Monte dei Paschi di Siena - we've been here before [1]

Written by **Jesse Harrington** [2] | Thursday 30 August 2012

In June, the Italian Parliament approved Italy?s struggling third-largest lender, Banca Monte dei Paschi di Siena (MPS), for another round of state aid. This week, Reutersreports [3] the Italian state may have to take a stake in the bank after it posted larger than expected first-half losses of €1.6 billion. MPS? ongoing difficulties stem from imprudent lending and acquisitions during both the Europe-wide credit expansion and the ?consolidation frenzy? which swept the Italian banking sector in the late 2000s, leaving it with low reserves compounded during the downturn by the bank?s €25 billion exposure to Italian government bonds ? described as ?proportionally higher than that of its domestic peers?.

One other interesting piece of information: founded in 1472, the Sienese institution also happens to be the world?s oldest surviving bank.

I say ?surviving?, of course, because the city of Florence had a history of much older banks, many of which went bankrupt over a hundred years before MPS was even founded. Their story, recalled briefly in Jesús Huerta de Soto?s *Money, Bank Credit and Economic Cycles* [4], is worth revisiting here because it reveals a similar set of preceding circumstances:

> *?Around the end of the twelfth and beginning of the thirteenth centuries, Florence was the site of an incipient banking industry which gained great importance in the fourteenth century. The following families owned many of the most important banks: the Acciaiuolis, the Bonaccorsis, the Cocchis, the Antellesis, the Corsinis, the Uzzanos, the Perendolis, the Peruzzis, and the Bardis. Evidence shows that from the beginning of the fourteenth century bankers gradually began to make fraudulent use of a portion of the money on demand deposit [ie. non-saving deposits], creating out of nowhere a significant amount of expansionary credit. ... [A]n increase in the money supply (in the form of credit expansion) caused an artificial economic boom followed by a profound, inevitable recession. This recession was triggered not only by Neapolitan princes? massive withdrawal of funds, but also by England?s inability to repay its loans and the drastic fall in the price of Florentine government bonds. In Florence, public debt had been financed by speculative new loans created out of nowhere by Florentine banks. A general crisis of confidence occurred, causing all of the above banks to fail between 1341 and 1346.? (pp. 70-71)*

A familiar pattern emerges from de Soto?s work: banks drawn into excessive lending on ever-diminishing reserves, triggering in turn credit expansion, recession, and financial vulnerability compounded ultimately by over-exposure to questionable government debt.

It is a pattern which demonstrates a weakness in our current economic system that is older even than the oldest of its contemporary institutions. More properly, it is a cautionary tale against state collusion in the active encouragement of excessive lending and credit expansion. In the fourteenth century, this was achieved through the privileges granted to banks by their avid state-borrowers, allowing them ignore the earlier legal principle of maintaining full reserves on non-saving deposits. In the twenty-first century, however, the pattern of depletion was significantly amplified by the availability of easy lines of credit through the European System of Central Banks.

De Soto would argue, as he does in his conclusions, that the way to avoid the kind of insolvency crisis which struck medieval Florence and threatens modern Italy is a system of free banking (ie. without central bank interference), accompanied by full-reserve requirements on non-saving deposits. The efforts of the Italian government to boost MPS? reserves aim to address an important weakness, but as long as the European Central Bank retains the capacity to expand credit artificially in the name of ?stimulus?, the risk of state-induced asset bubbles and sovereign-debt crises still exists [5].

Although today we use the euro instead of the florin, those two issues are still very much two sides of the same coin.

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