

MEMORANDUM



To: H. H. Sheikh Mohammed bin Rashid Al Maktoum, the Prime Minister & Vice President of UAE and Ruler of Dubai

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Subject: Current Financial Crisis of Debt-Based Capitalism Vs. Islamic Financial System

Your Highness

السلام عليكم ورحمة الله وبركاته

Further to my report, dated 06 May 2009, on my review of Dubai Construction Downturn and proposed solution (a copy attached for ready reference), I have set out a detailed report herein below on Islamic Financial System as a solution of current financial crises of debt-based capitalism. Though, the scope of this report is much wider but, nevertheless it will complement my previous report.

Current Financial Crises of Debt-Based Capitalism Vs. Islamic Financial System

INTRODUCTION

It is generally believed that the current financial crisis have been caused by an unprecedented credit crunch and sub-prime mortgage crash, which is the latest—albeit the most severe—demonstration of the systemic inconsistencies created by the US dollar reserve system. This implies that the US dollar reserve system has failed, and accordingly the fate of the world economy cannot and should not be tied to the fortunes of a national currency and vice versa. To resolve the current financial crises, there is a dire need to adopt a new approach to bring a suitable financial system which is backed by gold reserves or other precious commodity, e.g. oil and not dependent on a paper currency un-pegged from any real commodity, i.e. being tied to a currency (US dollar) that is backed by nothing, thereby creating a debt-based capitalism.

CAUSES OF THE GLOBAL ECONOMIC CRISIS

It is believed that the present economic crisis was triggered by the greed and unethical practices of major European and US bankers, the US sub-prime mortgage bust, and the consequential global credit crunch. But these are not the real causes but merely the symptoms of a deeper depression that has been distressing the global economic order for many decades. In the wake of the economic disaster following World War II, the Bretton

Woods Agreement of 1944 provided that the US dollar to be made the reserve currency of the globe because the US at that time had a large gold reserve, viz-a-viz its currency was then pegged to the yellow metal. But by 1971, because of burden of the Vietnam War and its aftermath and other expenditures, a substantial strain was put on US gold reserves, which resulted in the US President Richard Nixon's forced decision to un-peg the dollar from gold and consequently, the US dollar was turned into a fiat currency whilst still retaining its pre-eminent status mainly because America was the largest economy of the world. This new arrangement of US, freeing it from keeping a proportionate amount of real capital in reserve, prompted the US in printing as many dollars as it wanted to manipulate its global supremacy. Also since, all key commodities—especially oil—were globally traded in US dollars, therefore countries around the world were forced to buy and keep dollars in reserve in order to secure funds to meet their energy expenditure and to protect themselves against any balance of payment constraint. This global reserve currency status discounted the fear of any devaluation of the US currency and strengthened the pre-eminent status of US dollar.

However, this pre-eminent status of the US dollar proved to be harmful for American economy in the long run, e.g. the strength of the US dollar vis-à-vis other currencies was detrimental to US industrial exports and balance of trade. Also, countries having trade surpluses with the US decided against converting their large amount of dollar reserves in their own currencies as they feared this would strengthen their currencies vis-à-vis the US dollar and would make their exports to America expensive. For example, China and some other strong economy countries preferred to park their currencies in US dollar denominated assets, which increased the country's international reserves thereby causing economic bubbles in certain promising sectors of the US economy, i.e. IT and real estate, etc that initially hyper-inflated assets whilst leaving behind deflation and systemic banking crisis. Furthermore, US trading partners, with weaker currencies, enjoyed high export earnings as American consumers preferred to buy foreign goods as opposed to the more expensive products made in the United States. In addition to all that the dollar imbalance also led American firms to outsource jobs that strengthened the emerging economies of Asian countries. Thus US strength of having pre-eminent status of the US dollar, which turned the US from the biggest producing and creditor nation of the world into the biggest consumer and debtor nation.

It is widely held belief that the real cause of the present crisis is the pre-eminent status of the US dollar itself, which is also the standard accounting unit of all major economic indicators whilst the US dollar currency is neither backed by gold, nor any commodity. Since 1971, the US has been printing the global accepted currency almost at will, thereby causing major financial upheavals, trade and investment imbalances, and a rise in the frequency and severity of boom-and-doom economic cycles. Also, many experts believe that the US economy has already "fallen off the cliff" and may have dragged the world economy with it into stern long-term economic mire.

Under a fiat currency system, because of no constraint of gold reserve, America has been indulging in excessive deficit spending and has been accumulating large amounts of debt that in turn has not only been weakening its own economy but also has been infecting the entire global financial and economic system. If the US dollar was backed by gold, the country could not have had a current account deficit larger than its gold reserves or otherwise would have been forced to reduce its negative balance of trade and its mounting debt. This situation has apparently eroded the confidence in the US dollar as the global reserve currency. For example, China—the largest foreign creditor of the US—has called for a new global 'super currency' because it fears Obama's multi-trillion dollar economic plans would devalue the US dollar, thereby eroding their foreign reserves. Many countries including Russia, Brazil, India, South Korea and South Africa are also in favour of new global currency.

THE DAVOS SUMMIT IN THE WAKE OF THE GLOBAL ECONOMIC CRISIS

The Davos Summit was convened earlier this year, which although largely echoed the recommendations of the Dubai convention held in November 2008, but nevertheless it was still able to bring forth important and fresh visions, views and proposals on the global financial and economic crisis, through speeches of the participants, notably the speeches of the premiers of Russia, China, Germany and Britain. The Summit first time commissioned the Founder and President of the World Economic Forum (WEF), Klaus Schwab, with the task of launching a project for the reform of the world's financial and economic system and to begin its work at a time of severe problems facing the world financial and economic crisis, which has exposed the impracticality of the existing system, and inability of the institutions, to confront the current enormous crisis facing us today, established half a century ago (i.e. the World Bank and International Monetary Fund).

The WEF was charged to conduct meetings as the annual convention of global capitalism that looks into the state of the international economic environment and the policies and frameworks that manage it and to study the various positive developments as well as the crises that befall international economic scene and to bring much needed reforms to promote global capitalism. However, there were many contradictory messages voiced by those participating in the Davos Summit. Some highlights of the Summit are as follows:

- The need for international solidarity in confronting the global financial and economic crisis was especially focused at the Forum, with the need for all the related coordination for devising and implementing crisis management policies.¹
- The need for a balance between free market operations and effective regulation, and the supervision and transparency of the markets to prevent the transgressions that led to the present crisis was emphasized and generally consented at the forum.²
- The US administration was conspicuously absent at the forum, probably embarrassed by the fact that it bears the responsibility for bringing about the global economic and financial catastrophe, which ironically used to be at the head of the group promoting the free economy model of the World.
- The Russian Prime Minister Vladimir Putin called for extending a helping hand to developing countries and for a just and equitable partnership with them indicated that imposing a degree of protectionist measures was inevitable in the current circumstances and also issuing warning of the danger of retaining a single currency as the world's reserve currency because relying on the US dollar has created dangerous anomalies in the global economic system.³

¹ However this aim is now faced with conflict of interests that could hurt the prospects of a coordinated response, even as the crisis deepens after entering the real economy from the financial sector, e.g. the economic stimulus plan of the Obama administration, which includes limiting the purchase of iron and steel to be used in public projects, thereby the US is adopting protectionist policies that clearly contradict the principles of free-trade and the commitments of the United States to the World Trade Organization (WTO). Such a move would certainly harm the interests of steel producers in Europe, Japan, Russia and China and in other developing countries. Furthermore, if this US economic policy will be adopted by others, that would undermine coordination among big countries in confronting the crisis.

² In fact, such measures are now being deemed important for the continued progress of the free market system itself.

³ Putin said that the United States was endlessly printing money and consuming the riches of the world through its paper currency, even as the one country kept manufacturing and exporting cheap goods (hinting at China) and saving money that other countries are printing.

- Putin also warned against any plans of excessive military spending as a means for spurring economic growth.
- Putin called for the necessity of setting up new criteria for financial monitoring systems and accountability.
- Putin pointed out, that the present crisis actually erupted in the US economy and dragged down the global economy with it, by saying that the prosperity of the US was not the result of its own labor but because of excessive debt that its future generations would have to pay.
- The Chinese prime minister called for the creation of a new world economic system by focusing on the necessity of reforming the international monetary system and emphasizing the need of diversifying the monetary system in a manner that would gradually dispense with the dominance of the US dollar in world economic transactions.
- The Japanese prime minister called upon the US to put an end to excessive consumption, and urged countries like China to increase domestic demand and achieve growth based on the demand of its own population.
- German Chancellor Angela Merkel emphasized the need for reform of the capitalist system and for finding a middle ground or a third path between socialism and capitalism.

In conclusion, it can be said that the most important outcome of the Davos Summit was the recognition that the Bretton Woods system, which stood on three pillars: the World Bank, International Monetary Fund, and the adoption of the US dollar as the international reserve currency, is subject to change in the wake of the turmoil facing the current global financial and economic crisis and this change will focus primarily on reducing the role of the dollar as the international reserve currency in favour of other major currencies in a gradual manner. Also the change will be brought to the economic model and the inflexible ideological “prescriptions” of the International Monetary Fund and the World Bank to developing countries—which were indifferent to the nature of their respective economies, the level of their development and the conditions they faced at a given point in time. Their “standard prescription” caused major socio-economic crises in many developing countries, including some Arab countries that implemented it.

THE G20⁴ SUMMIT AND THE GLOBAL ECONOMIC CRISIS

The G20 summit was held on April 2, 2009 and unlike participation at ministerial level, was attended by heads of member states and was held at the time of a global economic and financial crisis and for the purpose to seek a solution to put in place a global program for dealing with the global economic malaise, therefore it is considered of exceptional importance. Some highlights of the Summit are as follows:

⁴ The G20 was established in 1999. According to the World Development Report of 2009, the aggregate Gross National Product (GNP) of G20 countries in 2007 was worth US \$54.6 trillion; constituting 83.8% of the global GNP in that same year. The G20 member states include the United States, Germany, France, Britain, Italy, China, India, South Korea, Japan, Indonesia, Turkey, Saudi Arabia, Mexico, Brazil, Argentina, South Africa, Canada, Australia and Russia, in addition to the European Union.

- The opening of the summit was marred by tensions and threats as some of the participants, such as France threatened to boycott the summit, if it failed to take effective action on important issues.
- France was particularly concerned about the issue of tax havens, where businessmen had been investing their money to evade taxes. Sarkozy government considered a clampdown on these tax havens as necessary for combating tax evasion and money laundering, and would help the government in confronting the global economic crisis.⁵
- China launched its historic campaign to remove the dollar from its position as the global reserve currency, which the US has abused as through this arrangement, the US has acquired illicit wealth at the expense of the world and it has indulged in monetary excesses as it is free of any link to the production of its goods or gold reserves. Also, the dollar reserve system has helped the US to increase its borrowings by issuing a large number of bonds and treasury bills.
- China openly called for the building of a new global financial system, free of dollar's domination.
- China has called for the creation of a new global reserve currency as a basis for all international financial deals and for pricing of products in the international market, proposing that this new currency to be regulated by the International Monetary Fund (IMF).
- The US categorically rejected the idea and used its influence to scrap the demand's inclusion from the agenda of the summit, being mindful of the implications of such a historic change on the international financial system and being aware of its weak position in any objective negotiation over the issue arguing that the US is in the same position as Britain was between the World Wars when it strongly resisted replacing the sterling with the dollar as the global reserve currency.
- The US is now resisting the force of history that seeks to remove the dollar from its perch as the global reserve currency as the dollar is still the global reserve currency despite the fact that it no longer enjoys the strong fundamentals for retaining this role. However if the status quo continues, China, Russia and other countries that have been hurt by the current dollar reserve system would use all their economic might and huge currency reserves to continue putting pressure on the US currency through their markets until the international financial system is reformed.
- Despite conflicting issues, there was agreement that governments increase public expenditure for confronting the global economic crisis and they decided to pump in enough liquidity into the banking system to revive and protect it, and support the IMF for providing help to developing countries that have been hit by the global financial crisis and its impact. It was agreed that about US \$1.1 trillion would be pumped into the global economy through global financial institutions, particularly the IMF. It was also agreed that the countries participating at the Summit would pump in US \$5

⁵ France's insistence that the G20 summit take effective action against tax havens sprung from its anxiety over falling tax revenues as Sarkozy government believes many French businessmen are laundering money to countries where taxes are low and are showing meager earnings in their accounts. Switzerland, France's neighbor, is a prime example of such a tax haven, where corporate tax rises to a maximum of 9%, compared to as much as 33% in France.

trillion in their economies in 2009-2010 to reactivate their economies and achieve a global growth rate to the tune of 4%.⁶

- At the Summit, the heads of state participating emphasized the need for rebuilding trust in the financial sector by tightening financial regulation and instituting a new Financial Stability Forum (FSF), which would include representatives of the 20 countries, to raise alarm before impending financial crises, and would put forward a plan for confronting the crisis.
- The announcement was made of possible action against uncooperative authorities in tax havens that would include the imposition of sanctions.⁷
- The summit's most important outcome was its decision to bring to an end the secret operations of banks, in order to clamp down on money laundering operations, corruption and illicit economic activities with a provision to facilitate the identification of wealth and increase in taxes for increasing public revenue of the country.
- In addition, the summit strengthened the role of international financial institutions, especially the IMF, whose revenues doubled by giving more power to the IMF to impose its rigid programs on countries that are most affected by the economic crisis, especially those who are seeking to reschedule their debts and get new loans.

In conclusion, it can be said that the summit demonstrated international solidarity in confronting the global economic crisis that would put down debate on the possibility of rising protectionist tendencies and growing economic clashes between big countries trying to protect themselves from the global economic crisis. The summit called for the promotion of government's role for economic recovery, as leaders of the G20 member states agreed to initiate big programs at a cost of around US \$5 trillion, with a purpose to rescue the economies from the uncontrolled excesses of market forces and the unjust distribution of wealth. This resolution, however, constitutes a clear departure from the liberal model that is opposed to any restraints or control and promotes tax evasion, which allows the growth of shadow economies promoted by bank secrecy.

THE IMPACT OF GLOBAL ECONOMIC CRISIS ON THE UAE ECONOMY⁸

The UAE, just like other countries exposed to globalization, has also been affected by the global crisis particularly as it subjected to a vicious defamation campaign intended at harming its reputation as a pioneering regional economic hub. Thus, it has become important for the UAE to launch a counter campaign to answer back all the charges intended to harm the developmental projects, be they economic or the culture-related. What is noticeable is that this biased media campaign against the UAE relied on claims by dubious news sources that do not present the whole truth as instead basing its arguments on information derived from reliable sources, e.g. studies and reports from renowned research centers that continue to confirm the strength of the UAE economy, it appears that certain desperate and spiteful elements, which envy the ambitious developments of the country, are averse to confronting this crisis. Instead, they find in the crisis an opportunity for spreading their poison of hate against the homeland and its achievements, by writing in some

⁶ The G20 increased the International Monetary Fund's resources, adding \$500 billion for a total of \$750 billion, to support a general allocation of \$250 billion worth of IMF Special Drawing Rights (SDRs) to IMF member countries to boost liquidity. It was also agreed to allocate at least US \$100 billion in additional loans through multilateral developmental banks. A plan costing US \$250 billion was approved to reactivate international trade.

⁷ Although no clear measures have been announced against tax havens or countries that insist on keeping their accounts secret, the decision by the summit on this issue was able to satisfy France, at least for now.

⁸ This study is based on the Article published by Abdullah Al-Awadhi on the internet.

disruptive websites and unpopular newspapers. In the early 1980s, a United Nations official who visited Dubai described the city, by judging it in accordance with almost all established standards, as one of the best and most famous cities in the world. Even after a quarter of a century, however, it seems the envious are not able to appreciate the level of development achieved by Dubai and the speed it achieved. The success of Dubai is not limited to finance, trade and economic development but also its excellent safety and security standards and expertise that have been perfected by its inhabitants over thousands of years. All important comparative studies prove that the level of security enjoyed by the UAE is very high compared to other important countries. This aspect has been acknowledged by international security institutions. To cite an example, not so long ago, a high-ranking US official from a prestigious security institution, in his address to a convention held in Dubai, spontaneously spoke of the peace and security in the country in these words: "I was amazed by the level of security the UAE enjoys, especially in Dubai. As I camped in a deserted area here, I did not come across anyone who said anything to offend me, let alone threaten me. I swear if I had taken a similar trip into the wilderness in America, I would not have been able to avoid being assaulted or lynched, because the level of safety and security in my country is very poor."

The UAE has been prompt in taking up the initiative to effectively confront the financial crisis, not only internally but also at the international levels. Although the crisis cannot be ignored, but nevertheless, it is neither the first of its kind nor it would be the last. It is believed that due to the transparency, credibility and wisdom of the decisions and policies of the UAE, it will be among the first to emerge out of this crisis and soon will play a decisive role in reducing the time required to get out of this devastating crisis.

ISLAMIC CREDIT SYSTEM

The term credit can be defined as 'any transfer of the ownership of a property and its risk of loss not against an immediately perceived counter-value, but against an obligation to provide such counter-value at a later date'. By choosing this definition, certain contracts do not fall under this definition such as:

- Ariya (loan of use), since ownership of the loaned article is not transferred;
- Istisna (manufacture), since the obligation to manufacture is exchanged not against payment, but against an obligation to pay when the object to be manufactured is completed; and
- Mudarabah (Mudarabah is one of the financial techniques in Islamic partnership dealings between two or more parties, whereby one party provides capital while the other party provides skill or service in a particular business, both sharing profits accordingly. In other words mudarabah is a complete interest free profit and loss sharing transaction), since in both of these contracts the risk of loss rests with the capital investor.

Although, Mudarabah performed functions identical to those performed by medieval European interest-bearing loans, which would be subsumed under the above definition of credit, but nevertheless, due to their allocation of the risk of loss to capital, Mudarabah is of a fundamentally different nature from the credit transaction treated herein and therefore is excluded from the definition. Those transactions which do satisfy the above definition include:

- Bay salam (immediate payment for future delivery);
- Bay' bit-ta-khir (credit sale, immediate delivery for future payment);
- Qard (loan of fungible goods); and
- Sharika al-wujuh (credit partnership, where the partnership's capital consists of goods bought on credit, borrowed money).

Bay salam: It consists of an advance payment for an obligation to provide the sale object at a later date. The legality of this contract is based on a Prophetic Hadith. Since it abrogates the rule requiring the object of a sale to be present, or at least in the possession of the seller, therefore it has to follow special rules (which vary from school to school).

Bay' bit-ta-khir: It occurs when the object of sale is transferred against an obligation to provide the price at a future time. In a credit sale where an object is sold for a price in currency, the exchange, may depending on the legal school, be deferred with or without an increase in the price due to the deferment.

Qard: The Shari'ah recognises two contracts which fall under loan. The first of these, 'ariya' is the loan of the use of given article, in which the loaned article remains the property of the lender, and only its usufruct is transferred, on a temporary and gratuitous basis, to the borrower. The second sort of loan is the loan of fungible goods, whose use cannot be separated from the consumption of the goods themselves (e.g. foodstuffs, money). This contract is also gratuitous in Islamic law, and it may be subject to riba, when the lender gains a premium from his loan in the form of interest. This type is the one that is considered under here. The Quran forbids riba.

Sharika al-wujuh: It is a partnership in which neither partner has capital to invest, and they buy goods for their partnership on credit or take a loan and buy goods with it.

Instruments of Credit: There are two main instruments of credit described in legal sources, namely (a) 'hawala' (transfer of debt) and (b) 'suftaja' (letter of credit). In addition, there existed other credit papers (not in the legal source), such as ruq'a (note), promissory note, and sakk (check).

Hawala is the transfer of a debt from one debtor's charge to another's charge. Although, it is classified under different headings according to each school, but its basic function is as follows: A (the transferee) owes a debt to B (the transferor) and B owes a debt to C (the creditor). B delegates the debt owed to him by A to C (with the consent of A and C), so that A will now owe debt to C and B is liberated.

Suftaja or 'letter of credit' is a loan currency to be repaid by the borrower (banker or its associate) in a different place. Its purpose is to avoid the risk of transport. It can be paid to either the original lender (who would carry the note with him) or to be sent to a third party.

With respect to other category of credit instrument such as ruq'a (note), promissory note, and sakk (check), these all can be counted under the category of hawala.

ISLAMIC BANKING

In recent years, the banking industry and the rules and procedures which regulate it in the world's major financial centres have undergone important changes. Such changes have yet to be absorbed fully in the banking laws and regulation, particularly in the developing countries. Furthermore, due to weakness in risk management, banking systems have been more prone to accident, including exposure to general volatility in price of financial and real sector assets. Consequently, one of every five developing countries today faces serious problems in their banking sector. Apart from a good risk management, sound management and well trained staff are essentials for successful banking operation which is lacking in the banking sector of the developing countries. Therefore, banking law in a given country constitutes the overall reform of the banking sector which must be a part of a broader reform of the country's legal and judicial framework as a whole. However, it must be understood that a banking law cannot be implemented in a vacuum as theoretically may fail in practice due to inconsistency with the rest of the legal system of basic defaults in that system or in its enforcement. The

elements of good banking law will differ from one country to the other, reflecting its degree of development and the need to ensure synergy with the rest of the legal system in the form of model banking law.

Under the IMF's 'Model Commercial Banking Law'⁹, permissible banking activities broadly encompass the definition which include: receiving money deposits, extending credits, buying and selling for the bank's account or for account of customers of money market instruments, futures, options related to debt securities or interest rates, exchange and interest rate instruments and debt securities, providing money transmission services, buying and selling foreign currencies pursuant to a proper licence, issuing and administering means of payment, money broking, safe keeping and administration of valuables, providing services as portfolio manager or adviser or a financial agent or consultant, providing credit reference services, and anything incidental to the foregoing. Banks may also be authorised by the central bank to owe subsidiaries that engage in other activities to be listed in the authorisation. However, the same Model Law prohibits banks from entering into transactions or practices that would provide them with, alone or with other, a position of dominance on the money, financial or foreign exchange markets, and from engaging in manipulative practices that could result in an unfair advantage for themselves or for third parties.

If we observe the development in international banking sector, we note four recent trends in banking law, namely: (a) the payment system, (b) banking supervision, (c) bank restructuring, and (d) money laundering.

The origin and most important reason for the growth of conventional commercial banking appears to be the profits that were made in the process of producing money for lending at interest, thereby banks acting as industry and money as product. Such lending criteria not only cause inflation but also encourage speculative booms and large inequalities in wealth. There is certainly no justice in this.

Nowadays, economic growth is heralded as the ultimate goal by so many governments which in turn are forced upon society as it struggles to meet the interest charges on its debt. For example, every year the US government pays billions of Dollars in interest on its national debt and so are the other nations. Yet this debt need not exist in the first place and interest payments on it are therefore incurred unnecessarily, thereby inflicting a cost upon the whole society. Interest bearing monetary system has now become a source of risk to society because of the fact that debt grows at compound interest towards infinity and consequently causing a big risk to society. On the other hand, in the absence of interest, society's economic efforts would be directed towards wealth creation instead of wealth transfer. The entrepreneur would share his profit with the financier based on mutual good fortune instead of an arbitrary rate of interest.

Theoretically speaking, the questioning of interest is not a recent development. Plato regarded it as a mean whereby rich would exploit the poor, whilst Aristotle believed that money ought to be used in exchange and not to increase at interest. It is also widely believed that the early Christians, Nysennas, Augustinus and Acquinas were against interest. Prohibitions on usury appeared in Torah and Bible.¹⁰

In Islamic economic, two major forms of interest (riba) are defined, namely: (a) riba al-qarud (interest involving loans), and (b) riba al-buya (interest involving trade). Riba al-qarud, the usury of loans, involves a charge on a loan arising due to the passage of time and it arises where a borrower of another's wealth, in any form, enters into a contract to repay to that

⁹ Prepared by the IMF's Legal Department in 1993 for the theoretical Republic of Ruritania.

¹⁰ "If you advance money to any poor man among my people, you are not to act like a money lender; you must not exact interest from him": Revised English Bible, Exodus 22:25. "you are not to exact interest on anything you lend to a fellow countryman, whether money or food or anything else on which interest can be charged", Revised English Bible, Deuteronomy 23:19-20

person a pre-agreed amount in addition to the principal that was borrowed. Since this increase is fixed in absolute amount at the outset of the transaction, the loan becomes a usurious one. Such interest is forbidden in Islam. Riba al-buya must be avoided and in order to avoid it, both the quality and quantity of the exchange amounts must match and the exchange must be simultaneous. For example, if wheat is to be exchanged for wheat, then it must be exchanged for an equal weight and quality simultaneously.¹¹ The Prophet condemned the one who takes riba, the one who pays riba, the one who writes the agreement for riba, and the one who witnesses to the agreement.

Islam provides a commercial banking structure in conjunction with the abolition of interest. The current account would work on the basis of wadia, being a sight deposit available for immediate withdrawal of deposited funds at the expense of a service charge to remunerate the deposit-taker for the costs of administration. In the non-interest based banking system, the share of profits due to the depositor and the banker on an investment account would be agreed prior to depositing of funds. The holder of an investment account would receive a share of the profit (based on the principles of mudaraba or musharaka) arising from the investment of those funds and the banker would retain the remaining share. However, there might be no pre-agreed time scale for redemption of investment accounts as this would depend upon the liquidity of the bank's portfolio.

ISLAMIC ALTERNATIVE TO DEBT-BASED CAPITALISM

For many decades, economists around the world were largely dismissing precepts of Islamic economics by viewing them as the somewhat 'extreme' and 'regressive'. In the aftermath of the global financial meltdown under the astronomical amounts of debt created by its interest-based banking system and speculation-driven derivatives, however, the approach of Shariah-based economic principles has started making a lot of sense to the Western financial experts as an alternative to be considered. The present crisis is so acute and demoralizing that many mainstream economists have started questioning their faith in capitalism itself and consequently, Islamic economic model as alternative to capitalistic and socialistic models is gaining greater acceptance in intellectual debates.

According to an article published by *Telegraph* newspaper entitled: "Fed's rescue halted a derivatives Chernobyl" (dated February 28, 2009), the US bank J. P. Morgan alone has \$90 trillion of derivatives exposure on its books. For this reason, in spite of the US government has poured in \$12.8 trillion in economic rescue plans, which is close to its GDP figure of about \$14.2 trillion, its economy still seems a long way off from foreseeable recovery as the global debt caused by financial instruments and derivatives alone, which are presently weighing on the balance sheets of the world's banks and financial institutions, are estimated to be about over half a quadrillion worth of dollars (over \$600 trillion), which is more than 10 times the world's GDP. Accordingly, there is a serious concern among Western economists of reforming the debt-based monetary system and its derivatives trading in the financial markets, which are now being dubbed as extremely deadly and baneful.

Under the global fiat currency system led by the US dollar, money is backed not by any value-based asset like gold and silver, but is literally created as debt, under what is known as the 'Fractional Reserve System', where money is created whenever anyone takes a loan from the bank. In such a situation, the total amount of money that can be created out of thin air has only one real limit, which is the total level of debt a bank has been able to raise. The big question is how did the global economy accumulate such enormous amounts of debt?

¹¹ Abu Sa'id said that Bilal brought to the Prophet some barni dates and when the Prophet asked him how the dates have been obtained, Bilal replied 'I had some inferior dates so I sold two sas for a sa. On this the Prophet said 'Ah the very essence of riba, the very essence of riba. Do not do so, but if you wish to buy, sell your dates in a separate transaction, then buy with the proceeds'. (Al-Muslim)

Ironically, the answer lies in the very basis of the global financial system, in that it is principally a debt and interest driven construct. Thus in today's world, debt acts as a substitute currency, despite it being an artificial construct with no built-in value.

As debt has become the source of money supply, all economic activities have become dependent on debt. Thus, to increase economic activity we have to increase the level of corresponding debt. For this reason, the Obama administration injecting more debt-backed money into the financial system to tempt banks into start lending credit to stimulate the US economy. Due to the US dollar remains the world's premier fiat reserve currency, the global economy becomes dependent on the monetary policies of the US. Also, the culture of easy loans and credit cards with high interest rates has increased the problems for the global economy and robbed the world even of its household savings. In the middle of the pursuit of debt-based, interest-driven fiat currency system, which threatens to bring down the world economy, the tenets of Islamic banking has raised hopes to the global community. Max Keiser, a notable economist, in a program aired on *Al-Jazira* channel in early April said: "Let us broaden the possible solutions here. The US problems are related to too much debt...it is just a form of the ancient usury. Why not bring in the concept of Shariah law into the global banking system as it is completely against usury. It is against all of this incredible debt that has destroyed the US and UK economy. How come nobody is talking about it at the G-20 Summit? To say there is a dichotomy between socialism and capitalism is wrong cause there is a third possibility here. Socialism, capitalism and Shari'ah law; let's talk about that."

Also Nobel Prize winning economist Joseph Stiglitz recently praised the largely positive performance of Islamic banks around the world, especially as it comes in the wake of the present economic downturn. According to Islamic law money should only be a medium of exchange for goods and services. It should be derived out of real wealth, not by money itself. Money should be backed by assets of intrinsic value-like gold and silver to give stability to the currency and to avert any risk of it collapsing in on itself, which the interest-based fiat money is prone to. However, today making money from money is an ideal that the rich strive for. Why work, it is said, when your money can work for you. Thus, the financial markets, which supposedly serve to promote the real economy, have now become its greatest bane. This is simply because money is now being used not as a medium of exchange, but as a commodity for making more money although it is itself derived from nothing. There is even a tendency in interest and speculation driven capitalism of today to create newer forms of esoteric financial instruments and derivatives, which constantly generate exponential amounts of uncertainty and debts, and threaten the collapse of the real economy. Therefore, Islam warns against what William Lyon Mckenzie King, former Prime minister of Canada, once rightly observed: "Usury once in control will wreck any nation."

Islamic economy also calls for the sharing profit or loss among all parties in an economic activity. Unlike communism, the Islamic economy is opposed to the excessive dependence of the population on government welfare and is a strong advocate of the free market. At the same time, Islam is opposed to interest-based capitalist economy that creates imbalances in distribution of wealth and makes speculators and moneylenders rich at the expense of entrepreneurs and the working classes.

To sum up this discussion, we can say that, Islam opposes all forms of interest (riba), speculation (gharar), gambling (maysir), market manipulation, price fixing, trade restrictions, and monopolies. It forbids all forms of short selling, futures contracts and derivatives as the Prophet Muhammad (SAW) had clearly instructed: "Do not sell what you do not own." Thus, Islam presents an ethical, transparent and practical economic model that can prove useful in replacing the present crisis-prone usury-based capitalist model of the West. Thus, it would only be fitting to conclude with the translation of a beautiful verse from the Holy Quran, which

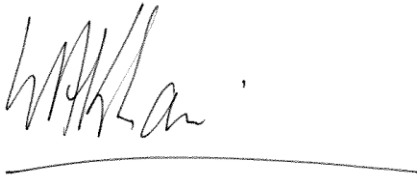
calls for charity by the rich to promote circulation of wealth as opposed to usury that concentrates wealth in the hands of the few and is ultimately harmful for all of humanity.

'The usury that is practiced to increase some people's wealth, does not gain anything from Allah. But what you give in zaqah, seeking Allah's pleasure, these are the ones who receive their reward mani fold.' (Ar-Rum 30:39)

CONCLUDING REMARKS

It is increasing becoming clear to most economists that the fate of the world economy cannot be tied to the US Dollar and vice versa as it has been proved that a system based on a paper currency unpagged from any real commodity and forming a debt-based capitalism has failed. Accordingly, Western economists have also started feeling that a new approach is needed, as German Chancellor Angela Merkel emphasized the need for reform of the capitalist system and for finding a middle ground or a third path between socialism and capitalism. Islamic financial system is the answer to the current financial crises as it is capable of providing a much needed middle ground and is the best alternative to the current debt-based capitalism.

Best Regards



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