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INDEBTEDNESS: ETHICAL PROBLEMS

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Abstract:

In the mid-1980s, economists became interested in studying situations of over-indebtedness in families, companies and governments, which some felt were rife at that time. It also became a concern for some experts in business ethics, but for reasons other than the stability of the economic system.

This article analyses the development of the different types of indebtedness in families and companies through history. The changes that have taken place in private economies make it necessary to reconsider ethical judgements on debt and credit: although the practical moral criteria that are applicable to private finance may be the same as in previous ages, their significance is different and should be dealt with under wider criteria.

INDEBTEDNESS: ETHICAL PROBLEMS

Excessive indebtedness?

In the 1980s there was a certain amount of concern in financial and economic circles worldwide about what appeared to be an excessive increase in overall debt, both public and private, in proportion to the increase in economic activity (measured, for example, in gross domestic product), and about the reduction in the quality of the debt (measured by the guarantees, chances of interest being paid, etc). The warnings issued by Kaufman (1979, 1986) and Friedman (1980, 1982, 1983), among others, sparked off research and discussion (cf, for example, Federal Reserve Bank of Kansas City, 1986) about the existence, meaning and possible economic effects of over-indebtedness, as well as the political measures which could or should be adopted where appropriate.

It was obviously an economic debate and not an ethical one. The concern was about economies becoming more vulnerable to recession when the economic agents –families, companies and governments, in the main– were heavily in debt, as well as about the temptation for the authorities to adopt lax and inflationary monetary policies when applying restrictive measures could cause many families, companies and financial institutions to become bankrupt and so eventually endanger the stability of the whole financial system.

This fear was confirmed, but only partly, during the recession of the 1990s, as it had been during earlier recessions. On the one hand, it is a fact that companies that go into a recession heavily in debt have a smaller chance of survival. On the other hand, the process of adjusting to this latest recession has been particularly long and hard in many countries –above all Japan, but also the USA, the United Kingdom and Spain, among others– on account of the high level of debt among families, companies and governments, and the fall in the value of the assets (property and shares, mostly) that are used as direct or indirect guarantees for loans. However, the drastic situations that had been feared did not arise: either the level of indebtedness was not as high as had been thought (1), or the consequences were not as disastrous as the critics had predicted.

In parallel to this debate, the explosion of debt problems in developing countries also attracted the attention of economists (2). In fact, the problem was exactly the same, only in this case it involved countries or groups of countries and not just domestic economic agents.

If some economists, financiers, politicians and journalists were worried at the time about the excessive increase in debt, it seems natural that moralists should have been similarly concerned. In effect, we have seen frequent complaints in this respect in recent

years, with over-indebtedness being related to the consumer society (3), the insecurity and volatility of earnings, the creation of «dependence» on or «addiction» to social protection, the growth in unemployment, the difficult economic situation in developing countries, etc. However, identifying the *causes*, ethical or otherwise, of over-indebtedness and investigating the interaction in the behaviour of debtors and creditors is of more interest than analysing the social, economic, political and ethical *consequences*.

The purpose of this paper is to present an ethical analysis of the problem of indebtedness in today's economies, and in particular in advanced capitalist societies. We will adopt the viewpoint of the debtor (families and companies) and we will not deal directly with the attitudes and problems of the banks or other creditor financial institutions, nor with public debt, nor with debt problems in developing countries (4). In the following section we will look at the different types of debt, their economic justification and their ethical dimension. Then we will develop the analysis, comparing a traditional backward society with a modern industrialized society in order to see what differences there are in the kind of financial and ethical problems that arise. After further consideration of the problems caused by the increase in debt, some conclusions will bring the work to a close.

The financial and ethical logic of debt

Why do people, families, organizations, governments and nations get into debt? As a general rule, in order to cover expenditure which is higher than their current level of income. Here is a set of possible reasons for getting into debt that are ethically acceptable (5):

1) *To maintain current levels of consumption or expenditure in the face of a temporary reduction in income:* for example, a bad harvest in an agricultural subsistence economy; a temporary reduction in a family's income because one of its members becomes unemployed; or a cash deficit because of a temporary reduction in sales in a company.

From the ethical point of view, it seems reasonable to turn to credit (6) in order to cover contingencies of this type: rational economic agents make long-term plans and provide for means to obtain the necessary resources. From the financial point of view, it will either be an acceptable practice or not, depending on the expected length of the indebtedness, the amount of interest and principal to be returned, the timeframe agreed, etc., and also taking into account the global financial situation of the agent concerned. But all this also forms part of the information needed to judge the case from the point of view of ethics, which cannot be separated from the economic and technical information. In any case, the inevitable uncertainty inherent in the problem requires suitable treatment, in accordance with the virtue of prudence.

If it is a matter of maintaining current spending levels in the face of a *permanent* reduction in income, the economic and moral problem is very different. If there is a volume of wealth available that can bear the future interest payments and repay the principal, getting into debt is the equivalent of financing expenditure by reducing one's wealth. This may be ethical and technically reasonable (7) (for example, in old age, or in temporary companies which are on the way to being wound up), but it can also be very unwise and unfair when it permanently diminishes the wealth of a family, or when it leads to the obligations towards the lender not being met (8).

2) *To finance expenditures in advance of a future increase in income (permanent or temporary).* This has similar characteristics to the previous example.

3) *To cover extraordinary expenditures* (motivated by illness, weddings, holidays, new houses, etc), which it does not appear reasonable to meet by reducing ordinary expenditure for the period. Turning to credit means that the flow of incomings can be independent of the outgoings, making the most of the latter. As long as the flow of expected future incomings and outgoings will allow the credit and the interest to be repaid, there can be no objections, either from an ethical or from a financial point of view.

4) *To carry out investments or to increase assets* (purchase of a house or financial assets, setting up as a self-employed professional, expansion of a factory, etc). Turning to debt is also justified in this case. In principle, the net wealth (solvency) of the debtor does not change, although it may do so in the future.

Historical changes in models of indebtedness

It is probable that all the aforementioned kinds of debt can be found in every type of society. However, through history there have been a number of economic and social changes that have affected these different kinds of debt.

1) In a stagnant rural society, the use of *credit to maintain a standard of living in the face of a temporary decline in income* was the logical consequence of a bad harvest. The risk inherent in this type of loan was very high:

- a) A succession of bad harvests could make it impossible to repay the sum received plus the interest, besides requiring further credit in the following years.
- b) In a stagnant society, the surplus of income over outgoings available to the family (or, more likely, the family business) for paying the interest and repaying the principal was very small. This meant that the capital would be extended, the debt would remain and the family business would eventually be ruined.
- c) Families had no alternative sources of income, except for domestic service, working as day-labourers on other farms, or some sort of emigration (military service, etc).
- d) In closed, non-competitive markets, interest rates were usually very high, which made the repayment of the loan unviable. The problem was even worse if the bad harvest affected a relatively large community, since the demand for credit would increase and the supply would shrink.

All this explains, at least in part, the attitude of moralists towards credit in days gone by (9). The most common case was that of the poor family business seeking help from a rich landowner after a bad harvest. The landlord gave them a loan at a high interest rate, which was to be repaid as soon as the next harvest was collected. The failure to repay the loan, for any of the reasons outlined above, increased the burden on the poor family until they came to the point of losing their estate. It is easy to understand why lenders were identified with usurers in previous times, why the charging of interest was criticised (or at least, the high rates of interest, bearing in mind that the loan was guaranteed by the debtor's lands), and why the moralists fiercely recommended that the virtue of prudence should be exercised when requesting a loan.

The problems facing a modern family that suffers a temporary reduction in income are very different.

- a) There are mechanisms in place (public or private insurance for health, disability, old age, unemployment, etc.) that provide the minimum income necessary and so reduce the need for credit to a residual role (at least in developed societies).
- b) Reductions in income are usually less concentrated in geographic and social terms than they were in agricultural societies (with the exception of serious industrial or mining recessions, which do affect a wide geographic area, or natural catastrophes, etc.).
- c) Families do not usually own agricultural land to act as a guarantee on their loans; in its place they may be able to mortgage their home (if they own it), seek other guarantees, request personal loans (with or without collateral) or, more simply, postpone payment (with or without the agreement of the creditor). Overall, the possibilities of obtaining credit are probably greater now than years ago and permit greater diversification among the sources of funds.
- d) Real interest rates for this type of credit are lower now, thanks to factors such as competition, deregulation, liberalization, etc. among the institutions and financial markets.
- e) Financial intermediaries are specialized in granting credits to different types of client and are therefore better equipped to study the needs of each debtor and to evaluate his solvency. The relationship is more professional, with undoubted advantages (10).

Indebtedness as a way of maintaining one's standard of living is not, therefore, such a problem today as it was centuries ago and still can be in underdeveloped societies. This may explain the change that has taken place in the generally held social and moral view of credit, interest, usury, etc. However, it does not mean that the ethical criteria have changed. When considering a request for a loan, the debtor must act with caution, the same as five centuries ago (although there are now new ways to hedge the risks), and the creditor must ponder the same elements as then (degree of need, availability of alternatives, guarantees, likelihood of the interest being paid, etc). It is these elements that will have changed and with them the social perception of the problem (11).

2) The request for credit in order to *anticipate expenditure in accordance with future expected income* is much more common now than in the past. In a stationary society, the hope of an increase in future earnings was very limited, except through strokes of good luck (the discovery of a hidden treasure, receiving an inheritance, etc). Therefore, to get into debt in these circumstances was an act of imprudence which moralists rejected. However, growth in income is somewhat more normal (12) today (except in some backward societies or in countries with serious political, social and economic problems), and so it is natural that rational agents should bear this in mind and anticipate consumption, getting into debt and leaving the payment of their debts for later, when their income will be greater (13).

What moral criteria should be applied in a case such as this? In general, the criteria will be no different from those that have traditionally been used for people taking on debts, although they do contain some nuances.

In the first place, the family's financial situation will become more fragile, given that the interest payments have to be added to the ordinary expenditure, while, at the same time, the existence of the debts reduces the net value of the family's wealth as a whole and also its capacity for future debt, should that be necessary. Therefore, an unexpected reduction in income or an increase in outgoings, or a delay in the arrival of the larger incomings, can present a significant financial problem, even insolvency. However, this obviously does not alter the moral evaluation of the indebtedness in this case; it simply makes it advisable to consider the different potential scenarios: high and low incomings, high and low expenditure, arrival or not of the larger incomings, economic disasters in the family, etc, resulting in a subjective probability for evaluating the risk that is being run in requesting a loan.

However, this probability does not have to remain stable, for three reasons:

- i) The fact that there is an average objective probability –a set rate for expected future growth in incomes, for example, or a certain probability of becoming unemployed– can serve as a guide for the family, but it does not exclude the existence of a differential risk, given that the increase in the income of this particular family may not, for whatever reason, be equal to the expected average (*idiosyncratic risk*). This must be borne in mind.
- ii) When a family evaluates its future at the beginning of an economic boom, it is reasonable to expect a high increase in income and a low probability of any loss of income; these expectations would be justified given the information that is available to them at the time. However, it is also likely that, at some point in the future, there will be a change in the economic cycle; the economy will go into recession and those optimistic expectations will not be fulfilled. This factor (*cyclical uncertainty*) creates the sort of social, economic and political problems that we referred to in the introduction. Clearly, the family will have to bear in mind any possible changes in cycles.
- iii) It can also happen that the past ceases to be a good guide for determining future probability –for example, because a geographic area goes into a long phase of industrial decline, or because the probability of unemployment leaps to higher levels, etc. (*change of tendency*). In such cases, even a prudent family which has considered the possibility of a change in the cycle can find that its forecasts were too optimistic.

The various uncertainties that a family has to face when it is considering taking on a debt also have implications for the lender:

- i) The risk of non-payment of the first type (family idiosyncrasy) can be detected through detailed analysis, demanding stronger guarantees, or simply, by counting on the probability of a number of defaults for this reason and sharing the cost out among all the other debtors.
- ii) In theory, a financial intermediary would be in a better position than families to anticipate the second type of risk (cyclical). In practice, this does not usually happen, because during a phase of euphoria future risks are undervalued in favour of short-term profits, especially when the other banks are all acting the same way. This can lead to financial and moral problems such as the underestimation of cyclical risk, the overvaluation of a client's guarantees, greater competition between financial institutions, etc., and eventually to an

imprudent credit concession policy. This carelessness, in turn, is transmitted to those seeking loans, who are given the opportunity to get into debt with low interest rates and favourable conditions, instead of being made to take on the exact nature of the risk.

And when the recession arrives, the problem will be reversed (14). Faced with the first non-payments, the banks will toughen their credit conditions and refuse to renew credits even to solvent clients (15), while interest rates will increase, especially if the recession is caused by a supply shock or restrictive monetary policies. Therefore, debtors will not only have had to revise their forecasts and make them more pessimistic, but they will also have had to accept new and more restrictive credit conditions. They can hardly be expected to have foreseen all this when they took out the loan.

The spread of an agent's financial problems ends up affecting everyone who relied upon the continuity and the proper functioning of the agent for their activities: clients, suppliers, workers, banks, etc. So there is an external effect (or externality) (16) which the debtor does not take into account when he is working out his personal economic calculations - although ethics is able to internalize it (17).

- iii) The third type of risk (change of tendency) is not foreseeable either by the lender or the borrower. It creates problems similar to those described in the previous section.

With companies, indebtedness as a way of anticipating expenditure before receiving the corresponding income is a matter of routine administration (18).

3) Indebtedness in order to *finance extraordinary consumer expenditure* has similar characteristics to the previous two types. In traditional societies, especially when they are near to subsistence level, such behaviour does not seem prudent given the difficulty of repaying the credit and the high risk that is being run. Conversely, in modern societies it is perfectly acceptable to take advantage of opportunities for expenditure, incurring debt in the process so long as the security measures we mentioned earlier are taken into account.

In the cases we have considered up until now, we can clearly see *a change in the social and economic perceptions of indebtedness*. Traditionally, families got into debt only for very serious reasons at times of emergency and had to bear very high costs and risks. This is what caused the social reticence towards those who abused the existence of credit, the call for prudence in running a family, and the lack of enthusiasm on the part of financial institutions for family credit plans, which were usually handled by private lenders, usurers, etc., who covered the risk they ran by means of very high interest rates, or else demanded very high guarantees (pawnbrokers, for example).

In modern societies, the function of credit is not so much to cover emergencies as to *redistribute expenditure in time, making it independent of the timing of income*. Rational agents supposedly take decisions about the optimum distribution of consumption or expenditure over time, which implies that at times the level of their income will be higher than their expenditure –that is to say, they are saving– and at other times the reverse occurs –i.e. they are spending. In the case of the latter, they reduce the level of their personal wealth, be it by selling assets, be it by taking on debt.

But this also has consequences for the ethical evaluation of debt. In the first place, the decisions to take on debt are tied in with earnings (expected future income, not present income) and with expenditure (also expected) on an extended horizon. They also are related to decisions about whether to increase or reduce one's assets (we will come back to this later). The family can make plans, for example, to increase its indebtedness over a longer or shorter period, independently of the form of the credit (for example, an informal credit granted by the corner shopkeeper, a consumer credit agreed with a bank, or a hire purchase agreement on an electrical appliance). The credit may be a short-term one but the family can request it with the intention of extending it over several years.

This means, therefore, that there is a first level of economic-financial and ethical decisions which we could call *the life cycle level*. This covers the family's planned consumption over time in accordance with its expected income, the tastes and preferences of the family members, its composition, the age of the family members, etc. The decision includes, for example, selecting periods of greater or lesser indebtedness (including increasing indebtedness), choosing criteria for the financing of extraordinary expenditures as well as of periods of temporary reductions in earnings, and deciding how the family will act if faced with serious financial difficulties (19). It is also a moral decision because it affects the family's chosen standard of living, its decision to work more or less, the size of the family, the level and nature of the risks they take on, etc. –and all these variables have clear ethical connotations.

There is also a second level of decision about the *composition of the portfolio*, which is also economic-financial and ethical. In this second level the family will decide which specific type of debt can be used in each situation. This decision must be understood within the context of the previous one: it is natural that the family should postpone the purchase of new consumer durables until it has paid off the credit on the earlier ones, or that it should negotiate a mortgage to pay off a whole group of separate debts unrelated to its property, etc. The traditional moral criteria recommended for decisions on indebtedness will once again become important at this point, but always within the criteria of rationality and morality that we indicated previously.

This means, for example, that a family can take on short-term debts *with the expectation of postponing them when they fall due*, if the lender permits it. In accordance with traditional criteria, this would be immoral because credits should be paid when they are due. But in the wider view that we are considering here, the extension of credit is compatible with the long-term planning of the family's economy. In addition, it fits in well with the plans of the lending institution, so that there are no moral objections to going ahead even though it does not agree exactly with the terms of the contract that was signed (unless there was a case of bad faith). The case might well be different if it were a loan granted by a non-financial person or company, who was relying on recovering the money on time, and for whom a request for an extension might create a financial problem.

4) Everything we have said up to now is also relevant to the fourth category of reasons for getting into debt, that of *purchasing physical or real assets using credit*. In traditional societies this is very rare, at least in terms of families: the high cost of credit, and the requirement for sufficient future income to pay the interest and return the loan –for example, for the purchase of a house– made it advisable to accumulate a sizeable part of the total amount before going ahead with the purchase.

But this rule has also lost relevance today. As we have already indicated, decisions by a family to purchase an asset (real or financial) form part of its long-term spending plans (often implicit), which take account of the generation of a net wealth and change over a long

time. Therefore, using the same logic that approves of turning to credit with the hope that the income needed to repay it will become available in the future, purchasing assets through the use of credit must also be approved –especially if one considers that the asset itself is the guarantee for the loan.

In the business world, the purchase of assets using credit has always been a much more widespread practice, mainly based on three factors: the guarantee of the item acquired, the guarantee of the company's total worth, and the existence of a regular cash flow which guarantees the probability of paying the interest and repaying the principal.

However, a simultaneous increase in the debt and the assets of a family or company is not without economic and moral consequences. Let us look at some of them:

- a) The mere fact of introducing a change in personal portfolio into the balance can deteriorate the financial equations. For example, it can increase the level of the overall risk of the family or company (20). It is worth mentioning here that it is possible to manipulate the accounting figures, which, through apparently legal operations and consolidations, can hide the company's true situation.
- b) Companies (and also families) continually change the composition of their assets and liabilities. The balance sheet that yesterday showed a low risk can today be a high-risk one.
- c) Keeping the proportion of debt over assets constant as a whole does not guarantee solvency if, for example, interest rates go up, because this increases the burden of interest and makes the level of debt less tenable.
- d) The purchase of a real asset can entail an instantaneous or quick loss in its value: a second-hand car is always worth less than a new car even if it has never been used. This is the equivalent of the idiosyncratic risk we mentioned earlier.
- e) There is also a cyclical risk. The value of an asset (a house, an industrial site or a package of shares) that is used (explicitly or implicitly) as a guarantee on a credit also varies for similar cyclical reasons to those mentioned earlier. In a recession, it is probable that the value will decrease (and that its liquidity will also decrease), leaving the debtor with the same debt as before but with a smaller guarantee and, therefore, a greater risk. If the creditor reacts to this situation by requiring new guarantees, or demanding that the loan be repaid early, the situation of the debtor can seriously deteriorate, very much more so than could reasonably have been expected at the beginning (21).
- f) The cyclical risk also carries an externality which affects other debtors indirectly but nonetheless effectively. If a mortgage debtor does not pay his loan, the bank will receive the house as a guarantee. When the bank tries to sell it, this will cause a fall in house prices (if the phenomenon is sufficiently common), which will reduce the guarantees of other debtors and spread the problem to them.
- g) A loss in the value of assets, followed by the usual deterioration of the borrower's solvency, can lead to a phenomenon of «forward flight». This consists of carrying out risky operations with potentially high profits in the hope of thereby being able to cover the financial deficit, but also with the chance of heavy losses.

Nonetheless, the authorities are likely to be worried about the stability of the financial system and will come to the aid of financial institutions which are supporting their customers' insolvency problems, especially during periods of long or deep economic recession, or which are facing the danger of a chain of defaults or bankruptcies, or when several large institutions could fall (generating the «systemic risk» that the lack of confidence will spread to all entities, including those that are financially stable).

The intervention of the authorities can take the form of action by the central bank as the lender of last resort, or it can take other forms. This may solve certain technical and economic problems such as the public's loss of confidence, the danger of «rushes» on the banks, etc. But it can also create other ethical and economic problems, mainly of moral risk and adverse selection, in so far as the banks are given incentives to carry out operations that are too risky, because neither they nor their customers will have to bear the final cost (which falls on the taxpayer), or because they pay less attention to the quality of their debtors, for the same reason (22).

Back to over-indebtedness

What we have said so far helps us to understand better the problem of over-indebtedness that we explained at the beginning. Although we do not have any evidence that modern societies are more in debt overall than traditional and backward societies, we have found economic reasons that support a greater recourse to credit, and even a different way of interpreting the role of debt in these societies. Above all, this new perception does not seem to create any special ethical problems.

This does not mean that there are no reasons for being concerned about a growth in the level of debt. For example:

- a) Tax policies of deducting interest payments as expenditures and tax dividends (even with several taxes) lead to an excess of debt and insufficient capital of its own (in other words, lower guarantees) (23).
- b) Also, higher prospective inflation encourages indebtedness (given a fixed nominal interest rate), because inflation reduces the real value of the future interest payments and the repayment of the loan.
- c) The phenomena of financial innovation and deregulation have facilitated the creation of debt. For example, the generalized use of variable interest rates has transferred the interest risk from the lender to the borrower and this has significant ethical and economic consequences (24).
- d) The practice of securitization has made it possible to negotiate credits that were not previously negotiable. This may have reduced the prudence of the financial institutions, which can rid themselves –apparently, at least– of bad debtors at lower risk.
- e) Financial globalization and internationalization have also made it easier to get credit in other markets, widening the range of opportunities.

- f) Prudent behaviour can be punished by certain practices, in that a company with little debt can be a good candidate for a takeover bid.

Be that as it may, these and other reasons do not warrant any special concerns from the ethical point of view. There is no lack of immoral conduct, of course, but there is no reason to suppose that modern developments in the credit markets and in the borrowers' businesses have led to any less acceptable moral behaviour. However, they could have generated, on the one hand, mechanisms which can encourage the assumption of higher levels of risk, and therefore greater possibilities of contracts being broken and, on the other hand, a greater level of certain external effects whereby some agents cause damage (potential at first) to others, where the moral content is clear, but only for those for whom no easy mechanisms of internalization exist –except for ethics.

Conclusion

Ethics, as the science that regulates the life of men, human organizations and society as a whole, in terms of what is good and bad, has a historical component. This does not mean that moral principles are conditioned by historical factors in the way that, for example, slavery was a morally acceptable institution in the first or sixteenth century but is not in the twentieth: such a doctrine does not seem acceptable. However, behaviours occur in history and their meaning and interpretation have to be sought *also* although not *exclusively* in history.

The financial markets have undergone significant changes over the course of time, and particularly in recent years (25). However, the evolution of economic society itself has above all given rise to a different perception of the financial and economic function of debt and, therefore, of the social, economic, technical and political framework in which the ethical principles and their application unfold.

In fact, at the end of the twentieth century, the reasons for taking on debt have different characteristics from the reasons for doing so in earlier ages: above all, credit today is perceived to be a way of making expenditure independent of the temporal distribution of income. This allows for wider rational criteria to be applied, and leads to decisions on indebtedness being considered as part of this long-term rationale, which affects not only economic and financial but also moral points of view.

All this does not prevent new problems from appearing, or rather, it does not prevent old economic and ethical problems from taking on a new meaning. Such is the case with external effects which are generated alongside the phenomena of the cyclical instability of credit and the major long-term changes in tendency. Economics looks at these external effects largely in terms of their relevance to the stability of the financial system. We have looked more at the ethical problems, since this is a potentially effective way of internalizing those effects. □

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1. This is the theory favoured by the majority of participants at the aforementioned symposium of the Federal Reserve Bank of Kansas City: for example, Higgins (1986), Meltzer (1986), Summers (1986), etc.
 2. Cf, for example, Dornbusch (1985), Dornbusch and Fischer (1985), Lever and Huhne (1986), Maddison (1985), Smith and Coddington (1985), the special edition of the *Journal of Economic Perspectives* of December 1990, etc. For the ethical point of view: Enderle (1989) and Pontificia Comisión «Iustitia et pax» (1986).

3. Cf Argandoña (1993) on the ethical problems of the consumer society.
4. The emphasis adopted here is also very different from that taken in other recent works on financial ethics, such as Argandoña (1995a,b), Lynch (1991), Prindl and Proshan (1994), Williams et al. (1989), etc.
5. Always supposing that the person seeking the credit is acting in good faith.
6. Later, we will use the words credit and loan indiscriminately, although they are actually two different contracts. What we are saying here covers to a great extent the different kinds of family and company debt: personal credits with a mortgage or pignorative guarantee, credit from financial institutions, commercial credit, instalment credit, etc for families; and for companies, discount credit, credits from financial institutions (in all its different forms), commercial credit, and the sale of bonds issued by the debtor (promissory notes, letters of credit, bonds, etc).
7. Credit can facilitate the operations to sell an estate, and reduce the costs.
8. Handing over part of an estate in payment of a debt can settle a legal problem, but from the ethical point of view other damage may have been caused to the creditor that also has to be taken into account.
9. See Chafuén (1986) for an interesting analysis of how this subject was treated by scholars in the Spanish School of Salamanca from the fourteenth to the sixteenth centuries.
10. And some disadvantages: the rich landowner was able to understand the real needs of his poor neighbour much better, and attend to them, moved perhaps more by compassion than by business interests.
11. There is a new problem, such as a new attitude towards failing to comply with one's moral obligation to pay one's debts. The peasant in our example had no choice but to pay, since his lands were known and were linked to the loan as a guarantee. Today's urban debtor can not pay a personal loan with greater impunity, or return a car that has only been partially paid for, with fewer social and legal consequences. However, he is still failing in his moral duty.
12. This growth is due to improvements in productivity at work and is linked to the formation of physical, human and technological capital. A simple way of quantifying this growth is to use the «72 rule»: by dividing 72 by the annual growth rate of a country you obtain the approximate number of years needed to double the standard of living. For example, a society growing at the rate of 2% a year doubles its production in 36 years, and a family whose income is growing at an annual rate of 4% will double its standard of living in 18 years.
13. Or what people rather do is to save little in the early years of their professional and family lives (very rarely do they use up their savings), leaving the accumulation of savings to their mature years, firstly in the form of repayment of their debts and then in the form of accumulation of net assets. Cf Ando and Modigliani (1954), Friedman (1957), Modigliani and Brumberg (1963).
14. The literature on financial cycles is plentiful already (cf note 22).
15. This is because of the existence of asymmetric information: the lender does not have the same information as the borrower, and has reasons for not trusting him (these are the economic and ethical problems of moral risk and adverse selection). In this respect, the creation of an ethical reputation is one way of overcoming the problem, by giving the creditor moral reasons for trusting the debtor.
16. An externality, or an external effect, happens when the actions of an agent benefit or harm another agent without there being an economic exchange between them. For example, a company which trains its workers well also improves the level of education of the whole of society and indirectly of other companies (positive externality), while a company that pollutes the atmosphere makes life more unpleasant for families living nearby (negative externality).
17. The problem has been widely studied from the economic point of view, especially to determine the type of regulation that would avoid the bankruptcy of financial institutions.
18. The repayment periods tend to be shorter than with families, maybe a few weeks or a few months, but can stretch to several years (on large projects, for example: nuclear power stations, motorways, large industrial complexes, etc).

19. For example, faced with a reduction in income which is seen as temporary (cyclical, to follow the terminology used earlier), the family will probably decide to maintain its level of consumption, and will maintain spending (including getting into debt). However, when the fall in income is long-lasting (for idiosyncratic reasons, a change in tendency, or simply because the recession is longer and deeper than expected), the family will give up its former standard of living and will revise its level of expenditure downwards (or will increase its earnings, if possible) in order to maintain financial stability.
20. For example, agricultural land can be a good guarantee for a credit but it cannot be used to pay it off without giving up the business, or nearly doing so.
21. For the negative effects on economic activity of the fall in the price of assets (debt deflation), the classic reference is Fisher (1933).
22. On these ideas, see Bernanke (1983), Calomiris and Hubbard (1989), Jaffee and Russell (1976), Mishkin (1992), Stiglitz and Weiss (1981), among many other interesting works. Randall (1993) is a recent summary of the regulation of financial entities.
23. The obligatory reference is Miller (1977).
24. It is interesting to note that these phenomena of risk transfer (including that which happens in the derivatives markets: options, futures, etc.) do not reduce the overall level of risk in the economy, although they can transfer it to agents who are better placed to deal with it.
25. Cf Argandoña (1995a,b) for a detailed study of these changes and their ethical significance.

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