

Usury & the Credit Crunch

By Alastair McIntosh & Wayne Visser

Historically, "usury" is term given to the charging of (excessive) interest. For over 4,000 years, it has been repeatedly condemned and criticised by religious, philosophical and economic traditions. This is summarised in a paper by Wayne Visser and Alastair McIntosh of Scotland's Centre for Human Ecology, published as "A short review of the historical critique of usury" in the journal, *Accounting, Business & Financial History* (1998, 8:2, pp. 175-198). Early in 2009, following requests from Muslim scholars to reprint and translate the article, the authors added the following postscript. The full piece can be read at http://www.alastairmcintosh.com/articles/1998_usury.htm.

POSTSCRIPT ON THE CREDIT CRUNCH, 2009: The global so-called "credit crunch" (defined as "a severe shortage of money or credit") is generally considered to have "started" on 9 August 2007 when disturbing figures from the French bank BNP Paribas raised the cost of credit and awoke the financial community to the wider seriousness of the situation (see the BBC's detailed timeline at <http://news.bbc.co.uk/1/hi/business/7521250.stm>).

Underlying this had been a rise in US interest rates between 2004 and 2005 from 1% to 5.35%, resulting in high levels of default at the "sub-prime" end, which is to say, the high risk end of the housing market. Because mortgage lenders had sold on their debts via hedge funds to other financial institutions, the consequence of irresponsible lending spread contagiously through banking systems, especially in the West, as house prices started to fall and the real estate asset value underpinning the loans became negative. When BNP Paribas told its investors that they would not be able to draw money out of two of its funds owing to a "complete evaporation of liquidity" it was the start of a domino effect, forcing governments to step in and avert potentially catastrophic runs on major banks.

From the perspective of our paper on usury which we now revisit more than a decade after its first publication in 1998, we find it instructive to reflect on how far such problems can be laid at the door of an interest-based banking system. Full consideration of this is beyond our current scope, but in this postscript we will confine ourselves to making three brief observations.

First, the credit crunch was a consequence of the preceding credit bubble inevitably bursting. In certain Western countries, including Britain and America, governments had deregulated financial agencies to an extent where irresponsible lending became normalised. For example, in Britain, through until 2008, it was easy for people to get

mortgage loans on property of 120% of the property value with few questions asked. Property prices were rising sharply, the global economy was booming, and traditional banking caution was thrown to the wind. People re-mortgaged their homes to pay off credit card debts that carried very high rates of interest, and which had been sold to them by aggressive marketing. People had started to believe that ever-rising house values and continuing economic good times would generate property values that would continuously outstrip their liabilities. Far from failing to dispel this notion, leading lenders exploited it. City staff were rewarded with massive “fat cat” bonuses based on the size and quantity of loans made. Concerns about their overall quality of lending portfolios were silenced through hedging – the selling on and spreading out of risk on speculatively buoyant markets.

While everybody played the game and interest rates remained low the system appeared to be working. It met investor expectations with high rewards. But as US interest rates rose in a necessary effort to counteract the economic knock-on effects of house price inflation, the consequences of having bought into a usurious and greed-driven system started to hit home. Loan default rates reached the point of crisis. Those who were able to see it coming, mostly the wealthy and well-advised who had a greater variety of financial options open to them, were able to bail out in time. Those who had been caught with little option if they wanted to buy a house to live in were squashed – leaving many young families now struggling to pay off debts as their house values fell into negative equity. As the media rightly observed, Wall Street’s gains are Main Street’s losses, with the negative externalities of financial speculation passed on to society as a whole. We might learn from this that an economics that canonises greed lays in store catastrophic weaknesses that will eventually hit the poor hardest.

Our second point is that globalisation, whilst creating massive new economic wealth from deregulated trade, has reduced resilience in the world financial system. Fire walls between different countries’ economies that were held in place by measures such as controls on foreign currency transactions substantially fell away in the years that followed the “new right” economics of Reagan and Thatcher. Enabled by computerised production planning and stock control, new notions of just-in-time commercial supply systems profitably maximised economic efficiency. But there was a hidden cost. It also reduced the resilience that slack allows in highly interdependent chains of supply. Without slack, supply networks, like the socio-ecological systems on which they depend, become brittle. They become prone to breaking rather than bending when placed under stress. And for a monetarily based economic supply system, a bank running out of liquidity is like a car suddenly losing its oil. Devoid of lubrication the engine grinds to a sudden halt. That was why, in 2008, governments were left with no option but to bail out the banks.

This loss of resilience is what distinguishes the current situation from the bank crashes of the 1920s. Back then, society and especially its food production was less industrialised. People lived closer to the land. Most essential services such as food production were local production for local consumption. But today, essential chains of

supply are long, often global, and therefore subject to international market and financial vagaries. A glimpse of the consequences of such dependency can be seen from what happened in Britain in September 2000 when fuel tanker drivers went on strike. Within five days, panic buying emptied some supermarket shelves and the media carried sporadic reports of fighting at the checkouts. The Blair government, fearing civil unrest, capitulated. Applied to the situation in 2008, we might ask much more unrest might have broken out if bank failure had resulted in the sudden loss of financial lubrication with its consequent immediate knock-on effects?

We might learn from this that the risks are too high for governments to wash their hands of regulating modern economies. Unfettered free markets expose the very fabric of civil society to the law of the jungle on a bad day. Overly deregulated markets can only be transient phenomena, like handing out free pizza. Because of their abstract nature based on confidence – the word means “faith together” – financial markets are all the more volatile. The brazenness by which financial engineers or rather, marketeers, tried to spread risk by creating derivative “products” driven ultimately by mortgage interest rates and their effect on property values reveal a massive collapse of responsibility. That collapse happened because faith shifted from having direct equity connection to tangible assets onto abstract financial connections that could be many times removed and diluted from the reality on the ground. Such derivatives had become ships of fantasy. Devoid of anchors, they drifted fecklessly with no bearings on the landmarks of reality until the rocks struck.

Our third observation is that many people ask whether the “credit crunch” (the term sounds disarmingly like a packet of breakfast cereal, with a free gift inside) signals the “end of capitalism”. On the contrary, we consider that it represents only a cyclical spasm in the process by which capitalism periodically restructures itself in a crash that most hurts the weak. The consequence of job losses and repossessions in the housing market are that the relatively disadvantaged, many now saddled with negative equity, will be forced long term to work harder to pay off debts, including their share of the national debt that will manifest in tax rises. As such, the creditors – many from their offshore tax havens – retain and reconsolidate a grip that they would not have had if their involvement in the process had been through risk-shared equity holdings, as with Islamic banking principles. These investors will, in future, be the people who find themselves in a position to buy up repossessed (which is to say, bankrupt) housing stock, and thereby strengthen their arm in future as rentiers to those who have lost out. The relatively poor will be forced to work yet harder on a treadmill that damages family life and with it, weakens the future fabric of society.

Capitalism can be understood at many different levels, from honest trade and entrepreneurialism all the way to its advanced Anglo-American casino version. In the latter, the role of money undergoes a shift. It changes from its primary role as a means of recording and lubricating exchanges of goods and services. It takes on second order abstract qualities of being speculative. Here money alone generates more money, and the principle of usury – defining it as the lending of money at real positive rates of

interest (i.e. rates greater than what is needed to cover inflation and risk) – is the inner wheel driving the system.

Although we believe capitalism in one form or another is here to stay, the "credit crunch" may go down in history as the most serious challenge yet to financially speculative advanced capitalism. Henceforth electorates and their governments should give more determined consideration to the oligarchic principle of allowing so much power and latitude to shareholders and their financial analysts whose investment motivation is purely to 'play the market'.

2009 will probably mark the point at which the pendulum starts to swing back to more carefully and strongly regulated financial markets. As it turns out, this approach is entirely consistent with the philosophy of the iconic economists Adam Smith (who was after all a 'moral philosopher') and John Maynard Keynes (who warned against the dangers of speculative activities). Ironically, these are often cited by neoliberal market fundamentalists in support of their ideological deregulatory stance. Any of us who have knowingly participated in usury-related casino economics share the responsibility for what has happened. Whilst neither of the current writers is a Moslem, we cannot help but be reminded of the Islamic *hadith* that states: "The taker of usury and the giver of it and the writer of its papers and the witness to it, are equal in crime." To put it in the language of other Abrahamic religions, we have worshipped at the shrine of Mammon, the god of wealth. Mammon has now transmogrified into Moloch – the fire-filled hollow stone god of the Hebrew Bible. Into his lap the children were reputedly sacrificed ... and that, in the name of idolatrously seeking future economic prosperity.

Through the lens of such metaphor the "credit crunch" must, like the "climate change crunch", be understood spiritually, or in terms of deep values. It is our consumer greed that has driven the problems now faced. Whatever our religious background if any, the crises of present times can be seen as a spiritual, or a values-based wake-up call. As such, modernity may still have something to learn from the ancients.

Source:

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