

Interest, that "something more" has well-based reasoning

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A guide to rereading the key words of economic behavior, after breaking down the myths and bursting a few bubbles. This is the eighth entry in Luigino Bruni's "Dictionary". The topics already analyzed over the last weeks are: Happiness, Profit, Market, Bank, Investment, Responsibility, and Rules. This week (and next) we consider "Interest".

Interest is a word with an ambivalent meaning. In economy, it could refer to at least two different realities. The first meaning that comes to mind is money interest. This interest, understood as compensation for who allows others to use money that does not belong to them (origin of "usury"), has been the object of century-long if not millennium-long debates, which are still well alive and of high civil relevance today.

Since the beginning of modernity, the lending with interest was prohibited from moral (religious) norms, and the main reason was of philosophical and theological nature, the sterile nature of money. In the story of Pinocchio, the Cat and the Fox well know that money does not bear true fruit, but naive Pinocchio believes that it will if he plants it in the Field of Miracles. If I borrow seeds from my neighbor in order to sow my crop, I would have the possibility to give back the seeds with interest because, in the meantime, those 10 seeds produced 100 more. With money, it was thought that this multiplication wouldn't come about, and asking "something more" when it came time to collect on the loan was considered an immoral act. Theologically, another argument was added: if I lend 100 today and tomorrow I reclaim 101, I'm profiting in time, the only element that changed. But time is not ours, time is of God.

At this point we can ask ourselves: was this condemnation of interest due only to a primitive and involved economic theory? Not only, as there is also a reasonable explanation today. We may intuit this explanation when we near the ancient prohibition ourselves, when some of us may consider it morally unjust to ask for "something more" from a neighbor when he gives back the money we loaned him to fix his house. In Medieval Christianity, fraternity was extended towards every Christian neighbor.

At the same time, we can understand how that ancient prohibition becomes obsolete if we think of the difference between a loan given to a relative to fix the house and a loan which allows him to not lose out on a good deal. In the second case, it becomes ethically legitimate to ask even a family member to receive a small share of future gains (interest). In fact, thanks to growth of commerce and markets, by the end of the Medieval Age, loans begin to be used normally for production investments, and it becomes morally licit to ask interest upon them. Interest was now viewed as compensation for one's participation in the risk of the enterprise (an idea still present today, even in the Islamic banking experience).

So, it was possible (at least for a few decades) to reconcile interest with Christian fraternity. That's why the taxation of interest is always directly linked to the risk of the investment. One of the reasons for the crisis that we're now living was the underestimation of this ancient truth.

There is also a second meaning to the word interest, going back to the motivation of economic actions. Normally, it is affirmed that one's economic behavior is moved by personal interests, by what Adam Smith called "self-interest" (in Italian, it translates to personal "benefit"). Actually, an economic project lasts through time if, besides answering to the general interests and the common good, it also responds to the interests and personal benefit of who promotes that activity and who works for it. But how can individual and collective interests coexist?

We'll find out next week

ABCDEconomy "O" as in "Organization"

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