

Interest and Its Role in Economy and Life (6 of 8)

Ills of Interest (1)

The Ills of Interest

Economists can attempt to come up with numerous justifications for the payment of interest but the real test is to study the effects that interest has. It is important to note that when something is prohibited by God, this does not mean that there is absolutely nothing beneficial in the prohibited item or practice. Indeed, one may be able to find something beneficial even in prohibited items. For example, God says in the Quran about alcohol:

“They ask you [O Muhammad] concerning wine and gambling. Say: ‘In them is great sin, and some benefit for people; but the sin of them is greater than the benefit...’ (Quran 2:219)

Thus, the essential point is not whether there is anything beneficial in something but whether the harm of something outweighs its benefit. Thus, economists may be able to find a hint of a justification for paying interest but this definitely would not outweigh the harms that interest can be shown to cause, as shall be discussed in this section.

Even if interest is considered some kind of payment to a factor of production, it has some unique characteristics that set it apart from payments to any other factor of production. Due to its unique nature, it leads to some very disturbing results.

First, interest leads to an inequitable distribution of income. This can be seen by taking an example of three people. Suppose there are three people who consume all of their income in a given year yet one of them starts with \$1,000 in savings, a second with \$100 and a third with zero. At 10% interest per annum, by the end of the year, the first person will have \$1,100, the second \$110 and the third person zero in their accounts. If the same scenario follows in the next year, the first person will have \$1,210, the second \$121 and the third will have zero.

Already, one can see how the distribution between them grows every year, even between the one who has some savings of his own. This scenario will be made even worse if the richest person will also be able to add savings. Suppose he adds one thousand at the end of each year. He will have 1,100 at the end of the first year, he adds \$1,000 and continues with his 10% interest and he will have \$2,310 at the end of the second year, and so on.

Now it is one thing if this money paid was actually due to some positive factor of production but in reality one cannot make that argument in this case. The money that the people are making via interest may have been squandered, lost or even stolen by the people who borrowed it, but one still has to be pay the interest. It may have been invested in a completely losing project and therefore it actually did not produce anything.

But all of that does not matter, it has to be paid regardless of whether that “factor of production” produces anything or not. This is simply one of the unique aspects of money and payments to money. No one can argue that this is just and therefore its results are an inequitable distribution of money.

Furthermore, the distribution of income becomes more and more skewed over time. One can imagine some individuals dealing in millions while others are dealing in hundreds or thousands. The disparity in their interest incomes will indeed be great and growing every year. In other words, as one hears often, it will lead to a situation where the rich keep getting richer while the poor keep getting relatively poorer.

Note that those in debt, paying interest that grows every year, have not been added to the equation. In their case, as interest continues to grow, more and more of their overall income is consumed by interest, further exacerbating the skewed distribution of income.

Someone could ask as to whether an inequitable distribution of income should be considered a major issue. Besides the psychological effects on the poor, especially given mass media advertising that emphasizes the good life and the need to consume, there are very important effects on the market as a whole.

In a market economy, production will be geared towards those who have the money to pay for the output, regardless of how necessary other goods may be for society. If the rich desire, demand and are willing to pay a lot of money for SUVs and gas-guzzling vehicles, those will be produced (regardless of how much conservationists may complain). As the income distribution becomes more and more skewed, more and more resources will be devoted to the demands of the richer classes.

Since resources are somewhat “fixed,” this means that less and less will be devoted to the needs of the poorer classes. Furthermore, the lesser resources devoted to the goods that the poor consume reduces supply and drives up the prices of those goods, further harming the poor people’s overall economic situation. For example, one can find numerous medical clinics catering to the rich (those who can afford such treatments), even if they are far from necessary, such as numerous places for cosmetic surgery and the like.

At the same time, one may find it very difficult to find clinics catering to the poor and meeting their basic needs. If they could pay more for those essential services, in a market driven economy, one would definitely find more of those types of clinics, more resources devoted to those needs and a cheaper price in the long-run for what they need. (In addition, this skewed distribution also has strong implications for the health of democracy; however, that discussion is beyond the scope of this paper.)

In addition, the burden of interest upon the poor who fall into debt puts them into a situation where they cannot advance socially or economically, widening the gap between the rich and the poor. Debt itself is a difficult situation for any individual. However, it is interest payments that make one’s debt a moving target, many times one that an individual simply cannot keep up with. Again, it is a bogus factor of production but it works to allow the rich to get richer while putting a great burden upon those who fall into debt.

Perhaps all the readers are familiar with how much of a debtor society the United States, the richest country in the world, has become. This has afflicted not only the lower classes but many of the middle class as well. Some sorry individuals do not realize that if they pay only the minimum on their credit card bills, for example, they will virtually never clear their balance.

But, of course, it is the poorest that are hardest hit. In fact, the system is stacked against them as the poorer an individual is, the worse his credit rating and the higher the interest rate he will be forced to pay. Mirza Shahjahan’s Income, Debt and the Quest for Rich America The

Economic Tale of Small and Mid-Sized US Cities is a study of how debt and its corresponding interest burden has afflicted much of “middle America.”

The plight of small-scale farmers forced to borrow due to dropping prices on their output has been well-documented. Many of them have pawned their precious belongings or lost their farms that have been in their families for generations simply due to interest payments that they could not keep up with. Shahjahan found that some of the poor pay over 15% of their yearly income on interest payments alone (with most paying between 8% and 12%)—not to mention the burden of calls and threats from creditors that the poor often receive. In Shahjahan’s conclusions, he states:

Both the monetary and real burdens of debt have kept many debtors in a lifelong struggle to service their debts. The average size of the debt of indebted households for the 1990-1993 period was \$32,493, equaling almost 100% of these households’ income. Our estimate of per capita household debt for 1990-1993 amounts to \$12,571. Debt of this magnitude, combined with a temporary job and low income, can be depressing and produce overwhelming psychological conditions...

Some households’ interest payments exceed 15% of their income. This high interest cost has been a source of significant erosion of household income...

Most households – millions in number – in mid-sized cities struggle day in and day out to meet their basic needs of life. Thousands of them fail to provide a decent life for their families or support the higher education of their children. They live in debt and die in debt. This situation makes them feel that they live less than a full life...

These households are caught in a situation of economic servitude where the most obvious escape routes are blocked by institutional forces. Acquiring skills or higher education could be the key that opens the way to real opportunity, but higher education is expensive and beyond the reach of most of the households in these cities. These households have no opportunity to excel and find themselves passed over for the positions they had hoped for. This is the nature of the plight of the working class families in the small and mid-sized cities of our nation.

Shahjahan notes, “Most households are not really aware of the degree of erosion of their

income which results from high interest payments on outstanding debts.” Mirza Shahjahan, *Income, Debt and the Quest for Rich America: The Economic Tale of Small and Mid-Sized US Cities* (Beltsville, MD: Writers’ Inc. International, 2000), p. 103.

Shahjahan, *passim*.

Shahjahan, pp. 224-236.