



4<sup>th</sup>

# International Conference on Islamic Business 2016

Quaid-e-Azam Auditorium,  
IIUI Faisal Masjid Campus,  
Islamabad, Pakistan

20 - 22  
February, 2016



Islamic Economics, Finance, Entrepreneurial Development & Public Policy for the Ummah's Socio-economic Wellbeing

Under the above theme, the speakers / paper presenters will discuss the vision of Islamic economics, business and finance, public policy for entrepreneurial development and to enhance social inclusion and good governance, meaning how to develop Islamic countries' economies giving fair opportunity to all segments of the society and provide them not only suitable jobs / employment but also dignity and respect in the society and falah in this world and the Hereafter. As it is possible only through application of the principles of the Shariah, in letter and spirit, in all socio-economic disciplines and business and finance affairs, Shariah compliance of all institutions, products and activities would also be covered in the Theme of the ICIB-2016 event.

Organized By:



Collaborators:



**ISRA** الأمانة العالمية للبحوث الشرعية  
International Shari'ah Research Academy for Islamic Finance

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# Elimination of Interest & Iceland Plan for Monetary Reform

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**February 21-22, 2016**

**4<sup>th</sup> International Conference: “Islamic Economics, Finance, Entrepreneurial Development, and Public Policy for the Ummah’s Socio-economic Well-being” Riphah Univ. & International Islamic University Islamabad (IIUI), the Madina Institute of Learning and Entrepreneurship (MILE), IRTI of IDB Group, Jeddah and BNM’s International Shariah Research Academy (ISRA) Malaysia. State Bank of Pakistan**



# Modern Financial System

- **Natural or Artificial?**
- **Good or Bad?**
- **Biased or Unbiased?**
- **Can it be reformed? – Can we convert Parliamentary Democracy to Khilafa/Shoora by making step-by-step changes?**



# Who creates money?

- **M0: Monetary Base – SBP**
- **DD=Demand Deposits – Private Banks**
- **Monetary Theory: SBP Controls M1/M2**
- **Reality: Money created by Private Banks**
- **Process: Borrowing Creates Money**
- **1-1 relation between Money & Interest Based Loans.**



# Implications of Private Creation

- **23 billion Rs: Minimum Capital for Bank**
- **Banks can CREATE money as loans**
- **Banks job: Selling Loans**
- **Loans for real investments: growth**
- **Loans for Land/Stocks: Rentiers**
- **Since 1980: Massive increase in Financial Sector: “Wealth Creation”**

# Stock Prices Versus Corporate Earnings





# Harmful Effects of Current System

- **Injustice: Rich get license to print money**
- **Inequality: At highest historical levels**
- **Speculation: Increasing land & stocks**
- **Real Estate Fraud → GFC 2008**
- **Minsky Financial Fragility – 200+ Crises.**
- **Taxation & Fiscal Constraints**



# Great Depression 1929

- **Creation of FED 1913 – prevent crises**
- **Banks popularize loans**
- **Installment sales.**
- **Free money leads to increasing land & stock prices.**
- **People take loans to buy land & stocks.**
- **Great Stock Market Crash.**



# The Chicago Plan

- **Fed must be able to control money**
- **Replace Fractional Reserve by 100%**
- **Can do pro-cyclical policy**
- **ZERO banking crises**
- **Investment → real sector**
- **Seignorage → low taxes, low debt, increased fiscal space for social sector.**
- **Rapid Development is possible.**



# Post GD 29 Bank Regulation

- **Small Regionally Restricted Banks**
- **No competition: max interest rate**
- **Glass-Steagall: No speculation**
- **Restriction of money creation to worthwhile investments**
- **Islamic Idea: Earn for SERVICE**

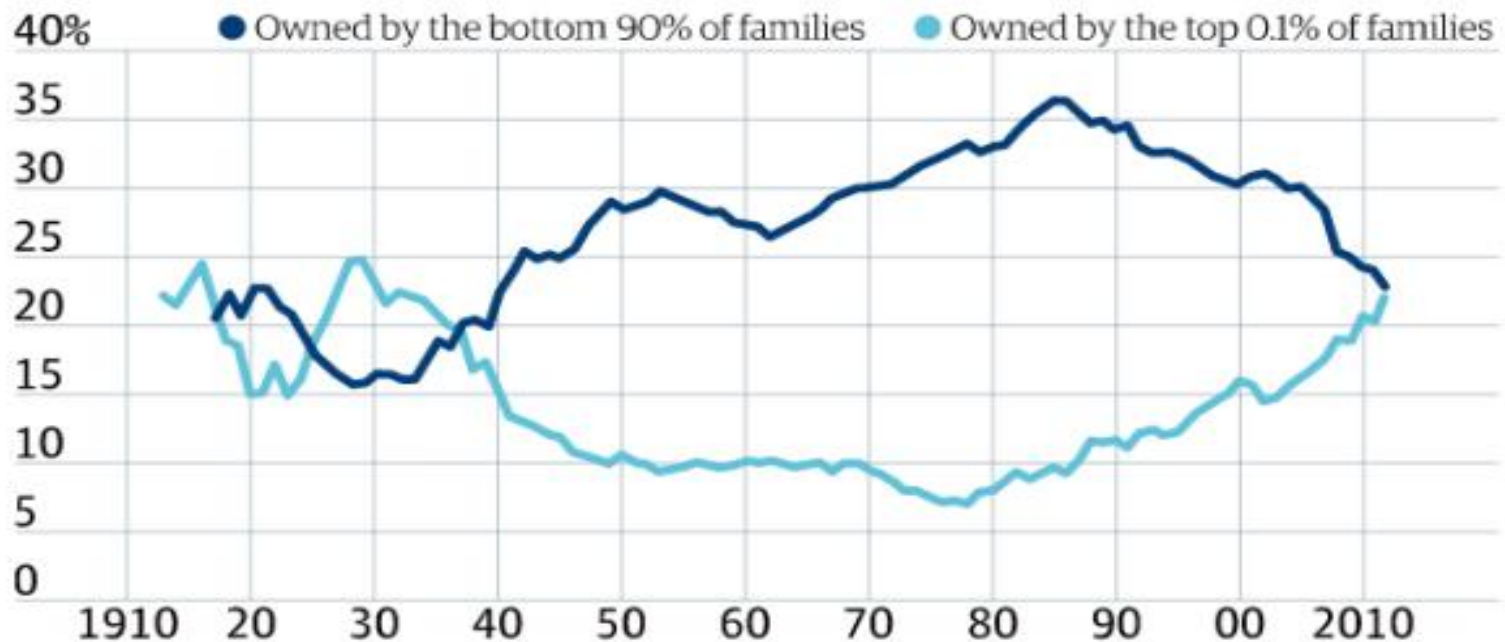


# Result of Regulation: Declining Share of top 0.1% from 1930-80

The share of wealth owned by the top 0.1% is almost the same as the bottom 90%

## The share of total US wealth

1913-2012



SOURCE: WASHINGTON CENTER FOR EQUITABLE GROWTH

# Creation of Theories & Institutions

- **Theories justified as *SCIENTIFIC***
- **Fools People, including Muslims, into believing ridiculous stories.**



# Quiet Preparation of Counter- Revolution

- **Friedman: Creating Theoretical & MORAL Framework == Wait for Crisis.**
- **Capitalism justified on Moral Grounds: Freedom for all. Rights to Property Value of Western Civilization.**
- **Stagflation of 70's → attack Keynes.**
- **Rise of Financial De-regulation in 1980's**
- **BREAKDOWN of QTM:**



# GFC 2008

- **Repeal of Glass-Steagall (30p) 1999**
- **Gramm-Leach-Bliley: Financial Services Modernization Act 2000**
- **Fraudulent Sales of Mortgages, MBS**
- **GFC 2008**
- **Bailout Banks, not mortgagors**
- **BLOCK regulations**
- **Dodd-Frank act 300+ pages**



# Islamic-Iceland Plan

- **Sovereign Money**
- **Quantity: Technical Committee**
- **How to Spend: Real Investments**
- **SEPARATION of Deposit Banking & Investment Banking**



# Advantages

## Zero Interest System

- **Investment Loans: Musharka**
- **Personal Loans: Qarz-e-Hasna**
- **Government: Does not take loans**
- **Currently GOP Budget:**
  - 1.4 Trillion Interest Payments
  - 0.7 Defence
  - 0.5 Development
  - Circular Debt Payments for Energy



# Zero Inflation Economy

- **Complete Price Stability**
- **ONLY possible with zero interest.**
- **Al-Ghazali argument: Money is the yardstick for measuring value.**
- **CANNOT have flexible yardstick**
- **Interest makes value of money flexible.**



# Prevention of Many Ills

- **No Banking Crises vs, 200+ in 30 yrs**
- **No Business Cycles – stable economy**
- **No Speculation & Gambling**
- **Stable Land & Stock Prices**
- **Euthanasia of the Rentier**



# How to SPEND money created?

## **Conventional**

- **Consumption: bad**
- **Investment: good**

## **Islamic**

### **CONSUMPTION**

- **Basic Needs: GOOD**
- **Wasteful-ISRAF: BAD**

### **INVESTMENT**

- **Real Sector: GOOD**
- **Speculation: BAD**



# Policy Implications

## Current System

- Low on Social Services
- Money Creation & Investment by Banks
- High Speculative Investments
- High Returns to Rentiers
- Low Returns to REAL Sector

## Islamic System

- High Provision of SS
- Sovereign Money
- High Investment in Real Sector
- Musharka differentiates between Good & Bad
- Ban on Speculation, Gambling
- Euthanasia of Rentier



# **Dilemma: Govt is POOR at Provision of Social Service AND Investment**

- Islamic Solution: Neighborhood Communities**
- Creation & Support of WAQF**
- Local Community Banks for Investment**

**BOTH PRONGS are essential for successful alternative system**

**Islamic Financial Institutions will be differentiated and complex. Focus on Service Provision**



# Ireland, Germany, Egypt

- **Sparkassen: German Banking Model**
- **Mit Ghamr – First Islamic Bank – highly successful**
- **Community Based Banking.**
- **Development Finance Banks**
- **Failure of Model in Pakistan DUE TO CORRUPTION.**
- **Islamic Lesson: Build PEOPLE first**



## HAVE THE BROKEN BANKS IN IRELAND BEEN FIXED?

- Banking crisis could happen again, prudent to **build resilience**  
within  
our communities
- Focus of all existing banks is on **maximising shareholder value.**
- Our SMEs are not being **nurtured** by their banks
- Local **bank branches are being closed** across the island with  
no  
commitment to local communities
- Our **Credit Unions** and **Post Offices** also under threat of closure
- Banks find **higher returns** can be found through **higher risk**  
ventures  
such as derivatives increasing danger of another crash

**IS THERE AN ALTERNATIVE?**



## SPARKASSEN GROUP: ACT LOCALLY, COOPERATE GLOBALLY



### ACT LOCALLY: 15,100 branches in Germany

- ◆◆ □ Responsibility of Municipalities with no shareholders => cannot be sold
- ◆◆ □ In existence for over 200 years
- ◆◆ □ Regional Principal: no overlap of territories
- ◆◆ □ 70% SME lending in Germany
- ◆◆ □ No International activities: no foreign branches

### COOPERATE GLOBALLY: Over 150 projects in 60 countries since 1992

- ◆◆ □ **SBFIC**: Savings Bank Foundation for International Cooperation
- ◆◆ □ Non-profit foundation: provides technical assistance worldwide
- ◆◆ □ Currently 5 projects in Europe
- ◆◆ □ Also 32 projects in other countries  
31 worldwide



# WHAT ARE THE FUNDAMENTAL CHARACTERISTICS OF “LOCAL PUBLIC BANKS”?



## Public Mandate:

Focus on providing banking services to **all** of the community, especially needs of the SME sector. The **profits from loans** is used for local public welfare projects, rather than lining the pockets of private investors.



## Regional Principle:

Each individual bank has a geographical area within which it can operate and it cannot lend outside that region. Thus money deposited locally gets lent to local businesses creating a **virtuous cycle** that increases the economic strength of the regions.



## Public Ownership:

The bank cannot be bought or sold and remains in the ownership of the people. This releases the bank from the shackle of **maximizing shareholder value**, as there are no dividends to be paid. Instead the **public's interest** must be maximized.



## Business Model:

In some ways familiar to the older generation as the “traditional way” banking was done in Ireland. This is most obvious when you look at the way a loan decision is made, based primarily on the **cash flow** of the project i.e. not asset based lending  
Another aspect is the centralized unit providing the services and technical backup to the network of banks, providing economies of scale and keeping costs down.