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## **WORKING PAPER N° 237**

**On Money, Credit and Interest in Social Science**

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## ON MONEY, CREDIT AND INTEREST IN SOCIAL SCIENCE

by Heiko Schrader<sup>1</sup>

### MONEY AND CREDIT

“Accumulate, accumulate! This is the golden rule’ of the capitalist economy, wrote Marx. Just as golden a rule would be ‘Borrow, borrow!’” (Braudel 1982: 386, quoting Marx 1970, I: Ch. 24, iii).<sup>2</sup>

#### Introduction

The list of economic, historical, anthropological and sociological literature on the origin or evolution of money, the emergence of financial institutions or the Christian condemnation of usury, is extensive. Every scholar defines money in his/her own way depending on his/her own background and these definitions and perceptions reflect the epochs of European thought on economy, society and the relation of the two.

Theories on credit, except for technical ones in business administration and financial science, are, however, largely absent. This is because most sociological and economic approaches treat credit as a corollary to the theory of money which in turn has been derived from the theory of exchange. In general I agree with this proceeding. Contrary to most economic approaches, however, I consider credit as not necessarily being monetised, and therefore it makes sense to start from the theories of exchange, treating theories on monetary exchange and money already as a particular case.

An important issue is the process of monetisation. While money was usually considered neutral in value, the process of monetisation was hardly discussed in a value-neutral way. According to O. Harris (1989), the emergence of general purpose money has been interpreted either as a ‘sign of alienation, individualism and the breakdown of social and communal values’ (Harris 1989: 134) which destroyed an intact old socio-economic order. Or, according to Liberal philosophy, modern money is a symbol of society having made the step towards rationality, civilisation and having liberalised itself from the bonds of dependency, marking the beginning of the modern era. One can assert with Parry and Bloch that ‘money (...) is in nearly as much danger of being fetishised by scholars as by stockbrokers’ (Parry and Bloch 1989: 3).

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<sup>1</sup> This chapter has been extracted from the author's Habilitationsschrift (1994b): *Changing Financial Landscapes in India and Indonesia - Sociological Aspects of Monetisation and Market Integration*, forthcoming (1996: Lit Publishers, Münster).

<sup>2</sup> With Marx (1970, I) and (1970, III) I refer to *Capital*, Volumes I and III, respectively.

What was concealed in the discussion of ‘traditional’ versus ‘modern’ society, and symbolised with the use of money, was in reality the perception of **profit** in sales-purchase transaction and **interest**, its twin in lender-borrower transactions. Harris (1989: 236ff.) rightly argued that, on the one hand, money is a historical phenomenon but, on the other, it operates as a general signifier on many levels, standing for the profit motive, the market, the evil ideology of capitalism or even for the profane, the opposite of the sacral which is incompatible with money (so long as venality and commodification have not been extended even into this sphere).

### ‘Homo Sociologicus’ and Homo Oeconomicus

General-purpose money and markets are closely linked. Their presence or absence marks two opposed socio-economic states - the self-sufficient society, based upon use values and governed by collective aims and morals, and the market society which is based upon exchange values and governed by individualism, means-end rationality, market laws and money (profit/loss as indicators of success in the market game). Throughout the history of the social sciences this dichotomy appears again and again,<sup>3</sup> whereas the individual scholar perceived the transgression of the former to the latter as either a step backward or progress in the evolution of society.

In his ‘*Politics*’ Aristotle (1962), for example, took up the former position. Parry and Bloch (1989) summarised his thoughts as follows:

“Like other animals, man is naturally self-sufficient and his wants are finite. Trade can only be natural in so far as it is oriented towards the restoration of such self-sufficiency. Just as in nature there may be too much here and not enough there, so it is with households which will then be forced to exchange on the basis of mutual need. ‘Interchange of this kind is not contrary to nature and is not a form of money-making; it keeps to its original purpose - to re-establish nature’s own equilibrium of self-sufficiency’ (...) Profit-oriented exchange is, however, unnatural; and is destructive of the bonds between households. Prices should therefore be fixed, and goods and services remunerated in accordance with the status of those who provided them. Money as a tool intended only to facilitate exchange is naturally barren, and, of all the ways of getting wealth, lending at interest - where money is made to yield a ‘crop’ or ‘litter’ - is ‘the most contrary to nature’” (Aristotle 1962: 42, 46, quoted by Parry and Bloch 1989: 2).

To sum up, Aristotle distinguished between the natural, *oikonomike*, use of money for the satisfaction of needs and the unnatural, *chrematistike*, use in which the acquisition of wealth becomes an end in itself. The position was revived by the Christian Church in the course of the late Middle Ages when the expanding economy and changing values questioned its authority (Le Goff 1980). Perhaps the most prominent proponent of this position was Karl Marx who witnessed the social consequences of

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<sup>3</sup> Toennies, for example, (1959) called these two stages *community* and *society*, while Durkheim (1964) circumscribed them with *mechanical* and *organic solidarity*.

the Industrial Revolution. His position on money, profit and interest will be considered in more detail later on.

The latter mainstream ideas put forward the liberalisation of the economy from moral obligations and restrictions, and were articulated in the Enlightenment, Liberalism and economic theory. Adam Smith argued that the wealth of the nation and the happiness of the individual is founded on the individual's 'propensity (...) to truck, barter and exchange one thing for another' (Smith [1776] 1976: 17) and pursue monetary self-gain. Classical and neoclassical economic theories are based upon the idea that scarcity governs social and economic action. From such a perspective the making of money is considered natural, harmless and desirable. In its strictest ideological manifestation, the free market, any moral consideration (even Adam Smith's 'moral sentiments', a kind of instinct which prohibits *ego* to finally exterminate *alter* in the market fight) loses force, since the market (demand, supply and utility in classical or price in neoclassical economic theory, respectively) is defined as self-regulating (Adam Smith's 'invisible hand') and any imbalance is explained as being the result of interference with the market. The state is ascribed no function other than to constitute the market system and to guarantee the framework for its functioning (law and order, free mobility of the factors of production, and so on).

Characteristic of 'modern capitalistic' societies, as Max Weber called them, is that 'man is dominated by the making of money, by acquisition as the ultimate purpose of his life. Economic acquisition is no longer subordinated to man as the means for the satisfaction of his material needs' (Weber in Andreski 1984: 114). The legal earning of money is the expression of virtue and proficiency in a calling. The conscious acceptance of these ethical maxims is a condition for the future existence of capitalism as well as of individual survival in capitalism. To offend against its premises means to lose. According to Weber, modern capitalism educates and selects the economic subjects which it needs through a process of economic survival of the fittest.

In economic anthropology these two mainstreams of thought merged into the antagonistic positions of **substantivism** and **formalism**. Substantivism understands 'economic' as an instituted process<sup>4</sup> of interaction between man and his natural social environment. Market systems, which are governed by the principle of means-end economising, developed only during the process of the **Great Transformation**,<sup>5</sup> in which the economy became disembedded from society. Historical markets were *loci* of exchange which were not determined by the economic principle of maximisation and sometimes even lacked the use of money. Social components played a similarly important role in the exchange as economic ones (Polanyi 1957: 248-50; 1978). One of the best-known discussions on the impact of Western money on a previously non-monetised subsistence economy is Bohanan's (1959) case of the Tiv in Northern Nigeria.

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<sup>4</sup> Polanyi (1957) defined a process as a movement of changes in location, appropriation or both. The instituting of this economic process vests that process with unity and stability and produces a structure with a definite function in society.

<sup>5</sup> Polanyi considered the Great Transformation as a relatively short period from 1815 to 1914. I believe that this process took much longer. It started slowly with the Commercial Revolution and ended with the First World War.

Bohanan concluded that money is one of the shatteringly simplifying ideas of all time and creates its own revolution.

Polanyi (1957: 245-6) argued that from the formalist perspective the meaning of 'economic' derives from the logical character of the means-end relationship. It refers to a definite situation of choice between the different uses of means induced by an insufficiency of those means. If the choice is logically rational, we may denote this logic as formal economics in which rational action is defined as the choice of means in relation to ends. Assuming that the choice is induced by an insufficiency of means, the concept of rational action turns into the theory of choice. However, Polanyi warned that choice and insufficiency are not necessarily interdependent.

The dispute between both positions during the 1950s and 60s was finally a dead letter ending in the dogmatic controversy whether man's nature is *homo oeconomicus* or a self-sufficient being which aims for social security. However, recently Polanyi's thoughts were revived by scholars working in the substantivist tradition (see, for example, Polanyi-Levitt 1990), and further elaborated by economic sociologists. Granovetter (1985, 1992) rightly argued in his famous article '*Economic Action and Social Structure: The Problem of Embeddedness*' that Polanyi overemphasised the degree of embeddedness of the economy in marketless societies and that of disembodiedness in market societies. I take up this critique by arguing that the concept of embeddedness is even relevant for western and non-Western contemporary societies, when we dissolve the high level of aggregation of 'embedded' or 'disembodied society'. Instead I suggest to consider the degree of embeddedness of particular action or interaction. I assume a wide range of more or less embedded types of action or interaction that are characteristic for different institutional contexts (e.g. anonymous market, neighbourhood market, family, network, etc.). A type of action or interaction is then a function of certain variables that are to some extent individually determined (e.g. closeness and distance to *alter*),<sup>6</sup> to some extent conditioned by social structure (the relation of individual and meta-preferences, conventions characterising socially legitimate action, etc.). This type of action is then taken as social measure for real economic action in a certain institutional context.

Interestingly neoclassical thinkers adopted Polanyi's position too. They use his claim of re-embedding the economy as a tool to legitimise the cutting of social transfer payments and public goods by getting family, kin and neighbourhood to take over once more part of their (pre-industrial) security functions which the state fulfilled so far.<sup>7</sup>

## **Exchange, Money and Credit**

Economists consider modern, general purpose money as simultaneously fulfilling the following five functions: (a) the medium-of- (commercial) exchange function; (b) the

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<sup>6</sup> Granovetter (1985, 1992) argued that action is usually embedded in a network of social relations. In the last analysis the degree of embeddedness of economic action is related to the degree of social distance.

<sup>7</sup> Elsewhere I discussed formalism and substantivism and its implications on exchange, trade and markets in more detail (Schrader 1994a).

means-of- (commercial) payment function; (c) the unit-of-(commercial) account (or reckoning) function; (d) the standard-of-deferred-payment function and (e) store-of value function. Theories on the origin of money which largely developed in nineteenth- and early twentieth-century Germany, make any of the functions of general purpose money responsible for the emergence of modern money. However, I do not want to analyse these types of money theories in detail, since they are hardly relevant for my study. What is important so far is that most theories, both commercial and non-commercial ones, identify the origin of money in a commercial or ritual exchange act.<sup>8</sup>

My first point is that, contrary to barter, both money and credit facilitate an exchange which involves time.

### Direct and Indirect Exchange

From the sociological perspective, exchange is one of the basic acts of man as a social being, a *total social phenomenon* (Mauss 1925, 1990). According to Max Weber (1978: 71-4), it is a compromise of interests between two parties in the course of which goods or other opportunities are exchanged as a reciprocal compensation according to tradition or convention. Every case of rationally oriented exchange is the resolution of a previously open or latent conflict of interests by compromise, the ‘continuation of war with peaceful means’ (Thurnwald 1932). The object of exchange is everything transferable from the control of one person to that of another and *vice versa*. It is not restricted to goods and services, but includes all potential economic opportunities.

Economic theory considers an exchange act as two movements, the process of giving and of receiving.<sup>9</sup> In **direct exchange** or **barter** these two processes take place simultaneously, so that no future claim by one party and no liability on the other’s part comes about. The perspective of objective value theory assumes that in free markets the exchange act is balanced.

While in *Capital I*, Chapter 3, Marx (1970) started his discussion of exchange from the perspective of objective value theory too, Simmel (1989: 60ff.) adopted a counter perspective from the subjective point of view. He maintained that exchange is as productive and value generating as production if one leaves behind the level of objective value theory. From the subjective perspectives of *ego* and *alter* goods (not only commodities) are obtained for other sacrificed goods, and given the condition of free exchange the final condition is satisfying more wants than the former one.<sup>10</sup>

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<sup>8</sup> For a more detailed discussion on the origin of money and money objects, see Schrader (1990).

<sup>9</sup> Simmel (1989: 73-4) claimed that such a view is too simple from the sociological perspective. It is not just the addition of the two movements, but a new, third thing, in which each of the two processes is at the same time cause and effect of the other.

<sup>10</sup> The economic value is never a value per se. Its nature is a certain quantity of value which can only be determined by the difference of two intensities of wants - receiving and sacrificing. The value of a certain thing means that this thing has some value for myself - that I am willing to sacrifice something for this thing - a subjective value. The price correlates with the objective economic value. From the individual point of view

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The exchange act becomes trans-individualised in two-sided exchange. While it is objectively just, it leads subjectively to an increase of the cumulative sum of felt values. One individual gives what it considers unnecessary and obtains what is more scarce for the person.

**Indirect exchange** is defined as an act in which money enters the transaction as an intermediate medium of exchange. From the perspective of objective value theory, with the introduction of money as the general form of value (characterising the price of a commodity), the exchange of two commodities becomes an indirect process, the metamorphosis or the circulation of commodities

Commodity - Money - Commodity, in short C - M - C (Marx 1970, I: 108).

From the point of view of the first commodity, the relation C - M characterises the first metamorphosis or the sale, the relation M - C the second, final metamorphosis or the purchase.

The metamorphosis C - M - C means that an equal value of a commodity C which is sold for money M returns in the form of another commodity to the former seller who is now in the position of a buyer. Marx maintained that the movement of commodities is a circular. Money, on the other hand, progresses from the starting point, the exchange between two individuals, to other exchanges. Currency is the circulation of money from one hand to the next (Marx 1970, I: 116-7).<sup>11</sup>

Arguing from the point of view of subjective value, Simmel (1989: 126) took a broader perspective: Money has a dual role, within and outside the exchange relation of objects. In the former case it functions as a means of exchange. However, by this role it develops as an independent value with its own demand and supply, its own market and an interest rate (expression of its value). In other words, the dual role means: (a) it measures the relation of value between exchangeable goods; and (b) it becomes commodified itself. Its value is determined by the exchange relation with goods and manifestations of money (loans, foreign exchange, and so on).

According to Simmel (1989: 210-11), the medium-of-exchange-function of money brings about the socio-economic position of trader and money itself. The trader is the differentiated role bearer of the exchange act which was initially carried out directly between producers. We might say with Simmel that the trader is just placed in between the two subjects of exchange, while money is placed just in between the two objects of exchange.

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the equivalence of exchange does not exist. The exchange partners are only willing to exchange if each of them has a higher preference for the state after the exchange act than before (Simmel 1989: 77-9).

<sup>11</sup> Note, he treats the circulation of capital as a separate theme; see the discussion in Chapter 4.



Since general-purpose money constitutes an intermediate means (or medium) of exchange, time may be involved between the first and second metamorphosis. However, these two processes are distinct and no future claims and liabilities continue to exist in each of them once the transaction is finished as compared to credit-involving transactions (whereas it is unimportant so far whether money enters the exchange act).

### Credit

It does not make sense for pre-modern and even developing societies to define credit in a modern economic sense as ‘the purchasing power without the possession of money against the promise of compensation in future’ (Sombart 1927: 175). It is more useful to include non-monetary transactions too which similarly engender claims and liabilities between the exchange partners. An example of a broad understanding of credit is provided by Raymond Firth’s definition. Credit is

“the lending of goods and services without immediate return against the promise of a future repayment. It involves an obligation by the borrower to make a return and confidence by the lender in the borrower’s good faith and ability to repay. The return may be the same article or service as lent, or a different one. It may be equivalent in value to the loan or augmented in value above the loan (i.e. with interest). The augmentation may be voluntary or prescribed, and it may be proportionate or not to the amount of time for which the object lent has been held. The repayment may be contractual and enforceable at law, or it may not have a legal backing but be socially binding. Such a list of alternative elements indicates not only the possible variations in the structure of credit transactions in an economy, but also various points at which such variations may be conditioned by social forces” (Firth 1964: 29).

However, it is useful to apply an even broader understanding of the term credit than Firth employed. Credit can be simply defined as the provision of goods and services against the promise of future compensation. Credit relations comprise a broad spectrum of variations. The compensation may be in the form of the same or another good (cash, kind or in a combination of the two) or service, interest may be involved or not, the debt may be documented or not, the loan can be provided on personal security or against collateral and the terms of repayment (one lump sum or instalments, the date of repayment, and so on) may be fixed or left open. All this demonstrates that credit relations are very complex. It is in many cases not the level of interest which is most important for borrower and lender, but other liabilities linked with the credit relation; for example, to assure a future reciprocity in case of emergency credit or, in case of traders to bind their customers to their supply.

In primitive and peasant societies borrowing for consumption purposes (including social events) is as a rule distinguished from borrowing for investment and both are often morally valued and priced differently, although the distinction between these forms is in many cases not clear-cut. Dalton and Bohanan (1964), for example, worked out the separate spheres of exchange and possible conversions. In case of emergency credit within a community, claims and obligations used to be balanced over a life time. Sometimes, but not generally, consumption loans do not incur interest,

while with a loan for productive purposes, the lender will be compensated from the productive benefit.

### The Gift - A Reciprocal Credit Transaction

In the first part of this paper I shall not consider the issue of interest. According to Einzig (1949), non-monetary and non-commercial credit existed from the earliest phases of economic activity. This is convincing if we think of ritual, inter-temporary exchange as, for example, in the case of the gift.

To distinguish a loan from a gift in the sense that a loan causes liabilities while the recipient of a gift is free of any obligations, is too superficial, if one draws attention to the structure-functionalists' relation of the gift and reciprocity. In his essay on *'The Gift'* Mauss (1925, 1990) analysed the gift as what he called the most elementary form of exchange. What seems to be a voluntary act in the ritual exchange of primitive societies was in reality a claim on the recipient of the gift which he had to reciprocate in the future. Mauss derived his theoretical implications from ethnographic descriptions of ritual exchange, such as Malinowski's *kula* ring from Polynesia or Boas' *potlatch* among the Northwest American Indians.

With regard to Boas' description,<sup>12</sup> Mauss argued that one important element in the *potlatch* is to create (ritual and economic) dependencies (claims) and humiliations. The latter are expressed in an inflated counter gift always exceeding the gift in value. Since there is a time interval between gift and counter gift, one can interpret the relation as a credit transaction, the inflation of value as an 'interest rate' and the creation of claims as 'investments' or 'insurance'. The reciprocation in the *potlatch* was not at all a voluntary act. Non-reciprocation was sanctioned with loss of rank and even the status of a free man (Mauss 1990: 100).

With regard to the ethnographic material, Mauss (1990: 122) maintained that gift exchange was characteristic of societies which had left the state of 'total presentation' (an exchange from clan to clan, family to family) behind but had not reached the phase of individual contracts, money markets, buying and selling, fixed prices, and so on. Principally, however, he interpreted gift exchange and commerce as complementary. This was misunderstood by many social scientists and, according to Bloch (1989: 168ff.), it became the 'received wisdom' in anthropology that gift exchange preceded market exchange. Mauss' view was moreover bound up with the aspect of the presence or absence of general purpose money, and hence dualistic concepts emerged as outlined at the beginning of this chapter. In my opinion the dualism is in many cases the result of the reduction of complex argumentation to catch words in which this complexity gets lost.

### Trust

Since in transactions involving no credit (barter and cash payment) no claims and obligations arise between the exchange partners, the questioned integrity of the exchange

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<sup>12</sup> Boas, 5th report: 38; 12th report: 54f., see Mauss (1990: 82, FN 122).

partner refers to aspects of the appropriateness of measures and the money used and quality promises. In credit-involving transactions, however, it is commonly assumed that the time gap between the two processes of exchange requires trust in the willingness of the exchange partner to fulfil his obligations.

According to Luhmann (1973a), trust principally plays an important role in the functioning of society. He called trust a 'mechanism' of co-operation which reduces societal complexity and increases the individual's toleration of uncertainty. He distinguished everyday trust (on the level of credit-involving transactions between exchange partners) and system-trust on the societal level.

In a later article, Luhmann (1988b: 94-107) came to distinguish familiarity, confidence and trust which are different modes of self-assurance. Familiarity is an unavoidable fact of life, confidence is the expectation of not being disappointed (i.e. in a contingency of events) and trust is the solution to specific problems of risk (i.e. to be responsible for the consequences of one's own action). Risk does not exist by itself but is only a component of decision and action, an internal calculation of external conditions. The importance of these three factors changed with the differentiation process of society. Luhmann claimed that trust was non-existent until the emergence of capitalism. It differentiates people into more risk-taking and risk-avoiding ones and marks the transition from adventurous enterprise to risk-taking capitalism.

The relation between trust and confidence changed when the predominant type of social differentiation shifted from stratification to functional differentiation, since the formerly defined socio-territorial setting was dissolved and people had to gain access to different functional systems. Trust has remained important in interpersonal relations, while functional systems require confidence. The important point of de-personalised trust and confidence in functional systems will be discussed later in this chapter, while I now consider the element of personal trust in the exchange act.

On the level of exchange in primitive and peasant societies,<sup>13</sup> in which a distinction between familiar and unfamiliar predominates, uncertainty in time-involving exchange was reduced by either personal knowledge of the exchange partner (which I count as familiarity) or, because of the absence or inefficiency of civil legislation, by sanction mechanisms which ranged from physical force to social sanctions, such as the threat of loss of social prestige. The 'embedded' (Polanyi 1957) or 'moral economy' (Scott 1976) of primitive and peasant societies is based, among other principles, on reciprocity,<sup>14</sup> and to offend this basic principle means to insult the social code of conduct.

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<sup>13</sup> The concept of peasant society is wider than that of primitive society in so far as it includes monetary economic systems and production for the market (Firth 1964: 16ff.).

<sup>14</sup> Polanyi (1957) identified three functional patterns of exchange, namely reciprocity, redistribution and (market) exchange. Reciprocity denotes movements between correlative points of symmetrical groupings. Redistribution is the pattern of appropriational movement towards a centre, dependent on some measure of centrality in a group. (Market) exchange refers to vice-versa movements in a market-system (Polanyi 1957: 250-252). While scholars used to interpret an evolution from one form to the next, a careful study of Polanyi points out that he disapproved of such an approach. Indeed, reciprocity and redistribution exist in market societies too, although the dominant pattern is that of market exchange.

I argue that the access to such social sanction mechanisms depends on whether or not the creditor belongs to the debtor's solidarity community.<sup>15</sup> On the other hand, the alien status of a creditor may make it easier to legitimise the use of physical force or permit an insistence on balanced or even positive reciprocity (Sahlins 1972)<sup>16</sup> in the exchange act, which may offend against another basic principle of moral economies: redistribution among kin or community. The latter point was focused on and elaborated in the theory of the *Traders' Dilemma* (Evers 1994) as a stepping-stone for traders to accumulate profit.

By analysing the role of trust in contemporary Chinese foreign business, Menkhoff (1993: 40ff., 145ff.) rightly questioned the usually assumed importance of trust in credit-involving exchange acts. He argued that perceptions of trust are often not reliable reflections of reality, since they include false interpretations or expectations of others' behaviour. Hence, the element of trust is substituted to some degree by other mechanisms, for example, by testing the credit-worthiness of the exchange partner, and finally by establishing long-term trading relations, which are based on experience rather than trust.

To summarise this point: With regard to credit transactions, I put forward that familiarity and traditional sanction mechanisms, as well as risk-avoiding strategies in modern credit transactions, be they on the personal level or based on confidence in the legal system, all aim at reducing uncertainty and increasing the element of calculability or probability of being compensated in future. One such effective mechanism is the taking of collateral for an unfulfilled claim which usually exceeds the value of the claim. Werner Sombart (1927) argued that trust is not necessarily tied to the personality of the debtor but may comprise 'objective' circumstances like property of the debtor, his business standing or - one could add - a regular salary. However, in primitive and peasant societies and among poor borrowers, this option very often does not exist. The provision of collateral depends on the existence of private property rights, scarcity of the collateralised good and, of course, the ability to provide collateral. Typical collateral in modern credit transactions are land or house mortgages. In pre-modern societies, however, land very often either belonged to the ruler, or there may have been an occupancy right which was, however, not alienable. Here again, land may have been abundant and therefore was not valuable at all.

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<sup>15</sup> Exceptions are of course trading entrepots, where the hegemonial power introduces a legal code of conduct which offers a certain measure of security to alien traders and sets aside the social code of conduct.

<sup>16</sup> Sahlins (1972) elaborated Polanyi's concept of reciprocity. He realised that reciprocity is not necessarily balanced. He argued that a material transaction is usually a momentary act in a continuous social relation. The social relation may dominate the flow of goods. Thus, he introduced a continuum of reciprocity exchanges ranging from negative reciprocity to positive reciprocity. Sahlins went as far as to argue that everywhere in the world the indigenous category for exploitation is 'reciprocity'. One particular form of interest is generalised reciprocity. It forms the solidaritarian extreme in that the individual's counter-claim remains undefined and confined to a particular situation. The clearing of claims and liabilities occurs on society's level only. In modern society, the social security and insurance systems are based on the principle of generalised reciprocity.

Another mechanism to minimise trust in exchange relation is the maxim of many Chinese shops with a signboard above the counter: 'Cash, no credit', i.e. the complete elimination of credit sales.

### Money and Credit in the Differentiation Process of Society

One topic in Simmel's '*Philosophy of Money*' which is relevant to this study with regard to the changing functions of financial agents, is the role of money in the differentiation process of society. Since I treat monetary credit as an extension of money, Simmel's hypotheses may be applied to credit too. To begin with Simmel (1989: 375ff.) interpreted the development of social relations as a process of constant change of obligations and freedom. What is often felt as a freedom is indeed no more than a change in obligations. More or less every obligation is at the same time somebody else's claim on the person with liabilities. Three different patterns of obligations exist: (a) a claim on the body of the obliged person; (b) a claim on a certain product of his work; and (c) a claim on the product independent of the input of work of the obliged person.

An extreme example of the first case is slavery, another one is bonded labour which was and is still common in India. Although formally it is a temporary obligation only, it lasts as long as the debtor does not repay a loan and the debt/bonded labour relation may even be hereditary. The step to the second stage is a temporary limitation of labour, such as corvée labour. An example for such labour provides the Cultivation System in the Netherlands Indies, which was based on compulsory labour and production. At this stage, argued Simmel, there is a shift from the temporary obligation of the person to the obligation to offer a certain object; for example, a fixed amount or a share of the harvest. Although this kind of obligation is probably more difficult to fulfil, it gives him more individual freedom.

The differentiation process of society is linked to an increasing spatial distance between subject and property. A landlord who leases his land and is compensated with a share of the harvest is still closer to his property than the owner of company stocks (I broadly understand both a lease and stocks as credit). Only money and monetary credit permit the owner and his possession to widely vary, and only with the inheritance of property (and one may add, claims and liabilities) does it extend beyond the individual and begin an existence of its own.

According to Simmel (1989: 463), the success of the money economy is related to the fact that money is a substitute for the dependency on the traditional solidarity system which was based on reciprocity. In the market the individual may purchase social

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security or obtain such from the state,<sup>17</sup> furthermore, the individual may liberate himself from social obligations towards the solidarity community by using a paid recruit as a substitute.

The same is true for punishment. Criminal law came into being with the emergence of a hegemonial power which, contrary to civil law, is not directed towards compensating for individual damage, whereas the hegemonial power punishes an offence against public peace and order (Simmel 1989: 495). For development sociologists this becomes relevant with the introduction of Western law in non-Western societies, which replaced traditional rules of compensating for damages.

### Financial Intermediaries and Their Position in Exchange

Simmel (1989: 210-11) placed the trader between the two subjects of exchange and money between the two objects of exchange. How then can we understand financial intermediaries in the exchange act?

In defining a financial intermediary as somebody who trades in money (money is commodified), one might superficially assign him the same role as the trader. However, it is somewhat more complicated. Isolating the exchange act of money against a promise of repayment or collateral (at this stage it is unimportant whether or not interest is involved), the relation depends on the type of financial intermediary. A money-lender or indigenous-style banker who works with his own money is one of the exchange partners. However, the loan money engenders another exchange act for the person who is currently short of cash. If such a lender takes part in the latter exchange act, his role is confined to financial intermediation.

The trader-cum-moneylender, on the other hand, combines both the position of trader and moneylender. He sacrifices goods and postpones his claims on other goods or money resulting from the exchange act.

Commercial banks and other financial agents or institutions working with borrowed capital have a specific position in the economy because they manage their customers' money.<sup>18</sup> Their claims in credit transactions are in reality claims on their customers and liabilities to banks are in reality liabilities to other bank customers. In addition to the management functions, banks hold further functions. They influence the process of currency circulation via the interest rate, have access to refinancing possibilities with the state bank, trade in securities and engage in other lucrative financial operations. Almost all banking assets and liabilities become eventually 'fictitious', i.e. only a title to value which can no longer be re-converted into money.

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<sup>17</sup> The introduction of a social security system by the state and provision of public goods, on the one hand, and the collection of revenue, tax, etc., on the other, is nothing but the commodification of generalised reciprocity (Sahlins 1972).

<sup>18</sup> Baecker (1991) emphasised that banks are highly dependent on the trust of others. He hinted at the paradox that banks persuade their customers time to borrow and to save at the same time.

Another exchange act which becomes important in this book is revenue payment to the hegemonial power. What is superficially seen as a one-sided movement of goods, services or money is, from the point of view of generalised reciprocity, a credit-involving exchange act, where the reciprocation of the exchange act by the authority is postponed and the claim remains undefined. Contrary to the voluntary exchange act in which, from the neoclassical perspective at least, the two parties involved have the same rights and power,<sup>19</sup> revenue payments are obligatory and one party fixes the conditions of the exchange.

### A Sociological Theory of Money and Credit

Klaus Heinemann (1969, 1987) developed a complex, elaborate sociological theory of money in the code of system theory. Although he referred to credit in an indirect way only, I summarise his contribution because he combined many of the aspects discussed so far. Heinemann started from the point that an exchange act controls the behaviour of others. In direct exchange it is based upon the right of disposal of scarce goods, which requires a preference structure. However, the dependencies which result from the preference structure, and which provide the opportunity to control others' behaviour, vary considerably and cannot be standardised. They depend upon the supplied and demanded goods, the preference structure and the possibility to substitute wants. Since claims have to be met at the same time in direct exchange, time differences in the satisfaction of wants can hardly be bridged.

Market exchange is characterised by functional-specific, affectual-neutral and mostly short-term social relations. The securing of claims on the exchange partner is no longer guaranteed by non-market social relations. This requires the clear documentation and (legal) security of claims. Such a document is a certificate which institutionalises and formalises modes and contents of communication (Heinemann 1987: 325-6).<sup>20</sup> Money itself is an example of such a certificate.

The acquisition of money is only the means to achieve ends and not an end in itself. Simmel rightly emphasised that its intrinsic value (means of status, symbol of prestige, and so on) stems from its character as a medium. Wants can only be satisfied indirectly through money. The motivation to accept money in an exchange act, or even to exchange, originates in the motivation to achieve the freedom of general choice.

To cut short Heinemann's analysis, in market exchange money becomes a generalised medium of control:<sup>21</sup> (i) It has been continuously secured as an expression of economic opportunities to control others, it is always and timelessly available, it is neutral to time differences; (ii) as a measure of quantities (value) money is neutral to

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<sup>19</sup> Interestingly neoclassical economists raise the question of power when they consider moneylenders and the provision of consumer credit. The perception of moneylenders in most cases is that they exploit their customer.

<sup>20</sup> Certificates are reduced to generalised texts or symbols, such as numbers, which symbolise a claim and a liability and certain modes of communication.

<sup>21</sup> Luhmann (1973b, 1988a) applied the term 'generalised medium of communication'.

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specific qualities of goods and services; (iii) money is neutral towards persons with whom the exchange takes place. This allows to conclude that (iv) money is an objectively and personally generalised medium (Heinemann 1987: 329).

Money provides the freedom of choice. It is independent of close social relations and norms of reciprocity or redistribution. Due to the large number of preferences, products, means of production and manufacturing technologies available, money has the important function of solving these problems in the framework of prices, the discussion of which I leave out of consideration. The price system is a condensed form of various sets of information: market exchanges, market relations, the assessment of goods and services, aims of market participants, preferences, etc. as far as they are relevant for all participants. Economists circumscribe this framework of information (called purchasing power) as an index of scarcity.<sup>22</sup> To take this framework of information as a guideline for individual decision means finally that the individual orients itself by plans and decisions of others (Heinemann 1987: 332).

Money neutralises personal relations (which are found in the norms of reciprocity) and enables the individual to adapt to the changing circumstances and wants - an individualisation, which is simultaneously opposed by an increasing socialisation of individuals in the sense that forever new, extended forms of social relations and bonds, new constraints of integration, co-ordination and assimilation emerge. Money substitutes social-normative relations with functional dependencies and institutionalises a stronger economic integration with the closer interlocking of interests. Liabilities and dependencies are depersonalised, although, they do not disappear. With the use of money an individual is socially bound in a three-fold form: by social relations with the exchange partner, by the fact that the possible claims which result from the possession of money are not directed toward a certain individual but remain undefined, and by the fact that money creates a joint feeling for all those who use the same currency. The individual will only accept money as a means of payment if he can expect future exchangeability for the satisfaction of wants (Heinemann 1987: 333-4).

When I discussed money as an indirect medium of exchange, I argued from the perspective of two exchange partners that no future claims and obligations arise with either of the exchange partners. However, this is different from the level of society and economy - and here we come back to the point of system-trust or confidence into functional systems. Heinemann (1987: 334-5) argued that money - useless in itself - becomes the symbol for a claim which is only secured by system-trust which is not so much directed in the legalised future acceptance of money by other individuals, but rather to the functioning of the economic system itself. This is what Luhmann (1988b) called confidence.

The changing physiognomy of money makes an increasing system-confidence apparent. Early modern money consisted of full-bodied coins, whose face value was an expression of the substance value. Eventually token money, paper money and plastic money (where the nominal value is much higher than its substance value) came to re

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<sup>22</sup> According to Luhmann (1988a: 253ff.), scarcity is a temporary/factual/social problem, developing when somebody prevents someone else from future access to resources. Luhmann understands money as a regulative instrument of scarcity.



place full-bodied coins. The stamp of the hegemonial power came to symbolise the guarantee for the future value and acceptance of the currency. This already requires a high degree of system-confidence.<sup>23</sup> In the times when the West-European political and economic systems were less stable than the modern Western states, the high level of system-confidence was reduced in that bank notes were for a long time a legal claim to an equivalent in gold and the national banks were obliged to keep a gold store equal in value to the real money supply. Most Third-World state apparatuses and economies, however, are very unstable and the less than full convertibility of their currency, the strong regulation of the money market and the investment of citizens in a more stable currency and gold are an expression of this.

However, in case citizens lose their confidence in the stability of the national or even international economy, the state or law and order - if society and economy become disequibrated as the economists call it - this causes a run on the savings and other claims and banks, and with them the whole monetary system, collapses. Like banks, the state cannot simultaneously fulfil its liabilities towards the holders of obligations and the banks.

What has been said here with regard to changing confidence in the process of evolution of modern money can be applied to changing confidence in credit-involving certificates, such as formalised promissory notes, letters of credit, debentures, and so on. A verbal promise of one exchange partner has limited value only if he cannot prove his claim. For example, in the case of usufructuary mortgages, the customary rule in Indonesia suggested that a mortgagor should mark fruit trees which he gave into pawn with his sign to demonstrate his future right to redeem the pawn. Another example is, a reliable person witnessing the credit-involving transaction to convince public opinion if necessary. To simplify the regulation of claims and liabilities in civil justice, standardised written promissory notes were introduced very early on. I do not want to go into too much detail; what I want to emphasise is that with the evolution of the legal sub-system during the differentiation process of society, familiarity with the reliability of the exchange partners became increasingly substituted by system-confidence: confidence in the general validity of the certificate, its recognition by the legal authorities, their incorruptibility and power to force debtors to fulfil their liabilities, and so on.

Heinemann (1987) expressed the increasing system-confidence (which he called trust) as follows. The more complicated and complex the economy, the more it is not a matter of knowledge or experience, since social life is rarely based on proofs. Social action always involved uncertainty. However, to some extent this uncertainty is compensated by 'social certainty' because it generates an expectation in the behaviour of others. Perhaps it is this 'social certainty' that the promise of a certificate can be taken for granted, that individuals have confidence in money and the economic system which permits planned action.

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<sup>23</sup> An expression of this system-confidence is perhaps the imprint on Dollar notes 'In God we Trust'. I interpret it as a substitute of an ancient confidence-generating mechanism: the temple as a place of exchange, where the exchange act took place under the eyes of the God who functioned as a witness.

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## CAPITAL AND INTEREST

### Interest and Interests

'Interest' or 'interests' is a central and controversial concept in economics, social science and history. The term came into widespread use towards the end of the sixteenth century and is derived from the Latin word *interesse*. At that time it had not much in common with our contemporary understanding of interest. Following Hirschman (1986a: 35ff.) the term was applied to the forces, based on the drive for self-preservation and self-deification which motivated or should motivate actions of princes or the state, of individuals and later on groups of people with a similar social or economic position (classes, group interests). In modern terms this action can be called self-centred, rational or instrumental action. In this connotation I will use the plural form to avoid confusion.

On the individual level the term was applied as an euphemism to make moneymaking in general and the taking of interest on loans in particular, respectable which had so far been called 'usury'. Various descriptions imply that the perception of profit and credit in ancient and medieval societies is somehow related to two essential factors: a religious ethic, on the one hand, and the development of commerce, on the other - or, more precisely, the decline of a particular mode of production (called 'feudal' by Marx) and with it, traditional elites (the rentiers) and the growth of another mode of production (merchant capitalism) with a new, commercial and financial elite.<sup>24</sup> Usury was defined strictly as 'where more is taken than is given' (Le Goff 1980: 29). This definition is similar to the contemporary understanding of interest and has nothing in common with the present connotation of usury.

Eventually economic requirements engendered the legitimisation of exceptions of usury in commerce, such as the buying of annuities, the taking of land in mortgage, the use of bills of exchange, partnership arrangements, risk premium and delayed repayment, and so on. Towards the end of the thirteenth century, and particularly during the fourteenth and fifteenth centuries, there was a gradual separation of economic from religious morality. In everyday-life it was more and more obvious that society and economy could not function without loans. Financial agents and institutions were a necessary precondition for an expansion of trade and commerce and *vice versa*.

Max Weber (1964: 251ff.) explained the final abolition of the prohibition of loan interest as the resolution of the antagonism between inner and outer morality in society. The formal equality of all individuals eventually led to the abolition of the prohibition to take interest from brothers (inner morality) but similarly helped to overcome the unrestrained personal appropriation and usury in external relations. However, this was a long-term process which I described elsewhere (see Schrader 1994b). It was strictly opposed by the Church (see Böhm-Bawerk 1970; Hirschman 1986a, b; Weber 1950, 1985). Nevertheless, it finally engendered the Protestant Ethic. The spirit of capitalism might be interpreted as a result of adapting to the devotional calling of making money, which the capitalist system demands (Weber in Andreski 1984: 123). Closely related to

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<sup>24</sup> See Böhm-Bawerk (1970), Braudel (1982, 1984), Homer (1963), Le Goff (1979, 1980, 1988, 1989), Shatzmiller (1990), Sombart (1927), and Weber (1950, 1964).

Max Weber's theory of the 'Protestant Ethic and the Spirit of Capitalism' are various theories on industrial entrepreneurship.

Finally the initial connotation of the interests was blurred (see Hirschman 1977). In economics the term took the dual, value-neutral connotation of interest from capital investment (natural interest) and money interest. This distinction goes back to the discussion of interest as an income obtained without work. Profit, wages and surplus value, and a theoretical distinction between money interest and natural interest, were the main topics which finally led to the labour and exploitation theory in *Capital*.

### **Marx on Capital, Credit and Interest**

Let us now return to Marx and his discussion of capital, natural and money interest. He focused his analysis on surplus value appropriation which he considered the chief characteristic of capitalism. In *Capital I*, Chapter 4, Marx came to distinguish money and capital. Money as currency and money as capital have two different forms of circulation, the former C - M - C, the latter M - C - M', which he called the metamorphosis of money into commodities and transformation back into money, buying something to resell it (Marx 1970, I: 174). This process makes sense only if there is some surplus value (Marx 1970, I: 149).

Marx concluded that money, whether in the form of currency or commodities, is transformable into capital, on the basis of capitalist production. It produces profit, i.e. the capitalist is able to extract and appropriate from the workers a certain proportion of unpaid labour, surplus product and surplus value (1970, III: 338). With this function of potential capital - a means of producing surplus - money becomes a commodity, but a commodity *sui generis*.

Marx's discussion of credit, however, is separated from his discussion of exchange, money and capital, and it appears in *Capital III*. Considering the place of credit in capitalist society, he identified a financial capitalist behind the industrial capitalist whose function is the financing of the latter. Therefore he receives a share of the profit called interest.<sup>25</sup> Marx polemically called the financial capitalist a parasite and an honourable bandit (Marx 1970, III: 350) in the medieval tradition, in that such a person neither (physically) works nor makes others (physically) work for him.

The key issues of large parts of *Capital III* demonstrate that the analysis is not generally valid but confined to the capitalist mode of production. Important are Marx's thoughts on the transformation process of economy and society from pre-capitalist to capitalist conditions. In *Capital I*, for example, Marx saw the exploitation of East India by the British as belonging to the 'rosy dawn of the era of capitalist production'

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<sup>25</sup> The circulation of interest producing capital may be expressed as follows (Marx 1970, III: 340): M - M - C - M' - M', where person B borrows some money M from A and circulates M - C - M'. The owner of money lends his money to another person and commodifies it as capital for himself and the other person, as a value which is able to produce surplus and profit, a value that continues to exist (Marx 1970, III: 343). Money lent to person B by person A as a sum A returns as A + 1/xA to person A (Marx 1970, III: 341).

(1970, I: 703), the process of so-called primitive accumulation. This era followed the trade war between European nations, and the different instances of primitive accumulation are more or less linked in a chronological sequence across the commercial empires of Spain, Portugal, Holland, France and England, which engendered the process of the transformation of a feudal into a capitalist society. This transformation process was based on violent action (Marx 1970, I: 703).

According to Marx, what was decisive for European colonial expansion was the introduction (or more precisely, the improvement) of the system of public credit, the '*credo* of capital' (1970, I: 706), which during the eighteenth century experienced an integration between the European commercial centres. The balancing of public debt was to be achieved with a more efficient fiscal system which, as a consequence of the continuously increasing public debt, tended to over-exploit the populations, particularly in the colonies. The third mechanism in the process of European colonial expansion was the policy of protecting the expanding European domestic manufactures which began to organise capitalist production (*ibid.*).

In various paragraphs Marx emphasised that 'merchant capital', which consists of commercial capital and interest-bearing capital, historically preceded and even created the conditions for the capitalist mode of production.

"Interest-bearing capital, or usurer's capital, as we may call it in its antiquated form, belonging together with its twin brother, merchant capital, to the antediluvian form of capital, which long precede the capitalist mode of production and are to be found in the most diverse economic formations of society'. Thus the medieval usurer, who is to the merchant as the financial capitalist is to the industrial capitalist, 'converts his hoard of money into capital for himself' according to the formula applicable to all capital,  $M-M'$ , with the surplus  $m$  being in this case interest" (Brunhoff 1973: 77, quoting Marx 1970, III: 593, 598).

Marx argued that under the pre-capitalist mode of production two kinds of usurious capital exist (which recur on the basis of capitalist production, although as subordinate forms only): Usurious capital by lending to spendthrifts of the upper classes and among these, in the first instance landlords; secondly, usurious capital by lending to small-scale producers who possess their own conditions of labour. These include the peasant and the artisan. Whether or not this usury transforms the old mode of production into the capitalist mode of production, as it did in modern Europe, depends on the historical stage of development and its conditions (Marx 1970, III: 594).

"Usury thus exerts, on the one hand, an undermining and destructive influence on ancient and feudal property. On the other hand, it undermines and ruins small-peasant and small-burgher production, in short all forms in which the producer still appears as the owner of his means of production" (Marx 1970, III: 596).

Usury centralises monetary wealth where means of production have been destroyed. It does not change the mode of production, but it lives off the debtors and forces them to reproduce in the most miserable conditions. This is the reason for the widespread hatred of usurers.

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Usury in pre-capitalist modes of production has a revolutionary effect in so far as old forms of property are destroyed. Under Asiatic forms of production usury can continue to exist for a long time without producing anything but economic decay and political decline. Only once the other prerequisites of capitalist production are fulfilled, does usury come to assist the establishment of the capitalist mode of production (Marx 1970, III: 597).

Marx maintained that the main domain of usury is the function of money as a means of payment. Every payment (rent, tribute, tax, and so on) payable on a specific date had to be made in cash. As will be shown in this study, during the period of colonialism one decisive element in the monetisation of rural regions was the reorganisation of the revenue system in that the peasants had to provide cash payments to the colonial government. The requirement of monetary payment forced peasants into cash-crop production, and the temporary gap between expenditure and income urged them to take up loans from moneylenders.

Marx continued that the development of a (formal, H.S.) credit system may be understood as a reaction to usury. In this credit system the interest rate is accommodated to the conditions of the capitalist mode of production. However, argued Marx,

“usury as such does not only continue to exist, but it is even freed, among nations with a developed capitalist production, from the fetters imposed upon it by all previous legislation. Interest-bearing capital retains the form of usurer’s capital in relation to persons or classes, or in circumstances where borrowing does not, nor can, take place in the sense corresponding to the capitalist mode of production; where borrowing takes place as a result of individual need, as at the pawnshop; where money is borrowed by wealthy spendthrifts for the purpose of squandering; or where the producer is a non-capitalist producer, such as a small farmer or craftsman, who is thus still, as the immediate producer, the owner of his own means of production; finally where the capitalist producer himself operates on such a small scale that he resembles those self-employed producers” (Marx 1970a, III: 600).

Marx emphasised that credit has an ancient and a modern aspect. The modern one, corresponding to the capitalist mode of production, has a certain specific structure such as paper money, book money, financial markets, and so on, while interest-bearing capital, however, is a general phenomenon as old as commercial production, as, according to Marx, the only condition for its existence is the simple circulation of money and commodities. The functioning of credit in the capitalist mode of production is not merely the modern form of merchant capital. A real break takes place when merchant capital is incorporated into capitalist production and begins to function merely as its agent. This break, which Marx referred to and which I consider as a process of change, is of particular importance in this study. It is related to my hypothesis that professional moneylenders and merchant bankers are pioneers in expanding capitalism who are replaced by banks in the long run.

Marx distinguished between commercial credit and banking credit. Commercial credit is rooted in simple circulation when money acquires the function of a means of payment. The seller becomes the creditor, the buyer the debtor. Credit-money emerges from the function of money as a means of payment. Debt certificates (for example,

bills of exchange) begin to circulate on their own. Both money as a means of payment and credit-money begin to extend, the latter of which in our time has reached unimaginable proportions in the form of book money, while the actual money supply has been restricted as an instrument of monetary policy.

Following Brunhoff (1973: 81-4), Marx (1970, I: 137-8) saw commercial credit to be on the border between monetary system and credit system. The circuit of financial transactions in commercial credit, which from a theoretical point of view forms a zero-balance, is, however, in fact never complete for several reasons. One main reason is price fluctuation, another is the diversity of branches of production, and a third one delayed payment. Therefore, Marx, and even Brunhoff two decades ago, believed that credit cannot substitute money, since ready cash is needed for various expenses, such as wages, taxes, and so on. Gaps have to be bridged with money, and money reappears as the general equivalent settling the transactions. The means of payment function involves the availability of cash. However, the credit card and electronic cash have revolutionised the money market and have to some degree deprived the use of cash in payment interactions of its function.

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