Lending without Interest in a Jewish State

English text with Hebrew translation.

Here in brief are some ideas from the paper "Interest Free Wage Linkage of Personal Loans and Mortgages", which can be found on my internet page - see end of article. Sincere thanks to family, colleagues, students, and friends for their help.

It is permitted to copy this article but only in its entirety.

This article describes a dream, which is inspired by the words: "If thou lend money to My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest." (Exodus 22:24). This dream is a response to an economic nightmare we experienced in Israel, not so long ago, and from which we must learn.

There were years in which prices increased by 25% every month or two, and penalty interest rates reached about 1760% per annum. I clearly remember seeing a sign on a shop selling car accessories warning - "deferred payments bear interest of 4% a day".

During those years, three zeroes were removed from the currency - remember the lira and the shekel before the new shekel. Sadly, there was a state of economic collapse, and tragically, some committed suicide because of escalating debts.

This dream is also a reaction to an old nightmare in which the Jew, and in particular the Jewish moneylender, has been portrayed as a villain, and persecuted. Let us hope, that with G-d’s help, these nightmares never return.

In spite of all this there were things to be proud of during those years of high inflation. The "Gemach" for example, continued to give interest free loans. Also, I remember a radio program where people phoned in to make contributions. Instead of money, several gave "a day", "a week" whilst a friend even contributed "a month". Contributing time, became more meaningful than contributing money, which was collapsing.

These events somehow gave me the idea of interest free linkage to the average wage or income.

Let me now state that I am not expert and do not have wide knowledge on the topics which I will present. So let me show the gleanings which I have gathered.

Linkage not Interest

We are forbidden to take interest on loans. On the other hand it is unfair to the lender if inflation erodes the value of his money. In order to deal with this problem, debts can be linked. By "linkage" we mean that the debt and debt repayments rise and fall in proportion to some index, e.g.
prices, wages, foreign currency, etc. It is proper to ask which formulae for calculating indices and which methods of linkage are reasonable from both a "Torah" and scientific viewpoint.

Wages not Prices

An index formula should be both accurate and stable. "Stable" means that prices (or wages), which do not result in a significant quantity of sales (an insignificant number of people with such a wage), should have little or no effect on the value of the formula. These matters are particularly important when debts are linked to an index formula. The issue of accuracy is both a scientific and Halachic requirement. Stability of an index formula is important for economic stability.

We have used a computer to simulate test situations where the true average index value is known. We observed that the formula for measuring wages was accurate in all our tests, whereas the formula used for measuring prices was accurate only when there was no correlation between price and quantity.

We also noted that the formula used for measuring wages has good stability characteristics, whereas the formula used for measuring prices has poor stability characteristics.

For these and other reasons, linkage to prices is not a good choice. Linkage to wages seems a good choice but under what conditions would this be Halachically acceptable?

Halachic questions

Firstly, a clarification. Regarding linkage we earlier defined that the debt and debt repayments would rise and fall in proportion to some index, e.g. prices, wages, foreign currency, etc. Linkage in equal measure to both rises and falls is important as this avoids the prohibition of צאן ברזל. See בָּא מֵאָסֶט פָּרָק הֵ' מְשָׁנָה ו.

Now we discuss four questions briefly.

1) Are price linked loans or wage linked loans in keeping of the spirit of the biblical command of "...thou shalt not be to him as a creditor..."? Does price linkage cause hardship to wage earners?

When prices increase more than wages borrowers pay more with price linkage and less with wage linkage. It therefore seems that wage linkage is in the spirit of the above biblical command, as less is taken from borrowers when they have less at their disposal. On the other hand, price linkage takes more from the wage earner borrower when he has less at his disposal and seems to contradict the spirit of the above biblical command, and this can cause wage earners hardship.

2) Would interest free wage linkage prevent erosion of the lender's money?

According to the data we studied, we found that wage linked loans, with an annual return of 0.2% above the price index, generate a depletion of the borrower's funds, but interest free wage linkage does not prevent depletion of the lender's funds.
On the basis of data we have studied, we found surprisingly that interest free loans linked to the published average wage would give an average yearly return of about 1.5% above the price index to the lender. Erosion of the lender's money is prevented, but there are risks. (Though the next question is not directly about handling risks, the method proposed there to deal with a certain Halachic objection, also reduces the risk.).

3) Is linkage to the average wage akin to a reciprocal work agreement in which the works of both parties are of equal difficulty and therefore permissible?

Reciprocal work agreements in which one party does harder work than the other party violate interest laws but if the works are of equal difficulty this is not prohibited, (Shulhan Aruch Yoreh Deah 160:9). So far as example if the lender worked for one month in the field for the borrower in summer when it is dry and pleasant, and in return the borrower worked for one month in the field for the lender in winter when it is cold and raining, this would violate interest laws, as work in the field in cold rainy conditions is harder than work in the field in warm pleasant conditions. We also see from table 4 in the full paper, that the price/wage ratio is generally lower in summer than in winter, indicating that it is harder to make a living in winter than in summer. In view of this, there is likely to be objection to lending one average monthly wage in summer and collecting one average wage in winter. However, there seems to be no objection to lending one average monthly wage in any month, and then collecting it in the same month in another year.

A better solution to this difficulty is for example, that the lender gives a loan of one average wage per month over one year and the borrower returns the loan paying one fifth of an average wage per month over five years. This is because one average wage of each of the months of the year is being lent and one average wage of each of the months of the year is being repaid. More generally, the loan can be provided in monthly instalments over one or more full years, and repaid in monthly instalments over one or more full years. This arrangement ensures that payments are made in terms of the average value of different kinds of labour of the whole country over one or more full years. Seasonal and regional fluctuations are thereby neutralized and the risk is lowered.

Another better solution to this difficulty is to calculate an average wage from data for the previous twelve months. So if average wages over twelve month periods are used for linkage, then again one average wage of each of the months of the year can be lent in any month, and one average wage of each of the months of the year can be repaid in any month. Here there is no need to give or collect the loan in instalments. Here too it is ensured that payments are made in terms of the average value of different kinds of labour of the whole country over twelve month periods. Here too, seasonal and regional fluctuations are neutralized and the risk is lowered.
4) From an Halachic standpoint, which methods of calculating the average wage or income are acceptable for debt linkage? Which methods are to be preferred?

The unit index is used for measuring wages which seems a good choice. However, the published average monthly wage means the average gross wage per employee post of those employed. Should the nett wage be used? Should those unemployed be included in this average with an income of zero or perhaps other income such as unemployment benefit? What is the correct average wage link to? And similarly for other income such as the unit index.

When lending to the needy however, it is correct in my opinion, not to use interest. When lending to the needy however, it is correct in my opinion, not to use interest.

We have also explained how the loan should be given so as to meet Halachic requirements and reduce the risk. We have also explained how the loan should be given so as to meet Halachic requirements and reduce the risk.

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We have also seen that interest free wage linkage will prevent erosion of the lender's money; is not oppressive to the borrower; and so should be used for personal loans and mortgages. We have also seen that interest free wage linkage will prevent erosion of the lender's money; is not oppressive to the borrower; and so should be used for personal loans and mortgages.

This is an important technique used for dealing with the Halachic difficulty discussed in question (3) above. In addition this technique reduces the risk, avoids problems of seasonality, and contributes to stability of an average wage, (and similarly for a price index, a foreign currency rate etc.).

Conclusions and suggestions

We have seen there are several reasons for using linkage to wages and not to prices for loans and other transactions.

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When lending to the needy however, it is correct in my opinion, not to use linkage; neither to take interest.

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The use of a twelve month period

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