

Chapter 16

On the Nature of Lending and Investing, and of Speculating and Exploiting

There is an important similarity but there are even more important differences between (1) lending and (2) investing, and (3) speculating and (4) exploiting. These differences become especially important in connection with banking. If the crisis Keynesianism has created is to be properly dealt with these differences must not be ignored.

1. A loan is a sum of money (this is called the principal) let by a lender to a borrower. It is a sum which the borrower is permitted to use usually for some agreed on purpose but only for a period of time and which is then to be repaid to the lender with an agreed upon compensation for its use (called interest).

2. An investment, on the other hand, is a sum of money (this is the capital) laid out by an investor for a long and often indefinite period of time for the purpose of obtaining a return for its use (the profit, interest, or dividends earned with the capital) without the loss of any of the capital invested. When such an investment is made by a bank it entrusts money of which it is the custodian to another party, perhaps by taking

a mortgage on real estate from him or by buying stocks or bonds from a corporation.

The similarity between the two is obvious. In both instances money is laid out and in both instances a return for its use is provided for. But the crucial difference between them so far as commercial banks are concerned is that, because of their almost limitless ability to multiply the amount of bank-money they can create and lay out, (a) they should restrict themselves to the making of *short term loans for commercial purposes only*, and (b) they should neither lay out money for investments themselves nor make long term loans to be used for any such purpose. Loans to borrowers for investment purposes, in their own business or any other, even though called loans and legally considered loans, are in fact not bank loans but bank investments.

In practice today banks make both long and short term loans. And in practice they make no distinction between whether loans are for commercial or for investment purposes.

Most of the confusion in connection with banking and most of the malpractice in banking today has its source in this fact.

If clarity is to replace confusion and integrity replace indifference, the term loan should be restricted to loans for legitimate commercial and productive purposes only. Short term investing, on the other hand, is a contradiction in terms. A so-called investor who buys stocks or commodities to resell at a profit in as short a time as possible is not an investor but a speculator. When banks make so-called loans for such so-called short term "investments", they are not financing legitimate investing but illegitimate speculating.

3. A speculation is a risky and hazardous transaction in which a sum of money is laid out not for any useful productive purpose but primarily and often only for the purpose of realizing a quick, a large, or both a quick and large profit

from the difference between the amount laid out and the amount realized. Speculations in stocks and commodities are usually short term gambles while speculations in land are usually long term gambles.

The similarity of speculations to both loans and investments is obvious. In all three money is laid out and a return for it expected. But the difference is of crucial importance, particularly so far as banking is concerned. When money is let or laid out for a productive purpose not only the lender and the investor gains but those who have the use of the money also gain. But with speculation this is not true. Only one of the parties to a speculation can gain. If the speculator is lucky and wins, he gains and somebody else loses what the speculator has won. If he is unlucky and loses, somebody else wins even though he has done nothing useful for what he has won. Speculation is a form of gambling, made respectable by modern business practice, but, as in all gambling, what one party wins the other party or persons involved must lose.

4. Exploitation is the result of any transaction which ends in the satisfaction and gratification of what one of the parties involved, the exploiter, wants and the deprivation of what his victim or victims do not want to lose. In monetary terms, the exploiter becomes richer while the victims of his exploit become poorer. It is because this is precisely and exactly what happens as a result of all speculative activities that even though perfectly legal they are, in human terms, exploitive.

A fifth definition, however, is needed, that of production, since the terms production and productive run all through this discussion. Production, as the term is being used here, refers to the results of any activity in which goods are provided to satisfy some human want and in which both the producer and the consumer, the seller and the buyer of what

is produced, both gain. It is this which makes production a legitimate human activity, and it is the lack of this which makes exploitation inhuman.

If the present day abuses in which banking abounds are to be ended, commercial banks should be restricted to the making of short term loans for productive purposes only. They should neither make loans—long or short—for speculative purposes nor themselves engage in speculating with the money of which they are custodians.

On the other hand, savings institutions—savings banks, building and loan associations, trust companies and mutual funds—should be restricted to the making of investments only, to the laying out of the money entrusted to them for a long period of time. They should have nothing to do with the making of short term commercial loans. And of course nothing to do with speculations no matter what they may be called.

Speculators, like all other gamblers, should use their own money only; they should no more be allowed to borrow money from a bank (no matter what kind of collateral they put up for it) to gamble in anything—land, stocks, commodities—then ordinary gamblers should be allowed to borrow money to bet at cards or to bet at a race track. Yet the facts are that billions of dollars entrusted in all good faith to our banks today are loaned by the banks for speculative purposes in the ordinary course of what is called "banking", every day that they are open for business.

Speculation can be rationalized, as it is by not only bankers but by economists. But nobody can justify it. It has not the slightest economic utility. On the contrary, all the evidence indicates that it is a dis-utility, that it intensifies and does not stabilize prices as those who rationalize it maintain. The more speculators win, the more the public as a whole—the economy as a whole—loses.

In this discussion the distinction between productive lending and investing, on the one hand, and the financing of useless, exploitive, speculative gambling on the other, is crucial.

The principle that commercial banks should only make short term productive loans and savings institutions only long term productive investments, and that neither should have anything in any way to do with the financing of speculations, becomes meaningful only if the distinction between production and exploitation is kept in mind.

Productive lending involves the making of loans to short-term borrowers for three purposes; (a) for the growing or fabricating of goods which can be sold at prices which will cover all the borrower's costs including the cost to him of his loan; (b) for the purchase of commodities to be wholesaled or of merchandise to be retailed, again for prices which will cover all the costs involved, and (c) to enable the borrower to extend to his customers the credit (in the form of current accounts receivable) it is customary in his business to extend.

Productive investing, on the other hand, involves the laying out of money for a long term (the capital of the investment) for a return to be received for its use from time to time (the profits, interest, or dividends on the capital) without impairment of the original amount of the capital invested.

The money laid out can include both what is needed to finance short term productive expenditures (such as those referred to in connection with productive lending) as well as to finance for a long term other enduring requirements such as (a) land and buildings for homes, for farming, for manufacturing and for other productive undertakings; (b) machinery and other tangible equipment for any kind of industry, (c) transportation equipment—planes, trains, ships, airports, docks, etc., and even (d) expensive office equipment like duplicators and computers.

Lending and investing which increases the production of goods is one thing, but, lending, or so-called investing, if it is

for the purpose of increasing the profits of the investor is something altogether different. That there will always be some speculation is certain; man seems to be a gaming and gambling animal, but, that bankers should take the money entrusted to them and the new money they can create available for such a purpose, no matter how profitable this may be for them, is a malpractice which should be recognized as intolerable.

Yet the fact is that billions of dollars are made available by bankers everywhere in the nation for this purpose daily. Wall Street could not survive without this flow of money from all over the nation. It could not carry on without the billions of dollars which, if properly laid out by bankers for genuine production loans, would transform a worried and distraught nation into a saner and more civilized one.

But to do that, bankers would have to stop concentrating on what is going on in Wall Street and in Washington and stop making a dirty profit out of what both call upon them and expect them to do. They would have to begin studying what the rural regions and the small communities of the nation need. They would have to forget their present preoccupation with the needs of big cities and big industries. But they would then begin making possible a town and rural renaissance by making available to every legitimate borrower, including those in the small communities of the nation, the funds this would require. They would then use the funds now channeled into speculation to finance land trusts which would make land available to those who want to get out and stay out of the urban and industrial rat race and to finance those who want to devote themselves in the useful and the artistic crafts.

That such a development is entirely possible is indubitably true, but that it is a probable development seems to me, I am sorry to have to say, very improbable. It is as difficult for two-legged leopards to change their spots as it is for four-legged ones.