

# MAN AND MONEY

Towards an Alternative Basis of Credit

Shaikh Mahmud Ahmad

Opposition to interest is as old as Hammurabi's Code. All great religions, and many philosophers and thinkers have expressed their abhorrence for it. Intractable economic maladies like unemployment, inflation and deficits, respond favourably to elimination of interest. Still it survives as the foundation of modern economic systems. The single, powerful reason for its endurance is that no one either knows or is concerned about devising an alternative banking structure.

This book examines the possibility of evolving an alternative framework of capital and credit availability, which completely excludes reliance on either interest or any subterfuge for interest. The author first surveys classical justifications of interest and identifies their fatal infirmities. Then, using exhaustive empirical data, he establishes that unemployment, inflation, deficits, and trade cycles can be brought under control through elimination of interest. Lastly, he presents an innovative alternative to interest. Through a unique deployment of time as the basis of availability of credit, a viable framework for the circulation of capital without interest is demonstrated.

The product of a life-long endeavour, this book offers the key to a market economy without exploitation, where liberty and social justice can coexist.

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### About the Author

Scholar, author, teacher, and public servant, Shaikh Mahmud Ahmad, was born in Kashmir, educated at the University of Aligarh, and had a distinguished career as an educationist. He has been principal of several colleges and was Director Education, Azad Kashmir; Director, Institute of Islamic Research; and Joint Secretary, Ministry of Education, Islamabad. A recognized authority on economics, Islam, and Allama Iqbal, he travelled widely and attended conferences and colloquia in many countries. His versified English translation of Iqbal's *Javed Nama* is recognized as the best translation of Iqbal's work. He has written numerous books on economics and public policy—in both English and Urdu—including *Towards Interest Free Banking*, *Social Justice in Islam*, and *Economics of Islam*.

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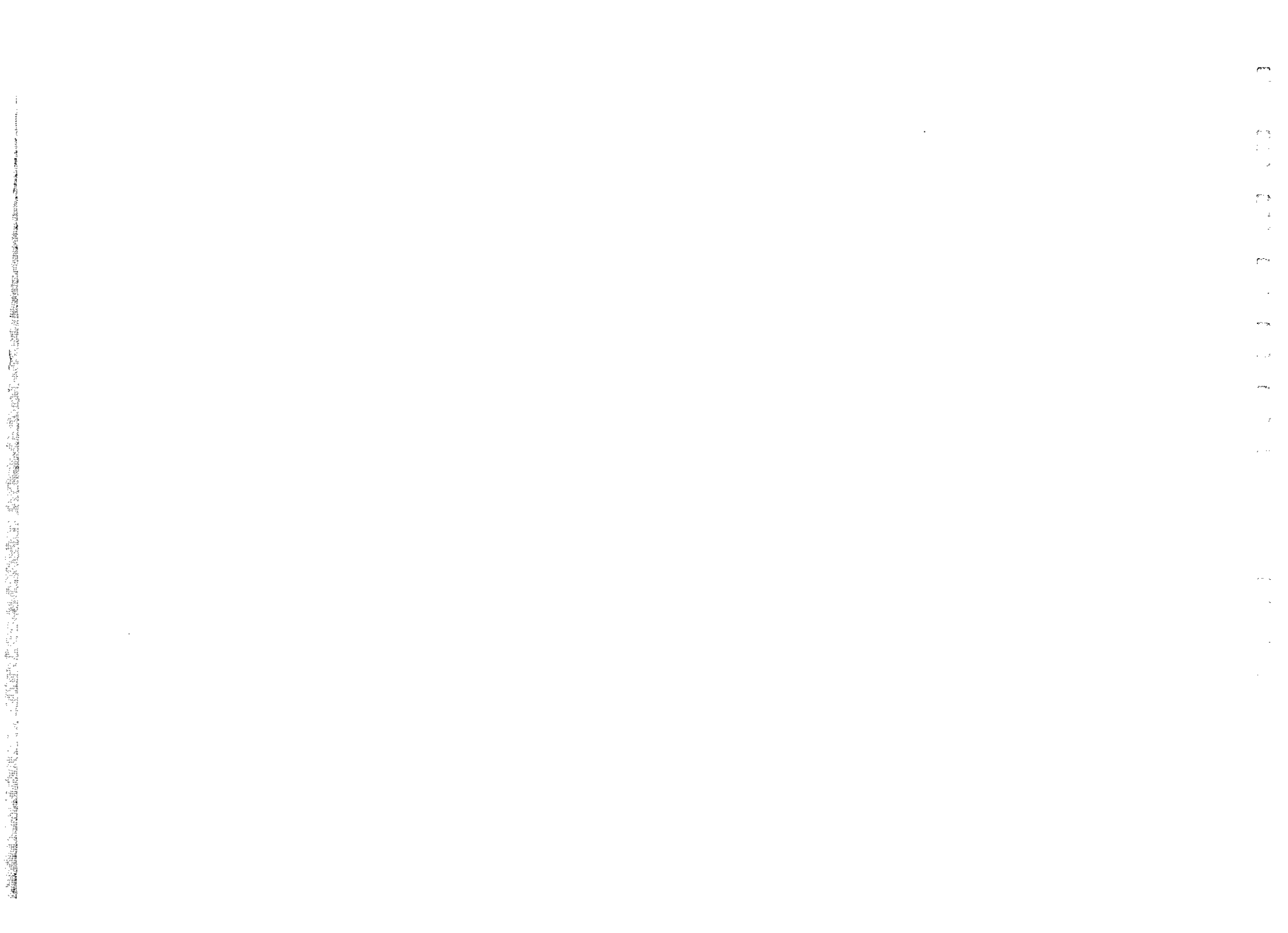


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## CONTENTS

	<i>page</i>
<i>Introduction</i>	vii
1. The Semantics of the Theory of Interest	1
2. Usury and Interest	60
3. Interest and Unemployment	105
4. Interest and Inflation	125
5. Ideology versus Understanding	226
6. Interest and International Exploitation	294
7. An Alternative Basis of Credit	424
<i>Bibliography</i>	539
<i>Index</i>	547

## INTRODUCTION

Unemployment, inflation, fiscal deficit and business fluctuations are some of the more significant problems for which orthodox economics does not appear to possess dependable remedies. These issues are precisely those of highest concern to average people throughout the world.

Standard textbook remedies for unemployment add to inflation, and those for curing inflation increase unemployment. Since the late 1960s, we have suffered simultaneously from both unemployment and inflation. If we check the logic behind proposed remedies, we find only prescriptions for overcoming symptoms rather than causes.

John Maynard Keynes asserted that unemployment cannot be extinguished without 'euthanasia of the rentier'. His prescription was never given serious consideration, partly because he simultaneously wandered over several other fields, such as the consumption function which introduced the possibility of enhanced returns to wealth-owning classes, whereas 'euthanasia of the rentier' directly hurt their interests. He also asserted, contrary to the view which commands virtual consensus among economists, that 'the remedy for the boom is not a higher rate of interest but a lower rate of interest' (Keynes 1951: 322). This claim has suffered identical neglect at the hands of orthodox economics.

The importance assigned to the consumption function led to the evolution of consumptional expansionism, including transfer payments which, notwithstanding their humanistic appeal and value, activate the parasitic function of wealth owners who can lend increasingly large sums to their governments every year to cover their fiscal deficit, adding a third dimension to the vulnerability of the entire economic system. The magnitude of fiscal deficit all over the free world exceeds one-half the total

loanable resources available to it, curtailing investments, increasing unemployment, increasing the cost of social security and raising the consequential fiscal deficit still further.

In the process, although cyclical swings have been significantly dampened, there is no guarantee that a recurrence of the events of the Great Depression is not possible. On the other hand, there is the fear that in case of such a global recurrence, the economic arrangements, made more fragile by the magnitude of public and private indebtedness, may not be able to muster the strength even of the early 1930s to face it. This position is further complicated by the massive indebtedness of the Third World, which may breed tensions and conflicts of a pattern and magnitude the world has not hitherto experienced. In addition, disequilibrium in foreign payments is only intensified by diverse trade restrictions that strain relations between nations, leading to potential international confrontation of an intensity that can possibly ignite global conflagration.

Even a superficial examination of these issues reveals a certain common relationship of each with the institution of interest. For instance, interest payments that many countries are obliged to pay to the rentier class make up a significant portion of their fiscal deficit. Similarly, the total shortfall in foreign exchange suffered by countries of the South does not exceed by any large margin the interest payments on their foreign loans. If interest could be abolished and an alternative unexploitative basis of credit devised, both these aspects of persistent disequilibrium will begin to look far more manageable.

What is more important than the national and international financial disequilibrium spawned by our credit structure is the facet of human suffering and deprivation represented by unemployment and inflation. It appears virtually unquestionable that unemployment cannot survive abolition of interest, if a substitutional unexploitative arrangement for availability of credit can be devised. As soon as unemployment ceases to exist, our consumptional expansionism represented by transfer payments, subsidies and massive fiscal deficits becomes

unnecessary, which in effect means that inflation also suffers simultaneous extinction.

If unemployment, inflation, fiscal and foreign deficits and consequential international tensions happen to be incurable by every medicine known to economics, including the various varieties of command economics tried so far, and respond favourably in an extraordinarily large measure to extinction of interest, a re-examination of the nature and necessity of this institution becomes necessary to evaluate the loss that we may be called upon to suffer in case we decide to shift to a more humane credit structure.

In striving to make a somewhat in-depth study of these issues, we confront the obstacle of an extraordinary confusion of thought that is not in evidence in any other branch of economics, but is unrelentingly pervasive in the matter of interest and other related subjects. Even the language is permitted to lapse into a measure of inexactitude which will not be tolerated in any other context. From Adam Smith to Paul A. Samuelson, enough economists have gone about merrily using the word 'profit' in the meaning of 'interest', and sometimes 'interest' in the meaning of 'profit', until economic analysis has made itself virtually incapable of distinguishing productive efficiency from exploitative strangling. This confusion related to mixing up two entirely different distributional categories bears a strange contrast with the insistence of distinguishing 'interest' from 'usury'. Etymology does not support further continuation of this distinction, since connotations attaching to the emergence of the word 'interest' have long since ceased to be relevant. Even more compulsive realities, such as history and current statistics, repudiate each one of the six postulates on which this distinction is based.

Identical is the situation of various positive contributions claimed on behalf of the institution of interest. The assertion of orthodox economics that interest generates and mobilizes savings is by and large the exact reverse of reality. So is the claim of inverse relationship between interest and prices, whereas direct relationship is not only closer to logic but also empirically far

more in evidence. It is demonstrable that interest perpetuates disequilibrium between saving and investment by creating opportunity for exploitative accumulations through purchase of debts, instead of being an equilibrating device as claimed by orthodox economics. Economics does not hesitate to validate interest on account of opportunity cost of capital, transposing a concept relevant to lending between individuals to institutional credit where it is completely inapplicable since premature withdrawal of even time deposits is possible. Economics supports the claim of interest on account of its performing some variety of allocative function, which on close checking turns out to be false. Similarly, neither logic nor empirical evidence spread over a whole century supports the contention that interest works as a support for the strength of foreign balances. Even its title as price for scarcity of capital has validity when we notice that the scarcity is self-contrived through the institution of bank reserve.

Until we consider whether interest and bank reserve can or cannot be replaced, which economics does not appear to have done, we cannot place the argument of unworkability against such momentous contributions that their extinction can make.

Opposition to interest is as old as Hammurabi's Code. All great religions such as Judaism, Christianity, and Islam are particularly uncompromising in their hostility to this institution. From such philosophers as Aristotle to poets as Dante we meet with singular abhorrence to it. In the field of economic theory the closest scrutiny of the bona fides of this institution was made by E. von Boehm-Bawerk towards the end of the last century. His *Capital and Interest* repudiates all theories of interest adumbrated before his time, including the ones related to abstinence, productivity, and demand and supply, with a singular unanswerable finality, which, however, has not stopped economists. Keynes testifies that 'for several millenniums, enlightened opinion held...the doctrine that the rate of interest is not self-adjusting at a level best suited to the social advantage'. He holds that this doctrine 'deserves rehabilitation and honour' and that wise governments will do well to curb interest 'by

statute and custom and even by invoking the sanctions of the moral law' (Keynes 1951: 351).

Yet Boehm-Bawerk and Keynes also contributed a new theory of interest each. The former adumbrated the time preference concept and the latter liquidity preference theory, both of which on close examination prove to be as devoid of intellectual content and verisimilitude as the theories Boehm-Bawerk overthrew.

Apart from straying of even the best minds, the institution of interest appears to command some kind of exceptional survival value. Neglecting free credit given by Babylonian and Greek temples and some other stray examples, interest rules in the capital market, notwithstanding the consistent urging of what Keynes has called 'the moral law'.

When we analyse this staying power, we find that it emerges from a single, extremely powerful source: no one either knows or appears concerned with devising an alternative banking structure. This could be regarded as a compulsive reason for the acceptance of interest but for the fact that since the industrial revolution little serious effort has been made to evolve an interest-free credit framework. Although much energy was spent in this direction during ancient and medieval times, and certain concepts were also developed, these were inadequate even during those periods and are absolutely unworkable in the present age. It therefore became necessary to re-examine the possibility of evolving an alternative framework of capital and credit availability which completely excludes reliance on either interest or any subterfuge for interest.

The functional obstacle and the theoretical issues, notwithstanding their obvious interrelationship, should have been dealt with separately. Even if we had no alternative basis of banking, and we noticed the depredation of interest going beyond acceptable limits, we should have conceded the fact that although interest is devoid of any positive quality, we are forced to retain it since we do not know and cannot devise any alternative basis of banking. Economic theory has not been fair to itself in ascribing non-existing virtues to interest, if the only

obstacle was unavailability of an alternative substitutional device. Often economists tend to cover up the manifestations connected with the spoilation of interest with fanciful myths regarding its virtues, without sharing with the reader the compulsions they confront. Only Samuelson has exhibited the moral courage to admit that economists are forced to indulge in a game of make-believe: 'For at least another hundred years, we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still' (1976: 817). The main contention of this book is that foul, far from being useful, is hurtful all the way, and therefore we need not persist in our pretensions and unnecessarily extend the period of misery. I share the view of Samuelson that 'At the zero rate of interest...we could...reach...a kind of golden age' (614). My plea is that we should hasten to construct a new credit structure which, being free of interest, does not obstruct the emergence of the golden age.

Considering the far-reaching significance of the subject, and the deep involvement it exhibits in relation to virtually every issue of major concern in the economies of so-called free countries, it deserved handling by a far more competent person. Yet the current run of economic thinking does not indicate an inclination to go beyond symptoms to basic causes of various ailments that afflict the economy. This is possibly because close concern with a subject tends to blur perspective. There is no dearth of specialized knowledge, but there is also no glut of broad understanding. In such a situation it is an interdisciplinary, even intercultural, approach which may bring a fresh view.

Nevertheless, the feeling of magnitude of the task and of my being unequal to it may have stopped me short of undertaking this work, but for the irresistible inducement provided by economics itself through its remarkable consistency in projecting a complete travesty of reality as indisputable truth so far as the institution of interest is concerned. If a discipline chooses to become almost 100 per cent incorrect in relation to an issue of vital concern with human welfare, a dissenter, notwithstanding

his inadequacy of competence, can feel encouraged by the mere awareness that his own margin of error cannot possibly exceed that of orthodox economics.

Actually, the hesitation from taking on a discipline should not have been diluted even by the valuable work done by such distinguished economists as Boehm-Bawerk, Keynes, Hawtrey, Harrod and Kurihara, considering the short shrift economics gave to the more valuable parts of their work, and giving credit to them for concepts in which without being free of blemish they were in accord with the preconceptions economics strives to stand by. Yet the more overwhelming the posture of pretension, the more irresistible the urge to speak out and try to tear the veil of make-believe.

In a sense, the subject was not entirely new to me, for I have wrestled with it for a lifetime in my earlier books. But these were written in the context generally of prohibition of interest in Islam, which is comparable to the pristine posture of Judaism and Christianity in the matter. Eventually, I concluded that the subject can be properly handled only in a secular and scientific context. The ultimate issue on which hinges the eventual acceptance of the posture of these religions is whether a viable, feasible interest-free credit structure can be designed. This calls for a purely secular exercise in which existing religious expositions do not appear to make any positive contribution. Even though no reliance is placed on any religious authority in the exposition of the desirability of extinction of interest, an acknowledgement of inspiration provided by the moral background needs to be recorded.

An earlier incomplete draft of the book was sent to many scholars around the world, generally eliciting favourable responses. That received from some scholars, including Mrs Joan Robinson, was particularly encouraging. Yet the labour involved in completing the work developed my own critical perception to a level in which rewriting a major portion of the draft became necessary. This in part explains the long time taken in the writing of the book, since it had to be done twice over for the greater part of it. Two scholars in particular have

read every word of both the first and revised drafts and have been exceptionally generous in offering their criticism: Dr Harrie Paul Hendrikx of Queensland University in Australia and Mr Mohammad Akram Khan, Deputy Auditor General of Pakistan, have both been copious in their comments. The former indicated wide areas of difference in perception and the latter that of identical thinking. I am grateful to both for the great help they have given in the formulation of my posture, though naturally I alone am responsible for whatever errors I may have committed.

For library facilities I am particularly grateful to authorities of Punjab University Library and Punjab Public Library, to the American Center and British Council libraries of Lahore, and to those of the State Bank of Pakistan Library at Karachi. They extended every facility which was in their power, including overlooking the non-return of books beyond prescribed periods. Going beyond this I owe special gratitude to Mr Ashraf Janjua of the State Bank of Pakistan, for providing facilities for carrying on research work within the premises of the Bank whenever I found it unavoidable. On the financial side, the University Grants Commission of the Government of Pakistan gave me a senior research fellowship for two years, and the International Centre for Research in Islamic Economics, King Abdul Aziz University, Jeddah, sent me a modest amount without any explanation which I decided to interpret as a support for this research. I must record my gratitude to both these institutions. My incomparably greater obligation in this direction, however, lies with my wife, without whose sparing me the bother of meeting household expenses for almost an entire decade after my retirement, with the help largely of such intangibles as frugality, faith, and inordinate self-denial, this book may not have been completed. Finally, I must record my obligation to the Institute of Islamic Culture, Club Road, Lahore, who made arrangements for computer typing and proofreading of the entire manuscript which naturally is an enormous help when such a large manuscript is involved.

# 1

## THE SEMANTICS OF THE THEORY OF INTEREST

### The Importance of Delimitation of Interest

While economists may be willing to concede that their institution of interest, generally, and that of its validity, social implications, and public policy projections in particular, leaves much to be desired, they in practice assume the amoral stance of accepting what exists. Haberler states that 'the theory of interest has for a long time been a weak spot in the science of economics' (Haberler 1939: 195), and Vera and Friedrich Lutz remark that 'the theory of interest is at present in a state of great confusion' (Lutz 1951: 237), but little fundamental analysis of this persistent confusion and how it can be overcome is available. Myrdal testifies that 'there is very little intensive research being done on how interest rates and other credit policies actually influence savings, enterprise and investment in various fields' (Myrdal 1973: 28).

One of the major stumbling blocks is the confusion which exists to this day between profit and interest. There has been a consistent blurring of socio-economic objectives dictated by enforced identification between profit and interest, which is only partially reflected in the frequency of misuse of the word 'profit' in the meaning of interest. This loosens our grasp on issues relevant to distributional justice and deprives us of the capability to identify or analyse, much less overcome, exploitative manifestations which, *prima facie*, appear to flow primarily out of one of these two categories. The confusion between interest

and profit, and the misdirection of public policy which this confusion entails, is the fundamental support on which the entire superstructure of various economic disequilibria rests. In any social arrangement in which both nectar and poison are equally available and equally valued to the extent that the word 'nectar' means both what it should and also its opposite, the likelihood of healthy survival of that community cannot exceed 50 per cent.

In such a situation, it is not a matter of surprise that billions of dollars are spent on curtailing agricultural production while millions die of hunger and malnutrition every year, nor that unemployment is so pervasive notwithstanding endless unsatisfied human wants, nor the situation that all our efforts to overcome it only inflict inflation without creating an enduring dent in unemployment.

Until we know what is the difference between profit and interest and insist on keeping their substantially antithetical significance under proper spotlight, we cannot have an answer to the endemic friction between growth and stability, and we do not have it. We cannot have an answer to the problem of unemployment, not the limping ones of which we have any number, but the two-legged one which may ensure its extinction, and we do not have it. We cannot have a real answer to the problem of inflation, and we do not have it. We cannot have an explanation for the coexistence of vast installed capacity of idle machinery and of unsatisfied demands that the working of inactive mills could have met, and we do not have it. We cannot explain the trade cycle, much less overcome it, notwithstanding our success in containing its amplitude, but the areas of uncertainty and unawareness refuse to shrink. We cannot explain or overcome the plight of the Third World, unless we know what interest has done to it. The fact is that no creative macroeconomic policy formulation is possible without our understanding of the role of interest, in contradistinction from that of profit. Without delineating the difference between these two, theoretical appraisal would be as sterile as any enunciation of public policy, regardless of which compartment of economics

we are dealing with at a given point of time. Policies relating to consumption, production and distribution directly, and the ones relating to exchange indirectly, hinge on the understanding of this differentiation and clarity of its comprehension.

### Misuse of the Word 'Profit' for Interest

Any attempt at clarity of thinking must start by ensuring the use of proper words. It is said that when Winston Churchill became Prime Minister of Great Britain during the Second World War, he issued a circular that exigencies of war and the critical state with which the country was faced made it of prime importance that exactitude of expression should be given high priority. In his view, war could not be won without writing correct English, of which he himself took particular care. Whatever be the relationship between writing correct language and winning a war, the evolution of any science, any systematic development of thought, must become stunted by misuse of words, particularly the key ones.

Perhaps no two words in the entire expanse of economics are of a more cardinal importance to the evolution of any variety of socio-economic philosophy than the words 'interest' and 'profit'. No distributional analysis or validity of any particular factor payment can be clearly visualized, much less established or repudiated without clear demarcation between these two categories. This in particular is the case in relation to these two words, because most question marks in the history of economic thought have been raised in relation to interest, and with the evolution of socialist thought the doubts and dissatisfaction with distributional justice have tended to shift the target of denunciation to profit. No one can either accept or repudiate any point of view, or avoid slipping over of the judgement to an area other than the one to which he may like to confine it, so long as demarcation between interest and profit is not clearly visualized and adhered to. It was for this reason that Schumpeter regards confusion between these two terms as a fundamental

error (Conard 1959: 12). The measure in which economic thought has insistently adhered to this error is well worth going into, in particular to underscore the magnitude of analytical effort that would be necessary to differentiate the two terms without which neither any variety of distributional justice, nor any significant macroeconomic planning nor any socio-economic objective can either be clearly conceived, striven for, or achieved. Surprisingly, capitalistic economics is as eager to confuse the two terms as is the socialistic one. Both have something which they are equally eager to hide, though for very different, even opposite reasons. Let us first see how at times, capitalistic economists misuse the word 'profit' for interest, and on occasion even the word 'interest' for profit.

The trouble starts with Adam Smith himself, who rightly distinguishes interest as a separate economic category, but also designates interest as 'profit' and the rate of interest as the 'rate of profit' and the natural rate of interest as the 'natural rate of profit'. Not only does the father of political economy confuse the two terms, but many who came after him also commit the same mistake: Ricardo, Malthus, Senior, Lauderdale, Boehm-Bawerk, Peshine Smith, Strasburger, John Stuart Mill, Alfred Marshall and Irving Fisher, among others. The story of capitalistic economists ends with Samuelson, as competent and dependable an economist as any one. His *Economics* is one of the best that one can have on this subject and is read by millions around the globe. He uses the word 'profit' as many times for what it means as for the entirely different meaning of 'interest'. He closes the discussion by declaring that there is virtually no difference between profit and interest.

Capitalistic economists are not alone in committing this mistake, for the position of socialistic economists is no better. This common confusion in both the systems of economic thought has hurt them equally grievously, persuading capitalistic economists to justify both profit and interest and the socialistic ones to reject them both without any persuasive analytical reason to herd them together.

The moral indignation of Marx against the profit motive is manifest. But with him the word 'profit' always includes profit, interest, and rent. For him, labour alone produces value. Payments made to capital, land, and enterprise, all constitute surplus value, and are denounced as profit. He was fully cognisant of the more reprehensible nature of interest compared with profit. His enunciation of his economic theory does not reflect a difference between interest and profit, and the latter word is invariably employed inclusive of the former. In spite of the enormous advantage Marx enjoyed over capitalistic economics in his awareness of the deprecatory role of interest and the positive role of enterprise, his mixing up of the two made him as incapable of separating the chaff from the grain as capitalistic economics remains to this day.

Every one of these illustrious capitalist and socialist economists knew thoroughly the difference between profit and interest. Extracts can be located in their writings where they indicate a complete grasp of the two concepts; yet, for some subjective reasons, they also exhibit an extraordinary urge to blur the boundary between them and other related words. Whether conscious or unconscious, they have largely succeeded in attaining the inevitable consequence of complete confusion. It is obvious that this gratuitous confusion has raised insuperable obstacles in their way to analyse, locate and remedy the frustrating resistance their economies project against meeting an elementary, yet inalienable aspiration of their peoples.

In any case, scientific terms are the tools of analysis. If they are mishandled, they can only generate confused thinking, which is exactly what has happened. We have imposed confusion on a large area of our analytical thinking by the indiscriminate use of the word 'profit' for 'interest' and vice versa. This confusion has obstructed economics from giving answers to questions of direct relevance to teeming millions round the globe which include the issues of poverty and privation, unemployment and inflation, deficit budgets in spite of perennially rising taxes, social tension among and between nations, squeezing of the

Third World until the cracking of its bones is all but audible, questioning the future of economics as a science.

Just as a journey of a thousand miles begins with the first step, the comprehension of antithetical qualities of profit and interest holds the key to a theoretical revolution in economic thought which by eschewing exploitation through extinction of interest may enable us to win bread for the first time in our history without recourse either to the demeaning dole under capitalism or sacrifice of dignity which socialism demands. Thus we could ensure survival.

### Possible Reasons for this Confused Thinking

In fairness to these great economists who failed to delineate the separate and even antithetical qualities of the two categories, it is to be admitted that they faced an inherent difficulty in the matter. The entrepreneur does not always borrow money on interest to undertake her or his pursuits, but sometimes already has some or all of the capital required. The return on this part of capital, which the entrepreneur does not borrow, is included in the gross profits that are made in the enterprise. Presumably, the gross profit that would be made, if all the capital were borrowed on interest, would be lower than when private capital is used. It is the difference in the gross profits in the two cases that needs to be analysed if we are to demarcate the boundary between profit and interest. The layman calls this difference 'profit', whereas economists call it 'profit of capital' and consider it one of the constituents of gross profit. These terms would have been sound if they did not deflect us from recognizing the essentially dissimilar nature and impact of entrepreneur's capital from loan capital.

Boehm-Bawerk has termed that part of the profit which accrues to the entrepreneur from the use of the entrepreneur's own capital by the name of 'natural interest'. He finds such significant affinity between natural interest and loan interest

that he has repeatedly emphasized that the key to the understanding of interest lies in the recognition of that affinity.

The subject of explanation is interest on capital. Since there is no question that contract interest (loan interest) is founded in essential respects on natural interest, and can be easily dealt within a secondary explanation, if this natural interest first be satisfactorily explained, the subject of explanation may be further limited to natural interest on capital....Where capital is employed in production, experience shows that, in the normal course of things, the return, or share in the return which the capital creates for its owner, has a greater value than the sum of the objects of capital consumed in obtaining it (Boehm-Bawerk 1890: 115-16).

What Boehm-Bawerk, like many others, has overlooked is that there are cardinal differences behind the apparent similarity between these two categories. Whereas personal capital does not impose any particular rate of interest which it makes a condition to its agreement to participate in a productive enterprise, loan capital dictates its price of participation in the shape of a fixed rate of interest. The difference in the terms on which the two varieties of capital participate have consequences of far-reaching implications in the spheres of investment and employment.

Personal capital in this context is a variety of risk capital and, like all risk capital, is content with the residue of value, after all other agents of production have been paid for their respective services. Loan capital regards itself, and by virtue of its superior bargaining power, forces us to acknowledge its superiority over all other agents of production. Its charge, i.e. interest, is the first charge to be met out of the value of the end product. The charge of loan capital is fixed, the reward of risk capital is variable. No loan capital is available on a negative rate of interest, while risk capital can and does quite often content itself to serve productive effort on negative terms. Loan capital for this reason imparts a peculiar rigidity to the entire range of economic considerations. Risk capital, on the other hand, projects a wholesome flexibility to the enterprises

concerned. Loan capital, by virtue of its interest, limits both the range and level of marginal efficiency of productive effort; risk capital imposes no such limit, and leaves it free to exploit all natural resources and employ all available manpower. In loan capital, consideration of interest outweighs all other considerations. In risk capital, it is the other considerations alone which have to be evaluated if risk capital is to reward itself with some return. Risk capital participates in a productive process on, at best, an equal footing, and seeks a reward only in proportion to the measure in which its services have proved productive of value. It may, therefore, be called 'productive capital'.

Loan capital, on the other hand, even while it facilitates the getting together of necessary supplies of productive agents, refuses to relate its reward to the actual accretion of value which has resulted from its facility, even though the price it insists on for the services it renders may bear no relationship whatsoever to the eventual production of value, which may conceivably be negative. In this case it becomes, in the language of Schumpeter, either a tax on profits or a parasite on wages and rent, and quite often both. In one word, it exploits. If it is essential to give it a name which distinguishes its role from that of 'productive capital', that name can only be 'exploitative capital'. Its participation in productive effort is a mere eyewash, with which it has for long sought to hide its real identity.

If we are to understand the nature of interest, the key will be provided not by the identity between natural interest and loan interest, which Boehm-Bawerk was at great pains to demonstrate, but by grasping the antithetical nature of productive and exploitative varieties of capital.

Once it is realized that difference in impact and consequences between loan capital and entrepreneur's capital make them two entirely separate categories, the confusion which we noted among economists, engendered and exemplified by the careless use of terminology, will cease to exist. The reward of loan capital is interest, and the compensation for entrepreneur's capital, along with other forms of risk capital, is return on

investment or dividend. The use of the word 'profit' for interest, in the context of a discussion on the validity of interest, not only hinders the grasp of its essential nature but also projects confusion that stultifies the evaluation of profit, which both from theoretical and public policy points of view is a misfortune of even greater implications.

Nor is this approach, concerned with discovering identity between the two, any more warranted by the consideration that an entrepreneur before engaging in an act of production always considers the relative advantages of lending on interest and investing in production. From the entrepreneur's point of view, the two outlets are identical, just two ways of making money, in which the comparative balance of advantage in anticipated return will determine the selection. This strong argument is swept out of consideration by the circumstance that the entrepreneur does so because of the institution of interest. The validity of interest is something which economics has yet to establish, notwithstanding all the attempts made so far. We can no more construct an argument for the validity of interest from the fact of its existence, or considerations that accrue to an entrepreneur on account of its existence, than we can build an argument, for instance, for the validity of blackmail or adulteration from the fact of their existence.

Surprisingly, an exponent of the theory of interest of the eminence of Irving Fisher can precisely take up this position: 'Some writers...postulate two questions...(1) why any interest rate exists and (2) how the rate of interest is determined. The second question, however, embraces also the first, since to explain how the rate of interest is determined involves the question of whether the rate can or cannot be zero, i.e. whether a positive rate of interest must necessarily exist' (Fisher 1930: 13-14). Transplanting the argument to the sphere of blackmail or adulteration, we can say that if we could answer the question how these things emerge and operate, we will have implicitly answered the question as to why these must exist.

If we confine ourselves in the application of this argument to the economic arena, we have only to know how unemployment

and inflation emerge and persist, to answer the question of why we cannot get rid of them. But even such transparently confused logic can win explicit acceptance from economist Joseph W. Conard, who regards Fisher's argument of such unquestionable validity that he can write, 'Until this simple logic is proved false, I shall continue to accept Fisher's conclusion' (Conard 1959: 14).

This simple logic provides justification to all unjustifiable things, from withering forests to pollution of the environment and from starvation of millions in Africa to secular growth of monopolistic forces. In telling how these things have come to emerge the question why these must stay is answered.

The question as to why Fisher should advance such a palpably poor argument can be answered by posing another question: whoever, in the entire realm of economics, advanced an argument in support of interest which was intellectually superior to the one advanced by Fisher? This is not the place to illustrate so sweeping a statement, but during the course of this book some of the major theories of interest, such as those of abstinence, productivity, demand and supply, time preference and liquidity preference, will be evaluated, as will such positive qualities of interest as deposit mobilization, rationing and price stabilization. It will be found that economics has chosen to live in a world of make believe and myths rather than to face the reality of either logic or empirical evidence.

Another possible reason for the indiscriminate use of the word 'profit' in place of 'interest' may be the conscious or unconscious desire to lighten the burden of reprehension heaped on to interest by centuries of opposition by the church and other enlightened opinion. From the sixteenth century onward the pressure of forces that accompanied the Industrial Revolution compelled financial houses and business and industrial leaders to find some way to circumvent this overwhelming unanimity of moralists and humanists. One way was to confuse the roles of interest and profit, for profit had often been supported as a useful instrument that served the social interest, even though its excessive forms had been criticized. Emphasis on entrepreneur's

capital was the best way in which to create this confusion, because this could be made into a joining link between interest and profit. Once they were so joined and the similarity between loan capital and entrepreneur's capital emphasized, it became virtually impossible to write about interest without using the word 'profit' now or then in place of interest. This helped the purpose of circumvention because the closer interest came to profit, the greater could be the acceptability of this once reprehensible institution.

Such a thing recurs to this day. In Pakistan, for instance, the Finance Ministry and the State Bank each year at the time of flotation of loans have invariably used the word 'profit' for interest. This, of course, is intended to overcome the obstacle of abhorrence which the word 'interest' is bound to create in the way of subscriptions by the common Pakistani Muslim who identifies interest with *riba* and usury.

In Pakistan, a more extensive use of the strategy has operated. Banks advance loans, not on interest but on the basis of mark-up. A fictitious deal is entered into between the borrower and the bank, by which the bank buys some of the borrower's stock, thus lending money to the borrower, and then claims back the advance with interest under the guise of mark-up by selling back again, not in fact but notionally, the same stock to the borrower at a higher price. The level of mark-up is 3 percentage points higher than the interest rate that was charged before the introduction of this pretentious process. Similarly, the depositor, instead of receiving interest, is supposed to share in the profit and loss of the bank, which in practice means sharing a percentage of mark-up, variable according to the period of deposit, exactly like interest-yielding fixed deposits. The longer the period of deposit, the higher the level of profit-sharing. Of course, there is never any loss and it is no wonder *The Economist* called it 'Islamic fudge' (*Economist*, 26 October 1985: 77). The logic behind this pretension is to hide the charging of interest behind the facade of profit. The bank has a right to buy a thing, and also to sell it for profit at a higher price, even to the party or person the bank originally bought it from. Correct, if they

actually did it. But they do not. They only enter into an agreement in writing that so-and-so sells such a thing to this particular bank for this amount and will buy back the same thing from the bank at the end of such-and-such a period during which it will pay mark-up at such-and-such a rate. It is all make believe, all myth, all pretension.

It is unfortunately overlooked that this is a self-defeating method. Suppose someone had a clever idea to start calling a thorny bush by the name of vine to increase the acceptability of the thorny bush. When the bush grows on a wide-enough scale, producing only thorns instead of grapes, people will not start opposing the growth of the thorny bush alone; they will agitate against the growth of vines as well, because they were misled into confusing the thorny bush for vines. This is exactly what happened in economic theory on account of the confusion created, wittingly or unwittingly, by earlier economists through their identification of interest with profit. The reaction was, naturally, equally confused. The critics took the economists at their word and all exploitation theorists, such as Rodbertus and Marx, did not oppose interest only; they opposed both profit and interest and sometimes profit even more than interest.

The necessity of exact conceptualization of profit and interest with substantially opposite consequences both in the economic and social arenas is not confined to capitalistic economics, but extends in an equal measure to socialistic economics. Both have unnecessarily derailed themselves by blinking over the difference between these two categories, with the consequence of projecting entirely different economic arrangements which, nevertheless, are similar in the matter of leaving some of the fundamental socio-economic problems confronting them completely unresolved. If it can be established without any shadow of doubt that exploitative tendencies exhibited by profit motive are reflex actions of interest, we are only left with the need of devising an unexploitative credit structure to enable capitalistic economics to overcome problems such as privation and unemployment, inflation and idle capacity. Identically, socialism becomes entirely capable of providing rule of law, an

open society, fundamental rights and, above all, a framework for efficient utilization of resources. If these two varieties of economics could learn that profit is the baby and interest the bath water, they would know what to retain and what to drain out. Of course, in both cases the ultimate question will be whether an alternative credit structure at a zero rate of interest can be devised, and whether exploitative manifestations of profit motive are endogenous to this motive, or exogenous projections of an interest-oriented credit structure.

### The Problems of Defining Capital

If entrepreneur's capital is an entirely different category from loan capital, and their superficial similarity merely hides the essentially different impact that each has in the socio-economic field, it obviously creates a problem in relation to the defining of capital.

At the end of all the controversies about the definition of capital, it will be overreaching the requirements of our analysis to reopen the issue. It need not create any obstacle in our way if we define capital as that part of wealth which is used to create further wealth. For one thing, this definition is already accepted by economists. For another, our two categories of capital, risk capital and loan capital, notwithstanding all the differences in their basic impact and consequences are, after all, portions of wealth, and are used to create further wealth. Whether the reward comes in the shape of dividend or interest, an accretion of wealth does take place. This definition is neutral to the difference in consequences that the two varieties of capital create in the spheres of investment, employment and social welfare. This difference, however, can be expressed by dividing capital into two essentially different and antithetical categories—risk capital and loan capital.

Risk capital is that variety of capital that relates its reward for its service of participation in the productive process to the measure of value that its participation creates. If production of

value is great, its reward will be proportionately high; if production of value is small, its reward will be identically low; if production of value is negative, its reward will be negative. It does not seek for itself any privileged position and is willing to swim or sink with the other agents of production. In fact, it is even willing to accept an inferior position to that of all active agents of production, is prepared to be satisfied with the residue of value and only if there is a residue after the services of other agents of production have been paid for. This generates among entrepreneurs a willingness to run risks in all kinds of productive enterprises, which the other variety of capital, i.e. loan capital, in view of the limiting nature of the rate of interest may not permit an entrepreneur to undertake. Risk capital, therefore, helps, sustains, and encourages production. Its distinct technical quality in relation to its impact and consequences forces us to distinguish it as 'productive capital'. If any one then questioned us as to why it was paid its reward in the shape of a dividend, we could fairly reply that it helps production and is willing to run risk inherent in any productive venture.

Loan capital, on the other hand, imposes a condition precedent of being rewarded at a certain rate of interest, irrespective of the quantum of value that its participation generates. Whether the value produced is great or small, its reward must remain positive. Its privileged position must be accepted by all the other agents of production. This attitude of loan capital not only subordinates active human beings to inanimate capital but forces them to surrender their share to satisfy the acquisitive instinct of capital, when the production of value is lower than the rate of interest. If the net increase in value is 5 per cent and the loan is taken at 10 per cent, 5 per cent must be paid out of the share of the active agents of production. This generates a timidity in undertaking ventures of marginal anticipations and long drawn out productive processes, which restricts investment, and, therefore, generates unemployment. It is the primary cause, along with such certain secondary causes as cost push of interest and leakage of purchasing power to the renter, which virtually perpetuates underemployment equilibrium. If we introduce

expansionary policies to extend the sphere of employment, inflation sets in, bringing unmeasured suffering to, among others, the humble wage earner. If we do nothing about it, we face the prospect of underemployment of human resources. If the quality of the impact of loan capital is to be expressed in its name, it may be called restrictive, acquisitive or exploitative capital. Since the last construction has already been employed in economics by virtually all socialistic economists for this aspect of capital, we might designate it by the name 'exploitative capital'.

This makes it somewhat easier to define and evaluate the role of capital, over which serious battles have raged between capitalistic and socialistic economics, for a long time. There are those who have regarded capital as productive, and have built up scores of productivity theories, each of which naturally has an element of truth, but none of which lays its hand on the entire reality of capital. Similarly, several of the keenest minds have emphasized the exploitative role of capital, calling it sheer robbery. Each of these has an element of truth in it, but the entirety of truth has slipped away when the other side of the picture has not been viewed.

Capital, therefore, is both exploitative and productive. It is exploitative when it bears a rate of interest as a condition precedent to its employment. It is productive when it imposes no such condition, and is willing to be rewarded either positively or negatively, as the quantum of the creation of value by its participation may warrant.

Capital distinctively can play this double role because, in contrast with all other agents of production, it exhibits a trait which Aristotle called sterility, a point that has seldom been given the weight it deserves even by those who have opposed the institution of interest. Whatever productivity we experience in capital utilization is the result of a social action, a joining together of certain other factors, primarily land and labour, with capital, which confers productivity on it. In the case of other factors, productivity is inherent, though social action enhances

it; in the case of capital it is absolutely non-existent until social action bestows productivity on it.

It is possible to conceive situations where every factor, other than capital, can exhibit productivity without the participation of any other factor. An entrepreneur may conceivably buy on credit a commodity in a cheap market and sell it simultaneously on cash in a dearer one, and this creates value without necessarily using any capital. Similarly, labour can be productive without the help of any other agent of production, e.g. household help. Identically, land is inherently productive, such as with natural forests. Adam Smith, even while withholding the quality of creativity from nature, admits that a notable portion, perhaps as much as one-third of the revenue of land, is due to the collaboration of nature (Gide and Rist 1953: 157). This means some measure of creativity inheres in every factor of production in contrast with capital.

If the productivity of capital is a social function, the reward of capital should be socially responsive. It can be socially responsive if the return it claims for its utilization is subservient to the claims of other agents of production in whom productivity inheres in a manner which is non-existent in the case of capital. Only risk capital is prepared to play this subservient role, claiming only a portion of productivity which is generated by social action. It is also willing to bear the bulk of suffering if negative results emerge. There is, therefore, a symmetry between its contribution and its claim, which excludes any occasion for social exploitation.

Loan capital, on the other hand, insists on a superior position by predetermining its return and by declining to respond to any shortfall in productivity for whatsoever reason it might emerge. This asymmetry between its contribution and its claim renders it socially unresponsive, exploitative of other agents of production, and for all practical purposes, a parasite of the entire economy. However antithetical these two forms of capital may be, it is in the interest of science to recognize the diversity of these two roles. Only then are we enabled to profit by the magnificent enunciations of the two opposing theories of truth,

but each misses an essential element which is provided by the other.

### **A Fundamental Reason for Complexity of the Issue**

There are streaks of complexity in the issue, buttressed by centuries of mixing which raise question marks and decline to suspend disbelief that capital can have a wholesome and a malicious variety working simultaneously. One can object that loan of capital cannot be completely shorn of the quality of productivity merely because it insists on ensuring its return before agreeing to participate in any enterprise. Perhaps some productivity may survive its exploitative impulse. Similarly, it may be argued that although risk capital does not insist on a predetermined return, it is no less acquisitive than loan capital, and when returns fall, it does not hesitate to leave for new pastures, deserting less rewarding enterprises. The stock exchange is as permissive of entry as of exit. Therefore, some streak of exploitation has to be conceded even in this productive variety of capital.

Economics is a science of generalizations, concerning itself with broad patterns, reactions and consequences of various economic phenomena. Productivity of loan capital, whatever it may be, and there is a lot to be said against it, is so heavily overlaid by its exploitative ramifications that it will have to be categorized by its dominant trait as exploitative capital. In brief, loan capital, through the predetermined return it insists on, fosters and perpetuates underemployment equilibrium, which remains incurable, notwithstanding all the pampering extended to capital interests in the shape of the most expansionary policies pursued since the end of World War II. These have only bloated the magnitude of loan capital, of the level of interest, of unemployment and of inflation. But supposing there is a streak of productivity hidden under all this exploitative magnitude, how does this entitle the owner of loan capital to demand a price for its use? As Bronfenbrenner has put it, 'The productivity

of capital...is not the productivity of the capitalist' (Kurihara 1955: 45). Joseph W. Conard, in spite of being substantially a conformist in the matter of interest, concedes: 'the ethical objection to "unearned income" is not weakened by the fact that the loan is a productive one, and so this part of the historic objection to interest is not removed' (Conard 1959: 97). Unless the emergence and availability of loan capital is proved to be a function of some variety of sacrifice or labour of the capitalist, productivity of his capital does not make him eligible for the predetermined return that is claimed on his behalf. Emergence of capital is a function of saving, which is dictated by considerations entirely unrelated to the level of interest. The concepts of abstinence, of waiting, advanced in this respect are fictitious mythologies. Except negative time preference there is no logically sustainable basis for the emergence of savings. People save because they regard their future needs of higher value than their present ones. This is a situation in which the observation of Joan Robinson holds, 'Of course, in reality the "reward" of owning wealth is owning wealth, whether or not it yields income; the "reward" of saving is an addition to wealth'. These are some of the circumstances which should hold us back from confusing 'the productivity of investment and the productivity of capital' (Robinson 1971: 29, fn. 5, and 33).

Uninvested savings take the shape of bank deposits which enable financial intermediaries to advance loans. There are good reasons and compelling empirical evidence to support the view that no reduction of savings is possible even if the depositors received no interest. Supposing this be the correct view in the matter, we are only left with the problem of advancing loans on zero rate of interest which does not appear to leave room for banks to meet their worthwhile profession. It will call for a fair measure of deep probing to decide whether a viable interest-free banking structure can or cannot be devised. Economics has hitherto avoided doing this exercise. We too cannot undertake it until the relevant theoretical issues become clearer than they happen to be at present. Let us assume that the result of that exercise is negative, and we conclude that banking is not

workable without using interest as its basis. In that case interest will exist but not for the reason that interest generates saving or that capital is productive, but for the reason that we are not able to evolve a non-exploitative substitute for interest.

We have not only to use correct technical terms, but also to persuade ourselves to give correct reasons. If we believe that it is necessary to pretend the existence of visionary things, we must develop the rectitude and courage of Samuelson, who can pretend and concede that he is pretending. In spite of affirming that love of money as a possession is a semicriminal and semipathological propensity, he has the courage to declare 'we must pretend to ourselves and to everyone that fair is foul and foul is fair...Avarice and usury...must be our gods for a little longer still' (Samuelson 1976: 817).

This, in brief, is the answer to the objection raised regarding denying productivity to interest-oriented capital. The second half of the objection relates to the possibility of exploitation existing at least partially in risk capital as well. This portion of the objection has more substance in it. Risk capital can at any times sell out shares and buy bonds. A measure of magnitude of impact of interest on risk capital may be gauged by the influence that interest has on the price of shares. If the interest rate falls, the value of shares rises *pari passu*, and if interest rises, the value correspondingly falls. Actually, the exploitative manifestation of risk capital is a reflex action of loan capital and the institution of interest. If there is no interest, no exploitative manifestation will remain possible with risk capital. The dictum of success at the stock exchange—in a recovering market sell bonds and buy shares, and at the start of a recession sell shares and buy bonds—indeed operates. But it does so because both shares and bonds are available. If we raise our vision to a situation, however imaginary it may be at the moment, in which no interest exists, there will by definition be no bonds, with the result that the spillover manifestation of exploitation from bonds to shares and from shares to bonds will cease to operate. The consequence will be that the saver will be left with only two options: either invest in some creative business, including shares, however low

the return, or deposit in a non-interest yielding current account, until a suitable profit-yielding opportunity emerges.

Even if we confine ourselves to the situation as it exists at the moment, the economist cannot abrogate the responsibility of identifying loan capital as primarily exploitative and risk capital as primarily productive. The macroeconomic twists and complexities engendered by interest, such as unemployment and inflation, are adequate compulsions to reach the former conclusion, and the spillover nature of exploitation, whenever visible in risk capital, the latter one. In the case of loan capital, exploitation is endogenous, coextensive with its own being; in the case of risk capital, exploitation is exogenous, transmitted to it from outside its own being.

When capital shifts from shares to bonds, it is because a higher rate of interest is available in bonds, compared to the return available in shares. If no interest were available, there will be no bonds and no shift from shares to bonds. It is true that the argument can be reversed: when there is shift from bonds to shares, it is also because the level of anticipated dividends is higher than the interest available in bonds. Apart from the point that the benchmark of comparison ceases to exist with the extinction of interest, we have to go further into the causes which tend to upraise the profits of enterprise beyond the legitimate costs of the labour of enterprise. Has interest an upraising impact on the level of profits? Does our credit structure hamstring competition, and create a situation in which monopoly profits become possible? It is on the answers to these questions that the demarcation between exploitative and productive capital comes to depend for its legitimacy.

If the theoretician does not accept these classifications and treats all capital the same, the revolutionary who represents the legitimate dissatisfaction and disillusionment of the multitude has neither the time nor the inclination to analyse their difference. This is what has already happened in the case of Marxist analysis of complete integration of profit and interest as falling in a single exploitative category.

## The Impact of Interest on the Profit Level

Another source of confusion between interest and profit is that both capitalistic and socialistic versions of economics treat profit as a benchmark, and derive their acceptance or denunciation of interest from their appraisal of profit, as it exists. Both overlook that by a sizeable margin the level of profits is a function of the level of interest. If exploitation manifests itself in profit level, we have to evaluate how much of it is inherent in the entity of profits and how much of it is transmitted to it by the institution of interest. The evaluation of interest has to precede the evaluation of profit, which is possible only if we outgrow the notion that it is profit which determines interest, and reach the reality of interest being a significant determinant of the level of profit.

So far as I am aware, it has never been questioned that interest has a hardening effect on the profit level. Every loan on interest increases hazards of enterprise. If we were to expect enterprise to upraise its profit, besides recovery of interest, by only one-half of the cost of capital, it will obviously involve excess in profits of 1.5 times the level of interest rate. If profit confines itself to the recovery of interest only, it means it is charging nothing for the increase of hazards which loan capital has imposed on it. This would be as unrealistic as it would be unlikely to happen, except when slump forces down the reward of enterprise itself.

The lowest estimate of this relationship has been given by Adam Smith, in whose time double interest was considered a fair rate of profit (Cassel 1903: 24). This obviously means that as a working hypothesis, profits may be regarded unexceptionable when their level is twice that of interest on capital employed in any venture. It appears to be a fair benchmark. According to Hawtrey, at 4 per cent interest an industrialist, keeping in view maintenance and depreciation, will seek a probable yield of 10 to 20 per cent (Hawtrey 1937: 217). According to Bronfenbrenner, 'when the pure or economic rate of interest approximated 5 to 6 per cent, a profit rate of 15 to 20

per cent may have been required to entice risk investment with all the resulting inequality in the personal income distribution. But when the pure interest rate falls to 2 or 3 per cent under the influence of banking, monetary and fiscal measures, it is possible for collective bargaining or direct controls to cut the gross profit rate to 5 or 10 per cent' (Kurihara 1955: 56). So, according to Hawtrey, profit is likely to pitch its level somewhere between 2.5 and 5 multiples of the level of interest, and Bronfenbrenner regards the likely level to fluctuate between 2.5 and slightly above 3 multiples. Bronfenbrenner has expressly called this gross profit and Hawtrey presumably means the same thing, so that actual profit in the estimation of the former may be deemed to be one step higher than what was regarded fair by Adam Smith, and in the estimation of Hawtrey somewhat above even that. Talking about the relationship of profit with interest and subscribing to the reflex impact of interest on the profit level, Kurihara reaches the conclusion that 'if the rate of interest is zero, the volume of investment will be pushed to the point where the marginal efficiency becomes zero, with the result that the owner of capital can no longer earn pure interest any more than a competitive firm can earn pure profit in the long run' (Kurihara 1955: 270).

When we look at empirical evidence, we find that the condition of the market has an enormously large bearing on the level of profits. When the times are good, gross profit can pitch itself as high as thirty multiples of the rate of interest; when these are not as salutary as the entrepreneur would wish, he can be satisfied with a level as low as two multiples. This wide variation involves examining the issue of monopoly profits, and the hamstrung nature of competition. But confining ourselves, for the present, to the tendency of interest to upraise the profit level, we may look up at five-year intervals the level of gross profits in the United States as multiples of net interest.

**Table 1.1**  
Gross profits as multiples of net interest in the USA 1945-79

	1945	1950	1955	1960	1965	1970	1974	1979	Total & weighted average
1	19,035	33,661	44,599	46,580	77,096	76,891	91,279	196,838	
2	31,663	38,355	42,479	46,978	56,674	56,140	58,113	131,575	
3	50,698	72,016	87,078	93,558	133,770	124,031	176,392	328,413	1,065,956
4	2,208	2,272	4,765	9,760	18,529	37,549	70,728	143,399	289,210
5	22.96	31.69	18.27	9.58	7.21	3.30	2.49	2.29	3.68

Source: *National income and product accounts of U.S. 1929-74, 1976-79.*

As is clear from Table 1.1, there is a wide variation in gross profits from year to year. There is at first the immediate post-World War II high level of profits followed subsequently with increasing saturation of the market by continuous pulling down of the relative profit level. The lowest relative level of profits is in 1979 at 2.29 multiples, and the highest in 1950 at 31.69 multiples of net interest. So there is no single level which may be regarded as immune from market conditions. In a sellers market enterprise tries to earn many times more than it can in a buyers market, and the difference can be as high as 14 to 1. Yet if we take the view that enterprise strives to attain a long-range level of profits, taking good years with bad, then in the thirty-five year period from 1945 to 1979, on the basis of five-year intervals, profits work out to a weighted average of 3.68 multiples of interest. If we go back some fifteen years, the multiples are likely to rise fractionally, and if we include ten subsequent years the multiples will fall fractionally, so that no significant change in the level of profits as multiples of interest may be expected even if we extended the period of enquiry to sixty years. The actuality appears to be somewhere between the not too varying estimates furnished by Hawtrey and Bronfenbrenner. Even though both from the intertemporal and interfirm points of view there may be wide variations, enterprise on the whole has been able to secure for itself 3.68 multiples of the rate of interest as its reward.

If Adam Smith's estimate of two multiples of the rate of interest as being fair profit be adopted, it is obvious that the balance of 1.68 multiples falls in the category of pure profit, i.e. profit above and beyond legitimate remuneration of enterprise. We do not know how much of it is due to interest, the reward appropriated by enterprise for running additional hazards in raising interest-bearing loans, and how much of it is due to imperfect competition, whether manoeuvred by the planning system or some inherent obstacle raised in the way of perfect competition by the inbuilt restrictive compulsions of our credit structure.

It is obvious that profits have a measure of exploitative component which in the case of the US economy over the period examined appears to have stood at an average of 1.68 multiples of the burden of interest, hitherto presented as the main, if not the sole, constituent of exploitation. Besides being a major instrument of exploitation, it is the main projector and transferer of this impulse in areas which are not endogenously exploitative like profit and rent. We have to examine how much of this slightly less than half the total profits can be directly attributed to interest, and how much of it is due to imperfect competition.

It is obvious that the entire exploitative component of profit, estimated at 1.68 multiples of interest cannot be directly attributed to the payment for enhancement of risk of enterprise on account of interest-bearing loans. We also do not have any measuring apparatus by which we may break up this exploitative component into its two main constituents—payment for hazards projected by interest and exploitation made possible by restricted competition. One of the reasons for the unworkability of any apparatus that may be attempted for this purpose is that there can be such wide variations between various firms and, even in the case of the same firm at different times, that no apparatus will remain workable at all times and places. There can be firms who have no exploitative component at all, in fact firms whose profit falls below two multiples of interest which we have deemed, somewhat arbitrarily, as fair reward of enterprise. There can be other firms whose exploitative component may far exceed

the 1.68 multiples of interest we have attributed to enterprise. Also, the same firm may fall in one category at one time and the opposite category at another time.

Even taking up two firms which reflect the average exploitative content, their break-up of the two impulses may not reflect a similarity. In one case the main or even exclusive contribution to profits may have been made by lack of competition, and in the other the main or even exclusive upraising of profits may be dictated by the exceptionally hazardous nature of the enterprise and extraordinarily unfavourable terms on which it could raise capital. We therefore have no option except that of an arbitrary allocation, which can be corrected by those who go further into the subject. In addition, the issue at this stage is not of exactitude of measurement, but exactitude of conceptual direction, of semantic probity.

From this point of view, and subject to the limitations already indicated, 1.68 multiples of interest that emerge as the exploitative component of profit may be divided into two parts, on a conjectural basis, as composed of 1 multiple of interest on account of imperfection of the market and 0.68 multiple as the cost of increase in the hazard of enterprise on account of the burden of interest. It may be that the real division of the two may be somewhat different or even the reverse of what we have indicated. But whatever the correct distribution between the two main reasons for the emergence of the exploitative component in profit may be, it will make no difference to the argument that is being developed.

So far as upraising of profit level on account of interest rate is concerned, it will naturally cease to exist if we can devise a credit structure which does not impose a burden of interest on loans required for productive purposes. The semantic disentanglement of profit and interest which we are attempting can afford to defer for some time the issue of whether such a credit structure can or cannot be devised. Supposing it can be, then that portion of the exploitative component of profit which is foisted on it by the interest rate will cease to exist. This means that profit level on average will tend to fall by 68 per

cent of the rate of interest that existed before the emergence of an interest-free credit structure.

This lowering of profit is contingent on situations where pure profit is emerging at the moment. In the case of firms that are merely fighting their way and where profits are lower than the legitimate reward of enterprise, the result can be the opposite of this, i.e. the profit level can rise.

In a sample survey, spread over 120 firms, the State Bank of Pakistan brings out the extraordinary conclusion that the profit level of these firms, instead of being a multiple of interest rate is only a fraction of it.

**Table 1.2**  
Interest and profit of sixteen groups of industries in Pakistan

	1972	1977	1983
Paid up capital	2,037.81	2,918.88	4,856.06
Reserves	1,123.70	1,926.63	4,353.41
Borrowing	3,248.18	4,691.21	10,615.52
Fixed assets	5,659.20	8,292.61	17,917.04
Sales	5,763.19	15,963.91	32,002.51
Interest payment	309.54	676.82	1,636.67
Profit before taxation	216.23	704.09	1,606.54
Taxation	159.40	391.07	443.56
Profit after taxation	56.83	313.02	1,182.88
Net profit as percentage of capital plus reserves	1.79	6.64	12.84
Net profit as percentage of interest paid	18.35	46.24	72.27

Source: Sample survey conducted by the State Bank of Pakistan.

As shown in Table 1.2, profits were 18.35 per cent of interest in 1972, 46.24 per cent in 1977 and 72.27 per cent in 1983. It is true that this is profit after tax and not profit before tax as in the case of the USA. Still, it indicates that the market has not permitted these enterprises to shift the burden of interest to the consumer by upraising the price level and the profit level. Just as the market sometimes, instead of rewarding enterprise with profit, prefers to inflict loss on it, the inadequate return of enterprise as shown in this sample survey indicates that even if interest were abolished, any slashing of profits may not occur in

the case of firms covered by this sample survey because of the meagre level at which these appear to stand at the moment. On the other hand it is possible that with the abolition of interest some increase of profits may occur in their case to bring reward of these enterprises to a more adequate level.

Among the dynamic consequences of abolition of interest, it is possible that with the availability of loans at zero rate of interest these industries earning low profit may like to deepen their productive operations and rationalize their productive facilities with significant increase in profitability. It is possible that this sample survey includes some sick mills which are barely breaking even or even running at a loss in the hope of some propitious development in the market. If it is so, abolition of interest is likely to put them on the path of recovery and profitability, in the measure in which concerned entrepreneurs take advantage of new possibilities.

This, however, is an exceptional case, and the general run of enterprises everywhere will be forced to shed some part of their inflated profits, partly because of extinction of risk related to the interest bearing loans. Even in Pakistan there is another set of enterprises whose sample survey undertaken by the present writer presents a different picture. It so happens that they are all foreign multinational firms.

**Table 1.3**  
Level of profit as multiples of interest as shown by sample survey of foreign firms in Pakistan for the year 1984

	<i>in millions of rupees</i>
Equity	1,330.02
Reserves	1,275.02
Shareholders' funds	2,605.04
Net profit	854.09
Interest payments	251.08
Profit as percentage of equity and reserves	32.81
Profit as multiples of interest	3.39

Source: Annual reports of sixteen foreign firms selected at random.

The profitability of these firms being net of taxes, is substantially higher than even that of firms in the USA. In their case also the consequence of abolition of interest will be reduction in the level of profits. But some part of inflated profits may survive the abolition of interest, as these firms represent the oligopolic variety of firms, until activation of competition catches up with them.

To sum up there are good reasons to believe that abolition of interest besides extinguishing exploitation at the capital level, will pare down exploitation at the profit level by nearly one-half or may be a little less of its total magnitude. We are now confronted with the problem of the balance of exploitation in the profit level and whether some institutional remedy can be conceived, at the theoretical level, to obliterate this residue of exploitation.

### **The Relationship of Credit Structure and Imperfect Competition**

The system of free enterprise projected by classical economics leaned on competition to ensure equilibrium. It was the theoretical lever which working through price determination activated self-correcting mechanism in the economy. There could neither be overproduction, nor over-saving, nor underinvestment, nor unemployment. Growth and stability kept pace with each other, Say's Law was operative, ensuring balance between spending and saving on the one hand and supplies and investment on the other. Firms competed to buy capital goods, raw materials, employ labour, and sell their products at prices which no one controlled. Most economists have noted that this classical model is not working in the real world. But they do not often go beyond the demonstrable reality of various disequilibria, and rarely enlighten on the basic fault in the logic of this classical model. Actually there is no theoretical blemish in the entire scheme of things, until it introduces interest, as an equilibrating mechanism between saving and investment. As

this part of the argument runs exactly parallel to the interaction of demand and supply in the determination of prices in the commodity market, few noticed the inelastic nature of the supply of saving, or the alternative to investment in the purchase of debts, provided by interest, ensuring perpetual disequilibrium between saving and investment.

The Keynesian inverse relationship between interest and saving was, of course, to come some time after. Even if this valuable contribution by Keynes had been accepted, it would not have compensated for the cardinal error in the theoretical formulation. In such a confused climate, it is no surprise that even fewer noticed the role of bank reserve, as a monetary scarcity instrument, which must result in the outflow of advances suffering deduction compared with the inflow of deposits. This amounts to inserting a structural slant in organized credit to ensure that financial accommodation is made incapable of striking any equilibrium with financial needs. We are not at this time concerned with evaluating the validity of the positive role assigned to bank reserve, nor whether any alternative is conceivable which may enable us to extinguish this built-in device of credit scarcity in the banking system. The only point that is being made is that the competitive model became inoperative because of the disequilibrating and exploitative ramification of interest, reinforced by the slant of credit resources toward shortfall compared with productive requirements, notwithstanding the fact that in the context of competitive free enterprise model, massive additional credit resources were necessary to avoid any drift towards oligopoly. The shortfall of resources, apart from the price demanded for their use, restricted competition and ensured the emergence of oligopoly in due course.

In the competitive model itself, but for the cardinal error of regarding interest as an equilibrating device between saving and investment and the grievous oversight regarding the constrictive implication of bank reserve, there was no place for exploitative profits. If enterprise sought gains beyond the legitimate rewards of management and risk taking, new competitors will emerge

and bring down profit to the level of productive contribution made by enterprise. It was noticed that this competitive effort would call for additional capital, but it was assumed that the requisite capital would emerge from the lure of an increased interest rate to which money market will respond with an increased supply of savings.

Only one exception was permitted in this unobstructed enforcement of profit level to stay on the rails, and that was the case of monopoly. But absolute monopoly of a single firm in which this exception visualized was in the words of Galbraith, 'so rare as to have the standing only of a curiosity. Apart from the public utilities there was, before the Second World War, only one example that could easily be brought to mind, namely the Aluminium Company of America' (Galbraith 1956: 53).

This exception being insignificant in relation with the broad sweep of the economy we are left with the competitive model. That the model does not work was noted rather belatedly in the early thirties under the shadow of the great crisis. In 1932-33, Professor E.H. Chamberlin and Mrs Joan Robinson repudiated the notions of both competition and monopoly, leading to a widespread recognition that the markets were neither purely competitive nor fully monopolized, but bore the characteristics of both competition and monopoly. These were imperfectly competitive.

This view received significant development in the lucid and persuasive analysis of Galbraith who finds the market in a large part controlled by what he calls the planning system, where competition is inoperative, as contrasted with the market system where it is. In his view in quite a few markets a handful of corporations control a significant part of the market and substantially exclude competition which enables them to obstruct the operation of the competitive model and which can now be straightened by introducing diverse controls including those of wages and prices. He regards this quasi-socialistic road as unavoidable (Galbraith 1973: 277).

Part of the reason for leaning in the direction of controls and avoiding competition is the notion that under competition 'all

economic life is a mortal struggle' (Galbraith 1968: 60), that there was 'no place for individuals who...had only a low or negligible marginal productivity' (ibid.: 43), and that though it drove men to render their best and most efficient service, it generated a sense of insecurity which could be cherished almost exclusively 'either in the second person or in the abstract' (ibid.: 89). All this is very true in the context of a society which is rendered inherently exploitative by the depredation of interest. But as Keynes visualized with disappearance of the rentier aspect 'much else...will suffer a sea-change' (Keynes 1951: 376). In an interest-oriented environment competition can lead to unmerited gains at one extreme, and inhuman privations on the other. But if interest is abolished, capital availability will provide a ceiling as well as a floor to the consequences of competition. At the upper level profits will be pared down by capital backed competitors and at the lower level extinction of unemployment will not let even persons with modest capabilities to stand in some kind of a bread-line.

In conformity with the general slant of economics to overlook the deprecatory impact of the institution of interest, all kinds of secondary explanations for market distortions are available. The growth of oligopoly, the trend of profit concentration, along with an identical hardening of the labour market are cases in which except for ever widening range of controls, euphemistically called income-policy, no remedy suggests itself to current thinking in economics.

Few have thought fit to go into the trend towards quasi-monopolistic growth of enterprise and labour as a function of the monopoly price charged by capital, although the dominant role played by this factor could not possibly fail to kindle what Galbraith has called in a different context, countervailing power in enterprise and labour. If capital enables itself to charge a monopoly price by generating artificial scarcity through bank reserve, other factors feel forced to make efforts to ensure their share of national income. It is this effort that has forced enterprise to achieve comparable strength through attaining, to the limit of possibility, the oligopolistic status, just as the

inherent monopolistic exploitation of capital, and the acquired oligopolistic exploitation of enterprise force labour to attain comparable strength through intensification of trade union organization, in its struggle for the sunshine.

So the oligopolistic growth of enterprise is not something inherent in the profit motive. As Galbraith notes the basic compulsion for it is the sense of insecurity. He affirms that enterprise in making this approach is 'seeking protection from the vicissitudes of the competitive economy' (Galbraith 1968: 91). He does not make allowance for the fact that whatever hazards competitive economy projects are for the unprogressive and the incompetent entrepreneur, and the firms belonging to the oligopolistic sector are both competent and progressive. Their risks relate primarily to the capital market in the measure of their magnitude, call for identical capital resources. That is the precondition both of investment and growth. The oligopolistic sector strives to meet this problem by internal generation of resources. Baran and Sweezy assert that every corporation 'aims at and normally achieves financial independence through the internal generation of funds' and thus outgrows 'subjection to financial control' (Baran and Sweezy 1966: 29). Although there appears to be a measure of overstatement in this appraisal, yet the striving of the corporations and their significant success is without doubt in this direction.

Now internal generation of resources is a function of pure profit, i.e. profit above and beyond the legitimate reward of enterprise. We noticed in the previous section that over the long haul, profits in the USA have averaged 3.68 multiples of interest. Leaning on the observation of Adam Smith that two multiples of interest are regarded adequate recompense of enterprise, we found 1.68 multiples of interest constitute the exploitative component of profit. Upraising of profits by 0.68 multiples of interest was ascribed to the enhancement of risk which borrowing on interest projected for enterprise. The balance of one multiple of interest which is the surviving exploitative component of profit should be ascribed to the necessity of

enhanced profits to enable firms to generate internal resources. This course can be as much dictated by the need to cover the shortfall of credit resources likely to be available, compared with their anticipated requirements, as to bolster the general sense of security against sharp downturns whose memory is by and large substantially alive. There is not much that the management can do to minimize risks which at times engulf the whole economy, and which, as we shall see later are themselves projections of our exploitative credit structure, and therefore undertakes something which is within its means and that of course is the maximization of profits.

Competition could have effectively obstructed this additional profit, but competition also calls for capital resources and bank reserve has imposed such a restriction in the path of their availability that competition stops short of performing the duty which the free enterprise model expected of it. Therefore the additional one multiple of interest which enterprise as a whole can generate above its legitimate return, has to be ascribed to limitations imposed by bank reserve on the resources necessary for activating competition. This means that the entire 1.68 multiples of interest which appear to be the measure of exploitative component of profit over the long haul, is not inherent in the nature of profit, but is transmitted to it by the credit structure. No variety of controls, no application of income policy will prove of anymore than marginal help, unless an alternative basis of credit other than interest, and an alternative liquidity and monetary management mechanism other than bank reserve are devised.

The conclusion we have reached regarding the compulsion of extinction of exploitative component of profit through the extinction of interest and of statutory reserve is not vitiated by the absence of inductive proof for most of the components of our argument. We have assumed that wages of enterprise should be regarded fair at 2 multiples of interest. Apart from the wide variations between firms at different times and places which has already been noted, it is possible that a competitive market may eventually regard only 1.5 multiples of interest as adequate

compensation for entrepreneurial labour, or maybe the evaluation of the market may tilt on the opposite side and may regard 2.5 multiples of interest as essential reward of management. Similar inexactitude is possible in the magnitude of reduction in the level of profit on account of removal of the exaction of interest, and unrestrictive provision of credit for investment purposes demolishing obstacles in the path of competition. Actually interest itself which has been used as a measuring rod ceases to exist, in the new scheme of things. Therefore magnitudes indicated are merely illustrative, but the conclusion these lead to is not invalidated for this reason. Let competition be restored by the abolition of bank reserve and let the burden of monopoly price of capital be lifted from the shoulders of enterprise, and no theoretical reason will be left as to why the classical, competitive, free enterprise model should not start working, with a potent self-correcting mechanism, capable of curing the various disequilibria that we witness around us.

It will take us a long time to come to grips with the issue whether a non-exploitative alternative to interest and non-restrictive alternative to bank reserve can or cannot be devised. In the context of semantics we are only concerned with indicating the nature of difference between profit and interest so far as the exploitative manifestation of either is concerned. In the case of interest, exploitation is endogenous, inherent, and unalloyed; in the case of profit it is exogenous, transmitted and superimposed on legitimate reward of a highly valuable variety of labour, consisting of managerial chores and given the name of enterprise. So long as exploitation survives in the credit system, transmission of exploitative impulse to the profit level has got to continue. The cure does not lie in devising any variety of controls, but in evolving a system of banking which may be able to answer in a creative, unrestrictive manner to needs of the economy. That is why confusion between profit and interest has got to be laid aside. If we could exclude the transmitted element of exploitation from profit, it emerges as the sole unadulterated guarantee of efficiency that human mind has been

able to devise so far. This is the baby, interest is the bath water. If some specks and stains cover the body of the baby it does not mean that the baby is at fault. Change the bath water and the specks and stains will disappear. But nothing will be achieved by throwing the baby out with the bath water as socialistic thinking visualizes, nor by retaining the dirty water along with the baby which capitalistic economics prescribes.

The common fault of both systems of economic thought is not merely that they err in their analytical clarity, but also in their common approach in justifying or denouncing interest by reference to their evaluation of profit. This is an error of a deeper dimension than their analytical confusion because this opens up the path to that confusion. Starting with profit and evaluating interest on that analogy is putting the cart before the horse. We should start with interest, measure the magnitude of its exploitative content, evaluate the transmission of this exploitative ramification to categories outside the credit structure like profit and rent, appraise whether this transmission can be adequately countered by any steps short of complete humanization of the credit structure, assess the loss of efficiency in quasi-socialistic and socialistic alternatives, compute what would eventually be to the advantage of man, and decide whether interest of man or interest on money should be accorded precedence.

We cannot even make a start with looking into any of these issues if we do not abjure our confused use of profit in place of interest and vice versa, the common fault of both capitalistic and socialistic versions of economics. Nor can we reach any creative conclusion unless we begin with interest in contrast with the approach hitherto practised of starting with profit. The secret of opening a tangled skein lies in locating the start of the thread. We must concern ourselves with the correct fixing of the kingpin, and the rest will themselves fall into place. We must ask ourselves as to what is the compelling consideration for the continuation of interest, in view of its unadulterated exploitation. We shall examine various theories and considerations advanced in this behalf subsequently, but it may

perhaps be not out of place if we evaluate right away a practical and a moral consideration advanced in support of interest. The practical consideration being that of scarcity of capital and the moral consideration being opportunity cost of capital.

### **The Issue of Scarcity of Capital as a Justification for Interest**

The issue of scarcity of capital cannot be segregated from the notional requirement of disentangling profit from interest which both capitalistic and socialistic versions of economics appear determined on mixing up, apparently from their opposite ulterior interests in either case. If capital is really scarce, the capitalistic thesis becomes, *ab-initio* at least, unanswerable. After all, scarce commodities have got to have a price. If capital is scarce, whatever be the social consequences of the price of capital, and whatever be the methods necessary to counteract those social consequences, the claim of capital for a price for its use, even if it is a predetermined price, cannot theoretically be called into question. While maintaining this posture capitalistic economics does not appear to indicate any awareness that, in the event of incurable scarcity of capital, the only answer to the misery of man, from the long range point of view, may perhaps lie in the acceptance of some revised version of socialism.

The question of scarcity is particularly relevant to the issue of counteracting oligopolistic tendency through activation of competition which was the thrust of the last section. If capital is intrinsically scarce, no method can be devised to cleanse profit of its exploitative component, because activation of competition is a function of easy and adequate availability of capital. If capital is scarce exploitative ramification of interest will pervade the scene, force upraising of profit level and deepen the oligopolistic tendency to march ahead unobstructed by the theoretical possibility visualized in the last section of activating competition. Fortunately things are not as bad as these are painted. The so-called scarcity of capital is not inherent in the

nature of capital, it is merely a direct function of bank reserve. Higher the bank reserve, greater the scarcity of capital, lower the bank reserve, lower the scarcity of capital, and if bank reserve could be reduced to zero, scarcity of capital will likewise be reduced to zero.

Credit availability, and for a while we shall concentrate on loan capital, is primarily a matter of decision by the credit institutions of any country. These credit institutions find themselves enabled to advance loans, on the strength in the main, of the deposits they receive from the community. A remarkable thing regarding these loans is that whatever the purpose for which a loan is sought and whatever the manner in which it is spent, the entire money tends to flow back to the banking system in accordance, by and large, with the pace of velocity of money. The borrower has yet to pay back his loan, but the banking system has already received back the amount. This makes deposits as much a function of advances as advances are a function of deposits. If no obstruction were placed either on the flow of deposits or the flow of advances and the pace of flow is kept even in either case, credit resources become infinite. This infinity is naturally not a function of magnitude of deposits, because these have to be finite under all circumstances, but is a function of the infinity of their flow. If flow is not obstructed at either end, no reduction can occur in the availability of either advances or deposits. But if the banks start deducting some percentage from their deposits, under the direction of monetary authorities, as is done in every country, under the nomenclature of bank reserve, the credit resources are bound eventually to reduce themselves to virtual non-existence. This situation used to emerge more often in the past and a distinctive trait of a crisis was the unavailability of credit on any terms. Our expansionary monetary policy has obstructed this consistent downslide in the quantum of credit resources, but it has not and actually cannot extinguish the scarcity of money which is dictated by the bank reserve. So the factual reality regarding scarcity of capital is that it is generated by our credit arrangement and is not inherent in the capability of banks to advance credit as such.

Scarcity of capital then is a self-contrived one. If we so desire we can replace it with such abundance which may be consistent with full employment growth potential of any country, at the given stage of its development. In this respect Keynes contrasted the scarcity of land which is intrinsic, with the scarcity of capital which is only contrived: 'The owner of capital', he wrote, 'can obtain interest because capital is scarce, just as owner of land can obtain rent because land is scarce. But while there may be intrinsic reasons for the scarcity of land, there are not intrinsic reasons for the scarcity of capital' (Keynes 1951: 376).

Unfortunately Keynes himself did not stick to the fundamental verity of this point of view. He lost himself in the labyrinth of liquidity preference concept which, in spite of relevance to the issue, has no practical existence. He does not even hint at, much less mention the main obstacle to the flow of money provided by bank reserves. Considering the perspicacity of Keynes, this omission appears most extraordinary. The magnitude of difference between liquidity preference even if it were a meaningful reality, which it is not, and bank reserves, exactly equals the one between a mote and a beam. That he could magnify this mote, place it at the centre of the stage, and belittle the beam to the ultimate limits of oblivion, is the biggest lapse of Keynes in his entire General Theory, notwithstanding all the plaudits that economics was, ideologically and therefore irrationally, forced to shower on him for the evolution of this mythological concept.

Since we cannot in this context evaluate whether or not we can outgrow bank reserve (or for that matter interest), we can say that whatever be the result of our enquiry, the present posture of economics will need to be amended. Suppose we reach the result that bank reserve cannot be replaced by something unobstructive of flow of advances, and that scarcity has to be the lot of credit resources, which therefore will necessitate the retention of interest, irrespective of the magnitude of the social costs and economic consequences involved, then this is what should be exactly stated and not the blind statement that capital is scarce and therefore a price has to be paid for it. Let us

confess that capital is not scarce; we are forced to make it scarce by the need of maintaining liquidity in our credit system, or meeting diverse purposes connected with monetary management and that these purposes cannot be met by any means that we know of other than that of bank reserve. This certainly imparts artificial scarcity into the credit structure which, if we try to counteract by expansionary monetary policy, only tends to ignite inflation without curing unemployment which our restrictive bank reserve framework dictates. An identical statement should be made in the case of interest, if no productive and humanistic alternative to interest can be discovered.

For one thing it would be more worthy of a science to state the facts rather than push them under the rug. For another it will focus attention of students and scholars to some of the fundamental problems confronting economics which they will strive every nerve to sort out. Recognition of existence of a problem would become a prelude to its eventual solution, contrary to the present position in which the problem itself is presented in the garb of a solution implicitly dissuading all intellectual effort to recheck some of the fundamental postulates of this science. This contributes to the continuation of its shortcomings in the realms of logic, realism and social relevance so far as various credit contrivances are concerned. And not these alone.

### The Opportunity Cost of Capital

In a chapter concerned with the conceptual unacceptability of interest both from points of view of logic and social relevance, particularly when it seeks legitimacy from its identity with profit, we cannot exclude the issue of opportunity cost of capital. This notion relies for the legitimacy of interest on the same or similar tools of logic and concern with social responsibility on which reliance has been placed for reaching the opposite conclusion.

When a person advances a loan to another person, he denies himself not only profitable opportunities that exist, but also such opportunities which may emerge during the pendency of the loan, and are not quite visible at the time of making the advance. But the risk and deprivations of the lender go beyond this. Supposing a loan is sought for one year and the lender does not visualize that the loan will not be returned within the stipulated time, and the delay in return deeply damages the profitable opportunities that emerge at the time anticipated for the return of the loan, the delay in repayment will be as much exploitative of the lender, as the charge for the use of money is projected as exploitative for the borrower, hindering his value-creating efforts.

The concept of opportunity cost is the modern expression of what was called 'extrinsic titles' in the discussions of schoolmen. Perhaps a good example of fairly mature posture of the Christian Church even as late as 1745 is Pope Benedict XIV's encyclical *VIX Peruenit* which repudiates the reasons that were advanced for legitimizing interest. According to this encyclical, it serves no purpose to say that the rate of interest is not excessive, but moderate; that it is not big, but small; that the one from whom it is claimed on account of the loan is not poor, but rich; or still that he must not keep the loan unused, but should spend it usefully in order to increase his goods, to get possession of more estates, to do gainful business. This is repudiation of the differentiation that was being projected between usury and interest, and unequivocal expression of unalloyed posture of the church which held that any contract which entitles the lender 'to a profit (sic) in addition to the return of his capital...is illicit and constitutes usury' (Bigo 1966: 332).

Despite this forthright expression the pressures of the market place are not completely absent. The same encyclical admits that there can be extrinsic titles justifying claim to something over and above the refunded amount, but these extrinsic titles formed such a familiar stock of justification for interest that the encyclical did not feel the need to specify them.

According to the discussions current among schoolmen, these extrinsic titles were the occurrence of loss (*damnum emergens*), cessation of gain (*lucrum cessans*) and incurred risk (*periculum sortis*). To provide against the possibility that these exceptions should become the general rule, the Pope took good care to add, 'it would be rash and unreasonable to believe that a loan is always accompanied by other legitimate titles' (ibid.: 333).

Later theologians found at least one extrinsic title attaching to all loans, namely cessation of gain. Jean Villain draws attention to the explanation of A. Vermeersch: 'Economic value attaches today to the actual possession of money'. Lending money means depriving oneself by the very fact of lending and in any case of the profit one could make by association with gainful business. The 'cessation of gain' case is no longer an exception. It becomes the rule in consequence of the change in economic conditions (ibid.).

Change in economic conditions is elaborated by stating that at times when the 'opportunities for investing money in commercial undertakings or converting it into revenue-producing property were comparatively rare, a loan made to a solvent person, instead of being onerous to the lender, was rather an advantage, in giving him full security for his money, for the borrower insured him against its accidental loss' (*Catholic Encyclopaedia* 1910: 15:236). But things are claimed to have undergone a change. 'There is however much greater facility nowadays for making profitable investment in savings, and a true value, therefore, is always attached to the possession of money' (ibid.: 237).

Not only 'cessation of gain' became a ground of virtually universal application for legitimizing interest against which the church had assumed a posture of uncompromising hostility for many centuries, the 'occurrence of loss' was deemed a reason for identical latitude in the matter. It was claimed that the bargains were not kept. A delay in payment might inflict serious loss upon the creditor. Interest really 'represented the difference between the creditor as he actually was and as he should have found himself had the bargain been kept' (ERE 1921, XII: 551).

It was argued that a debtor's failure to return the loan could involve the creditor in borrowing the necessary sum at a high rate of interest, justifying the claim of interest to compensate the creditor for the loss needlessly suffered by him. It was easy enough to universalize the applicability of this principle. 'Once delay in payment...was recognised as a reason for compensation, the practice easily sprang up of lending gratuitously for a short period and charging for delay beyond that period' (ibid.: 551). Fundamentally, it was these two considerations of 'cessation of gain' and 'occurrence of loss' which established the unanswerability of the case for interest, and eventually surmounted the hostility of the church. Both these considerations are now covered by the nomenclature of opportunity cost of capital which claims the same moral validity for interest in the present context which it established in the counsels of the church in the days gone by.

To establish the irrelevance of the concept today, it is not necessary to repudiate its validity in the past centuries. In the mid-eighteenth century when Pope Benedict XIV issued his encyclical, banking had developed substantially in most Christian lands to make these extrinsic titles of 'cessation of gain' and 'occurrence of loss' lose the bulk of their moral validity. Yet these were presented in the context of individual lending and borrowing as the establishment of these extrinsic titles is contingent on individual borrowing and lending and becomes extinct in institutionalized borrowing and lending. Whether or not credit was a function primarily of financial intermediaries in the eighteenth century, it is virtually the exclusive province of the banking system in the twentieth century.

The difference that this structural change in the credit system makes to the argument of opportunity cost of capital is so revolutionary that it is a surprise that it continues to be advanced at all. When an individual advances a loan to another individual it is possible to argue that the lender has foregone one or the other opportunity of gainful employment of the loaned amount of money. No one knows for certain the reality of the matter, no

one has the time to check and measure the value of claimed opportunities, and there is no practicable alternative to the acceptance of the claim for lost opportunity and thus concede the moral validity of interest.

All this undergoes complete transformation with the institutionalization of the credit market. All borrowers, or at least the bulk of borrowers, go to one or the other bank, and all lenders, or at least the bulk of them, also go to some bank to deposit their uninvested savings. During the period that these savings stay in the bank, there is no question of any loss of opportunity. The mere fact of the existence of a deposit is irrefutable evidence of non-existence of any opportunity worthy of utilization of this deposit. If at any time opportunity emerges during the pendency of a deposit, there is no obstacle to the withdrawal of that deposit, irrespective of whoever, for whatever purpose and whatever period may have borrowed this amount from the bank, or whatever portion of this amount the bank is capable of advancing consistent with the monetary policy of the country. The depositor is not concerned with any of these details. An opportunity has arisen and he wants his money back, and he can get it.

This applies to all kinds of deposits, to time deposits as much, or almost as much, as to current deposits. There is no limit to withdrawal from a current deposit, while there is generally a limit to withdrawal from a saving deposit, unless a notice of withdrawal is received by the bank, generally a week ahead of withdrawal. But most banks, from most constituents accept a predated notice of withdrawal along with the cheque for withdrawal, so that it is virtually as automatic and unencumbered as withdrawal of any amount from current deposit. The third possible variety of deposit is time deposit. In this deposit, the depositor fixes a period during which he does not intend to withdraw his deposit. The period generally varies from three months to five years, but these are by no means the limits. The level of interest to which a time deposit is eligible varies directly with the length of the period for which a deposit is made. The validity of opportunity cost of capital could survive, at least

partially, if this variety of deposit could not be withdrawn before the expiry of the stipulated period.

As it is, even in the case of time deposits, there is hardly any barrier to their withdrawal. Taking the example of Pakistan which is by no means substantially different from other countries, if a person has deposited an amount for one year, she can expect a return of 10 per cent. Supposing a depositor, in the expectation of not needing a particular amount for one year and lured by the significant interest (alias profit and loss sharing) of 10 per cent or thereabouts, deposits it for one year in the bank, and at the end of eight months (or two months) an opportunity for investment arises, there is nothing to stop her from demanding the return of her deposit, but the return that savings depositors get which, again taking the example of Pakistan, is kept fluctuating between 6 and 7 per cent, to create the illusion that it is not interest but only profit and loss sharing.

Let us forget the issue of variation of return between a time deposit and a savings deposit, and concern ourselves with the fact that all kinds of depositors, including time depositors, can withdraw their deposits without limit as soon as they feel that a suitable opportunity for investment has arisen. The crux of reality in the matter is that on account of this unrestricted freedom for withdrawal there is absolutely no loss of opportunity in a bank deposit, and as a consequence this concept of opportunity cost of capital becomes redundant. Institutionalization of credit has rendered this notion obsolete, which disposes of the 'cessation of gain' part of the argument.

The title represented by 'occurrence of loss' is at least indirectly covered by the nomenclature of opportunity cost of capital, which makes it necessary to examine its relevance as well, in the context of institutionalization of credit. At the individual level the argument was unanswerable that when the borrower fails to return the advanced amount at the stipulated time, it becomes at times occasion for considerable loss which the creditor has to suffer, either by losing opportunity for investment or by borrowing on interest the amount which should have come back if the borrower had adhered to the schedule for

return. But in the context of institutionalized credit, this part of the argument has become as obsolete as the other one relating to 'cessation of gain'.

There is no practical obstacle to the withdrawal of a deposit, no matter what its form or variety. The bank will not say to a depositor that many of its borrowers had not returned their loans on schedule, that the bank is proceeding against some of these in the court of law, and bringing pressure against others to meet their obligations to the bank, and as soon as some success attends its efforts it will return the deposit whose claim has been made. It may ask the depositor to sign a predated notice of withdrawal, and tell him that, instead of interest to which he was eligible as a time-depositor and to which he is no longer eligible, he would receive interest paid on saving deposits, but beyond these two things no hurdle will normally be placed against withdrawal of any deposit. The 'occurrence of loss' component of the argument for validity of interest is no longer applicable because no loss can occur to a depositor without a denial of return of deposit by the bank, which would have made it equivalent to the failure of a borrower to return the loan at the stipulated time.

So far as 'incurred risk' provided justification for interest, it had undeniable substance when schoolmen gave sanction to it. However dependable a borrower may be, circumstances can emerge which can make the return of a loan unlikely. That again relates to individual lending and is non-operative in the case of institutionalized lending. With enhanced responsibilities assumed by the central banks and governments the world over, there is hardly any risk in the case of bank deposits. In the United States at least, these are insured and the question of any risk, and any justification for interest for that reason, does not arise at all.

To sum up, whatever loss of opportunity occurs by advancing loans at the individual level, whether in the shape of 'cessation of gain' or 'occurrence of loss' or 'incurred risk', the loss becomes non-existent as soon as lending and borrowing is done through credit institutions. A deposit stays in the bank only so long as opportunity for investment does not emerge for a

depositor; when it emerges, the deposit ceases to stay with the bank at the bidding of the depositor. So in a bank deposit there is no loss of opportunity even for a single day, and therefore no moral justification to pay any interest to the depositors of any variety on the basis of opportunity cost of capital. This is a case which eminently illustrates the observation of Galbraith, 'The shortcomings of economics are not original error but uncorrected obsolescence' (Galbraith 1968: 15).

### Rent Provides No Justification for Interest

The technique of proceeding from the legitimate and showing it as an integral part of the illegitimate, with the object of securing approval and acceptance for the latter, is not confined to the word 'profit', which has been misused over the centuries to enable it to embrace and enclose interest. Other terms employed in a similar manner, whether consciously or unconsciously, and serving an identical objective are 'rent' and 'hire'.

Rent is the price paid for the use of scarce natural factors, which in scientific terminology are designated land. The price paid for the use of land is justified on the basis that humans cannot produce it to the extent of their requirements. The physiocrats noted that the produce of land is well above the cost of what is poured into it on a productive process. The value of labour, seed and manure is well below the value of the harvest. Rent is merely a portion of this difference of value, justified on the basis of a social contract expressed in the form of land ownership which entails a first claim on the productive quality of land. But all lands are not equally fertile. Nor can lands though equal in fertility but enjoying different status on account of their location in relation to population centres, markets, communications, etc., be treated on the same level. These differential advantages whether of location or of fertility over marginal lands, which enjoy no rent, measure the rent of better lands.

From this broad concept of rent, it needed very little ingenuity to extend it to the sphere of loan capital. 'English writers', writes Frank A. Fetter in his article on 'rent' in the *Encyclopaedia of Social Sciences*, 'from the sixteenth to the eighteenth century used the word rent as meaning interest on a loan'. Clever reasoning was employed to extend the area of rent to enclose that of interest.

The proximate cause of both (loan interest and land rent) is unequal distribution. One has more money than he uses, and another has less, and so the former finds a tenant for his money for the very same reason as the landlord finds a tenant for his land, namely, that the one has too much land, while the other has too little.

But why does the borrower consent to pay interest for the money lent? Again, on the same grounds as the tenant consents to pay rent for the use of land (Boehm-Bawerk 1890: 45). Superficially at least, the reasons adduced are persuasive and it is generally on these or identical grounds of similarity between land and loan capital that the justification of rent is sought to be extended to interest. While no one can deny that there are elements of similarity in these two categories, but because rent can also be oppressive and exploitative at times, this may not lend the requisite justification to interest. On the other hand, it is possible to conclude that land rent should be condemned as much as interest.

Elements of similarity between land and loan capital can be overemphasized as has often been the case. Against the points of similarity presented by Locke, we may note the following observations of Boehm-Bawerk:

In many essential respects land and capital take different ways. The former is immovable; the latter, for the most part, movable. The former is a gift of nature; the latter, a result of labour. The former cannot be increased, the latter can be...Income from land, while subject to many laws in common with income from capital, obeys many distinct laws of its own—land rent, for instance, rises with economic development, while interest falls. On all these

considerations, the number of which might easily be increased, it is most convenient to keep land quite distinct from the other kinds of productive wealth (Boehm-Bawerk 1891: 55).

Even in the realm where analogy between the two categories predominates, it has been possible to reduce the impact of exploitation of rent by legislative action. For instance, there is hardly any country of consequence in the world which has not undertaken land reforms, removing large disparities in the holding of land and fostering proprietary holdings. No similar action is conceivable, without complete negation of private property, in the realm of high finance. Can the holdings of a Rothschild or a Barings be distributed among those who do not own any capital? No one has so far argued either in socialistic or capitalistic camps for an egalitarian distribution of loan capital, though there are hardly any two opinions regarding the propriety of this objective in the case of land. If the two were as identical as Locke and others who have reasoned in his manner want us to believe, there could not be this wide disparity in approach in the two spheres.

Another point to note is what Aristotle said regarding the sterility of money. This can be contrasted with the essentially productive nature of land. Money without labour will not produce anything at all, that is, if we leave out of consideration its breeding of interest. Land even without labour will produce something; it may be only grass to graze the cattle on or bushes to provide fuel. No tenant will ever have to compensate a landlord for the loss of land itself, unlike the borrower whose efforts, in extremely unfavourable circumstances, far from rewarding him with any profit, may involve him in the loss of his borrowed loan, which he has to make good by the surrender of his security.

Again, there has never been a negative rate of interest, whereas negative rent on submarginal lands is a fact of daily experience. People who buy lands in new colonization schemes have to compensate the tenants for the first few years by a fixed annual subsidy, apart from all expenses of production, to persuade them to work on their lands. All these considerations

force us to conclude that separate categorization of interest and rent, both in popular usage as well as in economics, has ample justification behind it. Interest belongs to the unadulterated variety of exploitation; rent can have an element of exploitation, just as profits and dividends can, largely due to the impact of interest, be too high and oppressive; but none of these is inherently exploitative. So, whenever an argument starts from rent and its general moral or social acceptability and seeks to work up an analogy with interest to provide the cover of this acceptability to the latter, it overlooks not only the vast technical difference between the two factor costs, the difference in impact that each has on economic growth, and the difference that exploitation is a partial element in one and a coextensive element in the other, but also the final consideration that whereas the exploitative element in rent can be remedied by numerous varieties of legislative actions, the exploitation inherent in interest has refused to be overcome by any device known to economics.

Both of these are highly complex subjects and notwithstanding the impact that each can exercise on the other, the acceptability, or otherwise, of either should provide little ground for extension to the sphere of the other. We are concerned with consequences, intensities and dimensions in each case, and are likely to reach unimpeachable results only when we examine each category separately, without confusing one with the other, even though certain aspects of each may appear to spill over to the other.

Just as we examined in the case of profits, an element of exploitative function of interest and credit structure tends to spread itself to the sphere of profits by way of insurance against recovery of these charges and through curtailment of competition by raising insurmountable barriers against expansion of credit, there is a similar tendency towards hardening of the rates of rent on account of the pervasive nature of interest. If the rate of interest is 6 per cent, the rent of a land worth Rs 100,000 is unlikely to be below Rs 6000. This only indicates that if we could find a way to overcome the obstacle to productive

expansion raised by loan interest, we shall not only be able to erase this major source of exploitation but we shall also be able to extend its healthy impact on rent as much as on profit. Both will shed a large part of their hardening, and tend to be satisfied with a lower level.

The proper objective of economics, in case it wishes to retain social relevance, would not be to strive to extend legitimacy of rent to interest but to extinguish the exploitative component of rent by evolving a socially responsible basis of credit. Rent, from this point of view, instead of providing a justification for retention of interest, becomes yet another argument for its extinction.

### Interest not Comparable to Hire

An identical method of making interest legitimate is to regard it as a special case of the general concept of hire.

Aristotle had said that money was barren, and that to derive interest from lending it out was to put it to an unnatural use. And following his lead, scholastic writers argued with much labour and ingenuity that he who lent out a house or a horse might charge for its use, because he gave up the enjoyment of a thing that was directly productive of benefit. But they found no similar excuse for the interest on money; that, they said, was wrong, because it was charge for a service which did not cost the lender anything....

The doctrine of these writers therefore really implied, and in fact it did convey to people's minds the mischievous fallacy that...the loan of money, i.e. of command over things in general, is not a sacrifice on the part of the lender and a benefit to the borrower, of the same kind as the loan of a particular commodity: they obscured the fact that he who borrows money can buy, for instance, a young horse, whose services he can use and which he can sell, when the loan has to be returned, at as good a price as he paid for him. The lender gives up the power of doing this, the borrower acquires it; there is no substantial

difference between the loan of the purchase price of the horse and the loan of a horse (Marshall 1952: 486).

On the face of it the argument appears quite convincing. Indeed, as compared with rent, hire has greater potential capacity of being shown as identical to interest. The commodity hired has generally the same, or similar, mobility as loan capital. Hire is as much a payment for the use of the commodity hired as interest is regarded a payment for the use of a loan. Again, unlike land, both the commodity hired and the loan of money can suffer loss or depreciation by mischance or miscalculation.

Yet out of the last similarity between hire and interest emerges the gulf that separates the two and explains why 'scholastic writers' regarded the former as legitimate and the latter unjust. When there is loss by mischance or miscalculation, in the case of a hired item, it is the lender who suffers the loss; whereas in the case of a money loan every loss, whether by mischance, miscalculation or any other reason, has to be borne by the borrower. In the example given by Marshall, trying to establish identity between hiring a horse and borrowing money on interest and buying a horse, he overlooks this cardinal difference in the impact on the borrower in the two cases. When he hires the horse, and the horse meets with a nasty fall and breaks a leg, it is the lender who suffers this loss. The hire money not only compensates for wear and tear but is also supposed to include insurance payment to the lender for all accidents of this kind. On the other hand, if the borrower raises money on interest and buys a horse and this horse breaks his leg, he will have to bear the entire loss of this mishap himself and no part of it can be transferred to the lender of the loan money.

So the thing is not quite as simple as Marshall appears to make it. One may, of course, buy 'a young horse' and sell it after using it for a number of years at 'as good a price' as one paid for it, provided all goes well with the horse. It is this proviso which Marshall has excluded from his consideration. And it is in this very proviso that the entire difference between commodity and hire and money loan comes to operate. Marshall

forgets that a horse unfortunately is mortal; nor does it become any the less mortal if it is purchased with a money loan instead of being hired directly. But when it is hired directly, the death of the horse, for any reason beyond the reach of the borrower, exonerates him from all responsibility, whereas when he buys it with a money loan, however innocent he may be of wilful neglect, he must bear the entire responsibility for this loss. In the case of hire, some payment is made to the lender in the shape of hire money to compensate for the hazard of mortality; in the case of money loan, far from any compensation being paid to the borrower to meet this risk, he has to keep on paying interest to the lender until he pays back the loan even though the horse for which he contracted the loan died a long time back. It is the inequity inherent in interest that distinguishes it from hire which may or may not be equitable depending on whether the charges for hire are fair or not. Fair rent will be that rent which brings into equilibrium premium for wear and tear and disutility of parting with the thing, on the one hand, with utility to the borrower of the commodity, on the other.

No such equilibrium can be constructed in the case of interest. The equilibrium provided in books of economics is completely devoid of validity so far as justification for the supply price of loan is concerned, unless exploiting self-contrived scarcity of capital be frankly admitted and faced. In lending out money on interest, the lender 'charges for a service which does not cost the lender anything'. So insubstantial has this argument appeared to Marshall that the mere stating of it by him has been regarded as a sufficient reply to it. Or is it because it has come from mere 'scholastic writers' and not from, let us say, financial interests that it has merited no answer? However it may be, mere skipping it over will not dispose of this argument. The reason given by the 'scholastic writers' is that when a horse is hired out, the lender loses the use of the horse and incurs loss of wear and tear on the horse. The lender of a money loan not only does not incur any loss of wear and tear, he does not bear any variety of deprivation comparable to the loss of the use of the horse. Both parts of this last sentence can raise important questions whose

evaluation appears necessary to reach the conclusion that the differentiation between interest and hire underscored by schoolmen was far more realistic than their identification projected by Marshall.

The notion of schoolmen that the use of money by a borrower does not inflict wear and tear on it, as is the case in the matter of use of a horse or a house, is not supported by our experience since World War II. Actually, perpetual inflation could have been advanced as an inescapable justification of interest, if its emergence was not an unavoidable consequence of expansionary monetary and fiscal policies, not entirely correctly attributed to Keynes, in place of accepting his advice of taking steps to attain 'euthanasia of the rentier'. Unless money is deliberately and persistently mishandled, it does not suffer any loss in value. So the argument of schoolmen relates to the normal intrinsic trait of money of not suffering any loss in value within the framework of responsible monetary and fiscal policies.

The second part of the argument relates to denying of any sacrifice made by a money-lender compared with the one made by a horse-lender. This part of the argument had suffered complete extinction with schoolmen accepting the validity of opportunity cost of capital, in spite of the fact that institutionalization of credit excludes the operation of even that remnant of reason which relates to delay in return of loan, and causing thereby or at least creating the possibility of causing, loss to the lender.

People who can save keep some of their savings in hand, some in current account and some in fixed deposit apart from whatever they can invest directly. That in fixed deposit is that part of savings not likely to be needed for the period for which the deposit is made. Now, what is the nature of sacrifice by the lender in a fixed deposit? Foregoing the use of money is no answer. He does not need to use it for the period of his deposit. If he were likely to need it, he would not put it in a fixed deposit. Time-savings alone make for time loans, and time savings occur only for the period of time they are not needed at all by the saver. If this is a broadly correct picture of savings,

then the onus of proving the advancement of loan as equivalent to foregoing a need or involving a sacrifice becomes rather heavy.

One possible objection to the above exposition can be that this picture of time-savings conforms with reality most of the time but not all the time. There are occasions when a person seeks to withdraw money before the period of the fixed deposit expires, even though doing so makes her suffer a reduction of a part of interest she is eligible to earn on her deposit. But even taking premature withdrawal into consideration does not alter in the slightest degree the substance of the above presentation. A simple example will clear this difficulty. A woman deposits an amount for a period of one year. Unforeseen contingencies force her to withdraw her deposit only after eight months have passed. As soon as she does so, our period of enquiry simultaneously contracts from one year to eight months, because our objection relates to the period for which she actually earns interest. What is the nature of sacrifice undergone by the depositor in parting with her savings for those eight months? At no stage does she forego the use of the money. She had no use for it during those months. When the need arose, even though the initial deposit was for one year, she withdrew the amount. Her premature withdrawal cannot be converted into an argument justifying her earning of interest for the period she had no use for this money.

The argument of 'scholastic writers' that the lender of the money loan 'charges for a service which does not cost the lender anything' can only be repudiated by putting forth and proving that a deprivation of the same or similar nature occurs in a money loan as so obviously exists in the case of hiring out a horse. The mere fact that a person keeps and feeds a horse indicates that he needs a horse, and if one borrows it, he must pay for its hire. On the other hand, the mere fact that a person has a sum of money to lend for a year, shows that he does not need that sum of money for a year. There would be, in fact, more sense in asking the lender in this case to pay to the borrower compensation for the safe custody of that money than to claim interest from him. However, since the borrower

performs a service to himself as well, by putting this money to his use for a period of time, the two services equalize one another. Broadly speaking, neither positive interest nor negative interest need be paid for a money loan if the services performed by the lender and the borrower are to be equalized.

In the quotation under examination, Marshall also mentioned the hiring of a house. The situation does not alter if we analyse this issue as well. The owner of a house is paid for wear and tear, for periodical repairs and taxes. He is also compensated for the disutility of having to deny himself the use of his own house, and an insurance premium against the house being used with less care than the owner would exercise. Besides all these, the rent of a house includes an element of interest; but this will not provide a basis for the acceptance of interest for the simple reason that it is the latter which is exercising its reflex on the former. We live in an interest-ridden economy and if the current rate of interest is 6 per cent, the owner of a house worth Rs 500,000 claims Rs 30,000 annually, besides depreciations, etc., for the use of the house. He does so because the rate of interest is 6 per cent. Cassel explains this position by saying that 'in general, the interest on the capital invested in the building is the chief item in the house-rent' (Cassel 1903: 107). If there were no interest, the hiring of a house would not involve any payment for this constituent of rent, although shortage of houses might continue to demand some premium in the shape of high rents until activation of construction of residential accommodation, in consequence of extinction of interest, narrows the gap between the demand and supply of houses. When that situation is reached rent would be confined in the main to the wear and tear of a house and other real costs plus some reward for enterprise. So, we cannot argue that because in hiring a house we have to pay interest on the capital cost of the house, therefore money loans should also command interest. In fact, if the exploitation of interest could be exorcised, the element of exploitation included in the payment for the use of a house will also cease to operate. Hire, far from providing an analogy for the retention of interest, only projects yet another reason for its extinction.

## Change in the Direction of Our Enquiry Appears Essential

If we are to grasp the essentially exploitative nature of interest, we must stop confusing it with other economic categories. It is neither of the nature of profit, nor of rent, nor of hire. It spreads its influence on all these and tends to raise and harden their rates, just as it spreads its shadow on production, employment and human welfare. But it is a thing by itself, apart, alone and incomparable to any other economic phenomenon. It is a periodically fixed percentage or payment demanded for the use of a money loan. It is this fixed payment, as unresponsive to social needs and purposes as to actual production of value which the loan may or may not generate which makes it coextensive with exploitation in the system of free enterprise.

The introduction of concepts of gross and net interest are certainly helpful for purposes of analysis, but fail to be developed into a justification for the institution. The element of risk which forms a part of gross interest is for the most part a concept of theoretical utility only. Modern banking has devised methods by which practically all loans are secured against hypothecations of substantially greater value than the loans. So the element of risk, for all practical purposes, has ceased to operate in the case of the bulk of loans. However it may be, our analysis is concerned with net interest and, unless contrary meaning is justified by context, interest will be deemed to mean net interest.

But gross interest includes, besides net interest and risk, a payment for the cost of bringing the borrowers and the lenders together. This cost is also expressed as a certain percentage of the borrowed sum. Does this also have the same effect of exploitation? Let us be clear that the question will have only theoretical value and no practical significance. Even though the obvious reply is that this cost is a legitimate one and claim to be compensated for it would be completely fair and just, it does not lend any legitimacy to interest. Because the people whose business it is to bring the borrowers and lenders together cannot

be compensated for their labour by merely securing the expenses of running the establishment; they must be paid something in addition to this cost. The moment this something is added up and is given the shape of a periodic percentage of the borrowed sum, it becomes interest, the very thing which spreads inequality and inequity. So the practical solution is not to make the cost of bringing lenders and borrowers together the basis of our reason for the legitimacy of interest, but to grasp the exploitation inherent in interest, and make this the reason for devising a new form of compensation both for the cost of bringing the borrowers and lenders together and the labour involved therein. There is a valid reason to do so. It would be very difficult to draw a line where the element of cost ends and net interest begins. Since we have to devise anyway an alternative basis of banking in place of interest, the same basis can be extended to the cost of running a financial institution. That a basis of banking, other than interest, has not yet been devised is no reason to believe that it cannot be done. If man's ingenuity has taken him to the moon, it can also carry him to a more rewarding method of lending and borrowing money. If economists had faced facts in the matter of interest and spent only a tenth of their energy in working out a socially responsible basis for loans compared to what they expended in devising untenable theories on interest, we would long have had the answer to our problem. In this field there are two things man has not yet discovered: a sound and sustainable justification of interest and a sound and sustainable alternative to it. For the former we have tried for hundreds of years and failed. May we not shift the direction of our enquiry? Perhaps we can have an alternative to interest, but have not reached it only because we have not sought it.

After all, what have the economists achieved by persistently following the other track? The most muddled treatment of any subject in the entire realm of economics. The net result of all their efforts to this day, in fact the only concept which they have not themselves repudiated, is that interest exists because interest exists.

The cost is not confined to this intellectual sterility. It is responsible as much for theoretical confusion in both capitalistic and socialistic versions of economics as for misery of man, whether in denial of bread under capitalism or denial of dignity under socialism. Imagine the quantum leap both in economic theory and economic affairs if we could devise an unexploitative basis of credit and an alternative to bank reserve, since the functioning of the former hinges on the existence of the latter. Capitalistic economics would be able to revert to a revised classical model in which self-interest and compensation would continuously goad economic forces to a position of full employment at stable prices. The classical model would only need to shed its reliance on interest for the supply of capital, which actually has only constrictive implications, and lean instead on a restructured credit mechanism, shorn of the depredation of interest. If and when this can be done, Say's Law would become operative in real life.

When this happens, a regime of free enterprise and free competition will be ushered in, which, with the help of unexploitative credit, can ensure the trimming of profit to the creative value of the labour of enterprise. But it will not amount to a return to *laissez-faire*. There are things such as minimum wages, minimum hours of work, prevention of fraud and deception, precautions in the use of poisonous substances, environmental and ecological concerns that will perhaps stay or even advance further. Above all, money and credit will not be permitted to indulge in their unending exploitative manipulation. The strait jackets that these will be made to wear will take the shape of clipping away their exploitative tentacles of interest and bank reserve, and thus confer release on man and his enterprise from constrictive capitalistic environment. If, as appears to be the case, both man and money cannot be left entirely free, the right choice will be to circumscribe money and in so doing liberate man. The consequence will be that planning and competition will be joined in the only creative way in which these can be joined. As Hayek has well expressed it, we will be planning for competition, not planning against competition

(Hayek 1944: 31). And we have to do so not only because it is in most circumstances the most efficient method known, but even more because it is the only method by which our activities can be adjusted to each other without coercive or arbitrary intervention of authority (*ibid.*: 27).

Similarly in the context of the socialistic economic version, though the doctrinaire aspect would call for revision, socialist purpose would be effectively attained. Man will no longer need to wear any halters, since the fountainhead of all exploitation—institution of interest—will have been effectively plugged. With extinction of interest, the overflow of exploitative purpose in the realms of profit and rent will also cease to exist which, in any case, should never have been included in the concept of surplus value, their deformity not being inherent but exogenous.

This may lead to the emergence of a new social order which will need to be called by some name other than either capitalism or socialism, although positive qualities of both will be organically integrated in it. Peace within will lead to peace without. Wastage and folly which is called by the name of defence preparation will grind to a virtual halt, stopping the vast haemorrhage of resources which has already made the cheeks of humanity death-pale.

No one knows whether man can or will succeed in devising a free and unexploitative economy, contingent as it is on the evolution of an unexploitative credit structure, but considering the stakes involved the effort appears well worth making.