The Right to Credit

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# Introduction[[1]](#footnote-1)

Jacob Kowalski has everything it takes to start a bakery in New York City—almost. He is ambitious, enterprising, and desperate to escape his job in a cannery. He has inherited his grandmother’s passion for baking, as well as her secret recipes. There is just one snag: He doesn’t have the money. Jacob cannot get a loan, either: the bank turns down his request because he lacks collateral.

Jacob is a movie character,[[2]](#footnote-2) but his problem is real. In a survey conducted 2000 in more than 80 countries, more than a third of small and medium sized companies list financing as a major obstacle to growth.[[3]](#footnote-3) Lack of collateral, as seen in Jacob Kowalski’s case, is one ground of such denials.[[4]](#footnote-4) But it’s not the only ground. Discrimination,[[5]](#footnote-5) deficient financial products,[[6]](#footnote-6) lack of financial literacy,[[7]](#footnote-7) and poor financial regulation and supervision[[8]](#footnote-8) can impede access to credit. Some groups face such impediments in greater proportion than other groups. For example, access to credit is skewed in favour of the rich: less wealthy applicants need better quality projects than their wealthier peers to secure credit, and if they are nonetheless successful, need to accept higher interest rates.[[9]](#footnote-9) Credit constraints are pervasive even in countries with developed financial systems, such as the US and the UK. They stifle entrepreneurial activity,[[10]](#footnote-10) make good quality housing more expensive,[[11]](#footnote-11) and obstruct access to education.[[12]](#footnote-12)

My question is what makes for a just distribution of access to credit? Political philosophers often discuss the just distribution of the ultimate objects of justice—such as welfare, resources, primary goods, or capabilities.[[13]](#footnote-13) But economic institutions rarely dispense these goods directly. They mostly allot economic means, such as income and wealth, which afford access to what we ultimately care about. While credit works differently from income and wealth, it can improve economic agency as well. Hence, credit is well worth investigating from the perspective of distributive justice.

But the just distribution of access to credit has received less attention than the just distribution of wealth and income.[[14]](#footnote-14) This is presumably because credit is seen as a subordinate offshoot of income and wealth. But I show that access to credit plays a distinctive role in capitalist societies (section 1). I shall argue that whether Jacob receives credit is an issue of justice, over and above any claims of justice he might have concerning income and wealth. In fact, I will argue that Jacob has a *right* to credit, like all citizens of capitalist societies.

My argument for the right to credit is grounded in the nature of private property. I argue that any justifiable private property regime needs to recognise a right to credit. The reason is that private property is inherently exclusionary: it prohibits everyone else from controlling the things you own, and vice versa (section 2). Enforcing the right to exclude requires the coercive power of the state, and exercising the state’s coercive power needs to be legitimised. I adopt a contractualist approach to legitimacy, according to which non-owners need to have reason to accept a duty to respect others’ property rights (section 3). Non-owners lack sufficient reason to accept such a duty unless a right to credit mitigates the exclusionary character of private property. Hence, capitalist societies, which are based on private property, should recognise a right to credit (section 4).

Along with a new argument for the right to credit, I will also argue for a new content to this right, as well as new duties held by state actors (section 5). I argue that the right to credit is a conditional right: Only *creditworthy* applicants are entitled to obtain credit from banks. This right is, of course, no help to those credit-seekers that don’t satisfy the condition. However, it is not to banks, but instead to the state, that we need to turn to remedy the situation of uncreditworthy citizens. My argument has two powerful implications: first, the state has a duty to safeguard financial stability; second, the state has a duty to help uncreditworthy applicants become creditworthy, at least for certain purposes. Wealth redistribution may be one method by which the state can help people become creditworthy, alongside the encouragement of saving, the promotion of financial education, the minimization of mistakes in lending decisions, and the reduction of financial discrimination.

A *caveat* is in order: After decades of stagnating real wages, and at a time when private as well as public credit have risen considerably, arguing in favour of a right to credit might strike some readers as akin to arguing in favour of a right to swim aboard the sinking Titanic.[[15]](#footnote-15) As will become clear in the course of the essay, I oppose relying on credit as a substitute for income to maintain established living standards. Moreover, arguing for a right to credit is compatible with recognizing that there was an overabundance of credit especially in some parts of the consumer mortgage market. Easy access to mortgages contributed to the global financial crisis of 2008/9. The proposed right to credit, however, fully recognises the importance of financial stability and the protection of borrowers, as I will show in section 5.

In the movie, a secret benefactor gifts Jacob Kowalski a case of silver eggshells, which serve him as collateral to obtain credit and to open his bakery. Jacob Kowalski’s counterpart in a just capitalist society, however, should not have to wait for charity. If he is creditworthy, then he has a right to credit. If he is not creditworthy, the state has a duty to assist him in becoming creditworthy. By the end of this paper, I hope to have convinced you of these two claims.[[16]](#footnote-16)

# 1 The Role of Credit in Capitalist Societies is to Overcome Liquidity Constraints

As Jacob’s example illustrates, being denied credit can wreck dreams. Lack of access to credit can prevent individuals from starting businesses, going to university, or buying homes. Without credit, a firm might struggle to expand, enter a new market, or even weather a bad year. Where the poor find it more difficult to get credit than the rich, lack of access to credit deepens economic inequality. But why is credit so important in capitalist societies?

In this section, I will argue that credit fulfils a central function in capitalist societies, namely to overcome what I will call *mere liquidity constraints*. Moreover, I will show that it is no accident that mere liquidity constraints are pervasive in capitalist societies. Instead, people and firms run into mere liquidity constraints due to defining features of capitalist societies. The central role of credit in capitalist societies motivates my argument for entitlements to credit in the sections ahead.

I focus on *capitalist* societies, because in other kinds of societies, credit may function very differently, or play no role at all. For instance, mortgages account for more than one third of total credit in capitalist societies, making mortgage credit the single most important type of credit by volume.[[17]](#footnote-17) Thus mortgages seem to play an important role in the economic lives of many people in capitalist societies. Who can get a mortgage, and on what terms, is a serious issue of justice. But in a non-capitalist society like the former USSR, in which housing was nominally allocated according to need rather than purchasing power, mortgages would be superfluous. By focussing on capitalist societies, the role of credit assumes a particular shape and force.

I define capitalist societies as societies with three features. First, capitalist societies are *market economies*; second, they are based on *private property*; and third, they impose *hard budget constraints* on people and firms. Plenty of other definitions of the term ‘capitalism’ compete with mine.[[18]](#footnote-18) But nothing hinges on whether you agree with my definition. What matters is that the scope of my argument is limited to societies with these three features—for example European and northern American countries.

The first defining feature is the *market* *mechanism*. Inmarket economies*,* supply and demand determine the relative prices of goods and services.[[19]](#footnote-19) Recent work on finance and law has demonstrated that supply and demand are not just regulated by individual preferences, as some economists would have it, but also by laws and norms.[[20]](#footnote-20) Still, prices tend to reflect the relative scarcity of goods, whether caused naturally or by legal or moral restrictions. Therefore, in market economies relative scarcity feeds into consumption and production decisions via the price mechanism.

The second defining feature is *private property*.[[21]](#footnote-21) To own property is to have the enforceable right to use and control objects to the exclusion of others.[[22]](#footnote-22) In economies based on private property, a wide range of assets is owned by private individuals. Owners are thus entitled to exclude others even if those others have better use for, greater need of, or greater interest in the specific asset. Enforcing the right to exclude requires the coercive force of the state. The need for state coercion will become important later on, because state coercion needs to be justified. It will turn out that recognising a right to credit plays a crucial part in this justification.

The third defining feature is the *hard budget constraint*. Budget constraints require people and firms to raise enough revenue to cover their expenditure. Ifbudget constraints are *hard,* people and firms go bankrupt when they fail to cover their expenditure.[[23]](#footnote-23) By contrast, *soft* budget constraints allow people and firms to avoid bankruptcy if they cannot make ends meet. One way in which the budget constraint of a person or firm can become soft is if the state agrees to bail them out in times of financial trouble. Another way is if banks grant ‘soft credit’, providing struggling people or firms with credit even if they fail to qualify.

Soft budget constraints lead to poor economic performance, for three reasons.[[24]](#footnote-24) First, the prospect of receiving state support induces firms to charm government committees rather than customers to ensure their survival, and thus encourages what economists call ‘rent-seeking’.[[25]](#footnote-25) Second, firms make decisions for political reasons, choosing production inputs and negotiating supply contracts they would not choose in a regime with hard budget constraints. As a result, resources are systematically misallocated, leading to waste and shortages.[[26]](#footnote-26) Third, soft budget constraints stifle innovation. Schumpeter maintained that *creative destruction* is the driving force of capitalism.[[27]](#footnote-27) Soft budget constraints impede the destructive aspect of this process. Since unsuccessful firms persist, they use resources more creative firms could turn into successful products and services.[[28]](#footnote-28)

But not every deviation from a maximally hard constraint creates a bad incentive structure.[[29]](#footnote-29) In fact, maximally hard budget constraints could stifle economic activity altogether, as they would entail not limiting liability. Protection from creditors under bankruptcy further softens budget constraints. So does allowing for conditional bailouts, and extending the grace period for repaying credit should borrowers run into temporary financial troubles. Some softening of budget constraints, then, is compatible with capitalism. What matters is that capitalist economies impose *fairly* hard budget constraints. The threat of bankruptcy needs to be sufficiently credible and detrimental to motivate people and firms to avoid it.

At first glance, credit might appear to soften the budget constraint, as it tends to postpone bankruptcy. Does credit then contradict a defining feature of capitalism? Indeed, the desire to maintain a fairly hard budget constraint restricts how liberally credit can be granted to people and firms. ‘Soft credit’ can weaken the budget constraint, either if banks give credit to people and firms in financial distress, or if they do not hold borrowers to their existing credit obligations. Consider Josephine, who is already knee-deep in debt because her bakery keeps losing money. She has access to soft credit if she can secure another credit line regardless of her financial situation, or if the bank forgoes instalments of existing debt, perhaps because she is the mayor’s daughter. In the extreme, unlimited access to credit eliminates budget constraints altogether.

But not all credit is soft credit. Differentiating between two kinds of budget constraints, *liquidity constraints* and *solvency constraints,* shows that credit is in principle compatible with capitalism.[[30]](#footnote-30) To be *solvent*, the value of one’s assets must be at least equal to the value of one’s liabilities. Jacob’s main asset is his bakery business. Thus he is solvent if the income he generates from this business is sufficient to cover all his expenditure. Solvency is about the viability of economic activities considered over the entire lifespan of persons or firms. By contrast, *liquidity* is about the ability to meet financial liabilities when they fall due. Jacob is liquid if he can pay all his invoices as they come in, such as for rent, utilities, and wages.

Solvency and liquidity do not always go hand in hand. Once Jacob’s bakery is up and running, he will make handsome profits. But he first needs to invest in machinery, furniture, and staff. Considered over ten years, his revenue will easily cover his initial outlay. Hence Jacob is solvent. But if he starts the bakery without obtaining credit first, Jacob is nonetheless illiquid. He cannot meet his financial obligations when they fall due, because much of the expenditure is due before Jacob sells the first bread roll.

Jacob faces a *mere liquidity constraint*. Mere liquidity constraints arise when agents are solvent yet illiquid. Not all liquidity constraints are *mere* liquidity constraints. Some businesses never take off. For every Jacob, there is an aspiring baker Marcus who will not attract enough customers to break even. Marcus and Jacob have their liquidity problem in common, but Marcus faces a solvency issue as well. With this nuance in mind, I will now use ‘liquidity constraint’ to refer to the more cumbersome ‘mere liquidity constraint’.

The role of the credit system in capitalist societies is to enable economic agents to overcome liquidity constraints. ‘Hard’ credit temporarily relaxes the borrower’s liquidity constraint without thereby relaxing their solvency constraint. If Jacob gets credit, he can use the borrowed money to invest in his bakery, relaxing his liquidity constraint. But his solvency constraint remains intact, because he eventually needs to repay.

Deciding who is merely illiquid and who is insolvent is a difficult task, because solvency is challenging to evaluate. In principle, it is always possible that a person or firm will raise sufficient revenue to make up for a current deficit of any amount. The difference between Jacob and Marcus will only become apparent once they get their businesses underway. Beforehand, they may both quite reasonably expect that starting a bakery with borrowed money is within their respective solvency constraints. Neither of them needs to be presumptuous, since whether they succeed depends in no small part on uncertain economic developments beyond their control. Still, only Jacob’s bakery will be profitable, Marcus’ won’t. But once this unpleasant truth dawns on Marcus, meeting his solvency constraint may be out of the question.

Keeping liquidity constraints tight reduces the risk that people and firms violate their solvency constraints. Had Marcus not been granted credit, his liquidity constraint would not have allowed him to start the bakery in the first place and he would not have become insolvent. Any conclusive evaluation of people’s or firms’ solvency has to wait until the end of their economic lifespans. At this point, however, the effects of managing expenses without a budget constraint—rent-seeking, misallocation, and lack of innovation—have long since materialised. While liquidity is neither necessary nor sufficient for solvency, liquidity constraints do prevent people and firms from spiralling deficits. Moreover, liquidity can be readily assessed. Hence liquidity constraints are not just a dispensable nuisance, but give budget constraints their bite.

In sum, I have argued in this section that credit has the function of overcoming liquidity constraints in capitalist societies. This raises the question of whether people and firms have any entitlements to credit. I shall argue that exclusion from credit is not merely an unpleasant fact of economic life. Rather, people and firms have claims of justice to credit in capitalist societies. To understand why, we need to think about what it takes to morally justify private property, one of the features of capitalist societies.

# 2 Capitalist Societies Face a Challenge from Exclusion

In this section, I will argue that capitalist societies face a justificatory challenge, which I call the ‘challenge from exclusion’. Private property gives rise to the challenge, since private property regimes exclude everyone but the owner from control of property.[[31]](#footnote-31) My contribution is to argue that the challenge from exclusion gives rise to a right to credit.

As indicated in the introduction, I assume a contractualist theory of justification.[[32]](#footnote-32) A central tenet of the contractualist view is that a policy or institution backed by state coercion can only be legitimate if no citizen can reasonably reject it. It is insufficient that a policy or institution is beneficial in the aggregate. Rather, policies and institutions must be justifiable to each citizen. Private property can thus not be justified just by showing that it increases societal wealth overall. Rather, private property needs to pass Scanlon’s test: that no citizen has sufficient reason to reject it.

Establishing a sufficient reason to reject a policy or institution requires two steps. The first step is to show that some citizens are disadvantaged by the respective policy or institution relative to some alternative. It should give us pause if we find that some citizens do worse than they would under feasible alternative arrangements. Showing disadvantage gives rise to a justificatory challenge. But the mere fact that some citizens could do better under feasible alternatives does not yet make for a sufficient reason to reject the policy or institution. After all, there is almost always an alternative arrangement that would be better for some citizens but worse for others.

The second step turns a justificatory challenge into a reason for rejecting a policy or institution. While the first step merely shows that some citizens have a complaint, the second step shows that some alternative policy or institution would mitigate complaints of citizens without creating other equally or more serious complaints for others. Showing that such an alternative exists undermines the legitimacy of the policy or institution. By contrast, if it turns out that alternative policies or institutions create similar or greater complaints for others, the justificatory challenge established in the first step is overcome.

Let us apply this two-step procedure to private property, focusing on Jacob’s case. The exclusionary character of private property puts Jacob at a disadvantage. There are plenty of people in New York City sitting on the money he needs to start his bakery. Yet private property assigns exclusive control over this money to its owners. For Jacob, the situation is exasperating: the resources he needs are available in his community, but the rules of private ownership bar him from using them. Jacob would be ill-advised to take someone else’s money, for this amounts to stealing under private property, and society does not take kindly to thieves. Hence Jacob has a serious complaint, raising the justificatory challenge from exclusion. The question now is whether private property is still justifiable to Jacob despite his complaint.

I want to emphasise how commonplace complaints like Jacob’s are. In societies with large wealth inequalities, the poorest members have particularly compelling complaints. Here, the justificatory challenge comes down to justifying private property to those who own little or nothing. But Jacob’s complaint arises for everyone who does not own everything they need to pursue their plans. Thus, the justificatory challenge from exclusion arises even in societies where wealth is perfectly equally distributed. Even if everyone owns the same amount of wealth, private property excludes each from control over most resources. An equal distribution of wealth without a credit system would, for instance, exclude everyone from setting up businesses that require more initial investment than an equal share of wealth affords. The challenge is not to the effect that others should fund the expensive tastes of some by giving up on their equal share of wealth. Rather, the challenge is that private property regimes may strip everyone of opportunities, such as setting up a business requiring substantial investment. Access to credit could provide access to such opportunities without undermining everyone’s equal share of wealth. Hence even in an egalitarian society, the challenge from exclusion arises.

But recall that a justificatory challenge does not yet undermine the legitimacy of an institution or policy. Jacob has reason to reject the prevailing private property regime only if some alternative does not disadvantage others at least as much as the current regime disadvantages him. Advocates of private property can defuse the challenge from exclusion if alternatives impose greater burdens on other citizens.

The structure of contractualist justification implies that there cannot be a blanket argument for some private property regime. Rather, a private property regime needs to be justified in comparison to every feasible alternative. Proponents of private property have mostly taken aim at communal or collective property regimes. They point out that these alternatives create graver complaints than private property, both by having bad economic effects, and by limiting the freedom of citizens. I do not wish to enter the debate about whether the arguments brought forward in favour of private property are ultimately successful. I seek only to establish that capitalist societies should recognise a right to credit, not that societies should be capitalist. In what follows, I bring up the arguments in favour of private property not to make a compelling case, but to prepare the ground for showing that these arguments are insufficient to answer the challenge from exclusion.

Let’s turn to economic effects first. Private property regimes are considered much more productive, in the sense of increasing production as valued at market prices, than common or collective property regimes. Common and collective property regimes may be unjustifiable to citizens if their lack of productivity imposes large burdens on them, perhaps because these modes of production make much less of the goods required to pursue their life plans available to them than an economy based on private property.

Proponents of private property maintain that common property hampers productivity by encouraging resource overuse. Property owned in common is available to all. If everyone tries to reap the greatest personal benefit, each may harm everyone else in using resources more than is collectively useful. Pursuit of personal gain explains, for instance, overgrazing of commons, which harms everyone in the community.[[33]](#footnote-33) In private ownership regimes, by contrast, owners benefit from maintaining resources long-term. Call this the *incentive argument* in favour of private property*.*

Collective property entitles the collective to plan jointly how to use property. Proponents of private property maintain that collective property regimes are unproductive because planning committees lack the required knowledge about the needs and preferences of individuals and the best production techniques to plan efficiently. Private property regimes incorporate this knowledge better by decentralising decision making.[[34]](#footnote-34) Call this the *efficiency argument* for private property*.* If these arguments succeed, the loss of productivity in common and collective property regimes imposes a burden on citizens, giving them weighty complaints against these forms of ownership.

Let’s now consider the effects of private property on freedom. The most obvious way in which private property may be thought to increase freedom is by giving individuals exclusive control over property. But in the light of the challenge from exclusion, private property seems in fact to make citizens less free. While the private owner enjoys exclusive control, non-owners have no stake at all.[[35]](#footnote-35)

But proponents of private property still point to two ways in which private property enhances freedom. First, private property increases the freedom of citizens *vis à vis* the state by reducing the role of the state in the economy.[[36]](#footnote-36) Call this the *argument from state interference* for private property. Second, private property increases freedom by affording individuals a sphere of exclusive control over some objects. Note that the focus is not on the sheer number of objects under one’s control. Rather, it is about having a number of objects—however small—which one can *exclusively* control. Some have argued that having such a sphere of control contributes to the ethical development of private owners.[[37]](#footnote-37) Call this the *argument from exclusive control* for private property. In these two ways, common and collective property diminish the freedom of citizens compared to private property, giving citizens weighty complaints against these forms of ownership.

Proponents of private property suggest that the economic- and freedom-based complaints of citizens against collective and common property outweigh the complaints of citizens in private property regimes against their exclusion from control of most property. If so, these arguments defuse the challenge from exclusion *if the alternatives considered are common and collective property regimes.* What happens to the exclusion argument if we consider variation *among* private property regimes? As the next section will argue, any justifiable private property regime needs to recognise a right to credit.

# 3 Credit Mitigates the Challenge from Exclusion

Let us take stock. I have argued that capitalist societies face a justificatory challenge arising from the exclusionary character of private property. But collective and common ownership disadvantage citizens as well, plausibly outweighing the disadvantage suffered by citizens under private property due to exclusion.

The exclusion argument therefore fails *when the argument contrasts different types of property regimes.* I will now present a new, successful version of the exclusion argument, which contrasts private property regimes without an entitlement to credit with private property regimes with an entitlement to credit.

The first key move in the argument is to recognize that there is considerable variation *among* private property regimes. First, the *rights* of owners vary in different jurisdictions. For example, some countries restrict how people can invest their money. In the US, only accredited investors are allowed to invest in start-ups.[[38]](#footnote-38) Second, the *duties* associated with ownership vary in different jurisdictions. For example, some societies levy wealth taxes. None of the arguments considered in favour of private property favours *any particular* private property regime, because they do not differentiate between private property regimes.

The second key move is to run the exclusion argument amongst different private property regimes. To justify *any given* private property regime, we need to consider feasible alternative private property regimes. The exclusion argument targets private property regimes that don’t recognize an entitlement to credit. Considering this alternative, does Jacob have a reason to reject the *status quo,* throwing into doubt the legitimacy of the private property regime under consideration? Credit enables borrowers to command resources without owning them, easing the exclusionary effects of private ownership. Credit thereby reduces Jacob’s complaint caused by the exclusionary character of private property. The question is whether entitlements to credit give others new reasons to complain. Jacob has reason to reject the *status quo* if no new complaint is as grave as his own complaint against exclusion from control over most property. If this premise holds, private property regimes without an entitlement to credit are not justifiable within a contractualist framework.

I will now consider two objections to this critical premise, each urging that entitlements to credit would, after all, impose large burdens on citizens. The first objection warns that entitlements to credit unduly restrict the property rights of money owners. The second objection urges that entitlements to credit undermine hard budget constraints. Let me address these objections in turn.

## Do Entitlements to Credit Dilute Rights of Money Owners?

The first objection is that entitlements to credit would dilute the rights of money owners, in one of two ways. Either, according to one theory of credit creation, by forcing money owners to tie down their capital in bank accounts to enable banks to lend it out.[[39]](#footnote-39) Or, according to another theory, by diluting the value of money previously held by money-owners.

Consider the first version: If implementing a right to credit would require money owners to keep their money in bank deposits rather than spending it at will, this would impose a large burden on them. Thankfully, this objection rests on a mistaken view of credit creation, as I will now argue.

According to the view of credit creation underlying the objection, the money that banks loan to borrowers is drawn from the bank’s accounts. In this view, the amount of available credit is limited by the amount of deposits in bank accounts. The flip side of entitlements to credit for some would then be obligations to save for others.

No doubt, this popular view of credit creation has a certain allure. Handing out credit increases the bank’s assets. The assets and liabilities of banks need to even out, as a basic matter of accounting. Hence, the expansion of assets due to credit creation must be matched by an expansion of liabilities. You might therefore believe that banks need to attract deposits to boost their liabilities before granting a loan.

But the popular view is mistaken. It is now widely recognised that banks create credit out of thin air.[[40]](#footnote-40) Suppose a bank grants Jacob a business loan worth $10,000. In order to make the money available to Jacob, the bank credits his bank account with the value of the loan. The bank thus *creates* the deposit it needs to match assets and liabilities in the same breath as issuing the loan. The bank, then, does not need to first collect deposits and then pass them on to borrowers. A report by the Bank of England, the UK central bank, summarises: “Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits.”[[41]](#footnote-41)

Jacob will, of course, use the borrowed money to buy things for his business. Suppose he pays $1,000 in rent to his landlord Louise. Once the money leaves Jacob’s account, his bank’s liabilities diminish. Doesn’t the bank now need to attract deposits to make up for the shortfall in liabilities? No. Jacob’s payment will increase the liabilities of Louise’s bank. If we look at the banking system as a whole, the consolidated liabilities remain unchanged. At the level of individual banks, some borrower of Louise’s bank might make a transfer of equal value to someone at Jacob’s bank, restoring the balance. If payments between banks do not even out, deficit banks borrow from surplus banks.

Credit creation is still constrained, but not by the amount of deposits available. Rather, in capitalist societies, the amount of available credit is limited by market forces.[[42]](#footnote-42) As private institutions, banks face budget constraints in the same way other firms do. If borrowers default on a loan, their bank needs to write it off, shrinking the asset side of its balance sheet. On the liability side, the bank’s equity diminishes, meaning that the value of the bank diminishes. If the bank needs to write off too many loans, it goes bankrupt.[[43]](#footnote-43) Hence, credit creation by banks is ultimately constrained by their ability to identify profitable lending opportunities—not by the amount of money saved in their accounts.

What matters to rebut the first version of the objection is that the volume of available credit is not constrained by the amount of deposits banks attract. The reason is that banks grant credit by creating money. Therefore, recognising entitlements to credit does not unduly restrict the property rights of money owners.

This response of the first version of the objection motivates the second version of the objection.[[44]](#footnote-44) If granting credit is to create money, then each unit of money previously held by money owners will be worth less. Is not that a dilution of the rights of money owners? My answer is no, for three reasons. First, money creation is only inflationary insofar as the expansion does not lead to growth. If the growth in production equals the growth of the money supply, the real value of previously held money stays constant. Many kinds of credit, first and foremost business credit, lead to substantial expansions in production. Second, the expansion of the money supply through credit creation is temporary. Just as granting credit creates money, repaying credit destroys money. Third, and most fundamentally, diminishing the real value of previously held money would not be a violation of the rights of money owners even as a permanent condition. In general, asset holders do not have a right to the real value of their assets at any previous point in time. For example, building more housing in areas with a shortage of housing may lead to a drop in house prices of existing units. We do not think of this price drop as a violation of the rights of house owners. Similarly, I want to suggest that the rights of money owners are not violated even if the real value of money is diminished due to credit expansion. In sum, both versions of the objection that credit dilutes the rights of money owners fail.

## Do Entitlements to Credit Undermine Hard Budget Constraints?

The second objection is that entitlements to credit make credit ‘soft’, undermining hard budget constraints. Remember Josephine from section 1, who got credit just because she was the mayor’s daughter? Proponents of the second objection maintain that entitlements to credit turn everyone into a mayor’s offspring, by preventing banks from rejecting applicants. Borrowers by entitlement needn’t worry about their budget constraints, because they can always make up for deficits with more credit.

But entitlements to credit only make budget constraints meaningless if the entitlement to credit is unconditional. To mitigate the challenge from exclusion, the entitlement to credit does not need to be unconditional, however. Making access to credit conditional on creditworthiness avoids soft credit.

You might think that an entitlement to credit that is conditional on creditworthiness is too close to what banks already deliver to merit consideration. Sure enough, banks might still deny Jacob credit despite recognising his entitlement, because their assessment of his lack of creditworthiness might still stand. If only the creditworthy get credit, you might think that we haven’t properly addressed the challenge from exclusion, since those who aren’t creditworthy are still excluded from use of others’ property and don’t have access to credit.

But the conditional entitlement to credit is not toothless at all, for two reasons. First, the conditional entitlement to credit gives applicants a claim against banks to be assessed according to their creditworthiness. Judgments of creditworthiness are inherently fallible, so applicants are not entitled to flawlessness in credit assessments. People and firms are, however, entitled to a certain standard in credit assessment. This entitlement corresponds to a duty on the part of banks. Banks jointly have a duty to employ best epistemic practices.[[45]](#footnote-45) The duty falls on banks jointly because there is nothing wrong with individual banks specialising in certain customer segments, as long as every customer segment is served by some banks. Formulating an account of good epistemic practices for credit scoring is a fascinating task, especially as access to retail credit is increasingly decided by machine learning algorithms[[46]](#footnote-46)—but that task needs to wait for another paper. Even without such an account, some poor epistemic practices are easy to spot. Epistemic practices are poor if applicants find it impossible to obtain credit because they lack a credit history or the documentation required by standardised procedures, if a case-by-case assessment would reveal that they are creditworthy.[[47]](#footnote-47)

There is a further reason why my proposal has teeth: the entitlements citizens have arising from the challenge from exclusion arise first and foremost towards the state. The state can discharge its duty partly via private banks. But since the state can do more to mitigate the challenge from exclusion, it should. In particular, the state can cultivate the creditworthiness of its citizens, and safeguard financial stability. This division of labour between banks and the state provides a way to address the second objection. My proposal keeps hard budget constraints intact, because people and firms are only entitled to credit if they are creditworthy. By tasking the state with supporting citizens in becoming creditworthy, my proposal retains its bite. In section 5, I will discuss how the state can make good on its duty.

To sum up: I have argued that societies can recognise entitlements to credit without undermining key features of capitalism. Capitalist societies can thereby avoid imposing the burdens that count against common and collective property regimes. Jacob’s complaint can be addressed without imposing large disadvantages on others. From the contractualist perspective presented in the previous section, this has a remarkable implication: capitalist societies that fail to acknowledge entitlements to credit are not fully legitimate. Citizens can reasonably reject such private property regimes because entitlements to credit provide a feasible way to mitigate their exclusionary character, without giving rise to other outweighing complaints. This implies that to be fully legitimate, capitalist societies have to recognise that persons and firms have entitlements to credit.

# 4 Access to Credit is a Right

How important are entitlements to credit compared to other considerations of justice? I have suggested above that Jacob is entitled to some state support for becoming creditworthy. State support costs tax money which instead could be used to improve health care or prevent crime. Hence, policymakers face trade-offs. Banks face trade-offs as well, because guaranteeing fair credit assessments can conflict with pursuing business objectives. Determining the weight of entitlements to credit is thus required for setting priorities for public spending as well as bank strategy. In this section, I will argue that entitlements to credit are so weighty that they should be recognised as a right. In what follows, I employ some technical terms to make this basic point more precise, and argue for why claims to credit carry so much weight.

Entitlements of justice vary widely in weight. On one end of the spectrum, some entitlements are mere *pro tanto* reasons. For instance, that Jenny was first to apply to your course gives you a *pro tanto* reason to give her a place. *Pro tanto* reasons are sometimes decisive in settling distributive issues, but only if they are not overridden by weightier considerations. Perhaps Peter needs a place in your course to complete a compulsory module. Peter’s interest would outweigh Jenny’s *pro tanto* reason, so he should get the place.

On the other end of the spectrum, some claims of justice are full-fledged rights. Theorists disagree about the conditions under which rights can be overridden.[[48]](#footnote-48) But there is broad agreement that rights are very weighty considerations. Typically, rights are only outweighed by other rights. This puts rights holders in the position to *claim* their entitlement. If rights are legally recognised, rights holders can even appeal to courts to enforce their rights.

In order to address the challenge from exclusion, the entitlement to access to credit has to be a right. The reason is that the stringency of the claim to credit needs to be equal to the stringency of the claim to private property. Otherwise, citizens might find themselves in a society where private property rights are enforced by the police, but entitlements to credit are systematically eclipsed by competing considerations. Moreover, while property rights can be demanded in court, credit applicants enjoy no such legal recourse. Rather, their entitlement would only be one moral consideration among others. Citizens in Jacob’s situation have strong reason to reject a private property regime that recognises a feeble entitlement to credit. Since private property is a right in capitalist societies, the claim to access to credit has to have the status of a right as well.

But rights come in many shapes and forms. According to the standard Hohfeldian analysis, the complex internal structure of rights can be understood as composed of four basic elements, two of which are of interest here.[[49]](#footnote-49) First, a right holder R has a *privilege* to Φ if and only if R is under no duty not to Φ. Thus, a *privilege* right to credit means that the right holder is under no obligation not to obtain credit should the opportunity arise. But it puts no one under a duty to make sure the right holder has an opportunity to obtain credit. Second, a right holder R has a *claim right* to Φ if and only if some duty holder has a duty towards R to Φ. Thus a *claim right* to credit means that some duty holder has to provide the right holder, under certain circumstances, with an opportunity to obtain credit.

The right to credit has to be a *claim right*, rather than a mere privilege. A privilege to access credit only authorises rights holders to access credit if credit is available, but it does not require anyone to take steps to ensure that credit will in fact be available. Mind you, the legal privilege to obtain credit sparked large and competitive credit markets in capitalist societies, in which many can participate. But Jacob’s case of being denied credit is also prevalent in capitalist societies, indicating that a mere privilege is insufficient to address the challenge from exclusion. I conclude that access to credit is a claim right, rather than a *pro tanto* reason, or a mere privilege.

If credit is a claim right, who is the corresponding duty bearer? Ultimately, the state, because its use of coercive power to enforce private property justifies the right to credit. As indicated above, however, the state can discharge part of its duties via private firms. For ease of exposition, I formulate the right to credit as giving rise to duties against banks as well as against the state, assuming that actual credit decisions in capitalist societies are best made by private banks. But this should not distract from the fact that the duties I assign to banks first and foremost arise against the state. Fulfilling these duties on behalf of the state is part of any bank’s ‘license to operate’ in a capitalist society that recognises the right to credit.

# 5 Realising the Right to Credit

In this final section, I want to elaborate on the content of the right to credit. I have suggested that banks have a duty to provide creditworthy applicants with credit, and that the state has a duty to support uncreditworthy applicants in becoming creditworthy. In what follows, I discuss how this proposal can be fleshed out to best mitigate the challenge from exclusion, while staying within the bounds of capitalism.

Recall that my proposed justification for the right to credit hinges on its ability to mitigate the challenge from exclusion. This justificatory strategy gives rise to two constraints for determining the content of the right to credit. First, the right to credit should mitigate the exclusionary character of private property as much as possible. Otherwise, citizens would have reason to reject the proposal in favour of an alternative that better addresses the challenge from exclusion. Second, the right to credit should not undermine the reasons why private property regimes are desirable in the first place, as discussed in section 2.

Here is my proposal, which meets both constraints. Citizens have claim rights against banks or the state, depending on where they fall along two dimensions. The first dimension is whether they are illiquid or insolvent, as explained in section 1. The second dimension is whether applicants are—or are not—creditworthy.

Recall that whether a person or firm is insolvent or merely illiquid is an objective fact. The problem for creditors, of course, is that they do not know for certain whether an applicant is merely illiquid or also insolvent. In contrast, creditworthiness is a subjective *judgement* by a potential creditor about the ability and willingness of applicants to keep the terms of the credit contract.[[50]](#footnote-50) Such judgements are, of course, either correct or incorrect. Their correctness largely depends on whether applicants face a liquidity or solvency constraint: insolvent borrowers may go bankrupt, and in the process fail to repay their loan. By contrast, if the structure of the credit contract is right, solvent borrowers will be able to repay. Therefore, a judgement of creditworthiness expresses whether a creditor deems an applicant willing and able to keep the terms of the credit contract. Judgements of creditworthiness are *apt*, if creditors are justified to believe their assessment is correct.

Combining the two distinctions leads to four cases, two of which require the same duty, as illustrated in figure 1.

|  |  |  |
| --- | --- | --- |
|  | **It is apt to deem an applicant creditworthy** | **It is apt to deem an applicant uncreditworthy** |
| **Applicant faces liquidity constraint** | Banks have a duty to provide credit at reasonable rates. | The state has a duty to assist applicants in becoming creditworthy. |
| **Applicant faces solvency constraint** | The state has a duty to safeguard financial stability. |

Figure 1

The first duty concerns *applicants whom it is apt to deem creditworthy & who face liquidity constraints*. Banks have a duty to provide these applicants with credit at reasonable interest rates. [[51]](#footnote-51) The first step is to identify creditworthy applicants correctly. True, banks have a business interest in getting these judgements right. But what matters for banks economically is not that every applicant gets their due, but that their overall loan portfolio is profitable. For instance, a bank could make money by granting credit to ten applicants even if it knows that one will default. Conversely, a bank may decline credit to ten applicants even if it knows that some six applicants *will* repay.

From an ethical perspective, banks need to assess creditworthiness fairly. Fair treatment involves minimising the number of wrongfully excluded as well as wrongfully included applicants. A major challenge for banks is to incorporate considerations of fairness into their automatized credit scoring procedures, which are increasingly powered by deep learning mechanisms.[[52]](#footnote-52) How this can be achieved raises many interesting philosophical issues, which I need to save for another occasion.

The second duty concerns *whom it is apt to deem creditworthy & who face solvency constraints.* Banks typically cannot distinguish these insolvent applicants—think Marcus—from the merely illiquid group to which Jacob belongs. Hence banks will offer these applicants credit. If banks do their job well, not too many such mistakes are made. But if banks make many such mistakes, highly integrated financial systems become vulnerable to financial crises.[[53]](#footnote-53) Since financial crises can be hugely damaging to the economy, costing countless jobs and curtailing growth, the state has good reasons to safeguard financial stability anyway.[[54]](#footnote-54) The right to credit highlights an additional reason why the state has a duty to promote financial stability, namely because financial crises tend to freeze credit markets. To facilitate lending, the state has a duty to regulate and supervise financial institutions to safeguard financial stability.

The third duty concerns *applicants whom it is not apt to deem creditworthy, whether illiquid or insolvent*. I treat these two groups together because neither can obtain credit from banks. The difference between the two groups is that applicants facing a mere liquidity constraint are wrongfully excluded, whereas applicants facing a solvency constraint are rightfully excluded from credit. As indicated in section 3, the state should refrain from lowering lending standards to address exclusion, as this would cause more wrongful inclusion, in contravention of the state’s other duty to safeguard financial stability. Rather, the state should support applicants who cannot finance crucial projects because they are not eligible for credit.

The qualifier ‘crucial’ matters. Nobody can get credit for any desired purpose, and many purposes for which one might want credit are beyond the purview of justice. Which projects are crucial depends on what people and firms need credit for in a given society, as well as on your theory of justice. For instance, whether mortgages are crucial depends on whether there is a developed rental market, and whether student loans are crucial on whether education is publicly or privately financed.

If pursuing some purpose requires people or firms to take out credit, your theory of justice determines whether—and to what extent—the state should cultivate creditworthiness for this purpose. Consider mortgages. In countries like the US, where rental markets are immature, I propose that the state has a duty to support citizens in becoming creditworthy for a mortgage. But how large a mortgage are citizens entitled to? Proponents of different theories of justice will disagree with each other. Sufficitarians will want to enable everyone to buy a home that meets certain threshold criteria. Egalitarians will attempt to equalise access to good quality housing. Prioritarians will focus on improving access to housing for the worst off. In order to implement the right to credit, disagreement about justice needs to be resolved.

Capitalist societies can choose from several policies to cultivate the creditworthiness of citizens. Which policy—or mix of policies—is appropriate will depend on the specific reasons for wrongful exclusion. For example, Jacob is not deemed creditworthy because he does not own sufficient assets to serve as collateral. The state can realise the right to credit by opening up opportunities to Jacob to overcome this hurdle. One possibility is to provide each citizen with a certain amount of basic capital when coming of age.[[55]](#footnote-55) Another possibility is to provide opportunities for employment which enable citizens to save enough to meet collateral requirements.

There are also other reasons for financial exclusion, including lack of financial literacy, which can be addressed by promoting financial education. The appropriate policy mix cannot be determined from the philosophical armchair alone, but requires collaboration with economists and policy makers.

In sum, my proposed right to credit is a cluster of three claim rights. First, a claim right of creditworthy and illiquid borrowers to be offered credit by financial institutions at reasonable rates. Second, a claim right of citizens towards the state to safeguard financial stability. Third, a claim right by applicants deemed uncreditworthy to be assisted in becoming creditworthy. I submit that this proposal goes a long way in mitigating the challenge from exclusion, thus meeting the first constraint introduced above.

I will now argue that my proposal also meets the second constraint, by preserving the benefits of private property regimes. In section 2, I considered four arguments pointing to such benefits.

First, the incentives argument suggests that private property encourages owners to behave diligently. My proposal preserves this benefit by making access to credit conditional on creditworthiness.

Second, the efficiency argument that private property allows for decentralised decision making. This benefit would be undermined if the credit system were centrally planned. My proposal preserves this benefit because it envisages that private banks discharge the state’s duty to provide credit.

Third, the argument from state interference that private property regimes have the advantage of limiting the power of the state over its citizens. This benefit would be undermined if the state had undue influence on the credit system. For instance, a credit system that channelled preferential credit to sympathisers of the government while excluding political opponents would undermine this advantage. My proposal guards this benefit because it relies on private banks rather than the state to run the credit system. The role of the state is limited to assisting citizens in becoming creditworthy.

Finally, the exclusive control argument that private property regimes help to avoid relations of domination. This benefit would be undermined if relationships between creditors and borrowers led to domination. For example, the lack of an ethically acceptable bankruptcy procedure could make default unacceptably harsh on borrowers. This suggests that implementing the right to credit raises questions about morally acceptable bankruptcy regimes, which I need to return to a later date.

I conclude that my proposed right to credit can go a long way towards mitigating the challenge from exclusion, while retaining the advantages of private property. Therefore, my proposal meets the two constraints on the right to credit outlined above.

# Conclusion

I have argued that capitalist societies should recognise the right to credit. The right to credit gives creditworthy people and firms a claim right towards banks to be offered credit at reasonable rates. Uncreditworthy applicants have a claim right towards the state to be supported in becoming creditworthy, for certain crucial purposes. Capitalist societies can combine elements of different policies to cultivate creditworthiness, including financial education, promoting saving, and redistributing wealth. Realising the right to credit in a given society is a complex task that must be tackled by philosophers, economists, and policy makers together. It is also a vital task, because capitalist societies need to address the challenge from exclusion raised by private property. Without acknowledging the right to credit, capitalist societies cannot be fully legitimate.

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1. I would like to thank the following people for many helpful comments and suggestions: Alex Oliver, Anahi Wiedenbrug, Andreas Schmidt, Boudewijn de Bruin, Chris Thompson, Jens van’t Klooster, Joachim Helfer, Kate Vredenburgh, Lisa Herzog, Martin O’Neill, Mathias Risse, Richard Holton, Rutger Claassen, Stefanie Lenk, and the anonymous referees of this journal. [↑](#footnote-ref-1)
2. From the opening scene of *Fantastic Beasts and Where to Find Them* (Yates 2016). [↑](#footnote-ref-2)
3. Beck and Demirguc-Kunt 2006, p. 2936. [↑](#footnote-ref-3)
4. Rajan and Zingales 2003. [↑](#footnote-ref-4)
5. Dymski 2009, Blanchard et al. 2008. [↑](#footnote-ref-5)
6. Armstrong and Vickers 2012. [↑](#footnote-ref-6)
7. Alessi et al. 2011, Rooij et al. 2012. [↑](#footnote-ref-7)
8. Borio 2011, Admati and Hellwig 2013. Philosophical contributions by Barry et al. 2010, James 2012, Linarelli 2015, and De Bruin 2015. [↑](#footnote-ref-8)
9. Bowles 2006, p. 299ff., Beck and De La Torre 2007, Memmel et al. 2015. [↑](#footnote-ref-9)
10. Blanchflower and Oswald 1998, Holtz-Eakin et al. 1994. [↑](#footnote-ref-10)
11. Hawtrey 2009. [↑](#footnote-ref-11)
12. Lochner and Monge-Naranjo 2012. [↑](#footnote-ref-12)
13. Rawls 1999, pp. 78ff., Arneson 2000, Dworkin 1981a, 1981b, Sen and Nussbaum 1993. [↑](#footnote-ref-13)
14. Notable exceptions are Douglas 2015, Herzog 2016, Linarelli 2016, Gourevitch 2014, Hudon and Sandberg 2013, and Dobos 2012. [↑](#footnote-ref-14)
15. I am grateful to an anonymous reviewer for suggesting this vivid way of putting the challenge. See Streeck for a diagnosis along those lines (2014). [↑](#footnote-ref-15)
16. My proposal differs from Muhammad Yunus’ call for a human right to credit—philosophically discussed by Marek Hudon (2009). Yunus promotes an unconditional right to small amounts of credit. Moreover, Yunus’ justification is based on the alleged ability of credit to alleviate extreme poverty. His argument falls short because access to credit is not an effective means of escaping extreme poverty, as others have shown (Sorell 2015).

My proposal also differs from Kimberley Brownlee and Zofia Stemplowska’s proposed right to financial inclusion (2015). They assume a right to education, and argue on this basis for their proposed right. Theirs is a companion-in-guilt argument, presupposing the—controversial—right to education. Mine depends on the right to private property, which is actually recognised in many societies. [↑](#footnote-ref-16)
17. Jordà and Schularick 2016. [↑](#footnote-ref-17)
18. Hodgson 2015, pp. 25ff. [↑](#footnote-ref-18)
19. Gaus 2010, Sunstein 1999. [↑](#footnote-ref-19)
20. Deakin et al. 2017. [↑](#footnote-ref-20)
21. Waldron 1988. [↑](#footnote-ref-21)
22. Wenar 1998. [↑](#footnote-ref-22)
23. Kornai et al. 2003, p. 4. [↑](#footnote-ref-23)
24. Kornai 1986, 1992. [↑](#footnote-ref-24)
25. Kornai et al. 2003, p. 14. [↑](#footnote-ref-25)
26. Ibid. [↑](#footnote-ref-26)
27. Ibid., p. 15; Schumpeter 1934. [↑](#footnote-ref-27)
28. Kornai et al. 2003, p. 24. [↑](#footnote-ref-28)
29. Schaffer 1998. [↑](#footnote-ref-29)
30. Minsky 2008, Hicks 1989, chs. 7 and 13. [↑](#footnote-ref-30)
31. Brettschneider uses a similar strategy to argue for welfare rights (2012). [↑](#footnote-ref-31)
32. Scanlon 1998, ch. 5, Rawls 2001, pp. 41f. [↑](#footnote-ref-32)
33. Hardin 1968. For a challenge on this line of argument, see Ostrom 2015, esp. pp. 2-23. [↑](#footnote-ref-33)
34. Hayek 1945. For a more sympathetic perspective on market socialism, see Lange 1936 and 1937. [↑](#footnote-ref-34)
35. Cohen 1979. [↑](#footnote-ref-35)
36. Hayek 1944. [↑](#footnote-ref-36)
37. Hegel [1821], §§41-71. [↑](#footnote-ref-37)
38. Cf. rule 501 of Regulation D of the U.S. Securities and Exchange Commission (Legal Information Institute 2017). [↑](#footnote-ref-38)
39. My points about credit creation apply to creditors generally, not just to banks. I refer to banks throughout for simplicity. [↑](#footnote-ref-39)
40. Jakab and Kumhof 2015. [↑](#footnote-ref-40)
41. Ibid., p. 1. [↑](#footnote-ref-41)
42. Ibid., p. 5. [↑](#footnote-ref-42)
43. Hence it is important that banks are sufficiently capitalised. The Basel regulations are the most important piece of global banking regulation concerning the capital requirements of banks (Admati and Hellwig 2013). [↑](#footnote-ref-43)
44. Thanks to an anonymous reviewer for pressing me on this. [↑](#footnote-ref-44)
45. De Bruin 2015, chs. 2, 5. [↑](#footnote-ref-45)
46. Pasquale 2015, ch. 4. [↑](#footnote-ref-46)
47. Herzog 2016, p. 11. [↑](#footnote-ref-47)
48. Wenar 2005, Kramer et al. 2000. [↑](#footnote-ref-48)
49. Hohfeld and Cook 1917. [↑](#footnote-ref-49)
50. Thomas et al. 2002. [↑](#footnote-ref-50)
51. Developing my account of reasonable interest rates needs to wait for another day. The lower ceiling is set by the costs banks bear for providing credit. The upper ceiling is the interest rate that would make the project for which the borrower wants credit economically unviable. [↑](#footnote-ref-51)
52. Pasquale 2015, chs. 1 and 4. [↑](#footnote-ref-52)
53. Kindleberger 2011, Minsky 2008, Haldane et al. 2007. [↑](#footnote-ref-53)
54. James 2012, Linarelli 2015. [↑](#footnote-ref-54)
55. Williamson 2012, Ackerman and Alstott 1999, White 2015. [↑](#footnote-ref-55)