

## Chapter 18

# On the Nature of Banking

The "business of banking," as Webster's Unabridged Dictionary refers to it, originated in the middle ages when goldsmiths—in addition to accepting gold and silver coins from their customers for safe-keeping in their strong rooms—began to issue bills-of-exchange so that their customers could transfer their money from one city to another without having to transport the actual coinage itself. What was then called a bill-of-exchange is today called a check or a draft. What was then called safekeeping is today called depositing. What the goldsmith then did when he "cashed" a bill-of-exchange drawn on him by a goldsmith in another city is the equivalent of what a bank does today when it cashes a check presented by a customer but drawn on another bank.

Banking, no matter how complex in practice, reduced to its simplest form, consists of only two basic activities: (a) accepting deposits of money subject to withdrawal from those who entrust their money to a bank, and (b) lending or investing the money entrusted to it.

Banking, though universally considered a business, is not a business at all. That it is conducted as a business today by men who consider themselves businessmen—if by busi-

ness is meant an enterprise conducted for profit—is a sad but outrageous fact. In its essential nature banking is a profession, and like every profession should be conducted to render a service by men whose motivation is service first, last, and all the time. They must, of course, be properly compensated for their work, but this, in its essence, should be a fee, not a profit.

The principles involved seem to me the following:

1. Banking, because of its essential nature, is a profession and not a business. The banker, like the lawyer and the doctor, unless he stultifies himself, has to put the trust reposed in him before anything else. We entrust our health and even our lives to our doctor. We entrust our rights and our interests to our lawyer. We entrust our money and our wealth to our banker. The banker is a trustee, and he has no more moral right to exploit the funds entrusted to him than a doctor has a right to exploit the sickness of his patients, or a lawyer the problems and difficulties of his clients. Professional compensation is one thing, maximizing profits something altogether different.

2. Bankers, like lawyers and doctors, should therefore be licensed and only those qualified by study (usually at an accredited university) and who observe professional standards both in their practice and in their charges for their services should be permitted by law to engage in banking.

3. The banker, by the essential nature of the service he renders, is a fiduciary trustee. It is malpractice for him to do anything with the funds entrusted to him which he ought to know he should not, just as it is malpractice for a doctor to prescribe treatments which he ought to know endanger the health of his patients. Nobody, no matter how great the profit, has the right to betray those who trust him. It is betrayal to exploit the opportunity for profit which trust in his integrity create.

4. Bankers should not be granted charters to operate banks as business corporations; they should not be legally authorized to earn profits from stockholders because corporations limit the liabilities of those who own them. In practice the law makes it virtually impossible to hold their officers and directors liable for what they do. Banks should be owned and operated by sole proprietors, by partnerships, by mutual and cooperative associations, and all those who own and conduct them should be personally responsible and accountable for the safety of the funds entrusted to them. All laws which exempt bankers, as would be true of all laws which exempted any kind of professional man for full liability for his practices, are morally null and void.

Governments because of their political nature, should not own, operate, or control any kind of bank. The sole responsibility of the government so far as banks are concerned should be (a) to see that they are continuously audited by qualified and impartial certified accountants and (b) that if any of these audits show malpractices of any kind that those responsible, directly or indirectly, are held both civilly and criminally responsible for them.

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A bank is an establishment for the (a) custody, (b) exchange, (c) transfer, (d) lending, and (e) creation and issue of money.

There should be, to meet all the needs of the modern world, only three kinds of banks: (1) savings banks, (2) commercial banks, and (3) banks-of-issue.

Unfortunately there are four, the fourth one called (4) investment banks. They ought not to exist at all. They are frauds which engage in real banking only as a means of making respectable the business which they conduct. They are really corporation promoters; they issue securities; they manipulate the stock markets; they promote speculation as

a means of unloading the securities they issue. Worst of all, they make millions both out of the rise in prices of their securities and out of their decline when the securities and corporations they create fail. They ought to be called promoters, as the law required them to call themselves when corporations for private profit were first legalized. By calling themselves bankers instead of promoters they have made it much easier, and more respectable, to engage in the malversation they practice.

In the modern world there are legitimate banks which mix up all the activities in which banks can legitimately engage, activities which ought to be properly conducted only by banks established to conduct only one. Mixing them up, no matter how profitable it may be to the bankers or to the stockholders of banks, provides no service to the public which is worth the danger of the malpractices which this makes possible. Many of the worst of the monetary evils of mankind would be eliminated if banks were restricted to only one kind of banking.

1. A savings bank is one of a large variety of savings institutions. These include building and loan associations, trust companies, mutual funds, and life insurance companies. All of these institutions have in common the fact that they are in essence (a) custodians of the savings entrusted to them, (b) that they pay interest or dividends on the savings, and (c) that they should be administered by trained professionals whose integrity is unquestioned. The principle which they should all religiously observe is that they should restrict themselves to legitimate investments (real estate and high quality "blue ribbon" securities), and that they should not engage in commercial banking, and should have absolutely nothing to do with the financing of speculators and speculations of any kind.

What distinguishes a savings bank pure and simple from all other kinds of banks is that it restricts itself to (a) accepting

time-deposits of savings accounts and (b) accepts no demand-deposits or checking accounts. It restricts itself to acting as the custodian of the funds entrusted to it by those who wish to save and to invest their money in contrast to those who wish to use it for current needs.

The principle which should be observed in distinguishing between savings and commercial banks is that the first should restrict themselves to investments which in their essential nature cannot be liquidated in the ordinary course of the business of their borrowers.

There is hardly a single abuse of banking in the modern world which does not have its roots in the violation of this distinction. Commercial banks, most of which have savings departments today, violate this principle unless the funds of these departments are so completely separated that they are in effect operating two banks. The practice, which is justifiable only in terms of profits, should be abandoned.

To whatever extent commercial banks are responsible for inflation today, it is due to their failure to observe this distinction and (a) to commingle the time-deposits of savings banking and the demand deposits of commercial banking, and (b) to use their funds to finance speculations and government deficits. The Great Depression of 1929 was caused by the violation of this principle; the catastrophe toward which Keynesianism is leading the world is similarly being caused by its violation. It is only by what ought to be recognized as conspiracy between the bankers and bureaucrats of the nation, that it becomes possible for the sort of robbery represented by inflation, and the sort of misery inflicted by depressions, to take place.

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2. A commercial bank is properly a bank which is engaged in facilitating the buying and selling of commodities and merchandise. No commercial bank should therefore invest or speculate with the funds entrusted to it, *even if the investment or speculation is disguised as a loan*. None of its

funds should be invested in any kind of business, in any stocks or bonds representing a business enterprise, in any real estate or mortgages on real estate, or any kind of government securities.

The fact that stock markets make it possible to monetize securities, does not justify the violation of these principles. The fact that this process of monetizing or liquidating securities on stock markets can always break down must never be forgotten.

3. A bank-of-issue is not properly a bank at all in the manner of savings or commercial banks. Its functions are to establish a monetary unit (such as those now called dollars, pounds, francs and marks); to create and issue bank-money denominated in its own unit; to print and issue paper-money; to mint coinage; to accept deposits from and extend credit to banks; to support itself by interest charges, by service charges of various kinds, by seignorage, and by arbitrage; to distribute no profits but use them to set up reserves; and to be owned, operated and controlled on cooperative principles by its member depositors.

Banks-of-issue today are all government owned and government controlled even when, as is the case with our Federal Reserve System and the Bank of England, they are in form owned by bankers or private stockholders. They are political rather than banking establishments. Their primary function is serving national (really political) interests, their banking service is incidental to this and in practice is ruthlessly sacrificed when the public interest conflicts with the government's interests.

One of the most important of the novelties embodied in the Exeter experiments was my proposal that there should be a bank-of-issue which was completely independent, which was established solely and simply to serve the needs of a modern economy, and which was free to devote itself to this necessary service because it was organized so that it was not

controlled in any way by either private or government interests. The bank for the issue of a stable currency which I have tried to describe would be such a bank-of-issue.

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In reading over what I have here written, I feel it necessary to call attention to the fact that these are not descriptions of banks as they are. This is not a study in what I think of as descriptive economics. Descriptive sciences are one thing, normative sciences another. The description of banks as they are and explanation of what is taking place in them is only the premise from which this is written. This is a study in normative economics, of what banks should be and how they should be conducted, taking the needs for which money and banking should provide into account. Central banks, including our Federal Reserve System, though in fact banks-of-issue, are not what banks-of-issue should be. The charge, certain to be made, that I am unrealistic will be irrelevant, unless it can be proved that I am mistaken in my premises or mistaken in what logic justifies deducing from them.

When Plato called for a "science of good and evil" twenty five hundred years ago, he wasn't calling for an objective description of human conduct. What he was calling for was a normative science—a science which dealt with the problem of how human beings should conduct themselves and how they should treat one another. We need, it is true, a systematic and scientific description of the idiocies and the criminalities with which money has been and is being dealt with. We need no scientific rationalizations at all of Keynesianism and of the expedients now being used and proposed to keep bolstering it up. What we need to know is how money should have been dealt with in the past; what we need to know is what they should have done at Bretton Woods but did not do; what we need to know is what we should do about it now.