

# The Original and Modern Essence of a Bank

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**Abstract**—The peculiarity of the modern stage of economic science development is that many of its issues appear to be considered just logically, with neglect towards significant aspects. Among such issues is the question of the nature of a bank and the banking system, which are most frequently defined simply as credit institutions. The present article argues the thesis that banks and the banking system in general, despite fulfilling the credit function, are not in essence credit institutions. The essence of banks and the banking system is conditioned by their adhering to the monetary system of the country. In the course of the monetary system genesis, the banking system underwent transformation. Without understanding this natural relation, it is impossible to identify the essence of banks and the banking system, or to solve practical tasks of economic development. The methods of scientific abstraction, natural sequence, deduction and others were used in the study. As a result, it was concluded that the essence of banks and the banking system is that in the modern monetary system conditions, they are the functioning legal medium of the volume of monetary units.

**Keywords**—*money; monetary system; banks; banking system; bank functions; credit; borrowing and settlement*

## I. INTRODUCTION

In modern economic literature, it has become common to understand a bank as a credit institution see: [1], [2], [3], [4], [5]. Such a position, based on one of the functions performed by a bank, is already so customary that it is practically not questioned or critically reflected on. However, it raises questions for the Russian school of economic thought: 1) Does a bank perform only the specified credit function or implement other functions as well? If it does exercise other functions, does the specified credit function allow to position a bank as a merely credit institution? 2) Is it possible to reduce the essence of a bank to the function/ functions it performs? The Russian school of economic thought provides the answers to these questions.

As for the first question, the answer is just at the surface of market phenomena. A bank performs not one, but many important functions. Thus, prior to allotting credits, it ensures its lending capacity, which happens through attracting temporarily available funds of market relations participants. This means that before acting as a lender, a bank acts as a borrower, thus performing the borrowing function. If to reflect this logical and original function of a

bank in its definition, then it would be more precise to call it as a credit-borrowing institution.

It should also be mentioned that being a logical and original function of a bank, attracting temporarily available funds of the market relations participants is not its most immanent function, as it is not exceptionally performed by banks. The majority of the companies of the economic sector deal with attracting funds and providing loans; in this case they should also be positioned as borrowing institutions, just like banks. Meanwhile, the most important difference between banks and industry companies is that banks perform the function that is characteristic only for them - payments settlement between the customers of a bank. So, if to determine a bank by means of its most characteristic function, it should be positioned as a settlement institution, rather than a borrowing or credit one. Actually, this is how the entire banking system should be positioned, where banks, having correspondent accounts at each other, are united into a single national settlement system. The presence of temporarily available funds of market relations participants enables the system in general and each individual unit of this system (each bank) in particular to act as a creditor. Undoubtedly, a bank performs borrowing and credit functions; but performing settlement function is still more specific of it. For this reason, in general, banks should be positioned as settlement-credit-borrowing institutions.

However, it should be assumed that even if to use such a complex term when understanding a bank, it will still not reflect the full idea of its functions. Banks and the banking system in general, perform multiple functions, all in total accounting for over a hundred. If we mention them all in the definition of a bank, it will make it even more complicated and difficult to pronounce, compared to the term we used above.

According to the dialectical method, despite the fact that the functions of a thing are connected with its essence, they are not equivalent. The essence of a thing is its ultimate expression. It is something internal that belongs to the thing itself. Meanwhile, its functions make up the external. The functions express the purpose and intended use of the thing, they represent its essence. The essence and the characteristics (functions) are connected, but are not identical to each other. The essence is revealed through analysis, while the characteristics (functions) are on the surface. To identify the functions of a thing, a superficial glance is

enough. However, in order to distil the essence, it is necessary to go deeper, to understand to what higher order elements it belongs and what functions it performs there. This dialectical position fully applies to a bank and the banking system in general.

Apparently, as in order to reveal the real nature of a bank and the banking system, first, it is critical to determine what system of a higher order it belongs to. This system is actually the monetary system. Not only it is of a higher order, but it also is historically preceding the banking system. It appeared and for a long time functioned as such, and then at a certain historical stage of market relations development, within the monetary system the banking system emerged and started functioning. Consequently, the essence of the banking system in general and each of its individual elements in particular is determined by it being a part of the system of a higher order — the monetary system, the key element of which is money. The evolution of this monetary system element has led to the establishment of banks and the banking system. Hence, to understand the essence of banks, it is important to identify the essence of money. Revealing the essence of money requires at least a brief insight into the history of money evolution.

## II. GENESIS OF THE ESSENCE OF MONEY AND THE MONETARY SYSTEM

### A. *Development of the Essence of a Bank and the Banking System as Part of the Country's Monetary System*

Omitting the period of money evolution, when market relations were episodic in nature, we will consider the genesis of money from the moment when it appeared in the form of coins with the indication of their nominal value. Coins were made of gold, silver or copper; their nominal value directly corresponded to the volume of metal (gold, silver, copper) the coins contained. This established ratio between the two parameters of the coins constituted the scale of the monetary unit. The coins were of different values and weights, but they all had the same scale. If in some coins it was different, they were considered falsified and were not to be used in the settlement. The coin value constituted the quantitative definability of money, and the quality and weight of the metal in coins constituted the qualitative definability of money.

When market relations became widespread, it was not quite convenient and safe to use coins in monetary settlements. Clever people, goldsmiths, took up the challenge of overcoming these problems. They took coins for safekeeping and issued the corresponding receipts. These receipts were used in cash payments, first together with coins, and then instead of coins. Coins and gold bars were deposited in the storages of these goldsmiths. Each country had several prominent artisans with a considerable reputation, whose receipts, as it has been mentioned above, gradually were to be used in market payments instead of coins. Thus, if previously money and gold was spread over the market, then it appeared to be concentrated in several places, at the goldsmiths'. Receipts issued by them represented the corresponding volumes of monetary gold. More precisely,

the volume of monetary units indicated on receipts was supposed to represent a strictly defined amount of gold according to the scale of a monetary unit specific for a particular country.

Such institutions, organized by shopkeepers, goldsmiths, taking coins for safekeeping and issuing their receipts, became known as banks. The word “bank” translated from Italian means “shop”. Yet in ancient times, literally in the shops people were engaged in exchanging coins - large denominations for small and vice versa, gold for silver or copper and vice versa, foreign for domestic money and vice versa. Thus, the *essence* of the first banks in history was that they represented the total of monetary units on the market, represented by the volume of monetary units indicated on the issued receipts.

Over time, the receipts ceased to be personal and became payable to bearer. However, from that time on, for the emission of new receipts — banknotes, the banks had to fill up the stock of monetary gold on their own, in order to maintain the existing scale of the monetary unit intact. Throughout the period of great geographical discoveries and colonization of large territories, which caused the flow of gold into Western European countries, the banks of these countries managed this task rather well. Nevertheless, in the course of time, performing this task became quite burdensome and even unbearable. With increasing frequency, banks issued their banknotes not replenishing stocks of monetary gold, which could result in bankruptcy risks and losing their reputation. To avoid reputational risk, the banks decided to delegate the issuing function to the company that they jointly established. This subsidiary was the central bank. It received stocks of gold from its founders (in the form of mandatory reserves) and launched standard banknotes emission for the whole country. Thus, private banks became the elements of a single system - the banking system. The centre of the system was a single depository, representing the national monetary unit, with commercial banks around, which, in the absence of gold reserves represented the functioning banknotes (monetary units). This was actually the essence of this system. To repeat, it represented the unity of the “national coin” in the form of a depository of monetary gold reserves and the system of banks - banknotes, which indicated the volume of monetary units corresponding to the gold reserves of the central bank.

### B. *The Essence of Banks and the Banking System Within the Modern Monetary System*

The problem associated with filling up the stock of gold reserves, once burdensome for private banks, was delegated to the central bank. Solving this issue was quite an urgent matter. However, even more essential for the central bank was regulating the system of commercial banks and the monetary system of the country in general. The growth of market turnover and gross national income required the constant emission of banknotes, while replenishing gold reserves for this issued banknotes was a considerable practical challenge. When faced the choice between the need to maintain unchanged the scope of the monetary unit and the need to emit additional banknotes into the market, the

central bank with increasing frequency opted for the latter variant. Because of this practice, monetary gold reserves were gradually decreasing, as compared to the volume of monetary units indicated on the total volume of issued banknotes.

Again, once private banks were in a similar situation, ready to delegate the emission function to the established central bank. It was already impossible for the central bank to establish another organization to delegate the emission function to. The problem of filling up the monetary gold was typical for the central banks of almost all advanced countries. Without the practical possibility to replenish the monetary gold reserves sufficiently, the central banks of these countries decided to solve a difficult situation by refusing to fulfil their obligations to the owners of the notes issued by them. The corresponding decision was made unanimously at the International Jamaican Monetary Conference (1976). The volume of monetary units indicated on the banknotes, according to the decision of the central banks of the participating countries, no longer represented monetary gold stocks and therefore central banks were no longer obliged to convert the securities issued by them. Gold was no longer the element of the country's monetary system.

This very decision made the activity of the central bank got significantly simplified and both the type of the monetary system and the essence of the banking system changed fundamentally. In the terms of the neoliberal school of economic thought, the monetary system became fiduciary [6], [7], [8], and the essence of the banking system was no longer a national coin in the bank-banknote system, but a national functioning monetary unit, unifying a variety of banks that keep their clients' accounts.

It is worth mentioning that at the same stage of history, the Internet, computer, and other technical devices that allow distance cashless payments between banks customers appeared in the world. From that time on, not only banknotes and coins produced by the central bank started to act as the legal medium of the volume of monetary units, but also the accounts of bank customers. For individuals, the volume of monetary units in bank accounts started to be shown in bankcards, which thereby turned into electronic wallets. The availability of the equipment and software enabled people to use bank accounts in real time and remotely. The medium of monetary units' volume, a mobile phone with a corresponding application in particular, have appeared to be the banks' satellites, and banks themselves in fact started to function as monetary units [9] [10]. Nowadays, this is exactly the essence of banks and the banking system in general and as part of a new monetary system type.

### III. CONCLUSION

Since the banks are legal medium of the volume of monetary units having temporarily available funds from their clients, they are able to allot credits. Nevertheless, the fact that they provide credits to borrowers does mean that banks are credit institutions in essence. Providing loans is just one of the numbers of functions performed by banks. Their essence within the modern monetary system is not that they

are settlement, borrowing, credit, etc. institutions, but that they represent the functioning monetary units.

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