THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD

Niall Ferguson, 2008, Penguin Books Ltd., London, UK, pp. 350

Review*

Niall Ferguson is considered one of the most influential of economic historians. In his latest book *The ascent of money: a financial history of the world* he boldly argues that finance is behind every major event in history. But if financial history is one of the key elements in interpreting history, then surely it deserves more attention than 350 pages. The proper subtitle of his book might as well be *A very concise financial history of the world*. The reason why this book is relatively short, especially when the title is so ambitious, is that it was written as a script for a TV show of the same name, and I guess Ferguson failed to obtain funding for more than four episodes. The fact that this book is also a TV show is important in understanding its structure of arguments. The book is full of historical examples, biographies of people who have shaped finance in their times, which makes this book very enjoyable to read (and watch), but which does not necessary contribute to rigorous analysis or strengthen its arguments. In fact, the target group of this book seems to be "ordinary" people and not economic historians or finance experts.

Even if this book is not an epitome of rigorous scientific analysis, its conclusions clearly make it a part of the liberal camp of economic thought. Possibly one of the boldest claims of this book is that in spite of the recent crisis, the direction of development of finance is clearly upwards. Regardless of current setbacks, hedge funds are a way of managing risk superior to the welfare state, and Ferguson cites the example of Pinochet's Chile. Here Ferguson shows that he is not just an economic but also a political liberal. He clearly separates his support for Pinochet's economic policies from his dislike of the brutal dictatorship, and he even poses a question, which he rejects later, that it may be the case that radical pro-market reforms during Pinochet were possible only under dictatorship, where the opposition to these reforms is silenced by bullets. One issue where Ferguson dissaligns himself from his fellow liberals is his opposition to obsession with property ownership, especially owning houses. His reasoning is that future risks are better reduced by diversification than by putting all eggs into one house. The main objective of

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this book is to follow the historical development of financial markets and how the development of financial markets has influenced the development of human civilization. The book is divided into introduction, six chapters and an afterword.

In the introduction, Ferguson highlights the importance of the financial sector in modern economies. For instance, it accounts for 7.7 per cent of GDP in the US and 9.4 per cent in the UK, with these numbers likely to grow in future. The chapter concludes with three things Ferguson learned about financial markets while writing this book. The first thing is that the financial sector and banks can cause poverty. But, contrary to what one might expect, especially in the light of the current financial crisis, Ferguson argues that banks can create poverty not through greed but by their absence, combined with that of other "formal" financial institutions. In other words, the existence of banks is a prerequisite for poverty reduction. Second, the financial system is not perfect because it is just the "mirror of mankind" – it reflects both our virtues and our faults. Third, it is very difficult to predict the next financial crisis because the future always contains a degree of risk and uncertainty.

Chapter one gives a short history of the first step in the ascent of money, and that is the creation of banks. Before banks could be created, the true nature of value of money had to be discovered. Spanish believed that the value of money was inhered in the metal of coins. Hence, they believed all they needed to do to get richer was to bring more gold and silver coins from American colonies to Spain. The influx of gold and silver did not make Spain richer; it only increased its prices. The Spanish did not realize that money is worth only as much as others are prepared to give for it. In essence, the value of money is the trust we have in its worth, rather than the metal or paper it is made out of. Extra money is not created by printing more money, but through the financial system. In fact, "hard currency" is just a small part of today's money supply. Still, it took a long time to develop even the simplest forms of financial institutions like banks. Lending money and asking interest in return was considered immoral in the Christian world. According to the Gospel of Luke (6:35) one should "lend, [and] expect nothing in return". Dante even set up a special place in the 7th circle of hell just for usurers. Regardless of the importance of finance for the proper functioning of the economy, early money-lenders were frowned upon. The family that changed it was the Medici. The Medici came up with a way around strict Christian anti-usury laws. Instead of calling it interest, they referred to it as commission for changing currencies. Still, anti-usury laws were not the only problem of money-lenders. Equally important was a proper way to safe-guard against the risk of default. The Medicis were successful bankers because they managed to diversify their lending. By lending to many, the risk of a default that would ruin them was smaller. Hence, they could charge lower interest, or commission as they called it, making them the leading bankers of the Renaissance.

Chapter two is devoted to the second step in the ascent of money – the bond market. The first bonds were issued by Italian city-states in order to finance their wars. And from that time, wars were decided on the financial markets as much as on the battlefield. Maybe the clearest example were the Napoleonic wars, which saw Britain, financing these wars through issuing bonds, eventually overcoming France, whose war efforts were financed through higher taxes. Similarly, the North beat the South in the US civil war because no one wanted to buy Southern bonds. Empires were crushed if they could not keep their finances in order. Then again, the chapter ends with a "mystery". Why did markets not punish deficit-loving George W. Bush, instead of rewarding him? The answer to that question is in the stock markets.

The third step in the ascent of money – stock markets, is the theme of Chapter three. Stock markets bring on average higher return than bond markets. Yet, the stock markets are also more prone to boom-and-bust cycles. The first market bubble was created by John Law, a convicted murderer who managed to become French minister of finance, economy and the head of the central bank at the same time. John Law was the head of a company which had monopoly over all economic activities in the Mississippi area. In addition, he controlled a private bank which also had ability to print money. Printing money led to a surge in share prices because of increased purchasing power. But, it also led to inflation and eventually the bubble exploded, sending the French economy into the doldrums. For Ferguson, an overly expansive monetary policy was the main cause of financial bubble in the 1920s and during the current financial crisis, just as it was in France during John Law. Still, even with sound monetary policy, share prices are always going to be volatile because they are determined by current realities and future expectations, which are unpredictable. Since the future cannot be predicted, the question is how we can insure ourselves against the risks of future.

Chapter four is devoted to answering that question. There are two ways we can insure against calamities in the future. The first option is to leave it to the individual and the second option is for society to take this risk upon itself through the welfare state. Even though the welfare state had a lot of appeal in the decades following World War II, it is quite clear Ferguson's sympathies lie with individual responsibility. Ferguson argues that the welfare state has certain mechanisms through which it undermines itself. These mechanisms are work disincentives and population aging. While the former operates only in certain countries (e.g. in the more individualistic UK and not in the more egalitarian Japan), the latter operates in all countries. The aging of population increases the share of people who live off the welfare state and decreases the share of people who fund it. Therefore, the future of insurance against risk for Ferguson is in the dismantling of the welfare state. An especially prominent place in the story of the successful dismantling of the welfare state is reserved for relatively new mechanisms of risk insurance – hedge funds. Ferguson wrote his book in mid 2008, and it seems that subsequent events have put a huge question mark over the long-term benefits of complicated derivatives, which are operated by hedge funds.

Chapter five provides a criticism of the common belief that house is the best and safest investment. By expression "safe as houses", Ferguson not only means that people should save to own their own houses, but also that banks should give loans to homeowners. In case they cannot pay their debt, the bank can confiscate their house instead. This is a principal idea of homeowning democracy in which all parts of the society become petit capitalists. As a part of this drive, a number of governments, mostly right-wing, have made it an imperative to create as many homeowners as possible. George W. Bush even introduced a law which demanded that banks give loans to people with lower credit worthiness. As a result, even people with no stable job were given loans, also known as sub-prime loans. This policy became unsustainable after Fed increased interest rates from 1 to 5.25 per cent, which led to massive defaults and ultimately started the current financial crisis.

The moral of the story is that "safe as houses" is ultimately wrong, and that people should diversify their investment, instead of throwing everything into residential property.

The recurrent theme in Ferguson's work is how empires mishandle their finances, which ultimately results in their fall. Chapter six is devoted to the current empire, which he calls Chimerica, i.e. the US and China. On first sight, this is a wonderful symbiosis – the US consumes and China produces. In order to increase employment, the Chinese relied on cheap exports. But, in order to keep their exports cheap, the Chinese had to buy US dollars in order to keep the dollar strong and their currency weak. And Chinese willingness to finance US debt made pursuit of the American dream so much easier. But, there is a catch. By buying US government bonds, China has injected massive amounts of money into the American economy, and this extra money was then used to provide loans to not-so-creditworthy clients, which ultimately resulted in a financial meltdown. Ferguson asks a good question when he wonders how long this symbiosis can be maintained. He refers to a similar situation which involved the financial capital of the world at the time (Britain) and Europe's most dynamic industrialist economy (Germany). The collapse of their symbiosis and the first wave of globalization ended in large scale war.

In the afterword, entitled *The descent of money*, Ferguson again highlights his belief that in spite of the current crisis, the ascent of money has been one of the main drivers of human progress, and will continue to be so in the future. Still, this does not mean that it will not be a bumpy ride. Occasional booms and busts will be inevitable for the following reasons. No matter how sophisticated our tools became, the future will always remain uncertain. Next, human behaviour is prone to excesses, ranging from euphoria in good times to depression in bad times. Simply put, people are not entirely rational, and this degree of irrationality can be exploited to create booms. Finally, Ferguson compares financial markets to evolution. Destruction is a natural part of any market, and financial markets are no exception. As Joseph Schumpeter put it, the main characteristic of capitalism is creative destruction. Capitalism is not a straight drive but a very bumpy ride, but we are still driving forwards and not backwards.

The overall impression is that if this book is understood as a laymen's short guide to finances, then the book is brilliant. It is a very easy read with numerous historical digressions. Yet, these strengths are also the book's weaknesses. Numerous details from history and from biographies of persons that shaped finance, regardless of how interesting they are, do not contribute much to Ferguson's arguments. In fact, the book lacks strict scientific analysis, which can be seen in a lack of references to empirical research and ideological bias. It is not a problem that Ferguson is a liberal and that conclusions of this book clearly show it, but it does not seem appropriate to almost completely disregard opposing ideologies. In light of capitalism's greatest crisis in 80 years, it seems odd that capitalism's greatest critics – the Marxists – are barely mentioned. If there is one field of economics where Marxists continued to be perceived as "serious scientists", it is economic history, above all Eric Hobsbawm. I am not suggesting Ferguson turns Marxist, but an academic "discussion" with Marxist economic historians, who love to emphasize capitalist/banker greed, would contribute a lot to this book, even if the Marxist's claims are rejected. This way, the book is too one-sided and fails to meet the goals of its ambitious subtitle *A financial history of the world*.

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