UNDERSTANDING ISLAMIC FINANCE

The terms ‘Islamic finance’ and ‘Shari‘a compliant’ are used to indicate usury-free investment. Islamic investment cannot be subsumed under ethical investment, simply because many ethical investments are nevertheless usurious in nature. Although usury is loosely defined nowadays as the practice of lending money at an exorbitant or illegal rate of interest, in the past it was the practice of lending money at any rate of interest.

The practice of *riba* (usury) is clearly and unequivocally forbidden by the Shari‘a of Islam. Allah (God) contrasts *riba* with trade and with *sadaqa* (voluntary charitable giving) as follows:

Those who practise *riba* will not rise from the grave
    except as someone driven mad by Shaytan’s touch.
That is because they say, ‘Trade is the same as *riba*.’
    But Allah has permitted trade and He has forbidden *riba*.
Whoever is given a warning by his Lord and then desists,
    can keep what he received in the past
        and his affair is Allah’s concern.
But all who return to it will be the Companions of the Fire,
    remaining in it timelessly, for ever. (*Qur’an* 2.274)

Since practising Muslims long for the Garden in the next world, they are eager to avoid involvement in usury in this world – in their financial transactions, in their investments and in the purchase of their homes.

Modern Islamic Finance

It is for this reason that in the United Kingdom, the Ahli United Bank, HSBC, Lloyds and the Islamic Bank of Britain, for example, are all offering what are described as ‘Shari‘a compliant’ mortgages in the hope that Muslims who wish to purchase property will be attracted to these particular financial products.

Internationally, Muslims are being encouraged to bank with Islamic banks – without questioning too closely how Shari‘a compliant they are. They are assured by the advisory boards of the banks – comprised of apparently leading Islamic scholars – that the Islamic banks’ products and services are *halal* (permitted).

It is apparent, however, that the Islamic banks do not and cannot function independently from the main banking system. In fact the function of the Islamic banks is to provide portals which enable the wealth of Muslims to be invested and utilised within the main international usurious banking system.

Secondly and more profoundly, it is clear that the very currencies with which they deal are inherently usurious, which means that calling them ‘Islamic’ will not change anything. This means that any transaction which utilises them will itself be usurious because of this, even if all other aspects of the transaction appear to be Shari‘a compliant. This is an awkward truth for the purveyors of current Islamic financial products. How can this impasse be remedied?

In answering this question, it is necessary to go back in time and to compare the two main mediums of exchange, traditional gold and silver on one hand – and modern paper and plastic on the other.

Gold and Silver

Since the time of the Prophet Muhammad, who died in 632 CE, may Allah bless him and his family and companions and grant them peace, the traditional currency of the Muslims has always been the gold dinar and the silver dirham. The Islamic dinar is a specific weight of 22 carat gold equivalent to 4.25 grams. The Islamic dirham is a specific weight of pure silver equivalent to 3.0 grams. Umar Ibn al-Khattab, the second leader of the Muslim community after the death of the Prophet Muhammad, confirmed and established the known standard relationship between the two based on their weights: 7 gold dinars must be equivalent to 10 silver dirhams. These coins have intrinsic value. They can only be devalued either by debasing them with other metals, or by clipping them so that they are under weight.

It is also well established by the Shari'a that an IOU cannot be used as a medium of exchange. For example, A sells B some goods for 10 dinars. B does not have the money on him, so he writes A an IOU and takes possession of the goods. A is not permitted to use that IOU as a means for purchasing goods from C – because the transaction may become usurious. For example, C may only agree to sell goods which are worth 9 dinars for the IOU – for which he will subsequently receive 10 dinars from A. Or perhaps C will only accept 9 dinars in payment for the goods and A can only raise them from D who pays him 9 dinars for the IOU knowing that A will give him 10 dinars for it.

It is also well established that the *zakat* tax (the annual obligatory tax on Muslims payable on surplus wealth at a rate of 2.5% – which after being collected is distributed amongst the poor) can only be paid in gold and silver or in goods in kind, but not with an IOU nor with *fulus* (small change represented by base metal coinage or paper tokens, with no inherent value).

Historically, as long as the Muslims used gold dinars and silver dirhams, they thrived. Since it is an essential aspect of Islamic finance that money may be used as a means of exchange, but must not be treated as a commodity (which means that it cannot be rented out – that is, loaned on interest), and since the Shari'a forbids any unjust increment in a commercial transaction (even by so much as a blade of grass), in this age, usury was virtually non-existent and therefore there was zero inflation. For fourteen centuries, a silver dirham was enough to purchase a chicken and a gold dinar was enough to purchase a sheep. This is still the case today.

Since there was no usury and no inflation, other than the *zakat*, there was virtually no taxation. As long as the *zakat* tax was collected and distributed, there were no national debts. There was therefore no need to increase taxes every year in order to service the national debt, as is the case in most countries today, including the UK.

This state of affairs was shared by early Jewish and Christian societies as well. The *mark* was originally the gold coin of Europe. The *thaler* (from which the word dollar originates) was originally the silver coin of Europe. However these societies were more susceptible to the practice of usury.

Although the Torah prohibits usury (the root meaning of the Hebrew word for usury means 'to nibble'), this prohibition was later interpreted as applying only to transactions between Jews, but not to transactions with non-Jews. Similarly, although the Ingil (the Gospel) prohibits usury, Luther and Calvin decided in their re-formation of Christianity that the prohibition applied only to unreasonable rates of interest, and that reasonably sized usurious nibbles were permitted. Thus, for example, usury was subsequently legalised in England by King Henry VIII. Modernist Muslims have followed in these footsteps by re-defining terminology and disguising *riba* as a service charge.

Paper and Plastic

The introduction of IOU currencies (paper money) opened the door to institutionalised usury. The main means by which the Ottoman Empire was destroyed and dismembered into separate nation states was not so much by the use of armies and force, as by successfully persuading the Muslims to exchange their gold and silver for paper currencies. Once achieved, it was relatively easy to devalue these currencies by means of the exchange rate mechanism and to encourage the newly formed national governments to take out loans on interest in order to survive. As national debts burgeoned and expanded by the miracle of compound interest, they became unrepayable and therefore a control mechanism far more persuasive and effective than the threat of brute force.

At this stage – late 19^{th} century/early 20^{th} century – the 'strong' currencies were still backed by gold. For example, English bank notes promised to 'pay the bearer on demand' the equivalent in gold. Paper currency was a redeemable IOU.

Once, at a later stage, currencies were no longer backed by gold, the purchasing power of paper money (much of it is now electronic money) began to fall at an exponential rate. Paper currency was now an unredeemable IOU.

What is today described as 'inflation' is the direct result of the creation of money out of nothing by means of charging interest, combined with the fact that since it has no intrinsic value, modern money is only really worth the paper on which the numbers and fancy designs are printed. The various paper currencies are therefore even more at the mercy of the financial markets than they were in the past, their value determined by a combination of fiscal policy and market forces.

Thus the doubling in value of a house in ten years does not measure an increase in the house's real value, but rather it measures the decrease in the purchasing power of paper money. Among the casualties of this process are the increasing numbers of homeowners who find that the 'value' of their property has risen above the nil rate band – with all the Inheritance Tax implications that this entails.

Future Islamic Finance

It follows from this analysis that until gold and silver are reintroduced into the equation, it will not be possible to have a truly Shari'a compliant transaction and that Islamic finance will only be Islamic in name but not in reality. The Prophet Muhammad warned that a time would come when even if a Muslim did not participate directly in any usurious transaction, the dust of usury would still settle on him or her. Usury is a cancer. Gold dinars and silver dirhams – the foundation of true Islamic finance – are the cure.