Those Dishonest Goldsmiths

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Abstract: London's 17th-century goldsmiths are supposed to have invented fractional-reserve banking by clandestinely lending coin they were supposed to store. But this claim is neither supported by contemporary testimony nor consistent with English law of the time, which generally gave goldsmiths title to any loose coin handed over to them. In short, the goldsmiths were almost certainly innocent of the crime for which they are so frequently accused. The myth to the contrary may have resulted from the confusion of (1) crimes other than embezzlement of which goldsmiths were accused by their contemporaries with (2) documented embezzlement of stored coin not by goldsmiths but by the British crown and by some merchants' servants.

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JEL Classifications: G21, K12, N23

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"Foul cankering rust the hidden treasure frets,
But gold that's put to use more gold begets."

William Shakespeare, *Venus and Adonis*

"But the king shall cause the dishonest goldsmith, the worst
of all thorns, to be cut in pieces with sharp knives."

The Law of Manu IX

I. Introduction.

Posterity has not been kind to England's goldsmiths. True, they have been credited with the invention of modern banking. But their undertakings have also been portrayed as unscrupulous, usurious, and occasionally (if not systematically) felonious.

Indeed, the goldsmiths' most celebrated contribution to economic progress is itself frequently said to have been a byproduct of their having embezzled and defrauded unwitting clients. I refer to the development, around the middle of the 17th century, of fractional reserve banking. For it is widely believed that goldsmiths pioneered this practice by lending out portions of cash given to them solely for safekeeping, and that they did so unbeknownst to depositors.

Here I examine this popular belief in light of both contemporary circumstantial evidence and 17th-century English law, and conclude that it is a myth. I then offer some suggestions concerning the myth's likely origins. Although my paper's main purpose is to set the record straight concerning the beginnings of modern banking, I hope it may also correct misperceptions underlying some (though by no means all) recent calls for a return to "narrow" banking.[1]

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[1] See, in particular, the "Financial Services (Deposits and Lending) Bill, as published by the House of Commons on November 16, 2010, which seeks to "prohibit banks and building societies' lending on the basis of demand deposits without the permission of the account holder." In the U.S., Congressman Ron Paul, present Chairman of the House Financial Services Subcommittee on Domestic Monetary Policy and Technology, has long claimed that fractional reserve banks are inherently fraudulent.

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II. Fractional Fairy Tales

The claim that fractional reserve banking began when English goldsmiths discovered that they could get away with lending coins entrusted to them for safekeeping is a commonplace of economic textbooks. For example, Baumol and Blinder's (2009, p. 632) popular undergraduate text tells how

> the practice began of leaving gold in a goldsmith's safe storage facilities and carrying in its place a receipt saying that John Doe did indeed own 5 ounces of gold. ...Gradually...the goldsmiths began to notice that the amount of gold they were actually required to pay out in a day was but a small fraction of the total gold they had stored in their warehouses. Then one day some enterprising goldsmith hit upon a momentous idea that must have made him fabulously wealthy.
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> His thinking probably ran something like this: 'I have 2,000 ounces of gold stored away in my vault, for which I collect storage fees from my customers. But I am never called upon to pay out more than 100 ounces in a single day. What harm could it do if I lent out, say, half the gold I now have? I'll still have more than enough to pay off any depositors who come in for withdrawals, so no one will ever know the difference.'

Although Baumol and Blinder stop short of calling the goldsmiths criminals, their references to "warehouses" and to "storage fees" charged by them, and to the goldsmiths not telling depositors that their money was being lent, clearly suggest that goldsmiths pretended to supply bailment services only, while actually and illegally acting as financial intermediaries.

Some other references to the criminal beginnings of fractional reserve banking are more veiled still. Yet the suggestion that goldsmiths embezzled their customers is easily read between the lines. Thus Greg Mankiw (2008, p. 650), in explaining the origins of fractional reserve banking, begins with an account of an "imaginary" 100-percent reserve bank, and then has the bankers reconsider their management strategy: "Leaving all that money in their vaults seems unnecessary. Why not lend some of it out and earn a profit by charging interest on the loans?" Mankiw's account might be understood as pure fiction, of course. But the students for whom it is

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intended could hardly be blamed for assuming that it describes the actual deliberations of at least some of England's real-world pioneers of fractional reserve banking.

Nor does the story of goldsmiths' illicit and illegal lending give way to more circumspect accounts in graduate texts and other works by or for economists specializing in monetary economics. Here, for example, is a version in Greenbaum and Thakor's *Contemporary Financial Intermediation* (2007, p. 95):

> It gradually dawns on the goldsmith that it is not really necessary to have a unit of gold for each outstanding receipt. This idea must have come as a revelation, an epiphany. To be sure, the strait-laced would recoil at the idea of issuing more receipts than one had gold, but if no one [sic] ever withdraws the gold, then what possible harm? The naughty possibility of printing extra warehouse receipts changed the world. This discovery was the banking equivalent of the Newtonian Revolution, every bit as important to banking as gravity was to physics.

Only the goldsmiths, the authors might well have added, made their revolution by issuing phony warehouse receipts, whereas the great astronomer was considered so aboveboard that he was entrusted with tracking down forgers of the king's money! Here is another example, from Federal Reserve monetary economist Robert Laurent (1994, p. 4):

> Depository managers soon realized that only a small fraction of the coins on deposit were typically withdrawn at any given time. As a result, depositories could lend some of the money to borrowers and earn interest. Initially, depositories made these loans surreptitiously ... . But soon they began lending openly and assuaged depositors by paying interest on their deposited funds.

Similarly, in a book aimed at policymakers as well as graduate students, the late bank regulation expert George Benston (1999, p. 18) tells how England's goldsmiths

> came to realize that the people to whom they had given receipts for gold they held for safekeeping were using the receipts as money. ...But when the receipts were used as money, only a fraction was redeemed at any one time, permitting the goldsmiths to lend out the 'surplus' gold. Thus, they engaged in fractional-reserve banking. ...Furthermore, competition among goldsmiths led to their paying interest rather than charging fees for the safekeeping service.

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The clear implication once again is that goldsmiths were lending "surplus" gold while still issuing "receipts" to their clients and charging then "storage" fees, that is, pretending to act as their customers' bailees rather than as their debtors.[2]

In describing grain warehouses' former practice of illicitly issuing receipts in excess of their actual inventories, Jeffrey Williams (1984, p. 495) takes goldsmith bankers' like misconduct for granted: "But surely, "he writes, "all those involuntarily present at the birth of banking in London in the seventeenth century...felt similar outrage at the frauds perpetuated by the custodians of their gold":

> the fact remains that fractional reserve banking originates in fraud. Considering the reception to fractional reserve banking in grain, it is all the more remarkable that fractional reserve banking in any substance has become accepted.

That these statements appeared in the *Journal of Money, Credit, and Banking* is further proof that the "fraudulent beginnings" story is far from being merely a convenient parable not meant to be taken seriously: it forms, on the contrary, a part of many if not most economists understanding of the history of modern money.

The writings of some Austrian-school economists deserve special notice, because of their particular insistence upon the criminal beginnings of fractional-reserve banks, because they insist that banks continue to practice fraud or embezzlement in modern times, and because their arguments command a popular following that includes some prominent lawmakers. The late Murray Rothbard, chief representative of this line of thought, likens bankers to embezzlers or thieves, whose illicit borrowing of depositors' money are exposed only when they fail. The London goldsmiths, he writes, finding that their "warehouse receipts" were serving as surrogates for coin

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[2] The passage quoted is followed by the remarkable claim that goldsmiths' success at substituting their notes and deposits for coin "led the English government to require goldsmiths to hold 100 percent reserves or suffer execution—a rather extreme form of regulation." To my knowledge, nothing of the sort ever took place.

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itself, could not resist the temptation to embezzle their clients, that is, to appropriate money entrusted to their care by lending it out at interest. Such lending

> was duplicitous, since the depositors, possessing their warehouse receipts, were under the impression that their money was safe in the goldsmiths' vaults. ... Thus, gold in the goldsmiths' vaults was covered by two or more receipts. A genuine receipt originated in an actual deposit of gold stored in the vaults, while counterfeit ones, masquerading as genuine receipts, had been printed and loaned out by goldsmiths and were now floating around the country as surrogates for the same ounces of gold (Rothbard 2008, p. 90).

All this was, in Rothbard's opinion, strictly illegal. Yet the state of the English law of bailments at the time was such, he claims, that goldsmiths "boldly printed counterfeit warehouse receipts, confident that the law would not deal harshly with them" (ibid., p. 91).

Rothbard maintains, furthermore, that banks *still* defraud and embezzle their customers, with modern courts willing (if misinformed) connivance, by lending "deposits" they ought to treat as so much property left for storage. Fractional reserve banking should therefore be outlawed:

> I am advocating that the law be changed to treat bank notes and deposits as what they are in economic and social fact: claims or warehouse receipts to standard money—in short, that the note and the deposit holders be recognized as owners-in-law of the gold (or, under a fiat standard, of the paper) in the bank's vaults. Now treated in law as a debt, a deposit or note should be considered as evidence of a bailment. In relation to general legal principles this would not be a radical change, since warehouse receipts are treated as bailments now. Banks would simply be treated as money warehouses in relation to their notes and deposits (Rothbard, 1962, pp. 116-17).

Elsewhere (ibid., p. 115 n20) Rothbard adds: "I want to make it quite clear that I do not accuse present-day bankers of conscious fraud or embezzlement; the institution of banking has become so hallowed and venerated that we can only say that it allows for legalized fraud, probably unknown to almost all bankers. As for the original goldsmiths that began the practice, I think our opinion should be rather more harsh."

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Although Rothbard's arguments concerning the conduct of modern banks have been repeatedly criticized, his critics say little if anything regarding the activities of London's goldsmith bankers, and so leave both Rothbard's and other economists' claims concerning that group's dishonest undertakings more or less unchallenged.[3]

III. Fractional Facts

Fractional reserve banking actually long predates the rise of England's goldsmith bankers, having been common in northern Italy since the Middle Ages, and having perhaps been practiced in ancient Rome, if not by the *trapezites* of ancient Athens (Kohn 1999, Temin 2004, Andreau 1999, p. 39).[4] But while they didn't "invent" fractional reserve banking, as some accounts suggest, goldsmith bankers were certainly engaged in it within a decade or so following Charles I's 1640 raid upon the Royal Mint, having by then adopted the practice of keeping "deposits" and issuing bearer notes with an "aggregate value beyond the total of their cash reserves" (Judges 1931, p. 145). The question is whether they first did so, in some instances at least, surreptitiously, that is, by lending cash surrendered to them solely for safekeeping, as the common belief holds.

There is in fact no direct evidence supporting the belief in question. On the contrary, it is contradicted by circumstantial evidence consisting of (1) goldsmiths' practice of paying interest, or at least not charging any fees, to holders of their deposits and notes, which indicated that debts rather than bailments were being contracted; and (2) the lack of any contemporary testimony, in

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[3] See, for example, White (2003) and references cited therein.

[4] Ancient banks may only made loans using time deposits, in which case they cannot be said to have engaged in fractional-reserve banking in the sense of having held fractional reserves against deposits that, like bailments, were redeemable on demand (Temin 2004, p. 722). According to Rogers (1995, p. 117), "[t]he common notion that the goldsmiths began the business of banking is probably attributable to the fact that the particular path of development that their financial activities took happened to have involved the issuance of notes—the attribute that was regarded in the nineteenth century as the pre-eminent characteristic of banking." In fact bearer notes were a "niche market" prior to 1694, checks having until then been the more important means of deposit-transfer. (I thank Stephen Quinn for bringing this last fact to my attention.)

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court or otherwise, to the effect that goldsmiths embezzled money placed with them for safekeeping.

III. 1. Interest and fees

Contemporary accounts of the beginnings of fractional-reserve banking in England suggest that those beginnings coincided with the first appearance of interest-bearing "deposits" and, more generally, with the disappearance of explicit levies upon holders of goldsmiths' notes or deposit balances. Because such innovations were only possible to the extent that goldsmiths profited by lending coin placed with them, and because they allowed depositors and note holders themselves to benefit from such lending, they supply strong *prima facie* grounds for supposing, not only that the goldsmiths' customers were perfectly aware of the fact that their balances due were only partly backed by coin reserves, but that the customers preferred this circumstance to one in which they were denied interest and assessed fees in return for having their coins locked away.

Thus the anonymous author of "The Mystery of the New-Fashioned Goldsmiths, or Bankers, Discovered" (1676, p. 5)—the chief source for all later, authoritative accounts of the early history of banking in England—after observing how goldsmiths first became the principal keepers of London merchants' cash in the 1640s, goes on to observe that they very soon undertook

> to receive Gentlemens [sic] Rents...and indeed any Man's money, and to allow them some interest for it though it lay for a month only, or less...this new practice giving hopes to everybody to make Profit of their money until the hour they spent it, and the convenience as they thought, to command their money when they pleased... .

The goldsmiths' practice of paying interest on deposits, instead of charging storage fees, is further evidenced by Samuel Pepys, in a February 1, 1666 diary entry recording his visit to Sir Robert Viner (or Vyner)—one of two goldsmiths with whom Pepys appears to have kept private accounts. Pepys intended to "set all my reckonings straight...leaving clear in his [Viner's] hands just £2000 of my owne money, to be called for when I pleased" (Pepys 1904, p. 201). On March

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30 Pepys, having returned to Viner's the day before to retrieve his money, "having no mind to have it lie there longer," noted with satisfaction how, "contrary to expectations" Viner had paid him £35, or the equivalent of an annual rate of 7 percent, for keeping his money where it "hath been a convenience to me as to care and security of my house, and demandable at two day's warning." Some months later, in his entry for August 1666, Pepys (1904, p. 380) expressed his surprise at hearing that at the "Hollands Bank" (that is, the Bank of Amsterdam) "they do never give any interest at all to any person that brings in their money."[5]

Although Pepys' experience suggests that goldsmiths' sometimes paid interest even on deposits payable on short notice, that practice seems to have been abandoned at some point during the last two decades of the 17th century, not to be revived again until the era of joint-stock banking. But rather than representing any intent by goldsmiths to disguise (and thereby profit illicitly by) the lending of deposited coin, the new policy appears to have reflected an increase in the convenience of bank deposits relative to that of coin as means for effecting payments (Martin 1892, p. 133). Thus, according to D.M. Mitchell (1994, p. 35), during the 1670s and '80s Fleet Street goldsmith banker Thomas Fowle found it unnecessary to pay interest on his customers' credit balances, yet was able to charge them for overdrafts, because his clients valued such balances for their great convenience, drawing upon them "to settle a great variety of tradesman's bills, to pay fees and taxes, to provide ready cash, and to purchase shares, lottery tickets, and tallies," as well as to pay for plate and jewelry purchased from Fowle himself.

[5] That Pepys was surprised by the size of his reward suggests that it was, not interest in the strict sense, but a dividend or capital gain, and that Viner had acted as a broker, working for a fixed fee. This is opposite modern banking practice, where the depositor's return is fixed in advance, and the banker is a residual claimant. The brokering of loans was a common undertaking of London's early bankers, and one not always easily distinguished from that of serving as banker-intermediaries in the commonly understood sense, having had the distinct advantage of being more easily adapted to usury laws then in effect. For further details see Melton (1986, pp. 9-11), and Martin (1892, p. 151).

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On the other hand, Fowle and other goldsmiths incurred considerable expenses in inspecting and sorting coin deposited with them, in negotiating bills, and in serving as their clients' bookkeepers.[6] Because of usury laws then in effect, they also had to make allowances, as the author of "The Mystery of the New Fashioned Goldsmiths" points out (1676, p. 7),

> for Charges to defend themselves against Informers for their usurious Contracts, and procuring frequent Pardons, and for hazard of the loss of their Money lent upon unlawful Interest, every borrower having it in his powers to plead their usury against them in lue of the Debts.

Consequently, as Frank Melton (1986, p. 39) has observed, although the absence of interest on deposit balances might have obscured somewhat the contractual basis for goldsmiths' profiting from their clients' deposits, "the principle remains the same, that in exchange for [lendable] deposits the banker gives something in return." Goldsmiths' clients were, moreover, increasingly inclined to regard "services rendered by their bankers as a trade-off more profitable than a low rate of interest for their deposits."[7]

The deteriorated state of British coins almost certainly played a part in the disappearance of interest payments on demand deposits, by increasing the non-pecuniary advantages of making payments by transferring deposit credits and by increasing goldsmiths' costs of assessing and otherwise dealing with deposited coin. As Macaulay observes, in an oft-quoted passage in his *History* (1855, p. 619), by the time of the Glorious Revolution "The silver coin, which was then the standard coin of the realm, was in a state at which the boldest and most enlightened statesmen stood aghast," the tendency having long been for heavier coins to be culled from the rest, melted

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[6] For further details regarding services performed by London goldsmiths and other "cashier-bankers" see Melton (1986, pp. 33-6 and 213-14).

[7] Despite recognizing the "trade off" in question, Melton (1986, p. 39) is himself unable to resist speaking of early bankers' "clandestine investment...of clients' deposits" and to their having "surreptitiously expropriated" the same, as if the clients in question were inclined to think of services being rendered them as a "free lunch."

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down, and exported as bullion, often by the goldsmiths themselves, leaving only worn and clipped coins, generally predating the advent of the coining press, to circulate:

> it may well be doubted whether all the misery which had been inflicted on the English nation in a quarter of a century by bad Kings, bad Ministers, bad Parliaments and bad Judges, was equal to the misery caused in a single year by bad crowns and bad shillings. ...Nothing could be purchased without a dispute. Over every counter there was a wrangling from morning to night... No merchant would contract to deliver goods without making some stipulation about the quality of the coin in which he was to be paid (ibid., pp. 625-6).

Toward the end of the century, the deterioration of the currency

> proceeded with constantly accelerating velocity. ... It was a mere chance whether what we called a shilling was really tenpence, sixpence, or a groat ...[In 1695] The offices of the Exchequer weighed fifty seven thousand two hundred pounds of hammered money which had recently been paid in. The weight ought to have been above two hundred and twenty thousand ounces. It proved to be under one hundred and fourteen thousand ounces. Three eminent London goldsmiths were invited to send a hundred pounds each in current silver to be tried by the balance. Three hundred pounds ought to have weighed about twelve hundred ounces. The actual weight proved to be six hundred and twenty four ounces. Moreover the discrepancies varied considerably from district to district (ibid., pp. 624-5).

No wonder goldsmiths stopped paying interest to attract deposits, while still assuming the right to treat deposited coins as their own property: despite the change cash flowed their way like never before. According to Macaulay Charles Duncombe, having once "plied for customers under the arcades of the Royal Exchange, ... saluted merchants with profound bows, and ... begged to be allowed the honour of keeping their cash," now found himself so flush that "he laid down near ninety thousand pounds for the estate of Helmsley in North Riding of Yorkshire" (ibid.).

That depositors might feel adequately compensated, even at zero interest, for the risk involved in keeping goldsmiths balances instead of coin, becomes more understandable still when one bears in mind that, besides offering their holders the advantage of being able to effect payments without resort to heterogeneous or doubtful coins, goldsmiths balances relieved them of

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the very considerable risks run by keeping cash at home. "On more than one occasion," John Martin (1892, p. 126) observes, "Pepys suffered no less anxiety of mind from the actual custody of his gold than he could have experienced from fears of the solvency of his goldsmith."

When coin was surrendered to a goldsmith in exchange, not for a mere (non-transferable) receipt and corresponding ledger-book balance, but for a bearer note capable of passing from hand to hand, it should have been equally obvious to the note holder that the banker's obligation was that of a debtor rather than a bailee, because goldsmiths never charged fees to holders of such notes, as they would have to do in order to profit despite maintaining an inventory of coins equal to the notes' face value. Nor *could* they have done so because, as Lawrence White (2003, p. 425) has observed with regard to paper money generally, bearer notes were intended to pass anonymously from hand to hand. Unless holders of goldsmiths' notes were so naïve as to believe that the goldsmiths were engaged in charity, they must have understood that such notes were, not "receipts" for stored coin, but debt instruments backed only by fractional reserves.

The wording of the earliest known goldsmiths' notes—two issued by Field Whorwood in 1654—also accords with their being debt obligations. Both contain the phrase "I promise to repay upon demand," without stipulating any particular reserve or suggesting that coin is being stored (Melton 1978, p. 31; compare White 2003, p. 433). The earliest known goldsmith's deposit receipt, issued by Hoare's bank in December1633, likewise gives no indication of an obligation to store money. It says merely: "Receaved ye day and year above written…ye sum of three pounds and five shillings of current English money" (Richards 1929, p. 239).

In considering the significance of such evidence one must bear in mind that persons who placed cash with goldsmiths were far more sophisticated than most who deal with banks today: as a 1660 pamphlet observes, it was "many great merchants' cashes and some noblemen's cash" (Violet

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1660) that goldsmiths employed to their advantage, and not that of common folk unversed in the ways of finance.

III. 2. Lack of contemporary instances of the charge

That 17th-century sources contain no clear instances of the charge, so common in recent writings, that goldsmiths illicitly and illegally lent money deposited with them for safekeeping, is further reason to doubt the charge's veracity—and especially so in light of the many *other* complaints voiced against the goldsmiths by their contemporaries. The charge doesn't occur, for example, in "The Mystery of the New Fashioned Goldsmiths," which, though purporting to be a merchant's reply to a Country Gentlemen's request for advice concerning whether to bind his son to one of London's money men, is actually little more than a catalogue of goldsmiths' misdeeds. Nor does any trace of it occur in Hilton Price's comprehensive "Handbook of London Bankers," which assembles available information concerning London's goldsmiths, including causes of action in which they took part either as plaintiffs or as defendants.

One contemporary work that does appear to accuse goldsmiths of unauthorized lending is Sir Dudley North's *Discourses Upon Trade* (1691, pp. 32-3). Here North observes how

> The merchant and Gentlemen keep their Money for the most part, with Goldsmiths, and Scriveners; and they, instead of having Ten Thousand Pounds in Cash by them, *as their Accounts shew they should have*, of other Mens ready Money, to be paid at sight, have seldom One Thousand in Specie; but depend upon a course of Trade, whereby Money comes in as fast as it is taken out: Wherefore I conclude that the Specifick Money of this Nation is far less than the common Opinion makes [my emphasis].

Although the italicized phrase might be read as alluding to illicit fractional-reserve banking, it is more likely that North has simply attached to the bankers' accounting term "deposit" or "balance" a literal meaning it had long ceased to convey to those directly concerned. A bankers' obligation to pay money "at sight" is, in any case, not an obligation to have that money on hand at all times.

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North's statement, in short, amounts to little more than testimony to the effect that by the last decade of the 17th century goldsmiths were indeed engaging in fractional reserve banking—which, of course, no one disputes.

And, as Macaulay observes in his *History* (1855, p. 491), North was almost unique in his day in finding fault with goldsmiths' keeping only fractional reserves, having been "distinguished from all the merchants of his time by the obstinacy with which he adhered to an ancient mode of doing business, long after the dullest and most ignorant plodders had abandoned that mode for one better suited to a great commercial society." In general, by the 1690s, "[t]he advantages of the modern [i.e., fractional reserve] system were felt every day in every part of London; and people were no more disposed to relinquish those advantages for fear of calamities than to refrain from building ships for fear of hurricanes."[8]

Regarding actual lawsuits, Rothbard (2008, p. 89), after claiming that goldsmiths "boldly printed counterfeit warehouse receipts," admits that "[o]ddly enough, no one tested the matter in the courts during the late seventeenth or eighteenth centuries." Rothbard attributes this lack of lawsuits to the fact that "bailment law scarcely existed until the eighteenth century," so that the goldsmiths were able to misappropriate their clients' money with impunity. But this claim, as we shall see, is also not in accord with the facts.

Another possible explanation for the lack of lawsuits is, of course, that no one felt swindled, because no one was inclined to regard goldsmiths' notes as mere "warehouse receipts" rather than as debt instruments that happened to be payable on demand. Likewise for receipts or ledger entries representing deposit balances at goldsmiths. As we shall see, the legal basis for the

[8] North's claim that goldsmiths typically maintained reserves equal to less than 10 percent of their deposits is also inconsistent with other evidence indicating that, by the early 1700s, the standard percentage was actually closer to 20 (Horsefield 1949, p. 71). Quinn (2001) and Temin and Voth (2006) supply further details concerning some early goldsmith-bankers' lending and reserve-management practices.

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"modern" understanding of the nature of bank deposits and notes actually pre-dates goldsmiths' "invention" of fractional-reserve banking by at least half a century.

IV. The Meaning of Goldsmiths "Deposits"

Contrary to Rothbard's claim that in England "bailment law scarcely existed until the eighteenth century," a clear basis for distinguishing between money surrendered for safekeeping only—that is, for bailment—and money handed over with the understanding that it might be profitably employed by its new possessor, appears to have been firmly in place by Elizabethan times, which is to say, well before the time when goldsmiths are supposed to have first begun to lend portions of their customers' deposits. Indeed, it appears likely that the means for practically distinguishing between the two sorts of goldsmiths' "deposits" had been in place almost since the Conquest, having been a feature of the ancient Talmudic law of bailments, and having thus come to England with the first Jewish settlers, who were to monopolize money lending there until their expulsion by Edward I in 1290, and whose customary legal practices had by the thirteenth century "become part of everyday business in England" (Shapiro 1983, p. 1182).

According to Talmudic law, as summarized in Mishnah IX, "When one deposits money with a money-changer (for safe-keeping), the latter is not allowed to make use of the same if it is tied up in a package...; if the money is loose, he may use it... ." Hyman Goldin (1913, pp. 67-9), the Mishnah's English translator, elaborates:

> [W]hen one deposits money with a money-changer who has constant and immediate use and need of money in his business, it is presumed that the bailor has deposited such money with the express intention of permitting the bailee to make use of the same whenever he would so desire, and then the latter becomes liable in any case *in the capacity of debtor*. When, however, the money so deposited is contained in a sealed or privately knotted bag, this indicates the intention of the bailor that he has not consented to the money-changer's making use of the same [my emphasis].

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The same rule appears to have informed Roman banking practice, according to which bankers "had no right to use [a sum of money] or to make it bring a return by investing it" if the sum was contained in a closed sack (Andreau 1999, p. 40).[9]

That the law of money deposits developed in the Talmud was adopted as well by the Jews' Italian successors in England following Edward I's Edict of Expulsion seems likely, both because the Lombards were assisted, according to William Spalding (1922, p. 13), "by a certain proportion of the Jews, who, despite Edward I's edict of 1290, had possibly remained behind to continue their business with and under the guise of Lombards," and because Edward's Statute of Merchants, which anticipated the expulsion by five years, "granted to all non-Jewish creditors the same remedies and procedural rights previously available to Jews" (Shapiro 1983, p. 1199). The goldsmiths, in turn, evolved from the Lombards, having consisted at first, according to some accounts at least, of a subset of Lombards specializing in gold and silver plate, whose business was later entered into by Englishmen (ibid., p. 16). So it would not be at all surprising to discover that goldsmiths followed ancient Jewish rules for determining whether coin entrusted to them could be regarded as their own property, or was to be set aside for safekeeping.

Regardless of the extent to which Jewish custom was behind it, the fact remains that English law as it stood at the end of Queen Elizabeth's reign treated money—that is, coin—as an exception to the general principle of *nemo dat quod*, that is, that possession alone does not imply ownership. Money, according to a maxim first cited by English judges during the sixteenth century, "has no earmark," meaning that one coin was practically indistinguishable from another of like denomination. Consequently, the courts held that a depositor could not have an action in detinue,

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[9] It is far from certain, however, that Roman jurists recognized bankers' right to lend unsealed deposits for which no interest was paid. "In all probability," Andreau (1999, p. 41) observes, "only interest-bearing deposits would legally be considered as loans."

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that is, seeking the return of the specific coins deposited, unless those coins were contained in a sealed bag or box (Fox 1996, p. 549-50 and cases cited therein). Otherwise, an

> action which the plaintiff might bring for specific return of the coins would fail for lack of evidence. The consequence was that the defendant's title was good against the whole world because nobody could prove a better right to the coins than the defendant had through his actual possession of them. The defendant effectively had the property to them because his title was immune to challenge. ...The original owner's right to possession was practically unenforceable once he could no longer identify the coins to which it related (ibid., p. 553).

Although a depositor of loose coins might complain that he had not intended to have his money lent, he could only sue for damages, and not for the return of his specific coins. It followed that, so long as the bankers kept their payment promises, they did all that the law would or could require of them (ibid., pp. 550-51).

So when merchants first began, during the reign of Charles I, "depositing" with goldsmiths, not only plate and jewelry (as they had been doing since Elizabethan times), but also substantial quantities of loose coin, they had every reason to suppose that by so doing they also were giving the goldsmiths title to such coin, to lend or to otherwise employ as they pleased, the goldsmiths' obligation being solely to perform any promised cashier's services and pay any balance due, plus any stipulated interest. This usually implicit understanding became explicit whenever merchants chose *not* to transfer title to their coins when depositing them, for to do so merchants generally took the precaution of sealing their coins in bags. To give one instance only, in his history of the Goldsmiths' Company William Herbert (1836, p. 230) records how, on December 11, 1666, "Mr. Warden made known that he had delivered to Sir Robert Vyner a bag with some of the standard pieces, and some molten silver, sealed, both of which belonged to the Company."

Although 17th-century English law made it clear that a "depositor" of loose coin surrendered title to that coin, it remained murky insofar as it continued to apply the *language* of bailments to what were in fact debt transactions, referring occasionally to the goldsmith-bankers as

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"bailees" and to their customers as "bailors," even as it insisted on the crucial difference between "bailments of money" and those of ordinary chattel.[10] In the 1600 Exchequer Chamber decision in *Higgs* v. *Holiday*, for example, the court held that "if a man delivers money to another, the property in the money is in the bailee, because it cannot be known" (Fox 1996, p. 554).

In contrast, as Powell (1915, p. 171) observes, by the early 19th century "The relationship between banker and customer as that of debtor and creditor, and not trustee and cestui que trust, or bailee and bailor, seems to have been regarded as an established fact—obvious, notorious, and practically unchallengeable." Thus Joseph Story was able to observe matter-of-factly, his 1832 *Commentaries on the Law of Bailments* (1832, p. 66), that "[i]n ordinary cases of deposits of money with banking corporations, or bankers, the transaction amounts to a mere *loan* or *mutuum*, and the bank is to restore, not the same money, but an equivalent sum, whenever it is demanded." Story recognizes, further, that "persons are sometimes in the habit of making, what is called, a special deposit of money or bills in a bank, where the specific money [is] to be restored," but he observes that only when deposited money is "locked up in a chest, or enclosed in a bag" is it the case that the banker's right to use it can "scarcely be presumed to have been within the intention of both parties" (ibid., pp. 66, 68-9).[11]

It thus appears that when, in *Carr v. Carr* (1811)—described by Rothbard (2008, p. 291) as "The first fateful case" regarding the status of bank deposits—Sir William Grant declared money deposits to be, not "bailments" at all but debt, provided the money was not earmarked in a sealed

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[10] As Fox notes (1996, p. 554ff.), the appearance of goldsmiths' bearer notes during the last half of the 17th century itself gave rise to a new legal problem, for although such notes, unlike coin, had distinct identities or "earmarks," they could only obtain the status of currency if title to them, like title to coin, passed with possession. The eventual solution to this problem consisted of the abandonment of the traditional "no earmark" rule for currency in favor of the common-law rule of "bona fide purchase," originally applied to bills of exchange.

[11] In a later edition of the same work Story (1878, p. 47n2) further explains that "the word deposit, as [used] in the law of Bailments, has a technical meaning, far more restricted than our English word as commonly applied. The ordinary bank deposit, sometimes styled a *general* deposit, is no bailment at all."

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bag, he was not making new law, as Rothbard supposes. He was merely stating a long-standing legal principle in what were then new and more fitting terms.

V. True Crimes

Our review of the evidence suggests that clients of early goldsmith bankers can hardly have been unaware of the fact that goldsmiths were lending their "deposits," and that this lending was perfectly in accord with laws then firmly in place—laws that held the goldsmiths to be, in the absence of express instructions to the contrary, the true owners of any loose coins deposited with them.

These findings contradict the conventional wisdom that goldsmiths pioneered fractional reserve banking by illicitly and illegally lending cash that they were supposed to lock away. How, then, did the conventional wisdom gain currency? How did an accusation, so apparently unfounded, become part, not only of the popular lore concerning the goldsmiths' undertakings, but of expert understanding of the beginnings of modern banking?

One possibility, which I consider here without pretending to exclude others, is that the claim grew out of the conflation over time of (1) actual charges of misconduct by goldsmiths leveled at them by their 17th-century contemporaries, which contributed to the inclination of subsequent writers to regard them as having been capable of defrauding or embezzling their customers; and (2) actual 17th-century instances of embezzlement or illegal conversion of coin set aside for safekeeping, in which the goldsmiths were involved, *not* as perpetrators, but either as (perhaps unwitting) accomplices or as victims.

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V. 1. Other complaints against goldsmiths

Although the complaint that goldsmiths lent cash deposited with them for safekeeping gained currency long after the crime is supposed to have first been committed, early goldsmith bankers were far from being unsullied by accusations lodged against them by their contemporaries.

Indeed, our knowledge concerning the goldsmiths' early involvement in banking comes mainly from a few late 17th-century pamphlets, including several that charged goldsmiths with making money "on the edge of law and morality" (Coquillette 1993, p. 103). These pamphlets were aimed, presumably if not expressly, at furthering one of the many schemes for a government-sponsored rival to the goldsmiths, along the lines of the Bank of Amsterdam, projected during that the time—schemes that culminated, despite the goldsmiths' collective "howl of rage" (Macaulay 1855, p. 499), in the establishment of the Bank of England. "We must always remember," a 19th-century writer observes (Anonymous 1884, p. 729),

> that the establishment of the Bank of England was not the work of a day, but that plans for the formation of a national bank were submitted many years before any such bank was really in working order. It was during this very unsettled period, when by the action of the king credit was at a low ebb, the goldsmiths were nearly at their wits end, that many attacks, some virulent, some well merited perhaps, were made upon them. As a natural consequence, several articles and pamphlets were issued contradicting the statements made, and refuting the rash assertions which had been ruthlessly hurled at the very basis of what was then financial London.

The best-known contribution to this mini pamphlet war, the previously mentioned "Mystery of the New Fashioned Goldsmiths," was both one of the more "virulent" attacks upon the goldsmiths and, significantly, the principal source for modern accounts of the origins of banking in England. In other respects, though, it was, according to James Steven Rogers (1995, p. 118n65),

> an unremarkable tract of the sort that seems to have been common in every age of financial history, the basic thesis of which was that a group of evil men were making personal fortunes at the expense of the commonweal from some new form of financial dealing which violated basic principles of law and morality.

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Yet as we've seen, neither "J.R.", that pamphlet's otherwise anonymous author, nor any of the other pamphleteers ever accused goldsmiths of the crime for which they stand accused in modern works. Instead, contemporaries accused the goldsmiths of culling and then either clipping or exporting relatively heavy coin, and of usury. Concerning the first, the *Mystery* (1676, p. 4) tells how goldsmiths

> found a new mischievous trade to send all the money trusted into their hands into their Cocklofts, where they had scales and various weights adapted their purpose, and servants constantly weighed every half-crown (at least) and sorted them…those heaviest coins were sent away in specie, several French men and other merchants making it their whole and only business weekly to transport the gold and silver so culled, either melted down or in specie, and from hence the goldsmiths set up another new trade of buying old English gold coin at a rate much above its lawful coined value, buying and selling it at five, seven, eight and ten pounds in the hundred more than it was coined for, still sending it away.

Consequently "there was little coin passed in trade but overworn, and clipt, to the great vexation and loss of the traders."[12]

But the chief complaint leveled against the goldsmiths was, not that they lent more generously than they ought to have done, but that they lent on usurious if not extortionate terms. Here their chief critics included, not merely projectors of rival banks, but merchants of all kinds. As Macaulay reports (1855, p. 490):

> Oldfashioned merchants complained bitterly that a class of men, who, thirty years before, had confined themselves to their proper functions, and had made a fair profit by embossing silver bowls and chargers, by setting jewels for fine ladies, and by selling pistols and dollars to gentlemen setting out to the Continent, had become the treasurers, and were fast becoming the masters, of the whole City. These usurers, it was said, played at hazard

[12] An earlier pamphlet (Anonymous [An Appeal to Caesar], 1660) similarly alleged that "The merchants of London have transported all the gold and most of the silver out of England, probably by confederation and assistance of the goldsmiths in Lombard Street." One goldsmith, Thomas Violet, was informed against by a merchant in a 1637 Star Chamber interrogation, spent over twenty weeks in the Tower before gaining his freedom by informing in turn on some transporters of bullion, and later published a pamphlet (Violet, 1650) in which he bragged about having been a nark. Cf. Ruding (1857, ii, pp. 252-3). For a modern and very detailed account of another goldsmith's' role in clipping and exporting coin see Quinn (1996). Selgin (2009) examines the institutional causes of Great Britain's coinage woes.

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> with what had been earned by the industry and hoarded by the thrift of other men. If the dice turned up well, the knave who kept the cash became an alderman: if they turned up ill, the dupe who furnished the cash became a bankrupt.

Pepys, for example, noted in his diary entry for January 22, 1662, that there was then no credit to be had "but at the goldsmiths' shops, where they [that is, London merchants and government agents] are forced to pay 15 or sometimes 20 per cent. for their money, which is a most horrid shame, and that which must not be suffered." A few decades later, on June 11, 1696, John Evelyn registered the very same complaint, attributing that date's "want of current money" in part to "the fraud of the bankers and goldsmiths, who having got immense riches by extortion, keep up their treasure in expectation of enhancing its value. "J.R.", for his part, laments the goldsmiths' "Prodigious unlawful Gain" from lending to the king in anticipation of revenues. "[I]f *Solomon* be in the right," he wrote, "*that the Borrower is a Slave to the Lender*, the King and the Kingdom become Slaves to these *Bankers*" (1676, p. 5).

The "insults" and "extortion" to which merchants and the king were subjected by goldsmiths, through their charging of exorbitant rates, supplied what Daniel Defoe considered the most compelling reasons for establishing a "Royal" bank. "Our banks," Defoe writes in his *Essay upon Projects* (2008 [1697], p. 30),

> are indeed nothing but so many goldsmiths' shops, where the credit being high (and the directors as high) people lodge their money; and they—the directors, I mean—make their advantage of it. If you lay it at demand, they allow you nothing; if at time, 3 per cent; and so would any *goldsmith* in Lombard Street have done before. But the very banks themselves are so awkward in lending, so strict, so tedious, so inquisitive, and withal so public in their taking securities, that men that are anything tender won't go to them; and so the easiness of borrowing money, so much designed, is defeated.

Defoe relished the prospect that, by lending on generous terms, a public bank would deprive the goldsmiths of "their most delicious trade of making advantage of the necessities of the *merchants* in extravagant *discounts* and premiums for advance of money" (ibid., p. 29).

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V.2. Misappropriation of deposits by others

Although contemporary accounts do not accuse the goldsmiths of misappropriating money left with them for safekeeping, they do tell of such misappropriations by others, with goldsmiths playing the role either of victims or of (perhaps unwitting) accomplices.

One notorious misappropriation is, indeed, supposed to have propelled the goldsmiths into the banking business in the first place. This was the alleged seizure, by Charles I, of £200,000 in coin and plate from the Tower of London, where London merchants are supposed to have placed it for safety's sake, under the care of the Master of the Mint. Even this supposed misappropriation is itself largely legendary: in truth the bullion kept at the mint was put there by merchants not for safekeeping but to be coined, and the King's "seizure" of it amounted to an announcement that further coin deliveries would be postponed for some months, with interest-bearing exchequer receipts taking the place of withheld sums. What's more, when the merchants protested, Charles relented to the point of releasing two-thirds of their coin at once, while paying the rest back, with promised interest, after six months (Rogers 1995, p. 118).[13]

Still there is no question that the merchants' coin had been borrowed without their consent, and that they understood their "deposits" of bullion at the mint to be deposits in the literal sense of the term, rather than in the sense that was eventually to grow out of then-nascent banking practices. The merchants' long enduring memory of this act of confiscation is testified to by Pepys (1904, v. 5, p. 381), who records being told by one Richard Ford how

> it sticks in the memory of most merchants how the late King (when by the war between Holland and France and Spayne all the bullion of Spayne was brought hither, on-third of it to be coyned; and indeed it was found advantageous to the merchants to coyne most of it), was persuaded in a strait by my Lord Cottington to seize upon the money in the Tower,

[13] According to Rogers (1995, p. 118n65), the source of the oft-repeated legend of Charles I's seizure of money placed at the mint for safekeeping is probably a treatise by Adam Anderson (1762), who appears in turn to have based his own account on—what else?—the *Mystery of the New-Fashioned Goldsmiths*.

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> which though in a few days the merchants concerned did prevail to get it released, yet the thing will never be forgot.

As for coin itself, merchants at the time of the seizure were still in the habit of keeping it in their own homes. "So late as the time of the Restoration," Macaulay writes, "every trader had his own strong box in his own house, and, when an acceptance was presented to him, told down the crowns and Caroluses on his own counter" (Macaulay 1855, iv., p. 490). But as Hilton Price observes, (1881, p. 271), this strategy proved no less risky than that of bringing bullion to the mint, for during the revolutionary wars many servants and apprentices deserted their masters to join the army, making off with the cash entrusted with them. Others, according to "J.R." (1676, p. 4), turned to "clandestinely lending the same to the goldsmiths" at four pence per day, "without the Masters' privity." Eventually wiser merchants denied their servants this opportunity by placing their cash directly with the goldsmiths.

So the goldsmiths, though not guilty of embezzling their own customers, were perhaps guilty of receiving, knowingly or not, money embezzled by others. From here to the textbook account is but a small step.

The goldsmiths themselves in turn fell victim to the "stop" of the Exchequer. In an attempt to reduce its dependence on the goldsmiths, the Restoration government made increasing use of "tallies of sol"— assignable receipts given for money paid to the Exchequer—combined with negotiable repayment orders guaranteeing repayment with interest, to attract funds directly from the public. Then it took the further step of issuing "fiduciary" orders based, not on actual receipts, but on the government's general credit (Nichols 1971, pp. 97-99).

Despite the government's intentions, it was the goldsmiths who discounted and thus acquired most—over £1 million worth—of this floating debt. Consequently it was they who suffered, several to the point of bankruptcy, when, in 1672, the government, having issued orders

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far in excess of its ability to redeem them, stopped payments on most orders not based on specific Parliamentary authorizations, including all such orders that had been assigned to bankers by their original possessors (Horsefield 1982, p. 513). The goldsmiths in turn suspended payments on merchants' deposits, provoking complaints that caused Charles II to instruct them to start paying out "their current cash, which lay deposited in their hands, not to be lent for interest, but for the security of keeping it" (ibid.)! The King, in other words, endeavored to compel the goldsmiths to do what they never appear to have done on their own initiative, to wit, treat as their own property coin that was in fact given to them for safekeeping only. Whether any actually complied with the King's instructions is however not clear.

Although the government promised to resume payment in a year, with interest at six percent, the costs of the Third Dutch War caused it to renege on this promise as well. Eventually the government settled by agreeing to pay the goldsmiths an annual six percent annuity, funded on the Excise. Thus England's first funded National debt was created. The goldsmiths were in turn supposed to make *pro rata* payments to their own creditors, who received tallies for their claims directly from the Excise Office (Nichols 1971, pp. 101-2). In 1680, however, the government began to fall behind in its payments; and with the Revolution it stopped altogether. At last, in 1720 the debt was exchanged for South Sea stock. Thus, as Glenn Nichols observes (ibid., p. 103), "what began as a bad debt ended in a financial disaster."

"Somehow," Daniel Coquillette (1993, p. 103) observes, even the stop of the Exchequer "was seen as the goldsmiths' fault" by their critics, some of whom, including "J.R.," suggested that they employed it as a pretext for not paying their own clients despite still being capable of doing so:

> [T]hat cold storm of the People's fears that their money was not safe in the Bankers hands blighted them, and since their declension, the Famous stop upon the Exchequer almost blighted their very root, men being unwilling to trust money in their hands to lend his Majesty, so long as they hear the deplorable Cryes of the Widdow and the Fatherless,

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> whose money they say at Feasts, they lent the King, and cannot repay them, no not their Interest to buy them Bread.

Here, once again, it seems but a small step from the actual contemporary accusation—that the goldsmiths failed their clients by dishonoring their debts to them—to the fable that they failed them by becoming debtors in the first place, when they ought to have been mere bailees.

VI. Conclusion

> "Not that I altogether Mislike Banks, but they will hardly be brooked, in regard of certain suspicions."
>
> Francis Bacon, "On Usury."

Through their financial innovations, including the creation of a domestic payments system based on transferable deposits and notes backed only by fractional reserves of coin, London's goldsmiths supplied what Stephen Quinn (1997, p. 427) has termed the "critical background" for Great Britain's financial revolution.

But did they do so by clandestinely and illegally lending coin they were legally and morally obliged to keep on hand? Almost certainly not. Although the goldsmiths' contemporaries accused them of all sorts of misconduct, this particular accusation appears to date from later times; what's more, the right of "bailees" to lend any loose coins deposited with them, barring specific instructions to the contrary, was firmly established in English law decades before the rise of fractional-reserve banking.

In view of these facts, it seems only right that instead of claiming, on the grounds of suspicion alone, that goldsmiths misappropriated their clients' money, we ought to grant them the same benefit any 17th century English judge would have granted them, which means heeding the maxim, *in criminalibus probationes debent esse luce clarions*: "in criminal charges, the proofs should be as clear as day."

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