

THE PROBLEM OF JUSTICE IN DEBT IN EMERGING MARKETS

Dubyansky Aleksander

St. Petersburg State University, 7/9 Universitetskaya nab., St. Petersburg, 199034 Russia

Blagikh Ivan

St. Petersburg State University, 7/9 Universitetskaya nab., St. Petersburg, 199034 Russia

Abstract

The article examines the problems of equity and inequality in debt relations in developing economies. The author tries to explain the reason for the high tolerance for injustice of clients of microfinance organizations with the system of paternalistic relations, which are still typical for countries that have recently become market economies.

Keywords: justice, inequality credit, micro finance institutions, usury, percent, banks.

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Introduction

In modern Russia, the issue of the debt of the population is acute. Currently, 57% of the country's adult population have outstanding loans. In Russia, the debt of the population has sharply increased in recent years, but still lags behind developed countries, where almost 100% of the population has outstanding debts to various credit institutions. However, in our country, the problem of increasing the debt of the population is exacerbated not only by the lack of necessary institutions and low culture of debt relations, but by the low level of legal regulation of debt relations. The unsettled nature of credit relations creates many conflicts between borrowers and credit institutions, such as banks and microfinance organizations. The mass media periodically report on conflicts between collectors and borrowers who have overdue payments on loans.

The main problem is that Russia has not yet formed a proper institutional environment in which there would be an understanding of how debt relations should be built. Therefore, civil society is only now beginning to determine its position regarding the debt problem. First of all, this refers to the key category of these relations, namely, interest. Of the economic categories, interest is, if one may say so, one of the most uneconomic. This is due to the fact that there are no objective economically justified limits to which interest can grow. Still, William Petty noted the duality of the category of interest, on the one hand, the value of interest, in his opinion, is determined by the size of rent in agriculture, but only under «conditions of complete public safety». “As for Usury, the least that can be, is the Rent of so much Land as the money lent will buy, where the security is undoubted; but where the security is casual, then a kind of insurance must be interwoven with the simple natural Interest, which may advance the Usury very conscionably unto any height below the Principal it self”(Petty, 1899.p.48) Besides Petty and other well-known economists, such as A. Smith, D. Ricardo, O. Böhm-Bawerk, J. M. Keynes, understood the nature of interest in different ways, but all agreed that this is an ambiguous economic category, which also has no economic component.

Therefore, interest is considered an economic category, which, by its nature, unlike other economic categories, allows for moral, ethical, legal and other non-economic restrictions in relation to itself. The analysis of interest, perhaps like no other economic category, is a broad field for research on the possible coexistence of the principles of social justice and economic expediency. In the modern economic theory, the principle of economic expediency predominates with respect to the percent.

However, I would like to somehow correct this skew in the study of the category of interest, focusing more on the principles of social justice. This aspect is especially important in connection with the fact that debt relations underlie almost all conflicts and not necessarily economic disputes. In this article we try to answer the question related to the concept of justice. Why do debtors pay their debts, because the payment of the debt suggests that the borrower recognizes the debt and considers it as fair?

Modern money-lenders

Indeed, for millennia, «... the struggle between the rich and the poor often took the form of a conflict between creditors and debtors — a dispute about a fair and unjust interest, debt bondage, amnesty, seizure of property for debts ...» (Graeber, 2015, p.13)

In the Christian religion, indulgence and compassion for one's neighbor has always been preached as a virtue; in addition, the church taught its followers to neglect earthly goods. Naturally, the desire to cash in on the need of fellow tribesmen, the exploitation of the poor, was unequivocally condemned by Christians. The desire of Christianity to focus on moral principles is due to the fact that Christianity refers to religions of the orthodox type, in contrast to orthopraxic religions, in which the main emphasis is on regulating intra-community behavior and observance of ritual. (Susokolov AA 2011, p.65) The latter include, in particular, Judaism and Islam, therefore, in these religions, interest and usury were condemned, first of all, on the basis, of the desire for stability in inter-community relations.

In the Holy Scriptures, both the Old and New Testaments, there are numerous commandments condemning usury. Because of this, in Western countries, problems related to interest and debt relations have received a lot of attention, dating back to the Middle Ages. Suffice it to recall Thomas Aquinas, Augustine the Blessed. The canonists also contributed greatly to the condemnation of usury and interest: theologians, on whose works the building of canon law was built. This problem was noted earlier (see Dubiansky, 2011, 2012; Atwood, 2008).

J. Bentham (Bentham, 1818) and J. J. Locke (1824) opposed interest rate restrictions. They believed that limiting interest rates was a violation of market competition and a limitation of human rights. In this regard, these authors discussed with A. Smith, who held the opposite point of view and believed that in England the interest rate should be limited to 5%.¹ Indeed, any regulation of market categories, such as prices and interest rates, constitutes interference with objective market laws. However, with respect to interest rates, this restriction is necessary because interest has no objective economic basis, unlike, for example, commodity prices, which objectively depend on production costs. Fixing interest rates ultimately led to faster economic growth in European countries and rapid industrialization. In this regard, the sacrifice of economic freedom was justified. This problem was noted earlier (see Persky, 2007; Birnie, 1958).

It is necessary to define the categories and formulate a definition of usury. The author mentioned above, namely Bentham, gave two definitions. The first definition he reduced to paying more interest than the law allows, and called it legal. The second definition of usury was to pay more interest than is customary in society. In this case, Bentham spoke of a moral definition. We can agree in general with Bentham. Usury can be defined, on the one hand, as a rate of interest that is well above the market level, and, on the other, as a charge to the debtor that is far beyond its financial capacity.

It is generally accepted that in modern society usury as a whole is a kind of economic atavism. However, the facts of modern reality show that usury as an economic phenomenon exists to this day. Obviously, usurers are present in modern society and, unfortunately, will

¹ The passages in Smith are in Book II, Chapter IV (Smith, 1776).

continue to exist long enough in our life, just like their clients. When we talk about usury, we are not talking about these illegal entrepreneurs, but legal institutions that have been legalized lately, namely microfinance organizations (MFIs).

Speaking about microfinance, it should be understood that this term refers primarily to entities that receive microloans, rather than to organizations providing them. Microcredits can be issued by large banks and relatively small microfinance institutions or credit cooperatives. There are other ways of interpreting this term. One of them emphasizes the fact that microcredits are provided, first of all, to low-income clients. «In the narrow sense, microfinance refers to offering poor people access to basic financial services, such as loans, savings, money transfers and insurance». (Microfinance, 2012)

In the context of the topic of this article, devoted to the issue of equity in credit relations, it seems advisable to make a short historical digression into the history of the development of microcredit. Microfinance has gained special popularity in the world's recent history thanks to the financier Muhammad Yunus of Bangladesh, who began to develop it more than 30 years ago. The project was very successful, although microcredit services were always considered unprofitable among bankers and were not attractive to banks due to high risks caused by a large share of non-performing loans. However, M. Yunus managed to create a scheme for the mass granting of microcredits, which made them a profitable banking operation. For the development of microcredit among the poor in his country, he received a 2006 Nobel Peace Prize. Microcrediting was developed by him on the basis of the bank Grameen (literally its name is translated from the language of Bangla as a «bank of villages»). This bank was one of the first to provide microloans to the poorest sections of the country's population. However, despite the worldwide recognition of his professional activities, in 2011, Yunus was dismissed from the post of managing director, founded by him bank Grameen. Moreover, a criminal investigation was initiated against the operations of the bank that made him famous. The fact is that lending in this bank was, of course, not an act of mercy and compassion for poor people. Obviously, Grameen Bank, like any other bank, is not a charitable organization, but working with clients in it was far from the modern world banking standards.

As already noted, this bank provided loans to the unemployed and the poor, without demanding a pledge, because of the lack of tangible assets to secure a loan. Now at Grameen Bank on credit it is possible to receive from 100 to 10 thousand dollars. Currently, the main borrowers of the bank are women (97%). In Bangladesh and other Asian countries, they are more passionate than men, despite the low social status in Islamic society. However, credit is never granted to a person in person, in this case a woman, but only to those who voluntarily unite in the so-called «solidarity group». Usually such group «Gramina» consists of five people, among whom there should not be close relatives. It is important that credit is not given to all five in equal or unequal proportions, but only to two of them. «If one of the five girlfriends wants to take a loan, she first gets approval from the other four.» (Yunus, 2010, p.77) Other members of such a cell may receive a low-interest loan only if the loan is returned on time. The loan with interest must be repaid on a weekly basis. It turns out that the members of such a «solidarity group» are simultaneously mutual guarantors of the loan, and its guarantors, and if necessary collectors, i.e. «Beaters» of debt. «Although every woman is responsible for repaying her loan, her group plays the role of a small social network that provides moral and psychological support ...». (Yunus, 2010, p.77)

Often such «support» is manifested in physical violence to influence non-payers from their «solidarity group». Now, following the example of Grameen Bank, thousands of such microcrediting banks have been created in many countries around the world. With a high degree of probability, it can be assumed that these banks operate a similar scheme for providing microcredits as in Grameen Bank. The existence of such a rigid scheme for the provision of loans is primarily due to the poverty of potential consumers of microcredit services.

Economically, our country differs significantly from Bangladesh. However, the demand for loans for small entrepreneurs and individuals is as high as the interest on them. This high demand is due to the inability for this group of people to be credited to ordinary banks, due to lack of collateral, the required level of income and other reasons. There is a similarity in low ethical norms in credit relations. In this regard, Russia is similar to the countries of the third world.

As a kind of financial services, microfinance appeared in our country relatively recently, namely on January 1, 2011. It was from this date that a law came into force that defines a microfinance organization (MFI) as a legal entity that has the right to issue loans of up to 1 million rubles, including all interest paid on the loan.

Starting in 2015, two types of microfinance organizations operate in Russia, namely microfinance companies and microcredit companies. Microfinance companies should have their equity capital at least 70 million rubles. These companies are available the full range of operations that were previously allowed to microfinance organizations: issue of bonds, raising funds from citizens (in the amount of 1.5 million rubles) and legal entities. Microfinance companies have the right to issue microloans in the amount of up to 1 million rubles per borrower. At the same time, their activities are controlled by stricter prudential standards.

Microcredit companies are organizations with a capital of up to 70 million rubles. These companies are subject to a ban on attracting and investing people's funds. Such companies can issue micro-loans only at the expense of their own funds and the means of their owners, while the limit for issuing microloans to one citizen is set at a rate of up to 500 thousand rubles.

The interest assigned to borrowers in these organizations is essentially usurious. For example, the average value of the full cost of a loan for «loans to pay» up to 30 thousand rubles for a period of up to 30 days in 2017 was 614% per annum. However, in Russia, the concept of usurious interest is not defined, and therefore borrowers are forced to accept the enslaving terms of the loan. In the event of a delay in repaying the loan or its non-return, microfinance organizations sell «bad debts» to collector firms that until recently, i.e. before imposing restrictions on the part of the state, were distinguished by brutal methods of collecting debts.

What we can say about examples of financial institutions for the poor in Russia and Bangladesh? These are manifestations of paternalism, patronizing attitudes of banks or microfinance institutions to their clients. After all, ordinary banks have no interest in working with the poor, and microfinance institutions are ready to lend to the poor by providing them with a kind of favor, however, for a very high fee. Next, we consider how fair the debtors consider the fee for such loans.

Equity in credit relations

The question arises: Are such high interest rates and methods of collection of debts from the point of view of moral values and ethical norms society acceptable and fair to clients. The answer is obvious — no, they are not. After all, banks, using desperate position and extreme need for money, force their clients to agree to such obviously disadvantageous credit conditions. It is ethically difficult to justify this behavior.

However, from the point of view of sociology the issue is not solved as unambiguously as it might seem at first glance. In economic sociology, the so-called theory of justice, which explains the functioning of the mechanism of exchange in society, is used. The difference between this theory and the economic interpretations of the exchange lies in the fact that the notion of justice occupies a central place in it. For economists, in the exchange, the principle of equivalence is primarily important, if the exchange is equivalent, then it is fair. In this case, the exchange is mutually beneficial to both parties. By the way, the exchange may not be equivalent in the initial state, for example, in marginalism it is assumed that the parties exchange not equivalent benefits in terms of marginal utility. Each exchange participant is

inferior to the benefit of having less utility compared to the utility received in return, as well as the opposite side. However, as a result, each exchange participant receives what he or she wants and the exchange is considered mutually beneficial.

In sociology, exchange is viewed in a wider range than in economic theory. Sociologists consider other aspects of the exchange relationship, in addition to the justice already mentioned. If the exchange by some parameters is unfair, then each of the parties to the exchange will feel deceived. According to the theory of justice, in both participants of the exchange, the costs must be equivalent to the reward received on the basis of the exchange. (Brown, 1986) Only at costs sociologists, unlike economists, understand not material costs, but subjective losses estimates, participant status and other non-economic aspects.

One of the early versions of the theory of justice grew out of the research of Peter Blau, who watched state employees involved in a complex litigation. (Brown, 1986) According to the rules, they were forbidden to contact anyone other than the leadership. Of course, the employees did not want to run to the authorities at every difficulty, so as not to look annoying, and most importantly, not to appear incompetent and dependent. Therefore, they systematically violated the ban and consulted among themselves.

Blau watched these consultations and interpreted his observations through the prism of the theory of equality. He noted that less experienced workers rarely turned to their more qualified colleagues for help. Instead, they consulted «horizontally» equal managers, and more competent employees also consulted among themselves in their own circle.

This was because employees with low qualifications, in addition to words of gratitude, could offer little more than experienced employees in exchange for information or knowledge received. Initially, such a reward could bring satisfaction, but very soon lose a positive color. And thanking all the time for advice is a tedious task for lower-level employees. The exchange with peer-to-peer employees was more or less equivalent, and therefore more equitable, because of the equal costs.

When subjective elements are brought in to assess the actions of the above-described situation, such as gratitude, for example, we find ourselves in the field of the theory of fair exchange. Gratitude expressed by less qualified agents for exchanging with more experienced employees makes the transaction fair: costs on the one hand are equivalent to compensation on the other. This theory explains why those whose status in society is lower (for example, women in traditional societies) often act slavishly towards those members of society from which they receive something. (Akerlof, 2010) In order to equalize the objective and subjective costs and rewards of exchange, they have to sacrifice more than those with higher status. That is why the women from Bangladesh did not resent and are not indignant at such «draconian» loan conditions. Higher interest rates are the «sacrifices» they bring as gratitude for the loan granted to the owner of the bank.

As for the situation in Russian microfinance institutions, it may be noted that borrowers also believe that the inflated interest rates are fair in the sociological aspect due to the fact that these organizations provide them with loans on the same day without long bureaucratic procedures and collateral, unlike banks. If customers believe that the loan is unfair, then there is at least a moral reason not to repay the debt. However, there are no signs of a conscious and massive refusal to fulfill debt obligations.

Conclusion

In conclusion, we can say that the problems associated with high interest rates in credit relationships, are largely objective, despite its apparent subjectivity. Borrowers do not feel injustice to themselves, because they are grateful for the loan. In banks, people who are borrowers of microfinance institutions were not able to get a loan due to the lack of a bank account, credit history and the inability to make a deposit. In addition, banks are not

economically interested to issue loans for such small amounts. However, the problem of lending to low-income groups is acute in developing countries. These segments of the population are experiencing a severe shortage of cash resources, even if borrowed.

Therefore, microfinance institutions were able to find a profitable niche in the market of bank lending by working with clients, which for various reasons is closed access to bank loans.

Answering the question posed at the beginning of the article, why do debtors pay debts, you can briefly answer: because they consider themselves obliged to thank the lender for their payment rendered them the service of the loan. It is the payment of the debt that is evidence of the fact that debtors consider the interest paid by them to be fair.

However, despite the fact that the poor population recognizes the sociological aspect of the justice of high interest on debt, it is impossible to put up with the usury interest that is practiced in these organizations. Under the guise of aid to the poor, usury is flourishing with unreasonably high interest rates. It is obvious that the government should set a ceiling of the interest rate on the level of economically justified values.

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