

# Islamic Economic System & The Debt Trap

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# Basic Economic Problem

- How best to allocate scarce resources to satisfy infinite demands – known as basic economic problem.
- Virtually all countries follow a market based economic system as answer to this problem.
- This system encourages private ownership of property, goods and services, and believes the market is best placed to deliver the most efficient allocation of resources.
- This system also recognises market system is not perfect and provides for government intervention to rectify failures. E.g. preventing monopolies and cartels forming, or providing free health care and education.



# Islamic Economic System

- Accepts market based economic system but with certain key differences as follows:
- Market failures are widened to include economic activities circumscribed by shariah (alcohol, gambling, pornography etc.)
- Money is deemed to be a store of value and medium of exchange only – it cannot be used as a commodity capable of attracting a return on itself
- Gives right to secondary owners of wealth (poor in receipt of Zakah and family entitled in inheritance)
- All money circulating in the system must be fully backed by tangible assets. Fractional Reserve not permitted.
- These differences achieve eradication of poverty, money being spread more fairly in society and a more stable economic system



# MODERN DAY BANKING – THE ROOT OF THE PROBLEM

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# Brief history of banks

- 17<sup>th</sup> Century Goldsmiths, storing Gold – ‘Bankers’
- Receipts issued for Gold
- Public having confidence started trading in receipts
- Public not redeeming Gold from Goldsmith
- Bankers discovered they could pump masses of artificial receipts into the economy and earn ‘interest’
- Big Debate in 1800’s – Fractional Reserve
- Entire system based upon public confidence



# Fractional to Fictional Reserve

- Reserve Ratio gradually dropped lower & lower as Banks discovered Public's confidence was only requirement.
- 100% backing to Gold no longer necessary
- 1913 Federal Reserve Act gives right to 'privately owned' federal reserve to operate 'reserve ratio' and create artificial money.
- In 1931, Bank of England stopped exchanging notes for Gold due to 'artificial money', not being backed by sufficient Gold
- In 1944, Bretton Woods agreement ensured all currencies de-linked to Gold. Dollar was now benchmark. Dollar in turn linked to Gold.
- In 1971, under severe pressure, Nixon de-linked Dollar to Gold.
- Paper currencies can now no longer be exchanged for any tangible commodity eg Gold/Silver
- Currencies only worth public's confidence in them (Argentina).



*If the American people ever allow the banks to control the issuance of their currency, first by inflation then by deflation, the banks and corporations that will grow up around them will deprive the people of all property until their children will wake up homeless on the continent their fathers occupied. The issuing power of money should be taken from the banks and restored to Congress and the people to whom it belongs. I sincerely believe that banking institutions are more dangerous than standing armies.*

**Thomas Jefferson, the Writings of Jefferson, vol. 7**



# Detrimental Consequences of Banks

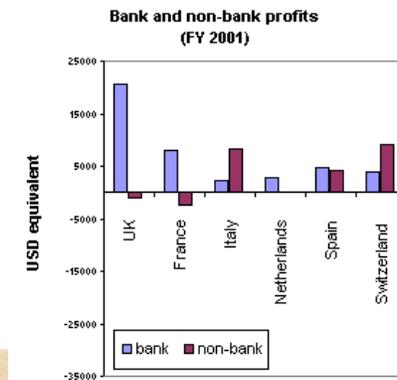
- Bankers make huge profits through artificial creation of money
- Banks prefer to lend to those with collateral – wealthy businesses have most collateral hence are given by far most loans. Businesses make large profits but only return a fixed rate of interest to banks.
- Therefore the rich (banks and business) get richer at the expense of everyone else.



# Crazy Credit ?

- Debt and Bankruptcies beyond control
- Debt-counselling clinics being set up nationally
- Debt thrown at citizens everywhere, TV, Radio, Motorway Services Internet, Postal etc
- Average U.K citizen in more debt now than ever before
- Property cycle started and perpetuated by Banks (80's experience)

• Banks often make more profit than entire residual economy Businesses put together



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# Indebting the 3<sup>rd</sup> World ?

- In 1987, IAA called for dissolving of IMF & World Bank
- No country has ever paid off debt taken (1/3 WB & 2/3 Private)
- Debt is not on leaders but people of sovereign state
- Debt Interest often constitutes a greater % of GDP than Education, Healthcare combined
- Debtor countries started off 1990's 61% deeper in debt than 1980's
- During 1982-90, developing countries paid £1.3Bn in Interest & Capital to creditor countries
- US holds 17% vote, with 85% needed to pass policy on WB Board
- Largest faith group in 3<sup>rd</sup> World are Muslims
- In 1989 review World Bank unable to point to a single project which has resulted in a better quality of life for citizens in recipient country



# Rich just get Richer

‘The richest 225 people in the world own more wealth than the poorest 2.5 Billion’

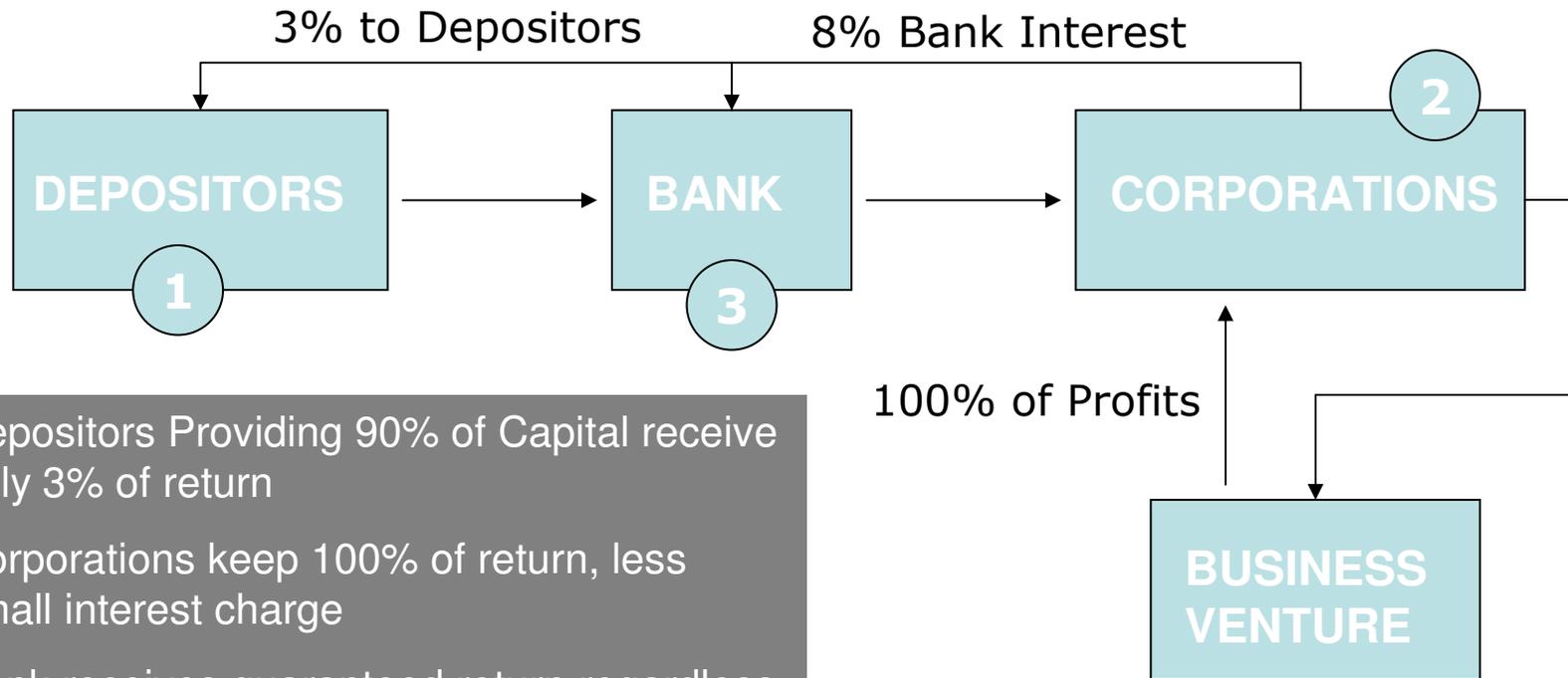
United Nations Development Report 1998

‘In 1998, 64.5% of all Bank Loans in Pakistan were advanced to under 0.5% of the population’

Historic Judgment on Interest



# Rich just get Richer



1. Depositors Providing 90% of Capital receive only 3% of return
2. Corporations keep 100% of return, less small interest charge
3. Bank receives guaranteed return regardless of borrower's fate.

As wealthiest have most collateral, they can borrow the most

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# The Islamic Alternative ?

- Money has no Intrinsic value, only a medium of exchange
- Investments must be asset-backed
- Therefore banks can only print money directly linked to assets held
- Finance can only be provided on equity basis
- Therefore Banks can only provide money by taking an equity share in business
- Money creation is forbidden
- Islamic Finance calls this 'Musharaka'
- Musharka is a viable alternative to Capitalism and has the potential to ensure wealth is shared more equally amongst society
- Winners therefore are society generally, and losers are the banks and major industrialists



*'In order to ensure that money performs its true function of operating as a means of exchange and distribution, it is desirable that it should cease to be traded as a commodity'.*

*Recommendation by Southampton University Committee established to investigate root causes on 1930's economic depression*

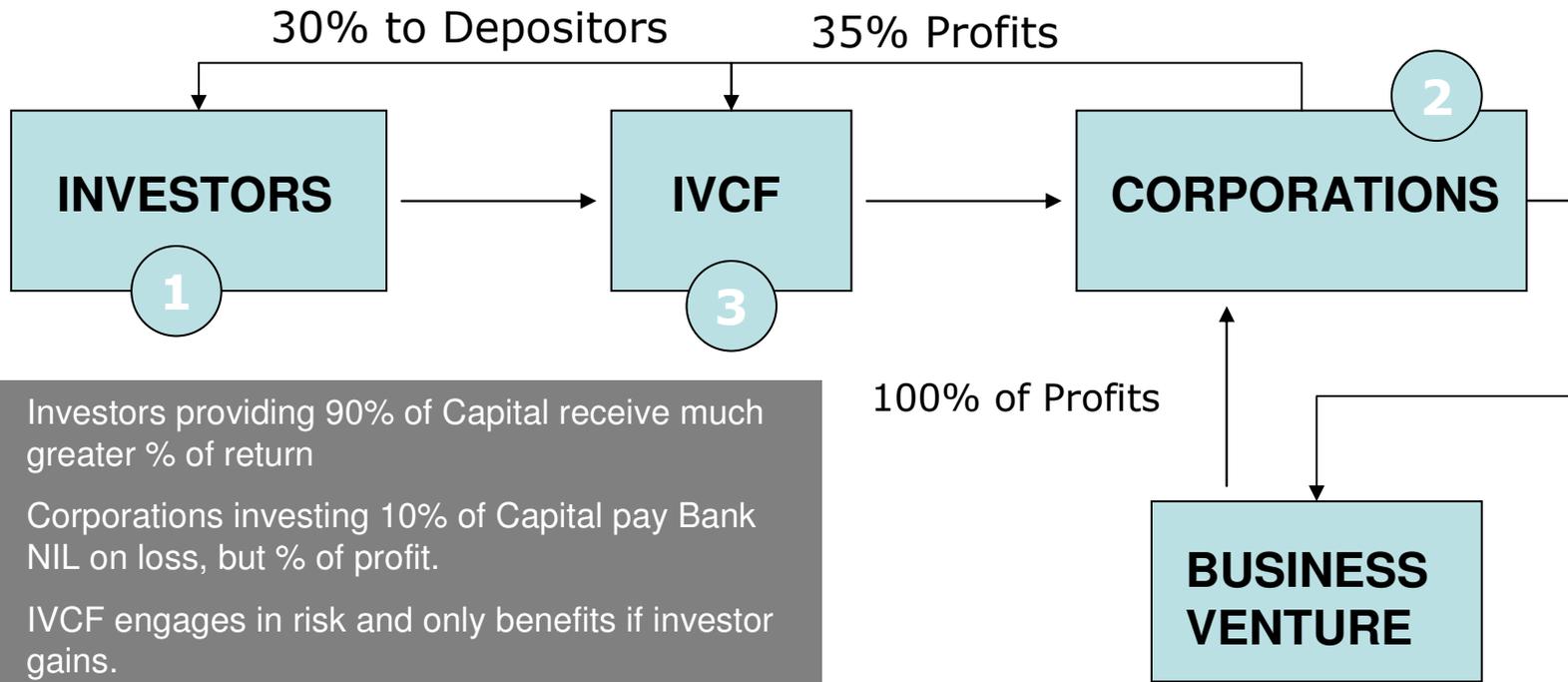
*'The creation of Dirhams and dinars are a blessing from Allah (SWT) as they have no intrinsic usufruct or utility, but everybody needs them as every human being needs commodities for eating, wearing etc. Often man does not have what he needs, or has what he does not need.....therefore transactions of exchange are inevitable. But there must be a basis of measure on which price can be determined as the exchanged commodities are neither of the same type nor the same size.....Therefore all these commodities need a mediator to judge their exact value, hence Allah (SWT) has created dirhams and dinars'*

*'Ihya Al-Uloom Ul-Deen', Imam Ghazzali*

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# Musharaka in Action



1. Investors providing 90% of Capital receive much greater % of return
2. Corporations investing 10% of Capital pay Bank NIL on loss, but % of profit.
3. IVCF engages in risk and only benefits if investor gains.
4. Capital allocated on project strength not collateral levels
5. Society wins – Direct Business investment

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*'So lose not heart,  
Nor fall in despair,  
For you are bound to rise,  
If you are true in faith'*  
Al-Quran 3:139

*'The collapse of the global marketplace would be a  
traumatic event with unimaginable consequences.  
Yet I find this easier to imagine than the  
continuation of the present regime'*

George Soros

