

New Light on the Prehistory of the Theory of Banking and the School of Salamanca

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As is known, Murray N. Rothbard was one of the theorists who defended with the most creativity and coherence the need for free banking subject to general legal principles, in other words, banking with a cash ratio of 100 percent of demand deposits. Likewise, he was one of the first theorists to stress the great influence which the theoretical contributions of the Spanish scholastics of the University of Salamanca in the sixteenth and seventeenth centuries were to have as the direct predecessors of the Austrian School of Economics.¹

We feel that perhaps one of the greatest tributes which can be paid to Murray N. Rothbard is to show how the theorists of the School of Salamanca, whose intellectual activity took place from the reign of Carlos V in the sixteenth century onwards, developed an incipient theory on the legitimate practice of banking which coincides, to a great extent, with the contributions on this subject by the Austrian School in general and, particularly, by Murray N. Rothbard.

The analysis of banking during the reign of Carlos V is paradigmatic for several reasons. Firstly, because the massive inflow of precious metals from America caused the economic center of gravity to move, at least temporarily, from the mercantile cities in the north of Italy towards Spain, specifically Seville, and the other Spanish

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¹See Murray N. Rothbard, "New Light on the Prehistory of the Austrian School," Edwin G. Dolan, ed., *The Foundations of Modern Austrian Economics* (Kansas City: Sheed and Ward, 1976), pp. 52–74. I have a letter from F. A. Hayek dated January 7, 1979, in which he states that, apart from Raymond de Roover, the researchers to whom we owe the establishment of the link between the School of Salamanca and the Austrian School are, chronologically, H.M. Robertson, *Aspects of the Rise of Economic Individualism* (Cambridge: Cambridge at the University Press, 1933); Marjorie Grice-Hutchinson, *The School of Salamanca* (Oxford: Clarendon Press, 1952); and, especially, Murray N. Rothbard in his above mentioned article.

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markets. Secondly, because Carlos V's constant need for cash, which was the result of his extravagant imperial policy, led him to continually finance his exploits through the banking system, taking advantage of the liquidity which it provided him without any scruples. The traditional complicity between bankers and governors which, although there was some degree of dissimulation, had already become a general rule was thus taken to its utmost limit by Carlos V. Moreover, he could not avoid the bankruptcy of the royal treasury which, logically, had pernicious consequences for the Spanish economy in general and, in particular, for the bankers who had financed him. All these events led the sharpest minds of the era, the theorists of the School of Salamanca, to begin to reflect on financial and banking activities and, as a result, we have a series of enormously valuable theoretical analyses which should be studied in detail. We analyze each of these aspects below.

The Development of the Banks in Seville

Thanks to the work of Ramón Carande,² we know about the development of private banking in Seville during the reign of Carlos V in some detail. Carande explains that he was able to carry out his research as a result of the list of bankers drawn up in relation to the confiscation of precious metals by the *Casa de Contratación* (Trade House) of Seville in 1545. The unsatisfactory situation of the treasury meant that Carlos V, violating the most elementary legal principles, resorted to appropriating money from where it was most readily available: deposits in the safes of the bankers of Seville. It is true that these bankers, as we will see later, also violated legal principles in relation to the demand-deposit contract (i.e., deposit of fungible money) and used a large part of the deposits received for their own business. However, it is no less true that the inauspicious imperial policy, by transgressing the most elementary principles of property rights and directly confiscating the stocks of money kept in the vaults, merely provided an even bigger incentive for the bankers to invest the greater part of the deposits received in loans, which became a habitual practice: if, in the final analysis, there was no guarantee that the public authorities would respect the part of the cash reserve which was kept in the bank (and experience showed that, when times were difficult, the Emperor did not hesitate to confiscate this reserve and substitute it by compulsory loans to the Crown), it was preferable to devote the greater part of the deposits to loans to private industry and commerce, thus avoiding expropriation and obtaining a greater profitability.

²Ramón Carande, *Carlos V y sus Banqueros*, 3 vols. (Barcelona and Madrid: Editorial Crítica, 1987).

In any case, this policy of confiscation is perhaps the most extreme manifestation of the public authorities' traditional policy of taking advantage of illegitimate banking profits by expropriating the assets of those who, by legal obligation, should best guard and preserve the deposits of third parties. It is understandable, therefore, that the governors, as the main beneficiaries of the bankers' illegitimate activity, ended up justifying it and granting it all kinds of privileges so that it could continue to act, with a fractional-cash ratio, outside the framework of general legal principles.

In his *magnum opus*, *Carlos V y sus Banqueros* ("Carlos V and his Bankers"), Ramón Carande lists the most important bankers in the Seville of Carlos V, specifically the Espinosas, Domingo de Lizarrazas and Pedro de Morga, together with other, less important, bankers, such as Cristóbal Francisquín, Diego Martínez, Juan Íñiguez and Octavio de Negrón. All of them inexorably became bankrupt, basically due to having insufficient liquidity to meet the withdrawal of demand deposits which had been placed with them. This shows that they worked with a fractional-cash ratio, thanks to the license or privilege which they had obtained from the Municipality of Seville and from Carlos V himself. We have no information on the percentage of reserves they held, but we do know that, on many occasions, they invested in their own shipping businesses (fleets which traded with America) and the collection of taxes which were a tremendous temptation because, if the conditions were favorable, the profits were very significant. Moreover, the successive confiscations of precious metals deposited with the bankers merely provided a greater incentive for their illegitimate behavior. Thus, the Espinosas went bankrupt in 1579 and the main partners were imprisoned. The bankruptcy of Domingo de Lizarrazas occurred on March 11, 1553, when he could not meet a payment of more than six and a half million maravedis. Pedro de Morga, who began operations in 1553, went bankrupt in 1575, during the second bankruptcy of King Felipe II. The rest of the less important bankers met the same fate and, in this respect, it is interesting to note the presence and comment of Thomas Gresham, who travelled to Seville with instructions to withdraw three hundred and twenty thousand ducats in cash, for which he had obtained the necessary license from the Emperor and from Queen María. Gresham was astounded to find that, in the city which received the treasures of the Indies, money was very scarce, as it was in the trade markets, and he feared that, upon withdrawal of the funds to which the orders he was bearing referred, all the banks of the city would suspend payments.³ It is regrettable that Ramón

³Finally, with a great deal of effort, he managed to obtain two hundred thousand ducats but, as he wrote, "I am afraid of causing the bankruptcy of all the banks of Seville."

Carande's theoretical analysis leaves so much to be desired and that his study interpreting the bankruptcy of these banks is based solely on anecdotal "explanations," such as "greed" for metals, which constantly placed the solvency of the bankers in a situation of crisis; the fact that the bankers carried out risky personal business deals, which continually implied heavy obligations (the chartering of vessels, overseas maritime trade, insurance transactions, various speculative types of business, etc.); and the royal treasury's repeated confiscations and need for liquidity. Nowhere is the true cause of the phenomenon mentioned: the inevitable recession and economic crisis resulting from the artificial boom caused by the inflation of precious metals from America and the artificial credit expansion without an adequate base of real saving, derived from the practice of banking with a fractional-cash ratio.

Fortunately, Carlo M. Cipolla has covered this gap in theory of Ramón Carande, at least partially, and has made a study interpreting the banking and economic crisis of the second half of the sixteenth century which, although it refers strictly to the Italian banks, is also directly applicable to the Spanish financial system, as the trading and financial circuits and flows between the two nations were, at that time, intimately related.⁴ Cipolla explains that the monetary supply (what is today called M1 or M2) in the second half of the sixteenth century included a large amount of "bank money" or deposits created out of nowhere by the bankers who did not keep a 100-percent-reserve ratio of the cash which had been deposited with them at demand by their clients. This led to a tremendous artificial thriving of the economy, which inevitably reversed in the second half of the sixteenth century when depositors began to experience economic difficulties and the wave of bankruptcies felt by the most important bankers in Florence began.

This expansionary phase was started in Italy, according to Cipolla, by the managers of the Ricci Bank, who used a significant part of the bank's newly created deposits to purchase public funds and grant credits. This policy of credit expansion dragged the other private banks along with it, if they wanted to be competitive and maintain their profits and market share. A state of credit euphoria was thus created, which gave rise to a great artificial expansion that soon began to revert. Thus, we

See Ramón Carande, *Carlos V y sus Banqueros*, vol.1, pp. 299–23, and esp. pp. 315–16, which deals with Gresham's visit to Seville.

⁴See Carlo M. Cipolla's important article "La moneta in Florencia en el Siglo XVI," published in *El Gobierno y la Moneda: Ensayos de Historia Monetaria* (Barcelona: Editorial Critica, 1994), pp. 11–142; esp. pp. 96 onwards. This book is the Spanish edition of the work originally published in Italian with the title *Il Governo della Moneta: La Moneta a Firenze nel Cinquecento* (Bologna: Società editrice Il Mulino, 1990).

can read an edict of 1574 in which accusations are made against bankers who refuse to return deposits in cash and which proclaims the fact that they only "paid with ink." They had increasing difficulties in returning deposits in ready money and a significant money shortage began to be perceived in the Venetian cities. The artisans could not withdraw their money or pay their debts and there was a heavy credit contraction (in other words, a deflation) and a deep economic crisis, which Cipolla analyzes in detail in his brilliant book. Cipolla's analysis is, therefore, much more solid from a theoretical point of view than that of Ramón Carande, although it cannot be considered perfect, as it places the emphasis more on the crisis and the period of credit contraction than on the preceding phase of artificial credit expansion, which was the true origin of the evils and of which, in turn, the most intimate cause of the bankers' violation of the obligation to guard and conserve intact 100 percent of the *tantundem* or equivalent of the original deposits.⁵

The School of Salamanca and the Banking Business: The Initial Contribution of Doctor Saravia de la Calle

The financial and banking phenomena that we are discussing made an impression on the outstanding minds of the members of the School of Salamanca who, according to the most reliable research, are the forerunners of the subjectivist conception developed by the Austrian School of Economics.⁶

⁵Cipolla tells us how the Ricci Bank, from the seventies onwards, was not able to meet the demand for payments in cash and, *de facto*, suspended payments, as it paid simply "with ink" or "with bank policies." The authorities of Florence, looking only at the symptoms and trying, with typical good intentions, to resolve this worrying situation merely by decrees, imposed on bankers the obligation to pay their creditors in cash without any delay, but did not attack the fundamental causes of the phenomenon (the undue appropriation of the deposits as loans and failure to hold a 100-percent-cash ratio). This meant that the successive decrees issued met with inevitable failure and the crisis became gradually more serious until it broke out with its full virulence in the mid-1570s. *Ibid.*, pp. 102–3.

⁶Among others, the following have recently studied the contribution of the Spanish scholastics to economic theory: Lucas Beltrán in "Sobre los orígenes hispanos de la economía de mercado," *Cuadernos del Pensamiento Liberal* 10, no.1 (1989): 5–38; Marjorie Grice-Hutchinson, *Economic Thought in Spain: Selected Essays of Marjorie Grice-Hutchinson*, Laurence S. Moss and Christopher K. Ryan, eds. (Aldershot, England: Edward Elgar, 1993); Jesús Huerta de Soto, "Génesis, esencia y evolución de la Escuela Austriaca de Economía," *Estudios de Economía Política* (Madrid: Unión Editorial, 1994), pp. 17–55; and esp. and most recently Murray N. Rothbard, *Economic Thought before Adam Smith: An Austrian Perspective on the History of Economic Thought*, vol. 1 (Aldershot, England: Edward Elgar, 1995), pp. 101–27. The intellectual influence of the Spanish theorists of the School of Salamanca on the Austrian School is not, however, a pure coincidence or a mere whim of history. It originates from and exists because of the intimate historical, political and cultural relations which, as from the reigns of Carlos V and his brother Fernando I, arose between Spain and Austria and which were to continue for several centuries. In addition, Italy also played an important role in these relations, acting as an authentic cultural, economic and financial bridge over which the relations between

Chronologically, the first work we should mention, which is also, perhaps, the most relevant to our purpose, is *Instrucción de Mercaderes* ("Instruction of Merchants") by Doctor Saravia de la Calle, which was published in Medina del Campo in 1544.⁷ Saravia de la Calle is extraordinarily hard on the bankers, whom he describes as "hungry gluttons, who swallow everything, destroy everything, confuse everything, steal and dirty everything, like the harpies of Pineo."⁸ He tells us how the bankers "come out into the square and road with their table and chair and cashbox and book, like the whores to the brothel with their chair" and, having obtained the corresponding license and guarantee ordered by the laws of the kingdom, they devote themselves to obtaining deposits from the clients, to whom they offer bookkeeping and cashier services, paying into their account and even paying interest on such deposits.

With sound legal criteria, Saravia de la Calle says that receiving interest is incompatible with the nature of a demand deposit and that, in any case, a fee should be paid to the banker for keeping or guarding the money under his custody. He even reprehends harshly the clients of the banks who agree to enter into such deals with the bankers. He states: "And if you say, merchant, that you do not lend it, but that you place it (or deposit it), that is a greater mockery; who ever saw the deposi-tary pay? He is usually paid for the safekeeping and the work of the deposit; much more than that, if you now place your money with the moneylender as a loan or as a deposit, in the same way as you take your part of the profit that the moneylender takes, you also take part of the blame, and even the greatest part."⁹ In Chapter 12 of his book, Saravia de la Calle also correctly distinguishes between the two radically different transactions which the banks carry out. On the one hand, the demand deposits, which the clients give, without any interest, to the bankers "to have them safer and to have them more at hand in order to deliver them to whom they are owed, and to free themselves from the burden and the work of reckoning and safekeeping, and also because, as thanks for this good deed which they do to the moneylenders in giving them their money, if it occurs that they have no money in the hands of the moneylender, the

the two furthest points of the Empire (Spain and Vienna) flowed. In this respect, Jean Berenguer's interesting book *El Imperio de los Habsburgos* (Barcelona: Editorial Crítica, 1993), should be consulted, particularly pp. 133–35. This book is the Spanish edition of the French original which was entitled *Histoire de L'empire des Habsbourg 1273–1918* (Paris: Librairie Arthème, Fayard, 1990).

⁷Luis Saravia de la Calle, *Instrucción de Mercaderes* (Medina del Campo: Pedro de Castro, 1544); republished in *Colección de Joyas Bibliográficas* (Madrid, 1949).

⁸Ibid., p. 180.

⁹Ibid., p. 181.

moneylender accepts some overdrafts from them also without interest.”¹⁰ On the other hand, very different from these contracts are the term “deposits,” which are true loans and are characterized because they are given over a time period in exchange for interest. Saravia de la Calle, following the traditional canon law doctrine, deeply condemns this practice. Moreover, he clearly indicates that, in the case of the first type of demand-deposit contracts, the clients should pay the banker “because if they place monies in deposit, they must give for their safekeeping, not receive the profits given to them when they deposit monies or goods which must be safely kept.”¹¹ Saravia de la Calle therefore criticizes those clients who selfishly try to take advantage of the illegitimate activity of the bankers, entrusting them with their money in demand deposits and trying to obtain interest on it. He adds the following illustrative words: “he is not free from sin, at least venial sin, because he entrusted the deposit of his money to whom he knows will not keep his deposit, but will spend his money, like he who entrusts the maiden to the lecher or the delicacy to the glutton.”¹² Neither may the depositor clear his conscience by thinking that the banker will lend or use the money of others, but not his own as if “it is believed of him that he will probably keep that money of the deposit and will not lend it; and this probability cannot be thought of any of these moneylenders, but the contrary, that he will immediately lend it and deal and obtain earnings with it, because how can those who give 7 and 10 percent to those who give them monies leave the monies which are thus placed with them in deposit idle? And even if it were very certain that you do not sin (which it is not, but the contrary), it is very sure that the moneylender sins lending your monies, and that he steals the patrimony of your neighbors with your money.”¹³ The doctrine of Saravia de la Calle is, therefore, quite clear: the use of money that is deposited at demand with the bankers, which in their own interest grant loans, is illegitimate and implies a grave sin. This doctrine fully coincides with the doctrine which was established by the classical authors on Roman Law and arises naturally from the essence, purpose and legal nature of the contract for the demand deposit of money.¹⁴

Saravia de la Calle is also very emphatic when talking about the enormous profits that the bankers receive from their illegitimate behavior of appropriating the deposits of their depositors, instead of being

¹⁰Ibid., p. 195.

¹¹Ibid., p. 196.

¹²Ibid., p. 197.

¹³Ibid.

¹⁴See Jesús Huerta de Soto, “A Critical Analysis of Central Banks and Fractional-Reserve Free Banking from the Austrian School Perspective,” *Review of Austrian Economics* 8, no. 2 (1995): 25–38, esp. pp. 29–30 n. 6.

content with the lesser remuneration which they would receive for the simple safekeeping or custodial oversight of the deposits, like good fathers of families. Let us see how vividly he expresses this: "And if you receive wages, they should be moderate, for you to support yourselves, and not such excessive robberies that you build superb houses and purchase rich property, have excessive costs of family and servants, and hold great banquets and dress in such a costly fashion, especially when you were poor when you began to lend and left poor trades."¹⁵ Saravia de la Calle indicates how the bankers have a great tendency to become bankrupt, even making a brief theoretical analysis which shows that, after the expansionary phase resulting from the artificial expansion of the credits which these *logreros* ("moneylenders") grant, there inevitably comes a phase of recession in which the bad debts cause a chain of bankruptcies among the banks. And he adds that, "if the merchant does not pay the moneylender, it makes him bankrupt, and thus he suspends payments and all is lost, of all which, as is notorious, these moneylenders are the beginning, occasion and cause, *because if they did not exist, each person would trade with his money as he could and no more, and thus things would cost their just price and more than the price in cash would not be charged.* And, therefore, it would be a great advantage if the princes did not consent to them in Spain, as no other nation in the world consents to them, and banished them from their court and kingdom."¹⁶ As we know, it is not true that the governors of other nations had had more success in controlling the activity of the bankers or lenders than in Spain, as more or less the same was occurring everywhere and the kings ended up by granting privileges for the bankers to carry on their activities using the money of their depositors for their own interest, in return for also being able to take full or partial advantage of a banking system from which they obtained funds much more easily and rapidly than from taxes.

As a conclusion to his analysis, Saravia de la Calle states that "under no circumstance should the Christian give his monies to these lenders because, if he sins in giving them, as he always sins, he should cease it because it is his own sin; and if he does not sin, he should cease it in order to avoid the sin of the moneylender." Moreover, Saravia de la Calle adds that, if the bankers are not used, there will be the additional advantage that the depositors "will not be startled if the lender suspends payments; if he becomes bankrupt, as we see so commonly and our Lord God permits, they and their owners will be lost like an ill-gained thing."¹⁷ As we can see, Saravia de la Calle's analysis, in

¹⁵Saravia de la Calle, *Instrucción de Mercaderes*, p. 186.

¹⁶*Ibid.*, p. 190; emphasis added.

¹⁷*Ibid.*, p. 198.

addition to its ingenuity and humor, is impeccable and has no contradictions, except, perhaps, that it puts too much emphasis on the criticism of the bankers for charging interest, which violated the canonical prohibition of usury, rather than for their undue appropriation of the demand deposits placed with them by their clients.

Martín de Azpilcueta Navarro

Another writer who made a correct analysis of the contract for the demand deposit of money is Martín de Azpilcueta, better known as “Doctor Navarro,” in his book *Comentario Resolutorio de Cambios* (*Resolatory Commentary on Exchanges*), first published in Salamanca at the end of 1556. Martín de Azpilcueta expressly refers to “banking for safekeeping,” which is the monetary demand-deposit transaction performed by the banks. For Martín de Azpilcueta, banking for safekeeping or the demand-deposit contract is completely fair and consists of the banker being the “warden, depositary and guarantor of the monies, which those who give him or send to him give to him or bank with him for what may be necessary; and that he is obliged to pay to the merchants, or to the persons whom the depositors wish in such or such a way, for which he may licitly take his fair wage, either from the republic or from the depositors; because this trade and duty is useful to the republic and does not contain any iniquity, as it is fair that he who works earns his wage. And the banker works in receiving, holding in deposit and ready the money of so many merchants, and in writing, giving and keeping accounts with all of them, with great difficulty, and sometimes danger of errors in reckoning and other things. The same could be done with a contract with which a person committed himself to the others to receive and hold their money in deposit, give, pay and keep the accounts of all of them, as they tell him, etc., because this contract is of hire to another and from another of his works and employment, which is a designated, just and holy contract.”¹⁸ As we can see, for Martín de Azpilcueta, the contract of a demand deposit is a fully legitimate contract, which consists of entrusting the safekeeping, custody or deposit of money to a professional, the banker, who should care for it like the good father of a family, always keeping it at the depositor’s disposal and performing the cashier services requested by the latter on his behalf. In return, he will have the right to receive the appropriate remuneration of

¹⁸Martín de Azpilcueta, *Comentario Resolutorio de Cambios* (Madrid: Consejo Superior de Investigaciones Científicas, 1965), pp. 57–58. When studying the position of Doctor Navarro, I have worked with the first Spanish edition published by Andrés de Portonarijs in Salamanca in 1556, and also with the first Portuguese edition published by Ioam de Barreyra in Coimbra in 1560 with the title *Comentario Resolutorio de Onzenas*. The quotes contained in the main text appear in the Portuguese edition on pp. 77–80, and on pp. 74–75 of the first Spanish edition.

his services from the depositors. In effect, for Martín de Azpilcueta, *the depositors should pay the depositary or banker*, never *vice versa*, so that the depositors “pay the former for the work and care of the banker in receiving and keeping their money and doing his work” and, therefore, the bankers should perform “their trade cleanly and be content with a just wage, receiving it from those who owe it to them and whose money they safeguard and accounts they keep and not from those who do not owe it to them.”¹⁹ Moreover, in order to avoid confusion and make things perfectly clear, Martín de Azpilcueta, along the same lines as Doctor Saravia de la Calle which we have seen above, expressly condemns the clients who do not wish to pay for the services of custody of their deposits or even try to receive interest on them. Thus, Doctor Navarro concludes that “in this type of exchange, not only the bankers sin, but, even . . . those who give them monies for them to keep, and do the same. And afterwards they do not want to pay them anything, saying that that which they earn with their money, and will receive from those to whom they pay in cash, suffices for their wages. And if the bankers ask them for anything, they leave them and go to deal with others, and so that they do not leave them, the bankers renounce the wage owed to them and take it from who does not owe it.”²⁰

The Contribution of Tomás de Mercado

Tomás de Mercado, in his *Suma de Tratos y Contratos* (“Compilation of Deals and Contracts”), Seville, 1571, makes an analysis of the banking business which follows a very similar line to the two above authors. Firstly, he points out, following the correct doctrine, that the depositors should pay the bankers for the work of keeping their monetary demand deposits, concluding that “for all of them it is a common and general rule to be able to take wages from those who place money in their bank, either a certain amount each year or a certain amount for each thousand, as they serve them and keep their patrimony.”²¹ However, Tomás de Mercado ironically mentions that the bankers of Seville are so “generous” that they do not make any charge for the custody of the deposits, using the following words: “those of this city, it is true, are so regal and noble that they do not ask for or take any wage.”

¹⁹Ibid., pp. 60–61.

²⁰Ibid., p. 61.

²¹I quote the edition by the Instituto de Estudios Fiscales published in Madrid in 1977, edited and introduction by Nicolás Sánchez Albornoz, vol. 2, chap. 16, p. 479. There is another edition, by Restituto Sierra Bravo, published by the Editora Nacional in 1975, which includes the quote given in the main text on p. 401. The original edition was published in Seville in 1571 “en casa de Hernando Díez Impresor de Libros, en la calle de la Sierpe.”

And Tomás de Mercado remarks that the bankers of Seville do not need to charge anything as, with the large amount of money they obtain from the deposits, they carry out their private businesses, which are very lucrative. We should stress the fact that, in our opinion, the analysis made by Tomás de Mercado in this respect refers simply to an observation of a fact, and does not imply any acceptance of its legitimacy, as several modern critics appear to suggest. To the contrary, following the purest, classical-Roman doctrine and the essence of the legal nature of the contract for the demand deposit of money, Tomás de Mercado is the scholastic writer who most clearly shows that the transfer of property which occurs in the monetary bank deposit does not imply a parallel transfer of availability and, therefore, for practical purposes, a *full* transfer of property does not take place. Let us see how clearly he expresses this: “[the bankers] must understand that the money is not theirs but belongs to someone else, and that is not all, when they have it serve them, it ceases to serve its owner.” Tomás de Mercado adds that the bankers should be subject to two basic principles, the first, “not to leave the bank so bare that they cannot then pay the drafts which come, because, if they make it impossible to pay them, spending and employing money in investments and speculative earnings or other deals, it is certain that they sin . . . The second: they should not enter dangerous businesses, because they sin, even if they result favorably, due to the danger of behaving wrongly and doing grave damage to those who trusted them.”²²

Although it is true that, with these recommendations, it seems as if Tomás de Mercado would admit the use of a certain fractional-reserve ratio, the fact is that he is very forthright in expressing his legal opinion that, in the final analysis, the money of the deposits does not belong to the bankers but to the depositors and when he says, moreover, that no banker heeds his two recommendations: “but in the case of earning, when it is comfortable, it is very difficult to restrain avarice, none of them heeds these two warnings, nor meets these conditions.”²³ Therefore, he considers very favorably the enactment of a rule prohibiting the bankers from doing private business, in order to remove the temptation implied by financing them indefinitely with the money obtained from demand deposits.

In addition, elsewhere in *Suma de Tratos y Contratos*, at the end of chapter 4, Tomás de Mercado tells us that the bankers of Seville act as depositaries for the money and precious metals of the merchants from

²²Tomás de Mercado, *Suma de Tratos y Contratos*, vol. 2, p. 480 of the edition of Instituto de Estudios Fiscales and p. 401 of the edition of Restituto Sierra Bravo.

²³*Ibid.*, p. 480.

the fleet of the Indies and that, with such substantial deposits “they make great investments” and obtain lucrative profits, now without expressly condemning this type of activity, although it is true that the passage in question is a description of a state of affairs rather than an analysis of the legitimacy of the situation. This analysis is made in much more depth in chapter 16, which we have discussed above. Tomás de Mercado concludes, moreover, that the bankers “also become involved in giving and taking in exchange and in collecting, and a banker in this republic covers a whole world and embraces more than the ocean, although sometimes he leaves so many loose ends that everything goes to ruin.”²⁴

The Cases of Domingo de Soto, Luis de Molina and Juan de Lugo

The scholastics who are most confused on the doctrinal treatment of the contract for the monetary bank deposit are Domingo de Soto and, above all, Luis de Molina and Juan de Lugo. In fact, these theorists allowed themselves to be influenced by the wrong medieval tradition of the glossators and, especially, by the doctrinal confusion which developed due to the concept of *depositum confessatum*. This was simply a loan which was disguised as a deposit in order to evade the canonical prohibition on charging interest, as this practice was considered acceptable if there was a (fictitious) delay on the part of the depository. In fact, de Soto and, above all, Molina wrongly considered that the demand deposit was merely a “loan” which transferred not only the property, but also the full availability of the deposits to the banker and, therefore, it could be considered legitimate to use them as loans, provided that these were made “prudently.” It may be implied that Domingo de Soto was the first to uphold this thesis, although very indirectly. In fact, in Book VI, Question XI of his work on *De Iustitia et Iure* (*On Justice and Law*) (1556), we can read that, among the bankers, there was “the custom, it is said, that if a merchant makes a bank deposit in cash, as a result thereof the banker answers for a higher amount. I delivered ten thousand to the moneychanger, then he will answer for me for 12, perhaps 15; because it is very good earning for the banker to have money in cash. Neither is any vice found therein.”²⁵ Another case of typical credit creation which seems to be

²⁴This is the quote from Mercado that Ramón Carande includes in Vol. 1 of *Carlos V y sus Banqueros* in the introduction to his analysis of the bankers of Seville and the crisis which led them all into bankruptcy. See Tomás de Mercado, *Suma de Tratos y Contratos*, vol. 2, pp. 381–82 of the 1977 edition by Instituto de Estudios Fiscales and p. 321 of the edition by Restituto Sierra Bravo.

²⁵According to Restituto Sierra Bravo, *El Pensamiento Social y Económico de la Escolástica*, vol. 1 (Madrid: Consejo Superior de Investigaciones Científicas, 1975), p. 215, this phrase of Domingo de Soto implies his acceptance of the banking business with a fractional-reserve ratio.

admitted by Domingo de Soto is that of a loan in the form of the discount of bills financed against the demand deposits of the clients.

But perhaps the member of the School of Salamanca who upheld the most erroneous doctrine in relation to the contract for the demand deposit of money made by the bankers was Luis de Molina.²⁶ In fact, Luis de Molina, in his *Tratado sobre los Cambios* ("Treatise on Exchanges"), upholds the medieval doctrine that the demand deposit is merely a "loan" contract in favor of the banker, which transfers not only the property, but also the full availability of the thing and, therefore, the banker can legitimately use it in his own interest, in the form of loans or in any other way. Let us see how he expresses his argument: "because these bankers, like all the rest, are the true owners of the money which is deposited in their banks, in which they are greatly differentiated from the other depositaries . . . in such a way that they receive it as a loan with no rights attached and, therefore, at their own risk"; and, elsewhere, further on, he again repeats that "such a deposit is really a loan, as has been said, and the property of the money deposited passes to the banker and, therefore, in the event that it perishes, it perishes for the banker."²⁷ This doctrinal position is a clear lapse and contradicts what the writer himself says in his other work, *Tratado sobre los Préstamos y la Usura* ("Treatise on Loans and Usury"), where he warns that the *term* is an essential element of any loan contract and that, if the time for which a loan may be held is not expressly stated (as happens in a demand deposit) and no date has been fixed for its repayment, "it will be necessary to abide by what the judge judges as to the time for which it may be held."²⁸ In addition, Luis de Molina ignores the fact that the nature and legal essence of the demand deposit contract has nothing to do with the loan contract and, therefore, his doctrine which tries to identify the one with the other is a clear regression, not only in relation to the much more coherent positions of Saravia de la Calle and Azpilcueta Navarro, but also in relation to the true legal nature of the contract as it had been developed by the old Roman legal tradition. It is, therefore, surprising that so clear and profound a mind as that of Luis de Molina did

²⁶It is very significant that various authors, among them Marjorie Grice-Hutchinson, are in doubt as to whether Luis de Molina should be included among the theorists of the 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.

²⁷Luis de Molina, *Tratado sobre los Cambios*, edition and introduction by Francisco Gómez Camacho (Madrid: Instituto de Estudios Fiscales, 1990), pp. 137–40.

²⁸*Ibid.*, p. 13.

not realize how extremely dangerous it was to accept the violation of the general legal principles on the bank deposit and to say that "it never occurs that all the depositors need their money in such a way that they do not leave many thousands of ducats in deposit with which the bankers may do business to obtain profits or losses."²⁹ Molina did not realize that not only the objective or essential purpose of the contract, which is the safekeeping and custody of money, is thus violated, but that all kinds of illicit businesses and abuses are encouraged, which inexorably generate an economic recession and bankruptcy of the bankers. If the traditional legal principle which requires the continual safekeeping of 100 percent of the *tantundem* in favor of the depositor is not met, there is no clear guideline for avoiding bankruptcy of the bankers. And it is evident that such superficial and vague suggestions as to "try to act with prudence" or "not get involved in dangerous business" are insufficient to avoid the very prejudicial economic and social effects of fractional-reserve banking. However, Luis de Molina does at least take the trouble to point out that "a warning should be given that (the bankers) are in mortal sin if they commit the money they hold in deposit in their businesses to such an extent that they then find themselves unable to deliver, at the appropriate moment, the amounts which the depositors request or order to be paid against the money which they hold in deposit . . . Likewise, they are in mortal sin if they engage in such businesses that they are in danger of reaching a situation in which they cannot pay the deposits. For example, if they send so much merchandise overseas that, if the ship is wrecked, or if it is captured by pirates, it is not possible for them to pay the deposits, even if they sell their patrimony. *And not only are they in mortal sin when the business ends badly, but even if the outcome is favorable. And this is due to the danger to which they expose themselves of causing damage to the depositors and guarantors which they themselves contributed for the deposits.*"³⁰ We consider this warning by Luis de Molina to be commendable, but we also consider it extraordinary that, it seems, he did not realize that it is, in the final analysis, intimately contradictory to his express acceptance of fractional-reserve banking, provided that the bankers practice it with "prudence." And it does not matter how prudent the bankers are, the only way to avoid risks and to guarantee that the depositors' money is always at their disposal is by maintaining a cash ratio of 100 percent of all the demand deposits received.

²⁹Ibid., p. 137.

³⁰Ibid., pp. 138–39; emphasis added.

After Molina, the only author who upheld an analogous position on banking is Juan de Lugo,³¹ also a Jesuit. In our opinion, this can lead us to consider that, in relation to banking, there were two schools of thought within the School of Salamanca: one, well-founded and doctrinally correct (close to the future “currency school”), to which Saravia de la Calle, Azpilcueta Navarro and Tomás de Mercado belonged; and another, more inclined towards the capriciousness of the inflationist doctrine and the fractional reserve (close to the future “banking school”), represented by Luis de Molina, Juan de Lugo and, to a much less extent, Domingo de Soto. We will study these two points of view in more detail in the next section.

The School of Salamanca: Banking and Currency View

The contributions of the theorists of the School of Salamanca in the monetary field are important and have been the subject of detailed studies.³²

The first scholastic treatise which dealt with money was written by Diego de Covarrubias y Leyva and published in 1550 under the title *Veterum Collatio Numismatum* (“Compilation on old moneys”). In this work, the famous Bishop of Segovia studied the history of the devaluation of the Castilian maravedi and compiled a large number of statistics on the evolution of prices. Although the essential ideas of the quantity theory of money are already implicit in Covarrubias’ treatise, he does not put forward an explicitly articulated monetary theory.³³ Some years were to pass before, in 1556, Azpilcueta Navarro expressed, for the first time, clearly and convincingly that the increase in prices, if one prefers, the decrease in the purchasing power of money, was the result of the increase in the monetary supply which was taking place in Castile as a result of the massive inflow of precious metals from America.

³¹R.P. Joannis de Lugo Hispalensis, S.I., *Disputationum de Iustitia et Iure, Tomus Secundus* (Lugduni, 1642), Disp. 28, Sec. 5, pp. 406–7. I would like to thank the Jesuit Father Prof. Enrique M. Ureña and the Dominican Father Rodrigo T. Hidalgo who provided me with different copies of de Lugo’s original book.

³²See, above all, the doctoral thesis which Marjorie Grice-Hutchinson published under the direction of F.A. Hayek with the title of *The School of Salamanca: Readings in Spanish Monetary Theory, 1544–1605*; Murray N. Rothbard, “New Light on the Prehistory of the Austrian School,” pp. 52–74; Alejandro A. Chafuen, *Christians for Freedom: Late-Scholastic Economics* (San Francisco: Ignatius Press, 1986), pp. 74–86; and Murray N. Rothbard, *Economic Thought before Adam Smith: An Austrian Perspective on the History of Economic Thought*, vol. 1, pp. 101–27.

³³The edition which I have used is the *Omnia Opera*, published in Venice in 1604, which includes the treatise on money by Diego de Covarrubias in vol. 1, under the full title of *Veterum Collatio Numismatum, cum his, quae modo expenduntur, publica, et Regia auctoritate perpensa*, pp. 669–710. This work by Diego de Covarrubias is often quoted by Davanzati and, at least once, in chap. 2 of Galiani’s famous *Della Moneta*, written in 1750. Also, and most significantly, it is quoted by Carl Menger, *Grundsätze der Volkswirtschaftslehre* (Vienna: Wilhelm Braumüller, 1871), p. 257; English edition, *Principles of Economics* (New York and London: New York University Press, 1981), p. 317.

In fact, the relationship between the amount of money in circulation and prices is impeccably expressed by Martín de Azpilcueta, for whom "in the lands where there is a great shortage of money, all the other things which may be sold, even the labor and work of men, are given for less money than in places where there is an abundance; as can be seen from experience, in France, where there is less money than in Spain, bread, wine, clothing, labor and work cost much less; and even in Spain, at the time when there was less money, the things which could be sold and the labor and work of men were given for much less than after the Indies were discovered and covered her with gold and silver. *The cause of which is that money is worth more where and when it is lacking than where and when it is in abundance.*"³⁴

However, in contrast to the deep and detailed studies which have been made of the monetary theory of the School of Salamanca, up to now there has been practically no effort to analyze the position of the scholastics in relation to banking.³⁵ And nevertheless, as we have seen in preceding sections, the theorists of the School of Salamanca made a very acute analysis of banking practices and, to a great extent, were the forerunners of the opposing positions which, more than two centuries later, were reproduced in England in the controversy between the members of the *banking school* and those of the *currency school*.

In fact, we have already set out the profoundly critical treatment of fractional-reserve banking which we owe, mainly, to Doctor Saravia de la Calle and which is included in the final chapters of his *Instrucción de Mercaderes*. Martín de Azpilcueta and Tomás de Mercado also developed a rigorous and very demanding critical analysis of banking activities which, although it did not reach the degree of criticism of Saravia de la Calle, included an impeccable treatment of the demands which, in accordance with justice, should be observed in the monetary-bank-deposit contract. For this reason, and due to their rigorous critical analysis of banking, we may consider this first group of authors (most of them Dominicans) to form part of an incipient *currency school*, which had been developed from the start within the School of Salamanca and which characterized by upholding coherent and rigorous positions in respecting the legal demands of the monetary-bank-deposit contract and by being, in general, very critical and distrustful of the practice of banking activities.

³⁴Martín de Azpilcueta, *Comentario Resolutorio de Cambios*, pp. 74–75; emphasis added.

³⁵Not even in the most brilliant and recent work by Murray N. Rothbard, *Economic Thought before Adam Smith*, vol. 1, to which the present article should be considered a humble addendum.

In opposition to this first group of theorists, a second group of “members” (most of them Jesuits) of the School of Salamanca can be clearly distinguished. This group would be led by Luis de Molina and also included Juan de Lugo and, to a lesser extent, Lessius and Domingo de Soto. These authors followed the leadership of Molina and, as we have already explained, are characterized by the wrong legal foundations which they give to the monetary-bank-deposit contract and by admitting that a fractional reserve be permitted, arguing that, more than a deposit, it is a “loan” contract. This is not the place to reproduce all the arguments against the position of Molina respecting the monetary bank deposit contract which merely repeat an error that, very much influenced by the *depositum confessatum*, had been upheld throughout the Middle Ages by the glossators. What we wish to emphasize here is that this second group of authors of the School of Salamanca was much more “comprehensive” with banking activities and even fully justified the practice outside the framework of traditional legal principles. It is not, therefore, inappropriate to consider this second group of authors to form part of an incipient *banking school* within the School of Salamanca who, like their successors of the English and continental banking school several centuries later, not only justified the practice of banking based on a fractional reserve, that is to say, violating basic legal principles, but also believed that this had very beneficial effects on the economy.

Although Luis de Molina’s theoretical arguments on the bank deposit contract are a clear regression and cannot be upheld on the basis of traditional legal principles, it is, however, *curious to draw attention to the fact that this author is the first member of the banking school tradition who was capable of realizing that checks and documents ordering payment at sight of specific amounts charged against the deposits fulfilled exactly the same function as cash*. The assertion that it was the theorists of the English banking school who, in the nineteenth century, first generally argued that the demand deposits of the banks formed an integral part of the monetary supply and thus had the same effect on the economy as banknotes is, therefore, incorrect. More than two centuries earlier, Luis de Molina had already shown this idea clearly in Disp. 409 of his *Tratado sobre los Cambios*. Luis de Molina tells us that “the money is paid to the bankers in two ways: one, in cash, handing over the coins to them; and the other, by trade bills or any other bills which are given to them, by virtue of which he who has to pay a bill becomes a debtor to the bank for the amount which the bill indicates will be paid into the account of he who presents the bill at the bank.”³⁶ Specifically, Luis de Molina

³⁶Luis de Molina, *Tratado sobre los Cambios*, p. 145.

refers to the written documents, which he calls in Latin *chirographis pecuniarum*, which were used as payment in the majority of market transactions. Thus, "although many transactions are made in cash, the majority are made by written documents which evidence either that the bank owes to them or that it agrees to pay, and the money remains in the bank." Molina also says that these cheques are drawn with "sight" or demand value and adds that "these payments are usually called 'sight' because the money must be paid at the moment the bill is presented and read."³⁷

But most importantly Molina expressed, much earlier than Pennington in 1826,³⁸ the essential idea that the total volume of monetary transactions carried out at a market could not be paid with the amount of cash which changed hands there, if it were not for the use of the money which the banks *generate* by their deposit entries and the issue of *checks* against them by the depositors. So that, thanks to the financial activity of the banks, a new amount of money is created from nowhere in the form of deposits, and is used in the transactions. In fact, Molina expressly tells us that "the majority of the transactions are previously carried out (are formalized) by signed documents; *as money is not so abundant as to be able to buy in cash the enormous quantity of merchandise which is taken there to sell, if they must be paid for in cash, nor to be able to carry out so much business.*"³⁹ Lastly, Molina distinguishes very clearly between those operations which imply the grant of credit, as payment of a debt is temporarily postponed, and those which are carried out paying by check or by charging the amount to a bank account, concluding that "it should be observed that it is not considered that credit is bought if the price is charged to the bank account itself, even if at the time cash is not paid; as the banker will pay in cash the debit balance which exists, at least at the end of the market."⁴⁰

Juan de Lugo follows firmly and absolutely the doctrine of Molina and erroneously considers, in the same way as the latter, that the monetary bank deposit is a "loan" which permits that, until the depositors require it, it may be used for the banker's private business.⁴¹

³⁷Ibid., p. 146.

³⁸See James Pennington's memo dated February 13, 1826 "On the Private Banking Establishments of the Metropolis," included as an Appendix in Thomas Tooke, *A Letter to Lord Grenville; On the Effects Ascribed to the Resumption of Cash Payments on the Value of the Currency* (London: John Murray, 1826); Murray N. Rothbard, *Classical Economics: An Austrian Perspective on the History of Economic Thought* (Aldershot, England: Edward Elgar, 1995), vol. 2, pp. 230–33; and F.A. Hayek, "The Dispute Between the Currency School and the Banking School, 1821–1848," Chap. 12 of *The Trend of Economic Thinking: Essays on Political Economists and Economic History*, W.W. Bartley, III, and Stephen Kresge, eds., vol. 3 of *The Collected Works of F.A. Hayek* (London: Routledge, 1991), p. 224.

³⁹Luis de Molina, *Tratado sobre los Cambios*, p. 147

⁴⁰Ibid., p. 149.

⁴¹"De Cambiis," R. P. Joannis de Lugo Hispalensis, *Societatis Iesu Disputationum de Iustitia et Iure, Tomus Secundus, Lugduni 1642*, p. 406, Section 5, No. 60.

Molina and Lugo uphold such a confused position in respect to their legal foundations for the bank deposit contract that they even admit that the contract may simultaneously (!) have a different legal nature, depending on the party under consideration (in other words, it may be a deposit for the depositor and a loan contract for the depositary banker). Apparently, they do not see any incongruence in this position and, as we know, in respect of the bankers' activity, they fix only one limit: that they should act with "prudence" so that, by virtue of the law of large numbers, they always have sufficient liquidity to allow the return of the deposits which are "normally" demanded from them. They do not realize that the criterion of *prudence* which they declare, is not an objective criterion that can guide the bankers' actions. It evidently does not coincide with the capacity to return the deposits held at any given moment and they themselves take great care to emphasize that the bankers are in "mortal sin" when they employ the funds of their depositors in imprudent and speculative activities, *even if they have a favorable result and they are able to return the money to the depositors on time*.⁴² Moreover, the criterion of prudence is not, in itself, sufficient: one can be very prudent and, however, not be very shrewd or even have bad luck in business, so that, when the moment arrives, sufficient liquidity is not available and the deposits cannot be returned.⁴³ What, then, does the criterion of prudence consist of? It is clear that there is no objective reply to this question which could serve as a guide for the bankers' activities. Particularly when the law of large numbers is not applicable to fractional-reserve banking, since the credit expansion which it causes leads to the generation of recurrent cycles of boom and depression which, inevitably, place the bankers in difficult situations. And the fact is that fractional-reserve banking itself, as shown by the Austrian theory of the business cycle, generates liquidity crises and, therefore, the generalized insolvency of the banks. In any case, at the moment of the crisis, it is very possible that the bank cannot pay, in other words that it must suspend payments, and, even if all its creditors are lucky enough to finally collect their money, this will only happen, in the best of circumstances, after a long period of liquidation during which the role of the depositors will change, as they will lose the immediate availability of their money and become *compulsory savers*, who will be obliged to postpone collection of their deposits until the moment when the orderly liquidation of the bank culminates.

⁴²*Ibid.*, pp. 406–7.

⁴³That is to say, in the terminology of Israel M. Kirzner, "Economics and Error," in *Perception, Opportunity and Profit* (Chicago: University of Chicago Press, 1979), pp. 120–36, committing sheer or pure entrepreneurial error (which cannot be insured by the law of large numbers) which causes serious entrepreneurial losses, regardless of the degree of prudence with which one has acted.

The above considerations are those which, without any doubt, lead Tomás de Mercado to indicate that the principles of prudence declared by Molina and Juan de Lugo constitute an objective which, in practice, *no* banker can meet. It seems as if Tomás de Mercado was aware that such principles did not serve as a practical guide in order to guarantee the solvency of the banks. And, if such principles are not efficient in permanently attaining the objective of solvency and liquidity, it is evident that a fractional-reserve banking system will not be able to meet its commitments under all conceivable circumstances.

The Contemporary Positions of the Jesuits Bernard W. Dempsey and Francisco Belda

In the present century, two Jesuit economists have again studied the doctrine of the scholastics concerning banking, one from the standpoint of the banking school and the other from the position of the currency school. The former is the Spanish Jesuit Francisco Belda, author of an interesting work entitled “*Ética de la creación de créditos según la doctrina de Molina, Lesio y Lugo*” (“Ethics of the creation of credits according to the doctrine of Molina, Lessius and Lugo”).⁴⁴ In fact, for Father Belda it is evident that “from Molina’s description, it may be deduced that, in the case of the bankers, there is authentic credit creation. Thanks to the intervention of the banks, a new purchasing power has been created, which did not exist previously. The same money is used simultaneously twice; the bank uses it for its business and so does the depositor. The overall result is that the payment means that circulation is several times greater than the real amount of money in cash which was originated by them and the bank benefits from all these transactions.” Moreover, Belda considers that, for Molina, “it is licit to do business with the clients’ deposits, provided this is done prudently, not risking being unable to meet one’s obligations on a timely basis.”⁴⁵

With regard to Juan de Lugo, Belda indicates that he gives “a meticulous description of the bankers’ practices. Here, there is explicit approval of credit creation, although not with the formal appearance of *created* credit. The banks do business with the deposits of their clients who, in turn, are not denied the use of their own money. There is an expansion of the payment means, produced by the banks through credits, the discount of trade bills and other economic activities carried on with the money of others. The final result is an increase in the purchasing

⁴⁴Published by the journal *Pensamiento: revista trimestral de investigación e información filosófica publicada por las Facultades de Filosofía de las Compañías de Jesús en España* 73, vol. 19 (January–March 1963): 64–89.

⁴⁵*Ibid.*, pp. 63 and 69.

power in the market very much greater than the amount represented by the cash deposits from which it originates."⁴⁶

It is evident that Belda is correct in indicating how the doctrines of Molina and Lugo are, from among those of the scholastics, the most favorable towards the banking business. However, we are obliged to criticize Father Belda for not even mentioning the positions of the other members of the School of Salamanca, specifically those of Tomás de Mercado and, above all, of Martín de Azpilcueta and Saravia de la Calle, which are much more rigorous and critical when analyzing the banking institution. Moreover, Belda's analysis of the contributions of Molina and Lugo is based on a Keynesian conception of the economy, which not only ignores all the negative effects which credit expansion provokes in the structure of production, but also considers it to be highly beneficial to the extent that it increases the "effective demand" and national income. Belda's analysis is, therefore, a study of the contributions of the members of the School of Salamanca from the point of view of the Keynesian and banking schools and is extremely confused regarding the legal justification of the institution of the monetary bank deposit, tending, therefore, to consider fractional-reserve banking to be legitimate.

There is, however, an economic treatise by another notable Jesuit, Father Bernard W. Dempsey, entitled *Interest and Usury*,⁴⁷ in which he analyzes the position of the members of the School of Salamanca on the banking business employing a profound knowledge of monetary and capital theory, very much superior to that of Father Belda.⁴⁸

Curiously enough, Dempsey develops his thesis, not by analyzing the positions of the theorists of the School of Salamanca who are most unfavorable to banking activity (Saravia de la Calle, Martín de Azpilcueta Navarro and Tomás de Mercado), but by concentrating on the works of the representatives who are closest to the banking school, Luis de Molina, Juan de Lugo and Lessius, making an interpretative

⁴⁶Ibid., p. 87. The reference to Juan de Lugo corresponds to *Disputationum de Iustitia et Iure, Tomus Secundus* pp. 60–62.

⁴⁷Bernard W. Dempsey, *Interest and Usury*, published with an introduction by Joseph A. Schumpeter (Washington, D.C.: American Council of Public Affairs, 1943). Attention should be drawn to the fact that Father Belda's article arose as a criticism, from the Keynesian point of view, of the theses upheld by Dempsey in this book. I would like to thank Professor James Sadowsky of Fordham University, who provided me with a copy of Dempsey's book, which was not available in Spain.

⁴⁸Father Dempsey's broad theoretical knowledge and familiarity with the economic doctrines of Ludwig von Mises, Friedrich A. Hayek, Wicksell, Keynes and others is very much emphasized in Schumpeter's "Introduction" to his book. Moreover, Schumpeter quotes and praises Dempsey in his *History of Economic Analysis* (New York: Oxford University Press, 1980), pp. 95–96 and 104.

study of the works of these authors which leads him to conclude that *from the point of view of their own doctrines, banking activity based on fractional reserves would not be legitimate*. Dempsey's conclusion is based on the application of the traditional principles on usury defended by these authors to the banking institution and the economic effects thereof which, although they were completely unknown at the time the School of Salamanca was writing, had, however, already been theoretically revealed by Mises and Hayek when Dempsey wrote his book. In fact, although Molina and Lugo's more favorable treatment of banking must be acknowledged, Dempsey expressly indicates that the loans which are created from nowhere by the banks, as a result of practicing their activity with a fractional reserve, means the generation of purchasing power which does not require any prior saving or sacrifice and gives rise to important damage to a large number of third parties, who see how the purchasing power of their monetary units decreases as a consequence of the inflationary credit expansion of the banks.⁴⁹ According to Dempsey, this creation of purchasing power from nowhere, which does not imply any prior loss of other people's purchasing power, is contrary to essential legal principles, as constructed by Molina and Lugo themselves and, in this respect, should be condemned. Specifically, Dempsey affirms that "we may conclude from this that a Scholastic of the seventeenth century viewing the modern monetary problems would readily favor a 100-per-cent-reserve plan, or a time limit on the validity of money. A fixed money supply, or a supply altered only in accord with objective and calculated criteria, is a necessary condition to a meaningful just price of money."⁵⁰

⁴⁹"The credit expansion results in the depreciation of whatever circulating medium the bank deals in. Prices rise; the asset appreciates. *The bank absolves its debt by paying out on the deposit a currency of lesser value . . .* No single person perhaps would be convinced by a Scholastic author of the sin of usury. But the *process* has operated usuriously; again we meet systematic or institutional usury . . . The modern situation to which theorists have applied the concepts of divergence of natural and money interest, divergences of saving an investment, divergences of income disposition from tenable patterns by involuntary displacements, all these have a sufficient common ground with late medieval analysis to warrant the expression 'institutional usury' for the movement heretofore described in the above expressions." Father Bernard W. Dempsey, *Interest and Usury*, pp. 225 and 227-28.

⁵⁰*Ibid.*, p. 210. Incidentally, Father Dempsey points out that the theory of time preference may even date from Saint Thomas Aquinas, as it was expressly stated by one of the latter's most brilliant pupils, Giles Lessines, for whom "future goods are not valued so highly as the same goods available at an immediate moment of time, nor do they allow their owners to achieve the same utility. For this reason, it must be considered that they have a more reduced value in accordance with justice." See p. 426 of *Opusculum LXVI, De usuris in communi et de usurarum contractibus*, written by Aegidius Lessines in 1285 (quoted by Bernard Dempsey in Note 31 of p. 214). Dempsey's discovery of Lessines exposition of time preference was not included in Murray N. Rothbard's *Economic Thought before Adam Smith*, in which Rothbard considers San Bernardino of Siena and Conrad Summenhart to have been in 1431 and 1499 the first expositors of time preference theory (pp. 85 and 92).

Dempsey states that the credit expansion generated by the banking industry tends to depreciate the purchasing power of money, so that the banks tend to return the monetary deposits claimed from them in monetary units with an increasingly reduced purchasing power.⁵¹ He therefore correctly concludes that, if the members of the School of Salamanca had had a detailed theoretical knowledge of the functioning and implications of the economic process to which fractional-reserve banking gives rise, it would have been described as a perverse, vast and illegitimate process of *institutional usury*, even by Molina, Lessius, and Lugo themselves.

⁵¹This is the same argument given by the great libertarian Jesuit Juan de Mariana in his book *De monetae mutatione* (*On the Alteration of Money*) published in 1609. Mariana condemns as robbery any government debasement of coins whereas Dempsey follows the same reasoning in relation to the even more disturbing credit inflation created by banks. On Juan de Mariana see the most brilliant analysis of Murray N. Rothbard, *Economic Thought before Adam Smith*, p. 119.