Hello! I’m Don Anderson, and I am going to talk about natural law, delve into an economic problem, and give a non-lawyers / non-economist’s appreciation of significance of the tie between them. To do this I will hyper-generalize 2300 years of legal-economic history in a few minutes. Here we go!
The U.S. Declaration of independence

In our Declaration of Independence particularly note the phrase:

the separate and equal Station to which the Laws of Nature and of Nature's God entitle them

It is very clear that our founders based their argument for independence on natural law. In dissolving their ties to Britain, they were not claiming to have invented new law, but appealing to preexisting laws which were not dependent on rulers or legislative institutions.

This is an appeal to universal law which applies to all men. It can not be repealed, or altered, nor should it be ignored by any government. What is this universal law?
Our founders found inspiration in John Locke’s writings on the nature of man. The inherent (or natural) rights that are independent of government or rulers. Natural law is generally understood to be a body of unchanging moral principles that is the basis for all human conduct. As such it is not the result of legislation, but is discovered and refined through reason and experience. However, natural law may be codified in legislation as an enforcement convenience.

Certainly, the concept of natural law existed long before Locke’s formulation. The great Roman jurists felt their task to be the discovery (not legislation or invention) of those principles that best guide the interactions of humans.

These Roman jurists also provided inspiration to our founders.
Roman jurisprudence became an independent profession in the 3rd century B.C.

Jurists at that time, such as Cato, and his son enjoyed high prestige and independence from the official legal experts.

They developed the concept of discovering fundamental principles that were unchanging guides to the logic of human relationships. Social changes would necessitate the application of these principles to new situations, which occasionally led to the refinement and extension of these basic principles, but the guide was always the nature of man.

They established that law was not invented or legislated – but *discovered*. 
The classical period of Roman natural law lasted three centuries and gradually discovered and refined the law based on the best logic that could be brought to bear on relationships between humans.

Our knowledge of the classical period comes through the work of the Emperor Justinian, who in the years 528-533 A.D. compiled the main contributions of these jurists in four books that survived the dark ages.

The great modern legal economist, Jesús Huerta de Soto writing in *Money, Bank Credit, and Economic Cycles* says, “Roman classical jurists deserve the credit for first discovering, interpreting, and perfecting the most important juridical institutions that make life in society possible,…”

Now let’s apply natural law to the area that we now call banking.
I am using modern banking terminology to illustrate the Roman handling of a distinction that has vast implications in the modern world. Two types of bank deposits:

1. **Demand deposits (not a loan to the bank)**
   - Often known as checking accounts.
   - Served to provide security for the deposit and reliable disbursement of payments.
   - Depositor has full access anytime (in Roman law this required 100% reserves).
   - Depositor normally pays for the service.
   - Failure to provide deposited funds on demand constitutes theft.

2. **Time deposits (a loan to the bank)**
   - Controlled by the bank for a defined period.
   - The time period is the essential element that makes it a loan.
   - Bank has no obligation to return funds prior to the period’s end.
   - Interest is normally paid to depositor.
A little background on the English common law before continuing our banking example.

Common law has significant similarities to Natural law, in part, because they both attempt to address the logic of human relationships in a way that leads to a peaceful and stable society.

They also both rely on discovery, not primarily legislation, to develop law.

Common law, however, gives great deference to preceding cases (stare decisis). Once a case with specific facts is decided, the next similar case will be decided with specific reference given to the previous decision. As a result, study of prior cases is very important.

In Roman natural law, each case required reference to the human relations principles distilled from previous scholarship.

Common law became more easily understood and predictable to the ordinary citizen and businessman, because they would hear and read about prior cases. Extended written decisions became the norm in common law cases, so there were good explanations available.
Diverging even further from our banking deposits, we look at the religious law. This law was laid down by the church, which during the middle ages, was one of the few bastions of civilization. Unfortunately their rules against charging interest on loans forced some rather dishonest subterfuges on businesses in that period. Charging a late payment penalty on a loan was legal, but perverted the clarity and interpersonal honesty of natural law.

Civil law developed across Europe using pieces of the old Roman law, some religious law and very extensive codified law generated by the growing governments. The only civil law example in the United States is in Louisiana. It has similarities to the pre-Napoleonic code of France and some features from the 1804 Napoleonic code.

In reality the most notable difference between common law countries and civil law countries is in the procedure for administering the law. Most common law areas use an adversarial court system in which the judge is expected to be neutral. A jury trial may be called in some cases. In civil law areas an inquisitorial court system investigates the case, finds the appropriate statute, and pronounces its decision.
For banking, Roman natural law treated demand deposits as security holdings for the depositor requiring a full 100% backing,

Common law, perhaps because of constant political demands from governments for loans, gradually permitted fractional holdings and didn’t behead bankers who made loans with their customer’s money.

This created competitive pressures on all bankers. Both in common law, and civil law areas, banker’s wanted to use demand deposits for their own purposes rather than for the depositors. The temptation to violate the sanctity of demand deposits was overwhelming, since profits could be multiplied many times. A 10% reserve requirement permitted as much as ten million dollars of loans to be written for each one million dollars deposited without touching the banks assets.

The expansion of credit far beyond actual savings generates business booms. Then when expansion slows, or enough mal-investment surfaces, we experience a bust. Since the busts would often sweep away the least cautious banks and their depositors’ money, there was
significant demand for a central bank that would provide emergency liquidity and save depositors, even when the bank had too few assets left.

The concept of fractional reserves also corrupted the issuance of money. Deposit receipts for a certain amount of specie (gold or silver) were circulated far beyond the holdings in their vault.

Eventually central banks issued fiat money with no specie backing at all.
Does fractional reserve matter?

(The full story is too large for this lecture, but here are a few observations)

Most loans do not come from real savings. They do not:

- represent foregone consumption
- reduce demand and prices of consumer goods
- free prior resources and labor for new capital investment

These loans do:

- inflate the money supply
- insure the new investments are costly
- reduce everyone’s wealth
- permit capital investments that are too expensive (mal-investments)
- stimulate booms and busts

Does fractional reserve banking matter?

The short answer is: Yes!

The detailed why is a fairly sophisticated economic topic for another time.

In short fractional reserve banking injects money into the economy for which no production has taken place. That money does not represent real savings and its accompanying reduction in consumption. That new “money” therefore inflates the money supply and makes the dollars of those last to receive the additional paper, poorer without their having spent a single dime.

Worse, it fails to curtail current consumption while injecting part of everyone’s wealth into the capital stream at points that can easily lead to mal-investments.

With real savings, demand and resources are removed from consumer goods and their prices can fall. Resources are then available at regular prices for employment in earlier stages of
production to make new products or further automate the production of existing products. Lower prices enable consumers to consider the new products.

Without real savings, but with increased money in circulation, consumer prices eventually rise shifting demand toward essentials. Meanwhile the new capital investments must fight for resources at inflated prices. Gradually lower wages or unemployment make some projects worthless and they must be abandoned.

The euphoria created by the phony money turns into despair as mal-investments pile up and boom turns into bust.
What is to be done?

The great contemporary economist, Jesús Huerta de Soto advocates full reserve banking.

This connects investment with savings. It provides the critical coordination over time that is necessary to achieve an affordable level of capital projects.

When a financial crisis arrives:

1) avoid granting new loans to companies from the capital goods stages,
2) avoid instituting “full-employment” policies (the name is a lie),
3) avoid allowing rigidity in any market, but especially labor,
4) avoid trying to restore macroeconomic aggregates (crises are microeconomic),
5) avoid manipulating the interest rate,
6) avoid creating artificial jobs (public works projects)

Making markets as flexible as possible will lead to the most rapid adjustment and end to the crisis.
Getting down to the essentials of natural law, Richard J. Maybury who bases his work on common law has an extremely succinct summary of the law (which includes natural law):

- Do all you have agreed to do
- Do not encroach on other persons or their property.

The first law covers contract law, the second covers tort and criminal law.

In conclusion, it would be well to remember the words from our Declaration of Independence that appeal to a law higher than that formulated by any government:

“the separate and equal Station to which the Laws of Nature and of Nature's God entitle them”

A proper humility before natural law promotes peace, honesty and life in accord with the manner in which we were created.

I thank you for your attention!