutional Analysis' - Avner Greif, 2000 Cambridge University Press