BANKERS, BOOKIES, AND GAMBLERS[1]

David Korten©

As they say, to get the right answer you have to ask the right question. I'm stunned by how often news reports on Wall Street ask the wrong question, as do our politicians. The August 26, 2010, *New York Times* front page story, "Despite Reform, Banks Have Room for Risky Deals," is a case in point. The article centers on the Volcker Rule provision of the new financial regulation legislation that "sought to prevent federally insured banks from making speculative bets using their own money." The legislation seems to presume that it is OK for banks to serve as bookies who set the odds and hold bets for gamblers (euphemistically referred to in the article as investors) so long as the banks don't put their own money in play.

The main point of the article is that the big Wall Street banks have difficulty making this distinction, because when they accept a bet for which there is no counterparty, they are actually making the counter bet themselves, i.e., assuming the risk by betting against the client. It becomes more than a little awkward when they are loaning the gambler the money used to place the bet in the first place — thus, in effect, betting against themselves. Then add in the fact that these same banks get cheap credit from the Federal Reserve, their depositors are federally insured, and the federal government feels compelled to step in and bail them out when their bets go badly wrong. The result is an impossible web of conflicting interests that Wall Street bankers are highly skilled at turning to their personal advantage. The implicit question addressed in the article is, "Should banks be allowed to gamble with their own money?" This question has been a subject of extensive debate in Washington and in the press. The question we should be asking is, "What is the proper role and social function of a bank?"

It seems that as a society we have lost sight of the crucial difference between productive investment and gambling. When I studied economics years ago, I recall we were taught that banks serve as financial intermediaries. They take deposits from people in their communities, which they in turn loan to local businesses to invest in productive activities that respond to community needs. The bank absorbs a certain risk in the process, for which it is rewarded with a modest profit. It seems that as a society we have lost sight of the crucial difference between productive investment and gambling, between the banker and the bookie, and between the insurer and the speculator.

Productive investment in a farm, a factory, a restaurant, a retail store, a cleaning service, education, physical infrastructure, and much more increases the real wealth of the society. The proper function of the banker is to convert savings into productive investment. The role of the bookie is to calculate the odds and hold the bets of people who are gambling on the outcome of a race in which they have no other skin in the game. Gambling on which horse is going to win the Kentucky Derby produces no new value for society.

Wall Street defenders commonly argue that Wall Street speculation stabilizes markets and protects real producers and real consumers from disruptive price swings. Beyond the mounting evidence that Wall Street speculation often creates and accentuates price volatility, this represents a failure to distinguish between the function of the insurer, who serves a vitally important social function by pooling risks to folks who have real skin in the game, and that of

[1] Yes! Magazine, August 30, 2010. The arguments presented here are developed in greater detail in: Korten, D.C. 2009. Agenda for a new economy: from phantom wealth to real wealth. Berrett-Koehler Publishers, Inc., San Francisco, CA. 196 p.

the speculator who has no other skin in the game beyond the bet placed with the bookie. It is entirely proper for me to take out fire insurance on my home. It is something else entirely when a stranger places a bet that my house will be destroyed by fire in the coming month.

Conventional banking and insurance are beneficial, indeed essential, social functions and they merit the support of public policy. These functions, however, are of little interest to Wall Street bankers who find gambling, bookmaking, usury, financial fraud, extortion, and the inflation of financial bubbles to be more profitable lines of business. With the benefit of massive public bailout funds, Wall Street is back to business as usual. Productive Main Street businesses continue to be starved of credit, however, because Wall Street is not in the business of funding productive investment.

Whether Wall Street banks have a right to engage in purely predatory activities may be subject to debate. Surely, however, reasonable people can agree that such activities should not enjoy the support of public subsidies and guarantees. Furthermore, we should be able to agree that conventional banking and insurance functions are essential to the health and function of the society and that we must take steps to create and strengthen specialized institutions designed and managed to perform these functions in response to the real needs of healthy Main Street, real-wealth economies. To get the right answer, i.e., that the proper function of a bank is to channel savings into real investment, we must start with the right question.