

CHAPTER XIII

SOCIAL AND PRESUMPTIVE JUSTIFICATIONS OF INTEREST

As we saw in the last chapter, interest cannot be conclusively justified on the ground of either productivity or service. It is impossible to demonstrate that the capitalist has a strict right to interest because his capital produces interest, or because it renders a service to the laborer or the consumer. A part, probably a small part, of the interest now received can be fairly justified by the title of sacrifice. Some present owners of capital would not have saved had they not expected to receive interest. In their case interest may be regarded as a just compensation for the sacrifice that they underwent when they decided to save instead of consuming.

Limitations of the Sacrifice Principle

Nevertheless these men would suffer no injustice if interest were now to be abolished. Up to the moment of the change, they would have been in receipt of adequate compensation; thereafter, they would be in exactly the same position as when they originally chose to save rather than consume. They would still be able to sell their capital, and convert the proceeds to their immediate uses and pleasures. In this case they would obviously have no further claim upon the community for interest. On the other hand, they could retain the ownership of their capital, and postpone its consumption to some future time. In making this choice they would regard future as more important than present consumption, and the superiority of future enjoyment as sufficiently great to compensate

them for the sacrifice of postponement. Hence they would have no moral claim to interest on the ground of abstinence. In general, then, the sacrifice-justification of interest continues only so long as the interest continues. It extends only to the interest received by certain capitalists in certain circumstances, not to all interest in all circumstances. Therefore, it presents no moral obstacle to the complete abolition of interest.

Since probably the greater part of the interest now received cannot be justified on intrinsic grounds, and since that part of it which is thus justified could be abolished consistently with the rights of the recipients, let us see whether it is capable of justification for reasons of social welfare. Would its suppression be socially beneficial or socially detrimental?

The Value of Capital in a No-Interest Régime

The interest that we have in mind is pure interest, not undertaker's profit, nor insurance against risk, nor gross interest. Even if all pure interest were abolished the capitalist who loaned his money would still receive something from the borrower in addition to the repayment of the principal, while the active capitalist would get from the consumer more than the expenses of production. The former would require a premium of, say, one or two per cent to protect him against the loss of his loan. The latter would demand the same kind of insurance, and an additional sum to repay him for his labor and enterprise. None of these payments could be avoided in any system of privately directed production. The return whose suppression is considered here is that which the capitalist receives over and above these payments, and which in this country seems to be about three or four per cent. It is what the capitalist gets as capitalist.

Would capital still have value in a no-interest régime, and if so how would its value be determined? At present the lower limit of the value of productive capital, as of

all other artificial goods, is fixed in the long run by the cost of production. Capital instruments that do not bring this price will not continue to be made. In other words, cost of production is the governing factor of the value of capital from the side of supply. It would likewise fix the lower limit of value in a no-interest régime; only, the cost of producing capital instruments would then be somewhat lower than to-day, owing to the absence of an interest charge during the productive process.

But the cost of production is not a constant and accurate measure of the value of artificial capital. The true measure is found in the revenue or interest that a given piece of capital yields to its owners. If the current rate of interest is five per cent, a factory that brings in ten thousand dollars net return will have a value of about two hundred thousand dollars. This is the governing factor of value from the side of demand. In a no-interest economy the demand factor would be quite different. Capital instruments would be in demand, not as revenue producers, but as the concrete embodiments, the indispensable requisites, of saving and accumulation. For it is impossible that saving should in any considerable amount take the form of cash hoards. In the words of Sir Robert Giffen: "The accumulations of a single year, even taking it at one hundred and fifty millions only, . . . would absorb more than the entire metallic currency of the country [Great Britain]. They cannot, therefore, be made in cash."¹ The instruments of production would be sought and valued by savers for the same reason that safes and safety deposit boxes are in demand now. They would be the only means of carrying savings into the future, and they would necessarily bring a price sufficiently high to cover the cost of producing them. One man might deposit his savings in a bank, whence they would be borrowed without interest by some director of industry. When the owner of the savings desired to recover

¹ "Growth of Capital," p. 152.

them he could obtain from the bank the fund of some other depositor, or get the proceeds of the sale of the concrete capital in which his own savings had been embodied. Another man might prefer to invest his savings directly in a building, a machine, or a mercantile business, whence he could recover them later from the sale of the property. Hence the absence of interest would not change essentially the processes of saving or investment. Capital would still have value, but its valuation from the demand side would rest on a different basis. It would be valued not in proportion to its power to yield interest, but because of its capacity to become a receptacle for savings, and to carry consuming power into the future.

The question whether the abolition of interest by the State would be socially helpful or socially harmful is mainly, though not entirely, a question of the supply of capital. If the community would not have sufficient capital to provide for all its needs, actual and progressive, the suppression of interest would obviously be a bad policy. Most economists seem inclined to think that this condition would be realized; that, without the inducement of interest, men would neither make new savings nor conserve existing capital in sufficient quantity to supply the wants of society.

Whether Interest Is Necessary

Perhaps the best known recent statement of the opinion that interest is inevitable, appears in Professor Irving Fisher's "The Rate of Interest."¹ While he does not assert explicitly that sufficient capital would not be provided without interest, and even admits that in certain circumstances interest might disappear, the general logic and implications of his argument are decidedly against the supposition that society could ever get along without interest. He lays such stress upon the factor of "impatience," *i.e.*, man's unwillingness to wait for future goods,

¹ New York, 1907.

as to suggest strongly that other causes of interest, and the number of savers free from "impatience," are quite insignificant. Now, if "impatience" were the only cause of interest the latter must continue as long as "impatience" continues; and if practically all savers, actual and possible, are completely dominated by "impatience" the abolition of interest would be socially disastrous. However, neither of these assumptions is demonstrable. We have just seen that the present rate of interest has other causes than "impatience"; that a large proportion of savers insist upon getting the present rate, not because they require it to offset their "impatience," but simply because they can obtain it, and because they prefer it to the lower rate. Therefore, the mere existence of the present rate does not prove it to be necessary. By the same argument it is evident that the existence of any interest does not demonstrate the necessity of some interest. In the second place, the number of savers, present and prospective, whose "impatience" is so weak as to permit them to save without interest, is probably greater than the average reader of Professor Fisher's pages is led to assume. The question whether interest is necessary cannot be answered by reference to the general fact of human "impatience"; it demands a preliminary analysis of the extent to which "impatience" affects the different classes of savers.

With interest abolished, those persons who were willing to subordinate present secondary satisfactions to the primary future needs of themselves and their families, would save at least as much for these purposes as when they could have obtained interest. Most of them would probably save more in order to render their future provision as nearly as possible equal to what it would have been had interest accrued on their annual savings. Whether a person intended to leave all his accumulations, or part of them, or none of them to posterity, he would still desire them to be as large as they might have been in a régime

of interest. In order to realize this desire, he would be compelled to increase his savings. And it is reasonable to expect that this is precisely the course that would be followed by men of average thrift and foresight. Such men regard future necessities and comforts, whether for themselves or their children, as more important than present non-essentials and luxuries. Interest or no interest, prudent men will subordinate the latter goods to the former, and will save money accordingly.

When, however, both future and present goods are of the same order and importance, the future is no longer preferred to the present. In that case the preference is reversed. The luxuries of to-day are more keenly prized than the luxuries of to-morrow. If the latter are to be preferred they must possess some advantage over the luxuries that might be obtained here and now. Such advantage may arise in various ways; for example, when a man decides that he will have more leisure for a foreign journey two years hence than this year, or when he prefers a large amount of future enjoyment at one time to present satisfactions taken in small doses. But the most general method of conferring advantage upon the secondary satisfactions of the future as compared with those of the present, is to increase the quantity. The majority of foreseeing persons are willing to pass by one hundred dollars' worth of enjoyment now for the sake of one hundred and five dollars' worth one year hence. This advantage of quantity is provided through the receipt of interest. It affects all those persons whose saving, as noted in the last chapter, involves a sacrifice for which the only adequate compensation is interest, and likewise all those persons who are in a position to choose between present and future luxuries. Were interest suppressed these classes of persons would cease to save for this kind of future goods.

According to Professor Taussig, "most saving is done by the well-to-do and the rich."¹ On this hypothesis it

¹ "Principles of Economics," II, 42.

seems probable that the abolition of interest would diminish the savings and capital of the community very considerably; for the accumulations of the wealthy are derived mainly from interest rather than from salaries. On the other hand, the suppression of interest should bring about a much wider diffusion of wealth. The sums formerly paid out as interest would be distributed among the masses of the population as increased wages and reduced costs of living. Hence the masses would possess an immensely increased capacity for saving, which might offset or even exceed the loss of saving-power among those who now receive interest-incomes.¹

To sum up the results of our inquiry concerning the necessity of interest: The fact that men now receive interest does not prove that they would not save without interest. The fact that many men would certainly save without interest does not prove that a sufficient amount would be saved to provide the community with the necessary supply of capital. Whether the savings of those classes that increased their accumulations would counteract the decreases in the saving of the richer classes, is a question that admits of no definite or confident answer.

The State Is Justified in Permitting Interest

If we assume that the suppression of interest would cause a considerable decline in saving and capital, we must conclude that the community would be worse off than under the present system. To diminish greatly the instruments of production, and consequently the supply of goods for consumption, would create far more hardship than it would relieve. While "workless" incomes would be suppressed, and personal incomes more nearly equalized, the total amount available for distribution would probably be so much smaller as to cause a deterioration in the condition of every class. In this hypothesis the State would do wrong to abolish the system of interest.

¹ Cf. Hobson, "The Economics of Distribution," pp. 259-265.

If, however, we assume that no considerable amount of evil would follow, or that the balance of results would be favorable, the question of the proper action of the State becomes somewhat complex. In the first place, interest could not rightfully be suppressed while the private taking of rent remained. To adopt such a course would be to treat the receivers of property incomes inequitably. Landowners would continue to receive an income from their property, while capital owners would not; yet the moral claims of the former to income are no better than those of the latter. In the second place, the State would be obliged to compensate the owners of existing capital instruments for the decline in value which, as we have already seen, would occur when the item of interest was eliminated from the cost of reproducing such capital instruments. It would likewise be under moral obligation to compensate landowners for whatever decrease in value befell their property as a result of the abolition of rent.

Nevertheless, the practical difficulties confronting the legal abolition of interest are apparently so great as to render the attempt socially unwise and futile. In order to be effective the prohibition would have to be international. Were it enforced in only one or in a few countries, these would suffer far more through the flight of capital than they would gain through the abolition of interest. The technical obstacles in any case would be well nigh insuperable. If the attempt were made to suppress interest on producing capital, as well as on loans, the civil authorities would be unable to determine with any degree of precision what part of the gross returns of a business was pure interest and what part was a necessary compensation for risk and the labor of management. Should the State try to solve this problem by allowing the directors of industry varying salaries to correspond with their comparative degrees of efficiency, and different rates of insurance-payments to represent the different risks, it would inevitably make some allowances so low as

to discourage labor and enterprise, and others so high as to give the recipients a considerable amount of pure interest in the guise of profits and salaries. Should it fix a flat rate of salaries and profits, the more efficient undertakers would refuse to put forth their best efforts, and the more perilous enterprises would not be undertaken. The supervision of expenses, receipts, and other details of business that would be required to prevent evasion of the law, would not improbably cost more than the total amount now paid in the form of interest. On the other hand, if the method of suppression were confined to loans it would probably prove only a little less futile than the effort to abolish interest on productive capital. The great majority of those who were prevented from lending at interest would invest their money in stocks, land, buildings, and other forms of productive property. Moreover, it is probable that a large volume of loans would be made despite the prohibition. In the Middle Ages, when the amount of money available for lending was comparatively small, and when State and Church and public opinion were unanimous in favor of the policy, the legal prohibition of loans was only partially effective. Now that the supply of and the demand for loans have enormously increased, and interest is not definitely disapproved by the Church or the public, a similar effort by the State would undoubtedly prove a failure. Even if it were entirely successful it would only decrease, not abolish, interest on productive capital.¹

In view of the manifold and grave uncertainties of the situation, it is practically certain that modern States are justified in permitting interest.

Civil Authorization Not Sufficient for the Individual

This justification of the attitude of the State does not

¹ Cf. Fisher, "Elementary Principles of Economics," pp. 396, 397. However, he does not discuss in this passage the possibility of suppressing interest on productive capital by a direct method.

of itself demonstrate that the capitalist has a right to accept interest. The civil law tolerates many actions which are morally wrong in the individual; for example, the payment of starvation wages, the extortion of unjust prices, and the traffic in immorality. Obviously, legal toleration does not *per se* nor always exonerate the individual offender. How, then, shall we justify the individual receiver of interest?

As already pointed out more than once, those persons who would not save without interest are justified on the ground of sacrifice. So long as the community desires their savings, and is willing to pay interest on them, the savers may take interest as the fair equivalent of the inconvenience that they undergo in performing this social service. The precise problem before us, then, is the justification of those savers and capitalists who do not need the inducement of interest, and whose functions of saving are sufficiently compensated without interest.

It is a fact that the civil law can sometimes create moral rights and obligations. For example; the statute requiring a person to repair losses that he has unintentionally inflicted upon his neighbor is held by the moral theologians to be binding *in conscience*, as soon as the matter has been adjudicated by the court. In other words, this civil regulation confers on the injured man property rights, and imposes on the morally inculpable injurer property obligations. The civil statutes also give moral validity to the title of prescription, or adverse possession. When the alien possessor has complied with the legal provisions that apply, he has a moral right to the property, even though the original owner should assert his claim at a later time. Some moral theologians maintain that a legal discharge in bankruptcy liberates the bankrupt from the moral obligation of satisfying his unpaid debts. Several other situations might be cited in which the State admittedly creates moral rights of individual ownership which would have

no definite existence in the absence of such legal action and authorization.¹

This principle would seem to have received a particularly pertinent application for our inquiry in the doctrine of *praemium legale* as a title of interest on loans. In the "Opus Morale" of Ballerini-Palmieri can be found a long list of moral theologians living in the seventeenth and eighteenth centuries who maintained that the mere legal sanction of a certain rate of interest was a sufficient moral justification for the lender.² While holding to the traditional doctrine that interest was not capable of being justified on intrinsic grounds, these writers contended that by virtue of its power of eminent domain the State could transfer from the borrower to the lender the right to the interest paid on a loan. They did not mean that the State could arbitrarily take one man's property and hand it over to another, but only that, when it sanctioned interest for the public welfare, this extrinsic circumstance (like the other "extrinsic titles" approved by moralists) annulled the claim of the borrower in favor of the lender. In other words, they maintained that the money paid in loan-interest did not belong to either borrower or lender with certainty or definiteness until the matter was determined by economic conditions and extrinsic circumstances. Hence legal authorization for the common good was morally sufficient to award it to the lender. More than one of them declared that the State had the same right to determine this indeterminate property, to assign the ownership to the lender, that it had to transfer property titles by the device of prescription. As we have already seen, Canon 1523 of the New Code of Canon Law explicitly declares that it is not necessarily wrong to bargain for and accept the legal rate of interest.

And yet, neither this nor any of the other precedents

¹ Cf. Lehmkuhl, "Theologia Moralis," I, nos. 917, 965, 1035.

² Vol. 3, pp. 617-629; 2d ed.

cited above, is sufficient to give certain moral sanction to the practice of interest-taking by those persons who would continue to save if interest were abolished. All the acts of legal authorization that we have been considering relate to practices which are beneficial and necessary to society. Only in such cases has the State the moral authority to create or annul property rights. In the seventeenth and eighteenth centuries the legal authorization of a certain rate of interest made that rate morally lawful simply because this legal act gave formal and authoritative testimony to the social utility of interest-taking. The State merely declared the reasonableness and fixed the proper limits of the practice. The beneficent effect of interest-taking upon society was its underlying justification, was the ultimate fact which made it reasonable, and which gave to the action of the State moral value. Had the taking of interest on loans not been allowed the bulk of possible savings would either not have been saved at all, or would have been hoarded instead of converted into capital. And that money was badly needed in the commercial and industrial operations of the time. Hence the owners of it were in the position of persons who regarded saving and investing as a sacrifice for which interest was a necessary and proper compensation. To-day, however, there are millions of persons who would continue to perform both these functions without the inducement of interest. Therefore, the public good does not require that they should receive interest, nor that the State should have the power to clothe their interest-incomes with moral lawfulness. Inasmuch as the State is not certain that the abolition of interest would be socially expedient or practically possible, it is justified in permitting the institution to continue; but it has no power to affect the morality of interest-taking as an individual action.

How the Interest-Taker Is Justified

Although the interest received by the non-sacrifice savers

is not clearly justifiable on either intrinsic or social grounds, it is not utterly lacking in moral sanctions. In the first place, we have not contended that the intrinsic factors of productivity and service are *certainly* invalid morally. We have merely insisted that the moral worth of these titles has never been satisfactorily demonstrated. Possibly they have a greater and more definite efficacy than has yet been shown by their advocates. In more concrete terms, we admit that the productivity of capital and the service of the capitalist to the community, are possible and doubtful titles to interest. A doubtful title to property is, indeed, insufficient by itself. In the case of the interest receiver, however, the doubtful titles of productivity and service are reinforced by the fact of possession. Thus supplemented, they are sufficient to justify the non-sacrifice saver in giving himself the benefit of the doubt as regards the validity of his right to take interest. To be sure, this indefinite and uncertain claim could be overthrown by a more definite and positive title. But no such antagonistic title exists. Neither the consumer nor the laborer can show any conclusive reason why interest should go to him rather than to the capitalist. Hence the latter has at least a presumptive title. In the circumstances this is morally sufficient.

To this justification by presumption must be added a justification by analogy. The non-sacrifice savers seem to be in about the same position as those other agents of production whose rewards are out of proportion to their sacrifices. For example; the laborer of superior native ability gets as much compensation for the same quality and quantity of work as his companion who has only ordinary ability; and the exceptionally intelligent business man stands in the same relation to his less efficient competitor; yet the sacrifice undergone by the former of each pair is less than that suffered by the latter. It would seem that if the more efficient men may properly take the same rewards as those who make larger sacrifices, the non-sacri-

fice capitalist might lawfully accept the same interest as the man whose saving involves some sacrifice. On this principle the lenders who would not have invested their money in a productive enterprise were nevertheless permitted by the moralists of the post-medieval period to take advantage of the title of *lucrum cessans*. Although they had relinquished no opportunity of gain, nor made any sacrifice, they were put on the same moral level as sacrificing lenders, and allowed the same interest.

As a determinant of ownership, possession is the feeblest of all factors, and yet it is of considerable importance for a large proportion of incomes and property. In the distribution of the national product, as well as in the division of the original heritage of the earth, a large part is played by the title of first occupancy. Much of the product of industry is assigned to the agents of production mainly on the basis of inculpable possession. That is; it goes to its receivers automatically, in exchange for benefits to those who hand it over, and without excessive exploitation of their needs. Just as the first arrival on a piece of land may regard it as a no-man's territory, and make it his own by the mere device of appropriation, so the capitalist may get morally valid possession of interest. Sometimes, indeed, this debatable share, this no-man's share of the product of industry, is secured in some part by the consumer or the laborer. In such cases their title to it is just as valid as the title of the capitalist, notwithstanding the doubtful titles of productivity and service which the latter has in his favor. First occupancy and possession are the more decisive factors. In the great majority of instances, however, the capitalist is the first occupant, and therefore the lawful possessor of the interest-share.

The general justification of interest set forth in the immediately preceding paragraphs is supplemented in the case of the great majority of capital owners by the fact that their income from this source is relatively insig-

nificant. This is notoriously true of the vast majority of farmers. It is likewise the case with a very large proportion of small manufacturers and shopkeepers and of almost all wage earners who have investments. The interest received by all these classes can easily be justified as a necessary supplement to the inadequate return which they obtain for their labor.

Again, there is a large number of interest receivers who are entirely dependent upon this kind of income, and who obtain therefrom only a moderate livelihood. They are mainly children, aged persons, and invalids. Unlike the classes just described, they cannot justify their interest as a fair supplement to wages; however, they may reasonably claim it as their equitable or charitable share of the common heritage of the earth. If they did not receive this interest-income they would have to be supported by their relatives or by the State. For many reasons this would be a much less desirable arrangement. Consequently their general claim to interest is supplemented by considerations of human welfare.

The difference between the ethical character of the interest discussed in the last two paragraphs and of that received by persons who possess large incomes, is too often overlooked in technical treatises. Every man owning any productive goods is reckoned as a capitalist, and assumed to receive interest. If, however, a man's total interest-income is so small that when combined with all his other revenues it merely completes the equivalent of a decent living, it is surely of very little significance as interest. It stands in no such need of justification as the interest obtained by men whose incomes amount to, say, ten thousand dollars a year and upward.

Still another confirmatory title of interest is suggested by the following well known declaration of St. Thomas Aquinas: "The possession of riches is not in itself unlawful if the order of reason be observed: that a man should possess justly what he owns, and *use* it in a proper manner

for himself and others.”¹ Neither just acquisition nor proper use is alone sufficient to render private possessions morally good. Both must be present. As we have seen above, the capitalist can appeal to certain presumptive and analogous titles which justify practically his acquisition of interest; but there can be no doubt that his claim and his moral power of disposal are considerably strengthened when he puts his interest-income to a proper use. One way of so using it is for a reasonable livelihood, as exemplified in the case of the farmers, business men, and non-workers whom we considered above. Those persons who receive incomes in excess of their reasonable needs could devote the surplus to religion, charity, education, and a great variety of altruistic purposes. We shall deal with this matter specifically in the chapter on the “Duty of Distributing Superfluous Wealth.” In the meantime it is sufficient to note that the rich man who makes a benevolent use of his interest-income has a special reason for believing that his receipt of interest is justified.

The decisive value attributed to presumption, analogy, possession, and doubtful titles in our vindication of the capitalist’s claim to interest, is no doubt disappointing to those persons who desire clear-cut mathematical rules and principles. Nevertheless, they are the only factors that seem to be available. While the title that they confer upon the interest receiver is not as definite nor as noble as that by which the laborer claims his wages or the business man his profits, it is morally sufficient. It will remain logically and ethically unshaken until more cogent arguments have been brought against it than have yet appeared in the denunciations of the income of the capitalist. And what is true of him is likewise true of the rent receiver, and of the person who profits by the “unearned increment” of land values. In all three cases the presumptive justification of “workless” incomes will probably remain valid as long as the present industrial system endures.

¹ “Contra Gentiles,” lib. 3, c. 123.