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SUMMARY

Christians rarely bother themselves with the economic teachings of the Old Testament, and the prohibition of interest in particular. This is surprising on two counts.

First, the texts themselves are fairly unambiguous. The Old Testament law is clear that indebtedness should not be entered into lightly and a loan should only be used for the relief of poverty. All interest on loans is prohibited with the only exception being loans to foreigners. This strong stance against interest is reinforced by later references in the Prophets and Wisdom Literature and is by no means weakened by Jesus' teaching recorded in the Gospels.

Second, the weight of opinion expressed during the majority of Church history has been opposed to interest-taking. The Early Church condemned it for its greed and uncharitableness and equated interest-taking to theft. The Medieval Church believed interest to be inherently unjust, largely because it was equivalent to the charging of rent for the use of money which ceased as soon as the borrowed money was spent. Attempts were made to apply the prohibition of interest-taking within the Church and throughout society.

From around 1500 onwards, the strong attack upon interest was diluted. The exceptions that the Church allowed to the rule became wider so as to fully compensate a lender for any loss incurred through the process of lending. Calvin rejected the view that interest was inherently wrong and this opinion became widespread whilst the qualifications Calvin made were forgotten. Commercial developments were combined with the weakening of influence of the Church over Western society and the dilution of antiinterest beliefs to produce financial systems that were predominantly interest-based. The subject of economic enquiry then became what determined the rate of interest and to what level should it be restricted rather than whether it should exist at all. Christians have acquiesced in this drift away from Biblical teaching and little contemporary Christian economic thought even bothers to raise the issue.

The author believes that the Old Testament ban on interest deserves more serious consideration. When viewed within the 'paradigm' of the Old Testament law, the teaching points to the need to decentralise financial flows. When looked at from a moral perspective, it can be seen that interest on consumption loans is inherently uncharitable whilst interest upon commercial loans is inherently presumptuous. Prompted by these insights and some of the problems caused by an interest-based financial system, it is possible to conceive of a non-interest financial system based on the principles of hire charges and profit-share partnerships. Although such a system would involve some disadvantages, theoretical results indicate that a non-interest financial system would not only be viable but, in many respects, economically beneficial. The experience of Medieval society and of contemporary Islamic profit-share banks give some tentative support to this conclusion.

INTRODUCTION

Christians rarely think twice about lending or borrowing money at interest. Bank deposits, savings accounts and mortgages are accepted as necessary features of modern life. Considering the antipathy of the Church to interest for three-quarters of her history and the strength of biblical condemnation of the practice, this is a remarkable reversal of attitude. The transformation has been produced by the interaction of weakening Church influence over social structures and Scriptural interpretation changing to accommodate developing economic conditions. The result has been that on this issue, as with many others, Christians have accepted the dualistic worldview that separates ethics from economics, rather than challenging economic structures from a biblical viewpoint.

The present aim is to make just such a challenge to contemporary economic thinking on the issue of interest. Having set out the biblical teaching on loans and interest, a survey will be made of previous lines of interpretation and the approach of modern economics. It will then be argued that the institution of interest is morally wrong and destructive of the economic paradigm that the Bible sets out. If accepted, this viewpoint has profound implications for the reform of the Western capitalist economic system and some of these will be analysed - particularly with regard to the features of an interest-free banking system. It is hoped that the line of argument will be sufficiently convincing to ensure that the prohibition of interest is not dismissed as naive wishful thinking but comes to be regarded as an essential ingredient of a God-centred economy.

1. A NECESSARY CLARIFICATION

The modern usage of the terms 'interest' and 'usury' differs from the original meanings of such terms and so some clarification is required. In common parlance, interest is distinguished from usury. The former term has the connotation of a legitimate payment for a loan whereas the latter has that of illegitimate extortion through interest rates exceeding legal limits or the boundaries of usual practice. It is usually believed to be usury that the Bible prohibits and not interest[1].

These were not the original meanings of the two terms. Usury initially referred to any charge made for the use of property, be it money, land or possessions. Usury is a 'use-charge'. Consequently, rent on land and hire charges for objects could be described as usury as well as any charge made for a loan of money. Meanwhile, 'interest' referred to payments made on a loan of money that acted as compensation to the lender for making the loan and were designed to ensure that the lender suffered no loss for engaging in the transaction. The occasions when such compensatory payments were regarded as legal ('extrinsic titles') were gradually increased until they effectively legitimised most charges for money loans under the guise of 'compensation'. The euphemism of interest has been persisted with in order to avoid the unwelcome connotations of 'usury' upon money loans. Hence the modern usage of the two terms despite their different original meanings. So as not to obscure the relevance of the following argument for contemporary society, any charge made for the extension of a money loan will be referred to as interest unless specified otherwise in the text.

[1]This misconception is reinforced by the Authorised Version translation giving 'usury' for what would now be referred to as interest.

2. OLD TESTAMENT TEACHING

a. Loans[2]

The primary emphasis of Old Testament teaching upon lending institutions within Israel is that loans are to be offered to the poor as a means of helping them out of their predicament (Deuteronomy 15:7-9). The Psalms attest to the righteousness of someone who fulfils this injunction (37:26; 112:5). This command to lend freely to the poor is closely associated with that to cancel all debts within the country every seventh year - a command that did not apply to loans to foreigners (Deuteronomy 15:1-3). This injunction applied to all debts, not just those to the poor, and even anticipates the reluctance to lend that would naturally arise as the time for debt cancellation approached and the loan would effectively become a gift. Such reticence is forbidden (v.9-11). The combination of an ample supply of loans to the poor, the periodic cancellation of all debts and the non-existence of interest upon them (see below) should have helped to ensure that poverty through individual misfortune, as opposed to laziness or famine, was a temporary phenomenon. It is significant that God's promise that there would be no poor in the land, if the law was obeyed, is given in the context of free lending and debt cancellation (vv.4,5).

These injunctions commending generosity to the poor borrower are balanced by provisions protecting the rights of lenders. Loans are to be distinguished from gifts and the obligation to repay that which was borrowed remained, unless the time for debt cancellation intervened. Hence the lender was entitled to take some form of security on the debt if this was felt to be necessary (Exodus 22:26,27; Deuteronomy 24:10-13)[3]. The seizure of security was regulated, however, so as to maintain the debtor household's ability to support itself (Deuteronomy 24:6). The dignity of the household was protected by preventing a creditor from entering the debtor's house so as to seize the pledge (vv.10,11). Despite these limitations, there was a strong obligation on the debtor to repay and the lender has the option of protecting himself against non-repayment through collateral or guarantees by third parties. Deliberate failure to repay a debt was tantamount to theft. David observes that 'the wicked borrow and do not repay' (Ps.37:21).

In extreme circumstances, poor debtors could put their labour up as collateral for a debt, by selling themselves to third parties as slaves in order to repay their debts, or enter into the service of their creditors so as to work off the remaining obligation (Deuteronomy 15:12; Leviticus 25:39,47). Such debt slaves had the same rights and duties as other slaves (Exodus 21:2-11). The practice of selling children as slaves in order to fulfil debt obligations was not unknown (II Kings 4:1-7) although Nehemiah was angered by the practice (Nehemiah 5:6). De Vaux states that insolvency was the main reason for Israelites being reduced to slavery (1961; p.172).

The provisions made for debt slavery indicate how seriously the Old Testament regards a debtor's obligation to repay. They are consistent with the general tenor of the Torah and Wisdom literature concerning borrowing and lending - that is, borrowing involves the undertaking of such a serious commitment and the loss of financial freedom that it should only be embarked upon when absolutely necessary. The borrower is automatically at the weaker end of a power relationship and is effectively the slave of the lender since:

> 'The rich rule over the poor, and the borrower is servant to the lender' (Proverbs 22:7).

The need to maintain financial independence is frequently commended in Proverbs which advises the wise man to avoid giving security to, and guaranteeing the debts of, others (6:15; 11:15; 17:18; 22:26,27). A sign of God's blessing upon an obedient Israel was that they would

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[2] A more comprehensive explanation of Old Testament teaching upon lending and borrowing can be found in Schluter (1988) and McCloughry and Hartropp (1988).

[3] The provision made for taking a poor person's cloak as security with the return of it at night was probably designed to prevent the use of the cloak as security for multiple debts.

lend to other nations and not need to subjugate themselves to others through having to borrow (Deuteronomy 15:6; 28:12). Conversely, a sign of God's curse would be the need for the Israelites to borrow from the resident aliens in their midst (Deuteronomy 28:44). The Old Testament concentrates its teaching about loans on lending to the poor. No provisions are made for the equivalent of 'consumer credit' - that is, borrowing to finance consumption when not in a position of impoverishment. Presumably the Old Testament writers believed that no-one would be so foolish or foolhardy as to borrow or lend in such circumstances. If a loan was required, it must have been the result of poverty. Consequently, if such a loan was to be given, it ought to have been for charitable purposes.

b. Interest

The prohibition of interest occurs three times within the Old Testament law[4]. This repetition is usually taken as a sign of additional emphasis. On two of these occasions, the prohibition is specifically placed in the context of lending to the poor (Exodus 22:25; Leviticus 25:36,37). The reference in Deuteronomy, however, stresses the universal nature of the prohibition on loans to fellow Israelites:

'Do not charge your brother interest, whether on money or food or anything else that may earn interest' (Deuteronomy 23:19).

If this reference had not been included in Deuteronomy, it might have been argued that the interest prohibition only applied to loans to the poor. Indeed, this has been how many commentators have interpreted the prohibition (e.g. Rushdoony, 1973, p.473; North, 1973, p.362). The all-embracing wording of Deuteronomy, however, rules out this line of interpretation, as well as that which would seek to allow interest on commercial as opposed to charitable loans. Indeed, it has been argued that since Deuteronomy is a restatement and reassertion of the other books of the law in covenantal form, the intention of the other references is a compete prohibition also since only 'the poor' would need to borrow in any case (Mooney, 1988, p.95)[5].

Consequently, the law prohibited all interest on anything that could be lent at interest in loan transactions between fellow Israelites. Within the context of the period, this is a unique injunction. Approximately contemporary law codes, such as the Babylonian Code of Hammurabi, regulated the levels of interest that could be charged in certain circumstances. But no law code of the time prohibited interest altogether (Gamoran, 1971, p.127). It was not until 342 B.C. that interest was legally prohibited under Roman law and this lasted for only a short time (Cleary, 1914, p.23). The complete absence of precedent for an interest prohibition simply serves to reinforce the notion that this was a divinely inspired command of particular importance.

The only exception to the interest proscription for an Israelite came in the case of loans to foreigners (Deuteronomy 23:20). This constitutes permission to charge interest on loans to foreigners but is not a command to do so. This exception is a direct parallel of the command to periodically cancel the debts of fellow Israelites but which need not be applied in the case of loans to foreigners (Deuteronomy

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[4] Two Hebrew words are translated as 'interest'. These are 'neshek' meaning a bite, and 'tarbith' meaning an increase. There is no consensus about whether a distinction between the original meanings of the two terms existed. However, it has been suggested that 'neshek' may have referred to a loan where the interest was deducted before the principal was transferred and 'tarbith' to interest that was added to the loan upon repayment (Stein, 1953, p.163). The vicious nature of interest was conveyed by 'neshek' since this comes from the root 'nashak', used to denote a snake bite (eg. Numbers 21:6,9; Proverbs 23:32).

[5] It is worth noting that each of the references in the Torah are combined with the distinctive emphasis of each book of the law. Exodus stresses the special privileges of election for the Israelites and Exodus 22:25 prohibits lending at interest to 'my people'. Leviticus accentuates the holiness of God and the respect He therefore deserves and so Leviticus 25:36 juxtaposes taking interest and fearing God. A major theme of Deuteronomy is the covenantal promises of blessing that will follow obedience to the law and Deuteronomy 23:20 gives a promise of blessing if interest is not taking from a brother Israelite.

15:4). This one exception has caused great difficulties for the Church in interpretation and application of the Old Testament law and these will be discussed below. What is worthy of note in the text is that the Hebrew word used for foreigner is 'nokri' as opposed to 'ger'. Nokri is usually translated as 'foreigner' or 'stranger' and carries the negative connotation of 'alien'. If the nokri was resident in Israel, this would only have been temporary. 'Ger', meanwhile, refers to a resident immigrant or sojourner within Israel and usually implies that the immigrant was a proselyte to the Jewish faith. The ger was given legal protection in Israel (e.g. Leviticus 19:33,34) and was held accountable to Jewish law (e.g. Leviticus 24:22). A ger is loved by God (Deuteronomy 10:18). No such privileges or obligations were extended to 'nokri', even if they found themselves within Israel's borders. Consequently, the Deuteronomic exception allowed for the charging of interest and non-cancellation of loans to strangers and foreigners but not to Gentile immigrants who were permanently resident within Israel[6]. The interest proscription applied to all dealings with those who were regarded as 'brothers'.

The subsequent references to interest in the Old Testament in no way weaken or qualify the prohibition found in Deuteronomy. Rather they emphasise the seriousness with which God regards the sin of taking interest by placing it alongside other blatantly sinful actions. David says that the righteous person will shun the taking of interest as well as slander and bribery (Ps 15:3,5). Ezekiel lists lending at interest in conjunction with theft and idolatry (amongst other sins) as marks of the person destined for destruction (Ezekiel 18:13) and includes the taking of interest as one of the sins of Jerusalem along with extortion and incest (Ezekiel 22:11,12). What needs to be noticed is the seriousness ascribed to the sin and the absence of exemptions that are conceded; including that of taking interest from foreigners. Put simply:

> 'A righteous man.... does not lend at usury or take interest' (Ezekiel 18:8).

This conclusion is further reinforced by the remaining Old Testament references. Proverbs 28:8 juxtaposes the man who adds to his wealth through interest with the man who is kind to the poor. The clear implication is that the man who takes interest is <u>not</u> kind to the poor. The application of the interest prohibition was regarded as of great importance by Nehemiah when acting as governor of Judah. He accused the nobility of the time of exploiting the poor through charging interest as well as selling their acquired debt-slaves to Gentiles, both practices being prohibited in the law (Nehemiah 5:7-11). Nehemiah rebukes the nobles for taking interest, states that he and his family are lending freely and demands the restitution of interest payments and property seized as collateral. Despite living many centuries after Moses had given the law, Nehemiah saw no reason to question the applicability of the interest prohibition - an attitude which he also applied to the periodic cancellation of debts (Nehemiah 10:31).

The Old Testament's attitude towards loans and interest is consistent and unambiguous. Loans are to be for poverty relief and are to be periodically cancelled. Debt was to be avoided if at all possible. Interest exploits the debtor and is prohibited on all loans to borrowers regarded as 'brothers'.

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[6] As an illustration of the distinction between the two terms, Ruth refers to herself initially as 'nokri' due to her Moabite ancestry (Ruth 2:10); but her conversion to the worship of God ensures that she becomes a 'ger' and is hence eligible for marriage to Boaz.

3. THE NEW TESTAMENT PERSPECTIVE

Jesus used the example of debt as a graphic illustration of the obligation that each individual owes to God because of his or her sin (Matthew 6:12) and spiritualised the practice of debt cancellation to illustrate God's grace in our forgiveness (Matthew 18:27). In both cases, the corollary is that we should forgive (that is, cancel the debts) of those who sin against us.

In terms of instructing his disciples on how they were to regard lending, Jesus reasserted the Old Testament emphasis upon lending to anyone who needs to borrow but broadens the scope of the previous teaching in two respects. First, the qualification for a loan is widened from anyone who needs to borrow (Deuteronomy 15:8) to anyone who wants to borrow (Matthew 5:42). Second, the emphasis is shifted from lending to brothers to lending to anyone, including enemies, without expectation of anything in return (Luke 6:34,35). The problem with this reference is that different translations are possible, each with a different application to lending practices. A possible translation would be:

> 'If you lend to those from whom you hope to receive, what credit is that to you? Even sinners lend to sinners in order that they may receive [or recover] the equal amount. But love your enemies and do good, and lend, despairing of nobody'[7].

Such a statement contrasts the actions of 'sinners', who only extend loans to one another with the expectation of recovering the principal, with those of Jesus' disciples who are to lend to anyone, even enemies, in the full realisation that their loan may not be repaid. Thus it may be specified that the transaction is a loan but with the realisation that repayment may never be forthcoming.

An alternative rendering of the final phrase could be 'lend, without hoping to receive any return' - a translation which employs an idiom known to be current from at least the fourth century. In the context of v.34, this could either mean that lending was to be undertaken without any thought of a pecuniary return in the form of interest or it could speak of lending without any thought of recovery of the principal from the inception of the loan. The 'loan' would then effectively become a gift, echoing Proverbs 19:17:

> 'He who is kind to the poor lends to the Lord.'

Marshall (1978, p.273) however, argues that 'receiving the equal amount' cannot refer to the extension of a loan with no thought of repayment because this is indistinguishable from a gift. Rather, he suggests that the phrase refers to receiving offers of loans in return. Some sort of equal treatment through reciprocal loans must then be the meaning of 'receiving a return' in v.35. The contrast is drawn between 'sinners' who lend to each other in the hope of being able to call on a return favour in the future (cf. Luke 14:12) and the obedient disciple who lends without entertaining such selfish motives.

Whatever the precise meaning of Jesus' teaching in Luke 6, two things of relevance to the issue in question are clear. First, Jesus rules out any reason for withholding a loan that his disciples might entertain. They are not to refuse to lend on the grounds that the borrower may be unable to repay, or that the borrower is an enemy, or that there is no personal advantage in the deal. The brother/foreigner distinction of Deuteronomy is transcended in a way comparable to Jesus' call to love enemies (Luke 6:27) and not just 'neighbours' (Leviticus 19:18). Second, Jesus makes no explicit reference to the charging of interest at all. His emphasis is that his followers should not be too concerned about the repayment of the principal, let alone any interest. The reward for such lending is to be spiritual and not monetary (Luke 6:35).

The only occasions when Jesus specifically referred to interest come in the similar parables of the talents (Matthew 25:14-30) and the ten minas (Luke 19:11-26). In each case, a master's servants are given

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[7] I am indebted to Dr. Roy Clements for his assistance in deciding upon this translation.

sums of money to be 'put to work' until the master returns. In each case, one servant fears the master's reaction if he loses the money and simply buries it. In each case, this servant is chastised for not even bothering to put the money on deposit to collect interest[8]. A cursory reading of the parables might indicate that Jesus is legitimising the act of placing money on deposit at interest. A closer inspection of the text yields a contrary interpretation, however. Jesus implicitly equates putting money out at interest with reaping where one has not sown and taking out where one has not put in. It is something 'hard' men would be expected to do (Luke 19:22). The lazy servant is chastised in each case for failure to be a trustworthy steward of his master's property but not because he failed to bank the money. His defence was that his master was a hard man, but if he had really believed this he should have done what a hard man would have approved of and taken interest. It was his own words that condemned him (v.22). Hence, Jesus cannot be claimed to be setting aside the Old Testament prohibition of interest. If anything, interest is portrayed as reaping where one has not sown[9].

The remainder of the New Testament has little to add concerning debt or interest. Paul urges the Christians in Rome to leave no debt obligations outstanding, especially in the context of the prompt payment of taxes (Romans 13:7,8). Despite reference being made to Christians avoiding the need to be dependent upon those outside the Church (e.g. I Thess. 4:12), which could involve abstaining from incurring debt obligations to others, the New Testament writers see no need to discuss the issue of debt and interest further. If this was an area of activity where the Christian was released from the strictures of Old Testament law, one might have expected that this be spelt out more clearly, as in other cases of ceremonial law (e.g. Mark 7:15; Hebrews 7:11,10:18). Conversely, the Council of Jerusalem did not stipulate that abstention from lending at interest was necessary for the early Gentile congregations (Acts 15:23-30). Given the inconclusive nature of the New Testament material and that the interest ban was not just a ceremonial injunction, the Old Testament law presumably still gives relevant guidance to the Christian in this area so long as it is interpreted in love (e.g. Romans 13:8-10).

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[8] Jesus' mention of putting money on deposit at interest may be a reference to the moneychangers at the temple in Jerusalem who accepted money on deposit and possibly lent at interest to foreigners so as not to contravene the Mosaic Code.

[9] This point is expounded more fully in Mooney, (1988, p.111-113). It is worth noting that, in both parables, Jesus makes a clear distinction between 'putting money to work' (presumably in the form of active involvement in a business venture) and putting money on deposit. The two actions are <u>not</u> synonymous (Carson, 1984, p.516).

4. PAST AND PRESENT INTERPRETATIONS

Although the meaning of the Bible on the issue of interest and loans is fairly clear (except for the Luke 6 passage), how it is to be interpreted and applied is a far more difficult and controversial matter. In particular, the general question of the Christian attitude to the application of the Old Testament law becomes a central issue and the stance taken upon why the Deuteronomic Code allowed the Jews to take loans from foreigners is crucial to one's perception of whether interest is intrinsically wrong or not. As with many difficult areas of biblical application, it is instructive to assess the applications made in the past so as to learn from previous insights and mistakes[10]. The approach of contemporary economics and modern Christian economics will also be surveyed.

a. The Jewish Approach

Despite their reputation for money-lending, Jewish communities have generally adhered to the prohibition of interest amongst themselves. They have regarded the extension of interest-free loans to one another as acts of 'chesed', (that is, loving-kindness) as opposed to acts of charity (Tamari, 1987, p.170); the obligation to lend being rooted in the acknowledgement of each individual simply being a trustee of their wealth rather than its sole owner. Tamari goes on to claim that one of the reasons why Jewish immigrant communities have become so well-established economically is that free loan societies have existed, allowing poorer newcomers to become quickly established in business (p.171). Such free loan societies and synagogue funds now exist in the state of Israel to perform the same function and to provide people with funds for any purpose they see fit.

The Jewish reputation for money-lending came about from the Deuteronomic permission to charge interest from foreigners but not 'brothers'. This was generally interpreted to mean that Jews could take interest from the Gentile population amongst whom a Jewish community found itself[11]. The reasons for the Jewish ability to engage in money-lending can be found in the prohibitions on owning land that they frequently encountered, the large profit margins earned on internationally traded goods, the need to keep assets liquid (usually in cash) in case of expulsions and persecution and their frugality of lifestyle which ensured sufficient surpluses to on-lend. Jewish unpopularity for the practice arose from the special dispensations given to Jews to lend at interest by many European princes at the time of the Crusades and after. Frequently, the government needed to borrow money to finance military expenditure but could not borrow from the nominally Christian populace because the Church prohibited the practice. The Jewish community were frequently given permission to transact at interest as a condition of their agreement to lend to the state treasury. Jewish readiness to engage in money-lending arose through the belief that interest was not inherently evil:

> 'All Jewish sources ..... show that Judaism does not see anything intrinsically wrong with lending money at interest. On the contrary, it is a perfectly normal and beneficial part of economic activity' (Tamari, 1987, p.167).

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[10] Only a brief survey of previous interpretations will be presented here. More comprehensive treatments can be found in Cleary (1914), Tawney (1925), Noonan (1957), Nelson (1969), Langholm (1984) and Mooney (1988).

[11] This traditional Jewish interpretation was challenged on many occasions by both Jews and Christians alike. For instance, Rabbi Leon of Modena in 1616 interpreted the 'nokri' of Deuteronomy 23:20 as only the seven peoples which had previously occupied Canaan and which God had commanded to be destroyed. It is therefore illicit to take interest from any other Gentiles (Marcus, 1969, p.439). Robert de Curzon (d.1219) felt that the Jews were not obeying the Torah since they were treating the Gentile societies in which they lived as 'nokri' as opposed to 'ger'. since Gentile countrymen were strangers but not foreigners, the law forbade the taking of interest from them (Nelson, 1969, p.12).

Lending at interest by Gentiles is regarded as the norm and perfectly legitimate. Its prohibition amongst the Jews is a sign of their special mutual responsibility towards one another. Jewish opinion is divided, however, on explaining why charging interest to Gentiles is allowed. Opinions vary from seeing the desirability of dissuading Jew-Gentile contact to the need to protect Jewish economic interests since Gentiles would be lending to them at interest.

Jewish opinion recognises no exception to the interest prohibition other than that to Gentiles. Consequently all commercial 'loans' between Jews must technically be conducted on a partnership basis so that the recipient of a commercial loan is not liable to pay a fixed sum for the use of the money. The legal form of such a partnership is known as 'heter iska' and enables the partner providing money capital to enjoy a fixed share of the profits (or losses) from the joint venture as well as share in the risks of losing all the capital. The requirement to operate under a 'heter iska' applies to all financial institutions in modern Israel. However, this makes little difference to banking practice because a partnership is deemed to exist whenever there is risk of non-repayment of the loan. Since this applies to virtually every loan (even mortgages), Israeli banks are under no real requirement to operate on a non-interest, profit-share basis alone (Tamari, 1987, p.185).

b. The Early Church

There is no guidance on how Christians are to regard the taking of interest in New Testament epistles (unlike other Jewish practices such as circumcision). Outbursts against interest were made by Apollonius and Tertullian but the first legislative enactment prohibiting interest was made by the Council of Elvira (300 AD). This proscribed the taking of interest by the clergy on pain of degradation and excommunication[12] - a decree that was reasserted by the Councils of Arles (314) and Nicea (325). Psalm 15 was cited as scriptural authority for the outlawing of interest although no rationalisation of the ban was given.

The Church Fathers of the fourth and fifth centuries were agreed in their condemnation of interest - Basil's homily upon Psalm 15 being the inspiration of much of later patristic thinking, particularly that of Gregory of Nyssa and Ambrose. Basil denounced interest for increasing the poverty of the borrower and for sometimes reducing him to slavery or suicide. Gregory proposed that since money was sterile, any progeny it produced in the form of interest must be unnatural. Ambrose explained the Deuteronomic discrimination against the foreigner by stating that the Jews were only allowed to take interest from the enemies of God's people - the original inhabitants of Canaan. Taking interest could thus be equated to an act of war:-

> 'From him.... demand usury, whom you rightly desire to harm, against whom weapons are lawfully carried.... From him exact usury whom it would not be a crime to kill. He fights without a weapon who demands usury; he who revenges himself upon an enemy, who is an interest collector from his foe, fights without a sword. Therefore, where there is right of war, there also is right of usury' (cited in Nelson, 1969, p.4).

Ambrose compared lending at interest to an act of killing - inherently evil in itself but permitted in certain circumstances (such as war and capital punishment). Meanwhile, Jerome contended that the prohibition of interest in Deuteronomy had been univeralised by the Prophets and the New Testament since Christians are to treat everyone as a 'brother'. Augustine was the first to state that the prohibition of interest was derived from the seventh commandment (against theft). Therefore, restitution against thieves who took interest could be claimed. All patristic writers regarded Luke 6:35 as a command against taking interest on a loan but as a precept with regard to the non-recovery of the loan principal.

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[12] In some records, the punishments also apply to the laity but it is uncertain as to whether this was included in the original decree or was a later addition. Cleary (1914, p.43-45) speculates that the decrees may not have been applicable to the laity due to the influence of Constantine who would have been angered by the Church prohibiting a practice that was legal under Roman law.

It must be realised that these writers were concerned only with the case of consumption loans to needy borrowers because this was the only form of loan prevalent in the economic circumstances of the time. If a loan was being made to someone who did not need it then the resources could have been better employed elsewhere. The point was made succinctly by Jerome:

> 'Did you give to a prosperous person or not? If he were prosperous then you should not have given it; if he were not, then you should not ask it back as if he were' (cited in Cleary, 1914, p.55).

The first occasion on which interest was prohibited for all Christians by a state government was in 789 at Aix-la-Chapelle under Charlemagne[13]. This decision was reinforced by a series of capitularies in 813, 825 and 829 which strengthened the punishments for taking interest within the Holy Roman Empire and appealed to the Counts to aid bishops in suppressing the practice. The synod of Ticinum (850) treated interest as theft and so ordered restitution of all funds. Similar sanctions were invoked against usurers in England by the Council of Northumberland, Alfred the Great and Edward the Confessor.

Up until 1050, interest was simply considered as a sin of greed and lack of charity. It was only with the commercial revival of the late eleventh century and the advent of business loans that writers began to consider lending at interest as a sin against justice. Anselm of Lucca was the first medieval writer to classify interest as theft under the seventh commandment and to quote Augustine as having canonical authority upon the subject. The Second Lateran Council (1139) was the first explicit decree of universal prohibition for all men passed by a body of bishops having the absolute authority of an 'infallible' ecumenical council. The fiercest campaign against interest yet was undertaken by Popes Alexander III (11591181) and Urban III (1185-7) who closed loopholes in previous legislation by outlawing credit sales at a higher price than that for cash. Urban was the first pope to cite Luke 6:35 as a direct command of Christ prohibiting interest - a move that had immense influence until the sixteenth century.

Before the scholastics' writings, the Church's teaching upon interest was based upon a combination of biblical texts, patristic opinion and conciliar decrees. Interest was defined simply as receiving back more from a loan than was originally lent and condemned severely because only consumption loans were ever considered. Interest was then always a sin against charity (Noonan, 1957, p.20).

c. Medieval Scholastic Writings

The economic teachings of the Church, including the prohibition of interest, began to be widely debated within Christendom from the twelfth century onwards. The group of writers who discussed such matters are known as the scholastics, the most influential of whom was Thomas Aquinas. The Church's attitude towards interest was extremely influential due to the close association of Church and State in most European countries with the accompanying assumption of universal Christianity made by the national churches. The teaching upon interest was a part of the wider Medieval worldview which saw every part of society, including economic organisation, sanctified by Church control and influence (Goudzwaard, 1979). The subject of interest provoked so much debate because it was the test-case for the survival of this world-view:

> '.... the issue at stake was not merely the particular question, but the fate of the whole scheme of economic thought which had attempted to treat economic affairs as part of a hierarchy of values embracing all human interests and activities, of which the apex was religion' (Tawney, 1925, p.106).

[13] Successive Byzantine governments had sought to regulate interest rather than prohibit it altogether.

Most scholastic writers supporting a prohibition quote biblical condemnations as evidence in their favour. Some are content to rest their case there and go on to apply that teaching to the types of loan contract prevalent at the time. Others are more concerned with giving a rationale for the biblical condemnation and basing their reasoning on 'natural law'. This was deemed necessary because the explicit biblical prohibitions of interest occurred in the Old Testament. Such laws were not regarded as binding upon Christians unless repeated in the New Testament or in accordance with the precepts of natural law (Langholm, 1984, p.19). Since there was uncertainty as to whether Jesus had prohibited interest in Luke 6 or not, confirmation of the ban had to be provided by natural law. Consequently the scholastic contribution to the interest debate revolves around whether the natural law case against interest stands up to examination. Rather than survey scholastic views by author or chronology, these natural law arguments will be examined in turn.

i) The Aristotelean Theory of the Sterility of Money

The most influential natural law argument against interest was that given by Aristotle in his 'Politics'. This was that money is naturally sterile, unlike land or wheat. He simply mentions the argument as part of a tirade against using money to make any profit at all:

> 'There are two sort of wealth-getting, as I have said; one is a part of household management, the other is retail trade: the former necessary and honourable, while that which consists in exchange is justly censured; for it is unnatural, and a mode by which men gain from one another. The most hated sort, and with greatest reason, is usury, which makes a gain out of money itself, and not from the natural object of it. For money was intended to be used in exchange, but not to increase at interest. And this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of getting wealth this is the most unnatural" (Book 1, Chapter 10)[14].

The barrenness of money argument had been used earlier by Gratian and Ambrose (Langholm, 1984, p.54). It did not receive widespread attention, however, until a Latin translation of Aristotle's works became available in the mid-thirteenth century. Much of the subsequent debate was then couched in terms of the Aristotelean observation. A weakness of much of this discussion was that it took the sterility of money as a given fact and then condemned interest for straining against a law of nature. Such an argument is open to many challenges. For instance, Gerarde of Siena contended that, if sterility was to be the reason for the interest ban then natural objects which could produce a yield naturally (eg. cattle) could be lent at interest without difficulty. Also, if rent is charged licitly on an unnatural object such as a house, the rental charges will eventually 'give birth' to another house - surely something against natural law also (Langholm, 1984, p.61). This basis of the interest prohibition is inapplicable to loans of naturally productive goods and is inconsistent once rental charges are deemed legal.

This simplistic interpretation of Aristotle is, however, probably misguided. Instead of saying that money is barren and therefore interest is wrong, the thrust of the argument seems to be that money can be fruitful but that this subverts the original purpose for which money was brought into existence - that is, as a medium of exchange. The affront to natural law comes in the use of money for a purpose (i.e. begetting itself) for which it was not intended, for the wrong motives. Aristotle did not regard it as wrong to use an object for a purpose other than its primary one, as Summenhart was later to accuse him of[15]; rather it was because lending at interest had to be with the intention of using money for profit that meant it was unnatural. This is consistent with Aristotle's condemnation of any commodity trade at a profit since this was also using money as a medium of exchange for the wrong motives. This interpretation of the argument

[14] *The Works of Aristotle*, Volume II, p.452, translated by B. Jowett.

[15] Summenhart argued that Aristotle's argument of appropriate use would mean that it would be wrong to store money in a shoe because this was not the original intention for the shoe's existence. Aristotle, however, had taken the shoe as an example of something that could be used for many purposes (Langholm, 1984, p.65).

could not be made by the scholastics because they received a Latin translation which condemned money-changing as opposed to trading at profit. This latter practice had, in any case, been regarded as licit for some time, so long as just prices were charged and wealth accumulated for charitable purposes rather than selfish motives.

A variant of the Aristotelean approach was formulated by Aquinas in an early treatment of interest (Noonan, 1957, p.51). This focussed on money being a measure of value which had to be nominally fixed if it was to satisfactorily carry out its primary function of facilitating exchange[16]. Money had to be considered independently from the things it measures and so stable in the valuation it produces. But lending at interest implicitly values the same amount of coinage differently at different times - a pound sterling of gold now is worth one pound two ounces of gold in a year's time since it can be lent now and received back at interest in a year. Aquinas saw interest as constituting a deliberate diversification of the measure and perversion of the intention for which money was produced. By making money an object of sale, in itself, one subverts the basis of the whole exchange system:

> 'To sell money would be to give simultaneously two different evaluations to the same measure. It was indispensable to the usury prohibition that the legal sameness of money at any time be taken to mean formally that its value was the same at any time' (Noonan, 1957, p.53).

As with the simplistic sterility argument, the ability to maintain a fixed value of monetary units only exists in an economic system which uses a metallic currency for money whose value is not being deliberately altered by agents within the system (eg. a government that is debasing the currency). Once 'money' becomes an abstract concept of a right of purchasing power over goods embodied in paper currency or drawing rights at banks, it becomes far more difficult to maintain a fixed value for a unit of money since supply can be highly volatile and determined by the complex interaction of many agents.

ii) The Thomistic theory of consumptibles

Aquinas' major argument against interest was, however, based on the observation that money is a consumptible. Like some other goods, such as food, money is essentially 'destroyed' or 'alienated' when it is used. When coins are borrowed, they are only of use if they are exchanged for goods. Hence, a lender of coins (or food) can expect the borrower to repay the exact value of coins (or food) but cannot receive back the same coins that were lent initially.

The importance of this observation is found in the distinction between loan and rental contracts in Roman law. The loan, or 'mutuum', temporarily transferred ownership of that which was lent. The risks associated with the use of the borrowed object devolved onto the temporary owner - that is, the borrower. The rental contract, or 'commodatum', did not transfer the ownership of the leased object but only its use. Any natural risk associated with the object in question remained with the lessor (eg. if a rented house is damaged by bad weather, the tenant is not liable for the damage). So long as the contract remained a commodatum, neither the Medieval Church nor Aquinas saw anything intrinsically wrong in the lessee paying a fee for the privilege of use. Hence rental contracts were deemed perfectly legitimate, so long as the rent charged was 'just'. A rental charge was licit because use and ownership of the object could be separated and the former could be charged for.

But having come to such a ruling, grounds for distinguishing between rent and interest had to be found. After all, if it was legitimate to charge for the use of a rented animal or a house, why was it not legitimate to charge for the use of rented money? It was to answer such a question that Aquinas propounded his views concerning the consumptibility of money:

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[16] Aquinas did not deny that the real value of money could fluctuate due to variation in the supply of goods relative to the supply of money. These fluctuations were accidental, however, and not brought about by intention.

> 'In those things whose use is their consumption, the use is not other than the thing itself; whence to whomever is conceded the use of such things, is conceded the ownership of those things, and conversely. When, therefore, someone lends money under this agreement that the money be integrally restored to him, and further for the use of the money wishes to have a definite price, it is manifest that he sells separately the use of the money and the very substance of the money. The use of money, however, as it is said, is not other than its substance: whence either he sells that which is not, or he sells the same thing twice, to wit, the money itself, whose use is its consumption and this is manifestly against the nature of natural justice' (De malo, Q.13, art.4c; cited in Noonan, 1957, p.53,54).

Aquinas is simply denying the possibility of a 'commodatum' for a consumptible. Since it is technically impossible to separate the use of such goods from their ownership, a rental contract which charges for the use and yet retains ownership rights for the lessor cannot be devised. Under such a contract, the exact item of food or money would have to be returned - an impossible stipulation to fulfil if the object is to be used[17]. In simple terms, Aquinas is saying that a loan of money at interest is equivalent to charging rent on money for the duration of the loan. But, since the money is to be used in exchange for goods, the borrower is being charged rent for something he no longer has use of. Consequently any charge made under such a contract must be either for the non-existent use of the money or for the ownership rights (which are paid for anyway when the loan is repaid). Interest is a charge for something that cannot exist or it is a second charge for something that will be paid for anyway. Hence Aquinas could invoke natural justice considerations against interest.

An interesting illustration of Aquinas' line of reasoning is his acceptance of a rental contract on money that was only to be used for display purposes ('ad pompam'). Under such a contract, the borrower undertook to return precisely the same coins as those which were initially lent having used them for visual effect. Here, ownership rights and use could be separated and a 'commodatum' contract could be formulated. This admission is taken by Noonan (1957, p.56) and Langholm (1984, p.90) to mean that the consumptibility argument was Aquinas' way of re-expressing the sterility argument. Opposition to interest only occurred when profit was being made on a transaction in which money was legally sterile (being consumed in use) and not providing the fruit of use separate from the rights of ownership.

iii) The prohibition of the sale of time

The final major natural law argument deployed by many writers was that interest was the equivalent of putting a price on time. This observation had been made by earlier writers but the first to develop it fully was William of Auxerre (1160-1229) who was seeking a reason to outlaw the charging of higher prices for credit sales - a practice that was not caught by the mutuum/commodatum distinction. According to William, such an exchange contravenes natural law because it involves the sale of time - a charge is made simply for the passage of time rather than any improvement in the physical state of the commodity bought. This practice contravenes natural law because time is common to all creatures and should not be appropriated for money (Summa, III, 21, f.225va). To give and take away time is the prerogative of God alone. The observation was also made that by charging for the use of money per unit of time meant that it was 'working' seven days a week in contravention of Sabbath regulations.

The obvious argument against these observations is that there are legal contracts, namely rental contracts, which effectively put a price upon time by charging for the use of an object in proportion to the time taken for that use. This argument was countered by several interest theorists (Langholm, 1984, p.113). For instance, Giles of Lessines stated that a lessee is not paying for time but that which happens to the rented goods in time (eg. compensation for their deterioration or recompense for the crop that rented land has produced). When the passage of time confers an advantage to the lessee or disadvantage to the lessor, this can be licitly charged for. When, however, this condition is not fulfilled (as in the case of

[17] Aquinas realised that rented objects could also deteriorate through use (eg. a horse or a house). Such deterioration, however, was 'accidental' in the sense that use of the object did not require it to occur. This is not the case with loans of consumptibles.

money) and the passage of time only measures duration rather than changes in value, an interest charge is illicit.

iv) Extrinsic titles to compensation

The prohibition of interest that the scholastics maintained did not mean that a lender would have to suffer loss from the act of lending. Not only could security or personal guarantees be requested by the lender but there arose various grounds for compensation that the lender could use in the event of a loss transpiring from the lending process through default. Such compensation was the original form of 'interest', as distinct from usury on money. Such interest could not be claimed as of right (as occurs now) but only in the event of an unforeseen event occurring which ensured that the borrower could not meet the contractual arrangements. If the lender set out with the intention of gaining such compensation, he was condemned for wishing to profit from the loan.

The first title to compensation ('poena conventalis') came from delay in repayment by the borrower in excess of the contractually agreed date. A penalty was levied for such delay and was designed to encourage prompt payment. The penalty had to take the form of a flat rate charge rather than one that increased in proportion to the time of delay. It was not strictly 'interest' because it was designed as a deterrent rather than compensation. Even this one concession, however, led to abuse by some money-lenders who made most of their profits from such 'penalties' (Noonan, 1957, p.108).

The notion of a penalty for late repayment was the basis for the titles to compensation that became widely accepted from the fourteenth century onwards. Compensation was to be given to the lender on the grounds that the delay in repayment could have caused the lender to miss an opportunity to make a profit elsewhere ('lucrum cessans') or could have resulted in the lender suffering loss through the absence of his money ('dammum emergens'). Initially, the onus of proof was upon the lender to show that loss had been incurred or profits forgone and the compensation was strictly related to these. Eventually, the assumption was made that the lender was automatically suffering through late payment and so had a right to compensation in delay. This was a position surprisingly supported by Aquinas since it assumes that money is automatically fruitful irrespective of the labour used in conjunction with it.

The most influential change in scholastic thinking which initiated much of the Church's leniency towards modern notions of interest (and the financial practices conducted in the Italian city states) was the extention of these titles to compensation from the start of the loan, irrespective of whether the borrower had fulfilled the contractual terms or not. This was an admission of two principles that were entirely alien to the early scholastic writers. First, it abandoned the principle that loans were essentially charitable and gratuitous and should not be regarded as a source of gain. Second, the permission for 'lucrum cessans' to be compensated admitted that possession of money is an automatic source of gain. Initially, both these titles had to be demonstrated by the lender from the outset of the loan. Eventually they became to be assumed so that the lender was entitled to compensation irrespective of whether financial loss had been incurred or not.

These developments did not occur without opposition. Until 1250, no attempt was made to justify any compensation beyond that caused by the borrower failing to fulfil the contractual terms of the loan. Aquinas blamed the lender for stupidity if he incurs loss during the contractual period of the loan (De Malo, Q.13, art.4 to 14). Scotus responded to the objection that it is licit for a lender to keep himself unharmed by assuming that the loan must be charitable:

> 'If (the lender) does not wish to be injured, let him keep back the money he needs, because no-one forces him to do a merciful deed for his neighbour; but if he prefers to show mercy to the other, he is compelled by the divine law not to vitiate the divine law' (In IV libros sententarium, IV:15:2, n.26. Quoted in Noonan, 1957, p.119).

Most of the early scholastic writers identify compensation from the outset of a loan for whatever purpose as removing the foundations of the prohibition of interest upon money. The first expression of approval for l'ucrum cessans' was given by Cardinal Hostiensis in 1270. This did not receive much support until the fifteenth century when the financial practices of the northern Italian city states, particularly in levying forced loans from their citizens and paying compensation, produced fierce discussion. Laurentius of Florence (1403) defended the practice on the grounds that the loans were not voluntary, and so the citizen was not seeking to gain from it, and that the interest paid (5%) was too low to realize any profit due to 'lucrum cessans' and 'dammum emergens'. He extended his argument to all loans made with primarily charitable intentions but which proved to be a cause of loss and inconvenience to the lender. Laurentius is supported by Bernadine of Siena who stated in 1425 that money had no value in itself but only when combined with the owner's industry. A loan deprives the lender of not only his money but also the fruit of exercising his industry through it (Noonan, 1957, p.127). The lender deserves compensation - but only if he would have personally used the money fruitfully and only if the intention behind the loan is charitable. Despite these preconditions, Bernadine is the first prominent theologian who was fully committed to the notion that interest from the beginning of a loan may be intrinsically lawful.

This admission that 'lucrum cessans' could be charged from the outset of a loan proved to be the genesis of uniform rates of interest and a banking system that gave interest upon deposits. It is clearly inconvenient for the lender to have to calculate the profit that he has forgone on every loan made and so it was eventually admitted that lucrum cessans could be declared by the lender as a single percentage interest rate that could be charged to each borrower. Once such an admission is made, the development of a banking system and 'money market' cannot be long delayed. If a lender could definitely receive 5% interest as compensation for profit forgone, a bank could also offer him 5% as compensation for making a deposit with it rather than making the loan. The bank could then justify charging at least 5% for the loans it gave by referring to the cost it was having to incur to attract the deposit or the profit that it was forgoing by not depositing t'he money with another bank. Such reasoning left itself open to the accusation that lucrum cessans' was being used to justify charging for forgoing to profit from another loan rather than profiting from active business involvement. The self-justifying logic of such a system was defended by Leonard Lessius (1554-1623) thus:

> 'Although no particular loan, separately considered, be the cause, all, however, collectively considered, are the cause of the whole lucrum cessans; for, in order to lend indiscriminately to those coming by, you abstain from business and you undergo the loss of profit which would come from this. Therefore, since all collectively are the cause, the burden of compensation for this profit can be distributed to single loans, according to the proportion of each.' (Quoted in Noonan, 1957, p.263).

Banks had been established in Northern Italy since the twelfth century and were deemed legal since they lent on a partnership basis (see below) or made money through the finance of trade. The crucial admission of 'lucrum cessans' enabled such banks to operate licitly on an interest basis from the sixteenth century onwards[18].

IIt was not until the fifteenth century that a scholastic writer considered the risk of non-payment ('periculum mutui') as valid justification for paying compensation to the lender. Such a title was opposed on a multitude of grounds. Albert the Great (1206-1280) observed that interest upon a commercial loan would mean that the borrower undertook all the risk and effort whilst the lender would be certain of his return. Bernadine argued that since risk of non-repayment is intrinsic to the very act of lending, to allow compensation for risk would be to give carte blanche to profit from any loan. Writing in 1449, Antoninus pointed out that the lender incurs no loss if the debt is repaid and can impose a penalty if it is not. In any case, to charge a uniform risk premium is to penalise reliable and unreliable borrowers alike. Scholastic writers also pointed out that since the lender could always insist on taking some form of security, further protection was unnecessary.

[18] This is not to say that professional money-lending and interest-based banking had not been tolerated by governments earlier. Rather, the title enabled such practices to be given the official sanction of the church (Noonan, 1957, pp.171-192).

The first breach in the principle of non-compensation for risk was made by Summenhart in 1499 when he claimed that a merchant should be allowed compensation for his fear of expenses to be incurred in collecting a debt, particularly when no security is involved. Theological reinforcement was given by John Medina in the early sixteenth century who drew analogies with the legality of paying a fee to a guarantor of a debt and charging higher rents when the fear of damage was greater. If recompense for incurring risk is licit in these circumstances, why not in that of a loan? Later Jesuit theologians (eg. Molina writing in 1593-7) accepted compensation for risk in principle whilst specifying certain conditions in which it did not apply (eg. where the borrower has offered security). Despite this position gaining support and a case being made for charging an annual rate of interest to compensate for risk, this title was always the most disputed until 1750 within the scholastic tradition (Noonan, 1957, p.292-3).

v) Partnerships

The scholastic opposition to usury upon money should not be taken to mean that an owner of monetary wealth was not allowed to profit from its use by others. This could be done legally through the formation of a partnership (or 'societas' under Roman Law) between two or more people who would supply varying proportions of monetary capital, labour, goods and expertise. Under Roman Law, the partners agreed their respective shares of the profits (or losses) that each would receive. These did not necessarily have to correspond to the shares of capital and labour each supplied, but the invariable rule of a 'societas' was that if a partner was to enjoy some share of the profit, then he was to share some of the risk of loss as well.

The earliest scholastic writings consistently regard the profiting from such a partnership as not contradicting the prohibition against interest and the partnership contract was widely used in business from the twelfth century onwards. The relevant reasoning was given by Aquinas thus:

> 'He who commits his money to a merchant or craftsman by means of some kind of partnership does not transfer the ownership of his money to him but it remains his; so that at his risk the merchant trades or the craftsman works with it; and therefore he can licitly seek part of the profit then coming from his own property' (Summa Theologica, II-II:9:78:2).

The justification of 'societas' was based on two assumptions. First, that it was legitimate to charge for the use of property so long as the ownership was not transferred. Second, that ownership of property was shown by the incidence of risk - the owner being liable to damages if something untoward occured. In a loan, all risk, and hence ownership devolves upon the borrower who is required to repay the principal irrespective of how successfully or otherwise the money was used. In a partnership, ownership of the capital contributed remains with the partners who run the risk of losing their capital and receive a return that is related to how successful the business venture turns out. The scholastic position was the not unreasonable one that capital return in a business venture had to be related to results, and so be liable to risk:

> "Any merchant making a contract with another for trading must, if he wishes to be a participant of the profit, show himself a participant of the danger and expenses which attend all buying and selling" (Robert de Courçon, De Usura, p.73; quoted by Noonan, 1957, p.135)[19].

The theoretical ramifications of this attitude were twofold. First, if any profit was to be derived from money capital in a business venture, the risk of a variable return had to be present for such profit to be legitimate. If a partnership contract was drawn up whereby a return without risk was guaranteed, it was deemed usurious. Second, the scholastics could make a strong distinction between money on loan and money in partnership, the latter being regarded as productive capital. Whilst money on loan was regarded

[19] Although they never clearly enunciated the opinion, Noonan (1957, p.152) believes that the partnership/loan distinction was maintained because of the risk-sharing benefits of the partnership. A commercial loan at interest implies that the borrower will make a certain return on the money to cover the interest payments. No such risky commitment is required when a partnership is involved.

as sterile, money in partnership was felt to have a 'seminal' quality - an opinion expressed by Aquinas and confirmed by Bernadine.

Later scholastic writers refined the Church's justification for the interest prohibition down to variants of the Thomistic argument that the use and substance of money cannot be separated. Noonan observes that, given the appropriate assumptions:

> 'The theory is formally perfect. But its perfection has been attained only at the cost of a multitude of admissions which render the cases where it is applicable, rare, and the prohibition, in general, nugatory' (1957, p.360).

He concludes that by 1750, despite some reservations,

> 'What is left of the usury rule ... is an objection to immoderate interest. It would be perhaps impossible to think of a transaction involving the extenion of credit at a moderate profit which would not have been justified in terms of the revised scholastic analysis' (1957, p.362).

d. The Approach of the Reformers

The Reformation challenged Catholic tradition in a multitude of areas, including teachings upon economic organisation and interest. In terms of the influence that their teaching on interest was to have upon succeeding generations, Calvin's attitude is the most prominent. The approach of Luther and Melanchthon is also worth noting since it illustrates the difficulties of biblical interpretation with which the Reformers had to grapple.

i) Luther and Melanchthon

Luther's teachings upon interest varied considerably during his lifetime and seem to have been influenced by contemporary political events. Until 1523, Luther was strongly opposed to the charging of interest, particularly in the form of usurious extortions from German states by the Church and ecclesiastical bodies. He rigorously applied the economic aspects of Christ's teachings, particularly when they fulfilled the injunctions of Mosaic law, and stated that Christians are commanded to lend without expecting repayment of the principal. It was therefore unnecessary for Christ to explicitly prohibit interest at all:

> 'If we look the word of Christ squarely in the eye, it does not teach that we are to lend without charge, for there is no need for such teaching, since there is no lending except lending without charge, and if a charge is made, it is not a loan' (Luther's Works, IV,52; cited in Nelson, 1969, p.34).

However, Luther's attitude began to change when radical preachers (eg. Jakob Strauss of Eisenach) began to advocate the cancellation of debts and the complete prohibition of interest. Some even proposed that the judicial aspects of Mosaic law should be used by princes on the basis of civil law. Against the background of the German peasant rebellion of 1525, Luther eventually concluded that Christians were not bound by the civil aspects of the Mosaic law and that to make this the basis of a principality's civil code was to assume mistakenly that a higher proportion of the population were true Christians than was the case. He declared that it was not sinful to pay interest and that, so long as it was regulated to certain levels, interest could be just in certain circumstances. In any case, it was for the princes to reform the law and not for the people to take the matter into their own hands.

Luther's final comments upon interest came in 1539-40 and were prompted by economic depression. Although he exhorted preachers to teach that profit upon a loan is against divine, natural and civil law, they were not to encroach on the areas of other authorities by declaring a particular contract illicit or not. A distinction could be made legitimately between lenders charging moderate rates (who could include the aged, widows and orphans) and gross usurers who charged extortionate rates.

The gradual softening of the condemnation of interest can also be detected in the teachings of Melanchthon. In 1521 he wrote that the prohibition was part of natural and divine law and that the Mosaic discrimination against aliens had been superseded by the Gospel which made all men kinsmen. No statute allowing interest could be legitimately issued. Yet by 1541, Melanchthon was supporting ordinances that regulated rather than prohibited interest. Although preachers were to claim all interest as sinful, the secular rulers should be free only to prohibit excessive interest (Nelson, 1969, p.62).

The key to understanding the changing fortunes of the interest question in the teachings of Luther and Melanchthon is that of how they regarded the application of the Mosaic law to the judicial codes of secular governments. Initially, both leaders felt that the Mosaic code of assumed brotherhood should be the basis of civil law. Their conviction was weakened following the radical conclusions that some preachers came to and the supposition that true Christians were not always the majority of the populace; it being foolish therefore to assume that a spirit of brotherhood could be relied upon, the assumption (in the form of an interest prohibition) should not be the basis of part of the civil law (Nelson, 1969, p.67).

ii) Calvin

Calvin's treatment of usury and interest is noteworthy because he made a distinctive break with the previous teachings of the Church and was freely cited, usually out of context, by those Protestants wishing to liberalise the interest prohibition. The crucial step that Calvin took was to argue that profiting from a loan was not inherently sinful. The basis for this conclusion was Calvin's interpretation of the brother/stranger distinction made in Deuteronomy 23:19,20. The prohibition of interest amongst the Jews was intended to promote brotherly affection. God could not have intended this as a universal spiritual law since it did not apply to dealings with all Gentiles. The Mosaic injunction to regard fellow Israelites as brothers and so to abstain from interest is inapplicable now since:

> 'There is a difference in the political union, for the situation in which God placed the Jews and many other circumstances permitted them to trade conveniently among themselves without usuries. Our union is entirely different. Therefore I do not feel that usuries were forbidden to us simply, except in so far as they are opposed to equity or charity' (Works, XI, p.248; cited in Nelson, 1969, p.78).

Calvin frequently describes the evils associated with interest and, in his commentaries on the Psalms and Ezekiel, accepted that the later Old Testament references gave a blanket prohibition of interest (Mooney, 1988, p.156). Yet the conclusion that Calvin comes to is that the individual conscience, trying to apply the Golden Rule of love, is more appropriate in the situation than the dictates of Mosaic law:

> '.... usury is not now unlawful, except in so far as it contravenes equity and brotherly union. Let each one, then, place himself before God's judgement seat, and not do to his neighbour what he would not have done to himself, from when a sure and infallible decision may be come to..., in what cases, and how far it may be lawful to receive usury upon loans, the law of equity will better prescribe than any lengthened discussions' (Works, XXIV, col.683; cited in Nelson, 1969, p.79).

However, Calvin did not accept the lawfulness of interest in all circumstances. He sanctioned profit from loans to the rich and for commercial purposes but rejected the taking of interest on any loan to the poor, any interest rate that was excessive or illegal and any return that resulted from riskless lending. Calvin's rule of thumb in such transactions was that anything was permissible unless it was injurious to the borrower [20]. Hence, the general attitude was that interest is acceptable but 'not everywhere, nor always,

[20] Somewhat contradictorily, Calvin did make statements to the effect that charging any interest did constitute injury to the borrower but did not then radically apply this opinion, preferring pragmatic vacillation. For instance, when commenting on Ezekiel 18 he stated:

nor in all goods, nor from all' (Works, XL, p.431-32; cited in Nelson, 1969, p.78). In addition, anyone who permanently lived off the fruits of money-lending was to be excommunicated.

Calvin was so unenthusiastic about interest as an institution and hedged it around with so many conditions that Roger Fenton, an anti-usury Puritan, felt able to write that: 'Calvin dealt with usury, as the apothecary doth with poison' (1612). In addition, many of Calvin's supporters in other matters sought to differ with him on this issue. For instance, every English Puritan publication on the subject in the period 1600-1640, and there were many, took a much stronger line in opposition to interest (George, 1957). Nevertheless, those seeking to attack the Church's traditional position upon interest now began to refer to Calvin's views as an authority favouring the legalisation of interest whilst forgetting the qualifications that Calvin believed so essential for the validity of the practice. Tawney remarks:

'Calvin's indulgence to moderate interest, like Adam Smith's individualism, was remembered when the qualifications surrounding it were forgotten; and the practical effect of his teaching was to weaken the whole body of opposition to usury by enabling the critics of the traditional doctrine to argue that religion itself spoke with an uncertain voice' (1925, p.120).

e. Subsequent developments: the regulation of interest

Calvin's influence was first felt in England during the long-running debate about the setting of a legal maximum rate of interest in the sixteenth century. Henry VIII had legalised interest up to ten percent in 1545 - an act that was repealed in 1552. In 1571, however, a further act declared that interest up to ten percent was legal if the borrower wished to pay it whilst declaring any contract above ten percent as void under law. Since borrowers rarely refused to pay moderate interest for fear of losing their creditworthiness, the act effectively legalised profiting from a loan up to ten percent per annum (Tawney, 1925). From then on, the debate revolved around the question of what rate of interest is wrong rather than whether interest is wrong per se[21]. By the time Adam Smith wrote the 'Wealth of Nations' (1776) he did not feel it necessary to discuss the issue of whether interest should exist or not but rather what the legal maximum was to be:

> 'In a country, such as Great Britain, where money is lent to government at three percent and to private people upon a good security at four and four and a half, the present legal rate (five percent) is as proper as any' for, if a higher legal maximum was permitted, 'the greater part of the money which was to be lent would be lent to prodigals and projectors, who alone would be willing to give this high interest' (p.357).

Smith recognised that if a free market in loans was allowed to exist by the state, inefficiencies would arise through loans being concentrated upon the over-optimistic or over-indulgent. This argument was subsequently denied by Bentham (1818) who claimed that money-lending was a trade like any other and that it was entirely inappropriate for the state to intervene and set an artificially low price. Men should not be deprived of the opportunity of paying any rate of interest they saw fit if they needed to borrow. The effect of usury laws which fixed a maximum legal rate was that in areas where the regulation could not be

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> '(W)e must hold that the tendency of usury is to oppress one's brother, and hence it is to be wished that the very names of usury and interest were buried and blotted out from the memory of men. But since men cannot otherwise transact their business, we must always observe what is lawful and how far it must go' (Calvin, 1948, Vol.II, p.228).

[21] The acceptance of interest did not occur overnight and some writers persisted in questioning the whole basis of interest (eg. Wilson, 1572; Smith, 1591; Fenton, 1611). Such views did not prove to be influential due to the seeming need for commercial loans at interest to maintain trading prosperity. In 1638, Claude Saumaise, a Dutch Protestant theologian, finally argued that interest was necessary to civilisation, with free competition in the loan market being of benefit to society by lowering costs.

enforced, particularly in loans to the poor, actual rates charged would be forced up to compensate for the risk of prosecution.

The debate about whether to regulate interest rates or not has continued until very recently, even in countries committed to the free movement of capital and the use of the price mechanism. For instance, until relatively recently the vast majority of states in the US continue to place legal maxima upon interest rates for certain categories of loan[22] although the tendency is towards deregulation. The Japanese government limits the rates chargeable upon short-term commercial loans by the banking system (Corbett, 1987) but no such limitations now exist in the UK - it being legal to charge any rate of interest as long as it is not proven in court to have been extortionate in the circumstances (Consumer Credit Act, 1974).

f. Subsequent developments: theoretical justifications

Since the advent of modern economics from the time of Adam Smith, the nature and function of interest has been hotly disputed. The argument has centred not on whether interest should exist or not but why it does so, how the rate of interest structure is settled upon and whether it is appropriate for the state to use its influence over the money supply to affect the prevailing rate of interest[23]. Rather than attempt to give the history of economic thought upon these issues (which has been done elsewhere by, for instance, Schumpeter (1954), Conard (1959) and Backhouse (1985)), it will suffice to briefly summarise the foundations of the current Western economic thinking as to what interest is.

Economic theory is agreed upon the obvious - that the rate of interest is theprice paid for obtaining the purchasing power over goods (that is, money) now (eg. Santoni and Stone, 1981, p.13). Why lenders receive and borrowers are willing to pay such a price are the issues that have been widely discussed and disputed over. The first comprehensive explanation of these phenomena to receive general support was that of Irving Fisher (1930). He produced a theory to explain how an individual maximised his or her income between present and future periods by investing in real productive assets which would yield future returns.

In order to understand Fisher's theory, however, an explanation must be given of what economists call 'time preference'. This is the term used for the supposedly automatic human psychological preference for the possession of money or goods now rather than in the future. Consequently, lenders must be compensated by interest if they are to receive back the equivalent worth of that which they lent. If a loan of £5 is made to be repaid in a year, 'time preference' ensures that more than £5 should be repaid because the lender values £5 in 1993 more than £5 in 1994. Therefore, to fully repay the loan, compensation must be given to the lender. This compensation is regarded by economists as 'pure interest' rather than compensation for risk undertaken or price inflation.

Such reasoning was never admitted as correct by any scholastic writer before Summenhart. In their view, what constituted the just repayment of a loan was the repayment of that which was lent in equal number and kind. So long as the contractual conditions were met, the borrower was under no obligation to compensate the lender for depriving him or her of the item for a period of time. Modern economics, however, does not recognise that this would adequately repay the loan since conditions have changed, even if it is only the passage of time. Five pounds in 1993 are not the same as five pounds in 1994[24]. This

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[22] These limits were persisted with despite inducing inefficient flows of funds through those states with the more lax restrictions (Bowsher, 1974).

[23] Henceforth, the term '<u>the</u> rate of interest' will be used to mean the complete interest rate structure, with different rates prevailing at any one time corresponding to the degree of risk and time to maturity involved.

[24] This argument is completely abstracted from price inflation. If all prices were entirely stable, economics would still maintain that time preference still exists.

'universal law' that everyone always prefers a bird in the hand today to a bird in the hand tomorrow has been made in the strongest possible way:

'Time preference is a categorical requisite of human action. No mode of action can be thought of in which satisfaction within a nearer period of the future is not - other things being equal - preferred to that in a later period' (von Mises, 1949, p.481).

Bohm-Bawerk (1890) was the first writer to attempt to systematically explain why future goods are generally valued less highly than present goods of the same kind and number. First, there is a difference between present and future needs relative to the means available to the individual to meet them. For instance, some people (eg. students) may expect that their earning capacity will be greater in the future and wish to borrow in the meantime[25]. Second, people value goods in the present more highly because they are finite and mortal. They may lack the willpower or imagination to postpone consumption or they may fear that death may prevent them from consuming in the future. Either way, it will be costly to the individual to postpone consumption until future periods.

These reasons for valuing present goods more highly than future ones are essentially dependent upon personal circumstance or psychology. Hence, there is not a uniform rate at which the value of future goods would have to be discounted to make them comparable to present values. This 'discount rate' varies between people and with the circumstances of any one person[26]. What modern economics insists on is that this discount rate is generally positive.

The implications of such reasoning for the process of lending and borrowing is relatively simple. Those wishing to borrow must be willing to pay compensation for the privilege since the very desire to borrow shows that they are valuing the principal lent more than the amount to be repaid. Conversely, those in a position to lend will only be induced to release their resources on condition that they are compensated for receiving future goods or money in return. Some saving might be undertaken without the expectation of a return but, for savings to be sufficient, an adequate return must be offered (Santoni and Stone, 1981, p.18).

Returning to Fisher, he demonstrated that given certain rigorous assumptions, individuals will be acting 'rationally' (that is, maximising total satisfaction over time) if they so arrange their levels of borrowing and saving so that the prevailing rate of interest is equal to their marginal rate of time preference[27]. The result should be that no individual could increase his or her total satisfaction over time by reaarranging their levels of borrowing, investing and lending. This will be an equilibrium position for the individual.

There is no guarantee, however, that when everyone has reached their own equilibrium position at the existing interest rate, that the total levels of desired lending and borrowing will match. If the interest rate is 'too low', there will be an excess demand for loans. If the interest rate is 'too high', there will be an excess supply of loans (in the form of bank deposits). Given the condition that the market for funds is competitive, the rate of interest should adjust until the supply and demand for such funds equate and the 'equilibrium rate' is achieved. Neither Fisher nor subsequent economists have believed that such an equilibrium can ever be achieved in reality because at no time are all the underlying assumptions fulfilled. Given these imperfections, the theory suggests that the rate of interest should always be moving towards the equilibrium level but may never attain it.

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[25] Economists call such considerations 'life-cycle' influences. Forward-looking individuals will wish to even out consumption levels over their lifetime by borrowing when needs are high relative to income (eg. a young family to support) and repaying when this situation is reversed (eg. when the children have left home).

[26] The percentage premium that a person is willing to pay at a particular moment to transfer one unit of consumption from the future to the present is known as the person's 'marginal rate of time preference'.

[27] This result is entirely dependent upon the assumptions that there are diminishing marginal returns to investment and a diminishing marginal rate to time preference.

This whole approach (known as the 'loanable funds' theory) sees the function of interest rate movements as being to match desired saving with desired investment in real terms and match desired lending with desired borrowing in money terms simultaneously. The interest rate acts like any price to ration the supply of available funds to those who desire to borrow most, that is, those who can invest most profitably or those with the greatest degree of time preference. It makes no distinction as to the social usefulness of borrowing for real investment and borrowing to consume. Such a theory argues against regulation of the rate of interest by government for purposes of social justice since such interference would produce inefficiencies in the allocation of the supply of funds.

The main alternative to this 'neo-classical' theory within conventional economics is based upon the contribution of Keynes, particularly in 'The General Theory of Employment, Interest and Money' (1936). The novelty of his approach centred upon a different view of what the payment of interest rewarded. It had previously been thought that interest was the wealth-holders reward for abstaining from immediate consumption. It was compensation for overcoming time preference and 'waiting' (eg. Cassel, 1903). Keynes objected because he felt a significant proportion of saving was done for motives other than to benefit from interest and because the hoarding of money was 'abstaining' from consumption but it was not rewarded by interest. Hence:

> 'The mistake originates from regarding interest as the reward for waiting as such, instead of as the reward for not hoarding...' (1936, p.182).

If interest is not the price of saving, what is it the price of? Keynes felt that it was the price of money, or rather the liquidity services that money provided. Interest was needed to induce wealth-holders to part with their money rather than hoard it to facilitate transactions, to meet unexpected liabilities in emergency and to avoid loss on capital assets when their prices fall. The rate of interest was determined in the market for money with the government being able to fix the supply (through bank regulation, control of currency issues and sales of government debt) and the demand coming from everyone who needed to hold money for whatever purpose. The equilibrium rate of interest occurred when people were willing to hold the amount of money that the government supplied to the economy.

An important aspect of Keynes' theory was that he believed a rate of interest that was too high could be a cause of chronic unemployment and depression (1936, p.204). The reasoning Keynes gives for his conclusion is given in Chapter 17 of the 'General Theory' and is somewhat complex[28]. Suffice it to say, Keynes envisaged an economy in which a bank deposit could yield a 10% return whilst the best projected return from investment in real assets could be 9%, with no inherent tendencies to change. Under such circumstances, some employment-producing investment would be curtailed before full employment was achieved, with spare resources deposited at the banks instead.

Keynes' belief that the free movement of the money rate of interest could prevent full employment coloured his views as regards policy direction. He advocated that the state should undertake a proportion of national investment (which could escape the discipline of the prevailing interest rate for the public good) and active involvement by the Central Bank in the bond market to depress the long-term rate of interest - a proposal which the post-war Labour government followed in its 'cheap money' policy of 1945-7. Keynes even reassessed past schools of economic thought under the criterion of how they tackled this problem associated with the money rate of interest. In this light he called for a rehabilitation of scholastic analysis. He saw the scholastic attempt to distinguish between the return on real investment (the 'marginal efficiency of capital') and interest on money as a device to maintain investment and prevent the diversion of scarce savings into hoards of money or consumption loans since:

> 'In a world... which no one reckoned to be safe, it was almost inevitable that the rate of interest, unless it was curbed by every instrument at the disposal of society, would rise too high to permit of an adequate inducement to invest...(I)t now seems clear that the disquisitions of the schoolmen (scholastics) were directed to the elucidation of a formula which should allow the schedule of the

[28] A paper by the author on the subject is available through the Jubilee Centre.

marginal efficiency of capital to be high, whilst using rule and custom and the moral law to keep down the rate of interest' (1936, p.351-2).

Although Keynes' perception of scholastic motiviation and understanding might not have been entirely accurate, he saw himself within the school of thought that advocated the abolition of financial return without effort, particularly from other people's debts (1932, p.136). Keynes believed that such a task would be accomplished within one or two generations as capital accumulated to such an extent that the rate of interest would naturally fall to zero. Such an outcome would result in the 'euthanasia of the rentier' (1936, p.376). In this, Keynes was not alone since, twelve years after the 'General Theory' was published, Roy Harrod (1948) gave a lecture entitled 'Is Interest Obsolete?' and seriously considered the implications of moving to an interest-free economy[29]. Although such contemplations appear wishful thinking to contemporary British eyes, it needs to be remembered that, at the time these ideas were being considered, Britain was experiencing relatively stable prices and very low interest rates.

This was the last occasion upon which the institution of interest has been questioned by Western economists outside Marxist theory. The 'neo-classical' and Keynesian theories of interest form the basis of most modern explanations of how the rate of interest is determined. The heat of the battle has now shifted to questions of whether the government can and should attempt to set the rate of interest and the best means of doing so, given the potential for price inflation in some courses of action.

g. The Current Position of Christian Economic Thinking

Given the importance with which the question of interest has been treated in the history of the Church, it might be expected that contemporary Christian writings upon economic issues would give some discussion of the biblical prohibition of interest and possible implications for a Christian social vision of economic organisation. Such treatments are few and far between, however.

In his Christian critique of contemporary economics, Donald Hay comments that:

> 'The prohibition of usury within the community (of Israel) meant that savings would be applied within the family enterprise, rather than lent for interest. There were no returns on resources without a direct exercise of stewardship responsibilities in deciding the use to which they were to be put' (1989, p.74, emphasis added).

Despite making this insightful comment, Hay does not develop any radical implications from the principle and just uses it to support the general norm that work is the means of exercising stewardship. Similarly, Storkey (1986) places the prohibition of interest within a category of laws which attempted to institutionalise loving interpersonal relationships (pp.72-73) but then fails to radically apply this insight (despite being willing to radically critique financial systems upon other criteria).

Neither of these authors regard the Old Testament law as strictly normative in shaping a Christian social vision. It is not surprising, therefore, that they do not see the need to apply radically the prohibition of interest. A more strict analysis is made by the 'Reconstructionist' school of Rushdoony (1973) and North (1973) who seek to apply many of the civil aspects of Old Testament law to Christian believers. They follow Calvin in making a distinction between profiting from loans to rich and poor borrowers. They feel that the Old Testament only prohibits any increase taken from the poor in return for a loan (eg. North, 1973, p.362). The blanket condemnation of interest given in Deuteronomy is explained by the observation that Deuteronomy is summarising the laws previously given in Exodus and Leviticus and so apparently assumes their emphasis upon loans to the poor (Rushdoony, 1973, p.473). Consequently, the interest-free loan should be an act of charity not to be confused with an interest-bearing loan for commercial purposes,

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[29] It must be noted that both Keynes and Harrod were hypothetically raising a situation where there was no return to any form of capital investment, not just no interest on money.

so long as there is participation by the lender in the risk of the enterprise (North, 1973, p.363). Neither author explicitly tackles the subject of taking interest from a consumption loan to a rich person but, given their definition of what the Bible prohibits, this would presumably not be outlawed.

The only recent writer (known to the author) to uphold a strongly prohibitive stance towards interest has been Mooney (1988). He writes within the 'theonomist' school of Old Testament interpretation which regards the law as still applicable to believers and unbelievers alike (see Bahnsen, 1977). Consequently, Mooney believes that the interest prohibition should still apply to everyone since the injunction of Deuteronomy means that interest should only be taken from those that one regards as 'enemies'. Since Christians are loath to regard anyone as an enemy they should not consider extracting interest from them or institutionalising emnity within the laws of society (1988, p.153). Mooney refutes every popular excuse for interest and even goes so far as to regard rent as interest and advocate its elimination (pp.172-190). However, he agrees with the justice of profiting from partnerships and equity ownership where the return to capital is not fixed. Given this perspective, Mooney believes that the initial response of the Church should be repentance.

The final current school of thought to have given consideration to the question of interest is that of 'Jubilee ethics' based on the initial work of Wright (1983) and Clements and Schluter (1986). They regard the Old Testament law as a model or 'paradigm' for Christian social ethics (Wright, 1983, p.43). The law is a model to be emulated but not a blueprint to be slavishly copied. In analysis, due weight must be given to how different laws interact with one another to see what God was trying to achieve as a whole. In application, the best methods of achieving these goals now should be advocated with due consideration being given to the possibility that literal application might still be appropriate. A priori, this approach should attempt to analyse what the prohibition of interest was attempting to achieve within the context of the time and using contemporary tools to achieve the same goals now, without automatically ruling out contemporary application of the interest ban if it is still the best tool for the job. Working within this framework, Schluter (1986) sees the Bible as prohibiting all interest and believes the reasons to be that it attempted to prevent financial flows from undermining kinship relations within Israel, the concentration of power through the concentration of finance capital and the growth of wide disparities in income and wealth (pp.5-8). In making policy proposals, Schluter suggests policies to restrain greater industrial concentration but does not attempt to examine the consequences of a contemporary prohibition of interest.

5. A CONTEMPORARY APPROACH

a. Lessons from the Paradigm [30]

The previous discussion gave a brief outline of the 'paradigm' method of using the Old Testament law for the purpose of formulating social ethics. This approach emphasises the interdependence of the civil laws and the need to appreciate how they interrelate before deciding on their ultimate purpose or contemporary application. Before the question of the morality of interest is examined, it is worthwhile to see how the prohibition fitted into the overall framework of law and economic institutions of the time in order to indicate its rationale.

The review of Old Testament teaching on loans and interest (pp. 4-7) made it clear that the loan was solely intended for charitable purposes. Not only was all interest on all loans to fellow countrymen prohibited but debts were to be cancelled every seven years and strong encouragement was given to the support of the poor through interest-free loans (Leviticus 25:35-38). This was reasserted as a positive command (Deuteronomy 15:7-9). Seemingly, a ready supply of interest-free loans was a central plank of Israelite welfare provision for the poor and complemented the periodic provision in kind made by the tithe system (eg. Deuteronomy 14:28, 29) and the gleaning regulations (Lev. 23:22) It can surely be no coincidence that the occasion when God promises the elimination of poverty within Israel if the law is obeyed comes in the context of debt cancellation and the command to lend freely. Many Jewish communities still maintain free loan funds and attribute some of their economic resilience to such funds.

The insistence that a loan must be motivated by love and generosity rather than as a source of profit reinforces the Bible's whole emphasis that material goods, including money, be made subservient to the fostering of healthy inter-personal relations. For instance, the law of the kinsmanredeemer (Leviticus 25:25) insists that the nearest relative must buy back any familial land that is sold outside the family, if possible; in addition, if a family member sells himself into slavery to a resident foreigner, any relative has the right of redemption over him (v.49). Jesus strikingly illustrated the point by advocating the use of wealth to develop relationships that would be counted as righteous come eternity (Lk 16:8, 9). Given this teaching, it is not surprising to find that interest is prohibited between brother Israelites whereas exception is made for foreigners (Deuteronomy 23:19, 20). This was an institutionalising of loving mutuality in financial relations between those living within the borders of Israel[31]. This imperative was given priority over any desire of Israelites to make interest-bearing loans. Freedom of contact was overridden in favour of encouraging healthy relationships. In this context, the sanction for the charging of foreigners can be explained by the need to dissuade financial contacts for reasons of religious purity or to emphasise the need for brotherly mutuality between fellow countrymen. The result may have been to draw attention to the righteous nature of Israel's law and so act as a sign to the nations of the wisdom of Israel's God (Deuteronomy 4:5-8).

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[30] The use of the Old Testament law as a paradigm for ethical purposes is based on the traditional belief that the books of the law were written largely by Moses during the period of Israel's wilderness wanderings. Consequently, they can be regarded as authoritative and interpreted as having a coherent plan to them. Much of the recent textual criticism has assumed a different authorship and time of writing for the separate books although the evidence is far from conclusive. The traditional approach can still be defended (eg. Young, 1970; Wenham, 1970). Further discussion of how the Old Testament should be used for the purpose of social ethics can be found in Goldingay (1981), Wright (1983), Webb (1988), and Clements and Schluter (1990).

[31] The incompatibility of interest with mutuality may not be immediately obvious to the Western mind. However, it is still regarded as improper to charge a sister for the loan of £20 or a neighbour for the use of one's lawnmower. If such charges were made, the loan would cease to be a favour and would become a commercial transaction.

The immediate effect of obedience to the laws on loans and interest would have been the extinction of the profession of money-lending. The prevalence of money-lenders has been and is a prominent feature of most agrarian societies. They tend to develop from the more prosperous farmers with spare money capital to lend, into a community's main source of credit both for consumption and investment purposes through the charging of high interest rates and the seizure of under-valued collateral[32]. As a result, land-holdings and monetary wealth can become concentrated in their hands and a significant proportion of the community can be reduced to being landless labourers or debt slaves following a poor harvest (eg. Spufford, 1988, pp.335-6). Money-lenders can often impose such harsh conditions due to the lack of competition in the supply of credit and justify their position by the high risks they undertake. Their depressing effect on rural prosperity and development has been well-documented (eg. Firth and Yamey, 1964).

The abolition of profitable money-lending that the Old Testament law envisages would have encouraged decentralised financial flows between members of the same family or neighbourhood. These would result from the lender's need for personal contact with the borrower. The absence of interest would ensure that the lender would need to know if the borrower had a good chance of repaying since provision for unrecoverable debts could not be made by charging a higher interest rate. Resort could be made to specifying security or accepting the debtor into household service until the remaining obligation had been repaid. Whatever happens, the lender needs to have some knowledge of the borrower's circumstances if a good chance of repayment is to be ensured. Alternatively, the lender could be motivated by the prospect of some non-monetary benefit being given in return for the loan. This could take the form of reciprocal free loans in the future, favours of various kinds or simply more trusting family relationships[33]. Finally, if a lender was providing money capital in a commercial partnership and agreed to receive a share of the profits or losses from the venture, not only would he need to have established a relationship of trust with his other partners but he would need to have good information on how the venture was progressing if he was sure that he was not being cheated. In all these circumstances, the charging of a fixed rate of interest would conserve on the need for information and trust, but, as a result, would have lessened the need for social interaction between lender and borrower. By being so informationally efficient, interest enables lender and borrower to relate only on financial terms, resulting in the potential for financial flows between individuals who hardly know each other. The prevention of such a tendency would have been one of the byproducts of the interest-ban and ties in with the emphasis placed upon subordinating the self-centred use of money to the wider social goal of developing and deepening relationships.

A final observation worthy of note in the context of the overall Old Testament paradigm is the interrelationship between the land and capital markets. It has long been argued that, if rent can be charged for the use of land, interest on money has to exist since a lender can always purchase land and earn a rent with the money he would otherwise have lent. Consequently, to induce anyone to lend, interest must be given to at least equal the return on land[34]. This precise argument will be addressed below. What is of interest, however, is the role played by interest as a discount factor in the valuation of land. The

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[32] Gordon (1982, p.414) has made the suggestion that the condemnation of the later prophets of the unwarranted and exploitation of loan collateral (Amos 2:6; Micah 2:8-10) may indicate that the ban on interest was being enforced effectively and that this was the only way to profit from a loan.

[33] In ancient agrarian communities, credit was closely allied to reciprocal gift-giving (Mauss, 1954). For instance, ancient Athenian society awarded great prestige to the interest-free loan between friends and relatives:

> "..interest in the Athenian model has an overtly ethical function...[I]n personal transactions between relatives, friends, neighbours and the like, there was an almost automatic expectation of a reciprocal favour at some future date; in impersonal transactions where there was no bond or a desire for a bond between borrower and lender, repayment terminated the association, and interest took the place of the return favour" (Millett, 1983, p.116).

[34] This argument was first propounded as a general explanation for <u>all</u> interest by the physiocrat Turgot (Bohm-Bawerk, 1890, p.40-41).

phenomenon arises because land is the only theoretically permanent asset that we can possess. Hence, its potential sale value is infinite since a rental income could be derived from it ad infinitum. However, this does not arise where aninterest rate exists to act as a rate of discount of rental incomes derived in the future[35]. Rents that would be received far in the future are made almost of no consequence in current values by the use of an interest rate as a discount factor. In this way, the sale value of land becomes finite and manageable. Clearly, if an interest rate does not exist it would seem impossible to transfer the freehold ownership of land in return for money (Mises, 1949, p.523). The Old Testament solved the problem by not allowing a freehold market in land and limiting the maximum term for leasehold to forty-nine years (Leviticus 25:14-17). Consequently, an upper limit is placed on the leasehold value of land at the value of forty-nine harvests. In this way the land could be transacted leasehold without the need for a discount factor to be applied. The ban on interest would seem to necessitate the declaration of a jubilee of the land.

These are some of the insights gained by viewing the ban on interest in the context of the whole Old Testament law. The applications it indicates include the need to foster decentralised financial flows within communities and the development of non-interest loans as a part of welfare provision. This approach, however, cannot definitely say whether the prohibition of interest is normative for today or not.

b. The Moral Status of Interest

Throughout Christian history, the crucial question surrounding interest is whether it is morally evil in God's sight or not. If it is, then the injunctions of the Old Testament law are binding on all Christians at all times. If it is not, then the law in question may provide some indication as to the structure society should adopt (as the paradigm approach suggests) but does not have binding moral force in all circumstances. The moral status of interest is, therefore, of crucial importance.

The most important indications that the prohibition of interest is a more serious moral issue than most Christians currently believe come from the biblical material itself. The injunction is given three times in the law and the reference in Deuteronomy is worded so as to rule out any exception in dealings with resident Israelites. The complementary law of debt cancellation should have ensured that loans could not have been a source of profit. Later references take an extremely serious view of the moral obnoxiousness of taking interest and mention no exceptions. Ezekiel lists interest-taking amongst the crimes for which Jerusalem was sacked (22:12) and for which a person will be severely judged (18:13). David believed that the righteous man would refrain from lending at interest (Ps. 15:5). It seems difficult to believe that such gravity would be ascribed to the moral seriousness of interest-taking if the law did not have more than a pragmatically beneficial effect. Nehemiah believed in the lasting significance of the law since he reimposed the interest ban (5:7-11) and the cancellation of debts (10:31) despite living hundreds of years after the law had been given and in changed circumstances.

Contrary to widespread opinion, Jesus does not legitimise the taking of interest in the parables of the talents and the ten minas (see above, p.9). In both cases the untrustworthy servant is condemned for his actions in not using his resources productively and for his words when he expresses the belief that the master was a 'hard' man. His words are inconsistent with his actions since a hard man would have 'reaped where he had not sown' by putting the money on deposit at interest. Since the servant failed to do this, his verbal defence collapses and his own words condemn him (Luke 19:22). Given this more careful reading of the text, it is difficult to see how it can be used to justify the taking of interest by Christians, particularly in view of the notorious difficulties in deriving ethical norms from the behaviour Jesus commends in some parables (e.g. Luke 16:111). This conclusion is reinforced by the other references to lending that Jesus makes in the Gospels (Matthew 5:42; Luke 6:34, 35). The thrust of the latter passage, irrespective of the precise detail of what was recorded originally, is that Jesus' followers are to go far beyond the "I'll scratch

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[35] As indicated above, orthodox economists now explain the existence of interest by the supposed psychological preference to consume goods now rather than in the future. Hence, the rate of interest can be used to discount future values to make them comparable to present ones.

your back if you'll scratch mine" philosophy of the "sinners" around them. He asks them to lend even to their enemies without expectation of either principal or favours being returned. Surely this must involve the relinquishing of interest in all circumstances by those claiming to follow Jesus' teaching?

For three quarters of its history, the Church interpreted this biblical material as indicating that profiting from a loan was morally sinful and required repentance and restitution of ill-gotten gains. This traditional approach has been attacked on three grounds in particular[36].

i) The 'Deuteronomic Double Standard'

The most obvious objection was raised in connection with Calvin's views and is prompted by the exemption from the interest ban of loans to foreigners. If the taking of interest is morally evil, why did God allow the Israelites to so 'exploit' the foreign borrowers whom they lent to (Deuteronomy 23:20)? If interest is inherently unjust, this would mean that God was sanctioning wrong-doing. Since this would otherwise produce a moral contradiction, interest must be morally acceptable and was prohibited amongst the Israelites for reasons specific to the time and their culture. Nelson (1969, p.xxiv) summarised the history of this line of argument thus:

> "Modern exegetes friendly to expanding capitalism cherished the isolated Deuteronomic exception as heavent-sent proof of their contention that their medieval predecessors had exceeded the Lord's mandate in proclaiming a universal prohibition of usury. Beginning with Calvin... they showed how it was possible to escape both horns of the Deuteronomic dilemma: they sloughed off the discrimination against aliens by appealing to Christian brotherhood, and sloughed off the prohibition of usury, the inevitable corollary of the Hebrew and medieval exhortations to brotherhood, by triumphantly citing the Deuteronomic exception."

However, the Deuteronomic exception can be explained in a number of ways. One of the most popular was that of Ambrose referred to earlier (p.12-13). This equates the 'foreigner' of Deuteronomy 23:20 with the original Canaanite peoples of Palestine whom God had allowed the Jews to exterminate on their entry into the land as judgement on the Canaanites' idolatry (eg. Deuteronomy 7:22-26). The charging of interest was thus a continuation of his 'holy war' carried out in the form of exploitative lending. Luther expressed the idea thus:

> "If, therefore, for the sake of vengeance on the Gentiles, God wants to punish them through usury and lending, and commands the Jews to do this, the Jews do well obediently to yield themselves to God as instruments and to fulfil His wrath on the Gentiles through interest and usury. This is no different from when He commanded them to cast out the Amorites and the Canaanites.." (Works; W,XIV,655; quoted in Mooney, 1988, p.150).

This argument sees the charging of interest as a demonstration of outright animosity on the part of the lender in his dealings with the borrower. Whilst the precise logic of the argument does not hold up to textual scrutiny[37], it puts in clear focus the question of lending and relationships that was raised in discussion of the overall paradigm. It seems reasonable to suppose that one of the reasons for the Deuteronomic exception was to help to create a feeling of social solidarity between all those living within

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[36] Many of the other popular justifications for interest not covered here (such as risk compensation, inflation, the encouragement of saving and time preference) are caustically and ably refuted by Mooney (1988, pp.115-214).

[37] The Hebrew word used for 'foreigner' in Deuteronomy 23:20 is 'nokri', an all-encompassing term for non-resident aliens. This term would have included many more than the seven racial groups that the Jews were given permission to exploit. If only this was intended, these races could have been specified. Conversely, remnants of these people remained resident within the borders of Israel after the conquest and would have presumably been referred to as resident aliens ('ger') rather than foreigners.`

the borders of Israel (Neufeld, 1955, p.406). When viewed in these terms, Christians today have to decide whether to treat the members of the society in which they live either as 'foreigners', and charge them interest, or 'brothers' and forego a return on loans (Mooney, 1988, p.151-2). Jesus' teaching upon the moral requirement to love one's enemies, let alone neighbours, in the specific context of lending must surely argue for the latter.

The most satisfying reconciliation of the Deuteronomic Double Standard with the inherent evil of interest is the need for reciprocal arrangements in the financial transactions prevailing between different societies if justice is to be maintained. Neufeld points out that foreigners were not regarded as part of Israel's theocratic brotherhood and were consequently not bound by Israelite law (1955, p.390-1). Hence, when lending to Israelites when in Israel, they were under no obligation to observe the interest ban or periodically to cancel debts. Obviously this was also true when Jewish travellers borrowed in other countries. Under these conditions, it is easy to see that the Israelites were open to exploitation if obliged to lend freely and cancel debts to foreigners when no such reciprocal obligation existed:

> "If an equal basis for trading between Israelites and foreigners was to be established it could be attained only in this way; that the restrictions of the release year and the law of interest, which were not binding on the stranger a priori, were also void for the Israelite insofar as trade with foreigners was concerned" (Guttmann, 1926, p.7)[38] [39].

The existence of the Deuteronomic exception can thus be reconciled with the inherent injustice of interest in some way. The explanations of the reinforcement of the theocratic brotherhood and the need for just reciprocity are complemented by the parallel exemption to the law of periodic debt cancellation[40] a text which those wishing to justify interest rarely mention. Consequently, the Deuteronomic exception cannot be used as a definitive proof of the moral acceptability of interest.

ii) Commercial Interest

This is not the last of the difficulties raised by the Deuteronomic Double Standard. It has been consistently used by those wishing to justify the charging of interest on productive or commercial loans, hence destroying the notion that interest is inherently unjust. This line of interpretation contends that the Old Testament abhorrence of interest applies to consumption loans only. For instance,

> "...in all passages forbidding interest-taking, only consumer loans are in focus, never loans for productive purposes. Borrowing money for the purpose of producing more money is never on the horizon of the Biblical writers" (Howard, 1962).

This assumption is based upon the observation that until the reign of Solomon, there is little evidence of Israelites being engaged in organised, large-scale trade despite major trade routes passing through Palestine (Neufeld, 1955, p.378). International trade was conducted solely by foreign merchants. Since the only commercial loans made by Israelites would be to these traders, the Deuteronomic exception has been taken to mean that commercial loans were exempt from the general prohibition of interest (eg. von Rad, 1976, p.148). This interpretation is, of course, reinforced by the common observation that if

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[38] Calvin recognised that the Deuteronomic exception worked to produce just, reciprocal arrangements (1950, p.128).

[39] Gordon (1982, p.412) has attributed the Double Standard to an application of the 'lex talonis' - the Jewish principle of just retribution (eg. Exodus 21:23-25) - which maintained a just reciprocity between crime and punishment.

[40] Any explanation of the Deuteronomic Double Standard must be compatible with Deuteronomy 15:3 since it is an exact parallel to the foreigner exception but applied to the periodic cancellation of debts. It is difficult to believe that this parallel is merely coincidental when both exceptions deal with lending practices and appear in the same law code.

money is borrowed and used in trade or production to produce a profit, what can be wrong with the lender sharing in the profit his money has made possible?

This explanation of the text does not stand up to scrutiny, however. The most powerful objection is that the universal wording of the Deuteronomy prohibition presupposes both commercial and consumption loans and rules out interest in both cases (Meislin and Cohen, 1964, p.265). If the original author had wished to allow commercial lending for productive purposes, then this distinction could have been used rather than that of brother/foreigner. In any case, in an agriculturally-based society, it is difficult to believe that 'productive' loans did not occur between the Israelites. The simplest case would have been loans of seed grain between farmers which would usually have been productive but which would still come under the Deuteronomic proscription. It is therefore something of a non sequitur to claim that Deuteronomy sanctions interest on commercial loans because the Israelites tended not to engage in international trade.

iii) The Reasonableness of Interest

The root cause of why the inherent evil of interest has been questioned throughout history is that it is not readily apparent what is wrong with it per se. The historical survey showed that societies have often seen the exploitative properties of interest when the rates charged have become too high and regulation of interest rates has been a common feature of economic law from the Code of Hammurabi to the present day. What natural intuition fails to grasp is why should the charging of profit on a loan be inherently unjust if both parties consent to the payment. If the loan is for consumption purposes, why should not the borrower pay for the privilege of consuming more goods now rather than in the future and the lender be compensated for the risk he undertakes and the inconvenience of being deprived of his money? If the loan is for productive purposes, why should not the lender benefit from the profit made with his money? The outcome of such thinking has been that only one attempt has been made to abolish interest in a society not committed to monotheistic revelation[41] [42]. The only serious attempts to question the very existence of interest have come from Judaism, Christianity and Islam whose attitudes on the subject have been directly or indirectly shaped by the Old Testament law[43]. The common problem that theologians and jurists from each tradition have been faced with is that the Scriptures involved are fairly explicit in their condemnation of interest but give no explicit explanation as to why this should be so. The result has been a multitude of speculations as to why interest is inherently immoral, some of which have been given in the analysis of medieval thinking. Yet clarity on the issue is vital if there is to be any conviction in reasserting the stance of the Old Testament and any possibility that those who do not recognise its authority will take the idea at all seriously. Some reasoning for the belief in the inujstice of interest must therefore be given.

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[41] The Roman Senate passed the Lex Genucia in 342 B.C. This attempted to abolish interest altogether and give debtors legal sanctions against usurers. The law had little practical effect, however, and the legal maximum rate of interest soon returned to 8 and one-third or 10% (Cleary, 1914, p.23; Maloney, 1971, p.91).

[42] These statements concerning the importance of monotheistic revelation do not apply to those societies founded upon the belief in the 'labour theory of value' and which consequently attack any notion of a return on capital being legitimate.

[43] The Islamic antipathy towards interest is, of course, based on the condemnations found in the Qu'ran. It is, however, likely that Mohammed was strongly influenced by the Old Testament since he had early contact with Jews and subsequently expressed support for the Jewish scriptures if not for the Jewish interpretation of them.

c. The Uncharitableness and Injustice of Interest

Rather than attempt to set out an all-embracing critique of interest, it will be easier to examine interest on consumption loans, then that on productive loans against the background of biblical teaching concerning returns to capital in general.

i) Interest on Consumption Loans

The most straightforward, but still disputed, case in which interest can be seen to be uncharitable is that of the consumption loan; that is, a loan to finance purchases of goods or services to satisfy current needs. The biblical material is insistent that such a loan be made for charitable purposes. Indeed, the Old Testament seems to assume that only if such a transfer is made without a charge can it be designated a 'loan'. As Luther remarked,

> "...there is no lending except lending without charge, and if a charge is made, it is not a loan" (quoted more fully above, p.23).

The purpose of such a loan was to satisfy immediate need. The result was that the borrower lost some degree of financial independence due to the obligation to repay in the future (Proverbs 22:7) and could lose the loan security if repayment was not forthcoming. Consequently, to charge for such a loan in the form of interest was to profit from the need of another and to further erode their financial independence by committing them to pay interest at an agreed rate irrespective of their circumstances. The commitment to repay interest-bearing debt on the part of the borrower must be seen as somewhat foolhardy since an assumption is being made that future income will be forthcoming sufficient to repay the debt and the interest, which may be charged at a variable, and hence more uncertain, rate. Such an assumption may turn out to be correct but if it does not the debtor can be further enslaved by the action of compound interest. The very nature of interest-bearing consumption loans acts to remove the financial liberty of the borrower, enables the lender to profit from need and frequently reinforces the inequality of wealth distribution in society since those in need of consumption loans tend to be those with fewest realisable assets.

The exploitative nature of consumer loans at interest has long been recognised and has been one of the major reasons prompting the regulation of interest rates and the periodic prohibition of compound interest[44]. Nevertheless, such regulation has usually been ineffective in benefiting the needy borrower since the prosecution of extortionate moneylenders means that the blackmarket rates of interest will be pushed even higher and most of the potential borrowers are in such a desperate plight that they have no alternative but to pay these higher rates. The ineffectiveness of such 'usury laws' in Britain prompted Parliament to remove any limit to interest rates in the Consumer Credit Act (1974). The subsequent deregulation of consumer lending practices has produced a far greater degree of over-indebtedness and consequent social problems. This, in turn, has prompted the relaxation of court procedures for personal debt recovery, in order to relieve the social distress that results from having a highly indebted population.

From a biblical and moral point of view, this outcome is far from satisfactory since the legislature is sanctioning the non-repayment of debt. This is tantamount to theft (Psalm 37:21) unless performed in the context of a deliberate debt cancellation programme. A far more satisfactory solution would be the reassertion of the legal requirement to repay debt, the abolition of interest on consumer loans and reliance upon local interest-free loan funds for those in need, preferably financed through personal deposits and donations than local taxation. Such an idea seems so impractical to the Western mind because we have become familiar with the notion that any loan we make to anyone for consumption purposes, via the mechanism of a bank deposit, is 'investment' and should be rewarded with interest. Very little is lent freely as a result because everyone now expects to be rewarded for placing their monetary wealth in someone else's hands. The intermediating role of Western

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[44] The Justinian Code, for instance, prohibited the compounding of interest ('anatocism') and did not allow the total interest paid to exceed the loan principal (Maloney, 1971, p.95).

banks has obscured the fact that every depositor who receives interest is, in part, profiting from the payment of interest on consumption loans.

ii) Rent and Hire Charges

The preceding analysis may have given the impression that any form of return derived from monetary capital is morally repugnant. There have been socialists, Christians amongst them, who have taken this view based on the belief that labour is solely responsible for the production of goods and services and should receive all the value created as remuneration[45]. This, however, has tended not to be the most widely-held belief in Christian tradition which has generally upheld the legitimacy of both rental charges and returns from risk-sharing capital investment.

The biblical attitude to rental and hire contracts is open to differing interpretations but seems to see little to object to in charging for the use of property. The Jubilee legislation ensured that a freehold land market should not have existed in Israel and provision was made for leasehold purchase until the next Jubilee (Leviticus 25:14-17). The text points out that the payment is for the harvests during the period and not for the 'use' of the property. In the case of productive land however, this distinction would appear to be purely semantic[46]. Houses in villages could not be sold freehold but were included in the leasehold of the associated land (v.31). It is unclear, however, whether any rental value for them was included in the leasehold price. Further references are made to the renting out of property (eg. Song of Songs 8:11; Acts 28:30), but these do not indicate any normative teaching. However, reference is made to a contract between owner and tenants in Jesus' parable of the tenants in the vineyard (eg. Luke 20:9-19). This is not a 'rental' contract, as most modern translations state, whereby a flat-rate rent was charged irrespective of the value of the harvest. Rather, this is a cropsharing arrangement whereby the return to the owner was dependent upon the size of the harvest. Such an arrangement shares the risk of crop failure between landlord and tenant and can be economically beneficial if the share received by the owner is not exploitative (Stiglitz, 1974). This parable cannot be definitively used to say whether crop-sharing arrangements are ethically preferable to rental contacts but Jesus does seem to accept the legitimacy of the owner receiving a return for the use of his property even though he has not personally laboured to produce it.

The Old Testament law contains numerous references to the hiring of workers for the payment of wages but only one regulating the hire of movable property (Exodus 22:15)[47]. When placed in the context

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[45] The belief that interest is immoral because it constitutes the profiting from another person's labour has been a recurrent theme running through the Christian analysis of interest (Birnie, 1952). although this has never been a majority view, and did not form the basis of the medieval antipathy to interest, anyone who lives solely off interest has been condemned as a social parasite in line with Paul's principle: "If a man will not work, he shall not eat" (II Thessalonians 3:10). Despite his qualified acceptance of interest, Calvin insisted on the excommunication of professional money-lenders in Geneva, for instance.

[46] If the text was taken literally to mean that the leasehold payment was to be the <u>total</u> expected value of the future harvests then this would exceed the value of a rental payment which requires some surplus to be left to remunerate the labour involved in cultivating the land.

[47] Mooney (1988, p.173-4) denies that this verse allows for the charging of the animal on its own and claims that the owner of the animal is simply being hired with it and is using the beast as a 'tool of the trade'. His rendering of the verse (v.15b) is:

> "..if he (the owner) is a hireling then it (the animal) came for his (the owner's) hire."

Mooney goes on to equate all rent with interest and believes the prohibition applies to rental contracts also. However, this is the less natural way of translating the verse. The more obvious translation attributes the hire-charge to the use of the animal. This conclusion is reinforced by the verse seeming to distinguish between two separate situations - one where the owner is present and one where he is absent.

of v.14, the passage legislates for three different situations when someone uses the services of an animal which he does not own. The first is that of a loan of the animal. In this case, if the animal dies whilst in the borrower's possession, he is obliged to restore an equivalent animal or its value to the lender - as is the general rule with all loan agreements. The second case (v.15a) arises when animal and owner are hired together, as a ploughing team for instance. Here, an all-encompassing hire charge is paid and if the animal dies, the lessee is under no obligation to replace it. The third instance (v.15b) occurs when the animal is hired on its own, as opposed to being borrowed[48]. If it dies whilst in the lessee's possession, there is again no obligation to make restitution because the hire charge should take some account of this risk[49]. The legitimacy of hire charges which this interpretation suggests is reinforced by the frequent references to the hiring of objects made in the rest of the Old Testament (eg. Isaiah 7:20; I Chronicles 19:6; Zechariah 8:10). The familiarity of the concept to Israelite society would suggest that if hirecharges were illegitimate, than an explicit statement to that effect would have been given in the law. Therefore, the biblical position seems to be that hire charges for property are justified although there is some indication that when dealing with productive land it is more desirable to enter into a crop-sharing agreement.

iii) Interest on Commercial Loans[50]

The other major form of money loan, other than that to finance consumption, is that to finance a supposedly profit-making business venture. The Bible is even less explicit in its teaching upon such arrangements than in the case of rental or hire charges. The Old Testament law does not object to the making of reasonable profit from trade or gaining from the leasing of productive land but does prohibit the profiting from a loan, including loans for investment purposes. This position is reflected by Jesus making a strong distinction between "putting money to work" (Matthew 25:16), presumably by trading, and "putting money on deposit with the bankers" (v.27) which he implicitly regards as "reaping where you have not sown" (v.26).

How, then, should commercial investment for profit-making purposes be financed? The solution seems to be provided by the traditional answer of the partnership, combining both equity ownership of money capital with a profit-share basis for remuneration (see pages 21-22 above). Partnerships have been legislated for in Jewish, medieval Christian and Islamic law codes as being a legitimate way to profit from the provision of monetary capital to a business venture consistent with the overall prohibition of interest. The crucial features are that the capital-providing partner agrees to accept a pre-arranged proportion of the profit or loss from the venture - the share being dependent on how much monetary capital and labour is being provided by other partners - and must be prepared to lose all his money if the business venture fails since he remains the legal owner of the share in the business and so must run the risks associated with its use. The crucial distinction between this arrangement and a commercial loan is that the return to the partner is related to the profitability or otherwise of the venture whereas interest is due irrespective of the return actually made with the money. This feature of interest can be seen as immoral in that it betrays a presumptuous attitude towards the future, since both borrower and lender are both assuming that a rate of return will be forthcoming that will at least cover the interest charges. This is not the attitude we are meant to have towards the future (Proverbs 27:1). "All such boasting (about future profitability) is evil" (James

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48 The distinction between loan and hire contracts indicates that the latter do not come under the interest prohibition. The charge for a loan ('nesbak') is prohibited. The charge for the use of an object is hire ('sakar') and is not overtly prohibited.

49 The simplest analogy is that of a rented house. If the house is destroyed through no fault of the tenants, they are not required to compensate the owner. Neither are they obliged to pay for insurance to cover this risk. The renting of property does not transfer ultimate ownership and the risk intrinsic to the property rests with the owner.

50 In a sense, this is equivalent to assuming that money is naturally fruitful and will yield a return without being used in exchange of goods and service which can be worked with to produce a return. But as soon as money is traded with, risk is involved and profit becomes uncertain. The partnershhip arrangement recognises that obvious fact of life and takes account of it.

4:13-16). Hence, the injustice of interest on commercial loans is not derived from the belief that any such return is exploitative but that it rests on an arrogant approach to the future and shifts all the risk involved in making a profit onto the borrower.

When seen in this light, the process of commercial lending at interest is, effectively attempting to make money itself profitable without being subject to the risks involved in using the money for profit-seeking purposes. It is enabling money savings to yield a return without ensuring the necessary investment that is needed to procure that return[51]. This paradox was highlighted by many authors in the 1930s and 1940s[52]. It was expressed by Benvenisti thus:

> "Under a contract of hypothecation (a secured loan) the lender not only expects his money to fructify without the immobilization of his principal, not only reserves his right to recover the principal intact at due date, and in some cases at will, but insists on complete protection against risk by securing a lien on the borrower's goods often far in excess of the amount of the loan.... The claim of the owner of money is.... that the capital to which it is a title must not only be fruitful but also rent producing, not only fruitful but also at the same time liquid which is absurd; for it means that it is at one and the same time to remain itself and become something else" (1937 p33,36).

Interest-based commercial loans do not automatically produce difficulties for the contracting parties. Often, sufficient return is made by the borrower to allow the repayment of principal and interest. An interest-based system is, however, particularly vulnerable to unexpected changes in the economic position of either individual borrowers or the whole society. During improving economic conditions, economic agents overborrow as interest rates tend to lag behind the improvements in expected profitability. When economic conditions deteriorate, borrowers find themselves over-committed to interest payments that can bear little relation to the diminished profits being made with the money. Bankruptcies ensue and price inflation slows down as more assets are sold to repay debts. This is part of a theoretical explanation of a trade cycle (Minsky, 1977). It would be overstating the case to claim that all cyclical fluctuations are the result of an interest and debt-based financial system, but there is little doubt that such a system has caused and amplified cycles in the past. Fisher (1933) highlighted the role of debt and interest when developing a theory to explain the 1930s depression.

The clearest example of the havoc that a financial system based upon interest can cause is that of bank lending to low income countries (LICs) in the past fifteen years. Western banks lent heavily at variable rates of interest to private and public bodies in these countries in the belief that a country as a whole could not go bankrupt. At the time, few problems were foreseen as rates of interest were moderate whilst the world prices of commodities, and hence LIC export earnings, were rising rapidly. At the time, the loans were heralded as a great contribution to the development of these poorer countries. The transition came with the sharp rise in world interest rates and an abrupt decline in world commodity prices of the early 1980s. The result was that the interest rates on LIC debts rose whilst their ability to repay worsened dramatically. It subsequently transpired that a significant proportion of the loan finance was not used to invest in productive or human capital but was embezzled, financed arms purchases or paid for large government projects now regarded as 'white elephants.' The result has been that LICs have been burdened with large debts, the interest on which they have problems in paying, defaults have occurred, further loans have not been forthcoming and severe economic recession has been forced on most of these poorer countries. It is believed that the lives of millions have been lost as a result and the health and education of millions more have been blighted (eg. Jolly, 1989).

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[51] The fallacy that money should be allowed to produce a return irrespective of how it is invested is most graphically highlighted by any simple exercise in calculating compound interest over long periods of time. For instance, it has been calculated that if Jesus had deposited a denarius with a banker at a compound interest rate of 4% p.a., the deposit would have been worth an amount of gold equivalent to the weight of the earth by 1750 (Kennedy, 1988, p.13).

[52] For instance, see Somerville (1932), Belloc (1932) and Kelly (1945).

The injustice of the situation is sensed by many but the root cause of the problem, interest charges being unrelated to the return earned with the money lent, is so obvious that few have recognised it as such. Western publics may be concerned about the plight of these countries but do not recognise that it is their banks' commitments to pay them a return on their deposits that is at the heart of the problem. Periodic problems in international lending will continue until it is realised that developmental finance for health, education and infrastructure projects should always be interest-free whereas potentially profitable projects should be on a profit-share, equity basis.

6. THE FEASIBILITY OF AN INTEREST-FREE FINANCIAL SYSTEM

It is one thing to criticise the current interest-basis of the Western financial system. It is quite another to formulate a practical replacement upon non-interest lines. Yet without such an alternative, there is little possibility that those who do not recognise the authority of the Bible on this issue will take the matter at all seriously. The key features of such a system are the elimination of all returns on monetary loans, the legitimacy of hire and rental charges and the financing of commercial investment through profit-share arrangements. These three aspects have been common to rabbinic, medieval Christian and Islamic schools of thought at varying times in their history. At present, the only serious work in this area is being conducted by Muslims convinced of the need to strictly obey Qu'ranic teaching and the Sharia. Before this work is reviewed, however, it will be instructive to analyse the Medieval experience of attempting to enforce the interest prohibition.

a. The Consequences of the Medieval Interest Prohibition

The Medieval Church began to enforce an interest prohibition with some vigour from the thirteenth century onwards. It is impossible to say how rigorously this proscription was enforced or obeyed and there were many examples of interest being charged upon loans, some of them (eg. Jewish moneylenders) being sanctioned by civil law. Various pieces of circumstantial evidence suggest, however, that the interest prohibition was generally adhered to. Commercial loans were frequently made on a partnership basis with the interest paid on bank deposits being classified as 'discretionary gifts'. Alternatively, banks made profits from dealing in bills of foreign exchange which were regarded as legitimate by the Church (de Roover, 1974). Moneylenders frequently resorted to forms of contract designed to conceal interest in a legal form. For instance, loans were given freely on condition that the borrower paid for an article of merchandise at an inflated price, or interest was payable so long as an unlikely event (such as the death of the borrower) did not occur. Such contractual forms illustrate that the interest prohibition was generally observed by the letter if not in spirit. Hence, in the light of the impact of the 1571 statute against usury in England, Jones observes:

> "Because they were so careful to secure their loans with contracts that fit like pieces of a jigsaw puzzle into the law's loopholes the lenders have left us clear evidence that they knew and feared the statute against usury (1989, p.117)[53]`.

A speculative conclusion that some writers have come to is that the interest prohibition was positively beneficial for medieval commerce since it had the effect of diverting liquid capital away from consumption loans and into productive enterprise. This was realised early in the critique of interest by Innocent IV. He believed that if interest was widespread:

> "..men would not give thought to the cultivation of their land...and so there would be so great a famine that all the poor would die of hunger." They would be unable to borrow to buy implements, since "the rich, for the sake of both profit and security, would put their money into usury rather than into smaller and more risky investments" (Apparatus, V, De Usuris, ante c.1; quoted in Tawney, 1938, p.56).

Noonan (1957, p.195) is tentative in his conclusion that the usury prohibition probably channelled some resources out of the small loan market but Spiegel (1987, p.770) is more confident in his assertion that the scholastics' stance encouraged the spirit of enterprise and risk-taking investment. The most compelling evidence, however, comes from the case study of Lane (1966). He estimates that by the early

[53] Despite the widespread use of legal fictions and non-observance of the law, Tawney (1925, p.134) believed that the interest prohibition was still of use because it denied the moneylender legal protection against default and deprived the profession of official respectability.

thirteenth century, 91% of Genoese commercial investment contracts were of the partnership form. The interest ban was particularly effective in this respect in Venice since there was no land to invest in or to act as security for consumption loans. He concluded that:

> "...the doctrine created pressure on men possessed of liquid wealth to find some way in which to make their wealth yield income. It thus encouraged the flow of capital into commerce. It is logical to conclude, then, that the usury doctrine, insofar as it was effective, stimulated economic growth" (p.68).

As a result, Taeusch (1942) was forthright in his praise of the Church's attempt to promote a credit system that recognised the need for flexibility of return. This principle is taken to its logical conclusion in the Islamic model of an interest-free system.

b. The Properties of a Modern Interest-Free System

i) An Interest-Free Bank[54]

If a moral stance is taken against interest, a bank can neither lend or borrow with returns unrelated to the profitability of the use to which such funds are put or which do not constitute a hire charge for the use of property. The working principle of such a bank is that of partnership. When money capital is provided for commercial investment, any profit or loss is shared on a pre-specified proportionate basis. In addition, the bank can also engage in commodity and share trading, it can finance real estate purchases or engage in leasing equipment or property. When a depositor designates his deposit for investment purposes, it is added to the bank's overall portfolio and allocated a share of any profit or loss that the bank makes on its investments. In essence, therefore, the investment side of the bank's business becomes equivalent to that of a unit trust with returns on deposits being related to profitability. Like a unit trust, the depositor could also lose part of the money if the portfolio proves to be loss-making. However, like conventional banks and unit trusts, the non-interest bank can diversify its investments so as to reduce the potential for loss.

The transactions side of a bank's business could be conducted in two ways. It could use a proportion of its demand deposits for investment purposes and so be able to provide current accounts to its customers with few charges. If this practice was widespread, the central bank would have to specify reserve requirements and provide a 'lender of last resort' facility to maintain public confidence in the transactions mechanism and to prevent any losses on the bank's portfolio from affecting its ability to honour its current account liabilities. Alternatively, the bank could simply hold transactions deposits in cash and highly liquid assets or use a proportion to provide interest-free short-term overdrafts to its profitshare borrowers. This option most closely resembles proposals for a 100% reserve banking system which would dispense with the need for state deposit insurance and remove the bank's ability to create money (Simons, 1948; Friedman, 1969).

ii) Parallel Forms of Finance

The interest prohibition is designed to eliminate certain types of loan. The most obvious is that of consumer credit at interest. However, the permissibility of hire contracts means that consumption could be achieved without the prior need for saving through the straightforward rental of the goods in question or hire purchase[55]. In addition, retailers' interestfree credit offers could be financed by banks who take a

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[54] There is no unanimity amongst Islamic writers concerning the precise operation of an interest-free bank. The basic model given is that of Siddiqi (1983a).

[55] Although the purchase of a consumer durable may cost just as much with a hire purchase scheme as with a loan at interest, the hire purchase form has the advantages that the purchaser is never 'in debt' with the option of returning the goods if payment cannot be maintained and that the hire charges are determined by the price of the goods involved rather than the overall level of interest rates in the economy.

share of the retailers' extra profit arising from the additional custom generated. These forms of consumption finance would need to be complemented by interest-free loan funds provided for poverty relief and financed by local taxation or a proportion of bank current accounts. Hopefully, these more convoluted forms of financing consumption before saving would lessen the current preoccupation with borrowing as much as one's income can service.

Similarly, the prohibition of interest eliminates the possibility of mortgage-finance for house purchase. The existence of rent, however, again makes the devising of alternatives comparatively simple. Either the bank can buy the property in question and let it out to tenants who pay in excess of the market rent whenever they wish or on a contractual basis and gradually accumulate an ownership share in the property or finance intermediaries to do this on a profit-share basis. This is equivalent to buying a house on a hire purchase basis. The advantages of such a scheme over those of mortgage-finance are that the buyer is not necessarily committed to buy the whole property but could just purchase a proportion, the buyer is not forced to accumulate ownership if his or her circumstances worsen and the price paid for houses would be primarily determined by the conditions in the housing market rather than the international money market influencing interest rates. Given the problems that mortgage finance has caused in the British housing market, such an alternative has attractions.

The clearest break that an interest-free system makes with the current system is in the area of public finance. Forms of government borrowing would be severely circumscribed in an interest-free economy. For public investment projects which are expected to produce a financial return, bank finance should be available on a profit-share basis or the state could float marketable shares. But for projects with no financial viability or for current expenditure needs, there would be no alternative to full taxfinance. The requirement of a balanced budget for expenditure purposes removes the state's vested interest in inflation (so as to reduce the real burden of its borrowing) and its potential for inflationary money-creation. It also ensures that a government is not allowed to shift the burden of current expenditure onto future generations of taxpayers[56].

iii) Effiency in the Allocation of Funds

An oft-used justification for the existence of interest is that it efficiently allocates loanable funds between competing uses. Those who can use such funds most profitably will be willing to borrow at higher rates of interest. As the rate of interest rises to attract a greater supply of funds, marginal borrowers will stop demanding such funds, leaving the most advantageous propositions to be funded.

In reality, such an outcome may not result from an interest-based system since it has been observed that 'credit-rationing' often results. This is when a borrower is denied credit despite being prepared to pay in excess of the going interest rate. This has been explained by banks being unable to assess the risk of a commercial project as well as the loan applicant. If they charged a higher rate of interest as a result of greater demand for loans, this would tend to dissuade those applicants who could make a moderate profit with little risk and leave them with the potentially high return but high risk projects which would tend to be less profitable overall. Bank revenue may therefore be maximised at an interest rate below the market-clearing level. Stiglitz and Weiss (1981) conclude that in such a situation:

> "there is no presumption that the market equilibrium allocates credit to those for whom the expected return on their investments is highest" (p.407).

This problem arises because banks do not benefit directly from financing the most profitable ventures and fund projects with the safest cashflow or collateral instead. Such conservatism is reinforced by these banks having taken deposits on an interest-basis which must be paid come what may. This conservatism is something a profit-share bank should be able to avoid since it has a direct incentive to identify and fund the most profitable ventures. This pressure is increased by competition for profitshare

[56] Interest payments on government debt account for approximately 20% of US federal expenditure. It is projected that this figure will rise to 25% in Italy in the mid-1990s (Congden, 1988).

deposits since these would be attracted to those banks who invest most profitably. The function of equating the supply and demand of loanable funds that the interest-based system claims it performs is emulated in the interest-free system by the banks altering the profitshares that they charge from borrowers and offer to depositors (Siddiqi, 1983b, p.101-110). Hence, the allocative properties of a profit-share system need not be derided and could possibly prove more beneficial than those of its interest-based counterpart.

iv) The Reaction of Savers

It is often stated that people only save because of the interest they receive. If interest were abolished, would this not lead to a large reduction in saving? This cannot be accepted as a foregone conclusion, however. A significant proportion of saving is prompted not by the size of the return but by psychological desires for security and wealth or to finance expected consumption in the future. In any case, the profit-share system does not eliminate returns on all saving but just makes the return more uncertain by being related to the profitability of the underlying investment. It is savers' reactions to uncertainty of return that is crucial. If they are risk averse, savers will tend to prefer consumption now rather than an uncertain return. But if savers have a target level of income they wish to achieve, the logical response to greater uncertainty is to increase the level of savings.

To add to this inconclusiveness, the realised real return on profitshare deposits may not be more uncertain in any case. The pooling of bank investments, a diversified bank portfolio and the use of reserves should ensure that investment deposits only suffer loss in a severe cyclical downturn. Meanwhile, interest rates on savings tend to be uncertain in that they are variable with the state of the economy and can have their real value eroded by an uncertain inflation rate. A profit-share system should relate the return on savings to the inflation rate in that as profits rise in inflationary conditions, this will be automatically passed on to savers through the profit-share mechanism. Consequently, there are no strong grounds for supposing that the real return on savings will be markedly more unstable in a non-interest system or that, if it were, the average savings propensity would definitely fall.

v) The Reaction of Borrowers

The crucial benefits and costs that the profit-share system produces arise with the relationship between bank and commercial borrower. The major benefit of the non-interest system is that it shares the risk of profit failure. Since the level of profit is always uncertain, a risk averse borrower will tend to prefer the bank to undertake some of these risks. The benefit is that when profits are unexpectedly low, the borrower is not saddled with fixed interest payments and when profits are unexpectedly high, they are shared with the bank. This seems a far more sensible way of allocating risk than the interest system whereby the borrower carries the risk of profits not matching up to interest payments and the risk of variable interest rates rising unexpectedly. The potential for bankruptcy is high, particularly for small businesses and farmers dependent on a single market or product.

The problems produced by a profit-share system are the disincentive effects that could arise when lending to farmers and small businesses and the greater information needs of the system. When financing individual entrepreneurs on a profit-share basis, there is the potential that the borrower will not maximise profits or put in as much effort since the bank will be taking a share. Under an interest arrangement, once interest and principal are paid, all extra profit goes to the individual. In addition, a profit-share bank would have to incur large information-gathering costs in assessing the viability of ventures and verifying the declared profits of the businesses concerned since they have an incentive to conceal profits. Hence, the banks need to employ their own business consultants, to advise on the feasibility of proposed projects, and their own auditors, or rely on the probity of the accountancy system. The bank needs to establish a long-term relationship with the firms involved, so as to reduce some of these costs, as is done in the Japanese financial system. Alternatively, the bank could gain inside information by being represented on the boards of companies in which it has a profit-share stake, as happens with German banks. These problems are not insuperable and may turn out to be to the borrower's benefit since profit-share banks will have an incentive to use their business experts to vet projects and to provide advice and financial assistance if the borrower runs into trouble or needs help in developing the business[57]. Hence, the risk-sharing benefits of a non-interest system need to be weighed against the possible disincentive effects and the extra costs of conducting bank business on a 'relationship basis'.

vi) The Stability of a Non-Interest Banking System

An interest-based banking system is inherently fragile because banks use transactions deposits, which can be demanded without notice by depositors, for the purpose of longer term investment while guaranteeing the nominal value of those deposits. This combination of features leads to the potential for runs on individual banks. Once it is suspected that a bank may be unable to meet its fixed obligations, depositors rush to withdraw deposits whilst the bank has reserves left to pay them. This could force a solvent bank into insolvency as it is forced to sell its assets quickly at low prices to meet its obligations. If the contagion spreads to other banks, the whole system could be in danger of collapse since all banks could try to sell assets at the same time, thus driving their prices down further. Each bank may also try to call in its loans from other banks who might, in turn, find themselves unable to repay immediately.

Such a crisis last happened on a large scale in the early 1930s and prompted most governments to devise methods of diffusing such risks. This has been achieved by deposit insurance (guaranteeing the nominal value of deposits up to a fixed limit) and the 'lender of last resort' facility to prevent the failure of solvent but illiquid banks. These precautions have generally succeeded in preventing widespread bank failures but not without cost. Deposit insurance has encouraged banks to take excessive risks and reduce their reserves in the belief that their depositors will not suffer financially if the bank collapses. This tendency is intensified by the 'lender of last resort' facility which can give the impression that some banks are too big to be allowed to fail. The provision of such safety nets has proved to be extremely costly to the taxpayer in instances where deposit insurance reserves are inadequate to make the required payout (such as the current Savings and Loan debacle in the US). Alternatively, the central bank may be forced into increasing the money supply on an ad hoc basis by providing emergency loans.

These costs, and the potential for bank collapse, should be reduced under an interest-free system. The flexibility of the value of savings deposits ensures that the bank's solvency is not threatened by a lossmaking portfolio since the shortfall is passed on to depositors. The sharp division between transactions and investment deposits should ensure that the transaction mechanism is not threatened by poor investment performance. If the profit-share bank had made some short-term interest-free loans, a central bank would still be required to provide emergency liguidity, but the bailing out of loss-making banks to prevent a widespread collapse and deposit insurance should become unnecessary, ensuring lower charges to borrowers and higher returns for depositors. The greater robustness of the profit-share system would not eliminate the need for bank regulation or all possibility of financial collapse, but the central bank's task of ensuring bank stability should be less burdensome.

vii) Cycles and Inflation

It has already been pointed out that the interest-based financial system can be accused of amplifying the trade cycle. Apologists for the profitshare proposals believe that it would not act in such a way. This is based on the claim that such a system would be less prone to bank panics and collapses and that finance for consumption and speculative purposes would play a far less prominent role. The profit-share feature could also reduce the probability of bankruptcy in times of slump and dampen investment demand when profits are buoyant.

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[57] Much of the success of the Mondragon complex of worker co-optives in Basque Spain can be attributed to its associated local bank, the Caja Laboral Popular, that collects savings from co-operative workers and reinvests them in the associated co-operatives. The CLP maintains a close relationship with the borrowing businesses including the formulation of business reconstruction plans and market research (Thomas and Logan, 1982).

Although difficult to assess, the potential for an interest-free system to prove inflationary would appear less than its interest-based counterpart. The impossibility of devising non-interest bearing equivalents to finance consumer borrowing and government deficits should ensure that the majority of bank finance should be used to facilitate new production. By only rewarding finance if it results in economic value and profit, a profit-share system links the growth of the money supply with that of real goods and services. If new finance results in the diminution of economic value (measured by financial loss), the 'money supply' contracts through the decline in the nominal value of deposits. The higher reserve requirements for transactions deposits should ensure less scope for banks to create money, or even eliminate this prerogative altogether. These features mean that the supply of money should be closely tied to the value of transactions within the economy and ensure that the monetary system has little intrinsic ability to create money.

viii) Assessment

This analysis of an interest-free system is not wholly hypothetical. Both Iran and Pakistan have theoretically abolished interest since the early 1980s. Whilst some interest-bearing contracts have been just replaced by those carrying arrangement fees and transactions charges, and conventional government debt persists, progress has been made in moving to a profit-share banking system - particularly on the deposit side of the business (Khan and Mirakhor, 1987). Where interest-free banks have been established they have been warmly welcomed by Muslim depositors and have performed as well as, if not better than, their interest-based competitors (El-Aksher, 1987). The theoretical evidence briefly surveyed here suggests that there would be certain disadvantages (most notably in greater information-gathering costs and weakening entrepreneurial incentives) and some forms of finance would disappear altogether. The rewards for such an upheaval would be found in a more allocatively efficient and robust financial structure which diversifies risk to a greater extent and does not amplify movements in the levels of productive activity or prices. The prohibition of interest may strike everyone as a revolutionary notion but it need not be impractical[58].

[58] The Islamic view of a theoretical financial system, that has been discussed here, has little to say about the need for the decentralisation of financial flows which is the basic application to be drawn from the paradigm approach to the Old Testament (Schluter, 1986). Reliance on profit-share would produce some move in this direction due to the need for a relational basis to bank business, but the prohibition of interest should not be seen as the only motivation needed to achieve this goal.

7. CONCLUSION

Whenever the question of the Biblical prohibition of interest arises, Christians always seem to explain away the teaching and never consider it of contemporary significance. The belief of this author is that the Bible deserves to be taken far more seriously on this issue than has been the case for the last four hundred years. It is hoped that the arguments set forth in this paper will convince some that this should be so.

The Christian should not need pragmatic justification for obedience to God's Word but on this issue we have been given plenty of evidence that an interest-basis to an economy can cause many problems and injustices. A non-interest system would not solve every financial difficulty but should be viable and possess enough attractive properties to be a more desirable system than our present one. The rest of society cannot be expected to take the notion at all seriously until more Christians believe that the Old Testament has contemporary relevance for social and economic policy. For too long we have accepted the economics of either Right or Left without question or alternative. The Old Testament teaching on interest provides just such a challenge and the basis for an alternative.

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