*European Journal of Science and Theology*, August 2013, Vol.9, No.4, 111-121

# FINANCIAL CREDITING PRODUCTS HELP OR OBSTACLE IN BOOSTING THE ECONOMY DURING CRISIS

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(Received 4 May 2013, revised 10 June 2013)

## Abstract

One of the basic functions of financial institutions is that of boosting economic activity through crediting. Unfortunately, reality has proven that, on the one hand, in most cases, the only goal of most financial institutions is profit at all costs, under any conditions, and on the other hand, that they are not interested in helping economic agents or the population through the redistribution of the revenues available in the economy. Moreover, benefiting from a silent concession to the regulatory and surveillance authorities, they resort to extortionist practices that only lead to the alteration of economic relations.

*Keywords:* banks, extortion, regulation, crediting, non-banking financial institutions

*Usura non natura pervenit, sed iure percipitur*
(Papinianus *liber 62 D. de R. V. 6, 1*)

## 1. The theological and canonical perspective

*The Encyclopaedic Dictionary of Roman Law* defines 'usurae' (usury) as "interest generally paid periodically in money (or in fungibles) by the debtor to the creditor as long as the principal (*sors*, *caput*) was not repaid" [1]. Usury was considered in the Roman Law as proceeds of the capital or 'fructus'. Although in the case of interest agreed upon through a 'stipulatio', a simple informal pact (*usurae ex pacto*) was not enough, such agreement could be taken into account in trials governed by good faith. The Roman Law regulated usury since the interest paid in an amount higher than permitted or prohibited by law could be claimed back by the debtor [1] Since the Twelve Tables legislation, the rate of interest was often limited. The rate of twelve per cent that was stipulated by the law was termed *fenus licitum* or *usurae legitimae*. Further, "a creditor who took higher interest could be sued for four times the amount exceeding the legal rate. Justinian considerably reduced the

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highest admissible rate, set different rates according to the nature of the loan and abolished the fourfold penalty.” [1, p. 469]

Regarding the theological perspective, the primary Church considered that ‘usurae’ was a sin. Therefore, the Canon Law regulates this ‘de facto’ situation, turning it into a ‘de iure’ situation. The 44 Apostolic Canon stipulates: “Let a bishop, presbyter, or deacon, who takes usury from those who borrow of him, give up doing so, or be deposed” [2]. Not does the canon prohibit illegal usury, but it also forbids legal interests because the Christian teaching acknowledges that taking the interests of one’s brother is a sin: “Give to every man that asketh of thee; and of him that taketh away thy goods ask *them* not again. [...] And if ye lend *to them* of whom ye hope to receive, what thank have ye? for sinners also lend to sinners, to receive as much again. But love ye your enemies, and do good, and lend, hoping for nothing again; and your reward shall be great, and ye shall be the children of the Highest: for he is kind unto the unthankful and *to* the evil.” (Luke 6.30, 34-35). Usury was also prohibited in the Old Testament, Deuteronomy 23.20-21: “Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury: that the LORD thy God may bless thee in all that thou settest thine hand to in the land whither thou goest to possess it. When thou shalt vow a vow unto the LORD thy God, thou shalt not slack to pay it: for the LORD thy God will surely require it of thee; and it would be sin in thee.” Also, Ezekiel 18.17: “That hath taken off his hand from the poor, that hath not received usury nor increase, hath executed my judgments, hath walked in my statutes; he shall not die for the iniquity of his father, he shall surely live”.

The same approach is found in *The Stromata* of Clement of Alexandria: “The law prohibits taking interest from a brother of nature, not only as a brother but also by those who are of the same religion with us, or one that is of the same nation with us” [3].

Canon 17 of Nicaea reads: “Forasmuch as many enrolled among the Clergy, following covetousness and lust of gain, have forgotten the divine Scripture, which says, ‘He has not given his money upon usury’, and in lending money ask the hundredth of the sum [as monthly interest], the holy and great Synod thinks it just that if after this decree any one be found to receive usury, whether he accomplish it by secret transaction or otherwise, as by demanding the whole and one half, or by using any other contrivance whatever for filthy lucre’s sake, he shall be deposed from the clergy and his name stricken from the list” [2, p. 38].

In his commentary on canon 17, Nicaea I, Balsamon states: “Some consecrated persons, knowing the canon, seek to avoid it, they try to observe the letter of the canon, but mercilessly violate the sense of the canon, because they lend money to people to work with it and divide the gain between them, but one who has received the money to pay usury for the received amount of money, these are indeed hunters of interests, who pretend to be pious” [4].

The fact that the Council fathers have taken this into consideration means that, at the time, this practice could have become a social evil; in this vein of thought, Zonaras states: “the percentages being different, the majority were of one hundred percent”. Further, explaining the word μεταχειριζόμενος, he points out: “some, pretending not to be money lenders, lend money on the basis of a mutual agreement between them and divide the gain, without participating in the losses, not being considered usurers, but partners” [5].

Considering this kind of trade a crime, canon 17 forbids all clerics to give money with interest. The custom of demanding interest, treated with great forbearance by civil laws, has remained in use even after the Council of Nicaea I, contaminating even the clergy.

We can further mention other canons which also expressly forbid the practice of usury, especially by clergy, namely: Canon 4 Laodicea (343-381) [2, p. 132], Canon 5, 16 Carthage (419) [2, p. 218, 230-231], Canon 10 Trullo (691) [2, p. 137].

Following the provisions of the canons, the Holy Fathers of the Church also forbade usury and urged the clergy to leave aside any deed that was not of ecclesiastical nature. Thus, Saint John Chrysostom bitterly rebukes certain bishops who “today are crushed by material concerns even more of the directors, treasurers, traders and priests of God deal with things that are not within their competence” [6].

Canon 14, Saint Basil of Great, reads: “What it takes to wear if you accept to give the shameful profit for the poor and after that getting rid of the disease of avarice will be accepted for the priesthood” [7].

In the western world, Saint Ambrose (339-397) attempted to combat this negative deed, insisting: “you did not consecrate to the Lord to make yours rich” [8], and recommends to priests not to deal with money issues, “the priest should not intrude on issues of money, in which often you cannot help but offend those who succumb in priestly office” [8, p. 62].

In his letter to the bishops of Campania, Piceno and Etruria, Leo I the Great points out: “We have not even thought of having to overlook the fact that some people, captured by the lust for filthy lucre, lend money with interest and want to get rich with the fruit (that is picked up), we regret that this happens not only in the case of those who are part of clerical ministry, but also in the case of lay people who wish to call themselves Christians. We establish that for those who have been guilty one should adopt a more severe punishment in order to remove any incentive to sin. We also felt that someone should warn any clergy that as he does not do it for himself, he should not do it in the name of the others; it is in fact inconvenient to personally commit a crime for the benefit of the others.” [9]

## 2. The economic analysis of the issue

The essence of loan is beneficial. It does nothing but cover certain temporary financial gaps with money surpluses not used by the owners. Its purpose is to improve the debtor's financial dysfunctions. Unfortunately, this financial intermediation turned into one of the most profitable activities, having gone well beyond the stage of assistance. Nowadays, an unstoppable desire for profit has been reached, not so much on the part of the initial holder of the financial surplus as on the part of the one that makes the placement and less.

Such substantial profits that can be obtained from the activity of intermediation led to a fierce competition on the financial market in Romania. If we have a look at the banking market, we may clearly notice that it is occupied in an overwhelming percentage by foreign capital (Table 1).

**Table 1.** The banking market in Romania according to the type of capital.

| | **2010** | **2011** |
|---|---|---|
| Total number of banks, of which: | 41 | 40 |
| - Banks, Romanian legal persons | 32 | 32 |
| - Branches of foreign banks | 9 | 8 |
| State capital banks | 2 | 2 |
| Total number of private capital banks, of which: | 30 | 30 |
| - having private Romanian capital | 4 | 4 |
| - having foreign private capital | 26 | 26 |

Source: National Bank of Romania

**Table 2.** Distribution of foreign capitals in Romanian within credit institutions.

| | **Millions RON** | **%** |
|---|---|---|
| Greece | 4192.5 | 22.9 |
| Austria | 3795.8 | 20.8 |
| The Netherlands | 2102.3 | 11.5 |
| Italy | 899.5 | 4.9 |
| Hungary | 661.2 | 3.6 |
| Cyprus | 653.9 | 3.6 |
| France | 578.5 | 3.2 |
| BERD | 361.7 | 2 |
| Other countries | 1209.6 | 6.5 |
| Foreign capital aggregated on the banking system | 14455 | 79 |
| Total capital of credit institutions | 18289.4 | 100 |

Source: National Bank of Romania

From a number of 40 banking institutions, only 2 have state capital and other 4 private domestic private capital [10], hence the clear dependency of the Romanian capital market on foreign capital. Foreign capital in the Romanian banking system is distributed as shown in Table 2.

As one can notice, there is a great gap between the first three positions and the following ones. We may ask ourselves why Greece, a country in which domestic banks are in difficulty in their turn, is on the first position. Besides this, the situation of the Romanian banking market is at risk in the event of massive capital withdrawal. We do not believe that there is interest in withdrawal from a market as profitable as Romania, but the degree of exposure obliges us to be very careful about the evolution of the financial situation at the international level.

Besides banks, we find many financial institutions on the Romanian financial market: insurance companies, insurance brokers, private pension funds, investment funds and non-banking financial institutions.

As far as insurance companies are concerned, the analysis of their behaviour on the domestic market has revealed that the approximate 40 existing companies offer a narrow range of products and services. Besides a few important players such as Allianz Tiriac Insurances, Generali Insurances, ING Insurances, Grup Ama, Wiener Stadiche, most of them work more on the car market where such insurance policies are mandatory. Unfortunately, the lack of firmness in regulation and surveillance of the companies allows many companies to penetrate a market with low prices that affect the quality of the services in the field. Many cases in which compensation is not awarded have been recorded, although the files claiming damages prove that those taking such action are entitled to receiving the respective amounts. Who is at a disadvantage in this case? Only the consumer as the institutions continue to collect considerable amounts in their accounts. This situation has been recorded for years, implying that certain companies are a constant presence in the ‘top’ of the most unreliable insurance companies.

**Table 3.** NBFC distribution according to the services provided.

| **Category of activity provided** | **General register** | |
|---|---|---|
| | **No.** | **%** |
| Crediting activities | 134 | 66 |
| Financial leasing | 52 | 25.6 |
| Issue of guaranties and commitments | 6 | 3 |
| Consumer credit | 5 | 2.4 |
| Financing commercial transactions | 4 | 0.5 |
| Factoring | 1 | 0.5 |
| Microcrediting | 4 | 2 |
| **TOTAL** | **203** | **100** |

Source: National Bank of Romania

Non-banking financial institutions have boosted lately. Set up as an alternative to commercial banks, a part of them are mainly, even exclusively, focused on profit, not being interested in satisfying the customers' needs. The situation of nonbanking financial institutions, according to the type of services provided at the end of 2011 is listed in Table 3.

We can see that most NBFCs focused on crediting activities (approx. 70%). At first sight, we should be content that a revigoration of the economy is attempted by the temporary redistribution of available revenues. Unfortunately, in some of the cases, revenue distribution is unidirectional for the profit of the financial institution. To support this claim, we may analyse the case of a non-banking financial institution (famous for its aggressive advertising and the 'inhumane' conditions that it promotes) – PROVIDENT. For several years, this NBFC has offered small credits on the retail market in Romania at shocking annual interests of approx. 85%. What is their target group? Those with low incomes that are in desperate need for money and will do anything to survive. Even if the interest varies from 30% to 35% per year (which is still very high), together with the DAE fees and commission, it goes beyond 80%. Naturally, we are wondering whether there are any differences between extortionists (that grant loans with interests between 6 to 10% per month, that is 72-120% per annum) and this financial institution. It seems there is only one difference. The former do not pay taxes and fees for the provided services and are outside the law (as they should be), the latter pays taxes and affords the costs without having to incur 'astronomic' interests. We wonder how they succeed on the market. It is very simple. First of all, there is the issue of addressability. Most loans may be more easily accessed than a bank loan. Therefore, those persons that resort to such an NBFC are persons that necessarily require financial resources (in most situations, for their subsistence) and seek to take loans in legal conditions. Secondly, a promoted 'perverse' marketing measure is the weekly payment of the interest. Thus, the one that takes the loan is not aware of the entire amount that needs returning and has the illusion that he or she supports easier the cost of indebtedness. The NBFC employees also put pressure on the customers as they come to his home to recover the money. This fractional payment hides another worrying truth. The annual fractional payment means another greater payment. So the indebtedness of the person resorting to a credit increases through the lenses of reimbursement fractions.

Why are such institutions successful? An explanation may be given by the existence of asymmetric information. Thus, the consumer relies on professional counselling. A feature of financial services is also the employment of experts to deal with customers relations. Most often, the customer cannot make a correct evaluation of the provided services. Asymmetric information diminishes on the loan market due to the nature of financial contracts – the promise of payment on a future date [11]. The persons that provide counselling services are selected according to the need to assure the consumer of the good faith of the institution and the fact that it may offer him the ideal solution to overcome his or her financial problems.

Another discrepancy occurs at the level of the information available to the customers and providers. The financial institution (not only NBFCs, but other categories, as well) holds information about customers that is not available to others. The customer cannot correctly assess the solvency of a financial institution because he or she cannot check independently the value of its assets. If the financial institution goes bankrupt, there is nothing to be done; but, if the customer goes bankrupt, he is subjected to financial foreclosure.

Behind these operations, there are usually the same persons and their interest is to make a profit from the good faith of misinformed customers. The existence of information imbalances leads to problems of adverse selection. This occurs when the parties capable of producing the most disastrous effects have the highest chances of being selected. Adverse selection has a negative influence on the capacity of the market to make feasible exchanges, the exchanges that the borrower and lender would like to achieve, had it not been for the doubt on quality. In certain situations, adverse selection may prevent the formation of a market.

Another gap for a great part of the consumers of financial products and services of Romania is the lack of financial education. Most of the people requesting a credit (especially in the case of NBFCs) do not have sound knowledge, be it legal or not, to enable them to understand the contract provisions and the evolution of the internal and international financial market or to know the currency forecasts for the following period.

Many of the credits on the Romanian market have been given during 2006 and 2009. It was a period in which BNR allowed the banks to give loans based on a much higher indebtedness degree (from 35% to 70-75%). One of the motivations was that national legislation is to be synchronized with the European one. However, there are great differences between the crediting conditions of a Western European citizen and a Romanian one. For instance, a rate of 400-500 Euros in Western Europe (corresponding to the level of average monthly rents) is 30-35% of the average obtained revenue. Thus, that citizen could borrow 1000-1200 Euros for an apartment without struggling to survive. The difference of 300-400 Euros was enough to cover the daily cost of living. In Romania, the application of the same degree of indebtedness made many Romanians stick to 200-400 RON out of a salary of 1200-1400 RON which was not enough to make a living.

Effects can be seen in this moment when more and more people do not know how to reimburse the contracted credits when the rate of unperforming credit goes around the value of 15% of the total credits.

It is still this lack of financial education that allowed the illogical increase of the prices in immovable goods. In a race against time for fabulous earnings, financial institutions and real estate agents ‘placed their bets’ on the same card – that of unlimited indebtedness of the final consumer. Although the evolution of the European markets, in general, and American markets, in particular, showed that the real estate market was overrated and would collapse, the regulatory institutions in Romania did not make a case of it and did not take the necessary measures to record the level of prices which was way above the normal level and to stop excess crediting with a minimum of safety elements. We believe that financial institutions ignored on purpose the unrealistic fluctuations on the real estate market from the wish to increase their portfolio of debtor customers of the bank on the long term.

The calculus is very simple: the credit is awarded on several years (20-25 years), the degree of indebtedness is over 70%, mortgages are applied on real estate goods, the interest to the contract is flexible and another important aspect is that the interest is cashed by the bank in the first years of the credit contract.

Thus, after 3-4 years of monthly payment for a credit of 50000 Euros, for instance, with an average interest of 450 Euros a month, the consumer pays over 20000 Euros to the bank in interest and when calculating the difference to be paid after these first years, he would see that of 50000 Euros, he has to pay another 48000. In this way, the profit of the bank is ensured and, in case of incapacity of payment, the bank enforces mortgages and recovers the entire amount initially owed.

These are not the only factors that led to the enslaving of the Romanian consumer of financial crediting products and services. At the origin of present day unperforming credits, another major cause is represented by the currency in which the loan was obtained. The ‘extortionism’ of financial institutions (after all, interest and extortionism are one and the same thing, only the percentage is different) is also shown in the aggressive marketing performed on credits in foreign currencies during 2006-2008. The stimulation of crediting in foreign currency had a double purpose: on the one hand, it is easier to handle an external financing line in open currency between the mother bank and the Romanian subsidiary, and, on the other hand, additional earnings may be obtained from the fluctuations of the exchange rate.

The latest developments of the Euro-RON, Swiss Franc-RON, and Dollar-RON currencies show that Romanians ended paying larger amounts than the ones initially contracted (Table 4).

**Table 4.** Developments of the exchange rates of the main currencies on the Romanian market.

| Currency | 20 June 2012 | 31 December 2011 | 31 December 2010 |
|---|---|---|---|
| Euro | 1:4.5848 | 1:4.3197 | 1:4.2848 |
| Dollar | 1:3.7438 | 1:3.3393 | 1:3.2045 |
| Swiss Franc | 1:3.8173 | 1:3.5528 | 1:3.4450 |

Source: National Bank of Romania

## 2.1. Example

A credit of 136000 contracted in francs in 2008 was the equivalent of 77000 Euro. In June 2012, after approximately 4 years, the equivalent in Euros that the customer (that had paid to the bank a rate of 700 francs during this period) pays is 105000. To this data, we may also add the fact that the real estate market decreased dramatically; therefore, the value of the real estate is not the same as it used to be 4 years ago. What will the borrower do in such a situation? He or she will continue to pay for the loan. It is precisely due to the fact that the acquired immovable good does not have the initial value and in an auction the borrower would not even obtain the money initially borrowed from the bank. We no longer take into consideration the reality that many of the auctions of this type are to the detriment of the consumer in his good faith due to the machinery consisting of banks, legal executors, real estate agents or extortionists.

These situations on the Romanian market make us realize that the loan in Romania turned into a modern form of slavery. A way of slavery in which the one that works goes by himself to deposit the ‘money owed’, as opposed to the Middle Ages when he awaited at his home for those collecting the debt. The loan is actually a means to exert control over a society.

What else is promoted by credit? Consumption on money is further promoted, money that comes from probable, unsure, future earnings. Many long lasting assets bought on the basis of this ‘trickster’ of the crediting system – credit with your ID – have an expiry date ending before the total return of the borrowed value. In this entire spiral of crediting regulatory institutions have to play an essential role. In this period of deep financial crisis, the entire world looks at central banks. Their reaction was natural. The Central European Bank decreased the level of refinancing interest to historical minimums. Likewise, the National Bank of Romania reduced the reference interest precisely to give an incentive to crediting and relaunch economy. Theoretically, everything should go according to the plan. However, the effects in Romania were different from the ones in the Euro system countries. There, the diminishment of interest led to the granting of loans with profitable interests that allowed the elimination of financial blockages, the stimulation of demand and, implicitly, the increase of the offer. In Romania, the diminishment of the interest by BNR had a single visible effect: the banks’ increase of the profit margin. Justified by the increased country risk (categories given by rating institutions that showed their subjectivism through the scandals that came out overseas), banks operating in Romania kept the same interests, often adding in an abusive manner, margins between Euribor and Libor and interest to the client that reach unencountered thresholds in Europe. Knowing that no person may borrow money directly from BNR and only financial institutions have this privilege, the reality of the crisis years, 2009-2012, shows us that the Central Bank – Commercial Bank – borrower chain does nothing else than justify the more expensive credits.

No one took a stand and banks used their freedom of setting margins (stipulated by credit contracts), without justifying their value in an objective manner. Thus, those pseudo-threats, such as the leaving of the Romanian bank market should attempts to the regulation of margins or other agreement provisions be made, were not mere theatrical scenes meant to scare the public opinion and discipline it in accepting any interest, margin or rate. Lately, other 'progressive ideas' have occurred and they are meant to provide solutions to incent credit: Romanians are suggested to resort to financial institutions to receive loans. The increase of crediting would lead to the achievement of the intended profits for banks (that are established annually by mother banks) and thus interests would relax, interests that have been imposed especially to reach the financial performance levels required. It seems that there are no limits to the imagination of those who wish to make profit at all costs, to the detriment of the common customer.

What can we do after all these convulsions provoked by the obsessive desire for profit of the financers combined with the present financial crisis? We believe that the reforms in the financial system should reconsider the macro-prudential perspective. Most of the present day regulations were achieved from a micro-prudential perspective. The perspective was to protect individual banks through cash, capitalization, and efficient control systems. This focus on individual banks led to ignoring the system problems. Decisions that, at first sight, seemed rational at the level of individual companies such as the decision to grant credits to real estate developers that raised artificially the price of real estate proved not to be rational at the system level, as it encouraged the real estate specula through the unrealistic development of this market and the double or triple rise in prices. Clearly, systemic risks are more dangerous for financial stability. Healthier interventions on the financial market, regulations able to control the unjustified desire for profit in financial institutions, as well as a predisposition for the end consumer's needs and protection may reduce the gap between the small groups of financial players animated by the desire for profit and the great mass of those that do not want anything else than enjoy their rights from above.

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