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## The rabbis and the credit crunch

**Nobel laureate Robert Aumann on where the Talmud meets economics.**

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Nobel Laureate economist Professor Robert (Yisrael) Aumann described in a recent speech his outlook on the link between economics, Judaism and the current economic downturn. In the inaugural lecture of the Center for the Study of Judaism and Economics at the Jerusalem Institute for Market Studies, Professor Aumann said that economics is based on incentives, and it is only when people and firms have the right incentives to work and produce can an economy grow and prosper. He argued that many examples illustrate how the Torah and the Talmud acknowledge the importance of economic incentives within a competitive market economy.

As one example of fundamental market-oriented principles inherent in Judaism, Professor Aumann cited the support in the Talmud for unfettered price competition, adding that the Talmud preceded Adam Smith's groundbreaking ideas on price competition by hundreds of years. In the Talmud, there is absolutely no room for price fixing; only support for ensuring the use of honest weights and measures. In a competitive market economy, the firm selling at the highest price will either go out of business or be forced to decrease its price in order to survive.

Professor Aumann's point can be seen in Israeli government decisions over the years. One example is the outrageous fees paid to Bezeq for international phone calls in the 1990s. Once the market was opened to competition, calling family and friends or doing business abroad quickly became 70% cheaper. Economic growth could be restored by quickly introducing and deepening the competitive environment in Israeli markets, especially in the energy and shipping sectors.

As another example of economics in Judaism, Professor Aumann discussed the concept of the *Pruzbul*. The *Pruzbul* allowed creditors to collect repayment of loans past the *Sh'mitah* (Sabbatical) year. Until Hillel instituted the *Pruzbul*, creditors were forbidden to collect loans after the seventh year. One effect of this prohibition was that very few individuals offered loans in the years preceding the seventh year.

The lack of liquidity, or credit crunch, had devastating effects on the economy. Hillel realized that in order to assure a sound credit market and a continuous flow of loans to firms, the *Pruzbul* had to be instituted.

Politicians in Israel should follow the example of Hillel and ensure that small and medium sized businesses have easy access to loans to finance their operations. Unfortunately, according to a report by the Milken Institute, the current situation is that 1% of Israel's largest companies receive 71% of available credit. This severe credit crunch hampers economic growth since expansion of small and medium business is often the main engine of job creation and increasing societal wealth.

Professor Aumann also talked about the many discussions of the moral hazard problem in the Torah and Talmud, and how moral hazard is currently at the heart of the faulty proposals currently being offered to solve the current financial crisis. The term moral hazard is used by economists to describe the fact that when an individual, a firm or an institution is "insured", there is an incentive to act less carefully and take harmful risks. For example, an individual with insurance against valuables kept in the home may be less vigilant about locking doors or investing in a good alarm system.

As Nobel Prize Professor Gary Becker writes on his blog: If individuals are not held accountable for decisions and actions that harm themselves or others, they have less incentive to act responsibly in the first place since they will escape some or all of the bad consequences of their actions.

This point relates directly to what is happening today as failing banks and other companies ask for government guarantees to stave off bankruptcy. This type of "insurance" against bad business decisions in the past will lead to even more bad investments and trouble in the future.

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