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THE MORAL LEGITIMACY OF INTEREST AND BANKING

by Gary North

For [the kingdom of heaven] is as a man travelling into a far country, [who] called his own servants, and delivered unto them his goods. And unto one he gave five talents, to another two, and to another one; to every man he according to his ability; and straightaway took his journey. Then he that had received the five talents went and traded with the same, and made [them] five other talents. And likewise he that [had received] two, he also gained other two (Matt. 25:14-17).

This parable is a kingdom parable. It follows the five-point covenant model that was first discovered by Ray Sutton.¹ First, the master calls his servants before him (sovereignty). Second, he delegates authority to them as his economic representatives by transferring money to them (hierarchy/representation). Third, while it is not stated explicitly, he commands them to make a profit (law/dominion). We know this because all three immediately take steps to obey his implicit economic command. Fourth, he returns and imposes positive sanctions: blessings to the profitable servants. Fifth, the blessings that he gives them involve rulership (succession/continuity). He then imposes negative sanctions against the unprofitable servant, casting him into outer darkness (disinheritance).

This parable contains several theological messages, but the three main ones are these: first, God owns all things; second, He delegates temporary control over these things to men; third, men are required to increase the value of whatever God has entrusted to them.

There are also secondary implications. First, it should be noted that the servants were required to act on their own initiative for a long period. The master was not present to tell them precisely what to do. He imposed a **profit management system of control, a bottom-up hierarchy**. It was not the management alternative, a non-market, top-down bureaucracy.² He wisely decentralized his investment portfolio before he departed. He allowed his subordinates to make their own decisions regarding the proper use of his capital. He subsequently held them legally responsible for the results.

It should also be noted that he gave a greater or lesser quantity of capital to each servant according to the individual's ability. He had watched them perform, and he knew who was most reliable. **There is no equalitarianism visible in this parable, no theory of "equal starting positions."** The better performers gained access to the largest initial advance of capital. This is a basic principle of free market competition: those who perform profitably are subsequently entrusted with greater capital and greater respon-

sibility, and if successful, they receive greater rewards. In other words, capital is transferred to managers who are believed by owners to be most likely to produce profits. If they continue to perform profitably, they gain control over ever greater quantities of capital.

Marxism as Covenant-Breaking

What about the person who takes no risks, buries his talent, and returns to the master only what he had been given initially? This man has produced losses. He is an evil, unprofitable servant. He has not performed according to minimum standards.

Like so many other incompetent, slothful people in history, the servant of the parable tries to justify his poor performance by blaming the master. He accuses the master of being a thief, or at least an unscrupulous exploiter. "Then he which had received one talent came and said, Lord, I knew thee that thou art an hard man, reaping where thou hast not sown, and gathering where thou hast not strawed. And I was afraid, and went and hid thy talent in the earth: lo, [there] thou hast [that is] thine" (vv. 24-25).

What was the slothful servant's accusation of the master? Clearly, he was accusing him of being a **capitalist**. The master is rich, yet he does not go into the fields to labor. He expects a positive return on his money, even though he goes away on a journey. In short, **the servant is an incipient Marxist**. He believes, as Marx did, in the labor theory of value. He also believes in Marx's exploitation theory of profits. Anyone who gets money without working for a living is nothing but an exploiter, living on the labor of the poor. The servant calls him "a hard man." (Theologically speaking, this is the covenant-breaker's accusation against God: God is an unfair exploiter.)

The master accepts the ideological challenge. He reminds the servant that he is indeed a hard man, meaning someone who has the lawful authority to establish standards of profitable performance, as well as the authority to hand out rewards and punishments. He admits freely to the servant that as a successful capitalist, he does not personally go into the fields to plant and reap, yet he reaps a profit. "His lord answered and said unto him, [Thou] wicked and slothful servant, thou knewest that I reap where I sowed not, and gather where I have not strawed" (v. 26). Then he tells the servant the minimum that he is entitled to, an interest return: "Thou oughtest therefore to have put my money to the exchangers, and [then] at my coming I should have received mine own with usury" (v. 27).

The Legitimacy of Interest

The King James translators used the English word *usury* to translate a Greek word that is more accurately translated as *interest*. This discussion of interest here is very revealing, for two reasons. First, this parable of God's king-

1. Ray R. Sutton, *That You May Prosper: Dominion By Covenant* (Tyler, Texas: Institute for Christian Economics, 1987).

2. Ludwig von Mises, *Bureaucracy* (Spring Mills, Pennsylvania: Libertarian Press, [1944] 1983).

dom acknowledges that **interest-taking is legitimate**. God eventually comes to every person and demands a positive return on whatever had been entrusted to him by God. The master had done without the use of his funds during his absence. He is therefore entitled to a minimum return: interest.

Second, **the parable clearly distinguishes between profits and interest**. The other two stewards each produced a profit of 100 percent. They received the greater praise and greater visible rewards. The minimum required performance was an interest payment. The slothful servant had been unwilling to take even the minimal risk of handing the money over to specialists in money-lending, who would seek out entrepreneurs to lend the money to, entrepreneurs who would then pay a competitive return to the money-lenders on this passively managed investment.

In other words, the master's capital was supposed to become productive. Each steward had to become an entrepreneur, or else had to seek out an entrepreneur who would put the money to economically productive uses. The talent was not to sit in the earth; it was to perform a socially useful function.

The Entrepreneur and the Banker

The economic agent who is on the cutting edge of both prediction and production is the entrepreneur. The first two men in the parable were entrepreneurs. They went out and found ways of investing the master's money that produced a positive rate of return. As the parable presents it, this rate of return was higher than what could have been earned by depositing the money with money-lenders. Thus, the entrepreneur is understood to be someone who bears much greater risk than someone who deposits money in a bank. The economist calls this form of risk **uncertainty**. It cannot be estimated in advance.³ It involves guesswork, unlike the depositor who is promised a specific rate of interest when he deposits his money.

The only way that the banker can afford to pay out a promised return is because he successfully seeks out final borrowers (entrepreneurs) who produce an even higher rate of return. The banker makes his living on the difference between the interest payment which the final borrower pays to him and what he in turn pays to the depositors. He makes it "on the spread."

The future is uncertain to men. We do not know it perfectly. We barely know it at all. We see the future as though we were peering through a darkened glass. Nevertheless, all of life involves forecasting. There is no escape. We must all bear some degree of uncertainty. But some people are willing to bear more of it than others, and of these, some are more successful in dealing with it successfully. In economic terminology, some produce greater profits than others. Profit is a **residual** that remains, if at all, only after all costs of the business have been paid, including interest.

Banking: Reducing Uncertainty

The banker is able to offer a special service to investors. He can diversify depositors' uncertainty by lending to many people—people who, like the servants in the parable, have performed successfully in the past. They have "a track record," to use the language of racing. By lending out money to many borrowers, the banker therefore converts a portion of the depositors' uncertainty into risk, meaning from the statistically incalculable to the statistically calculable. The banker is like an insurer. In fact, in the Middle Ages, the bank was an insurance company, since both church and State had made it illegal for Christians to ask

or pay interest.⁴ The modern profession of banking grew out of the marine insurance guild, which was legal in the Middle Ages.⁵

What does an insurance company do? Its statisticians (actuaries) calculate the likelihood of certain kinds of undesirable events in large populations. These unpleasant events cannot be statistically calculated individually, but they can be calculated collectively if the population involved is large enough. The seller of insurance then persuades members of these large populations to pay periodic premiums so as to "pool" their risks. When one member of the pool suffers the event that has been insured against, he is reimbursed from the pool of assets. Hence, some of life's inescapable and individually incalculable uncertainties are converted to calculable risk by means of diversification: "the law of large numbers."

The same is true of banking. Borrowers will seldom all go bankrupt at once. Most borrowers will repay their debts as specified in their loan agreements. Bad loans are more than offset by the good ones. Thus, the banker can offer a fixed rate of return to depositors. In almost all cases, depositors will be repaid as promised because most of the borrowers repay their loans as promised. (The exception is in a depression, when banks fail. Depressions are the result of prior monetary inflation, which in our day means fractional reserve banking.)⁶

What we must understand is that **the master in this parable protects his funds in much the same way**. He seeks out a group of potential entrepreneurs. He gives each of them an amount of money to invest. He makes predictions regarding their future performance based on their past performance, and then he allocates the distribution of his assets in terms of this estimation. He protects his portfolio by diversification.

He is not an interest-seeking banker, however. The money he invests is his own. He is not acting as the legal agent of other depositors. He legally claims all of the profits. He does not contract with borrowers who agree in advance to pay him a fixed rate of interest. The entrepreneurs are strictly his legal subordinates, unlike the relationship between banker and borrower.

Yet in the Old Testament era, there was a relationship of **economic subordination** between lender and borrower: the borrower was servant to the lender (Prov. 22:7). This economic subordination was based on the legal authority of the lender to place the borrower in indentured servitude. Because the borrower today can lose his collateral or his reputation, there is still a mild form of economic subordination in every debt contract. Debt is still a threat, even though it can also be very productive. It is like fire: a useful tool but a danger if it gets out of control.

The Forfeited Productivity of Inaction

The master in the parable is outraged by the co-burying servant. The parable is intended to show the subordinate (indebted) position of all men before God. The servant was cast into outer darkness because he was an unprofitable servant (v. 30). The parable stands as a warning to all men because the Bible teaches that all people are unprofitable servants (Luke 17:10).⁷ This is why we need a profitable servant as our intermediary before God, our perfect sin-bearer. But to understand our relationship of in-

4. Jews could legally lend to Christians, which is why Jews from the Middle Ages onward have been found in banking. It was a near-monopoly granted to them by Christian legislators.

5. John T. Noonan, *The Scholastic Analysis of Usury* (Cambridge, Massachusetts: Harvard University Press, 1957), ch. 10.

6. Ludwig von Mises, *Human Action* (3rd ed.; Chicago: Regnery, 1966), ch. 20.

7. Gary North, "Unprofitable Servants," *Biblical Economics Today* (Feb./March 1983).

3. Frank H. Knight, *Risk, Uncertainty and Profit* (New York: Harper Torchbooks, [1921] 1965).

debtedness to God, the parable's language must be taken seriously. We cannot make accurate theological conclusions about the broader meaning of the parable if the symbolic reference points of the parable are themselves inaccurate.

There is no question that the master not only approves of taking interest, he sends the servant to the nether regions for not taking it. This is strong imagery! **The interest payment belongs to the master.** By having refused to deposit the master's money with the money-lenders, the servant has in effect stolen the master's rightful increase. The servant was legally obligated to protect the master's interests, and interest on his money was the minimum requirement. He failed. The master's judgment of the servant's past performance had been accurate; he was entitled to only one talent initially, for he had not demonstrated competence previously. Had he been given more, he would have wasted more.

The idea that the interest return was the master's minimum expectation leads us to the question of **the origin of interest.** Why did the master deserve an interest return? Because he had possession of an asset that could have been put to productive use, but was not. He had forfeited an economic return that could have been his. This concept of the **forfeited return** appeared in medieval economic literature as the doctrine of *lucrum cessans*. The owner of money who could have made a profit by investing it elsewhere, but who loaned the money to someone, was said by some theologians to be entitled to an interest payment from the borrower because of the income he had forfeited. Interest compensated the lender for the opportunity he had missed.

This raises the whole question of **cost.** What is the cost of any action or any purchase? It is the value of whatever has to be forfeited, i.e., the value of **the most valuable foregone use.** If I do one thing with my money, I cannot do something else with it. The value of whatever I would actually have done but did not do is what it costs me to do whatever I do.

The lender who transfers to another person the use of an asset, monetary or nonmonetary, has given up whatever other opportunities might have been available to him. There are always other opportunities available. There is therefore always a cost to the lender of lending money.

The master in the parable was being gracious to the servant. He recognized from the beginning that the man was not very competent. The master did not tell the servant that he had failed because he had not made 100 percent on the money entrusted to him. He told him only that he had failed because he had not earned an interest payment. This is the least that the master could have expected.

The master probably could have doubled his money by entrusting it to either of the first two servants. But he had sought greater economic safety instead. He had adopted the principle of **risk reduction through portfolio diversification.** You get a lower rate of return but a more sure return. But the master had been cheated. He could have deposited his money directly with the money-lenders instead of giving it to the servant. That would have been safer—greater diversification through the bank—and it almost certainly would have produced a positive rate of return, however low. Instead, he received only his original capital in return.

He had forfeited his legitimate interest payment because he had transferred the asset to the slothful, risk-averse servant. This servant is a model of wickedness, not because he was actively evil, but that he was **passively unproductive.** He did nothing with that which had been entrusted to him. Doing nothing is sufficient to get you cast into hell, when doing the minimum would at least quench

the master's wrath. (Warning: only one man in history has ever performed this minimum: Jesus Christ.)

Interest and Capitalization

Is interest-taking morally legitimate? This debate has been going on since at least the days of Aristotle, who called money sterile and interest illegitimate. But if money is sterile, why have men throughout history paid to gain access to its use for a period? How are so many people fooled into paying for the use of a sterile asset? Besides, interest is a phenomenon of every loan, not just loans of money. Modern economics teaches this; so does the Bible.

The Old Testament forbids the taking of interest in **charitable loans made to fellow believers:** "If thou lend money to [any of] my people [that is] poor by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury" (Ex. 22:25). Leviticus adds "Thou shalt not give thy money upon usury, nor lend him thy victuals [food] for increase" (25:37). (This law appears in the middle of the jubilee laws.) Not just usury from money-lending is prohibited, but usury from food-lending as well. Furthermore, "Thou shalt not lend upon usury to thy brother: usury of money, usury of victuals, usury of any thing that is lent upon usury: unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury" (Deut. 23:19). So, God recognized that many scarce economic resources are lent at interest, but this was not to be the case in Israel. However, resident aliens and foreign heathens are lawful targets of the money-lender.

Why this distinction between borrowers? Because **the poverty-stricken unbeliever is in principle a moral slave,** and therefore he can be legitimately treated as a slave: placed in the bondage of debt and interest. But the language and context of the prohibition in the Old Testament makes it clear that the prohibition applied only to charitable loans, not business loans. Jesus' parable of the talents did not break with this Old Testament requirement. "Thy brother who is poor" was the Old Testament context.

It is obvious that the phenomenon of interest is not confined to money. Aristotle was incorrect. **The phenomenon of interest applies to every scarce economic resource.** Interest is, in the language of Ludwig von Mises, a **category of human action.** We always discount future value. Whatever we own in the present is worth more to us than the promise of owning that same item in the future. Promises to repay can be broken (the risk factor), but more to the point, **the present commands a price premium over the future.**⁸

I use the following example again and again. Say that you want to buy a piece of property: specifically, a gold mine. This mine is expected by every potential buyer to produce a net profit after all expenses of one ounce of gold per year for a thousand years, beginning next year. Would you pay one thousand ounces of gold today to buy it? Not if you are rational. Why not? Because that thousandth ounce of gold one thousand and one years in the future is not worth to you what the thousandth ounce of gold you own today is worth. You discount the future value of that thousandth ounce of gold. Even if you were planning on living for a millennium, you would still discount it. The fiftieth ounce of gold fifty-one years away is worth less to you than the fiftieth ounce of gold you own today is worth.

We live in the present. We make all of our decisions in the present. We enjoy the use of our assets in the present. While wise people plan for the future by purchasing streams of future income by buying assets that they expect to produce net income over time, they purchase these hoped-for streams of income at a discount. The **rate of dis-**

8. Mises, *Human Action*, ch. 19.

count that we apply to any stream of expected future income is called the **rate of interest**. Mises called it **time-preference**.

Thus, the rate of interest is not exclusively a monetary phenomenon. **Interest is a universal discount that we apply to every economic service that we expect to receive in the future.** We buy a hoped-for stream of rents; we can buy them for cash; but we expect a discount for cash. This purchase at a discount for cash is called **capitalization**. It is the heart of capitalism. It is the heart of every society more advanced than the utterly primitive.

The person who lends money at zero interest is clearly forfeiting a potential stream of income. He will seldom do this voluntarily, except for charitable reasons. The ownership of the asset offers him an expected stream of income: psychological, physical, or monetary. If it did not offer such a stream of income, it would be a free good. It would not be demanded. It would therefore not command a price. The owner expects to receive a stream of income. He chooses the degree of risk that he is willing to accept, and he then refuses to lend the asset for less than the interest rate appropriate to this degree of risk.

The borrower compensates the owner for the use of the asset, or its exchange value, for a specified period of time. He borrows it only because he values its stream of services more highly than he values its rental fee (interest). He expects to make a profit of some kind on the temporary exchange of control over it.

The "Economics of Love"

Consider the promoter of the **zero-interest economy**. He is the economic world's equivalent of the self-proclaimed scientist who insists that only **perpetual motion machines** should be legal. He is the classic defender of something (the use of an asset) for nothing (no rental fee). He says that you can construct an honest, fair, and productive economy by making interest payments illegal.

I have in my possession a recent paperback book by a self-proclaimed Christian Reconstructionist. It is his first book. He never graduated from college, nor has he studied economics formally. Nevertheless, he has now written a book on economic theory. (Freedom of the press is unquestionably not a free good for the public: there are always risks.) Because the author is a brighter-than-average economic crank, I have been asked by a few of my readers to answer him. I choose to avoid mentioning either his name or the book's title, because I choose not to embarrass him publicly, and also because I see no reason to promote the sale of any book as preposterous as his is. Let him develop his own mailing list to sell his books.

If his economic theories should ever become dominant in the Christian Reconstruction movement, then I have spent the bulk of my academic life in vain. He calls for an economically just world that is devoid of both rents and interest payments. He insists that from a biblical perspective, "it is not lawful for one to sell the use of his property (rent)." While he is sufficiently astute tactically not to spell out the implications of this statement, what he really means that it is illegal biblically to seek a positive rate of return by loaning someone money to buy a house, and it is also illegal biblically to rent him a house. You have to give him the use of the loan, interest-free, or use of the house, rent-free. **This is the economics of love. It is also a classic crank prescription for creating a society of homeless people.**

Sadly, this book is being read by otherwise intelligent Christians who are not used to following a complex chain of economic reasoning, so this broken chain of economic error impresses them.

He wrote the book specifically to refute me, as his footnotes and text reveal. He has read (but has not understood) my view of time-preference as the true origin of interest. He recognizes that I am following Böhm-Bawerk and Mises on this point: **that there is always a discount for cash when you purchase an expected stream of future services.** People discount the present value of expected future goods in comparison to the same goods in the present. Because of this, no rational person will pay a thousand ounces of gold, cash, for that hypothetical gold mine.

He argues that there are no future goods but only present goods. In one sense, he is correct. I would put it this way: "The present is all that any man can be certain he has, moment by present moment." But the author believes that he has somehow refuted the concept of the inescapable discount applied to future goods. He has not.

Future goods are not real in the present, he says, so therefore they do not command a cash price. He does not recognize, for one thing (among many, many others), that this non-existence of future goods is a very good reason why there is always a **risk premium** in free market interest rates: the promised future goods may not actually be returned to the lender. Instead of acknowledging this obvious fact, the author concludes: "Since the contemplation of 'future goods' is characterized by idealism, one may not actually compare 'present goods' and 'future goods' for purposes of economic calculation. The preference that is dictated by the discount of the 'future goods' cannot be avoided because one cannot possibly call upon an idea in his mind to serve a purpose that only a concrete object can serve." This is the economics of love. It is also the economics of incoherence.

To the extent that I can make any sense of this argument, I think he is saying that **future goods, not being physically present, are therefore irrelevant for present decisions.** So much for the biblical doctrine of eternal judgment in the afterlife! He regards the concept of future goods in much the same way as the covenant-breaker regards the concept of eternal punishment. "If it ain't now, it ain't relevant now." This is a fanatical form of **present-orientation**, the outlook of the lower class.⁹

If everyone were to conclude that future goods are irrelevant for economic calculation, as the author insists that they are, then free market interest rates would approach infinity, for no one would voluntarily give up present goods for the sake of receiving economically "irrelevant" future goods. Also, the price of durable capital goods and durable consumer goods would fall almost to zero, for no one would value them for their future productivity. We would say goodbye to civilization. This is the "economics of love."

Conclusion

Non-fractional reserve banking and the taking of interest are both biblically legitimate. The parable of the talents should be sufficient proof for anyone who is not trying to make an overnight theological reputation for himself based on the promotion of the utterly fantastic. We should take the Bible seriously in preference to Aristotle, and also in preference to the economics of love.

9. See Edward C. Bantfield, *The Unheavenly City* (Boston: Little, Brown, 1970), pp. 53-54.