

# The Origins of Value

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**Publisher:** Oxford University Press, August 2005 **ISBN:** 0195175719

“Those who are ignorant of history are doomed to repeat it,” is a widely cited but often ignored truth. The undisputed triumphs of technology in the 20th century often lead to a dismissive attitude toward antiquity. Indeed, many remain skeptical about what lessons we can learn from “more primitive” people who lived hundreds or even thousands of years ago. But *The Origins of Value* seeks to refute this complacent sentiment by demonstrating how much that we take for granted today has deep historical roots.

The material covered in this beautifully crafted book ranges from Babylonian cuneiform tablets that record loan commitments created almost 4,000 years ago to contingent rights certificates from 1953 that triggered the issuance of new German debt when the country reunited in 1990. A brief review does not allow a careful analysis of all 20 of the book’s fascinating essays. So I will confine myself to summarizing a selection of topics reflecting issues that are still very much with us today, including the following:

- **The origin of loans.** Development of the first true cities appears to have begun about 5,200 years ago in southern Mesopotamia or Babylon. Accompanying this urbanization was a rapid increase in specialization into farming, herding and fishing as well as non-agricultural craft production. This in turn gave rise to the need for writing to facilitate the necessarily complex exchange among specialist producers. Early in this period, the allocation of goods was highly centralized, first through the temple and later through the palace. Such distributions were funded by mandatory donations to a central fund.

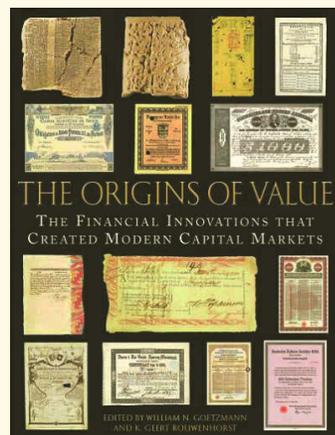
Given the seasonality of agricultural production, as well as its non-seasonal volatility based on variations in growing conditions, regular periodic contributions were not possible. This gave rise to a combination of arrearages and private borrowing to meet the required contributions. Both sit-

uations were regarded as loans and carefully recorded on clay tablets to document the obligation. Since all would continue to receive their regular ration allotment even if they could not make their current contribution, these loans serve as a vivid example of credit as the mechanism for inter-temporal transfer of production and consumption.

- **The suspicion and persistence of interest.** It is interesting that these earliest loan records clearly reflect inclusion of interest. The suspicion, indeed the condemnation, of charging interest is well known throughout history and persists to this day. We often associate such views with religious teachings, but even Aristotle was outspoken on the issue, saying “...this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. That is why of all modes of getting wealth this is the most unnatural.”

It is clear that the traditional moral condemnation of charging interest grew out of a world in which only the unfortunate would be required to borrow money. Why, it would be easy to ask, should people borrow money who had their own to spend? The modern answer, of course, lies in what economists call the marginal efficiency of capital. Roundabout means of production, which require deferring current consumption to invest in improved production tools, result in greater total output in the long run. By such real investments, borrowers can indeed breed money from money.

Chapter 1 of *The Origins of Value* points out that some hint of this modern insight may be present in the ancient Babylonian loan tablets. The Sumerian word for “interest” was “mas,” which is the same as the word for “lamb.” While this could be purely an etiological coincidence, it may relate to the practice of charging grazing fees for the temporary use of agricultural land. The right to graze sheep on an owner’s land would normally lead to growth in the shepherd’s flock through the birth of new lambs. Part of the



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grazing fee would often be paid by handing over to the landowner a small number of these lambs.

It is no great leap to imagine the grant of temporary grazing rights as a loan of the land and the corresponding fee as payment for such a loan for a set period. If you introduce the concept of monetary loans to facilitate productive activity, interest payments emerge as a perfectly logical extension of grazing fees to compensate for an in-kind loan of land.

- **The role of money.** The introduction of money to facilitate exchange ranks among the most significant innovations in the history of economic development. For any form of money to be successful, however, the public must be confident in the durability of its scarcity value. To establish this confidence, the earliest forms of money were commodities with a value in their own right.

The world's first viable paper-based fiat currency appeared in the 11th century under the Song Dynasty in China. During a centuries-long struggle to ward off attacks from central Asian invaders, however, the Song repeatedly issued excessive amounts of paper money and thereby undermined public confidence in its value. Subsequent dynasties fell victim to the same temptation, leading to the virtual disappearance of paper currency in China for hundreds of years until the modern era.

This period in Europe was also characterized by wartime funding requirements among the Italian city-states. If the time and effort to levy and collect taxes was incompatible with military priorities, the city-states began to borrow from their wealthiest citizens.

These voluntary loans were supplemented, in time, by forced subscription to new government debt. In general, however, these obligations paid a stipulated rate of interest. In times of crisis, obligations were issued at a discount, raising their effective interest rate. More importantly, the proof of indebtedness that accompanied these loans eventually became negotiable, giving rise to an early market in public debt.

By making a virtue of necessity, European political entities created a means of raising needed funds that did not alienate powerful constituencies and did not require debasing their currencies. It also provided a model and institutional framework in which private debt markets could arise. The contrast with the Chinese experience was to have profound implications for the economic fortunes of the two regions over the past 500 years.

- **Arbitrage across weights, currencies, time and place.** We think of hedge funds as recent innovations involving arbitrage across markets. *The Origins of Value*

points out, however, that ancient traders had to arbitrage across a welter of inconsistent weights and currencies, as well as across time and place. Their ability to do so quickly and take advantage of temporary inconsistencies can be thought of as a forerunner of modern hedge funds.

- **Equity shares and the role of futures and options.**

Common stock is so much a part of our modern economy that we take it for granted. It is worth remembering, however, that its roots lie in the financing of temporary, risky undertakings such as sailing expeditions. Investors would purchase a "share" of the ultimate proceeds of the venture upon completion for an up-front investment used to equip the project.

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Gradually, such "share" funding of temporary ventures evolved into the means of financing open-ended commercial ventures. Originally such shares could only be traded periodically, corresponding to when the issuer was prepared to record the change of ownership on its books. This gave rise to a market for futures contracts to lock in an agreed price at which the future transfer would occur as well as for options to protect against the potential change in value until the next transfer date.

In addition to the events previously cited in this review, *The Origins of Value* also traces the historical origins of many other modern financial phenomena. These include collateral agreements, member-only clearinghouses, inflation-indexed bonds, "Eurobonds" and life annuities.

For those who seek an improved sense of how the modern financial world came to be, *The Origins of Value* provides a varied and interesting perspective. It also offers some ancient but still relevant lessons about political manipulation, adverse selection, exuberant expectations and the larceny that lurks in the human soul. ■

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