CHAPTER XII

ALLEGED INTRINSIC JUSTIFICATIONS OF INTEREST

In his address as President of the American Sociological Society at the annual meeting, Dec. 27, 1913, Professor Albion W. Small denounced "the fallacy of treating capital as though it were an active agent in human processes, and crediting income to the personal representatives of capital, irrespective of their actual share in human service." According to his explicit declaration, his criticism of the modern interest-system was based primarily upon grounds of social utility rather than upon formally ethical considerations.

A German priest has attacked interest from the purely moral viewpoint.[1] In his view the owner of any sort of capital who exacts the return of anything beyond the principal violates strict justice.[2] The Church, he maintains, has never formally authorized or permitted interest, either on loans or on producing capital. She has merely tolerated it as an irremovable evil.

Is there a satisfactory justification of interest? If there is, does it rest on individual or on social grounds? That is to say: is interest justified immediately and intrinsically by the relations existing between the owner and the user of capital? Or, is it rendered morally good owing to its effects upon social welfare? Let us see what light is thrown on these questions by the anti-usury legislation of the Catholic Church.

[1] Hohoff, "Die Bedeutung der Marxschen Kapitalkritik"; Paderborn, 1908.

[2] Pp. 64-67, 88, 89, 96.

Attitude of the Church Toward Interest on Loans

During the Middle Ages all interest on *loans* was forbidden under severe penalties by repeated ordinances of Popes and Councils.[1] Since the end of the seventeenth century the Church has quite generally permitted interest on one or more extrinsic grounds, or "titles." The first of these titles was known as *lucrum cessans,* or relinquished gain. It came into existence whenever a person who could have invested his money in a productive object, for example, a house, a farm, or a mercantile enterprise, decided instead to lend the money. In such cases the interest on the loan was regarded as proper compensation for the gain which the owner might have obtained from an investment on his own account. The title created by this situation was called "extrinsic" because it arose out of circumstances external to the essential relations of borrower and lender. Not because of the loan itself, but because the loan prevented the lender from investing his money in a productive enterprise, was interest on the former held to be justified. In other words, interest on the loan was looked upon as the fair equivalent of the interest that might have been obtained on the investment. It took the gain that was passed by.

During the seventeenth, eighteenth, and nineteenth centuries, another title or justification of loan-interest found some favor among Catholic moralists. This was the *praemium legale,* or legal rate of interest allowed by civil governments. Wherever the State authorized a definite rate of interest, the lender might, according to these writers, take advantage of it with a clear conscience.

To-day the majority of Catholic authorities on the subject prefer the title of virtual productivity as a justification. Money, they contend, has become virtually productive. It can readily be exchanged for income-bearing

[1] Cf. Van Roey, "De Justo Auctario ex Contractu Crediti," and Ashley, "English Economic History."

or productive property, such as, land, houses, railroads, machinery, and distributive establishments. Hence it has become the economic equivalent of productive capital, and the interest which is received on it through a loan is quite as reasonable as the annual return to the owner of productive capital. Between this theory and the theory connected with *lucrum cessans* the only difference is that the former shifts the justification of interest from the circumstances and rights of the lender to the present nature of the money itself. Not merely the fact that the individual will suffer if, instead of investing his money he loans it without interest, but the fact that money is generally and virtually productive, is the important element in the newer theory. In practice, however, the two explanations or justifications come to substantially the same thing. Nevertheless, the Church has given no positive approval to any of the foregoing theories. In the last formal pronouncement by a Pope on the subject, Benedict XIV [1] condemned anew all interest that had no other support than the intrinsic conditions of the loan itself. At the same time, he declared that he had no intention of denying the lawfulness of interest which was received in virtue of the title of *lucrum cessans,* nor the lawfulness of interest or profits arising out of investments in productive property. In other words, the authorization that he gave to both kinds of interest was merely negative. He refrained from condemning them.

In canon 1543 of the new and revised Code of Canon Law approved and promulgated by Pope Benedict XV, September 15, 1917, we find a reiteration of the traditional principle that it is unlawful to take interest on the intrinsic ground of the loan itself. On the other hand, we find a rather general, though negative, authorization of interest taking on extrinsic grounds. Indeed, one such title, legalization by the State, is mentioned specifically. The whole

[1] Encyclical, "Vix Pervenit," 1745.

canon may be thus translated: "If a fungible thing (anything that is consumed at first use and is replaceable in kind) is transferred to a person so as to become his property and later returnable only in the same kind (not identically) no profit may be taken by reason of the contract itself; nevertheless it is not *per se* unlawful to contract for the legal rate of interest, unless that be clearly exorbitant; nor is it wrong to agree upon a higher rate if there is at hand a just and proportionate title."

In brief, interest is not necessarily wrong if it does not exceed a reasonable legal rate; nor even if it does exceed the legal rate, provided that it is based upon adequate external grounds. Undoubtedly such grounds would include greater risk and the opportunity of larger alternative gains through investment.

All the theological discussion on the subject, and all the authoritative ecclesiastical declarations indicate, therefore, that interest on loans is to-day regarded as lawful because a loan is the economic equivalent of an investment. Evidently this is good logic and common sense. If it is right for the stockholder of a railway to receive dividends, it is equally right for the bondholder to receive interest. If it is right for a merchant to take from the gross returns of his business a sum sufficient to cover interest on his capital, it is equally right for the man from whom he has borrowed money for the enterprise to exact interest. The money in a loan is economically equivalent to, convertible into, concrete capital. It deserves, therefore, the same treatment and the same rewards. The fact that the investor undergoes a greater risk than the lender, and the fact that the former often performs labor in connection with the operation of his capital, have no bearing on the moral problem; for the investor is repaid for his extra risk and labor by the profits which he receives, and which the lender does not receive. As a mere recipient of interest, the investor undergoes no more risk nor exertion than does the lender. His claim to interest is no better than that of the latter.

Interest on Productive Capital

On what ground does the Church or Catholic theological opinion justify interest on invested capital? on the shares of the stockholders in corporations? on the capital of the merchant and the manufacturer?

In the early Middle Ages the only recognized titles to gain from the ownership of property were labor and risk.[1] Down to the beginning of the fifteenth century substantially all the incomes of all classes could be explained and justified by one or other of these two titles; for the amount of capital in existence was inconsiderable, and the number of large personal incomes insignificant.

When, however, the traffic in rent charges and the operation of partnerships, especially the *contractus trinus,* or triple contract, had become fairly common, it was obvious that the profits from these practices could not be correctly attributed to either labor or risk. The person who bought, not the land itself, but the right to receive a portion of the rent thereof, and the person who became the silent member of a partnership, evidently performed no labor beyond that involved in making the contract. And their profits clearly exceeded a fair compensation for their risks, inasmuch as the profits produced a steady income. How then were they to be justified?

A few authorities maintained that such incomes had no justification. In the thirteenth century Henry of Ghent condemned the traffic in rent charges; in the sixteenth Dominicus Soto maintained that the returns to the silent partner in an enterprise ought not to exceed a fair equivalent for his risks; about the same time Pope Sixtus V denounced the triple contract as a form of usury. Nevertheless, the great majority of writers admitted that all

[1] Cf. St. Thomas, "Summa Theologica," 2a 2ae, q. 78, a. 2 et 3.

these transactions were morally lawful, and the gains therefrom just. For a time these writers employed merely negative and *a pari* arguments. Gains from rent charges, they pointed out, were essentially as licit as the net rent received by the owner of the land; and the interest received by a silent partner, even in a triple contract, had quite as sound a moral basis as rent charges. By the beginning of the seventeenth century the leading authorities were basing their defense of industrial interest on positive grounds. Lugo, Lessius, and Molina adduced the productivity of capital goods as a reason for allowing gains to the investor. Whether they regarded productivity as in itself a sufficient justification of interest, or merely as a necessary prerequisite to justification, cannot be determined with certainty.

At present the majority of Catholic writers seem to think that a formal defense of interest on capital is unnecessary. Apparently they assume that interest is justified by the mere productivity of capital. However, this view has never been explicitly approved by the Church. While she permits and authorizes interest, she does not define its precise moral basis.

So much for the teaching of ecclesiastical and ethical authorities. What are the objective reasons in favor of the capitalist's claim to interest? In this chapter we consider only the intrinsic reasons, those arising wholly out of the relations between the interest-receiver and the interest-payer. Before taking up the subject it may be well to point out the source from which interest comes, the class in the community that pays the interest to the capitalist. From the language sometimes used by Socialists it might be inferred that interest is taken from the laborer, and that if it were abolished he would be the chief if not the only beneficiary. This is incorrect. At any given time interest on producing capital is paid by the consumer. Those who purchase the products of industry must give prices sufficiently high to provide interest in addition to the other expenses of production. Were interest abolished and the present system of private capital continued, the gain would be reaped mainly by the consumer in the form of lower prices; for the various capitalist directors of industry would bring about this result through their competitive efforts to increase sales. Only those laborers who were sufficiently organized and sufficiently alert to make effective demands for higher wages before the movement toward lower prices had got well under way, would obtain any direct benefit from the change. The great majority of laborers would gain far more as consumers than as wage earners. Speaking generally, then, we may say that the capitalist's gain is the consumer's loss, and the question of the justice of interest is a question between the capitalist and the consumer.

The intrinsic or individual grounds upon which the capitalist's claim to interest has been defended are mainly three: productivity, service, and abstinence. They will be considered in this order.

The Claims of Productivity

It is sometimes asserted that the capitalist has as good a right to interest as the farmer has to the offspring of his animals. Both are the products of the owner's property. In two respects, however, the comparison is inadequate and misleading. Since the owner of a female animal contributes labor or money or both toward her care during the period of gestation, his claim to the offspring is based in part upon these grounds, and only in part upon the title of interest. In the second place, the offspring is the definite and easily distinguishable product of its parent. But the sixty dollars derived as interest from the ownership of ten shares of railway stock, cannot be identified as the exact product of one thousand dollars of railway property. No man can tell whether this amount of capital has contributed more or less than sixty dollars of value to the joint product, *i.e.,* railway services. The same is true of any other share or piece of concrete capital. All that we know is that the interest, be it five, six, seven, or some other per cent, describes the share of the product which goes to the owner of capital in the present conditions of industry. It is the conventional, not the actual and physical, product of capital.

Another faulty analogy is that drawn between the productivity of capital and the productivity of labor. Following the terminology of the economists, most persons think of land, labor, and capital as productive in the same sense. Hence the productivity of capital is easily assumed to have the same moral value as the productive action of human beings; and the right of the capitalist to a part of the product is put on the same moral basis as the right of the laborer. Yet the differences between the two kinds of productivity, and between the two moral claims to the product, are more important than their resemblances.

In the first place, there is an essential physical difference. As an instrument of production, labor is active, capital is passive. As regards its worth or dignity, labor is the expenditure of human energy, the output of a *person,* while capital is a material thing, standing apart from a personality, and possessing no human quality or human worth. These significant intrinsic or physical differences forbid any immediate inference that the moral claims of the owners of capital and labor are equally valid. We should expect to find that their moral claims are unequal.

This expectation is realized when we examine the bearing of the two kinds of productivity upon human welfare. In the exercise of productive effort the average laborer undergoes a sacrifice. He is engaged in a process that is ordinarily irksome. To require from him this toilsome expenditure of energy without compensation, would make him a mere instrument of his fellows. It would subordinate him and his comfort to the aggrandizement of beings who are not his superiors but his moral equals. For he is a person; they are no more than persons. On the other hand, the capitalist as such, as the recipient of interest, performs no labor, painful or otherwise. Not the capitalist, but capital participates in the productive process. Even though the capitalist should receive no interest, the productive functioning of capital would not subordinate him to his fellows in the way that wageless labor would subordinate the laborer.

The precise and fundamental reason for according to the laborer his product is that this is the only rational rule of distribution. When a man makes a useful thing out of materials that are his, he has a strict right to the product simply because there is no other reasonable method of distributing the goods and opportunities of the earth. If another individual, or society, were permitted to take his product, industry would be discouraged, idleness fostered, and reasonable life and self-development rendered impossible. Direful consequences of this magnitude would not follow the abolition of interest.

Perhaps the most important difference between the moral claims of capitalist and laborer is the fact that for the latter labor is the sole means of livelihood. Unless he is compensated for his product he will perish. But the capitalist has in addition to the interest that he receives the ability to work. Were interest abolished he would still be in as good a position as the laborer. The product of the laborer means to him the necessaries of life; the product of the capitalist means to him goods in excess of a mere livelihood. Consequently their claims to the product are unequal in vital importance and moral value.

The foregoing considerations show that even the claim of the laborer to his product is not based upon merely intrinsic grounds. It does not spring entirely from the mere fact that he has produced the product, from the mere relation between producer and things produced. If this is true of labor-productivity we should expect to find it even more evident with regard to the productivity of capital; for the latter is passive instead of active, non-rational instead of human.

The expectation is well founded. Not a single conclusive argument can be brought forward to show that the productivity of capital directly and necessarily confers upon the capitalist a right to the interest-product. All the attempted arguments are reducible to two formulas: *res fructificat domino* (a thing fructifies to its owner) and "the effect follows its cause." The first of these was originally a legal rather than an ethical maxim; a rule by which the title was determined in the civil law, not a principle by which the right was determined in morals. The second is an irrelevant platitude. As a juristic principle, neither is self-evident. Why should the owner of a piece of capital, be it a house, a machine, or a share of railway stock, have a right to its product, when he has expended neither time, labor, money, nor inconvenience of any kind? To answer, "because the thing which produced the product belongs to him," is merely to beg the question. To answer, "because the effect follows the cause," is to make a statement which has nothing to do with the question. What we want to know is why the ownership of a productive thing gives a right to the product; why this particular effect should follow its cause in this particular way. To answer by repeating under the guise of sententious formulas the thesis to be proved, is scarcely satisfactory or convincing. To answer that if the capitalist were not given interest, industry and thrift would decrease and human welfare suffer, is to abandon the intrinsic argument entirely.

The Claims of Service

The second intrinsic ground upon which interest is defended, is the *service* performed by the capitalist when he permits his capital to be used in production. Without capital, laborers and consumers would be unable to command more than a fraction of their present means of livelihood. From this point of view we see that the service in question is worth all that is paid in the form of interest. Nevertheless it does not follow that the capitalist has a claim in strict justice to any payment for this service. According to St. Thomas, a seller may not charge a buyer an extra amount merely because of the extra value attached to the commodity by the latter.[1] In other words, a man cannot justly be required to pay an unusual price for a benefit or advantage or service, when the seller undergoes no unusual deprivation. Father Lehmkuhl carries the principle further and declares that the seller has a right to compensation only when and to the extent that he undergoes a privation or undertakes a responsibility.[2] According to this rule, the capitalist would have no right to interest; for as mere interest-receiver he undergoes no privation. His risk and labor are remunerated in profits, while the responsibility of not withdrawing from production something that can continue in existence only by continuing in production, is scarcely deserving of a reward according to the canons of strict justice.

Whatever we may think of this argument from authority, we find it impossible to prove objectively that a man who renders a service to another has an intrinsic right to anything beyond compensation for the expenditure of money or labor involved in performing the service. The man who throws a life preserver to a drowning person may justly demand a payment for his trouble. On any recognized basis of compensation, this payment will not exceed a few dollars. Yet the man whose life is in danger will pay a million dollars for this service if he is extremely

[1] "Secunda Secondae," q. 77, a. 1, in corp.
[2] "Theologia Moralis," I, no. 1050.

rich. He will regard the service as worth this much to him. Has the man with the life preserver a right to exact such a payment? Has he a right to demand the full value of the service? No reasonable person would answer this question otherwise than in the negative. If the performer of the service may not charge the full value thereof, as measured by the estimate put upon it by the recipient, it would seem that he ought not to demand anything in excess of a fair price for his labor.

It would seem, then, that the capitalist has no moral claim to pure interest on the mere ground that the use of his capital in production constitutes a service to laborers and consumers. It would seem that he has no right to demand a payment for a costless service.

The Claims of Abstinence

The third and last of the intrinsic justifications of interest that we shall consider is *abstinence*. This argument is based upon the contention that the person who saves his money and invests it in the instruments of production undergoes a sacrifice in deferring to the future satisfactions that he might enjoy to-day. One hundred dollars now is worth as much as one hundred and five dollars a year hence. That is, when both are estimated from the viewpoint of the present. This sacrifice of present to future enjoyment which contributes a service to the community in the form of capital, creates a just claim upon the community to compensation in the form of interest. If the capitalist is not rewarded for this inconvenience he is, like the unpaid laborer, subordinated to the aggrandizement of his fellows.

Against this argument we may place the extreme refutation attempted by Ferdinand Lassalle:

"But the profit of capital is *the reward of abstinence*. Truly a happy phrase! European millionaires are ascetics, Indian penitents, modern St. Simeon Stylites, who, perched on their columns, with withered features and arms and bodies thrust forward, hold out a plate to the passers-by that they may receive the wages of their privations! In the midst of this sacrosanct group, high above his fellow mortifiers of the flesh, stands the Holy House of Rothschild. That is the real truth about our present society! How could I have hitherto blundered on this point as I have?"[1]

Obviously this is a malevolently one-sided implication concerning the sources of capital. But it is scarcely less adequate than the explanation in opposition to which it has been quoted. Both fail to distinguish between the different kinds of savers, the different kinds of capital-owners. For the purposes of our inquiry savings may be divided into three classes.

First, those which are accumulated and invested automatically. Very rich persons save a great deal of money that they have no desire to spend, since they have already satisfied or safeguarded all the wants of which they are conscious. Evidently this kind of saving involves no real sacrifice. To it the words of Lassalle are substantially applicable, and the claim to interest for abstinence decidedly inapplicable.

Second, savings to provide for old age and other future contingencies which are estimated as more important than any of the purposes for which the money might now be expended. Were interest abolished this kind of saving would be even greater than it is at present; for a larger total would be required to equal the fund that is now provided through the addition of interest to the principal. In a no-interest régime one thousand dollars would have to be set aside every year in order total twenty-thousand dollars in twenty years; when interest is accumulated on the savings, a smaller annual amount will suffice to produce the same fund. Inasmuch as this class of persons

[1] "What is Capital?" p. 27.

would save in an even greater degree without interest, it is clear that they regard the sacrifice involved as fully compensated in the resulting provision for the future. In their case sacrifice is amply rewarded by accumulation. Their claim to additional compensation in the form of interest does not seem to have any valid basis. In the words of the late Professor Devas, "there is ample reward given without any need of any interest or dividend. For the workers with heads or hands keep the property intact, ready for the owner to consume whenever convenient, when he gets infirm or sick, or when his children have grown up, and can enjoy the property with him." [1]

The third kind of saving is that which is made by persons who could spend, and have some desire to spend, more on present satisfactions, and who have already provided for all future wants in accordance with the standards of necessaries and comforts that they have adopted. Their fund for the future is already sufficient to meet all those needs which seem weightier than their present unsatisfied wants. If the surplus in question is saved it will go to supply future desires which are no more important than those for which it might be expended now. In other words, the alternatives before the prospective saver are to procure a given amount of satisfaction to-day, or to defer the same degree of satisfaction to a distant day. In this case the inducement of interest will undoubtedly be necessary to bring about saving. As between equal amounts of satisfaction at different times, the average person will certainly prefer those of the present to those of the future. He will not decide in favor of the future unless the satisfactions then obtainable are to be greater in quantity. To this situation the rule that deferred enjoyments are worth less than present enjoyments, is strictly applicable. The increased quantity of future satisfaction which is necessary to turn the choice from the pres-

[1] "Political Economy," p. 507.

ent to the future, and to determine that the surplus shall be saved rather than spent, can be provided only through interest. In this way the accumulations of interest and savings will make the future fund equivalent to a larger amount of enjoyment or utility than could be obtained if the surplus were exchanged for the goods of the present. "Interest magnifies the distant object." Whenever this magnifying power seems sufficiently great to outweigh the advantage of present over future satisfactions, the surplus will be saved instead of spent.

Among the well-to-do there is probably a considerable number of persons who take this attitude toward a considerable part of their savings. Since they would not make these savings without the inducement of interest, they regard the latter as a necessary compensation for the sacrifice of present enjoyment. In a general way we may say that they have a strict right to this interest on the intrinsic ground of sacrifice. Inasmuch as the community benefits by the savings, it may quite as fairly be required to pay for the antecedent sacrifices of the savers as for the inconvenience undergone by the performer of any useful labor or service.