2

Historical Violations of the Legal Principles Governing the Monetary Irregular-Deposit Contract

In this chapter we will present various examples to show how bankers have throughout history violated traditional legal principles in the irregular deposit, and we will consider the reasons behind the failure of society's regulatory mechanisms to put a stop to these abuses. We will also contemplate the role of governments in this process. Far from endeavoring to scrupulously defend property rights, they supported bankers' improper activity almost from the beginning and granted exemptions and privileges in order to take advantage of this activity for their own uses. Thus the intimate complicity and solidarity traditionally present (and still existent) in relations between state and bank institutions. To understand why the different attempts to legally justify abuses have failed, we must first properly understand the legally corrupt origin of fractional reserves in monetary bank deposits. We will examine attempts at justification in chapter 3.

1
Introduction

In the last chapter we presented the clear, coherent legal nature of the monetary irregular-deposit contract. Undoubtedly,

those who from the beginning received money from their fellow citizens for safekeeping knew the obligations they were taking on, specifically, to guard the *tantundem* like a good parent, to keep it constantly available to the depositor. This is precisely the meaning of safekeeping in a deposit contract of a fungible good. However, while the legal nature of the irregular deposit contract is clear and easy to understand, human nature is imperfect and weak. Therefore it is comprehensible that those receiving monetary deposits were tempted to violate the safekeeping obligation and use for themselves money that should have been kept available to others. The *temptation* was very strong: without depositors realizing it, bankers could handle large amounts of money; and if they used it well, it could generate substantial profit or interest, which bankers could keep without openly harming anyone.[1] Given the weakness of human nature and the almost irresistible temptation felt by bankers, it is comprehensible that the traditional principles of safekeeping on which the monetary irregular-deposit contract is based were violated from the very beginning in a concealed manner. In addition, given the abstract, confusing nature of monetary relations, most citizens and the majority of authorities in charge of enforcing moral and legal principles failed to notice this phenomenon, except in rare instances. And once abuses and cases of fraud began to surface and became better understood, the institution of banking had

[1]We are referring to the most obvious source of profit, which initially motivated bankers to misappropriate depositors' money. In chapter 4 we will examine a source of much greater earnings: the power of bankers to issue money or create loans and deposits out of nowhere. The resulting profit is immensely larger; however, as it arises from an abstract process, it is certain not even bankers were fully aware of it until very late in the evolution of finance. Nevertheless, the fact that they did not understand, but only intuited, this second type of profit does not mean they failed to take advantage of it completely. In the next chapter we will explain how bankers' violation of traditional legal principles through fractional-reserve banking makes it possible to create loans out of nowhere, the return of which is then demanded in hard cash (with interest to boot!). In short, we are dealing with a constant, privileged source of funding in the shape of deposits bankers create out of nothing and constantly employ for their own uses.

already been in operation so long and had acquired such power that it was practically impossible to effectively curb corruption. Moreover, the gradual discovery authorities made of banks' immense power to create money explains why, in most instances, governments ended up becoming accomplices to banking fraud, granting privileges to bankers and legalizing their improper activity, in exchange for the opportunity to participate, directly or indirectly, in their enormous profits. In this way they established an important alternative source of state funding. Furthermore, this corruption of the state's traditional duty to define and defend property rights was encouraged by governments' enormous, recurrent need for resources, due to their historical irresponsibility and lack of financial control. Thus, a more and more perfect symbiosis or community of interests was formed between governments and bankers, a relationship which to a great extent still exists today.

However, despite the complexity of the above situation, certain shrewd thinkers long ago began to understand it. Doctor Saravia de la Calle, in his book, *Instrucción de mercaderes*, attributes the destructive effects of banking to the fact that

> man's insatiable greed has so thoroughly banished his fear of God and sense of shame, and I even believe it is due to the neglect of the republic's spiritual and temporal leaders.[2]

If Saravia de la Calle shows any weakness, it is an excess of charity toward the leaders. He correctly attributes fraud in the irregular deposit to men's frailty or greed, but he only holds the leaders responsible for their "neglect" in not being able to end abuses. Historical events reveal that, apart from demonstrating undeniable neglect, on many occasions governments have clearly and explicitly taken advantage of the large profits of the banking "business." In addition, we will see that, in other instances, authorities have not only granted

[2]Luis Saravia de la Calle, *Instrucción de mercaderes* (Medina del Campo: Pedro de Castro, 1544; Madrid: Colección de Joyas Bibliográficas, 1949), chap. 8, p. 179.

the bankers privileges so they could carry out their activities with impunity in exchange for specific favors, but they have even created government banks in order to *directly* take advantage of the corresponding profits.

Although banking activities developed long ago and practically coincided with the appearance of money, the dawn of trade, and the first steps in the division of labor[3], we will present and illustrate the violation of traditional legal principles in

---

[3]The archeologist Lenor Mant discovered among the ruins of Babylon a clay tablet with an inscription attesting to intercity trading and the use of commercial and financial means of payment. The tablet mentions an Ardu-Nama (the drawer, of the city of Ur) ordering a Marduk-Bal-at-Irib (the drawee) of the city of Orkoe to pay in Ardu-Nama's name the sum of four minas and fifteen shekels of silver to Bel-Abal-Iddin within a set time period. This document is dated the 14th of Arakhsamna, year 2 of the reign of Nabonaid. For his part, the researcher Hilprecht discovered in the ruins of the city of Nippur a total of 730 baked clay tablets with inscriptions, thought to have belonged to the archives of a bank existing in the city in 400 B.C., called Nurashu and Sons (see "Origen y desenvolvimiento histórico de los bancos," in the *Enciclopedia universal ilustrada europeo-americana* [Madrid: Editorial Espasa-Calpe, 1979], vol. 7, p. 477). In turn, Joaquín Trigo, apart from offering us the above information, reports that around the year 3300 B.C. the temple of Uruk owned the land it exploited, received offerings and deposits and granted loans to farmers and merchants of livestock and grain, becoming the first bank in history. In the British Museum we also find tablets recording the financial operations of the bank Sons of Egibi. The sequence of the tablets demonstrates that from the time of the Assyrians, and for more than 180 years, the institution was controlled by a true financial dynasty. The Code of Hammurabi facilitated the transfer of property and strictly regulated the rights associated with it, as well as commercial activity, limiting interest rates and even establishing public loans at 12.5 percent. Partnership agreements were also regulated, as was the keeping of accounts of operations. The Manu Smriti of India also makes reference to banking and financial operations. In short, remaining records indicate that financial operations occurred between 2300 and 2100 B.C., though the spread of the "banking" business began between 730 and 540 B.C., when Assyrian and New Babylonian dynasties ensured safe trade, which gave rise to specialized banks. This activity also spread to Egypt, and later from there to the Ancient Greek world (Joaquín Trigo Portela, "Historia de la banca," chapter 3 of the *Enciclopedia práctica de la banca* (Barcelona: Editorial Planeta, 1989), vol. 6, esp. pp. 234–37).

the irregular deposit by bankers and authorities in three different historical instances: the Greco-Roman world; the Mediterranean trading cities of the late Middle Ages and the beginning of the Renaissance; and finally, the emergence of the first important government banks beginning in the seventeenth century. Moreover, the evolution of banking in these three separate historical instances produced to a large extent the same characteristic results. Indeed, in each case we observe that as people began to violate traditional legal principles, harmful effects followed, not only in the shape of bank failures, but also profound financial and economic crises. In the following historical examples the same frauds are committed, followed by the same typical stages and results, and the same failed attempts to enforce traditional principles of safekeeping. The same damaging effects then inexorably follow, and this process is repeated again and again, up to the present day. Let us now examine the violation of legal principles and authorities' complicity in banking frauds and abuses throughout history.

2
BANKING IN GREECE AND ROME

In ancient Greece temples acted as banks, loaning money to individuals and monarchs. For religious reasons temples were considered inviolable and became a relatively safe refuge for money. In addition, they had their own militias to defend them and their wealth inspired confidence in depositors. From a financial standpoint the following were among the most important Greek temples: Apollo in Delphi, Artemis in Ephesus, and Hera in Samos.

TRAPEZITEI OR GREEK BANKERS

Fortunately certain documentary sources on banking in Greece are available to us. The first and perhaps most important is *Trapezitica*,[4] written by Isocrates around the year 393

[4]Raymond de Roover points out that the current term banker originated in Florence, where bankers were called either *banchieri* or *tavolieri*, because they worked sitting behind a bench (*banco*) or table (*tavola*). The

B.C.[5] It is a forensic speech in which Isocrates defends the interests of the son of a favorite of Satyrus, king of Bosphorus. The son accuses Passio, an Athenian banker, of misappropriating a deposit of money entrusted to him. Passio was an ex-slave of other bankers (Antisthenes and Archetratos), whose trust he had obtained and whose success he even surpassed, for which he was awarded Athenian citizenship. Isocrates's forensic speech describes an attempt by Passio to appropriate

---

same logic was behind terminology used in ancient Greece as well, where bankers were called *trapezitei* because they worked at a *trapeza*, or table. This is why Isocrates's speech "On a Matter of Banking" is traditionally known as Trapezitica. See Raymond de Roover, *The Rise and Decline of the Medici Bank, 1397–1494* (Cambridge, Mass.: Harvard University Press, 1963), p. 15. The great Diego de Covarrubias y Leyva, for his part, indicates that

> the remuneration paid to money changers for the exchange of money was called collybus by the Greeks, and therefore money changers were called collybists. They were also called nummularii and argentarii, as well as trapezitei, mensularii or bankers, because apart from changing money, they carried out a much more profitable business activity: they received money for safekeeping and loaned at interest their own money and that of others.

See chapter 7 of *Veterum collatio numismatum*, published in *Omnium operum* in Salamanca in 1577.

[5]Isocrates was one of the ancient *macróbioi*, and he lived to be almost 100 years old (436–338 B.C.). His life began during the last years of peaceful Athenian dominance over Persia and lasted through the Peloponnesian War, Spartan and Theban supremacy and the Macedonian expansion, which ended in the battle of Chaeronea (Chaironeia), in which Philip II defeated the Delian League the same year Isocrates died. Isocrates's father, Theodorus, was a middle-class citizen whose flute factory had earned him considerable wealth, permitting him to give his children an excellent education. Isocrates's direct teachers appear to have included Theramines, Gorgias, and especally Socrates (there is a passage in Phaedrus where Plato, using Socrates as a mouthpiece, praises the young Isocrates, apparently ironically, predicting his great future). Isocrates was a logographer; that is, he wrote legal speeches for others (people suing or defending their rights) and later he opened a school of rhetoric in Athens. For information on Isocrates, see Juan Manuel Guzmán Hermida's "Introducción General" to *Discursos* (Madrid: Biblioteca Clásica Gredos, 1979), vol. 1, pp. 7–43.

deposits entrusted to his bank by taking advantage of his depositor's difficulties, for which he did not hesitate to deceive, forge, and steal contracts, bribe, etc. In any case, this speech is so important to our topic that it is worth our effort to consider some of its passages in detail.

Isocrates begins his arguments by pointing out how hazardous it is to sue a banker, because

> deals with bankers are made without witnesses and the injured parties must put themselves in jeopardy before such people, *who have many friends, handle large amounts of money and appear trustworthy due to their profession*.[6]

It is interesting to consider the use bankers have always made of all of their social influence and power (which is enormous, given the number and status of figures receiving loans from them or owing them favors) to defend their privileges and continue their fraudulent activity.[7]

---

[6]Isocrates, "Sobre un asunto bancario," in *Discursos* I, p. 112.

[7]More than 2200 years after Isocrates, the Pennsylvanian senator Condy Raguet also recognized the great power of bankers and their use of it to intimidate their enemies and to in any way possible discourage depositors from withdrawing their deposits and hinder these withdrawals, with the vain hope, among others, of avoiding crises. Condy Raguet concluded that the pressure was almost unbearable and that

> an independent man, who was neither a stockholder or a debtor who would have ventured to compel the banks to do justice, would have been persecuted as an enemy of society.

See the letter from Raguet to Ricardo dated April 18, 1821, published in David Ricardo, *Minor Papers on the Currency Question 1805–1823*, Jacob Hollander, ed. (Baltimore: The Johns Hopkins University Press, 1932), pp. 199–201. This same idea had already been expressed almost three centuries earlier by Saravia de la Calle, who, indicating obstacles created by bankers to keep depositors from withdrawing their money, obstacles few dared to protest, mentioned the

> other thousands of humiliations you inflict upon those who go to withdraw their money from you; you detain them and make them waste money waiting and threaten to pay them in weak currency. In this way you coerce them to give you all you want. You have found this way to steal, because when

Isocrates explains that his client, who was planning a trip, deposited a very large amount of money in Passio's bank. After a series of adventures, when Isocrates's client went to withdraw his money, the banker claimed he "was without funds at the moment and could not return it." However, the banker, instead of admitting his situation, publicly denied the existence of any deposit or debt in favor of Isocrates's client. When the client, greatly surprised by the banker's behavior, again claimed payment from Passio, he said to the banker,

> after covering his head, cried and said he had been forced by economic difficulties to deny my deposit but would soon try to return the money to me; he asked me to take pity on him and to keep his poor situation *a secret* so it would not be discovered he had committed fraud.[8]

It is therefore clear that in Greek banking, as Isocrates indicates in his speech, bankers who received money for safekeeping and custody were obliged to safeguard it by keeping it available to their clients. For this reason, it was considered fraud to employ that money for their own uses. Furthermore, the attempt to keep this type of fraud *a secret* so people would conserve their trust in bankers and the latter could continue

---

> they go to withdraw their money they do not dare ask for cash, but leave the money with you in order to collect much larger and more infernal profits. (*Instrucción de mercaderes*, p. 183)

Finally, Marx also mentions the fear and reverence bankers inspire in everyone. He cites the following ironic words of G.M. Bell:

> The knit brow of the banker has more influence over him than the moral preaching of his friends; does he not tremble to be suspected of being guilty of fraud or of the least false statement, for fear of causing suspicion, in consequence of which his banking accommodation might be restricted or cancelled? The advice of the banker is more important to him than that of the clergyman. (Karl Marx, *Capital*, vol. 3: *The Process of Capitalist Production as a Whole*, Frederick Engels, ed., Ernest Untermann, trans. [Chicago: Charles H. Kerr and Company, 1909], p. 641)

[8]Isocrates, "Sobre un asunto bancario," pp. 114 and 117.

their fraudulent activity is very significant. Also, we may deduce from Isocrates's speech that for Passio this was not an isolated case of fraud, an attempt to appropriate the money of a client under favorable circumstances, but that he had difficulty returning the money because he had not maintained a 100-percent reserve ratio and had used the deposited money in private business deals, and he was left with no other "escape" than to publicly deny the initial existence of the deposit.

Isocrates continues his speech with more words from his client, who states:

> Since I thought he regretted the incident, I compromised and told him to find a way to return my money while saving face himself. Three days later we met and both promised to keep what had happened a secret; (he broke his promise, as you will find later in my speech). He agreed to sail with me to Pontus and to return the gold to me there, in order to cancel the contract as far from this city as possible; that way, no one from here would find out the details of the cancellation, and upon sailing back, he could say whatever he chose.

Nevertheless, Passio denies this agreement, causes the disappearance of the slaves who had been witnesses to it and forges and steals the documents necessary to try to demonstrate that the client had a debt with him instead of a deposit. Given the secrecy in which bankers performed most of their activities, and the secret nature of most deposits,[9] witnesses were not used, and Isocrates was forced to present indirect witnesses who knew the depositor had taken a large amount of money and had used Passio's bank. In addition, the witnesses knew that at the time the deposit was made the depositor had changed more than one thousand staters into gold.

---

[9]The Greeks distinguished between monetary demand deposits (phanerà ousía) and invisible deposits (aphanés ousía). The distinction, rather than denote whether or not the money was continually available to the depositor (in both cases it should have been), appears to have referred to whether or not the deposit and its amount were publicly known. If they were, the money could be seized or confiscated, mostly for tax reasons.

Furthermore, Isocrates claims that the point most likely to convince the judges of the deposit's existence and of the fact that Passio tried to appropriate it was that Passio always refused to

> turn over the slave who knew of the deposit, for interrogation under torture. What stronger evidence exists in contracts with bankers? We do not use witnesses with them.[10]

Though we have no documentary evidence of the trial's verdict, it is certain that Passio was either convicted or arrived at a compromise with his accuser. In any case, it appears that afterward he behaved properly and again earned the trust of the city. His house was inherited by an old slave of his, Phormio, who successfully took over his business.

More interesting information on the activity of bankers in Greece comes from a forensic speech written by Demosthenes in favor of Phormio. Demosthenes indicates that, at the time of Passio's death, Passio had given fifty talents in loans still outstanding, and of that amount, "eleven talents came from bank deposits." Though it is unclear whether these were time or demand deposits, Demosthenes adds that the banker's profits were "insecure and came from the money of others." Demosthenes concludes that "among men who work with money, it is admirable for a person known as a hard worker to also be honest," because "credit belongs to everyone and is the most important business capital." In short, banking was based on depositors' trust, bankers' honesty, on the fact that bankers should always keep available to depositors money placed in demand deposits, and on the fact that money loaned to bankers for profit should be used as prudently and sensibly as possible. In any case, there are many indications that Greek bankers did not always follow these guidelines, and that they used for themselves money on demand deposit, as described by Isocrates in *Trapezitica* and as Demosthenes reports of other bankers (who went bankrupt as the result of this type of activity) in his speech in favor of Phormio. This is true of

[10]Isocrates, "Sobre un asunto bancario," p. 116.

Aristolochus, who owned a field "he bought while owing money to many people," as well as of Sosynomus, Timodemus, and others who went bankrupt, and "when it was necessary to pay those to whom they owed money, *they all suspended payments* and surrendered their assets to creditors."[11]

Demosthenes wrote other speeches providing important information on banking in Greece. For example, in "Against Olympiodorus, for Damages,"[12] he expressly states that a certain Como

> placed some money on demand deposit in the bank of Heraclides, and the money was spent on the burial and other ritual ceremonies and on the building of the funerary monument.

In this case, the deceased made a demand deposit which was withdrawn by his heirs as soon as he died, to cover the costs of burial. Still more information on banking practices is offered in the speech "Against Timothy, for a Debt," in which Demosthenes affirms that

> bankers have the custom of making entries for the amounts they hand over, for the purpose of these funds, and for deposits people make, so that the amounts given out and those deposited are recorded for use when balancing the books.[13]

---

[11]Demosthenes, *Discursos privados I, Biblioteca Clásica Gredos (*Madrid: Editorial Gredos, 1983), pp. 157–80. The passages from the text are found on pp. 162, 164 and 176, respectively, of the above edition. For information on the failure of Greek banks, see Edward E. Cohen, *Athenian Economy and Society: A Banking Perspective* (Princeton, N.J.: Princeton University Press, 1992), pp. 215–24. Nevertheless, Cohen does not seem to understand the way in which bank credit expansions caused the economic crises affecting the solvency of banks.

[12]Demosthenes, *Discursos privados II, Biblioteca Clásica Gredos (*Madrid: Editorial Gredos, 1983), pp. 79–98. The passage mentioned in the main text is found on p. 86.

[13]Ibid., pp. 99–120. The passage cited is found on p. 102.

This speech, delivered in 362 B.C., is the first to document that bankers made book entries of their clients' deposits and withdrawals of money.[14] Demosthenes also explains how checking accounts worked. In this type of account, banks made payments to third parties, following depositors' instructions.[15] As legal evidence in this specific case, Demosthenes

> adduced the bank books, demanded copies be made, and after showing them to Phrasierides, I allowed him to inspect the books and make note of the amount owed by this individual.[16]

Finally, Demosthenes finishes his speech by expressing his concern at how common bank failures were and the people's great indignation against bankers who went bankrupt. Demosthenes mistakenly attributes bank failures to men who

> in difficult situations request loans and believe that credit should be granted them based on their reputation; however, once they recover economically, they do not repay the money, but instead try to defraud.[17]

We must interpret Demosthenes's comment within the context of the legal speech in which he presents his arguments. The purpose of the speech was precisely to sue Timothy for not returning a bank loan. It would be asking too much to expect Demosthenes to have mentioned that most bank failures occurred because bankers violated their obligation to safeguard demand deposits, and they used the money for themselves and put it into private business deals up to the point when, for some reason, the public lost trust in them and tried to withdraw their deposits, finding with great indignation that the money was not available.

---

[14]G. J. Costouros, "Development of Banking and Related Book-Keeping Techniques in Ancient Greece," *International Journal of Accounting* 7, no. 2 (1973): 75–81.

[15]Demosthenes, *Discursos privados II*, p. 119.

[16]Ibid., p. 112.

[17]Ibid.,, p. 120.

On various occasions research has suggested Greek bankers usually knew they should maintain a 100-percent reserve ratio on demand deposits. This would explain the lack of evidence of interest payments on these deposits, as well as the proven fact that in Athens banks were usually not considered sources of credit.[18] Clients made deposits for reasons of safety and expected bankers to provide custody and safekeeping, along with the additional benefits of easily-documented cashier services and payments to third parties. Nevertheless, the fact that these were the basic principles of legitimate banking did not prevent a large group of bankers from yielding to the temptation to (quite profitably) appropriate deposits, a fraudulent activity which was relatively safe as long as people retained their trust in bankers, but in the long run it was destined to end in bankruptcy. Moreover, as we will illustrate with various historical examples, networks of fraudulent

---

[18]S.C. Todd, in reference to Athenian banking, affirms that

> banks were not seen as obvious sources of credit . . . it is striking that out of hundreds of attested loans in the sources only eleven are borrowed from bankers; and there is indeed no evidence that a depositor could normally expect to receive interest from his bank. (S.C. Todd, *The Shape of Athenian Law* (Oxford: Clarendon Press, 1993), p. 251)

Bogaert, for his part, confirms that bankers paid no interest on demand deposits and even charged a commission for their custody and safekeeping:

> Les dépôts de paiement pouvaient donc avoir différentes formes. Ce qu'ils ont en commun est l'absence d'intérêts. Dans aucun des cas précités nous n'en avons trouvé des traces. Il est même possible que certains banquiers aient demandé une commission pour la tenue de comptes de dépôt ou pour "l'exécution des mandats." (Raymond Bogaert, *Banques et banquiers dans les cités grecques* [Leyden, Holland: A.W. Sijthoff, 1968], p. 336)

Bogaert also mentions the absence of any indication that bankers in Athens maintained a certain fractional-reserve ratio ("Nous ne possédons malheureusement aucune indication concernant l'encaisse d'une banque antique," p. 364), though we know that various bankers, including Pison, acted fraudulently and did not maintain a 100-percent reserve ratio. As a result, on many occasions they could not pay and went bankrupt.

bankers operating, against general legal principles, with a fractional-reserve ratio bring about credit expansion[19] unbacked by real savings, leading to artificial, inflationary economic booms, which finally revert in the shape of crises and economic recessions, in which banks inexorably tend to fail.

Raymond Bogaert has mentioned the periodic crises affecting banking in ancient Greece, specifically the economic and financial recessions of 377–376 B.C. and 371 B.C., during which the banks of Timodemus, Sosynomus and Aristolochus (among others) failed. Though these recessions were triggered by the attack of Sparta and the victory of Thebes, they emerged following a clear process of inflationary expansion in which fraudulent banks played a central part.[20] Records also reflect the serious banking crisis which took place in Ephesus following the revolt against Mithridates. This crisis motivated authorities to grant the banking industry its first express, historically-documented privilege, which established a ten-year deferment on the return of deposits.[21]

In any case, the bankers' fraudulent activity was extremely "profitable" as long as it was not discovered and banks did not fail. We know, for example, that the income of Passio reached 100 minas, or a talent and two-thirds. Professor Trigo Portela has estimated that this figure in kilograms of gold would be equivalent today to almost two million dollars a year. This does not seem an extremely large amount, though it was really quite spectacular, considering most people lived at mere subsistence level, ate only once a day and had a diet of cereals and vegetables. Upon his death, Passio's fortune

---

[19] The money supply at Athens can thus be seen to consist of bank liabilities ("deposits") and cash in circulation. The amount of increase in the bank portion of this money supply will depend on the volume and velocity of bank loans, the percentage of these loan funds immediately or ultimately redeposited in the trapezai, and the time period and volatility of deposits. (Cohen, *Athenian Economy and Society,* p. 13)

[20] Bogaert, *Banques et banquiers dans les cités grecques*, pp. 391–93.

[21] Ibid., p. 391.

amounted to sixty talents; given a constant value for gold, this would add up to nearly forty-four million dollars.[22]

Banking in the Hellenistic World

The Hellenistic period, especially Ptolemaic Egypt, was a turning point in the history of banking because it marked the creation of the first government bank. The Ptolemies soon realized how profitable private banks were, and instead of monitoring and cracking down on bankers' fraudulent activities, decided to cash in on the overall situation by starting a government-run bank which would conduct business with the "prestige" of the state.

Although there was never a true government monopoly on banking, and private banks (mostly run by Greeks) continued to operate, Egypt's prosperity secured a predominant role for the state bank. Rostovtzeff observes that the Ptolemaic bank also developed a sophisticated accounting system:

> Refined accounting, based on a well-defined professional terminology, replaced the rather primitive accounting of fourth-century Athens.[23]

Several archaeological studies show how widespread banking was during the Hellenistic period in Egypt. An incomplete document found in Tebtunis containing daily account records of a rural bank in the province of Heracleopolis shows the unexpectedly high number of villagers

---

[22]Trigo Portela, "Historia de la banca," p. 238. Raymond Bogaert, in contrast, estimates Passio's annual income before his death at nine talents, several times larger:

> Cela donne en tout pour environ 9 talents de revenus annuels. On comprend que le banquier ait pu constituer en peu d'années un important patrimonie, faire des dons généreux à la cité et faire les frais de cinq triérchies. (Bogaert, *Banques et banquiers dans les cités grecques*, p. 367 and also Cohen, *Athenian Economy and Society*, p. 67)

[23]M. Rostovtzeff, *The Social and Economic History of the Hellenistic World* (Oxford: Oxford University Press, 1953), vol. 1, p. 405.

who, whether farmers or not, did business through banks and made payments out of their deposits and bank accounts. Relatively wealthy people were few, and most of the bank's customers were retailers and indigenous craftspeople, linen merchants, textile workers, tailors, silversmiths and a tinker. Also, debts were often paid in gold and raw silver, following the ancient Egyptian tradition. Grain, oil and cattle dealers, as well as a butcher and many innkeepers were documented as clients of the bank. The Ptolemaic government bank, private banks, and temples alike kept custody of different kinds of deposits. According to Rostovtzeff, bankers accepted both demand deposits and interest-paying time deposits. The latter were, in theory, invested in

> credit operations of various sorts—loans on collateral security, pledges, and mortgages, and a special very popular type—bottomry loans.[24]

Private banks kept custody of their clients' deposits while at the same time placing their own money in the government bank.

The main innovation of Egyptian banking was centralization: the creation of a government central bank in Alexandria, with branches in the most important towns and cities, so that private banks, when available, played a secondary role in the country's economy. According to Rostovtzeff, this bank held custody of tax revenues and also took in private funds and deposits from ordinary clients, investing remaining funds in benefit of the state. Thus, it is almost certain that a fractional-reserve system was used and that the bank's huge profits were appropriated by the Ptolemies. Zeno's letters provide ample information on how banks received money from their clients and kept it on deposit. They also tell us that Apollonius, the director of the central bank in Alexandria, made personal deposits in different branches of the royal bank. All of these sources show how frequently individuals used the bank for

---

[24]M. Rostovtzeff, *The Social and Economic History of the Hellenistic World* (Oxford: Oxford University Press, 1957), vol. 2, p. 1279.

making deposits as well as payments. In addition, due to their highly-developed accounting system, paying debts through banks became extremely convenient, as there was an official record of transactions—an important piece of evidence in case of litigation.

The Hellenistic banking system outlived the Ptolemaic dynasty and was preserved during Roman rule with minor changes. In fact, Ptolemaic centralized banking had some influence on the Roman Empire: a curious fact is that Dio Cassius, in his well-known Maecenas speech, advocates the creation of a Roman government bank which would offer loans to everyone (especially landowners) at reasonable interest rates. The bank would draw its capital from earnings on all state-owned property.[25] Dio Cassius's proposal was never put into practice.

Banking in Rome

Since there are no Latin equivalents of the speeches by Isocrates and Demosthenes, Roman banks are not documented in as much detail as their Greek counterparts. However, we know from Roman law that banking and the monetary irregular deposit were highly developed, and we have already considered (in chapter 1) the regulations classical Roman jurists provided in this area. Indeed, Roman *argentarii* were not considered free to use the *tantundem* of deposits as they pleased, but were obliged to safeguard it with the utmost diligence. This is precisely why money deposits did not pay interest and in theory were not to be lent, although the depositor could authorize the bank to use the money for making payments in his name. Likewise, bankers took in time "deposits," which were actually loans to the bank or *mutuum* contracts. These paid interest and conferred upon bankers the right to use the funds as they thought fit for the duration of the agreed-upon term. References to these practices appear as early as 350 B.C. in comedies such as Plautus's *Captivi*, *Asinaria* and *Mostellaria*, and Terence's *Phormio*, where we find

[25]Ibid., p. 623.

delightful dialogues describing financial operations, clearings, account balances, the use of checks and so on.[26] In any case, it appears the work done by professional jurists better regulated Roman banking and provided at least a clearer idea of what was and was not legitimate. However, this is no guarantee that bankers behaved honestly and refrained from using money from demand deposits to their own benefit. In fact, there is a rescript by Hadrianus to the merchants in Pergamum who complained about the illegal exactions and general dishonesty of their bankers. Also, a written document from the city of Mylasa to the emperor Septimius Severus contains a decree by the city council and the people aimed at regulating the activities of local bankers.[27] All this suggests that, while perhaps less frequently than was common in the Hellenic world, there were in fact unscrupulous bankers who misappropriated their depositors' funds and eventually went bankrupt.

The Failure of the Christian Callistus's Bank

A curious example of fraudulent banking is that of Callistus I, pope and saint (217–222 A.D.), who, while the slave of the Christian Carpophorus, acted as a banker in his name and took in deposits from other Christians. However, he went bankrupt and was caught by his master while trying to escape. He was finally pardoned at the request of the same Christians he had defrauded.[28]

---

[26]In Plautus's *Captivi*, for example, we read: "Subducam ratunculam quantillum argenti mihi apud trapezitam sied" (i.e., "I go inside because I need to calculate how much money I have in my bank") cited by Knut Wicksell in his *Lectures on Political Economy* (London: Routledge and-Kegan Paul, 1935), vol. 2, p. 73.

[27]Trigo Portela, "Historia de la banca," p. 239.

[28]The extraordinary fact that someone in the banking profession actually became Pope and later a saint would seem to make Callistus I a good choice for a patron saint. Unfortunately, he set a bad example as a failed banker who abused the good faith of his fellow Christians. Instead, the patron saint of bankers is St. Charles Borromeo (1538–1584), Archbishop of Milan. He was the nephew and administrator of Giovanni Angelo Medici (Pope Pius IV) and his feast day is November 4.

Refutatio omnium haeresium, a work attributed to Hippolytus and found in a convent on Mount Athos in 1844, reports Callistus's bankruptcy in detail.[29] Like the recurring crises which plagued Greece, the bankruptcy of Callistus occurred after a pronounced inflationary boom followed by a serious confidence crisis, a drop in the value of money and the failure of multiple financial and commercial firms. These events took place between 185 and 190 A.D. under the rule of the Emperor Commodus.

Hippolytus relates how Callistus, at the time a slave to his fellow Christian Carpophorus, started a banking business in his name and took in deposits mainly from widows and Christians (a group that was already increasing in influence and membership). Nevertheless, Callistus deceitfully appropriated the money, and, as he was unable to return it upon demand, tried to escape by sea and even attempted suicide. After a series of adventures, he was flogged and sentenced to hard labor in the mines of Sardinia. Finally, he was miraculously released when Marcia, concubine of the Emperor Commodus and a Christian herself, used her influence. Thirty years later, a freedman, he was chosen the seventeenth Pope in the year 217 and eventually died a martyr when thrown into a well by pagans during a public riot on October 14, 222 A.D.[30]

We can now understand why even the Holy Fathers in their Apostolic Constitutions have admonished bankers to be honest and to resist their many temptations.[31] These moral exhortations warning bankers against temptation and reminding them of their duties were used constantly among early Christians, and some have even tried to trace them back to the Holy Scriptures.

---

[29]Hippolytus, *Hippolytus Wercke*, vol. 2: *Refutatio omnium haeresium* (Leipzig: P. Wendland), 1916.

[30]Juan de Churruca, "La quiebra de la banca del cristiano Calisto (c.a. 185–190)," *Seminarios complutenses de derecho romano,* February–May 1991 (Madrid, 1992), pp. 61–86.

[31]"Ginesthe trapezitai dókimoi." See "Orígenes y movimiento histórico de los bancos," in *Enciclopedia universal ilustrada europeo-americana* (Madrid: Espasa Calpe, 1973), vol. 7, p. 478.

THE SOCIETATES ARGENTARIAE

Banker associations or *societates argentariae* were a peculiarity of banking in the Roman world. Financial contributions from members supplied the capital to form them, and this capital was relied upon to pay debts. However, as banks were of particular public interest, Roman law established that members of the *societates argentariae* must guarantee deposits with all of their assets.[32] Hence, members' joint, unlimited liability was a general principle of Roman law, intended to minimize the effects of fraud and abuse by bankers and to protect depositors' right to recover their money at any time.[33]

---

[32]See Manuel J. García-Garrido, "La sociedad de los banqueros (societas argentaria)," in *Studi in honore di Arnaldo Biscardi* (Milan 1988), vol. 3, esp. pp. 380–83. The unlimited liability of banker association members under Roman law was established, among other places, in the aforementioned text by Ulpian (*Digest*, 16, 3, 7, 2–3) and also in a passage by Papinian (*Digest*, 16, 3, 8), where he dictates that money to repay the debts of fraudulent bankers be drawn not only from "deposited funds found among the banker's assets, but from all the defrauder's assets" (*Cuerpo de derecho civil romano*, vol. 1, p. 837). Some present-day authors have also proposed a return to the principle of unlimited liability for bankers, as an incentive for them to manage money prudently. However, this requirement is not necessary to achieve a solvent banking system, nor would it be a a sufficient measure. It is not necessary, since a 100-percent reserve requirement would eliminate banking crises and economic recessions more effectively. It is not sufficient, because even if banks' stockholders had unlimited liability, bank crises and economic recessions would still inevitably recur when a fractional reserve is used.

[33]Under the Roman Empire, some large, influential temples continued to double as banks. Among these were the temples at Delos, Delphi, Sardis (Artemis), and most importantly, Jerusalem, where Hebrews, rich and poor, traditionally deposited their money. This is the context in which we must interpret Jesus's expulsion of the money changers from the temple in Jerusalem, as described in the New Testament. In Matthew 21:12–16 we read that Jesus, entering the temple,

> overturned the tables of the money changers and the benches of those selling doves. "It is written," he said to them, 'My house will be called a house of prayer,' but you are making it a 'den of robbers.'"

Mark 11:15–17 offers an almost identical text. John 2:14–16 is a bit more explicit and tells us how, after entering the temple courts,

The *argentarii* conducted their business in a special place called a *taverna*. Their books reflected the debits and credits made to their clients' checking accounts. Roman bankers' books qualified as evidence in court and had to be kept as set down in the *editio rationum*, which stipulated the way accounts were to be dated and managed.[34] Bankers were also

> he found men selling cattle, sheep and doves, and *others sitting at tables exchanging money*. So he made a whip out of cords, and drove all from the temple area, both sheep and cattle; *he scattered the coins of the money changers and overturned their tables*.

(New International Version). The translation of these biblical passages is not very accurate, and the same mistake is found in García del Corral's translation of the *Digest*. Instead of "money changers," it should read "bankers," which is more in accordance with the literal sense of the Vulgate edition of the Bible in Latin, in which Matthew's account reads as follows:

> Et intravit Iesus in templum et eiiciebat omnes vendentes et ementes in templo, et *mensas numulariorum*, et cathedras vendentium columbas evertit: et dicit eis: Scriptum est: Domus mea domus orationis vocabitur: vos autem fecistis illam speluncam latronum. (*Biblia Sacra iuxta Vulgatam Clementinam*, Alberto Colunga and Laurencio Turrado, eds. (Madrid: Biblioteca de Autores Cristianos, 1994), Mateo 21:12–13, p. 982)

These evangelical texts confirm that the temple at Jerusalem acted as a true bank where the general public, rich or poor, made deposits. Jesus's clearing of the temple can be interpreted as a protest against abuses stemming from an illicit activity (as we know, these abuses consisted of the use of money on deposit). In addition, these biblical references illustrate the symbiosis already present between bankers and public officials, since both the chief priests and the teachers of the law were outraged by Jesus's behavior (all italics have, of course, been added). On the importance of the Jerusalem temple as a deposit bank for Hebrews, see Rostovtzeff, *The Social and Economic History of the Roman Empire*, vol. 2, p. 622.

[34]Jean Imbert, in his book, *Historia económica (de los orígenes a 1789)*, Spanish translation by Armando Sáez (Barcelona: Editorial Vicens-Vives, 1971), p. 58, points out that

> the praescriptio was an equivalent of today's checks. When a capitalist instructed a banker to make a loan payment in his name, the banker would do so upon presentation of a bank draft called a praescriptio.

called *mensarii*, after the *mensa* or counter where they originally carried out their money-changing activities. Much like today's banking licenses, the *mensa* could be transferred. In Rome, however, as the state owned the premises where banking took place, it was the right to operate (granted by the state) that was transmitted. A transfer could include all furniture and implements of the *taverna*, as well as financial assets and liabilities. In addition, bankers formed a guild to defend their common interests and obtained significant privileges from emperors, especially Justinian. Some of these privileges appear in the *Corpus Juris Civilis*.[35]

The economic and social disintegration of the Roman Empire resulted from inflationary government policies which devalued the currency, and from the establishment of maximum prices for essential goods, which in turn caused a general shortage of these goods, the financial ruin of merchants and the disappearance of trade between different areas of the Empire. This was also the end for banking. Most banks failed during the successive economic crises of the third and fourth centuries A.D. In an attempt to contain the social and economic decay of the Empire, additional coercive, interventionist measures were taken, further accelerating the process of disintegration and enabling the barbarians (whom Roman legions had defeated repeatedly and kept at bay for years) to devastate and conquer the remains of the ancient, thriving Roman Empire. The fall of the classical Roman world began the long medieval period, and it was nearly eight hundred years later that banking was rediscovered in the Italian cities of the late Middle Ages.[36]

---

[35]See, for instance, *New Constitution 126* on "Bank Contracts," edict 7 ("Decree and Regulation Governing Bank Contracts") and edict 9, "On Bank Contracts," all by Justinian and included in the *Novellae* (see *Cuerpo de derecho civil romano*, vol. 6, pp. 479–83, 539–44 and 547–51).

[36]A superb overview of the causes of the fall of the Roman Empire appears in Ludwig von Mises's work, *Human Action: A Treatise on Economics*, Scholar's Edition (Auburn, Ala.: Ludwig von Mises Institute, 1998), pp. 161–63. We will also quote Mises's *Human Action* by the more widespread third edition (Chicago: Henry Regnery, 1966), pp. 767–69.

3
BANKERS IN THE LATE MIDDLE AGES

The fall of the Roman Empire meant the disappearance of most of its trade and the feudalization of economic and social relationships. The enormous reduction in trade and in the division of labor dealt a definitive blow to financial activities, especially banking. The effects of this reduction lasted several centuries. Only monasteries, secure centers of economic and social development, could serve as guardians of economic resources. It is important to mention the activity in this field of the Templars, whose order was founded in 1119 in Jerusalem to protect pilgrims. The Templars possessed significant financial resources obtained as plunder from their military campaigns and as bequests from feudal princes and lords. As they were active internationally (they had more than nine thousand centers and two headquarters) and were a military and religious order, the Templars were safe custodians for deposits and had great moral authority, earning them the trust of the people. Understandably, they began to receive both regular and irregular deposits from individuals, to whom they charged a fee for safekeeping. The Templars also carried out transfers of funds, charging a set amount for transportation and protection. Moreover, they made loans of their own resources and did not violate the safekeeping principle on demand deposits. The order acquired a growing prosperity which aroused the fear and envy of many people, until Philip the Fair, the King of France, decided to dissolve it. He condemned those in charge to be burned at the stake (including Jacques de Molay, the *Grand Maître*), with the prime objective of appropriating all of the order's riches.[37]

---

[37]See, for example, J. Piquet's book, *Des banquiers au Moyen Age: Les Templiers, Étude de leurs opérations financièrs* (Paris, 1939), cited by Henri Pirenne in his work, *Histoire Économique et Sociale Du Moyen Age* (Paris: Presses Universitaires de France, 1969), pp. 116 and 219. Piquet believes he sees the beginnings of double-entry bookkeeping and even a primitive form of check in the records kept by the Templars. However, it appears the Templars' accounting practices were, at most, mere direct predecessors of double-entry bookkeeping, later formalized in

The end of the eleventh century and beginning of the twelfth brought a moderate resurgence of business and trade, mainly among the Italian cities on the Adriatic (especially Venice), Pisa, and later, Florence. These cities specialized in trade with Constantinople and the Orient. Significant financial growth in these cities led to the revival of banking, and the pattern we observed in the classical world was reproduced. Indeed, bankers at first respected the juridical principles passed down from Rome and conducted their business lawfully, avoiding illicit use of demand deposits (i.e., irregular deposits of money). Only money received as loans (i.e., *time* "deposits") was used or lent by bankers, and only during the agreed-upon term.[38] Nevertheless, bankers again became tempted to take advantage of money from demand deposits. This was a gradual process which led to abuses and the resumption of fractional-reserve banking. The authorities were generally unable to enforce legal principles and on many occasions even granted privileges and licenses to encourage bankers' improper activity and derive benefits from it, in the shape of loans and tax revenues. They even created government banks (such as

---

1494 by Luca Pacioli, the Venetian monk. A bank in Pisa used double-entry bookkeeping as early as 1336, as did the Masari family (tax collectors in Genoa) in 1340. The oldest European account book we have evidence of came from a Florentine bank and dates back to 1211. See G.A. Lee, "The Oldest European Account Book: A Florentine Bank Ledger of 1211," in *Accounting History: Some British Contributions*, R.H. Parker and B.S. Yamey, eds. (Oxford: Clarendon Press, 1994), pp. 160–96.

[38] In theory at least, early banks of deposit were not discount or lending banks. They did not create money but served a system of 100 percent reserves, such as some monetarists today would like to see established. Overdrafts were forbidden. In practice, the standards proved difficult to maintain, especially in face of public emergency. The Taula de Valencia was on the verge of using its deposited treasure to buy wheat for the city in 1567. Illegal advances were made to city officials in 1590 and illegal loans to the city itself on a number of occasions. (Charles P. Kindleberger, *A Financial History of Western Europe*, 2nd ed. [Oxford: Oxford University Press, 1993], p. 49)

Barcelona's Bank of Deposit, or *Taula de Canvi*, and others we will consider later).[39]

The Revival of Deposit Banking in Mediterranean Europe

Abbott Payson Usher, in his monumental work, *The Early History of Deposit Banking in Mediterranean Europe*,[40] studies the gradual emergence of fractional-reserve banking during the late Middle ages, a process founded on the violation of this general legal principle: full availability of the *tantundem* must be preserved in favor of the depositor. According to Usher, it is not until the thirteenth century that some private bankers begin to use the money of their depositors to their own advantage, giving rise to fractional-reserve banking and the opportunities for credit expansion it entails. Moreover, and contrary to a widely-held opinion, Usher believes this to be the most significant event in the history of banking, rather than the appearance of banks of issue (which in any case did not occur until much later, in the late seventeenth century). As we will see in chapter 4, although exactly the same economic effects result from the issuance of bank notes without financial backing and the loaning of funds from demand deposits, banking was historically shaped more by the latter of these practices

[39]Islamic law also banned bankers' personal use of irregular deposits throughout the medieval period, especially on the Iberian Peninsula. See, for instance, the *Compendio de derecho islámico* (Risála, Fí-l-Fiqh), by the tenth-century Hispano-Arabic jurist Ibn Abí Zayd, called Al-Qayrawání, published with the support of Jesús Riosalido (Madrid: Editorial Trotta, 1993). On p. 130 we find the following statement of a juridical principle: "he who uses a money deposit to do business commits a reprehensible act, but if he uses his own money, he may keep the profit." (See also pp. 214–15, where it is stipulated that, in the case of a true loan or mutuum, the lender may not withdraw the money at will, but only at the end of the agreed-upon term, as Málik indicates; the Islamic legal concept of money deposit closely parallels that of the Roman irregular deposit.)

[40]Abbott Payson Usher taught economics at Harvard University and authored the celebrated work, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, Mass.: Harvard University Press, 1943).

than by the former. Usher states that: "the history of banks of issue has, until lately, obscured the importance of due deposit banking in all its forms, whether primitive or modern." In an ironic reference to the undue importance given by economists to the problems of banks of issue versus the older but equally harmful activities of deposit banks, he concludes that:

> the demand for currency, and the theoretical interests created by the problem, did much to foster misconceptions on the relative importance of notes and deposits. Just as French diplomats "discovered" the Pyrenees in the diplomatic crisis of the eighteenth century, so banking theorists "discovered" deposits in the mid-nineteenth century.[41]

Again and again, Usher shows that the modern banking system arose from fractional-reserve banking (itself the result of fraud and government complicity, as Usher illustrates in detail via the example of the late medieval Catalonian banking system), and not from banks of issue, which appeared much later.

Usher points out that the first banks in twelfth-century Genoa made a clear distinction in their books between demand deposits and "time" deposits, and recorded the latter as loans or *mutuum* contracts.[42] However, bankers later began gradually to make self-interested use of demand deposits, giving rise to expansionary capabilities present in the banking system; more specifically, the power to create deposits and grant credits out of nowhere. Barcelona's Bank of Deposit is a case in point. Usher estimates that the bank's cash reserves amounted to 29 percent of total deposits. This meant their capacity for credit expansion was 3.3 times their cash reserves.[43]

---

[41]Ibid., pp. 9 and 192.

[42]"In all these Genoese registers there is also a series of instruments in which the money received is explicitly described as a loan (mutuum)." Ibid., p. 63.

[43]
> Against these liabilities, the Bank of Deposit held reserves in specie amounting to 29 percent of the total. Using the phraseology of the present time, the bank was capable of extending credit in the ratio of 3.3 times the reserves on hand. (Ibid., p. 181)

Usher also highlights the failure of public officials at different levels to enforce sound banking practices, particularly a 100-percent reserve requirement on demand deposits. Moreover, the authorities ended up granting banks a government license (a privilege—*ius privilegium*) to operate with a fractional reserve. Banks were nevertheless required to guarantee deposits.[44] At any rate, rulers were usually the first to take advantage of fraudulent banking, finding loans an easy source of public financing. It is as if bankers were granted the privilege of making gainful use of their depositors' money in return for their unspoken agreement that most of such use be in the shape of loans to public officials and funding for the government. On various occasions, rulers went so far as to create government banks, in order to *directly* reap the considerable profits available in banking. As we will see, Barcelona's Bank of Deposit, the *Taula de Canvi*, was created with this main objective.

However, we cannot agree with the statement Usher makes immediately afterward; he contends that private banks also operating in Barcelona at the time must have had a much lower reserve ratio. Quite the opposite must have been true. As private banks were smaller, they would not have inspired as much confidence in the public as the municipal bank did, and as they operated in a strictly competitive environment, their cash reserves must have been higher (see pp. 181–82 of Usher's book). In any case, Usher concludes that

> there was considerable centralization of clearance in the early period and extensive credit creation. In the absence of comprehensive statistical records, we have scarcely any basis for an estimate of the quantitative importance of credit in the medieval and early modern periods, though the implications of our material suggest an extensive use of credit purchasing power. (Ibid., pp. 8–9)

We will later cite works by C. Cipolla, which fully confirm Usher's main thesis. In chapter 4 we will examine bank multipliers in depth.

[44]In fifteenth-century Catalonia, guarantees were not required, though only bankers who offered them were allowed to spread tablecloths over their counters. By this system, the public could easily identify the more solvent businesses. Ibid., p. 17.

THE CANONICAL BAN ON USURY AND THE "DEPOSITUM CONFESSATUM"

The ban on usury by the three major monotheistic religions (Judaism, Islam and Christianity) did much to complicate and obscure medieval financial practices. Marjorie Grice-Hutchinson has carefully studied the medieval prohibition of interest and its implications.[45] She points out that Jews were not forbidden to loan money at interest to Gentiles, which explains why, at least during the first half of the medieval period, most bankers and financiers in the Christian world were Jewish.[46]

This canonical ban on interest added greatly to the intricacies of medieval banking, though not (as many theorists have insisted) because bankers, in their attempt to offer a useful, necessary service, were forced to constantly search for new ways to disguise the necessary payment of interest on loans. When bankers loaned money received from clients as a loan (or "time" deposit), they were acting as true financial intermediaries and were certainly doing a legitimate business and significantly contributing to the productive economy of their time. Still, the belated recognition by the Church of the legitimacy of interest should not be regarded as overall approval of the banking business, but only as authorization for banks to loan money lent to them by third parties. In other words, to

---

[45]Marjorie Grice-Hutchinson, *Early Economic Thought in Spain 1177–1740* (London: George Allen and Unwin, 1978). See "In Concealment of Usury," chap. 1, pp. 13–60.

[46] Until the thirteenth century, the greater part of financial activity was in the hands of Jews and other non-Christians, usually from the Near East. For such unbelievers from the Christian point of view there could be no salvation in any event, and the economic prohibitions of the Church did not apply to them. . . . Hatred for the Jews arose on the part of the people who resented such interest rates, while monarchs and princes, if less resentful, scented profits from expropriation of this more or less helpless group. (Harry Elmer Barnes, *An Economic History of the Western World* [New York: Harcourt, Brace and Company, 1940], pp. 192–93)

act as mere financial intermediaries. The evolution of Church doctrine on interest in no way implies a sanction of fractional-reserve banking, i.e., bankers' self-interested use (which usually means granting loans) of demand deposits.[47]

To a great extent, the conceptual confusion we are dealing with arose in the Middle Ages as a result of the canonical ban on interest. One of the main artifices[48] devised by economic agents to conceal actual interest-paying loans was to disguise them as demand deposits. Let us see how they did it. First, we must think back to our discussion of the monetary irregular-deposit contract in chapter 1. One of the most notable guidelines found for this contract in the *Corpus Juris Civilis* stipulated that, if the depositary were unable to return the deposit on demand, not only was he guilty of theft for misappropriation, but he was also obliged to pay interest to the depositor for his delay in repayment (*Digest*, 16, 3, 25, 1). Hence, it should come as no surprise that throughout the Middle Ages,

---

[47]This is precisely the opinion held by Father Bernard W. Dempsey S.J., who concludes in his remarkable book *Interest and Usury* (Washington, D.C.: American Council of Public Affairs, 1943) that even if we accept interest as legitimate, fractional-reserve banking amounts to "institutional usury" and is especially harmful to society, since it repeatedly generates artificial booms, bank crises and economic recessions (p. 228).

[48]A clear, concise list of the tricks used to systematically disguise loans and interest can be found in Imbert's book, *Historia económica (de los orígenes a 1789)*, pp. 157–58. Imbert mentions the following methods of concealing interest-bearing loans: (a) bogus contracts (such as repurchase agreements or real estate guarantees); (b) penalty clauses (disguising interest as economic sanctions); (c) lying about the amount of the loan (the borrower agreed to repay a sum higher than the actual loan); (d) foreign exchange transactions (which included the interest as an additional charge); and (e) income or annuities (life annuities including a portion of both the interest and the repayment of the principal). Jean Imbert makes no express mention of the *depositum confessatum*, one of the most popular ways of justifying interest. It fits well into the "penalty clauses" category. See also the reference Henri Pirenne makes to the "utmost ingenuity" used to conceal "dangerous interest." *Economic and Social History of Medieval Europe* (London: Kegan Paul, Trench, Trubner and Company, 1947), p. 140.

in order to circumvent the canonical ban on interest, many bankers and depositors *expressly declared* that they had taken part in a monetary irregular-deposit contract, when they had actually formalized a true loan or *mutuum* contract. The method of concealment to which this declaration belonged was aptly named *depositum confessatum*. It was a simulated deposit which, despite the declarations of the two parties, was not a true deposit at all, but rather a mere loan or *mutuum* contract. At the end of the agreed-upon term, the supposed depositor claimed his money. When the professed depositary failed to return it, he was forced to pay a "penalty" in the shape of interest on his presumed "delay," which had nothing to do with the actual reason for the "penalty" (the fact that the operation was a loan). Disguising loans as deposits became an effective way to get around the canonical ban on interest and escape severe sanctions, both secular and spiritual.

The *depositum confessatum* eventually perverted juridical doctrine on the monetary irregular deposit, robbing these tenets of the clarity and purity they received in classical Rome and adding confusion that has persisted almost to the present day. In fact, regardless of experts' doctrinal stand (either strictly against, or "in favor" within reasonable limits) on interest-bearing loans, the different approaches to the *depositum confessatum* led theorists to stop distinguishing clearly between the monetary irregular deposit and the mutuum contract. On one hand, over-zealous canonists, determined to expose all hidden loans and condemn the corresponding interest, tended to automatically equate deposit contracts with mutuum contracts. They believed that by exposing the loan they assumed was behind *every* deposit they would put an end to the pretense of the *depositum confessatum*. This is precisely where their error lay: they regarded all deposits, even actual ones (made with the essential purpose of safeguarding the *tantundem* and keeping it always available to the depositor) as *deposita confessata*. On the other hand, those experts who were relatively more supportive of loans and interest and searched for ways to make them acceptable to the Church, defended the *depositum confessatum* as a kind of precarious loan which, according to the principles embodied in the *Digest*, justified the payment of interest.

As a result of both doctrinal stances, scholars came to believe that the "irregularity" in the monetary irregular deposit referred not to the deposit of a certain quantity of a fungible good (the units of which were indistinguishable from others of the same type and the *tantundem* of which was to be kept continually available to the depositor), but rather to the irregularity of *always* disguising loans as deposits.[49] Furthermore, bankers, who had used the *depositum confessatum* to disguise loans as deposits and to justify the illegal payment of interest, eventually realized that the doctrine which held that deposits always concealed loans could also be extremely profitable to them, because they could employ it to defend even the misappropriation of money which had actually been placed into demand deposits and had not been loaned. Thus,

---

[49]Canonists' equation of the monetary irregular deposit with the mutuum or loan contract led experts to search for a common juridical feature between the two contracts. They soon realized that in the deposit of a fungible good, "ownership" of the individual units deposited is "transferred," since the depositary is only obliged to safeguard, maintain, and return upon demand the *tantundem*. This transfer of ownership appears to coincide with that of the loan or mutuum contract, so it was natural for scholars to automatically assume that all monetary irregular deposits were loans, since both include a "transfer" of "ownership" from the depositor to the depositary. Hence, theorists overlooked the essential difference (see chapter 1) between the monetary irregular deposit and the mutuum or loan: the main purpose of the irregular deposit is the custody and safekeeping of the good, and while "ownership" is in a sense "transferred," availability is not, and the *tantundem* must be kept continually available to the depositor. In contrast, a loan entails the transfer of full availability, apart from ownership (in fact, present goods are exchanged for future goods) and involves this fundamental element: a term during which the goods cease to be available to the lender. Irregular deposits do not include such a term. In short, since the canonical prohibition of interest gave rise to the fraudulent and spurious institution of the *depositum confessatum*, it was indirectly responsible for the loss of clarity in the distinction between the monetary irregular deposit and the mutuum. This confusion is clearly behind the wrong 1342 final court decision on the *Isabetta Querini vs. The Bank of Marino Vendelino* case, mentioned by Reinhold C. Mueller in *The Venetian Money Market: Banks, Panics, and the Public Debt, 1200–1500* (Baltimore: Johns Hopkins University Press, 1997), pp. 12–13.

the canonical ban on interest had the unexpected effect of obscuring Roman jurists' clear, legal definition of the monetary irregular-deposit contract. Many capitalized on the ensuing confusion in an attempt to legally justify fraudulent banking and the misappropriation of demand deposits. Experts failed to clear up the resulting legal chaos until the end of the nineteenth century.[50]

Let us now examine three particular cases which together illustrate the development of medieval banking: Florentine banks in the fourteenth century; Barcelona's Bank of Deposit, the *Taula de Canvi*, in the fifteen century and later; and the Medici Bank. These banks, like all of the most important banks in the late Middle Ages, consistently displayed the pattern we saw in Greece and Rome: banks initially respected the traditional legal principles found in the *Corpus Juris Civilis*, i.e., they operated with a 100-percent reserve ratio which guaranteed the safekeeping of the *tantundem* and its constant availability to the depositor. Then, gradually, due to bankers' greed and rulers' complicity, these principles began to be violated, and bankers started to loan money from demand

---

[50]In fact, Pasquale Coppa-Zuccari, whose work we have already cited, was the first to begin to reconstruct the complete legal theory of the monetary irregular deposit, starting from the same premise as the classic Roman scholars and again revealing the illegitimacy of banks' misappropriation of demand deposits. Regarding the effects of the *depositum confessatum* on the theoretical treatment of the juridical institution of irregular deposit, Coppa-Zuccari concludes that

> le condizioni legislative dei tempi rendevano fertile il terreno in cui il seme della discordia dottrinale cadeva. Il divieto degli interessi nel *mutuo* non valeva pel *deposito irregolare*. Qual meraviglia dunque se chi aveva denaro da impiegare fruttuosamente lo desse a deposito irregolare, *confessatum* se occorreva, e non a mutuo? Quel divieto degli interessi, che tanto addestrò il commercio a frodare la legge e la cui efficacia era nulla di fronte ad un mutuo dissimulato, conservò in vita questo ibrido instituto, e fece sì che il nome di *deposito* venissi imposto al mutuo, che non poteva chiamarsi col proprio nome, perchè esso avrebbe importato la nullità del patto relativo agli interessi. (Coppa-Zuccari, *Il deposito irregolare,* pp. 59–60)

deposits, often, in fact, to rulers. This gave rise to fractional-reserve banking and artificial credit expansion, which in the first stage appeared to spur strong economic growth. The whole process ended in a general economic crisis and the failure of banks that could not return deposits on demand once the recession hit and they had lost the trust of the public. Whenever loans were systematically made from demand deposits, the historical constant in banking appears to have been eventual failure.[51] Furthermore, bank failures were accompanied by a strong contraction in the money supply (specifically, a shortage of loans and deposits) and by the resulting inevitable economic recession. As we will see in the following chapters, it took economic scholars nearly five centuries to understand the theoretical causes of all of these processes.[52]

---

[51]For example, Raymond Bogaert mentions that of the 163 known banks in Venice, documentary evidence exists to show that at least 93 of them failed. Bogaert, *Banques et banquiers dans les cités grecques*, note 513, p. 392. A detailed list of 46 failures of deposit banks in Venice can also be seen in Mueller, *The Venetian Money Market*, pp. 585–86. This same fate of failures affected all banks in Seville in the 15th century. Hence, the systematic failure of fractional-reserve private banks not supported by a central bank (or equivalent) is a fact of history. Pascal Salin overlooks this fact in his article "In Defense of Fractional Monetary Reserves," presented at the Austrian Scholars Conference, March 30–31, 2001.

[52]As is logical, bankers always carried out their violations of general legal principles and their misappropriations of money on demand deposit in a secretive, disgraceful way. Indeed, they were fully aware of the wrongful nature of their actions and furthermore, knew that if their clients found out about their activities they would immediately lose confidence in the bank and it would surely fail. This explains the excessive secrecy traditionally present in banking. Together with the confusing, abstract nature of financial transactions, this lack of openness largely protects bankers from public accountability even today. It also keeps most of the public in the dark as to the actual nature of banks. While they are usually presented as true financial intermediaries, it would be more accurate to see banks as mere creators of loans and deposits which come out of nowhere and have an expansionary effect on the economy. The disgraceful, and therefore secretive, nature of these banking practices was skillfully revealed by Knut Wicksell in the following words:

BANKING IN FLORENCE IN THE FOURTEENTH CENTURY

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, creating out of nowhere a significant amount of expansionary credit.[53] Therefore, it is not surprising that an 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

---

> in effect, and contrary to the original plan, the banks became credit institutions, instruments for increasing the supplies of a medium of exchange, or for imparting to the total stock of money, an increased velocity of circulation, physical or virtual. Giro banking continued as before, though no actual stock of money existed to correspond with the total of deposit certificates. So long, however, as people continued to believe that the existence of money in the banks was a necessary condition of the convertibility of the deposit certificates, these loans had to remain a profound secret. If they were discovered the bank lost the confidence of the public and was ruined, especially if the discovery was made at a time when the Government was not in a position to repay the advances. (Wicksell, *Lectures on Political Economy*, vol. 2, pp. 74–75)

[53]Various articles have been written on this topic. See the interesting one by Reinhold C. Mueller, "The Role of Bank Money in Venice, 1300–1500," in *Studi Veneziani* n.s. 3 (1979): 47–96, and chapter 5 of his book, *The Venetian Money Market*. Carlo M. Cipolla, in his notable publication, *The Monetary Policy of Fourteenth-Century Florence* (Berkeley: University of California Press, 1982), p. 13, also affirms: "The banks of that time had already developed to the point of creating money besides increasing its velocity of circulation."

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. As could be expected, these bank failures were detrimental to all deposit-holders, who, after a prolonged period, received half, a third, or even a fifth of their deposits at most.[54] Fortunately, Villani recorded the economic and financial events of this period in a chronicle that Carlo M. Cipolla has resurrected. According to Villani, the recession was accompanied by a tremendous tightening of credit (referred to descriptively as a *mancamento della credenza*, or "credit shortage"), which further worsened economic conditions and brought about a deluge of industry, workshop, and business failures. Cipolla has studied this economic recession in depth and graphically describes the transition from economic boom to crisis and recession in this way: "The age of 'The Canticle of the Sun' gave way to the age of the *Danse macabre*."[55] In fact, according to Cipolla, the recession lasted until, "thanks" to the devastating effects of the plague, which radically diminished the population, the supply of cash and credit money per capita approached its pre-crisis level and laid the foundation for a subsequent recovery.[56]

---

[54]Cipolla, *The Monetary Policy of Fourteenth-Century Florence*, p. 9.

[55]Ibid., p. 1. See also Boccaccio's commentary on the economic effects of the plague, cited by John Hicks in *Capital and Time: A Neo-Austrian Theory* (Oxford: Clarendon Press, 1973), pp. 12–13; see footnote 60, chap. 5.

[56]Carlo M. Cipolla's interpretive analysis of historical events reveals a greater knowledge and application of economic theory than other authors have displayed (such as A.P. Usher and Raymond de Roover, who both express surprise at medieval economic recessions, the origins of which are often "mysterious and inexplicable" to them). Still, his analysis, monetarist in nature, focuses on the stages of recession, which he attributes to a shortage of the money supply, resulting in turn from an overall tightening of credit. Remarkably, he ignores the prior economic boom, unconsciously lapsing into a "monetarist" interpretation of history and thus failing to recognize the artificial boom caused by credit expansion as the true source of the ensuing, inevitable recessions. Cipolla's thesis that it was the Black Death that eventually resolved the

THE MEDICI BANK

The history of the Medici Bank has come to light through the research and determination of Raymond de Roover, whose work was in turn advanced by the 1950 discovery of the Medici Bank's confidential ledgers (*libri segreti*) in Florence's *Archivio di Stato*.[57] The secrecy of these ledgers again betrays the hidden, shameful nature of bankers' activities (see footnote 52), as well as the desire of many customers of Italian banks (nobles, princes, and even the Pope) to deposit their money in secret accounts. The discovery of these bank books was indeed fortunate, as they provide us with an in-depth understanding of how the Medici Bank operated in the fifteenth century.

We must stress that the Medici Bank did not initially accept demand deposits. At first it only took time deposits, which were actually true loans from the customer to the bank. These mutuum contracts were called *depositi a discrezione.* The words *a discrezione* indicated that, as these supposed "deposits" were really loans, the bank could make full use of them and invest them freely, at least for the length of the stipulated term.[58] *Discrezione* also referred to the interest the

---

"shortage" of money is highly debatable, since money shortages tend to correct themselves spontaneously through a general drop in prices (via a corresponding increase in the value of money) which makes it unnecessary for individuals to maintain such high cash balances. There is no need for a war or plague to decimate the population. Even if there had been no plague, once the investment errors made during the boom had been corrected, the process of economic decline would have ended sooner or later, due to an increase in the value of money and a subsequent reduction in cash balances. This process undoubtedly coincided with, yet occurred independently of the Black Death's effects. Hence, even the most educated and insightful historians, like Cipolla, clearly make partial judgement errors in their interpretations when they do not use the appropriate theoretical tools. At any rate, it is still very significant that these defenders of an inflationary interpretation of history continue to point out the "positive effects" of wars and plagues and consider them the key to recovery from economic crises.

[57]De Roover, *The Rise and Decline of the Medici Bank, 1397–1494*.

[58] The Medici Bank and its subsidiaries also accepted deposits from outsiders, especially great nobles, church dignitaries,

bank paid clients who loaned it money in the form of time "deposits."

In his book, Raymond de Roover performs a thorough, detailed study of the development and vicissitudes of the Medici Bank through the century of its existence. For our purposes, it is only necessary to emphasize that at some point the bank began to accept demand deposits and to use a portion of them inappropriately as loans. The *libri segreti* document this fact. The accounts for March 1442 accompany each demand deposit entry with a note in the margin indicating the likelihood that each depositor would claim his money.[59]

A balance sheet from the London branch of the Medici Bank, dated November 12, 1477, shows that a significant number of the bank's debts corresponded to demand deposits. Raymond de Roover himself estimates that at one point, the bank's primary reserves were down to 50 percent of total demand liabilities.[60] If we apply the standard criterion used by A.P. Usher, this implies a credit expansion ratio of twice the demand deposits received by the bank. There is evidence, however, that this ratio gradually worsened over the bank's life-span, especially after 1464, a year that marked the beginning of growing difficulties for the bank. The roots of the general economic and bank crisis that ruined the Medici Bank resemble those Carlo M. Cipolla identifies in his study of fourteenth-century Florence. As a matter of fact, credit expansion resulting from bankers' misappropriation of demand deposits gave rise to an artificial boom fed by the increase in the money supply and its seemingly "beneficial" short-term effects. Nevertheless, since this process sprang from an increase in the money supply, namely credit

---

condottieri, and political figures, such as Philippe de Commines and Ymbert de Batarnay. Such deposits were not usually payable on demand but were either explicitly or implicitly time deposits on which interest, or rather discrezione, was paid. (De Roover, *The Rise and Decline of the Medici Bank 1397–1494*, p. 101)

[59]Ibid., p. 213.

[60]Ibid., p. 245.

unbacked by growth in real savings, the reversal of the process was inevitable, as chapters 4 and following will explain in detail. This is exactly what happened in Italy's large business centers in the second half of the fifteenth century. In terms of economic analysis, Raymond de Roover's grasp of the historical process is unfortunately even shallower than Cipolla's, and he even goes so far as to state, "what caused these general crises remains a mystery."[61] However, it is not surprising that the Medici Bank eventually failed, as did the other banks that depended on fractional-reserve banking for a large part of their business. Though Raymond de Roover claims he does not understand what caused the general crisis at the end of the fifteenth century, his blow-by-blow historical account of the final stage of the Medici Bank reflects all of the typical indications of an inescapable recession and credit squeeze following a process of great artificial credit expansion. De Roover explains that the Medicis were forced to adopt a policy of credit restriction. They demanded the repayment of loans and attempted to increase the bank's liquidity. Moreover, it has been demonstrated that in its final stage the Medici Bank was operating with a very low reserve ratio, which even dropped below 10 percent of total assets and was therefore inadequate to meet the bank's obligations during the recession period.[62] The Medici Bank eventually failed and all

---

[61]Ibid., p. 239.

[62]Hence, over the bank's lifespan, its owners gradually increased their violations of the traditional legal principle requiring them to maintain possession of 100 percent of demand deposits, and their reserve ratio continuously decreased:

> A perusal of the extant balance sheets reveals another significant fact: the Medici Bank operated with tenuous cash reserves which were usually well below 10 percent of total assets. It is true that this is a common feature in the financial statements of medieval merchant-bankers, such as Francesco Datini and the Borromei of Milan. The extent to which they made use of money substitutes is always a surprise to modern historians. Nevertheless, one may raise the question whether cash reserves were adequate and whether the Medici Bank was not suffering from lack of liquidity. (Ibid., p. 371)

of its assets fell into the hands of its creditors. The bank's competitors failed for the same reasons: the unavoidable effects of the artificial expansion and subsequent economic recession invariably generated by the violation of the traditional legal principles governing the monetary irregular deposit.

Banking in Catalonia in the Fourteenth and Fifteenth Centuries: The *Taula de Canvi*

The emergence of private banks in Barcelona coincided with the development of private banking in large Italian business centers. During the reign of Jaime I, the Conqueror, (1213–1276), the Gothic and Roman laws governing business were repealed and replaced by the *Usos de Barcelona*. In addition, a thorough, detailed set of regulations to control banking was established by the Cortes of 1300–1301. It set down the powers, rights, and responsibilities of bankers, and stipulated requirements with respect to guarantors. Some of the rules adopted are quite relevant to our topic.

For example, on February 13, 1300 it was established that any banker who went bankrupt would be vilified throughout Barcelona by a public spokesman and forced to live on a strict diet of bread and water until he returned to his creditors the full amount of their deposits.[63] Furthermore, on May 16, 1301, one year later, it was decided that bankers would be obliged to obtain collateral or guarantees from third parties in order to operate, and those who did not would not be allowed to spread a tablecloth over their work counter. The purpose was to make clear to everyone that these bankers were not as solvent as those using tablecloths, who were backed by collateral. Any banker who broke this rule (i.e., operated with a tablecloth but without collateral) would be found guilty of fraud.[64] In view of these regulations, Barcelona's banking system must initially have been quite solvent and banks must have largely respected the essential legal principles governing the monetary bank deposit.

---

[63]Usher, *The Early History of Deposit Banking in Mediterranean Europe*, p. 239.

[64]Ibid., p. 239.

Nevertheless, there are indications to show that, in spite of everything, private bankers soon began to deceive their clients, and on August 14, 1321 the regulations pertaining to bank failures were modified. It was established that those bankers who did not immediately fulfill their commitments would be declared bankrupt, and if they did not pay their debts within one year, they would fall into public disgrace, which would be proclaimed throughout Catalonia by a town crier. Immediately afterward, the banker would be *beheaded* directly in front of his counter, and his property sold locally to pay his creditors. In fact, this is one of the few historical instances in which public authorities have bothered to effectively defend the general principles of property rights with respect to the monetary bank-deposit contract. While it is likely that most Catalonian bankers who went bankrupt tried to escape or pay their debts within a year, documentary evidence shows that at least one banker, a certain Francesch Castello, was beheaded directly in front of his counter in 1360, in strict accordance with the law.[65]

Despite these sanctions, banks' liquid funds did not match the amount received on demand deposit. As a result, they eventually failed en masse in the fourteenth century, during the same economic and credit recession that ravaged the Italian financial world and was studied by Carlo M. Cipolla. Though there are signs that Catalonian banks held out a bit longer than Italian ones (the terrible penalties for fraud undoubtedly raised reserve ratios), documents show that in the end, Catalonian banks also generally failed to meet their obligations. In March 1397, further regulations were introduced when the public began to complain that bankers were reluctant to return money deposited, offered their clients all

---

[65]Ibid., pp. 240 and 242. In light of recent scandals and bank crises in Spain, one could jokingly wonder if it might not be a good idea to again punish fraudulent bankers as severely as in fourteenth-century Catalonia. A student of ours, Elena Sousmatzian, says that in the recent bank crisis that devastated Venezuela, a senator from the Social-Christian Party Copei even "seriously" suggested such measures in a statement to the press. Incidentally, her remarks were quite well-received among depositors affected by the crisis.

sorts of excuses, told them to "come back later" and would pay them (in the end, if the clients were lucky) only in small coins of little value and never in the gold which had originally been deposited.[66]

The bank crisis of the fourteenth century did not lead to increased monitoring and protection of the property rights of depositors. Instead, it resulted in the creation of a municipal government bank, the *Taula de Canvi*, Barcelona's Bank of Deposit. This bank was formed with the purpose of taking in deposits and using them to finance city expenditures and the issuance of government bond certificates for the city of Barcelona. Hence, the *Taula de Canvi* fits the traditional model of a bank created by public authorities to take direct advantage of the dishonest benefits of banking. A.P. Usher studied the life of this bank in detail. Predictably, it ended up suspending payments (in February 1468), because a large portion of its reserves had been channeled into loans to the city of Barcelona and the bank was unable to satisfy depositors' demands for cash withdrawals.[67] From that point on, the bank was reorganized and gradually given more and more privileges, such as a monopoly on all deposits deriving from judicial attachments and seizures. This was an almost guaranteed source of continuous income and acted as collateral for loans to finance the city's projects. The *Taula* was also granted a monopoly on resources from all administrative deposits, guardianships and testate proceedings. These funds were deposited and fixed in the bank.[68]

---

[66]Ibid., p. 244.

[67] In February 1468, after a long period of strain, the Bank of Deposit was obliged to suspend specie payments completely. For all balances on the books at that date, annuities bearing interest at 5 percent were issued to depositors willing to accept them. Those unwilling to accept annuities remained creditors of the bank, but they were not allowed to withdraw funds in cash. (Ibid., p. 278)

[68]Documents show that in 1433, at least 28 percent of deposits in Barcelona's Taula de Canvi came from compulsory judicial seizures and were very stable. See Usher, *The Early History of Deposit Banking in Mediterranean Europe*, p. 339, and Kindleberger, *A Financial History of*

4
Banking During the Reign of Charles V and the Doctrine of the School of Salamanca[69]

Banking during the reign of Charles V is a good example of the scenario we have been describing. First, the massive influx of precious metals from the Americas shifted the economic focus, at least temporarily, from the Northern Italian trading cities to Spain; specifically, Seville and the other Spanish business centers. Second, due to his imperial policy, Charles V was in constant need of funds, and he turned to the banking system for a continual source of financing. In this way, he unscrupulously took advantage of the liquidity it provided him and powerfully reinforced the traditional complicity between authorities and bankers. A more disguised collaboration between the two was already the norm at that time. Furthermore, Charles V was unable to keep the royal treasury from going bankrupt, which, as could be expected, had very negative effects on the Spanish economy and on the bankers who had financed his projects. All of these events motivated the most brilliant minds of the time, the scholars of the School of Salamanca, to reflect on the financial and banking activities they witnessed. These theorists left us with some very valuable analyses worthy of being studied in detail. We will now examine each of the historical events in order.

Western Europe, p. 49. At any rate, the reserve ratio progressively worsened until the suspension of payments in 1464. Following its reorganization at that time, Barcelona's Bank of Deposit managed a fragile financial existence for the next 300 years, due to the privileges it enjoyed with respect to judicial deposits and the limits established on loans to the city. Shortly after Barcelona was captured by the Bourbons on September 14, 1714, the bank was taken over by a new institution with statutes drafted by the Count of Montemar on January 14, 1723. These statutes were the bank's backbone until its final liquidation in the year 1853.

[69]Another English version of this section appeared in Jesús Huerta de Soto, "New Light on the Prehistory of the Theory of Banking and the School of Salamanca," *Review of Austrian Economics* 9, no. 2 (1996): 59–81.

The Development of Banking in Seville

Ramon Carande deserves credit for uncovering in some detail the development of private banking in Seville during the reign of Charles V.[70] According to Carande, his research was aided by the discovery of a list of bankers compiled prior to the confiscation of precious metals by Seville's Casa de *Contratación* (Trading House) in 1545. An impoverished treasury prompted Charles V to disregard the most basic legal principles and seize funds where he could find them: i.e., deposited in the vaults of Seville's bankers. Granted, these bankers also violated the basic legal principles governing the monetary irregular deposit and employed in their own private dealings a large share of the money deposited. However, the emperor's policy of directly confiscating whatever funds remained in their vaults incited bankers to routinely loan to third parties most money on deposit. If there was ultimately no guarantee that public authorities would respect bank reserves (and bankers' own experience taught them that, when short of money, the emperor had no qualms about forcibly appropriating those funds in the form of compulsory loans to the Crown), it seemed wiser to invest most deposited money in loans to private industry and commerce, thus evading expropriation and earning higher profits.

The practice of confiscating deposits is perhaps the most extreme example of public authorities' traditional tendency to capitalize on banking profits by expropriating the assets of those who have a legal duty to better guard the deposits of others. It is therefore understandable that rulers, being the main beneficiaries of bankers' dubious activities, ended up justifying them and granting bankers all kinds of privileges to allow them to continue operating with a fractional reserve, on the fringes of legality.

In his chief work, *Carlos V y sus banqueros*, Ramón Carande lists the most important bankers in the Seville of Charles V, namely the Espinosas, Domingo de Lizarrazas, and Pedro de

---

[70]Ramón Carande, *Carlos V y sus banqueros,* 3 vols. (Barcelona and Madrid: Editorial Crítica, 1987).

Morga, along with the less prominent Cristóbal Francisquín, Diego Martínez, Juan Íñiguez, and Octavio de Negrón. All of them inexorably went bankrupt, for the most part due to a lack of liquidity with which to satisfy depositors' withdrawals of demand deposits. This demonstrates they were operating with a fractional reserve, aided by a license or privilege obtained from the city of Seville and from Charles V himself.[71] We do not have information on their exact reserve ratio, but we do know that on many occasions they made personal investments in the fleet used for trading with the Americas, in the collection of taxes, etc. Such risky ventures were always tremendously tempting, because when they went reasonably well they yielded enormous profits. Moreover, as mentioned above, the repeated confiscation of bank deposits of precious metals only further encouraged bankers to carry on their illegitimate activities. Consequently, the Espinosas' bank failed in 1579 and the senior partners were imprisoned. The bank of Domingo de Lizarrazas failed on March 11, 1553, when he was unable to make a payment of more than six and a half million maravedis, while the bank of Pedro de Morga, who began his operations in 1553, failed in 1575, during the second bankruptcy of Philip II. The less prominent banks suffered the same fate. Thomas Gresham made an interesting comment on this issue. He had traveled to Seville with instructions to withdraw three hundred twenty thousand ducats in cash, for which he had obtained the necessary license from the emperor and Queen Mary. Gresham marveled that in the very city that received the treasures of the Indies money could be so extremely scarce. The same was true for the markets, and Gresham feared that all the city's banks would suspend payments

---

[71]Spanish banks of the seventeenth century had no better luck:

> At the beginning of the seventeenth century there were banks in the court, Seville, Toledo and Granada. Shortly after 1622, Alejandro Lindo complained that not one still existed, the last one (owned by Jacome Matedo) having failed in Seville. (M. Colmeiro, *Historia de la economía política española* (1863) (Madrid: Fundación Banco Exterior, 1988), vol. 2, p. 342)

as soon as his withdrawal was completed.[72] It is unfortunate that Ramón Carande uses such inadequate analytical tools and that his interpretation of these bank failures derives mainly from anecdotal information, such as the greed for metals, which constantly threatened banks' solvency; bankers' daring personal business ventures (their involvement in the chartering of vessels, overseas merchant shipping, insurance, various types of speculation, etc.), which continually placed them in serious predicaments; and the royal treasury's repeated confiscation of valuables and its want of liquidity. He never once mentions the following chain of events: Fractional-reserve banking led to an artificial credit expansion unsupported by sufficient real savings; this, along with the inflation of precious metals from the Americas, generated an artificial boom; the boom, in turn, produced an economic crisis and inevitable recession; and this was the true cause of the bank failures.

Fortunately, Ramón Carande's omission of theory has been at least partially compensated for by Carlo M. Cipolla's interpretative study of the economic and bank crisis of the second half of the sixteenth century. Though this analysis refers strictly to Italian banks, it is also directly applicable to the Spanish financial system, due to the intimate relationship existent at the time between the financial and trade routes of the two countries.[73] Cipolla explains that in the second half of the sixteenth century, the money supply (what we refer to today as M1 or M2) included a large amount of "bank money," or deposits created out of nowhere by bankers who did not maintain possession of 100 percent of the cash on demand deposit. This gave rise to a period of artificial economic growth, which began to

---

[72]Eventually, after much effort, he was able to obtain around 200,000 ducats, writing at the time, "I am afraid I will cause the failure of all the banks in Seville." See Carande, *Carlos V y sus banqueros*, vol. 1, pp. 299–323, esp. pp. 315–16, which refer to Gresham's visit to Seville.

[73]See Cipolla's *Money in Sixteenth-Century Florence* (Berkeley: University of California Press, 1989), esp. pp. 101ff. The intimate financial and trade relationship between Spain and Italy in the sixteenth century is very well documented in Felipe Ruiz Martín's book, *Pequeño capitalismo, gran capitalismo: Simón Ruiz y sus negocios en Florencia* (Barcelona: Editorial Crítica, 1990).

reverse in the second half of the sixteenth century, when depositors nervously started to experience economic difficulties and the most important Florentine banks began to fail.

According to Cipolla, this phase of expansion was set in motion in Italy by the directors of the Ricci Bank, who used a very large share of their deposits to buy government securities and grant loans. The other private banks were obliged to adopt the same policy of credit expansion if their managers wanted to be competitive and conserve their profits and market share. This process gave rise to a credit boom which led to a phase of great artificial expansion that soon began to reverse. In 1574, a proclamation accused bankers of refusing to return deposits in cash and denounced the fact that they only "paid with ink." It became increasingly more difficult for them to return deposits in ready cash, and Venetian cities began to experience a significant money scarcity. Craftsmen could not withdraw their deposits nor pay their debts and a severe credit squeeze (i.e., deflation) followed, along with a serious economic crisis analyzed in detail by Cipolla in his interesting paper. From a theoretical standpoint, Cipolla's analysis is stronger than Ramón Carande's, although it is not completely adequate either, as it places more emphasis on the crisis and credit squeeze than on the prior stage of artificial credit expansion, wherein lies the true root of the evil. The credit expansion phase, in turn, is rooted in the failure of bankers to comply with the obligation to safeguard and maintain intact 100 percent of the *tantundem*.[74]

---

[74]Cipolla indicates that in the 1570s, the Ricci Bank could no longer meet demands for cash withdrawals and actually suspended payments, only paying "in ink" or with bank policies. Florentine authorities focused on just the symptoms of this worrisome situation and made a typically spontaneous attempt to resolve it with mere ordinances. They imposed upon bankers the obligation to pay their creditors immediately in cash, but they did not diagnose nor attack the fundamental source of the problem (the misappropriation of deposits and channeling of them into loans and the failure to maintain a 100-percent cash reserve). Consequently, the decrees which followed failed to have the desired effect and the crisis gradually worsened until it exploded violently in the mid-1570s. See Cipolla, *Money in Sixteenth-Century Florence*, p. 107.

Of international relevance were the long-standing relations between Charles V and members of the prominent Fugger banking family (known in Spain as the *Fúcares*). The Fuggers of Augsburg started out as wool and silver merchants and also traded spices between their city and Venice. Later they concentrated on banking, and in their heyday they operated eighteen branches in different parts of Europe. They granted loans to help finance the election of Charles V as emperor and later funded his exploits on many occasions, receiving as collateral both the silver shipments from the Americas and the authorization to collect taxes. Their business came to a standstill and barely escaped bankruptcy in 1557 when Philip II *de facto* suspended payments, and in fact they continued to lease the lands belonging to military orders until 1634.[75]

The School of Salamanca and the Banking Business

These financial and banking phenomena did not go unnoticed by the illustrious minds of members of the School of Salamanca who, according to the most reliable research, paved the way for the modern subjectivist theory of value, developed by the Austrian school of economics.[76]

---

[75]The best source on the relations between the Fugger Bank and Charles V is arguably Ramón Carande's *Carlos V y sus banqueros*. Also deserving mention is a study by Rafael Termes Carreró, entitled *Carlos V y uno de sus banqueros: Jacobo Fugger* (Madrid: Asociación de Caballeros del Monasterio de Yuste, 1993). Rafael Termes makes an interesting observation about the Fuggers' dominance in Spain, pointing out that

> there is a street in Madrid named after the Fuggers. Calle de Fúcar, between Atocha and Moratín streets, bears the hispanized version of their last name. In addition, the word fúcar is listed even today as meaning "rich and wealthy person" in the *Diccionario* of the Spanish Royal Academy. (p. 25)

[76]The following authors, among others, have recently examined the contributions of Spanish scholastics to economic theory: Murray N. Rothbard, "New Light on the Prehistory of the Austrian School," in *The Foundations of Modern Austrian Economics*, Edward G. Dolan, ed. (Kansas City, Mo.: Sheed and Ward, 1976), pp. 52–74, and *Economic Thought Before Adam Smith*, chap. 4, pp. 97–133; Lucas Beltrán, "Sobre los orígenes hispanos de la economía de mercado," in *Ensayos de economía*

Chronologically speaking, the first work to consider, and perhaps the most relevant to our thesis, is *Instrucción de mercaderes* (Instruction to merchants), written by Doctor Luis

---

política (Madrid: Unión Editorial, 1996), pp. 234–54; Marjorie Grice-Hutchinson, *The School of Salamanca: Readings in Spanish Monetary Theory 1544–1605* (Oxford: Clarendon Press, 1952), *Early Economic Thought in Spain 1177–1740*, London: George Allen and Unwin, 1978, and *Economic Thought in Spain: Selected Essays of Marjorie Grice-Hutchinson*, Laurence S. Moss and Christopher K. Ryan, eds. (Aldershot, U.K.: Edward Elgar, 1993); Alejandro A. Chafuen, *Christians for Freedom: Late-Scholastic Economics* (San Francisco: Ignatius Press, 1986); and Huerta de Soto, "New Light on the Prehistory of the Theory of Banking and the School of Salamanca," pp. 59–81. The intellectual influence of the School of Salamanca on the Austrian school is not a mere coincidence or quirk of history, but a consequence of the close historical, political and cultural connections established between Spain and Austria during the time of Charles V and his brother Ferdinand I. These ties lasted for several centuries, and Italy played a crucial role in them, acting as a true cultural, economic and financial link between the two furthermost tips of the Empire (Spain and Vienna). (On this subject, we recommend Jean Bérenger's interesting book, *A History of the Habsburg Empire, 1273-1700,* C.A. Simpson, trans. [London: Longman, 1994, pp. 139–37]). Nevertheless, the scholastics' doctrine on banking has been largely overlooked in the above writings. Marjorie Grice-Hutchinson does touch upon the topic with a near verbatim reproduction of Ramón Carande's brief contribution to the matter (see *The School of Salamanca*, pp. 7–8). Ramón Carande, in turn, simply cites (on pp. 297–98 of volume 1 of his book, *Carlos V y sus banqueros*) Tomás de Mercado's reflections on banking. A more profound examination is made by Alejandro A. Chafuen, who at least reports Luis de Molina's views on banking and considers the extent to which the School of Salamanca approved or disapproved of fractional-reserve banking. Another relevant source is Restituto Sierra Bravo's work, *El pensamiento social y económico de la Escolástica desde sus orígenes al comienzo del catolicismo social* (Madrid: Consejo Superior de Investigaciones Científicas, Instituto de Sociología "Balmes," 1975), vol. 1, pp. 214–37 includes a rather biased interpretation of the views of members of the School of Salamanca on the banking business. According to Sierra Bravo, some among the School's theorists (including Domingo de Soto, Luis de Molina, and even Tomás de Mercado) tended to accept fractional-reserve banking. However, he ignores the writings of other members of the School who, on firmer theoretical grounds, held a radically opposing view. The same criticism can be applied to references Francisco G. Camacho makes in his prefaces to the Spanish translations of Molina's works, particularly his "Introduction" to *La teoría del justo precio*

Saravia de la Calle and published in Medina del Campo in 1544. Saravia de la Calle criticizes bankers harshly, calling them "voracious gluttons who swallow everything, destroy everything, confuse everything, steal and soil everything, like the harpies of Phineus."[77] He says bankers "go out into the street and square with their table and chair and cash-box and book, like harlots to the brothel with their chair," and having obtained the necessary license and guarantee required by the laws of the kingdom, they set about acquiring deposits from clients, to whom they offer bookkeeping and cashier services, making payments from clients' accounts as ordered and even paying interest on such deposits.

With sound legal reasoning, Saravia de la Calle indicates that interest is incompatible with the nature of the monetary deposit, and that in any case, the banker should receive a fee for the custody and safekeeping of the money. He even severely rebukes customers who enter into such deals with bankers, and states:

> And if you say, merchant, that you do not lend the money, but that you deposit it, that is a greater mockery; for who ever saw the depositary pay? He is usually paid for the trouble of safeguarding the deposit. Furthermore, if you now entrust your money to the profiteer as a loan or deposit, just as you receive a part of the profit , you also earn a portion of guilt, even a greater portion.[78]

In chapter 12 of his book, Saravia de la Calle makes a neat distinction between the two radically different operations

---

(Madrid: Editora Nacional, 1981), esp. pp. 33–34. This version of the doctrine, according to which some members of the School of Salamanca accepted fractional-reserve banking, has been greatly influenced by an article by Francisco Belda, S.J., entitled "Ética de la creación de créditos según la doctrina de Molina, Lessio y Lugo," published in *Pensamiento* 19 (1963): 53–89. For the reasons indicated in the text, we disagree with the interpretation these authors make of the doctrine of the School of Salamanca with respect to banking. We will consider these objections in greater detail in section 1 of chapter 8.

[77]Saravia de la Calle, *Instrucción de mercaderes*, p. 180.

[78]Ibid., p. 181.

bankers carry out: demand deposits and time "deposits." In the first case, customers entrust their money interest-free to bankers

> so the money will be safer, and more accessible for making payments, and to avoid the hassle and trouble of counting and guarding it, and also because, in gratitude for this good deed they do the moneylender in giving him their money, if it so happens they have no money left under his charge, he will also accept some overdrafts without interest.[79]

The second operation, the time "deposit," is very different from the first and is in fact a true loan or mutuum which is granted the banker for a fixed term and yields interest. Saravia de la Calle, in compliance with the traditional canonical doctrine on usury, condemns these transactions. Furthermore, he clearly states that in the case of the demand-deposit contract, customers should pay the banker

> for if they deposit money, they should pay for the safekeeping and should not derive as much profit as the laws permit when depositing money or property that requires safeguarding.[80]

Saravia de la Calle goes on to censure those clients who selfishly try to capitalize on the illicit activity of bankers, making deposits and expecting bankers to pay interest. As he vividly puts it,

> He who deposits his money with someone he knows will not guard it, but will spend it, is not free from sin, at least venial sin. He acts as one who turns over a virgin to a lecher or a delicacy to a glutton.[81]

Moreover, the depositor cannot ease his conscience by thinking the banker will loan or use other people's money but not his own.

---

[79]Ibid., p. 195.

[80]Ibid., p. 196.

[81]Ibid., p. 197.

> He believes the banker will probably guard the money he deposits and not do business with it, when this cannot be expected of any of these profiteers. On the contrary, the banker will soon invest the deposit for profit and try to earn money with it. How could bankers who pay 7 and 10 percent interest to those who provide them with money to do business with possibly refrain from using deposits? Even if it had been clearly demonstrated that you do not sin (which is not the case, quite the opposite), the moneylender very certainly sins when he does business with your money and he definitely uses your money to steal the property of your neighbors.[82]

Saravia de la Calle's doctrine is very coherent, inasmuch as the self-interested use (via the granting of loans) of money placed on demand deposit with bankers is illegitimate and implies a grave sin. This doctrine coincides with the one originally established by the classical authors of Roman law, a doctrine which derives naturally from the very essence, purpose, and legal nature of the monetary irregular-deposit contract, which we studied in chapter 1.

Saravia de la Calle also vividly describes the disproportionate profits bankers obtain through their illegitimate practice of appropriating deposits instead of being satisfied with the more modest earnings they would receive for the simple custody or safekeeping of deposits. His explanation is quite descriptive:

> If you receive a wage, it should be moderate and adequate for your support, not the excessive loot with which you build superb houses, buy lavish estates, pay servants and provide extravagant luxuries for your families, and you give great feasts and dress so splendidly, especially when you were poor before you began your dealings, and you left humble trades.[83]

In addition, Saravia de la Calle explains that bankers are quite prone to bankruptcy, and he even carries out a cursory

---

[82]Ibid.

[83]Ibid., p. 186.

theoretical analysis which demonstrates that the expansionary phase brought on by the artificial expansion of credit granted by these "profiteers" is inevitably followed by a period of recession, during which the non-payment of debts produces a chain of bank failures. He adds that

> the merchant does not pay the profiteer, he causes him to go bankrupt, and he suspends payments and all is lost. As is common knowledge, these moneylenders are the beginning, occasion and even the cause of all this, *because if they did not exist, each person would use his money to the extent he could and no more, and things would cost what they are worth and more than a fair cash price would not be charged*. Therefore it would be very worthwhile for princes to stop tolerating these profiteers in Spain, since no other nation in the world tolerates them, and to banish this pestilence from their court and kingdom.[84]

As we know, it is not true that the authorities of other nations had controlled the activity of bankers more successfully than Spanish authorities. Instead, the same thing happened more or less everywhere, and rulers eventually granted bankers privileges to allow them to make self-interested use of their depositors' money, in exchange for the ability to capitalize on a banking system which provided much faster and easier financing than taxes.

To conclude his analysis, Saravia de la Calle affirms that

> a Christian should under no circumstances give his money to these profiteers, because if he sins in doing so, as is always the case, he should refrain from it to avoid sinning; and if he does not sin, he should refrain to avoid causing the moneylender to sin.

Furthermore, he adds that if bankers' services are not used, the following additional advantage will result: the depositors

[84]Ibid., p. 190; italics added.

[85]Ibid., p. 198.

> will not be shocked if the moneylender suspends payments; if he goes bankrupt, as we see so often and Our Lord God permits, let him and his masters be lost like dishonest gains.[85]

As we see, Saravia de la Calle's analysis, along with his cleverness and humor, is impeccable and free from contradictions. However, in his criticism of bankers, he perhaps places too much emphasis on the fact that they charged and paid interest in violation of the canonical prohibition of usury, instead of emphasizing that they misappropriated demand deposits.

Another writer who examines the monetary irregular-deposit contract is Martín de Azpilcueta, better known as "Doctor Navarro." In his book, *Comentario resolutorio de cambios* (Resolutory commentary on exchanges), first published in Salamanca at the end of 1556, Martín de Azpilcueta expressly refers to "banking for safekeeping," which consists of the bank contract of monetary demand-deposit. For Martín de Azpilcueta, banking for safekeeping, or the irregular deposit contract, is fully just and means that the banker is

> guardian, depositary and guarantor of the money given him or exchanged for whatever purpose by those who give or send him money, and that he is obliged to make payments to merchants or persons to whom depositors want payments made in such and such a way, [for which] he may legitimately charge a fair fee to the republic or the depositors, as this trade and responsibility are useful to the republic and free from iniquity; for it is fair for a worker to earn his wages. And it is the moneychanger's job to receive, safeguard and keep the money of so many merchants ready, and to write and keep their accounts, with great difficulty and at times risk of error in their records and in other things. This arrangement could be formalized in a contract by which a person commits himself to hold other people's money in deposit, make payments and keep records as arranged by them, etc., since this is an agreement to hire a person for a job, which is a well-known, just and blessed contract.[86]

---

[86]Martín de Azpilcueta, *Comentario resolutorio de cambios* (Madrid: Consejo Superior de Investigaciones Científicas, 1965), pp. 57–58. In our study of Dr. Navarro's doctrines we have used the first Spanish edition,

As we see, Martín de Azpilcueta regards the monetary irregular-deposit contract as a completely legitimate contract by which people entrust the custody of their money to a professional (the banker), who must safeguard it like a good parent and keep it constantly available to the depositors, providing whatever cashier services they ask of him; and he has a right to charge the depositors a fee for his services. As a matter of fact, Martín de Azpilcueta feels it is the depositors who must pay the depositary or banker and never the *reverse*, so depositors "pay in compensation for the trouble and worries the moneychanger has in receiving and safeguarding their money," and bankers must conduct

> their business honestly and be satisfied with a fair wage, receiving it from those who owe it to them and whose money they safeguard and whose accounts they keep, and not from those who are not indebted to them.[87]

Moreover, in an effort to clarify matters and avoid confusion, Martín de Azpilcueta (using the same reasoning as Doctor Saravia de la Calle) expressly condemns clients who wish to pay nothing for the custody of their deposits and try to even earn interest on them. Doctor Navarro concludes that

> in this sort of exchange, not only the moneychangers sin, but also . . . those who entrust their money to them for safekeeping as above. They later refuse to pay a fee, claiming the profits earned with their money and received from those they pay in cash is enough of a wage. And if the moneychangers request a fee, the customers leave them and take their business elsewhere. So, to keep these clients, the bankers renounce their fee and instead take money from those who owe them nothing.[88]

---

published by Andrés de Portanarijs in Salamanca in 1556, as well as the Portuguese edition, published by Ioam de Barreyra in Coimbra in 1560 and entitled *Comentario resolutorio de onzenas*. In this edition, the text corresponding to the above quotes appears on pp. 77–80.

[87]Azpilcueta, *Comentario resolutorio de cambios*, pp. 60–61.

[88]Ibid., p. 61.

In his book, *Suma de tratos y contratos* (Compilation of deals and contracts) (Seville 1571), Tomás de Mercado performs an analysis of the banking business very much in the same line as the studies by the preceding authors. He begins by correctly stating that depositors should pay bankers for the work of safeguarding their monetary deposits, concluding that

> it is a common, general rule among all bankers to be able to take wages from those who deposit money in their bank, a certain amount each year or for each thousand, because bankers serve depositors and safeguard their assets.[89]

Nevertheless, Tomás de Mercado ironically points out that bankers in Seville are so "generous" they charge nothing for guarding deposits: "those of this city, it is true, are so regal and noble they ask for and take no wage."[90] Tomás de Mercado observes that these bankers have no need to charge anything, since the large amount of currency they obtain from deposits earns them substantial profits in personal business deals. We must emphasize that, in our opinion, Tomás de Mercado simply verifies a fact here and does not imply that he considers these actions in any way legitimate, as various modern authors (among others, Restituto Sierra Bravo and Francisco G. Camacho) appear to suggest.[91] Quite the opposite is true. From the standpoint of the purest Roman doctrine and the essential legal nature of the monetary irregular-deposit contract analyzed in chapter 1, Tomás de Mercado is the scholastic writer who most clearly demonstrates that the transfer of property in the irregular deposit does not imply a concomitant

---

[89]We quote the Instituto de Estudios Fiscales edition published in Madrid in 1977, edited and prefaced by Nicolás Sánchez Albornoz, vol. 2, p. 479. Restituto Sierra Bravo has another edition, published by the Editora Nacional in 1975. The above excerpt appears on page 401 of this edition. The original edition was published in Seville in 1571 "en casa de Hernando Díaz Impresor de Libros, en la calle de la Sierpe."

[90]Mercado, *Suma de tratos y contratos*, vol. 2, p. 480 of the Instituto de Estudios Fiscales edition and p. 401 of the Restituto Sierra Bravo edition.

[91]See the writings by Restituto Sierra Bravo, Francisco Belda, and Francisco García Camacho cited in footnote 76.

transfer of availability of the *tantundem* and therefore, for all practical purposes, there is no *full* transfer of property. He expresses himself quite well: "they [bankers] must understand that the money is not theirs, but belongs to others; and it is not fair that by using it, they cease to serve its owner." Tomás de Mercado adds that bankers should obey two fundamental principles. First: they should

> not strip the bank so bare they cannot then cover the drafts they receive, because if they become unable to pay them because they have spent and invested the money in shady business and other deals, they certainly sin. . . . Second: they should not become involved in risky business deals, for they sin even if the deals turn out successfully, because the bankers chance not being able to fulfill their responsibilities and doing serious harm to those who have trusted them.[92]

Though one could take these recommendations as an indication that Tomás de Mercado resigns to accept a certain fractional reserve, it is important to keep in mind that he is very emphatic in expressing his legal opinion that deposited money does not ultimately belong to bankers but to depositors, and in stating, furthermore, that none of the bankers complies with his two recommendations:

> however, since when business goes well, in affluent circumstances, it is very difficult to bridle greed, none of them takes heed of these warnings nor meets these conditions.[93]

For this reason, he considers the regulations enacted by the Emperor Charles V in this respect to be very beneficial. They prohibited bankers from carrying out personal business deals and were aimed at eliminating the temptation to finance such dealings indefinitely with money obtained from depositors.[94]

---

[92]Mercado, *Suma de tratos y contratos*, vol. 2, p. 480 of the Instituto de Estudios Fiscales edition and p. 401 of the Restituto Sierra Bravo edition.

[93]Ibid.

[94]*Nueva Recopilación*, law 12, title 18, book 5, enacted in Zamora on June 6, 1554 by Charles V, Queen Juana, and Prince Philip; it reads:

Also, at the end of chapter 4 of *Suma de tratos y contratos*, Tomás de Mercado states that the bankers of Seville hold deposits of money and precious metals belonging to merchants who traded with the New World, and that with such considerable deposits they "make great investments," obtaining hefty profits. Here he does not openly condemn these practices, but we must remember that the passage in question is, again, more a description of a state of affairs than a judgment on its legitimacy. However, he does consider the issue of legitimacy in greater depth in chapter 14, which we have already covered. Tomás de Mercado concludes as well that bankers

> are also involved in exchanging and charging; bankers in this republic engage in an extremely wide range of activities, wider than the ocean, but sometimes they spread themselves too thin and all is lost.[95]

The scholastics most misguided in their doctrinal treatment of the monetary irregular-deposit contract are Domingo de Soto and (especially) Luis de Molina and Juan de Lugo. Indeed, these theorists allowed themselves to be influenced

---

> Because the public banks in the markets of Medina del Campo, Rioseco and Villalón, and in the cities, towns and villages of these kingdoms . . . [have engaged in business other than their specific task concerning money], they have as a result suspended payments and failed; [in order to] avoid the above-mentioned events, we decree that, *from now on, they confine themselves to their specific duty*, and that not just one person but at least two be required to establish these public banks . . . and that before they . . . [can practice their profession], they must provide sufficient guarantees. (italics added)

Note that "public banks" refers here not to government banks but to private banks which may receive deposits from the public under certain conditions (more than two owners, sufficient guarantees, etc.). See José Antonio Rubio Sacristán, "La fundación del Banco de Amsterdam (1609) y la banca de Sevilla," *Moneda y crédito* (March 1948).

[95]This is the quotation of Mercado which Ramón Carande includes in vol. 1 of *Carlos V y sus banqueros*, in the introduction to his treatment of bankers in Seville and the crisis that led them all to fail. See Mercado, *Suma de tratos y contratos*, vol. 2, pp. 381–82 of the 1977 edition of the Instituto de Estudios Fiscales and p. 321 of the Sierra Bravo edition.

by the medieval tradition of the glossators, which we covered in section 2 of this chapter, and especially by the doctrinal confusion resulting from the *depositum confessatum*. De Soto and especially Molina view the irregular deposit as a loan in which both the ownership and full availability of the *tantundem* are transferred to the banker. Therefore, they believe the practice of loaning deposited funds to third parties is legitimate, as long as bankers act in a "prudent" manner. Domingo de Soto could be considered the first to maintain this thesis, though he did so very indirectly. In fact, in book six, topic eleven of his work, *La justicia y el derecho* (On justice and law) (1556), we read that bankers have the

> custom, it is said, of being liable for a greater amount of money than that deposited if a merchant makes his deposit in cash. I gave the moneychanger ten thousand; so he will be liable to me for twelve, perhaps fifteen; because having cash is very profitable for the moneychanger. Neither is any evil seen in it.[96]

Another typical example of credit creation which Domingo de Soto appears to accept is a loan in the form of the discount of bills, financed using clients' deposits.

Nevertheless, the Jesuit Luis de Molina is the scholar who has most clearly maintained an erroneous doctrine on the bank contract of monetary irregular deposit.[97] Indeed, in

---

[96] Habet autem praeterea istorum usus, ut fertur si mercatorum quispiam in cambio numeratam pecuniam deponat, campsor pro maio ri illius gratia respondeat. Numeravi campsori dece milia: fide habebo apud ipsum & creditu pro duodecim, & forfam pro quim decim: qui capsori habere numerata pecuniam bonum est lucrum. Neq, vero quicq vitij in hoc foedere apparet. (Domingo de Soto, *De iustitia et iure* [Salamanca: Andreas Portonarijs, 1556], book 6, topic 11, the only article, p. 591. Instituto de Estudios Políticos edition [Madrid, 1968], vol. 3, p. 591)

Sierra Bravo (*El pensamiento social y económico de la Escolástica,* p. 215) is of the opinion that these words by Domingo de Soto imply his acceptance of fractional-reserve banking.

[97] It is very significant that various authors, including Marjorie Grice-Hutchinson, hesitate to place Luis de Molina among the theorists of the

Tratado sobre los cambios (Treatise on exchanges) (1597), he upholds the medieval doctrine that the irregular deposit is a loan or mutuum contract in favor of the banker, a contract in which not only ownership is transferred, but full availability of the *tantundem* as well, which means the banker can legitimately use the money in his own interest, in the form of loans or in any other manner. Let us see how he presents his argument:

> Because these bankers, like all the others, are true owners of the money deposited in their banks, and they differ greatly in this way from other depositaries . . . so they receive the money as a precarious loan and hence, at their own risk.

Further on he indicates even more clearly that

> such a deposit is really a loan, as has been said, and ownership of the money deposited is transferred to the banker, so if it is lost it is lost to the banker.[98]

This position conflicts with the doctrine Luis de Molina himself upholds in *Tratado sobre los préstamos y la usura* (Treatise on loans and usury), where he indicates that a *term* is an essential element of all loan contracts, and that if the duration of a loan has not been expressly stipulated and a date for its return set, "it will be necessary to accept the decision of the judge as to the loan's duration."[99] Moreover, Luis de Molina ignores all of the arguments presented in chapter 1 to demonstrate that the irregular deposit contract has nothing in common, in

---

School of Salamanca: "The inclusion of Molina in the School seems to me now to be more dubious." Marjorie Grice-Hutchinson, "The Concept of the School of Salamanca: Its Origins and Development," chapter 2 of *Economic Thought in Spain: Selected Essays of Marjorie Grice-Hutchinson*, p. 25. It seems clear that the core members of the School of Salamanca were Dominican, and at least on banking matters it is necessary to separate them from Jesuit theologians, a deviationist and much less rigorous group.

[98]Luis de Molina, *Tratado sobre los cambios,* edited and introduced by Francisco Gómez Camacho (Madrid: Instituto de Estudios Fiscales, 1991), pp. 137–40. The original edition was published in Cuenca in 1597.

[99]Luis de Molina, *Tratado sobre los préstamos y la usura*, edited and introduced by Francisco Gómez Camacho (Madrid: Instituto de Estudios Fiscales, 1989), p. 13. The original edition was published in Cuenca in 1597.

terms of legal nature and essence, with the loan or mutuum contract. Therefore, his doctrinal attempt to identify the two contracts with each other is a clear step backward, not only in relation to the much more coherent views of Saravia de la Calle and Martin de Azpilcueta, but also with respect to the true legal nature of the contract as it had already been developed by Roman juridical science. Therefore, it is strange that a mind as bright and penetrating as Luis de Molina did not realize the extreme danger of accepting the violation of the general legal principles governing the irregular deposit, and that he claimed,

> it never occurs that all the depositors need their money in such a way that they do not leave many thousands of ducats deposited, with which the bankers can do business and either earn a profit or suffer a loss.[100]

Molina does not recognize that in this way not only is the objective or essential purpose of the contract (custody and safekeeping) violated, but also that an incentive is provided for all sorts of illicit dealings and abuses which inexorably generate an economic recession and bank failures. When the traditional legal principle requiring the continual safekeeping of the *tantundem* in favor of the depositor is not respected, there is no clear guide to avoiding bank failures. Furthermore, it is obvious that such vague, superficial suggestions as "try to act prudently" and "do not become involved in risky business deals" are not sufficient help in preventing the very harmful economic and social effects of fractional-reserve banking. At any rate, Luis de Molina does at least bother to state,

> It is important to warn that [bankers] commit mortal sin if they use in their own business dealings so much of the money they hold on deposit that they are later unable, at the right time, to hand over the quantities the depositors request or order to be paid against their deposited funds. . . . In addition, they commit mortal sin if they become involved in business dealings entailing a risk of not being able to return deposits. For example, if they send so much merchandise

---

[100]Molina, *Tratado sobre los cambios*, p. 137.

> overseas that, should the ship sink or be captured by pirates, they would not be able to repay deposits even after selling all of their assets. *And they are not guilty of mortal sin only when the deal turns out poorly, but also when it turns out well. This is due to the chance they take of hurting depositors and the guarantors they themselves supply for the deposits.*[101]

We find this warning of Luis de Molina admirable, but at the same time we are astonished at his failure to recognize the profound contradiction that ultimately exists between his warning and his explicit acceptance of "prudent" fractional-reserve banking. The fact is, regardless of how prudent bankers are, the only surefire way to avoid risks and ensure that deposits are permanently available to depositors is to maintain a 100-percent reserve ratio at all times.[102]

---

[101]Ibid., pp. 138–39; italics added.

[102]After Molina, the leading scholar with a similar viewpoint on banking issues is Juan de Lugo, also a Jesuit. This suggests that, with regard to banking, the School of Salamanca comprised two currents of thought: one which was sound, doctrinally well-supported, close to the future currency school, and represented by Saravia de la Calle, Martín de Azpilcueta, and Tomás de Mercado; and another, one more prone to the follies of inflationism and to fractional-reserve banking, and close to the future banking school. Luis de Molina, Juan de Lugo, and to a much lesser extent, Domingo de Soto exemplified this current. In chapter 8 we will set out this thesis in greater detail. For now we would just like to point out that Juan de Lugo followed in Molina's footsteps and gave an especially clear warning to bankers:

> Qui bene advertit, eivsmodi bancarios depositarios peccare graviter, & damno subsequuto, cum obligatione restituendi pro damno, quoties ex pecuniis apud se depositis tantam summam ad suas negotiationes exponunt, ut inhabiles maneant ad solvendum deposentibus, quando suo tempore exigent. Et idem est, si negotiationes tales aggrediantur, ex quibus periculum sit, ne postea ad paupertatem redacti pecunias acceptas reddere non possint, v.g. si euenrus ex navigatione periculosa dependeat, in qua navis hostium, vel naufragij periculo exposita sit, qua iactura sequunta, ne ex propio quidem patrimonio solvere possint, sed in creditorum, vel fideiussorum damnum cedere debet. (R.P. Joannis de Lugo Hispalensis, S.I., *Disputationum de iustitia et iure tomus secundus*, Disp. 28, section 5 [Lyon: Sumptibus Petri Prost, 1642], pp. 406–07]

5
A New Attempt at Legitimate Banking: The Bank of Amsterdam. Banking in the Seventeenth and Eighteenth Centuries

The Bank of Amsterdam

The last serious attempt to establish a bank based on the general legal principles governing the monetary irregular deposit and to set up an efficient system of government control to adequately define and defend depositors' property rights took place with the creation of the Municipal Bank of Amsterdam in 1609. It was founded after a period of great monetary chaos and fraudulent (fractional-reserve) private banking. Intended to put an end to this state of affairs and restore order to financial relations, the Bank of Amsterdam began operating on January 31, 1609 and was called the Bank of Exchange.[103] The hallmark of the Bank of Amsterdam was its commitment, from the time of its creation, to the universal legal principles governing the monetary irregular deposit. More specifically, it was founded upon the principle that the obligation of the depository bank in the monetary irregular-deposit contract consists of maintaining the constant availability of the *tantundem* in favor of the depositor; that is, maintaining at all times a 100-percent reserve ratio with respect to "demand" deposits. This measure was intended to ensure legitimate banking and prevent the abuses and bank failures which had historically occurred in all countries where the state had not only not bothered to prohibit and declare illegal the misappropriation of money on demand deposit in banks, but on the contrary, had usually ended up granting bankers all sorts of privileges and licenses to allow their fraudulent operations, in exchange for the opportunity to take fiscal advantage of them.

---

[103]As for the curious reference to the public banks of Seville (and Venice) as models (!) for the Bank of Amsterdam, included in a petition from leading Dutch merchants to the Council of Amsterdam, see José Antonio Rubio Sacristán, "La fundación del Banco de Amsterdam (1609) y la banca de Sevilla."

For a very long time, over one hundred fifty years, the Bank of Amsterdam scrupulously fulfilled the commitment upon which it was founded. Evidence reflects that during the first years of its existence, between 1610 and 1616, both the bank's deposits and its cash reserves came very close to one million florins. From 1619 to 1635, deposits amounted to nearly four million florins and cash reserves exceeded three million, five hundred thousand. After this slight imbalance, equilibrium was restored in 1645, when deposits equaled eleven million, two hundred eighty-eight thousand florins and cash reserves added up to eleven million, eight hundred thousand florins. Equilibrium and growth were more or less stable, and in the eighteenth century, between 1721 and 1722, the bank's deposits totaled twenty-eight million florins and its stock of cash reached nearly that amount, twenty-seven million. This great increase in the deposits of the Bank of Amsterdam stemmed, among other causes, from its role as a refuge for capital fleeing the crazy inflationist speculation that the system of John Law produced in France in the 1720s. We will deal with this more in depth later. This continued until 1772, in which both deposits and cash reserves totaled twenty-eight to twenty-nine million florins. As is evident, during this entire period, to all intents and purposes *the Bank of Amsterdam maintained a 100-percent cash reserve*. This allowed it, in all crises, to satisfy each and every request for cash withdrawal of deposited florins. Such was true in 1672, when panic caused by the French threat gave rise to a massive withdrawal of money from Dutch banks, most of which were forced to suspend payments (as occurred with the Rotterdam and Middelburg banks). The Bank of Amsterdam was the exception, and it logically had no trouble returning deposits. Increasing and lasting confidence in its soundness resulted, and the Bank of Amsterdam became an object of admiration for the civilized economic world of the time. Pierre Vilar indicates that in 1699 the French ambassador wrote in a report to his king:

> Of all the towns of the United Provinces, Amsterdam is without any doubt the foremost in greatness, wealth and the extent of her trade. There are few cities even in Europe to equal her in the two latter respects; her commerce stretches

> over both halves of the globe, and her wealth is so great that during the war she supplied as much as fifty millions a year if not more.[104]

In 1802, when, as we will now see, the Bank of Amsterdam started to become corrupt and violate the principles on which it was founded, the bank still enjoyed enormous prestige, to the point that the French consul in Amsterdam noted:

> At the end of a maritime war which has kept the treasures of the mines pent up in the Spanish and Portuguese colonies, Europe is suddenly inundated with gold and silver in quantities far above what is needed, so that they would decline in value if they were put into circulation all at once. In such an eventuality, the people of Amsterdam deposited the metal in ingots in the Bank, where it was kept for them at a very low cost, and they took it out a little at a time to send to different countries as the increase in the rate warrants it. This money, then, which if allowed to flood in too rapidly would have driven up the prices of everything exceedingly, to the great loss of all who live on fixed and limited incomes, was gradually distributed through many channels, giving life to industry and encouraging trade. The Bank of Amsterdam, then, did not act only according to the special interests of the traders of this city; but the whole of Europe is in its debt for the greater stability of prices, equilibrium of exchange and a more constant ratio between the two metals of which coin is made; and if the bank is not reestablished, it could be said that the great system of the trade and political economy of the civilised world will be without an essential part of its machinery.[105]

---

[104]Pierre Vilar, *A History of Gold and Money, 1450–1920*, Judith White, trans. (London: NLB, 1976), p. 207. The deposit and reserve figures we have cited in the text are also found here on pp. 208–09. Two other European banks modeled after the Bank of Amsterdam were the Bank of Venice and the Bank of Hamburg. They were both founded in 1619. Although the first eventually violated the strict safekeeping obligation and disappeared in 1797, the Bank of Hamburg operated in a more consistent manner and survived until merging with the Reichsbank in 1873. J.K. Ingram, "Banks, Early European," in *Palgrave's Dictionary of Political Economy*, Henry Higgs, ed. (London: Macmillan, 1926), vol. 1, pp. 103–06.

[105]Vilar, *A History of Gold and Money, 1450–1920*, p. 209.

Therefore, we see that the Bank of Amsterdam did not try to attain disproportionate profits through the fraudulent use of deposits. Instead, in keeping with the dictates of Saravia de la Calle and others we have mentioned, it contented itself with the modest benefits derived from fees for safeguarding deposits and with the small income obtained though the exchange of money and the sale of bars of stamped metal. Nevertheless, this income was more than sufficient to satisfy the bank's operating and administration costs, to generate some profit and to maintain an honest institution that fulfilled all of its commitments.

The great prestige of the Bank of Amsterdam is also evidenced by a reference to it found in the incorporation charter of the Spanish Banco de San Carlos in 1782. Although this bank, from its very inception, lacked the guarantees of the Bank of Amsterdam, and it was created with the intention of using its deposits, authority, and clout to help finance the Treasury, it could not escape the immense influence of the Dutch bank. Thus, its article XLIV establishes that private individuals may hold deposits or

> equivalent funds in cash in the bank itself, and whoever wishes to make deposits shall be allowed to do so, either in order to draw bills on the money or to withdraw it gradually, and in this way they will be exempt from having to make payments themselves, their bills being accepted as payable at the bank. In their first meeting, the stockholders will determine the amount per thousand which merchants must pay the bank in relation to their deposits, *as they do in Holland*, and will establish all other provisions concerning the best dispatch of discounts and reductions.[106]

[106]We quote directly from a copy of the *Real Cédula de S. M. y Señores del Consejo, por la qual se crea, erige y autoriza un Banco nacional y general para facilitar las operaciones del Comercio y el beneficio público de estos Reynos y los de Indias, con la denominación de Banco de San Carlos baxo las reglas que se expresan* ([Royal Charter of H.M. and Members of the Council, by which a universal, national bank is created, erected and authorized, to promote trade and the common good of these kingdoms and the New World), printed by Pedro Marín (Madrid, 1782), pp. 31–32; italics added. There is an excellent profile on the history of the Banco de San Carlos by

David Hume and the Bank of Amsterdam

A sign of the enormous prestige of the Bank of Amsterdam among scholars and intellectuals, as well as merchants, is the express mention David Hume makes of it in his essay *Of Money*. This essay first appeared, with others, in a book called *Political Discourses*, published in Edinburgh in 1752. In it David Hume voices his opposition to paper currency and argues that the only solvent financial policy is that which forces banks to maintain a 100-percent reserve ratio, in accordance with traditional legal principles governing the irregular deposit of money. David Hume concludes that

> to endeavour artificially to encrease such a credit, can never be the interest of any trading nation; but must lay them under disadvantages, by encreasing money beyond its natural proportion to labour and commodities, and thereby heightening their price to the merchant manufacturer. And in this view, it must be allowed, *that no bank could be more advantageous, than such a one as locked up all the money it received, and never augmented the circulating coin, as is usual, by returning part of its treasure into commerce. A public bank, by this expedient, might cut off much of the dealings of private bankers and money-jobbers; and though the state bore the charge of salaries to the directors and tellers of this bank (for, according to the preceding supposition, it would have no profit from its dealings), the national advantage, resulting from the low price of labour and the destruction of paper credit, would be a sufficient compensation*.[107]

Hume is not completely correct when he claims the bank would not earn a profit, since its safekeeping fees would be sufficient to cover operating costs, and it might even generate modest profits, as in fact the Bank of Amsterdam did. However his analysis is categorical and reveals that, in defending

---

Pedro Tedde de Lorca, entitled *El banco de San Carlos, 1782–1829* (Madrid: Banco de España and Alianza Editorial, 1988).

[107]We quote from pp. 284–85 of the excellent reissue of David Hume's work, *Essays: Moral, Political and Literary*, edited by Eugene F. Miller and published by Liberty Fund, Indianapolis 1985; italics added.

the creation of a public bank with these characteristics, he had in mind the success of the Bank of Amsterdam and the example it had already set for over one hundred years. Furthermore the third edition of his *Essays and Treatises on Several Subjects*, published in four volumes in London and Edinburgh, 1753–1754, includes a note by Hume in reference to the phrase, "no bank could be more advantageous, than such a one as locked up all the money it received." Footnote number four contains the following words: "This is the case with the Bank of Amsterdam." It appears that Hume wrote this footnote with the intention of more clearly emphasizing his view that the Bank of Amsterdam was the ideal model for a bank. Hume was not the very first to propose a 100-percent reserve requirement in banking. He was preceded by Jacob Vanderlint (1734) and especially by the director of the Royal mint, Joseph Harris, for whom banks were useful as long as they "issued no bills without an equivalent in real treasure."[108]

SIR JAMES STEUART, ADAM SMITH, AND THE BANK OF AMSTERDAM

Sir James Steuart offers us an important contemporary study of the Bank of Amsterdam's operation in his treatise published in 1767 entitled, *An Enquiry into the Principles of Political Oeconomy: Being an Essay on the Science of Domestic Policy in Free Nations*. In chapter 39 of volume 2, Steuart presents an analysis of the "circulation of coin through the Bank of Amsterdam." He maintains that "every shilling written in the books of the bank is actually locked up, in coin, in the bank repositories." Still, he states,

> Although, by the regulations of the bank, no coin can be issued to any person who demands it in consequence of his credit in bank; yet I have not the least doubt, but *that both the credit written in the books of the bank, and the cash in the repositories which balances it, may suffer alternate augmentations and*

[108]Quoted by Rothbard, *Economic Thought Before Adam Smith,* pp. 332–35 and 462.

> *diminutions, according to the greater or less demand for bank money*.[109]

At any rate, Steuart indicates that the bank's activities "are conducted with the greatest secrecy," in keeping with the traditional lack of openness in banking and especially significant in the case of the Bank of Amsterdam, whose statutes and operation demanded the maintenance of a continuous 100-percent reserve ratio. If Steuart is correct and this ratio was at times violated, it is logical that at the time the Bank of Amsterdam tried to hide the fact at all costs.

Although there are signs that at the end of the 1770s the Bank of Amsterdam began to violate the principles upon which it had been founded, in 1776 Adam Smith still affirmed in his book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, that

> The Bank of Amsterdam professes to lend out no part of what is deposited with it, but, for every guilder for which it gives credit in its books, to keep in its repositories the value of a guilder either in money or bullion. That it keeps in its repositories all the money or bullion for which there are receipts in force, for which it is at all times liable to be called upon, and which, in reality, is continually going from it and returning to it again, cannot well be doubted. . . . At Amsterdam no point of faith is better established than that for every guilder, circulated as bank money, there is a correspondant guilder in gold or silver to be found in the treasure of the bank.[110]

Adam Smith goes on to say that the city itself guaranteed the operation of the Bank of Amsterdam as described above

---

[109]We quote from the original edition, published by A. Miller and T. Cadell in the Strand, London 1767, vol. 2, p. 301; italics added. Prior to Steuart's analysis, we find a more superficial study of the Bank of Amsterdam's operation in the Abbot Ferdinando Galiani's famous book, *Della moneta*. The original edition was published by Giuseppe Raimondi (Naples, 1750), pp. 326–28.

[110]We quote directly from the original edition of Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: W. Strahan and T. Cadell in the Strand, 1776), vol. 2, pp. 72–73.

and that it was under the direction of four burgomasters who changed each year. Each burgomaster visited the vaults, compared their content in cash with deposit entries in the books and with great solemnity declared under oath that the two coincided. Adam Smith remarks, tongue-in-cheek, that "in that sober and religious country oaths are not yet disregarded."[111] He ends his commentary by adding that all of these practices were sufficient to guarantee the absolute safety of deposits in the bank, a fact which was demonstrated in various Dutch political revolutions. No political party was ever able to accuse the prior of disloyalty in the management of the bank. By way of example, Adam Smith mentions that even in 1672, when the king of France marched into Utrecht and Holland was in danger of being conquered by a foreign power, the Bank of Amsterdam satisfied every last request for repayment of demand deposits. As we stated before, this acted as an even more impressive reinforcement of the public's confidence in the absolute solvency of the bank.

As additional evidence that the Bank of Amsterdam maintained a 100-percent reserve ratio, Adam Smith offers the anecdote that some coins removed from the bank appeared to have been damaged in the building fire that struck the bank soon after its creation in 1609, which shows those coins had been kept in the bank for over one hundred fifty years. Finally, Adam Smith, in strict keeping with the true legal nature of the irregular-deposit contract, which requires that it be the depositors who pay the bank, indicates that the bank's income stemmed from safekeeping fees:

> The City of Amsterdam derives a considerable revenue from the bank, besides what may be called the warehouse-rent above mentioned, each person, upon first opening an account with the bank, pays a fee of ten guilders, and for every new account three guilders three stivers; for every transfer two stivers; and if the transfer is for less than three hundred guilders, six stivers, in order to discourage the multiplicity of small transactions.[112]

---

[111]Ibid., p. 73.

[112]Ibid., p. 74.

In addition, Adam Smith refers to other sources of income we have already mentioned, such as the exchange of money and the sale of gold and silver bars.

Unfortunately, in the 1780s the Bank of Amsterdam began to systematically violate the legal principles on which it had been founded, and evidence shows that from the time of the fourth Anglo-Dutch war, the reserve ratio decreased drastically, because the city of Amsterdam demanded the bank loan it a large portion of its deposits to cover growing public expenditures. Hence, deposits at that time amounted to twenty million florins, while there were only four million florins' worth of precious metals in the vaults; which indicates that, not only did the bank violate the essential principle of safekeeping on which it had been founded and its existence based for over one hundred seventy years, but the reserve ratio had been cut from 100 percent to less than 25 percent. This meant the final loss of the Bank of Amsterdam's long-standing reputation: deposits began to gradually decrease at that point, and in 1820 they had dwindled to less than one hundred forty thousand florins.[113] The Bank of Amsterdam was the last bank in history to maintain a 100-percent reserve ratio, and its disappearance marked the end of the last attempts to found banks upon general legal principles. The financial predominance of Amsterdam was replaced by the financial system of the United Kingdom, a much less stable and less solvent system based on the expansion of credit, deposits and paper currency.

The Banks of Sweden and England

The Bank of Amsterdam was a forerunner of the Bank of Stockholm (Riksbank), which began operating in 1656 and was divided into two departments: one responsible for the safekeeping of deposits (using a 100-percent reserve ratio) and modeled after the Bank of Amsterdam; and another devoted to loans. Although the departments supposedly functioned

---

[113]Vilar, *A History of Gold and Money, 1450–1920*, p. 208. On the operation of the Bank of Amsterdam see also Wicksell, *Lectures on Political Economy* vol. 2, pp. 75–76.

separately from one another, in practice they were separate only on paper, and the Bank of Stockholm soon abandoned the standards set by the Dutch bank.[114] The Swedish authorities nationalized it in 1668, making it the first government bank of the modern world.[115] Not only did it violate the traditional principles which guided the Bank of Amsterdam, but it also initiated a new fraudulent and systematic practice: the issuance of banknotes or deposit receipts for a sum higher than actual deposits received in cash. This is how banknotes were born, along with the lucrative practice of issuing them for a higher amount than the total of deposits. Over time, this activity would become the banking practice *par excellence*, especially in the centuries that followed, during which it deceived scholars, who failed to realize that the issuance of banknotes had the same repercussions as artificial credit expansion and deposit creation, two practices which, as A.P. Usher has noted, had been at the core of the banking business from its origins.

The Bank of England was created in 1694 and was also patterned after the Bank of Amsterdam, due to the considerable influence Holland exerted on England following the accession of the House of Orange to the English throne. However, the bank was not constituted with the same legal guarantees of safekeeping as the Bank of Amsterdam. Instead, one of its main aims from the outset was to help finance public expenditures. For this reason, although the Bank of England was intended to stop the commonplace, systematic abuses committed by private bankers and the government,[116] in practice this goal was

---

[114]In this sense, as Kindleberger perceptively points out in *A Financial History of Western Europe*, pp. 52–53, the Riksbank's system of organization was a precursor to the structure which two centuries later the Peel Act (Bank Charter Act) of 1844 assigned the Bank of England.

[115]In celebration of the tercentenary of the Bank of Stockholm in 1968, an endowment was made to fund a yearly Nobel Prize in economics.

[116]For instance, in 1640, Charles I, echoing the policies pursued in Spain a hundred years earlier by his namesake the emperor Charles V, seized the gold and valuables deposited for safekeeping in the Tower of London and in the process completely ruined the reputation of the mint as a safe place for valuables. Thirty-two years later, Charles II also failed in his duty, causing the royal treasury to suspend payments and precipitating

never achieved. In short, the Bank of England eventually failed, despite its privileged role as the government's banker, its monopoly on limited liability in England and its exclusive authorization to issue banknotes. As a result of its systematic neglect of the safekeeping obligation and its practice of granting loans and advances to the Treasury against the bank's deposits, the Bank of England eventually suspended payments in 1797 after various colorful vicissitudes, including the South Sea Bubble.[117] Also in 1797, the same year the Bank of England was forbidden to return deposits in cash, it was declared that taxes and debts were to be paid in bills issued by

---

the bankruptcy of many private banks that had extended loans to the crown or had directly bought treasury bonds with funds from demand deposits. See Kindleberger, *A Financial History of Western Europe*, pp. 53–54.

[117]In 1720 the South Sea Company devised an ambitious plan to take over Britain's national debt for a sum of money. This company emerged from the Tory party, just like the Bank of England, and was intended to help finance the war. In return, the government granted privileges to certain corporations. The actual aim of South Sea Company promoters was to speculate with company stock, to the extent that government debt obligations were accepted in payment for new stocks. During that year the Bank of England extended loans on its own securities to facilitate their acquisition, just as the South Sea Company had done. This set off an inflationary process in which the price of company and bank stock was driven to great heights, generating huge profits. Speculators, including many company officials, took advantage of these benefits. A portion of profits was invested in land, the price of which also rose significantly. All of this speculative and inflationist mania came to an abrupt halt during the summer of 1720, at the same time John Law's network of speculation began to deteriorate in Paris. Once prices began to fall it became virtually impossible to stop their plunge. South Sea Company stock prices plummeted from 775 points in September to 170 in mid-October and Bank of England stocks dropped from 225 points to 135 in just one month. Parliament responded by passing the Bubble Act, which from that time on severely limited the establishment of corporations. However, it was not until 1722, and after much difficult negotiation, that the financial problem was alleviated. That year Parliament approved an agreement between the Bank of England and the South Sea Company, stipulating that the former was to receive four million pounds of the latter's capital through yearly payments of 5 percent, guaranteed by the Treasury.

the bank, and an attempt was made to limit advances and loans to the government.[118] This was the dawn of the modern banking system, based on a fractional-reserve ratio and a central bank as lender of last resort. In chapter 8 we will analyze in detail the reasons central banks were created, their role and theoretical incapability of fulfilling it, as well as the central banking vs. free banking controversy and its influence on the different theories of money, banking and economic cycles. The current chapter would not be complete, however, without a brief reference to the development of banking and paper money in eighteenth-century France.

JOHN LAW AND EIGHTEENTH-CENTURY BANKING IN FRANCE

The history of money and banking in eighteenth-century France is closely linked to the Scottish financier John Law and the "system" he concocted and put into practice there. Law persuaded the French regent, Philippe d'Orleans, that the ideal bank was one that made use of the deposits it received, since this increased the amount of money in circulation and "stimulated" economic growth. Law's system, like economic

---

[118]From this point on many theorists, especially in the United States, proclaimed the great threat posed to individual liberty by an implicit or explicit alliance between bankers and governments. This type of pact was expressed through the continual, systematic granting of privileges to allow banks to violate their legal commitments by suspending the cash repayment of deposits. For example, John Taylor, an American senator from the second half of the eighteenth century, classified this practice as true fraud, stating that "under our mild policy the banks' crimes may possibly be numbered, but no figures can record their punishments, because they are never punished." See John Taylor, *Construction Construed and Constitutions Vindicated* (Richmond, Va.: Shepherd and Polland, 1820; New York: Da Capa Press, 1970), pp. 182–83. Another very interesting piece on this topic is James P. Philbin's article entitled "An Austrian Perspective on Some Leading Jacksonian Monetary Theorists," published in *Journal of Libertarian Studies* 10, no. 1 (Fall, 1991): 83–95, esp. 89. Murray N. Rothbard wrote a magnificent summary of the emergence of fractional-reserve banking in the early United States: "Inflation and the Creation of Paper Money," chapter 26 of *Conceived in Liberty,* vol. 2: "Salutary Neglect": *The American Colonies in the First Half of the 18th Century (*New York: Arlington House, 1975), pp. 123–40; 2nd ed. (Auburn, Ala.: Ludwig von Mises Institute, 1999).

interventionism in general, arose from three different, though interconnected factors. First, disregard for traditional legal and moral principles, particularly the requirement for continual safekeeping of 100 percent of deposited money. Second, a reasoning error that appears to justify violating legal principles to attain seemingly beneficial goals quickly. Third, the fact that there will always be certain agents who view in proposed reforms an opportunity to make huge profits. The combination of these three factors allowed a political dreamer like Law to launch his "banking system" in France at the beginning of the eighteenth century. In fact, once the bank had earned people's trust, it began to issue banknotes far exceeding deposits on hand and to extend loans against deposits. The quantity of bills in circulation increased very rapidly, and as is logical, a significant artificial economic boom resulted. In 1718 the bank was nationalized (becoming the royal bank) and began churning out even more bills and granting more loans. This encouraged stock market speculation in general, and in particular speculative buying and selling of shares of Law's *Compagnie de la Lousiane ou d'Occident* or Mississippi Trading Company, aimed at fostering trade and advancing colonization of this French territory in America. By 1720 the absurd proportions of the financial bubble had become clear. Law tried desperately to stabilize the price of the company's stock and the value of his bank's paper money: the bank and trading company were merged, company stock was declared legal tender, coins lost part of their weight in an attempt to restore their relationship to bills, etc. However, all was in vain and the inflationary bubble burst, bringing financial ruin not only to the bank but also to many French investors who had placed their trust in it and in the trading company. The losses were so heavy and the suffering so immense that for over a hundred years it was even considered a faux pas in France to utter the word "bank," a term which for a time was synonymous with "fraud."[119] The ravages of inflation plagued France again a

[119]A detailed account of Law's notorious bank failure in France by a scholar with first-hand knowledge of the events can be found in the book *Della moneta* by Ferdinando Galiani, pp. 329–34; and in chapter 23 through 35 of volume 2 of *An Enquiry into the Principles of Political*

few decades later, as evidenced by the serious monetary chaos during the revolutionary period and the uncontrolled issuance of *assignats* at that time. All these phenomena made a permanent impression on the collective psyche of the French, who are still aware today of the grave dangers of paper money inflation and preserve the custom of storing considerable amounts of gold coins and ingots. In fact, France, together with India, is one of the countries whose people hold the largest stock of gold on a private basis.

All of the above notwithstanding, and in spite of his ill-fated banking experiment, John Law made some contributions to monetary theory. Although we cannot accept his inflationist and proto-Keynesian views, we must acknowledge, as Carl Menger did, that Law was the first to formulate a sound theory on the spontaneous, evolutionary origins of money.

Richard Cantillon and the Fraudulent Violation of the Irregular-Deposit Contract

It is a remarkable fact that three of the most noted monetary theorists of the eighteenth and early nineteenth centuries were bankers: John Law, Richard Cantillon,[120] and Henry

---

Oeconomy, by Sir James Steuart (pp. 235–91). An enlightening and theoretically solid analysis of the financial, monetary, and banking systems in eighteenth-century France is found in F.A. Hayek's article "First Paper Money in Eighteenth Century France," first published as chapter 10 in the book, *The Trend of Economic Thinking: Essays on Political Economists and Economic History*, vol. 3 of *The Collected Works of F.A. Hayek,* W.W. Bartley III and Stephen Kresge, eds. (Londonand New York: Routledge, 1991), pp. 155–76. The best biography of John Law is by Antoin E. Murphy, *John Law: Economic Theorist and Policy Maker* (Oxford: Clarendon Press), 1997.

[120]Richard Cantillon was the first to maintain that "safe" banking could be conducted with only a 10 percent reserve ratio: "Dans ce premier exemple la caisse d'un Banquier ne fait que la dixième partie de son commerce." See p. 400 of the original edition of *Essai sur la nature du commerce en général*, published anonymously in London, Fletcher Gyles in Holborn, 1755. Incredibly, Murray Rothbard does not mention this in his brilliant study on Cantillon. See Rothbard, *Economic Thought Before Adam Smith*, pp. 345–62.

Thornton. Their banks all failed.[121] Cantillon alone escaped relatively unscathed, not only because he stopped his risky speculation in time, but also (and most importantly) because of the large profits he fraudulently obtained by violating the obligation to safeguard his customers' assets.

Indeed, Cantillon clearly violated the contract of irregular deposit, however in this case the deposit was not of money, but shares of stock in the Mississippi Trading Company, founded by John Law. Cantillon's fraudulent scheme was as follows: he loaned large amounts of money to his customers to allow them to buy shares in the company, on the condition that the stocks act as collateral and remain at Cantillon's bank as an irregular deposit, in this case of fungible and indistinguishable shares. Later Cantillon, *unbeknownst to his clients,* misappropriated the deposited securities, selling them when he thought their market price was high and keeping the money from the sale. Once the shares had lost practically all of their value, Cantillon bought them back for a fraction of their old price and restored deposits, securing a hefty profit. Finally, he demanded repayment of the loans he had initially made to his clients, who were unable to return the money, since the collateral they had at the bank was worth close to nothing. These fraudulent operations led to multiple criminal charges and civil suits against Cantillon, who, upon being arrested and briefly incarcerated, was forced to leave France in a hurry and flee to England.

Cantillon, in defense, put forward the same argument so often used throughout the Middle Ages by writers determined to confuse the irregular deposit with the loan. In fact,

---

[121] Admittedly, Thornton's bank did not fail until after his death, in December 1825. See pp. 34–36 of F. A. Hayek's "Introduction" to Henry Thornton's book *An Inquiry into the Nature and Effects of the Paper Credit of Great Britain*, originally published in 1802 and reissued by Augustus M. Kelley, 1978. A.E. Murphy also notes that Law and Cantillon share the unhappy "distinction" of being the only economists, apart from Antoine de Montchrétien, who were accused of murder and other crimes. See A.E. Murphy, *Richard Cantillon: Entrepreneur and Economist* (Oxford: Clarendon Press, 1986), p. 237. Thornton's religious and puritanical reputation at least protected him from being charged with such atrocities.

Cantillon tried to defend himself by claiming that the stocks deposited with him as unnumbered fungible goods had not actually constituted a true deposit, but a loan implying the full transference of ownership and availability to the banker. Thus, Cantillon considered his operations perfectly "legitimate." Nevertheless, we know his legal argument was unsound and even though the deposit of securities was considered an irregular deposit of fungible goods, the obligation to safeguard the shares and maintain continual possession of all of them remained. Therefore, when Cantillon sold the shares to the detriment of his customers he clearly committed the criminal act of misappropriation. F.A. Hayek explains Cantillon's attempt to justify his fraudulent actions:

> His point of view was, as he later explained, that the shares given to him, since their numbers had not been registered, were not a genuine deposit, but rather—as one would say today—a block deposit so that none of his customers had claim to specific securities. The firm actually made an extraordinary profit in this way, since it could buy back at reduced prices the shares sold at high prices, and meanwhile the capital, for which they were charging high interest, lost nothing at all but rather was saved and invested in pounds. When Cantillon, who had partially made these advances in his own name, asked for repayments of the loans from the speculators, who had suffered great losses, and finally took them to court, the latter demanded that the profits obtained by Cantillon and the firm from their shares be credited against these advances. They in turn took Cantillon to court in London and Paris, charging fraud and usury. By presenting to the courts correspondence between Cantillon and the firm, they averred that the entire transaction was carried out under Cantillon's immediate direction and that he therefore bore personal responsibility.[122]

In the next chapter we will explain that the violation of the irregular deposit of securities is just as corrupt from a legal standpoint as the violation of the irregular deposit of money and gives rise to very similar economic and social evils. A perfect example in the twentieth century was the failure of the

---

[122]See Hayek, "Richard Cantillon (1680–1734)," chapter 13 of *The Trend of Economic Thinking*, pp. 245–93, esp. p. 284.

Bank of Barcelona and of other Catalonian banks that systematically accepted the irregular deposit of securities without keeping full custody of them.[123] Instead, to attain a profit, they used them in all sorts of speculative operations to the detriment of their true owners, just as Cantillon had done two hundred years earlier. Richard Cantillon was brutally murdered at his London home in 1734, after twelve years of litigation, two arrests, and the constant threat of imprisonment. Although the official version was that he was murdered and his body burned beyond recognition by an ex-cook who killed him to rob him, it is also plausible that one of his many creditors instigated the murder, or even, as suggested by A.E. Murphy, his most recent biographer, that Cantillon staged his own death to escape and to avoid more years of lawsuits and legal action against him.[124]

---

[123]On the irregular deposit of securities and the type of misappropriation committed by Cantillon and later Catalonian bankers until the start of the twentieth century, see *La cuenta corriente de efectos o valores de un sector de la banca catalana: su repercusión en el crédito y en la economía, su calificación jurídica en el ámbito del derecho penal, civil y mercantil positivos españoles según los dictámenes emitidos por los letrados señores Rodríguez Sastre, Garrigues, Sánchez Román, Goicoechea, Miñana y Clemente de Diego, seguidos de un estudio sobre la cuenta de efectos y el mercado libre de valores de Barcelona por D. Agustín Peláez, Síndico Presidente de la Bolsa de Madrid* (Madrid: Delgado Sáez, 1936).

IS THIS ONE BOOK TITLE? WHO IS THE AUTHOR?

[124]Antoin E. Murphy, *Richard Cantillon: Entrepreneur and Economist* (Oxford: Clarendon Press, 1986), pp. 209 and 291–97. Murphy mentions the following facts in support of this last thesis: (1) Cantillon liquidated a substantial part of his assets the day prior to his murder; (2) The body was burned beyond recognition; (3) His family displayed a mysterious indifference following the murder; and (4) The accused behaved strangely, never acting like the typical murderer.