

Are loan-sharks the real predators in the financial ocean?

By Wayne Visser

South Africa has a Usury Act, as do most countries, to protect the public against the exorbitant interest rates of proverbial "loan-sharks". But is this all we have to worry about when considering the effects of interest on society? My previous article alluded to a long history of opposition to usury in many cultures and religions. This time, I look at the problems with interest in the modern capitalist economy.

The practice of charging interest is an ancient one (at least 4,000 years old). Therefore, one must assume there is some good rationale for it. And of course there is. Interest is a fee for the risk which a lender bears of non-repayment, administrative costs associated with the loan, and the foregone opportunities for the lender to use/invest the money elsewhere.

In its best use, a loan which is put towards a productive enterprise, allows for a healthy return on investment and a comfortable repayment of the debt plus interest. Lender and borrower both gain - everyone is happy J. The problem is that so many loans are to meet consumption needs, and do not in themselves generate any income to service interest payments. These "cash loans quick" or "buy now-pay later" schemes are increasingly visible in SA's high streets. And it is these kinds of loans, especially to the poor, which the world's major religions have historically condemned. More often than not, they lead to a downward spiral into destitution as borrowers fall (or are pushed) into the so-called "debt trap".

This problem is closely linked to the "exponential growth" nature of interest - interest is "compounded" over time, i.e. charged not only on the original loan sum, but on accumulated interest as well. This is why we usually repay (over 20 years) four times the original value of our house bonds in SA. Illustrated with an extreme example, one penny of debt incurred at the birth of Jesus Christ with an interest rate of 5% would have grown to the cost of one ball of gold equal to the weight of the earth by 1466; it would buy 2,200 billion such balls of gold by 1990 - that's compound interest at work!

This phenomenon occurs at a national level too, as the Third World debt crisis continues to painfully demonstrate. According to the United Nations, developing countries paid US\$1.662-trillion in debt that was due between the years 1980 and 1992. This is three times the original amount owed in 1980. Despite this repayment, the total debt of developing countries is still estimated to stand at more than US\$1.3-trillion. More flows out of developing countries in debt servicing than flows in through international aid. In

SA, between \$1.5 billion and \$2.6 billion is spent each year on debt repayments. Much of this burden is the resulting effect of compound interest on consumption loans.

Another area in which interest is creating problems is its role in "discounting", which, in the latter half of this century, has become the dominant basis for investment decision making. Essentially, the viability of any project is evaluated against the returns which would be gained were the money simply invested at the highest prevailing interest rate. Hence, if the return (or yield) of a natural resource or a social project happens to be less than the interest rate, it makes "economic sense" to exploit that resource or cancel the project in order to invest the money. This theoretically leads to "economically rational extinction or depletion", an absurdity which ecological economists Daly and Cobb call the problem of "when to kill the goose which lays the golden egg?"

Finally, the arguments of reformist thinker Margrit Kennedy are worth considering. Firstly, she calculates that around 50% (for Germany - it would be higher in SA) of the prices paid on basic goods and services, is a hidden interest cost, paid at each step of the production process. She also shows the growth in national interest payments in Germany is outstripping the growth in GNP, implying an inflationary effect. And finally, she illustrates a "trickle-up" effect of interest, whereby the poorest 10% of German households are each paying out DM 1,800 every year in net interest, while the richest 10% are receiving DM 34,200 per annum in net interest - "No wonder", she says, "the rich getting richer and the poor getting poorer".

Even if these problems with interest were recognised, however, are there any solutions? Next time, I'll look at what alternatives are being proposed, and what is being practised.

Recommended reference: *Interest and inflation free money*, by Margrit Kennedy, Seva International (Michigan, USA), 1995.

Source:

First published as an article in *Money Values*, 08 September 1997.