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To
*Babu Patwardhan, who first alerted me to
the ill effects of usury*

AGAINST USURY

*Resolving the Economic, Ecological
and Welfare Crisis*



Robert Van de Weyer

SPCK

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Foreword by Professor Philip Booth

*Editorial and Programme Director
Institute of Economic Affairs*

Robert Van de Weyer's thesis is that usury is at the root of most of the serious problems that society faces. He defines usury, not in the way that is commonly understood, but as the unequal sharing of risk by two parties. Van de Weyer makes the case that this is the historically correct definition of usury. It explains why, for example, in Islamic financial arrangements equity finance is permissible (because the lender is bearing the risks) but a fixed interest loan is not generally permissible. In the case of a fixed interest arrangement the borrower bears the risk of failure and gets the benefits from success but the lender obtains a fixed return. The author then goes on to suggest that a lot of the problems within the financial system have arisen as a result of the unequal sharing of risks in this way.

The author is certainly right to highlight this issue. Governments throughout the world have done everything they can to crucify equity interests (or company shares) whereby the investor directly bears the risks of investment projects. Equity interests in companies are substantially over-taxed compared with fixed-interest investments, and often the returns to equity are taxed twice or three times. Indeed, this is one of the main explanations for the existence of so-called tax havens, which ensure that equity returns are only taxed once. Furthermore, the regulation of insurance companies and pension funds in recent years has made it more and more difficult for these entities to take equity risks in their investment policies. Members of defined benefit pension funds, who used to bear some of the

risks of low returns, have now, as a result of legislation, pushed that risk on to sponsoring companies. Relating this problem specifically to the financial crash, it is clear that one reason for the gearing and excessive risk taking of the investment banks was the tax treatment of equity investments. This made banks ever-more keen to create new packages and methods of gearing that were constructed out of fixed interest lending. Indeed, as the author points out, the very existence of high general tax rates discourages the taking of equity risks because the Treasury gains from the success that comes from equity risks but does not lose from the failure: all income and capital taxes, by their nature, tax success. Taking these points together, we can say that the government creates an environment that actively encourages the form of usury that the author describes.

How should we deal with this problem? Firstly, the author would like to see much lower rates of tax, partly resulting from his other proposals discussed below. However, even in a lower-tax environment and in non-discriminatory tax systems, it is likely that usury would develop as a result of voluntary decisions. But, again, these voluntary decisions are distorted by the ability of banks to minimise the amount of liquid assets they hold against deposits, and by the use of deposit insurance systems that allow depositors to impose the risks of their financial decisions on the deposit insurance system and, in the last resort, on the taxpayer. This can be regarded as ‘involuntary usury’. Banks take individuals’ deposits of money and are able to lend them out to borrowers as if the deposits were long-term capital investments knowing that, if the risks they are taking are too great, they would be ‘bailed out’ directly or indirectly by the taxpayer.

The solution to this, argues Van de Weyer, is, more or less, to separate the investment side from the deposit-taking side of banks’ activities. The money that we hold for everyday financial transactions would be kept in ‘deposit banks’. The capital that we accumulate for longer-term saving would be kept in ‘capital banks’. The activities of the latter would not need to be

surrounded by detailed regulation (and investors would be aware that their capital was at risk), but the former would be limited in their activities so that cash was always available to repay deposits on demand.

This proposal is controversial in the free-market circles of the Institute of Economic Affairs (IEA). Tim Congdon, for example, has made a very strong case against what are sometimes called ‘narrow banking’ models similar to those proposed by the author. Many ‘Austrian’ economists, on the other hand, would approve. Some would believe that the proposals of the author would come about in a financial system that was completely unregulated by the state; others have suggested that such a system should be brought about by legislation. The advantage of the separation of investment and deposit banking, argue its free-market proponents, is that it creates a case for a very specific regulatory framework but allows financial institutions to operate very freely within that framework.

This is a debate that will continue, and the author’s highly original contribution is very welcome. It is certainly preferable to the mass of commentary on the tedious debate within the European Union about how to extend the tentacles of detailed regulation into those parts of the financial system (hedge funds and so on) which, in fact, had nothing to do with the financial crash. The author’s ability both to circumnavigate that debate and relate a much more pertinent debate to an important discourse on the meaning of usury is laudatory.

The author also relates the concept of usury to a much wider range of situations. For example, he discusses the issue of global warming. Perhaps it is the second biggest economic issue in most people’s thoughts, after the financial crash.

The author suggests outlawing CO₂ production at a pre-announced future date. It is arguable that the production of CO₂ by one person causes harm to another so, perhaps, a case could be made that we should ban it. But perhaps there is another way here. As the economist Graham Dawson has

suggested, there is no reason why the production of CO₂ should not be treated as a potential tort. A collective action application for an injunction or compensation could be taken out and the science (and the extent of damage) could be argued out in court. After all, there is little point in making the production of CO₂ a criminal offence if it does not harm anybody. If it does harm somebody then we have a perfectly good legal mechanism (especially in the UK) for dealing with this matter. Nevertheless, the author's analysis that pollution (and CO₂ production) should be intrinsically regarded as a problem of one party imposing costs and risks on others without them having any say in the matter at least gets us arguing about the appropriate measures to take. As is so often the case in this book, the author's points are inter-related (his approach is 'holistic' in today's management jargon). High taxes especially penalise high-risk investments because the state gains from progressive taxation of profits but does not share in the losses of investment projects. 'Green' technologies are especially high risk and speculative. Our tax system therefore particularly penalises 'green' technologies. Would the railways ever have been built in an economy that taxes profits remitted as dividends to individuals at a rate of close to 60%? Perhaps not.

The author's conclusions about taxes and the welfare state are particularly pertinent. Whilst much ink has been spilt on the financial crash – and the political class has made much political capital from it – that same political class is largely silent about the moral hazard caused by taxation and the welfare state. Despite the lessons of history, and lessons from abroad, there is still little serious discussion amongst politicians about the need for much lower taxes and the desirability of individuals, families and communities taking charge, once again, of their own health and welfare arrangements. The author suggests one way in which we could move in that direction, whilst emphasizing, of course, the moral hazard and unequal sharing of risks that come from tax-financed and government

planned provision for potentially insurable risks. Returning health and welfare insurance to the individual, the family and to civil society, using commercial and semi-commercial organisations, in the way that the author suggests, would be hugely beneficial. The poor would be protected through having their contributions to providers financed through taxation. Others would take responsibility for themselves within a structure that was simultaneously paternalistic but largely voluntary.

This is a thoughtful and important book. In some places it will be regarded as idiosyncratic. Without that combination I am sure that the author would not have received commendations from the Archbishop of Canterbury, Tony Benn and the Editorial Director of the IEA! There is no harm, of course, in taking risks with thought experiments; many useful ideas come out of idiosyncratic thinking and the author should be congratulated on this as well as his careful scholarship and original thinking in the field of Christian social thought. We have hopefully now finished with the debate on liberation theology and the need for revolution to overthrow 'sinful' structures. It would be nice to think that we are also coming to the end of the era of Christians responding to every economic problem by suggesting that the state should raise taxation or pass a law to directly address all that we dislike in society. The author is, by no means, taking a libertarian position, but he does propose returning financial decision making and welfare provision to the community. We can argue about the details of the author's proposals but how can Christians, over the past two generations, have so comprehensively misunderstood the legitimate role of political authority? It is to be hoped that this book will help push Christian social thinking in a much more fruitful direction.

Foreword by Tarek El Diwany

Consultant on Islamic Finance
Author of The Problem with Interest

As a boy, I spent a school holiday with my mother in what was then the German Democratic Republic. She was born near Leipzig in the 1930s and had remained there until her escape to the West some 20 years later. Our home for those few weeks was a small town, unchanged for centuries it seemed, except for the backdrop of identical grey apartment blocks on the nearby hills. These spoke of central planning and hatred for life on a human scale. One evening we sat in a smoke-filled lounge enjoying the supplies of coffee and chocolate that had arrived with my mother. ‘Which is better,’ an old man asked me in front of the assembled guests, ‘*communismus oder kapitalismus?*’ ‘*Capitalismus,*’ I replied gleefully.

But of course I was wrong. It is clear to me now that communism and capitalism have failed the world in ways that are approximately as bad as one another. Though generations of students have faced a seemingly stark choice of value system, in practice these two thoroughfares of political economy have led to precisely the same destination: a land in which the masses toil for the benefit of a small elite.

While communism exercised its power through such blatant injustices as the confiscation of assets, the instruments of capitalism have tended to work more subtly and have therefore remained largely beyond the public conscience. Chief among these is the practice of usury. Though rarely scrutinised by the modern economist, its destructive power has not lessened since the best minds of Greece and Rome denounced it. Today

its casualties include the children of Africa and the rainforests of the Amazon, both despoiled in the effort to service foreign debt. Among its allies is a culture of debt-finance that has spawned massive global corporations and led to a debasement of daily life even in the rich world. The artisans who built the charming villages of England have been replaced by a few monolithic building companies whose bequest to future generations is a landscape of characterless housing estates. Gone too are the small shopkeepers of the local town, their business usurped by out-of-town monopolies that call themselves supermarkets. Never was the word 'market' used so inappropriately. Life is being cheapened, variety is diminishing, and control is being centralised. Isn't this what communism did to Eastern Germany?

In these times of financial crisis, people of religious faith have an opportunity to show the world that there really is a third way of organizing our economic affairs. Such efforts will inevitably bring the crime of usury back into the public conscience for this is a central part of our common prophetic heritage. Of the various forms of usury that are defined in Islam, the usury of loans is nowadays the most widely practised. It is therefore my pleasure to support a work that addresses this form of usury and seeks to understand the rationale for its prohibition. Such discussions have become all the more critical in the face of attempts by practitioners of usury to ignore or underplay it as an issue. While not all of the ideas expressed here will accord with the juristic position in Islam, we remain united on the central theme before us. 'Even if usury is much, it always leads to utter poverty,' said the prophet Muhammad, peace be upon him. From this it is clear that the issue of usury cannot be ignored for ever. It will either be resolved by force of argument, or by force of circumstance when the people have nothing left to eat.

Preface

The line of thinking explored in this book began for me on a dusty road in central India in June 1969. I was on a long hike when I encountered an elderly man called Babu Patwardhan. A long-standing follower of Mahatma Gandhi – and looking remarkably like the Mahatma in both dress and visage – Babu Patwardhan now wandered from village to village promoting an idea he called ‘Chalanashuddhi’. This in essence is a means of reordering the economic system to abolish usury; he argued that it is the only means of realizing Gandhi’s vision of an economy that provides for welfare and work for everyone, and functions in harmony with the natural environment.

Babu Patwardhan also gave in the course of our long conversation a remarkable exposition of the teachings of Jesus Christ, relating them to the Hindu philosophy of Advaita Vedanta. That exposition helped me towards my eventual conversion to Christianity 18 months later; I have also come to see a link between Advaita Vedanta and the abolition of usury – a link which I address briefly at the end of this book.

Babu Patwardhan gave me a copy of the book he had written two years earlier entitled *Chalanashuddhi*, in which he presented his ideas in detail. I still treasure that copy; and I dedicate this book to his memory.

As the years have passed, the issues addressed by Babu Patwardhan have become more and more serious, not only in rural India but across the world. I have no compunction in saying that they now constitute a trio of crises. And it is to Babu Patwardhan that I owe the insight that these crises form a single crisis, with the same underlying cause, and with connected solutions. If this present book has any merit, it is in

Preface

amplifying this insight with ideas drawn from elsewhere, from the religious traditions and from the history of economic thought.

I hope the whole of this book engages readers' interest. I hope too that, where I bring economic theories to bear, I have emulated the example of the great economists from the past, such as Adam Smith and John Maynard Keynes, in their simplicity and clarity of exposition. Also, so as not to interrupt the flow of argument, I have added an Epilogue, giving the intellectual background to key ideas.

Nonetheless I feel diffident about inviting people to read an entire book of ideas and proposals from start to finish, albeit that the subject matter could hardly be more important. So those pressed for time might confine themselves to the Prologue and the Anti-Usury Manifesto that forms Chapter 5 – and then dip into earlier chapters as the Manifesto indicates and as they feel inclined.

I wish to express my gratitude to Professor Philip Booth of the Institute of Economic Affairs and to Tarek El Diwany, a distinguished expert on Islamic finance, for their very helpful comments during the writing of this book – and also for their Forewords. Needless to say, all the book's errors and shortcomings are entirely my own.

Although my own reflections on usury date from an encounter with a Hindu, it is in the scriptures and later writings of Judaism, Christianity and Islam that one finds the most trenchant opposition to usurious practices of various kinds – with usury presented as the primary economic sin. The titles of the first four chapters are in Hebrew and Arabic, as well as English, to reflect this religious background.

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Prologue

1 Ecology

In 1798, Thomas Robert Malthus, who was both a priest and an economist, wrote an essay, which brought him great fame, predicting ecological catastrophe. He expressed the belief in *An Essay on the Principle of Population* that the human population would always tend to grow faster than the capacity of the earth to provide food for it. So even if the Industrial Revolution, then in its infancy, was able to provide more goods to consume, the planet itself placed limits on the degree to which the economy could grow.

In the following century and a half the expansion of the global economy seemed to disprove this gloomy prediction. Vast tracts of the Americas, Asia, Australia and Africa were successively brought under the plough, or turned into plantations or ranches. In addition farming methods improved, steadily increasing the harvests. As a result the burgeoning populations of Britain and the other industrial countries remained well-fed.

But in the 1930s an English amateur meteorologist, G. S. Callendar, began to warn of another way in which the human population was pressing on the limits of the planet. In letters and notebooks he analysed how emissions of carbon dioxide from fossil fuels were beginning to create a 'greenhouse effect' that would eventually cause the earth's climate to become substantially hotter. Although in his lifetime Callendar was largely ignored, in the years following his death in 1964 people became aware of various other ways in which human activity was upsetting the ecology of the planet. From the 1980s fears about

climate change also began to grow, until by the turn of the millennium these fears were gripping the public consciousness.

At a technical level there is little argument about what needs to be done to avert global warming. As a matter of urgency we must develop technologies that can generate energy without emitting greenhouse gases – and hence without using fossil fuels. Moreover, it seems likely that green technologies might, with sufficient research, be cheaper than using oil and coal. Yet during the past two or three decades investment in the development of green technologies has been pitiful, and the results have been correspondingly meagre.

Malthus offered no means of avoiding the ecological catastrophe he foresaw. He hoped that priests like himself, when young couples came to arrange their weddings, would offer a short homily on the dangers of over-population, and urge them to practise sexual abstinence. But he thought it more likely that humanity would soon be haunted by chronic famine, leading to warfare and disease. As the present generation contemplates the fate of its grandchildren and great-grandchildren, it can't help fearing that Malthus will at last be vindicated.

2 Economics

In 1820 Malthus made a second prediction, claiming in *Principles of Political Economy* that industrial economies have an inherent tendency towards depression. He lamented the high level of unemployment in Britain following the end of the Napoleonic Wars, and feared that this would be normal in peacetime. The reason was that the new middle classes, who were making their fortunes from industry, tended to save excessively, in their desire to achieve financial security and to accumulate wealth for their heirs. While they invested some of these savings in new factories, much of it was hoarded as gold and silver coins. This represented a continuous drain of demand from the economy, throwing people out of work.

In the following century the enormous expansion of world trade seemed to prove Malthus wrong. As Britain, followed by the rest of the Western world, opened up shipping routes to Asia and then to Africa, demand for goods manufactured in Western factories grew sufficiently to keep the machines humming. There were periodic depressions, but the global economy always bounced back into boom.

However, in the 1920s the industrial countries at last sank into a depression that, left to itself, threatened to become permanent, with unemployment in some places rising to a third of the workforce. The dominant economist of the period, John Maynard Keynes, argued that Malthus' prediction was at last being fulfilled; and he developed an overarching theory to explain this. In *The General Theory of Employment, Interest and Money* (1936), he urged governments to compensate for excessive private savings by public profligacy, spending more than they raised in taxation – and borrowing the difference. But he recognized that such measures could only be temporary, since governments who borrow continually, like households, eventually become insolvent. So he regarded 'secular stagnation' as the natural state of modern economies.

Once again, however, events seemed to disprove such fears. Hitler's war and the subsequent reconstruction caused government borrowing to balloon; and persistent inflation, rising to over 20 per cent in the mid 1970s, eroded the debt, enabling governments to borrow more. Then rapid industrialization in Asia boosted demand for Western goods. As they grew richer, Asians saved a very high proportion of their incomes, threatening depression. But by the mid 1990s this money was finding its way through the global banking system to Western families, who used much of it to buy more housing than they needed – larger houses in which to live, plus second homes elsewhere. As house prices surged, Western families came to regard their houses as their pensions, and so they virtually gave up saving. The global economy thus enjoyed the longest boom in history.

surrounded by detailed regulation (and investors would be aware that their capital was at risk), but the former would be limited in their activities so that cash was always available to repay deposits on demand.

This proposal is controversial in the free-market circles of the Institute of Economic Affairs (IEA). Tim Congdon, for example, has made a very strong case against what are sometimes called ‘narrow banking’ models similar to those proposed by the author. Many ‘Austrian’ economists, on the other hand, would approve. Some would believe that the proposals of the author would come about in a financial system that was completely unregulated by the state; others have suggested that such a system should be brought about by legislation. The advantage of the separation of investment and deposit banking, argue its free-market proponents, is that it creates a case for a very specific regulatory framework but allows financial institutions to operate very freely within that framework.

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