

The Earliest Securities Markets

Stocks and bonds have origins stretching back across the centuries.

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Securities markets took centuries to develop. The idea of debt dates back to the ancient world, as evidenced for example by ancient Mesopotamian clay tablets recording interest-bearing loans. However, tradable bonds were a more recent innovation, spearheaded by the Italian city-states of the late medieval and early Renaissance periods.

In 1171, the authorities of the Republic of Venice, concerned about their war-depleted treasury, drew a forced loan from the citizenry. Such debt, known as *prestitti*, paid 5 percent interest per year and had an indefinite maturity date. Initially regarded with suspicion, it came to be seen as a valuable investment that could be bought and sold. The bond market had begun.

From 1262 to 1379, Venice never missed an interest payment, solidifying the credibility of the new instruments. Other Italian city-states such as Florence and Genoa became bond issuers as well, often as a means of paying for warfare. Bonds were traded widely in Italy and beyond, a business facilitated by bankers such as the Medicis.

War between Venice and Genoa resulted in suspension of *prestitti* interest payments in the early 1380s, and when the market was restored, it was at a lower interest rate. Venice's bonds traded at steep discounts for decades thereafter. Other blows to financial stability resulted from the Hundred Years War, which caused monarchs of France and England to default on debts to Italian banks, and the Black Death, which ravaged much of Europe. Still, the idea of debt as a tradable investment endured.

As with bonds, the concept of stock developed gradually. Some scholars place its origins as far back as ancient Rome. (See sidebar, "Shares of Ancient Rome?") Partnership agreements dividing ownership into shares date back at least to the 13th century, again with Italian city-states in the vanguard. Such arrangements, however, typically extended only to a handful of people and were of limited duration, as with shipping partnerships that applied only to a single sea voyage.

The forefront of commercial innovation eventually shifted from Italy to northern Europe. The Hanseatic League, an alliance of mercantile towns such as Bruges and Antwerp, operated counting houses to expedite trade. The term "bourse," which would become synonymous with "stock market," arose in Bruges, either from a sign outside a trading center showing one or a few purses (*bursa* is Latin for bag) or because merchants gathered at the house of a man named Van der Burse; nobody's quite sure.

By the late 1500s, British merchants were experimenting with joint-stock companies intended to operate on an ongoing basis; one such was the Muscovy Company, which sought to wrest trade with Russia away from Hanseatic dominance. The next big step was in Amsterdam. In 1602, the Dutch East India Company was formed as a joint-stock company with shares that were readily tradable. The stock market had begun.

From Amsterdam to London

The Dutch East India Company, formed to build up the spice trade, operated as a colonial ruler in what's now Indonesia and beyond, a purview that included conducting military operations against recalcitrant natives and competing colonial powers. Control of the company was held tightly by its directors, with ordinary shareholders not having much influence on management or even access to the company's accounting statements.

However, shareholders were rewarded well for their investment. The company paid an average dividend of over 16 percent per year from 1602 to 1650. Financial innovation in Amsterdam took many forms. In 1609, investors led by one Isaac Le Maire formed history's first bear syndicate, but their coordinated trading had only a modest impact in driving down share prices, which tended to be robust throughout the 17th century. By the 1620s, the company was expanding its securities issuance with the first use of corporate bonds.

The Dutch West India Company was formed in 1621, bringing a new issuer to the burgeoning securities market. Amsterdam's growth as a financial center survived the tulip mania of the 1630s, in which contracts for the delivery of flower bulbs soared wildly and then crashed. New techniques and instruments proliferated for securities as well as commodities, including early forms of options trading and margin trading.

In 1688, Joseph de la Vega, an Amsterdam trader from a Spanish Jewish family, published *Confusion of Confusions*, the earliest book about stock trading. Taking the form of a dialogue between a merchant, a shareholder and a philosopher, the book described a market that was sophisticated but also prone to excesses, and de la Vega offered advice to his readers on such topics as the unpredictability of market shifts and the importance of patience in investment. (See sidebar, "Four Very Old Rules.")

The same year in which de la Vega published also saw an event that would help spread financial techniques and talent from Amsterdam to London. This was the "glorious revolution," in which Dutch-born William of Orange ascended to England's throne. William sought to modernize England's finances to pay for its wars, and thus the kingdom's first government bonds were issued in 1693 and the Bank of England was set up the following year. Soon thereafter, English joint-stock companies began going public.

London's first stockbrokers, however, were barred from the old commercial center known as the Royal Exchange, reportedly because of their rude manners. Instead, the new trade was conducted from coffee houses along Exchange Alley. By 1698, a broker named John Castaing, operating out of Jonathan's Coffee House, was posting regular lists of stock and commodity prices. Those lists mark the beginning of the London Stock Exchange.

South Sea Turmoil

The next few decades saw one of history's greatest financial bubbles. At the center of it were the South Sea Company, set up in 1711 to conduct English trade with South America, and the Mississippi Company, focused on commerce with France's Louisiana colony and touted by transplanted Scottish financier John Law, who was acting in effect as France's central banker. Investors snapped up shares in both, and whatever else was available. In 1720, at the height of the mania, there was even an offering of "a company for carrying out an undertaking of great advantage, but nobody to know what it is."

By the end of that same year, share prices were collapsing, as it became clear that expectations of imminent wealth from the Americas were overblown. In London, Parliament passed the Bubble Act, which stated that only royally chartered companies could issue public shares. In Paris, Law was stripped of office and fled the country. Stock trading would be more limited and subdued in subsequent decades. Yet the market survived, and by the 1790s shares were being traded in the young United States.

The first 600 or so years of securities trading were filled with booms and busts, crises and wars. But as such they showed that securities markets have a profound resilience and tenacity, bouncing back from problems by rebuilding credibility and confidence. That lesson from distant history is noteworthy in the present troubled time.

Shares of Ancient Rome?

There is little consensus among scholars as to when corporate stock was first traded. Some see the key event as the Dutch East India Company's founding in 1602, while others point to earlier developments. Economist Ulrike Malmendier of the University of California at Berkeley argues that a share market existed as far back as ancient Rome.

In the Roman Republic, which existed for centuries before the Empire was founded, there were *societas publicanorum*, organizations of contractors or leaseholders who performed temple-building and other services for the government. One such service was the feeding of geese on the Capitoline Hill as a reward to the birds after their honking warned of a Gallic invasion in 390 B.C.

Participants in such organizations had *partes* or shares, a concept mentioned various times by the statesman and orator Cicero. In one speech, Cicero mentions "shares that had a very high price at the time." Such evidence, in Malmendier's view, suggests the instruments were tradable, with fluctuating values based on an organization's success.

The *societas* declined into obscurity in the time of the emperors, as most of their services were taken over by direct agents of the state.

Four Very Old Rules

Joseph de la Vega, also known as Joseph Penso de la Vega and by other variations of his name, was a prolific writer as well as a successful businessman in 17th-century Amsterdam. His 1688 book *Confusion of Confusions* explained the workings of the city's stock market, and advised participants to follow four basic rules, which echo through the ages:

"The first rule in speculation is: Never advise anyone to buy or sell shares. Where guessing correctly is a form of witchcraft, counsel cannot be put on airs."

"The second rule: Accept both your profits and regrets. It is best to seize what comes to hand when it comes, and not expect that your good fortune and the favorable circumstances will last."

"The third rule: Profit in the share market is goblin treasure: at one moment, it is carbuncles, the next it is coal; one moment diamonds, and the next pebbles. Sometimes, they are the tears that Aurora leaves on the sweet morning's grass, at other times, they are just tears."

"The fourth rule: He who wishes to become rich from this game must have both money and patience."

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