... a response

Interest, usury and time: a comment [1]

Paul Styger
Department of Economics
Potchefstroom University for CHE
POTCHEFSTROOM

1. Introduction

In this comment it is argued that the paper titled "Interest, usury and time" by J. Tiemstra shows a misunderstanding of the role of interest as remuneration of the production factor capital, as well as the fact that interest also implies the price paid for money as a commodity. This misunderstanding by some Christian economists may sometimes be ascribed to the fact that they still believe there is some validity in the Scholastic views on interest. The distinction between nominal and real prices (interest) for money also becomes a problem when monetary policy is examined.

In this comment views on interest and usury will be discussed briefly and then some of the statements that Tiemstra made in his paper will be dealt with.

2. Historical views on interest and usury

With the development of trade in the late Middle Ages the use of money and commercial loans increased. Loans were made according to Roman Law. The Jews became the most important moneylenders because the Mosaic Laws only forbade lending to other Jews (Tawney, 1984:49). The Church was very concerned with this development and made more stringent rules to curb loans at interest. The Synod of Lyons (1274) and Venice (1312) declared a usurer as an

1 The ideas expressed in this comment were discussed with several colleagues. I am grateful for their help, particularly Dr. Fanus van der Merwe. I take responsibility for the views expressed.

outlaw who could not rent a house, confess in church, could not get a Christian burial and whose will was not valid (Tawney, 1984:57, 58).

St. Thomas Aquinas and the other Scholastics condemned interest as sinful and unnatural payment, because of the Aristotelian views on the barrenness of money (Ekelund & Herbert, 1975:28). To develop a value theory St. Thomas formulated the (Aristotelian) idea of a just price. According to St. Thomas a just price should only include remuneration for the contribution of labour to the product (Roll, 1983:49; Ekelund & Herbert, 1975:26-28). Money was considered sterile but when it was used in conjunction with labour, value was created. Value was regarded as a result of labour and not as a result of money.

There were, however, important concessions or exceptions. The best-known was the *damnum emergens*, the suffering of a loss by the lender. When a delay occurred in the repayment of a loan, the lender was entitled to exact a conventional penalty (Roll, 1983:50).

In the time of the Reformers the emergence of national states and especially the exploration expeditions led to changes in Western Europe. The economic recovery placed emphasis on economic issues in the Mercantilist Period. Luther, however, supported the views of the Scholastics against usury. He stated that the only remuneration (just price) is for labour; trade was considered only for the acquisition of necessities (Tawney, 1984:101). Luther denounced the concessions to practical necessities, like the payment of interest as a compensation for loss, and refused usurers the sacrament, absolution and a Christian burial.

Calvin denied, in a letter written in 1574, that the taking of payment for the use of money was sinful in itself. He repudiated the Aristotelian doctrine that money was sterile and indicated that money could be used to buy things that would bear a revenue (Kitch, 1969:129 and Roll, 1983:51).

As the economic theory developed, the understanding of the role of interest as a remuneration for the production factor capital developed. The work of Smith on production, Ricardo and Malthus on rent, Mill on demand and supply, Walras and Marshall on the market adjustment mechanism and the Keynesian and Monetarist thought have over years contributed to the better understanding of the role of interest.

More 'modern' Christian economists give three reasons to claim a rate of return for money loaned out (North, 1974:364-366):

* The time-preference factor. The use and availability of money immediately at a given moment is more valuable to a person than the value of future economic goods.
* The risk premium. The lender knows he may not get his money back.

* The inflation premium. A lender wants to be paid back in money that will purchase as many goods as the money he has lent.

3. Biblical views on usury

The Scholastics and the writers on usury (even today) based their condemnation of the use of interest (at least in loans to the poor) on well-known Old Testament passages like Deuteronomy 23:19; Leviticus 25:35-37; Exodus 22:25 and Psalm 15:5 – biblical indications that forbid usury and loans at interest to the poor.

The customs of the time should, however, also be considered when interpreting these writings. The following should be kept in mind:

The system of rent-holding (tenure) by which a farmer pays a part of the produce as rent to the owner who furnishes stock and seed, was apparently never practised in Israel in the early days (De Vaux, 1976:167). Hiring, apart from the hiring of services from wage-earners, was scarcely known among the Israelites. Only the text of Exodus 22:14 might refer to the hiring of a beast. Amos 5:11 contains only an uncertain allusion to the hiring of lands (De Vaux, 1976:169).

When a loan was made, the creditor could demand security to guard against his debtor's defaulting. The pledge was often a garment, and if it was a poor man's, it had to be handed back at dusk (Ex. 22:25-26). This garment was a substitute for the person who stood as security and who was handed over to the creditor when the debt matured and no payment had been made. The debtor then passed into the service of the creditor who employed him to recover the loan (2 K. 4:1-7 and Ne. 5:2). If the debtor did not enter the service of the creditor, he had to sell himself to a third party so as to repay his debt (Deut. 15:12 and Lev. 25:39,47). Insolvency was the main cause of Israelites being reduced to slavery (De Vaux, 1976:172). Immovable pledges could also be used, for example, when the Jews pledged their fields, vineyards and houses to get corn (Ne. 5:3). The orphan's ass and the widow's ox (Jb. 24:3) were also pledges that were used by the creditor.

4. The factors of production, their remuneration and money as a commodity

The factors of production are land, labour, capital and entrepeneurship. The remuneration for land is rent, for labour wages, for capital interest and for entrepeneurship profit. In the times of ancient Israel and even during the time of the Scholastics, as indicated earlier in the discussion, the four factors of production were not part of general (economic) thought. In ancient Israel only wages for labour were known and rent was not common practice. The Scholastics only recognised wages as a contribution to value. It has only been since modern times that all the factors of production and their remuneration have been recognised.

The risk involved with a loan was, however, generally accepted. As shown, the Jews made provision for this risk with the pledges that they required. As also shown, these pledges were used by the creditors to their own advantage. In the case of the poor the creditor could use their land, cattle or children. The loan to the poor did not bear any real risk to the creditor. The creditor also recovered the principal amount of the loan and 'interest' from the use of the pledge. This 'interest' was the remuneration for the capital, in other words interest implied refunding the creditor for the fact that he forfeited income because he could not use the money himself. It is therefore clear that the code of the Covenant prohibited interest on loans to the poor because the 'extra' interest would indeed then be excessive and thus result in usury because the loan was risk-free and compensated the creditor. This aspect was not clearly understood by the Scholastics and early writers. These pledges were also not inhumane because in the Sabbatical year the pledges (also slaves) were set free (Deut. 15:1-28).

Although in modern economic thought a comprehension of the role of the factors of production and their remuneration has solved many of the problems, it has not been fully understood until very recently that money itself was also a commodity. Grumball (1987:1) states that the fact that people have not regarded money as just another commodity has until recently delayed the establishment of financial futures' markets. The fact that money is also a commodity (like cereals, clothing and gold) implies that it should also have a price just like any other commodity. When it is scarce the price will be high and when its supply rises, the price should come down.

Interest is the remuneration for capital, and interest is also the price paid for the commodity money. A price (interest rate) that is too high and which does not reflect the true (just) value of money or a just remuneration for the risk or the capital employed is usury.

5. Tiemstra's views

In the abstract of his paper Tiemstra placed emphasis on the future as the future implies risk. The remuneration for the bearing of a risk is interest and the nature and extent of the risk should determine the interest rate. It is therefore not correct to generalise that high interest rates are wrong or immoral.

Tiemstra states that the calculation of the land price in Leviticus 25:14-17 applies a zero discount rate to future returns (see page 369 of this issue). The Jubilee Year recurred every fifty years. In the Jubilee Year every man re-entered his ancestral property. Consequently, transactions in land had to be made by calculating the number of years before the next Jubilee: one did not buy the land but a number of harvests (Lev. 25:15). Slaves were set free, so the purchase price was calculated by using the number of years to the next Jubilee (De Vaux, 1976:175). This text (Lev. 25:15) could just as easily suggest a positive discount rate by recognising the time horizon of the purchase. Specifying the fact that only the harvests up to the Jubilee Year were bought and not the land, protected the prospective buyers but does not readily imply a zero discount rate.

On page 370 Tiemstra states that people prefer to have things immediately (a now preference) rather than at a later stage and that this preference leads to a low rate of saving and a high level of debt that results in very high interest rates at the long end of the yield curve. This phenomenon is not always the case. In South Africa with its high uncertainty, the now preference is high and the personal savings rate at an all-time low, but South Africa has experienced an inverse yield curve for more than three years (SA Reserve Bank, 1993:S26-27). In Japan, with its very sophisticated consumer economy (now preference), the personal savings rate is very high. Tiemstra concedes that the market prices reflect the situation, but says that from a Christian point of view it is wrong. What he does not take into consideration is that the now preference is stimulated by the risk factor. The higher the risk, the higher the interest rate – as just compensation for the risk should be. A just compensation cannot be unchristian.

On page 371 Tiemstra argues that high interest rates lead to the rapid depletion of natural resources. Although it may be true that high interest rates may lead to shortcuts in production, with the possible more rapid depletion of resources, it is also true that high interest rates discourage investment, with the effect that the pressure on the resources is less.

In his arguments Tiemstra again does not make a distinction between real and nominal interest rates when he looks at the international debt crisis. He also does not supply any proof for the contentious statement that high interest rates lead to the neglect of the production and the marketing functions of business. In a time of high interest rates the only way to stay competitive is not to neglect marketing and production.

It is true that too high interest rates (real) will have a detrimental effect on research and development and on the sustained ability of economic activity in the long run. Again the emphasis should be on too high real interest rates. In times of inflation due to too much money in circulation, it would be wrong not to have higher interest rates to curb inflation with its detrimental effects. The solution is not as simple and downright as Tiemstra presents it. When the monetary authorities raise the interest rate to curb inflation, they have to consider the fact that in the short run more people may lose their jobs, but in the longer run the whole community may benefit from it. Should the interest rate not be raised in order to curb inflation, the whole community could impoverish in real terms. It is a folly to state that an ethical set of policies will keep interest rates low. To require of the monetary authorities to keep the financial system liquid negates everything monetary policy stands for .

It is true that the option value of an investment must be taken into consideration, but it is a gross generalisation to state that it is the only approach that is consistent with the ethical social responsibility of the firm.

6. Conclusion

When dealing with the role of interest in the economy it is important to make a distinction between nominal and real interest rates. Even more important, when dealing with the ethical implications of interest rates and its role in the discounting of time the question remains what a just interest rate implies. It is not correct to condemn high interest rates as such. As shown, interest is the compensation for the bearing of a risk and a remuneration for the production factor capital. The ethical question that should be asked is whether the interest rate is a just reward for the bearing of the risk and for the owner of capital. When the monetary authorities raise the interest rate it should be asked whether it is still a just rate.

A just interest rate is not wrong even when its seems to be high – even in real terms. As God's stewards we should run the economy and use the resources in such a way that it is not necessary for just rates to be so high, in order to counter effects like inflation that has a detrimental effect on investment, growth and employment.

In the abstract Tiemstra argues for lower interest rates. The question is what a low interest rate is? Is it 10 percent nominal or is it 4 percent in real terms? The issue still remains to determine and define a just interest rate.

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