# Towards a Tranquil Safe World under the Shade of the Economic System of Islam

**Hizb ut Tahrir**

2009 - 1430 Hijri

# Towards a Tranquil Safe World under the Shade of the Economic System of Islam

**Hizb ut Tahrir**

2009 - 1430 Hijri

# Contents

# Introduction

All Praise is to Allah (subhanahu wa ta'ala) who bestowed on is the blessing of Islam and peace and blessings upon the Messenger of Allah (sallallahu alaihi wa sallam) and His family, companions and all those who followed him.

On the 7th of Muharram 1430 Hijri, corresponding to the 3rd of January 2009, Hizb ut-Tahrir held a global economic conference in Khartoum, Sudan. It was attended by an audience of over six thousand men and women who answered the call of the party to attend the conference. Thinkers, scientists, politicians and economists from around the world attended the conference.

The widely publicised conference took place against the backdrop of the current economic crisis that has illustrated the astounding failure of the capitalist system to create a secure and just life, free from crises.

The conference began in the morning with the recitation of the Glorious Book of Allah (subhanahu wa ta'ala), an address about Israel's onslaught on Gaza and a call to the armies to move to rescue the dignity of the Muslims of Palestine.

The opening address was a poignant message from the global leader of Hizb ut-Tahrir, Alim Ata ibn Khalil Abu Rashta. The talks that followed examined the origins of the economic crisis, the inherent weaknesses of the capitalist system, the failure of the capitalist solutions and the global impact of the crisis in Pakistan, Bangladesh, Turkey, Sudan, Indonesia, the Arab countries and the western world.

The conference ended with the final presentation that detailed the principles of the economic system in Islam and demonstrated how this system would succeed where both Capitalism and Communism had failed.

The conference was widely reported in the print and broadcast media, especially in Sudan. It was widely covered on both satellite television and radio and was reported in over a dozen newspapers.

We have presented in this book, the papers that were presented at the conference, in order to instil confidence in the Ummah in the economic system of Islam which will be applied under the Khilafah state, whose return is imminent.

Finally, we ask Allah (subhanahu wa ta'ala) to enable all of those who participated and contributed to this conference to see with their own eyes the return of the Islamic Khilafah which will apply the Islamic economic system and spread safety, security and justice throughout the world.

# Opening Address

بسم الله الرحمن الرحيم

الحمد لله، والصلاة والسلام على رسول الله، وعلى آله وصحبه ومن والاه، وبعد..

**Distinguished Audience,**

السلام عليكم ورحمة الله وبركاته

You have been witnessing the global financial crisis; the flames of which started in the United States of America and engulfed other countries by the arm of Capitalism and the splinters of globalisation such that no country could be immune to the scorching effects of its flames - however small or far-away it may be.

Similarly, you have been witnessing the various 'solution' packages to overcome the crisis being prepared around the world. These solution packages are being drawn up by individual countries as well as alliances and unions in their conferences and summits such as the European Union, the Group of 20 in Washington, and the Lima Summit and the Qatar Summit, etc. But these packages have not resulted in solving the crisis; rather these solutions have at best only provided a short-term and momentary respite, lasting only days or even a few hours before the crisis returns to haunt them again.

**Distinguished Audience,**

A keen observer who examines the rulers and the economists of these countries will find that in terms of these solutions, there have been two approaches to solve the crisis:

The first is the one which has been based upon the shutting of eyes to the very principles of the corrupt capitalist system that caused this crisis in the first place. This category has 'worked out solutions' based on the outward symptoms and not examined the real inner causes behind these symptoms. They have concluded that the financial institutions have lost liquidity; therefore they decided to pump billions and billions to provide these financial institutions with liquidity. They felt that the investments and financial markets are stagnant and frozen; therefore they decided to reduce interest rates on loans in order to encourage lending and thereby stir up the markets. They saw that shares, bonds and financial instruments have lost most of their value and crossed the red-light; so they decided that the state should intervene and buy the fallen shares and bonds.

Thus in their attempts to treat the problem, they focused on the outward and apparent symptoms and closed their eyes to the real basis of the corrupt and failed capitalist system, which was left as it was. They forgot or ignored that the system itself was responsible for the crisis and therefore all their solutions were merely cosmetic, and provided a temporary drug fix to overcome the effects of the crisis for some moments before the crisis re-emerged even stronger and destructive than before.

Their examples are that of the man who observes a deep crack in the walls of his house and rushes to fetch some cement mixture and paint to fill and cover the crack and presumes that he has solved the problem and retires to bed for some rest! Moments later the crack re-emerges, not strange or surprising at all, because the man only treated the crack and not the actual deeper cause that caused the crack in the first place, which was weakness in the foundation. Thus, this category was the one that merely covered the crack and ignored its real cause.

As for the other category, the basic principles of the corrupt and failed capitalist system were not totally ignored and solutions for the crisis were sought, however, they restricted their thought and searched for solutions within the two systems and did not look beyond to the third option. They looked at the communist system, which already had failed and disintegrated, and Capitalism which is shaking but not dead yet. They view Capitalism with all its fault lines and shortcomings as better than socialist Communism. Hence for a solution, they approached the critics of Capitalism's failures and asked them: "What is the alternative then?" while fully knowing that there is no alternative and that socialist Communism should not be accepted as the solution and they and their economists do not look beyond these two systems: The failed and disintegrated Communism and rapidly cracking Capitalism on the verge of collapse whose head has not hit the ground yet!

Strangely, this group either neglected or is unaware of an economic system which has stood the test of time over centuries and lasted longer than any other system can boast; has proved safe and provided security, and led people to enjoy economically prosperous and secure lives free from the scaring worries and uncertainties of crises for thirteen centuries, during which time one had to hunt for a destitute person to feed from the bait ul-maal of the Muslims! And yet one could not find the destitute. As opposed to this, there are millions of poor and needy people even in the wealthiest of nations. This is the direct result of economic systems of either Capitalism or Communism, which have resulted in such human hardships and misery.

Indeed, it is strange that this group ignores the fair and equitable economic system of Islam which for centuries provided safe and secure economic prosperity to people without misery and exploitation. This group presumes that there are only two alternative economic systems, Capitalism or Communism and all their efforts and searches are restricted to these two systems alone: either the state sector owns everything or the individuals that constitute the private sector owns everything; there is no third option for them. Either the state owns agriculture, industry and trade, whereby it becomes socialist communist ownership or the companies and individuals own agriculture, industry and trade, whereby it becomes private ownership and free markets and the state would not interfere in the financial markets!

If only this group could look at these economic sectors it would find that they are very different to each other. Owning a deep mine of minerals or petrol is not the same as owning a house or a piece of land; neither is owning petro-chemical plants or various energy generating units or a weapons manufacturing facility the same as owning a cotton weaving factory or a sweet meat confectionery; and neither is owning a railway network similar to car ownership.

If this group examines the economic system of Islam, it would find that wealth and properties are grouped into three distinct categories:

The First: These are public properties whose revenues are disbursed among the Ummah after deductions for incurred costs; these include mines - whether of solid minerals or liquids like petrol or gases, etc. - all these are public properties and it is not permissible for the state, or individuals or private companies to own them. Rather, they are public property under the guardianship of the state and the proceeds from these properties are distributed among them after incurred costs are deducted.

The Second: These are the state properties and are used at the discretion of the state, which spends the revenues generated from these for its own expenses and investments in agriculture, industry and trade etc. which are not in the public sector, and also from this may be spent to create balance between people in terms of wealth as has been detailed in the economic system of Islam.

The Third: These are the individual properties which are owned by persons in the agriculture, industrial and trade sector and excluding the public and state properties and are detailed in the economic system of Islam.

Islam has identified these properties with mind boggling precision:

**First Example: Transportation:**

Islam has distinguished between various forms of transport like those that move on tracks such as the railways, or the electric-operated over ground tramways and trolley buses and those moving on asphalt roadways, etc. like cars and buses.

The first group invariably uses public utility and proceeds along fixed permanent tracks, like the railways that shuttle over railway tracks upon the ground and the electric cable system which uses the over ground or underground tracks. Since these are public properties, these must always be reserved for the public sectors and it is not allowed for the state, companies or the individuals to own them; they are eternally for the public sector only. Thus, the trains, tramways and trolley buses, etc. must always be owned by the public sector under the state supervision and their revenues must be disbursed to the people after deducting incurred costs.

As for the buses and cars, they move over roads that are not reserved in a permanent fashion for them alone, but are capable of being used freely by others. In addition, cars and buses can also be owned by the state as well as individuals which implies that it is permitted for the state, and permitted for individuals and permitted for companies to own them.

**Second Example: Electricity:**

Electricity is used to drive plants i.e. it is used as fuel for engines, for lighting etc. As for its use in the plants, it is described as 'fire' in the Hadith:

«الناس شركاء في ثلاث الماء والكلأ والنار»

"People are partners in three; Water, Pastures and Fire."

Therefore, 'fire' includes all that implied by it in terms of energy, whether derived from burning of trees, coal or electricity, etc. - all of these would be categorised under the public wealth and the state, individuals or companies are not allowed to own these sources of electricity used as fuel to drive industrial plants. These resources are public properties supervised by the state and revenues generated from these are to be disbursed to the state's citizens after deduction of costs.

As for the use of electricity for the purpose of lighting, it is not a part of the public properties and is not implied by the term 'fire'. It is therefore allowed for the state, individuals and companies to own electric generators for the purpose of lighting private houses or offices under the condition that electricity cables are not extended into the public domain, whereby they would be subjected to the public wealth group.

I would only cite these two examples to illustrate the preciseness with which Islam has categorised wealth into three domains.

Despite the fact that this exhaustive and comprehensive system is not merely a philosophical ideology lost in the pages of books, but rather is the economic system that had been implemented continuously for the longest period of recorded economic history; we say that this group of capitalists has chosen to shut its eyes and ignore it without searching it for solutions to their problems.

Thus, this group of capitalists has also failed to find real solutions for the economic crisis because they confined their search to the two failed man-made systems and ignored the truth of the rightful economic system. Their example is that of one who has eyesight but cannot see, and if he opens his eyes he does not ask for the alternative for which he has been searching, even if it were in front of him staring him in the face!

**Distinguished Audience,**

Indeed the economic system of Islam under the Khilafah state is the only system that provides a secure and prosperous economic life, free from calamities and crises for the people.

This is the system revealed and mandated by Allah (swt), who is the Creator and knows what is best for His creatures. He (swt) says:

{أَلَا يَعْلَمُ مَنْ خَلَقَ وَهُوَ اللَّطِيفُ الْخَبِيرُ}

*"Should not He Who has created know? And He is the Most Kind and Courteous (to His slaves), the Well-Acquainted (with everything)." [TMQ al-Mulk: 14]*

I pray to Allah (swt) success for your conference and that during the course of it, you are able to appreciate that the economic system of Islam is truly and rightfully the one that provides a secure and prosperous economic life, free from calamities and crises.

والسلام عليكم ورحمة الله وبركاته

**Alim Abu Yasin Ata ibn Khalil Abu Rashta**
**Ameer of Hizb ut-Tahrir**
**7th Muharram 1430 Hijri / 3rd January 2009**

بسم الله الرحمن الرحيم

# Capitalism is inherently flawed and prone to crises

**Introduction**

Roger Terry, in his book *Economic Insanity*, says,

> "The Americans know that there is a problem in America, but they do not know what it is, or why it is. More importantly, they do not know how to correct that problem. All they can do is to point at symptoms of the disease...In reality some of what are named solutions only make the problem worse, because these solutions attempt to change the results of the system without changing the system which has led to those results...The problem does not include the question of how we implement our economic system, for our economic system itself is the problem. The problem is in the foundational structure of our economic system, and partial solutions or bandaging the consequences is not a solution that will deal with the problem. If we want to reach our standards then we must weed out the problems from their roots and not merely clip some leaves. It is upon us to assess the foundations and assumptions on which our system is built and to expose it for what it really is."

Abraham Lincoln, the sixteenth American president, said,

> "...corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands and the Republic is destroyed."

Willis Harman said,

> "It seems that mere patching of the capitalist system (the info-money) will not suffice...the reality of the matter is deeper than that and requires fundamental change in the concepts and assumptions of the system itself."

Jeffrey Garten, the American Undersecretary of Commerce for International Trade in the first Clinton Administration, said,

> "Big companies have disproportionate clout on national legislation. Our scandalously porous laws for campaign contributions leave little doubt that megacompanies will exercise huge power over politicians…For all the talk about free markets, companies such as Citigroup may simply be too big to fail…Megacompanies are almost beyond the law, too, because their deep pockets allow them to stymie prosecutors in ways smaller defendants cannot. Or, if they lose in court, they can pay large fines without much damage to their operations. Corporate giants will also exert massive pressure on America's international political behavior. Defense contractors such as Lockheed Martin have successfully pushed for NATO expansion and for related military sales to Poland, the Czech Republic, and others. Combined entities such as Boeing-McDonnell Douglas will tighten their already formidable grip on U.S. trade policy. Companies like Exxon-Mobil Corp. will deal with oil-producing countries almost as equals, conducting the most powerful private diplomacy since the British East India Company wielded near-sovereign clout throughout Asia."

This is how the proponents of Capitalism assess their own system. If this system, which is run by the capitalists through global corporations, is corrupt and corrupting according to its own leaders, then why should we adopt it? It is a deadly poison which destroys economies of states and results in direct poverty of nations by its resultant crises.

At present this system has reached the peak of its failure with the current crisis revealing its iniquity and weakness. Alan Greenspan, the former Chairman of the Federal Reserve of the United States, has described the current crisis as a "once-in-a-century credit tsunami". Nevertheless, Capitalism has not been without crises since its inception. The International Monetary Fund has counted the number of financial crises in the capitalist world in the last thirty years alone to be over one hundred. The most prominent crisis in the last century was the Great Depression in 1929 when the American Stock Exchange collapsed, resulting in recession and stagnation all over the world. Then the 1987 Wall Street crash when the Dow Jones index fell by 22.6 per cent, in turn affecting the international financial markets. In 1997, the prices of stocks in the major financial markets fell sharply, starting in Hong Kong, then Japan and Europe, and then America. It was said at the time that the Hong Kong Stock Exchange lost approximately one trillion dollars in one day! This was preceded by the 'Asian Tigers' crisis. In the crisis of 2002 the international financial markets fell after the accounting fraud of Enron. All of this was before the current crisis.

The capitalist ideology has taken the economic situation to a startling end such that the main resources and wealth end up in the hands of a few, whilst the majority of humanity lives in abject poverty. As for consumption, it is conspicuously excessive in areas of little benefit and deficient in areas deserving spending. Statistics published by the United Nations show that of the 6 billion people who live on Earth, 4.3 billion live in the developing states. Of these approximately 3 billion are below the poverty line (two US dollars a day), and of these 1.2 billion live off less than one US dollar a day.

In comparison, statistics show that the industrial states own 97 per cent of all world privileges, and that multinational corporations own 90 per cent of technological, production and sale privileges. In addition, 80 per cent of profits from foreign direct investment in developing states go to 20 of the rich developed states. One third of people in developing states do not have safe access to adequate drinking water, one-quarter do not have appropriate housing, one-fifth do not have access to adequate simple health services, one-fifth of children do not reach the fifth grade of primary schooling and one-fifth of students suffer from poor diet.

At the same time the wealth of three of the wealthiest people in the world equals the totality of national production of the poorest 48 states and the wealth of the richest 200 people is more than that of 48 per cent of the world's population! Studies have shown that if they gave just 1 per cent of that wealth that would cover the cost of primary school education for all the children of the developing world! Further, whilst 35,000 children die in developing countries each day due to starvation and disease, one-fifth of the people living in the developing world spend the day in hunger. The aid given to these poor nations through the United Nations is less than what nine developed countries spend on food for cats and dogs in only six days! The most recent UN statistics have also shown that more than 100 million children sleep in the streets in the developing world.

In comparison to this reality, the state of spending in the world is also worth mentioning so that the picture of the capitalist status quo is complete in our minds. $1.059 trillion are spent on armament according to Oxfam, and this is 15 times the volume of current spending on international aid. According to the American Ministry of Defence, armament programs in the US increased in September 2001 from $790 billion to $1.6 trillion. Around the world, $248 are spent on armament per person, according to al-Ahram Centre. $400 billion are spent on narcotics, and Europe alone spends $100 billion on alcohol each year, whilst spending $67 billion on cats and dogs ($52 billion in America). $600 billion is spent in America on plastic surgery and make-up products. As for the volume of debts in the third world states, it has been above the total production of these states for a number of years now.

This is the dire situation Capitalism has brought the world to and it clearly shows that the capitalist economic system is inherently flawed. These flaws are apparent in both its foundations as well as their consequences.

These foundations and consequences can be summarised as follows:

**The foundations upon which the capitalist system is built**

**(1) Ideological creed: separation of religion from life**

The limitation in human beings and their dependency on the Creator is natural and inherent in them. Man is in need of the Creator to organise the affairs of his life, as he is dependent on sanctification and worship. This is because man's own organisation of his affairs is subject to change, contradiction, bias and difference. However, the capitalist system is negative with regards to the solution to man's greatest problem (belief in Allah and organising life by his legislation). The capitalist ideology separates religion from life, making belief in religion an individual matter, leaving every individual to adopt whatever belief they want. This conclusion was reached on the basis of the idea of compromise, and it means that the human thinkers and leaders legislate the system whereby life's affairs will be organised.

As a result, the West has fallen into spiritual decay and the purpose of life has become maximising one's share of sensual pleasures; this being understood also as the path to happiness. In turn the people spend their lives in a frenzied pursuit of satisfying their instincts and organic needs. Most of the capitalists have reached thereby the extreme in seeking satisfaction, having tried every evil, whilst it is painted to them as a good. To the extent that one of the major capitalist economists, speaking of the future of Capitalism in the last century, said, "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."

By this ideology the capitalist finds himself in facing two dangerous situations:

1. If he does not have enough money he naturally cannot completely satisfy all his needs. This pushes him in most cases to frustration and despair, and in turn to psychiatric illnesses. Thus we find that the psychiatrists in America for example have higher salaries than other medical practitioners. Some people also react to this grim situation by trying to escape reality and society through crime, drugs and the like.

2. In the case that he does have enough money to completely satisfy his needs and wants, then he becomes exposed to live in a fatal vacuum which can lead to suicide or abnormal behaviour, or at the very least to a worthless life of boring monotony. This is why we find that the proportion of suicide in the West is much higher than anywhere else. Studies have shown that in France alone 160,000 people attempt suicide each year of which 32 are successful each day; most of them are youth.

Professor Van Eeten, a teacher of history at the University of California, said, "There is no doubt that the capitalist ideology is without moral or religion. This is how it has been since its inception till this day." This is how they acknowledge the reality themselves. Whilst the one who thinks about this life will find that a firm and stable basis which man must rely on is extremely important. Allah (subhanahu wa ta'ala) says,

{أَفَمَنْ أَسَّسَ بُنْيَانَهُ عَلَىٰ تَقْوَىٰ مِنَ اللَّهِ وَرِضْوَانٍ خَيْرٌ أَم مَّنْ أَسَّسَ بُنْيَانَهُ عَلَىٰ شَفَا جُرُفٍ هَارٍ فَانْهَارَ بِهِ فِي نَارِ جَهَنَّمَ ۗ وَاللَّهُ لَا يَهْدِي الْقَوْمَ الظَّالِمِينَ}

*Is he, therefore, better who lays his foundation on fear of Allah and (His) good pleasure, or he who lays his foundation on the edge of a cracking hollowed bank, so it broke down with him into the fire of hell; and Allah does not guide the unjust people.* (*TMQ al-Taubah*: 109)

The corrupt foundation upon which the capitalist ideology is built gives rise to criteria of the same type of thought as the criteria of benefit. Everything that people desire is thought to be beneficial, there being no difference between alcohol and juice, extra-marital relations and marriage, drugs and coffee and between invasion and liberation. In reality therefore the capitalist liberal ideology is an ideology of no principles. When a crisis hits the capitalist he changes his skin with relative ease. Any path to profits is taken, even if it means the destruction of another society. When failure hits, backups are invented even if they contradict the ideology, like the partial or complete state intervention (nationalisation) used to save collapsing organisations as we have seen in the current crisis.

**(2) Focus on the growth of wealth, instead of its distribution**

The capitalist system focuses on the creation and growth of wealth instead of the distribution of wealth to the extent that growth is taken as something sacred and as a magical solution to economic problems, poverty in particular. Bernard Shaw, the European philosopher and critic, who was bald and had a thick beard, said, "Capitalism is like this head of mine and this beard of mine: high in production and unjust in distribution."

The focus on growth in Capitalism is the result of wrongly defining the economic problem; a fallacious conception with which it has deluded humanity, including those who are overwhelmed by it. The capitalists consider the scarcity of goods and services relative to human needs as the economic problem. That is that the limited goods and services are not sufficient to satisfy the unlimited needs of man. By this they make and assume a problem which has no solution! This incorrect diagnosis leads to an even worse prescription: increasing the goods and services (production) so that everyone who has the wealth can access them. As for those who do not have wealth, they do not satisfy their needs. Hence the capitalists do not seek to completely satisfy the needs of each and every individual as they consider this to be impossible, so they resort to increasing the total wealth; this is what they call 'growth'. They forget that the economic requirement is to serve the society as a whole, not to subject the society to economic growth such that the wealth from this growth goes only to a few. And when the growth is achieved through loans, like the building of dams and roads, then the first to pay the bill is the majority of people, those who are poor and deprived from the benefit of that growth!

Therefore the excessive media propaganda around the world about economic growth is not surprising, particularly in the Islamic world. In actuality however we find that the resources are plenty but poverty is ever-increasing. Yet the rulers are still pushing for growth in their policies to the extent that growth is becoming a debt on nations.

In reality, the economic problem is the distribution of wealth. As for the need to increase wealth, it is not in need of ingenuity. Billions of people in the world work to increase wealth in order to survive. As for the distribution of wealth it is the economic problem upon which Islam focuses and provides a comprehensive and correct solution through the Islamic Shari'ah.

It is pertinent that we ask here how the capitalists do not comprehend the true economic problem. The cause is two-fold:

1. They believe that the human needs are unlimited; this is wrong for the human needs are of two types: (i) essential needs; and (ii) non-essential needs (or what we can call 'wants'). Water, for example, without which man cannot do, is an essential need of every human. But that it be cold, or chilled, or mixed with

sugar or juice, these are all non-essential. Distribution of wealth must be such that it allows the satisfaction of the essential needs of each and every individual human being, and beyond this facilitates the satisfaction of wants as much as possible.

2. They do not differentiate between growth and distribution. Rather they include distribution in growth, even though the two are different. Increasing goods and services and their availability in the market is a study of its matter and reality, and is part of the study of economic science. There is a big difference between economic science and economic system. The distribution of goods and services across the individuals of society is a matter resolved by the economic system which is comprised of ideas and rules related to understanding the reality of the problem and its solution. That is, it is the deduction and application of the idea or rule upon the reality of the problem to understand it and its solution. Consequently this economic system must necessarily emanate from a particular perspective about life (a worldview) and is thereby specific and connected to the creed of a people and their view towards life. As for economic science, it is universal and involves the study of matter, its increase, decomposition and growth, given the available means.

This is the fallacious understanding the capitalists fell in, and in following their flawed and crisis-prone economic system the world came down with them. The critical mistake is the understanding that having abundant goods and services in the market will solve the economic problem, which itself rests on the wrong premise that what is important is the satisfaction of the needs of the collective, not all the individuals. Indeed this is a grave error.

The economic and petroleum expert Dr. Abdul-Hayy Zalloum says in his book The Dangers of Globalisation, "Economics has not reached the level of a science, even though the international capitalists present it as if it is the father of the sciences and includes in it laws like the Newtonian Laws of motion. Together with the economists who agree with them they blow the trumpet of their own unholy ideology as if it is the most sacred of things and the likes of these economists have become the leaders of the ideology".

Milton Friedman, in his book Monetary History of the United States, says, "Keynesian ideas are inherently wrong, even though they were overly propagated and the capitalists systems were built on their basis for a quarter of a century after the Second World War. These ideas, and Keynes himself, were products of the systems and tools of Bretton Woods like the International Monetary Fund and the World Bank."

Little wonder, for this is the judgment of man!

**(3) Absolute Freedom of Ownership**

Absolute freedom of ownership (which means the removal of restrictions that organise ownership) is another cause of the failure of the capitalist system. It results in breaking the economic balance in society, and by it are freed the greedy and the monopolists, those who innovate means and styles to grow their wealth. In turn, we find in society both gross wealth and abject poverty. We find millionaires and landlords who own large estates and properties, just as we find those who obtain their provision from rubbish bins. All of this is because the problem is attempted to be solved by freedom of ownership and work, instead of principles and concepts which organise how things are to be owned and disposed.

The capitalists disregarded and rejected the implementation of the principle of balance in society, like the prevention of wealth merely circulating amongst the wealthy, the prohibition of hoarding, the defining of public ownership and how it is to be distributed, the setting of rules to care for those less able and those in need, the obligation of a right in the wealth of the rich for the poor and needy, the prohibition of usury, cheating, fraud and monopoly. All of these rules which maintain an economic balance in society were disregarded because they contradict the principles of the four freedoms they hold, at the peak of which is economic freedom.

We find that this absolute freedom of ownership and the consequent freedom of competition and non-intervention by the state has led to the origination of capitalist corporations who influence the political sphere and whose greed has led to the kindling of wars, as is the case at present with the Iraq war for the pillage of oil, and in Afghanistan for securing the oil of the region all for these corporations.

We notice therefore that the capitalist western companies concentrate upon energy resources and related commodities like minerals (potassium, mercury, uranium). However this requires the political domination of other lands in which these resources are plentiful. Hence the western states – led by the US - implement policies in these lands over a period of time in an effort to break any resistance until they can finally force obedience. In this too the failure is clear and its leads to the poverty of nations and the affluence of the capitalists!

**(4) The Banking and Financial System**

The banks and financial institutions in the western capitalist systems are established for the realisation of material gain which satisfies a need, regardless of the destruction of individuals and society. It is established on the basis of usury which has a destructive effect on society and is from the major sins in Islam. Most of the banks are structured as private organisations owned by an individual or group of individuals from amongst the rich, or as joint-stock companies. The main function of the banks is built on profiting from money itself (usury): they hold people's money whilst paying them a small rate of interest and loan this money out to others at a higher rate. Some smaller organisations function on the basis of depositing money in bigger organisations to realise higher rates, whether in the same country or overseas, and they offer services like term deposits whereby depositors leave their savings with the bank or institution for a period of time and earn a higher interest rate by foregoing direct access to their deposits.

The destructive effects of this financial system can be summarised as follows:

(a) It makes the wealth circulate amongst one section of society to the exclusion of others. By taking the money from the people the banks are able to collect the money which can then be used by the rich capitalists who are able to use it in enterprise and to pay back the large amounts they can borrow from the banks. This naturally makes the rich richer and the poor poorer. The rich undertake the major projects which define the economy of the nation, whilst the poor live under the mercy of this elite class with respect to the supply of goods and services and the determination of their prices. In this manner, the deposits of the poor working class are used as a tool to make things worse for them (or at the least to keep things as they are), whilst they think that saving their money will bring them good.

Of the most mischievously ingenious tools created by the banking system is the credit card, whereby people are able to buy what they want through an electronic network without carrying any cash. These cards charge high interest rates for the service they provide. Through this the banks and financial institutions are able to control the residual liquidity of the depositors. Thus all the cash of consumers is within the financial system for the utilisation of the bank, and thereby, the utilisation of the rich.

(b) The banks create high prices in society by facilitating the monopoly of economic projects by the capitalists who set the prices they choose. They raise the price, withhold commodities or dump them when its suits their interests. The cause of this is the bank interest rates which the capitalists have to pay and which it is in their interest to pay sooner rather than later. This adds to the cost of their business operations which they simply pass on to consumers in the form of higher prices.

From the most apparent of what the financial system does at present is the 'housing crisis' which has raised house prices because of high demand fuelled by mortgages taken from banks at high rates of interest resulting in many defaults as well as bankruptcy of banks.

(c) Fraudulent bankruptcy abounds in the financial system due to the absence of the correct creed and morals. When a bank is on the verge of bankruptcy some of the managers collude with the major depositors informing them of the situation so they can withdraw their deposits (in return for money), whilst all the small depositors loss out when the bank defaults.

(d) The banks contribute to the crises which occur in the financial market by loaning money to those who partake directly in the stock market with large amounts of money which enable them to buy large numbers of shares for specific projects, in turn raising the price of these shares. This makes the people think that the value of this share is rising, resulting in a buying frenzy of this share, as occurred in South Asia. When the people complete buying the shares in large amounts, the shares suddenly collapse, the purpose of the prices rising having been achieved by the capitalists, namely, to make the general masses believe that the shares are a good purchase. What happened on the Wall Street Stock Exchange in the current financial crisis of the rising prices of shares beyond what was reasonably expected was by the facilitation of the banks and when the debtors defaulted on their loans the banks collapsed as did their share prices.

**(5) Capitalist Corporations and the Creation of Poverty**

The capitalist corporations do not differ much from the banks. In fact they are of the same type in terms of origination, acquisition of wealth and function. They resemble the banks to a great extent. Historically, these companies originated in the sixteenth century, when the British Crown had the authority to allow companies to undertake activities. This was considered a privilege because the accountability of the beneficiary for losses of the company was limited to his share in the company (limited liability). This indicates that this style of company was originated so that the capitalists could invest and utilise the money of people and if this money was lost, their accountability would not extend beyond their own money, securing them from default. The role of the capitalist was to be considered as utilisation of savings, whilst if the people lost their money that was their destiny, even though the cause was the capitalists themselves. In the beginning the majority of companies were used to dominate colonised lands; the most famous examples of this being the East India Company and Hudson’s Bay Company. The East India Company was in reality a state within India with her own militia and her own economics which she ran herself.

The fundamental idea on which the capitalists developed these companies, including the joint-stock company, was the idea that the capitalist would invest 51 per cent or 50 per cent and gather the remaining 49 per cent or 50 per cent from the saving of the poor, thereby being able to make more profits by having more money than what he would have by himself.

These corporations became bigger and more influential to the extent that they became the effective ruler of capitalist states when they blossomed and become deep-rooted in capitalist economics. In doing so they contributed to making the wealth circulate amongst the minority rich class in society and creating on the other hand a subjugated class, a class deprived of volition and decision by the means of wealth and enticements. The citizens of capitalist states have become effectively mortgaged to the companies by the means of debts which now encompass almost all the needs of the citizens (homes, cars, etc.). The citizen fears losing his employment by which he maintains his debts and thereby becomes a slave to the system. These corporations have also made the ruling class of society the large capitalists alone; those who own the large corporations. The rest of the people are deprived of this by the ability of this class to buy votes.

The judgment on these companies from the advocates of Capitalism themselves is equally critical. The nineteenth president of the America, Rutherford B Hayes, said, "This is a government of the people, by the people, and for the people no longer. It is a government of corporations, by corporations, and for corporations."

Abraham Lincoln, the sixteenth president of America, informing about the crises that these corporations will cause, said, "I see in the near future a crisis approaching that unnerves me and causes me to tremble for the safety of my country. As a result of the war, corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands and the Republic is destroyed."

These fundamentals are the foundations upon which the capitalist economic system rests and each one of them is inherently flawed. Further, the capitalist system has various tools for these five fundamentals which they use to dominate local and global economics. These tools can be briefly summarised in what follows:

**(1) Fiat Paper Currency**

When the global monetary system was based on gold and silver there was no problem in prices given the stability of the value of money which remained for long periods. The money would successfully fulfil its role as a measure of exchange - a storage of value and a measure of benefit. Money would produce money through the mediation of the production of commodities (the principle being: money-commodity-money). However the fully or partially gold-backed money did not suffice the capitalist greed. The capitalist seeks to spend more than he owns and this led to the inequitable idea of printing paper money that was not backed by anything.

In the nineteenth century the capitalist nations were obliged to give all those who held their particular currency what it represented of gold on demand but because of their covetous nature they did not fulfil this obligation. When they entered the First World War they were in need of large amounts of wealth to finance the war effort so they simply printed unbacked paper currencies, selling a lie to the world by giving them worthless paper in exchange for valuable commodities. When this was publicly revealed the currencies of these states declined, particularly Germany, Britain and France.

When America entered the war it owned the largest reserves of gold, so it exploited the international situation by gathering the capitalist nations in Bretton Woods and signing the Agreement of 1944 which made the American dollar a partner to the gold and obliged that anyone would be able to convert $35 for 1 ounce of gold because their currencies would be completely backed by gold or it would be accumulated with them.

However America was afflicted with what afflicted those before it and it reneged on its covenant. It entered the Vietnam War and in pursuit of capitalist greed it printed money that was not backed. Its gold vanished for the world with respect to the companies and others, and on August 15, 1971 Nixon announced his ominous decision of annulling the Bretton Woods Agreement and making the dollar inconvertible to gold directly. He also imposed a 10 per cent import surcharge. This brought the world to a new period in terms of money: that of the hegemony of the American dollar. This was because the other states of the world had stored the dollar on the understanding that it was gold, and when the

Nixon decision came they had no way out but to accept the dollar as the substitute for gold. Thus every state's economy became dominated by fiat paper currency.

The failure therefore that resulted from the capitalist system in terms of money was that whenever their systems needed wealth which could not be obtained by real production or debts, it resorted to printing paper and entered it into the economic cycle. Thereby it stole the wealth of other nations, and in the case of America whose currency was international, it stole the wealth of all the nations. This was because the original state of the money supply is that it covers all the real production of any state. When unbacked currency is printed and added to the money supply this leads to that currency losing value (depreciation). For example, in Sudan the Sudanese Pound used to be equal 3 American dollars in 1979. In 2009, after huge amounts of fiat money have been printed, 1 American dollar is worth 2200 Sudanese Pounds! This indicates an incredibly high amount of inflation. The American money supply increased forty times in the presidency of Ronald Reagan alone. The dollar became worth 5 cents in real terms (the cost of its printing!). But in terms of the American economic reliance on the (parallel) financial economy and the multiple increases in the money supply after Reagan, the real value of the dollar is 98 per cent less than its present market value. The value of the real economy in America, according to some experts, is 2 per cent of its total market value.

Thus the paper fiat currency system in its current form has many negative effects on society, some of which are:
(a) Perpetual instability and fluctuation in local exchange rates due to it not being tied to a stable standard.
(b) Fluctuation in the exchange rate of the international monetary standard (the American dollar). This results in large losses in the economies of the world and the American economy itself. America continuously takes military burdens upon itself and spends more than what it owns domestically and internationally. This results in a depreciation of its currency. Domestically it raises prices and lowers wages. Internationally, the states connected to the dollar, although their rates rise with respect to the dollar as it depreciates, however this causes their stagnation, forcing them to purchase the dollar surplus and to provide economic support to it to return it to its (false) health.
(c) Constant fluctuation in the fiat paper exchange rates of some states prevents investors from economic activity with these states whose currencies do not hold confidence.

**(2) International Organisations (e.g. the IMF)**

In 1944 the victorious nations of World War Two gathered in Bretton Woods, America, to agree on the first international monetary agreement, whereby the International Monetary Fund was established with the purpose of overseeing the implementation of the Agreement by two main roles:

(a) stabilising the exchange rate; this by every member state announcing its local exchange rate and maintaining that rate by direct intervention in the financial market.

(b) granting short-term loans to member states; this role of the Fund allows it to intervene in the matters of the economies of the member states and thereby to facilitate American hegemony over their economies by pushing them into a debt trap with assistance from the World Bank. These loans have compound interest rates which the debtor states cannot succeed in repaying. For example in Sudan the official statistics shows that the principal debts of Sudan are $14 billion, and the interest payments are $19 billion, the total being $33 billion. Some experts mention that the principal debt is only $4 billion. The loans which the IMF gives are various but the policies the Fund implements with regards to the debtor states are in reality a policy of bringing poverty to nations and humiliation to governments.

The Capitalist 'prescription' the IMF enforces includes:

1. The state seeking a loan depreciating its exchange rate (even though the fundamental role of the IMF is to stabilise exchange rates).
2. Removing the various customs and tariffs used to protect local production, because according to the ideology of the IMF these lead to reducing international competition and thereby reducing the productivity of the poor nations.
3. Giving complete freedom to the entry of foreign capital to the poor nations in order to finance investments in them and to transfer technology to them.
4. Removing subsidies from all the price of foodstuffs and essentials, because the IMF claims that this policy of subsidies does not facilitate total domestic product growth of these goods.
5. Following the policy of very minimal government spending on education, health and infrastructure.
6. Freezing wages and limiting government employment.
7. Removing price restrictions.

It should be noted that this alleged solution was placed on part of the IMF in order to stabilise the currency exchange rates within set limits, as a result of states trying to solve the problem by printing money not backed by anything. This capitalist solution is in the style and manner of the system itself: the poor states have not committed any crime but are being punished because they live under the roof of the capitalist system by facing crises the extent and length of which is known to none save Allah, the Exalted.

In order to appreciate how the capitalist management in the world deals with other nations, one example suffices: when the financial crisis hit the South Asian countries in 1997, the then Malaysian Prime Minister Mahathir Mohammad warned them to implement policies to fix the financial markets and to prevent the speculators from controlling the market. At this the capitalist world was up in arms, particularly in America, where the media machine promoted the opposite (leaving the market open and not intervening). Mahathir Mohammad advised Indonesia to implement its own policies, and the then Indonesian President Suharto adopted this, rejecting the conditions imposed by the IMF of removing support for essential goods, reducing government employment and following the policy of privatisation. Washington then intervened, threatening Jakarta to accept the conditions of the IMF. The then American President Bill Clinton said to Suharto, "It is upon you to accept these prescriptions given to you by the Fund." The result of following the policies of the IMF was that 260 out of the 280 companies in the Jakarta financial market collapsed and the greedy pirates of Wall Street came in thereafter to buy what remained of these companies at very cheap prices.

**(3) Market policies, Privatisation & Globalisation**

The market policies are an implementation of the freedom of ownership (emanating from the capitalist creed) but in an international form. They are possible by the facilitation of freedom of ownership by means of trade relations between states. This policy is to end state intervention in trade particularly and in the economy generally. Thus America works to push the states of the world to remove the barriers and restrictions on international trade, such as protection of trade, support of some local goods or limiting the volume of trade exchange. The objective of the market policy led by America and Britain is to change the world to a free market, to open markets to foreign investment and to make other states leave their roles in administering their economies by making them privatise the public sector, particularly those states in which the public sector forms a large part of the economy. The capitalist states have adopted various means to achieve these ends, such as creating economic blocs like NAFTA and trade agreements like GATT.

It is clear that the objective of the capitalist states from these policies is to open the markets of the world for their own products and investments, so that the 'developing' nations remain under their economic dominance without gaining their economic independence from the rich nations by building their own economies. These policies naturally lead to the end of local trade and failure of local traders at the hand of 'new agents'. It also means that developing nations cannot establish their own heavy industry which is the foundation of any economy in the modern age.

As for privatisation, which is the transformation of factories, establishments, installations and economic facilities from state or public ownership to private ownership, then it also has dangerous effects which add to the failure of Capitalism. These include:

1. Prevention of the common people from their right to benefit from public ownership like water, oil and waterways.
2. Concentration of wealth and resources, in all their forms, in the hands of a few individuals or companies. This means the majority of people cannot enjoy this wealth and a small minority benefit from it hugely. This reality is apparent in capitalist countries, particularly Europe and America.
3. The accompanying of privatisation in the Islamic lands with the opening of the door for capitalist investors means subjecting these lands to economic invasion.
4. Transferring projects from state or public ownership to private ownership usually leads to a reduction in employment, a significant rise in unemployment and in turn more poverty.
5. The state abandons its responsibility by abolishing state and public ownership, because this means the loss of its financing sources, putting the state in a position where it cannot provide health and education for example, in turn creating poverty. On losing these sources of revenue these states are left to resort to placing high taxes on the people, in turn raising prices and adding to the difficulties of consumers.

From the market policy is globalisation, which one economic expert Dr. Abdul-Hayy Zalloum described as the system which seeks to modify states to make them republics serving the American Empire. American strategists have said about globalisation that for them it is a great thing because they exchange paper currency (dollars not backed by gold) for real goods and services and benefit thereby. This is clear also from the giants of Wall Street who consider their own benefits and profits as their top priority even if it comes at the expense of entire nations. Thus in America when the capitalists find that production costs are high they take their investments to poorer nations (like Mexico, Russia and China) where the costs are cheaper and this makes thousands of people unemployed as these companies reduce their business in America.

**(4) Stock Exchanges**

There would not be any market for the sale of stocks and bonds had it not been for the capitalist joint-stock companies and the usury-based banks. These stock exchanges are one of the main factors which cause crises in the economy particularly when the share markets collapse leading to economic recession and stagnation.

The idea of the stock exchange originated outside the boundaries of the real and direct economy. It originated an economy which is neither real nor direct (a 'parasitic' economy). The real economy is that in which actual production takes place like heavy industry and the like and which exhibits the money-commodity-money chain of flow. This naturally increases the wealth of society. As for the idea of the stock exchange, and with respect to the first fundamental (separating religion from life), the overriding criteria of benefit and the protection of freedom of ownership, the capitalists have originated a market and economy, built on the publicity of quick profits, parallel to the real economy. Its tools are shares, bonds and currencies which act as supports to its deceptive 'trade'.

When the capitalists buy and sell these financial papers they do not do so with the intention of owning the real commodity behind these papers. Rather the paper itself is intended as it is considered an article of trade. Confidence in such trade is built on the publicity that these papers are profitable, that they are guaranteed and that their value will not fall. Hence there are huge amounts of speculation and bidding which raises the price of these shares and bonds to levels much higher then what they represent in the real economy. Further, the money in circulation is much higher than actual real production due to the fiat paper currency, and this excess money facilitates the speculation in the financial markets, the biggest of which is Wall Street. The movements on these markets (represented by indices) have also become the new measure of a productive economy, and as economic experts say, the proportion of the financial economy in America is 98 per cent; the real economy is only 2 per cent of the total economic activity.

Therefore, any shock to these financial markets directly affects the currency of the affected country and if that market is international (like Wall Street) then the shock is international. So for example, when Wall Street encounters a shock this results in the depreciation of the dollar rate directly. However what America did with the world in August 1971 made the states of the world enslaved to the dollar.

As for the cause of the shocks which hit the stock exchanges, then they occur as follows: the banks, for example, give out usurious loans to real-estate companies, individuals, as well as credit in all its types, and they lend to those who participate in the stock exchanges and others. When these debtors are not able to repay these debts the bank announces bankruptcy and collapses. In turn, the banks' shares collapse, the stock exchange collapses and so does the economy. The banks collapse due to the loss of confidence in them which leads to depositors withdrawing their deposits and it is revealed that the bank has no money. The shareholders are safe because they have limited liability, and indeed it was this limited accountability which made the banks lend irresponsibly to all and sundry. The money was not its money and it was not accountable for that money.

The stock exchange was created by the capitalists to realise quick profits through cooperation with the banks by using usurious loans and selling debts, thereby creating wealth no less than 60 times their principal. The articles bought and sold on the stock exchange are not even taken possession of in the majority of cases. Rather, the money enters and exits, and in the case of loss of confidence, or even a mere rumour that there will be losses, the money is feverishly withdrawn. In such a case all those holding shares are forced to get rid of them as soon as possible and this causes a collapse if the crisis is widespread. So for example when Lehman Brothers collapsed on the 20th of September 2008 Wall Street lost $500 million on one day alone.

**Conclusion**

This then is the capitalist system which is built upon greed and exploitation and this is the lie perpetrated by the 'International Community' in the form of four objectives: i) eliminating poverty, ii) perpetual growth, iii) justice in the distribution of incomes and opportunities, and iv) life in a clean environment. We find devastating failure in all of these as the reality is one of increased poverty, fluctuating growth, injustice in distribution of incomes and opportunities and the domination of one wealthy class. As for the clean environment, it has been polluted without care by Capitalism and the capitalist states are the first to not restrict their economic activity by agreements on protecting the environment.

The capitalist ideology is corrupt in the foundations and principles as well as in what results from it. It has destroyed the beauty of life.

Separating religion from life is absurd, for Allah (subhanahu wa ta'ala) is the Creator of everything, the Judge on the actions of man, and the one who determines the system of life, including economics, for humanity. The perspective of material benefit is a danger for those who adopt it, over and above those

who are the subject of its exploitation, for it makes the criminals, corrupt and the mafia the leaders of the world, as freedom allows them to economically colonise the world by the worst of means.
Defining the economic problem is not about increasing wealth, although this is needed, rather it is, as explained in the noble Qur'an and Prophetic Sunnah, solving the problem of poverty by the rules of Islam and it is what is known as distribution.

Freedom of ownership has made the capitalist system one where the rights and wealth of others are consumed wrongly, like the public and state ownership. Islam details that there are three types of ownership: public ownership, state ownership and private ownership, and it is not allowed to make them all private.

The banks and companies are one of the main problems in the capitalist system because of their reliance on usury. The companies, with their limited liability, cause the loss of investors' money. Further, the basis on which the companies are formed in terms of conditions of company structure is not from the conditions of companies in Islam.

In reality, there is no good in the capitalist system. It is a system which was originated for the benefit of a specific class to the exclusion of the majority of people. It was created to make the rich richer and the poor poorer so that an elite few could live off the blood and sweat of the majority.

The capitalist nations do not know what to do and where to go, for the system itself prevents this knowledge. The information and media is monopolised in order to make these nations subjugated to the capitalists. Some people love the system because they benefit from it. They do not look around them and think about the overall situation with an enlightened or even deep thought. They are content to live under the shade of the system without concerning themselves with what happens in the society.

As for what is to come, then it is good, and it is Islam. That way of life which Muhammad (sallallahu alaihi wa sallam) was sent with. It alone can remove the capitalist nightmare from the world by the means of its great state whose time has come. The Islamic state alone can stop the capitalist advance and stop its negative effects on the world, so that its nations and people can live by the light and justice of Islam.

**Abdullah Abdurrahman**
**7th Muharram 1430 Hijri / 3rd January 2009**

# The Present Economic Crisis: Causes and Effects

In order to address the causes and effects of the present economic crisis, it is necessary to understand its reality and distinguish it from similar crises. This will also help the understanding of how the crisis began and how it developed with such startling speed.

The present global crisis is neither regular nor benign; nor is it a routinely occurring crisis in the boom and bust cycles of the capitalist economy. It is true that regular crises are a feature of the capitalist economic system; the International Monetary Fund (IMF) has recorded over a hundred economic crises that occurred in the capitalist world over the past thirty years. However, this new crisis is a lethal one, comparable to a tsunami, generated by the monstrous Capitalism, in its most recent American edition, marked by globalisation, privatisation and stock market speculation.

Since its beginning and throughout its course, this crisis had three main characteristics: it was comprehensive, far-reaching and surprising.

This crisis affected all economic sectors in a comprehensive manner, not sparing any type of economic activity, even production and development. The crisis started out in the financial institutions, banks and stock markets, but it then affected all economic activities whether financial or production.

One of the most recent victims of the economic crisis was General Motors Company, the biggest car company in the world. Its managers hinted that they would declare bankruptcy and its shares declined in value by 55 per cent within only a few days. The other two major car companies in the United States, Ford and Chrysler, asked Congress for 25 billion dollars in urgent assistance.

Thus all branches of the American economy were paralysed. Even the largest American bank, Citigroup, with a budget of 1.35 trillion dollars, is edging on collapse, with its shares declining in value by 60 per cent within a week. The US government rushed in with a $20 billion lifeline to prevent its collapse, fearing a repeat of the Lehman Brothers saga.

It was an even bleaker situation in Europe. The steel industry, for instance, was down 43 per cent across Europe. Giant German chemicals company (BASF) declared its intention to close down 80 factories. Most industrial companies in Europe are in similar trouble.

In Japan, a trade deficit was announced for the first time in decades, totalling 665 million dollars, whereas last year the trade surplus exceeded 100 billion dollars.

All these examples of collapse in great economies provide evidence of the large extent of the present economic crisis and how it encompassed all aspects of economic activity.

As for the second characteristic of the crisis, i.e. its far reach; the crisis has spread throughout the world and encompassed all countries. The expansion of the crisis was due to globalisation which was imposed over the past twenty years. The integration of local economies into the global economy controlled by the United States helped expand the crisis in the form of recurring feedback cycles. That made American economic crises quickly affect all other economies, forcing those countries to pay off huge expenses on behalf of the United States. Thus the American economic and financial problems were globalised, creating problems for all countries whenever the United States mismanaged its economy, whenever they overspent to cover their colonial war expenses or whenever American citizens consumed much more than they could afford. In all those cases, which have become normal, other countries had to pay the bills. Those countries had to deal with American problems even before dealing with their own.

It is clear then that the crisis started in America but then quickly turned into a global problem, resulting in economic shrinkage in all countries and setting off alarms of further consequences. The United States, Europe and Japan have pumped hundreds of billions of dollars into their economies to prevent the current recession from becoming a great depression comparable to the one that began in 1929.
The United States has so far lost 3 trillion dollars due to this crisis, Europe lost more than 2.5 trillion dollars and the Arab states have lost more than half a trillion dollars. For example, ABC Bank lost more than 1250 Million Dollars and the Gulf Bank of Kuwait collapsed. Arab financial markets lost half their value, estimated to be billions of dollars. Elsewhere, most countries lost money in proportion to their income, not excluding any country in the world. This global economic crisis was thus dubbed "The Tsunami of the Century." It was described by the former chairman of the Federal Reserve of the United States, Alan Greenspan, as "a only once in a century credit Tsunami."

As for the third characteristic of the crisis, i.e. surprise; the crisis caught most politicians and economists off guard, especially those outside of the United States. Before it occurred, no one talked about it, and when it happened, everyone talked about its huge size, its depth, breadth and devastating consequences. Olivier Blanchard, chief economist at the IMF, said in an interview with a Swiss newspaper: "The financial crisis that has engulfed many top banks is spiralling into a broader economic crisis that has yet to peak," and he added: "The worst is yet to come." German Chancellor Angela Merkel said: "2009 will be a bad year for the German Economy" and Italian Prime Minister Berlusconi warned that "the global financial crisis will influence real economy in Italy and it may get very deep." The British Chancellor of the Exchequer, Alistair Darling, appealed to British citizens to spend more to "avoid the collapse of British economy" even though his government pumped billions of pounds into banks. Canadian Minister of Finance, Jim Flaherty, said that his country was "headed for a technical recession." Thus the crisis has affected the economies of all countries in a real and profound way.

The question that begs to be asked is: where were these politicians and experts before the crisis began? And why didn't they expect it before it happened? This clearly shows that "surprise" has been a defining characteristic of this crisis.

This crisis, with it three characteristics, was neither normal nor local. It was unprecedented, as well as global.

Now that we have defined the reality of the crisis, its size, its boundaries, and characteristics, let us examine the reasons that caused it to take place.

As a matter of fact, every economic crisis has general causes and particular causes.

As for general causes, they originate from the rotten capitalist system, for it carries within itself the seeds for recurring crises. Although that is not the topic of this paper, it is proper to outline the basic fundamentals of the system, which are related to this crisis:

The basic doctrine of Capitalism, i.e. the separation of religion and state, which made the legislators (thinkers and politicians) in charge of defining the system. They, in turn, pictured that the purpose of life was to acquire utmost bodily pleasures. They embraced material benefit as the scale of actions; every individual had the right to pursue their own benefit, and thus considered it of economic interest, even if it caused harm to other people. This trend was clear and present in the causes of the crisis at hand.

The economic problem, according to Capitalism, is the scarcity of goods and services relative to the needs. Therefore, they focus on production of wealth rather than its distribution, and they leave it to the price mechanism to allow people to acquire goods. For instance, to solve the problem of allowing people to acquire bread, they would focus on producing the amount of loaves needed to satisfy those people; so if the population is half a million, and each person needs three loaves of bread a day, then the focus would be on making a million and a half loaves of bread. After that, it does not concern them if most loaves are acquired by a portion of the population, while others are left with nothing. This focus on production rather than distribution, and the reliance on each individual's capabilities to acquire goods, allowed the huge gap between the rich and the poor in their societies.

Capitalism allows individuals to own whatever they wish without government intervention, thus the freedom of the market. This resulted in crooked methods, speculations and parasitic markets. Those who better mastered the crooked methods made more money. This was also evident in the causes of the present crisis.

This capitalist freedom of ownership resulted in the banking system of usury, financial markets, share-hold companies, stocks, bonds and securities, etc. Who is to tell what other creative money-making methods are yet to come from capitalist minds?

The preceding points suffice in outlining the general causes of the crisis, which emanate from the doctrine of Capitalism and its system. We now turn the focus to the specific causes of the crisis.

The specific causes are divided into two categories. The first category includes causes particular to the United States economy that indirectly paved the way for the crisis. These are three: trade deficit, national debt and the deregulation of the financial industry.

The second category includes direct causes for this crisis and these are two problems: the problem of credit and the problem of speculation in the stock markets.

As for trade deficit, the United States imports more goods and services than it exports. The American consumer has an extraordinary appetite for imports. For instance, the United States imported 1,652 billion dollars of goods and services in 2003, while it exported a total of 1,203 billion dollars, resulting in a trade deficit of 449 billion dollars. In 2007 the trade deficit rose to 816 billion dollars. The reason for the trade deficit is the American consumer's appetite for cheap goods and services imported from Asian and Latin American countries, in addition to the huge amount of military spending to wage wars around the world, which raises government expenditure. Moreover, the relocation of American factories to cheap labour countries contributed to the rise in the trade deficit.

The difference between imports and exports was made up for by the printing of American Dollars and/or American Treasury bonds. Naturally, that resulted in an actual fall in dollar value and reduced investor confidence in the American economy. It is also clear evidence that the world keeps paying the bill of increased American consumption and consecutive colonialist wars.

As for American national debt, the Treasury Department stated that the combined governmental debt (federal, state and local) was up from 4.3 trillion dollars in 1990 to 8.9 trillion dollars in 2007, i.e. it more than doubled. The national debt now constitutes 64 per cent of the Gross Domestic Product (GDP), which puts the United States among those countries suffering from severe national debt. The burden of debt does not stop at governmental debt; it also includes individual and company debt. Individual debt has recently reached an amount of 6.6 trillion dollars, while company debt occupied first place, with an amount of 18.4 trillion dollars. The grand total is about 34 trillion dollars, i.e. three times the GDP. This debt is in itself a dangerous economic crisis. The United States has dealt with this issue by printing more and more Dollar bills and Treasury bonds – if it were not for this their economy would have otherwise collapsed a long time ago.

As for the deregulation of the financial industry, that was in 1999, when Congress reversed the last limitations placed by Franklin Roosevelt's "New Deal" legislation. That legislation was meant to end the Great Depression which started 1929 and to regulate the financial institutions so that they would not repeat the kind of risky adventures that resulted in the economic collapse. Legislation was enacted in 1933 that regulated the financial industry, forcing each institution to practice only one kind of activity; thus separating banks from brokers from insurance companies. It also separated investment banking from commercial banking.

American legislators have lifted those limitations piece by piece over the years, until 1999 when the Financial Services Modernization Act was approved by Congress and signed by former President Bill Clinton. This act removed the last limitations set by the 1933 law and allowed financial institutions to merge and engage in all kinds of activities (investment and commercial banking, brokerage, insurance) under one roof. That year, a wave of mergers, acquisitions and expansion ensued. The big banks and financial institutions were finally allowed to expand their activities free from the old laws. These were the same institutions that actually collapsed or stood on the verge of collapsing in the present crisis, due to their own doing, and due to the complacency of corrupt politicians.

As for the direct causes of this crisis, they can be divided into two problems:

1. The problem of credit and real estate mortgages.
2. The problem of speculations in financial markets.

The credit problem materialised in the United States in the real estate mortgage crisis, after the banks went too far in lending to home buyers between 2002 and 2006, tempting people with low incomes to take out loans by offering them lucrative deals like financing 100 per cent of the home price, which was never done before. Moreover, the banks offered Adjustable Rate Mortgages, in which the interest rate varied depending on the Federal Reserve interest rate, which was down to 1 per cent in 2002. Those deals were heavily promoted by swarms of real estate agents and brokers, whose sole purpose was to find new clients for home buying, regardless of their ability to pay back.

Another factor that made the small banks even more enthusiastic about recruiting home buyers was the reselling of the mortgage contract as soon as it was done. The small banks sold the mortgages to larger banks such as Lehman Brothers, Merrill Lynch or Bank of America. Other buyers of mortgages were Freddie Mac and Fannie Mae, two companies established by the federal government to promote home sales by buying mortgages. The two companies together control about one quarter of real estate mortgages in the United States. These two companies, along with the large banks, issued real-estate-backed securities and sold them to investors, such as banks, individuals, investment funds, etc.

Due to globalised markets and open trading among companies, American-issued real-estate related securities and stocks became popular investments with multinational companies, commercial and central banks, pension funds and individuals. They all anticipated high profits in the flourishing real estate market of the United States. The market values of real estate property, and thus stocks and securities, soared steadily in the United States and all around the world. American individuals and companies took out bank loans to buy homes either for residence, long-term investment or quick speculative profit.

Due to this rush to take out loans and mortgages, the Federal Reserve gradually raised the interest rate from 1 per cent in 2002 to 5.25 per cent in 2006, which caused the interest rate on home mortgage loans to rise from 2.5 per cent to 7 per cent. That scenario brought home buyers face-to-face with the harsh reality of the deals they signed into and many defaulted on their loans, either because they weren't qualified to buy the homes in the first place or because of the sharp rise in interest rates which they could not afford.

The end result was that neither home buyers nor banks could benefit from the homes. Billions of dollars were lost on bricks, wood, steel and building materials. The sold homes were mortgaged out to the banks and investment groups, the home buyers were unable to pay back and nobody wanted to buy homes anymore. The American real estate market was dealt a fatal blow, the stocks of lending institutions plummeted and the depositors and investors rushed to withdraw their money. The lending institutions' inability to return the money resulted in a violent financial shock that swept away the largest financial institutions in America and Europe. Invested money and savings were lost and the crisis ate away hundreds of billions of dollars. This credit problem was the spark that started the present economic and financial crisis, and the resulting fire spread out from the United States to the entire world as a result of globalisation. Many world leaders realized this effect, especially in Europe, where French President Sarkozy said in an angry speech: "The economic turmoil provoked by crises in the American subprime and finance markets has put an end to the free market economy," and "globalization is nearing an end, along with the sundown of Capitalism, which has dominated the entire economy and contributed to its derailing." Then he added: "Laissez-faire (government non-intervention in the markets) is finished, the all-powerful market that is always right, that's finished." German Chancellor Angela Merkel did not hesitate in publicly saying that the United States is primarily responsible for this crisis, and therefore should contribute the largest share towards overcoming the crisis by implementing stronger measures. The Russian President blamed Washington for causing the global financial crisis. According to him, a major cause for the present crisis was that the role of the United States in the global economy was much larger than its real economic abilities.

As for the problem of speculation in the financial markets, it caused those markets to act like black holes, where money went in but never came out. It resulted in huge sums of money that only existed on paper, without any relation whatsoever to assets on the ground. Eventually the money on paper evaporated in an instant and without warning.

Take the following fact into consideration: the actual global production of goods and services is close to 40 trillion dollars a year, but the total sum of the same goods and services negotiated in the financial markets is close to 500 trillion dollars a year, i.e. 12.5 times the actual production. That clearly shows that the financial markets are nothing but parasitic and illusionary markets through which the big speculators get their hands on the money paid by small investors. The big speculators make handsome fortunes using crooked methods that are protected by the law, which is based on the capitalist principle of freedom of ownership. They earn profits without making any real effort, turning the markets into casinos where speculators gamble with buying and selling stocks and securities hoping that their prices will move in the right direction to achieve huge profits. No production is involved and nor is there any movement of goods or services from one place to another to realise the profit. The change in prices is based on the time rather than the place of sale. Hype and gossip are basic tools of the trade, and the change in prices usually depends on prediction of the future; hence the name "speculation" Such dealings have no similarity to lawful transactions in Islam and thus are prohibited from the viewpoint of Islam.

To accelerate the process of changing the prices of financial stocks, legions of fortune seekers work on behalf of big crooks and corrupt governments to raise the value of certain stocks by spreading false rumours about them or by generating noticeable negotiation of the stocks. Once the stocks are subject to fast negotiation in the market and their prices soar, the big speculators sell off their stocks at the highest price. The sale price in that case has no connection to the rules of supply and demand and the huge profits made in such sales have no underlying production of any sort.

That is exactly what transpired in the months preceding the present crisis, when speculators in the financial markets speculated on everything; from oil to wheat to steel and other basic materials. The speculation resulted in the unreasonable rise in the prices of those materials, until the speculators realised their profits by selling the related futures at the highest prices, causing the prices to return to normal. To mention just one example, speculation caused the price of oil to jump to 147 dollars per barrel in July 2008. The price plummeted to below 50 dollars after the speculation ended.

The manipulation of the markets by speculators caused most small investors to lose their money. It also resulted in the flip-flopping of prices, sending wave after wave of high prices and lower living conditions in most societies. In addition, many poor countries suffered from starvation due to the rise of prices of basic foods which were included in the dirty game of speculation.

The President of Brazil, Lula da Silva, described the financial markets as a "global casino run by the Americans," and French President Sarkozy demanded strict rules for the operation of financial markets to curb speculations. He said: "We want a moral Capitalism and the creation of value, not the Capitalism that serves speculations."

Besides usury, four vices are involved in the financial markets and the speculation therein. First: the sales do not entail the transfer of any goods in return for money. Second: uncertainty in the sold commodity due to prediction and speculation. Third: the usual lies and embezzlement to promote certain financial stocks. And fourth: the trading of shares of unlawful share-hold companies, which lack the presence of legitimate partners in their entities. All these vices are strictly prohibited by Islam.

In summary, these two problems - the problem of bad credit and the problem of greedy speculation in the financial markets, both emanating from the latest edition of rotten Capitalism – resulted in the present economic crisis, which rocked the entire world economy.

**Abu Al Izz Abdus Salam**
**7th Muharram 1430 Hijri / 3rd January 2009**

# The Impact of the Global Financial Crisis on Bangladesh and Pakistan

**Introduction**

To understand the current financial crisis in the United States and its spread across the world, it is important to understand the origin of the housing boom and the sub-prime mortgage crisis. Having understood the sub-prime lending and mortgage crisis, the author investigates what would be the likely implications of the global recession emanating from the global financial crisis for South Asian countries and Bangladesh and Pakistan in particular.

**Understanding the Global Financial Crisis: Frameworks**

The current global financial crisis is deeply rooted in several issues pertinent to political economy consideration, bank regulation framework and weak corporate governance. These three frameworks are discussed for understanding the global financial crisis.

Political economy consideration: The global financial crisis started with the US financial crisis. The crisis had its seed in the 'targeted credit program' enacted by the US lawmakers for the less fortunate and less creditworthy potential homeowners – what is known as sub-prime mortgage credit. The bill followed the US election in the following year. Hyper expansionary monetary policy was pursued by the Fed in the US and aggressive investments to highly risky mortgage back securities (MBSs) were made by other financial market institutions in the West as well. Consequently, excess liquidity was made available to banks and other mortgage based lenders especially for home loan and car loans to sub prime clientele groups.

Bank regulation framework: Regulators are less innovative, and they always lag behind, and their initiatives are guided by needs that emerge. Therefore regulation ⇒ regulatory avoidance ⇒ re-regulation continues. Although the crisis was revealed in early 2007, the Fed and other leading central banks' inertia to take timely actions and initiate strategies to offset the possibilities of failure of financial institutions made the crisis worse.

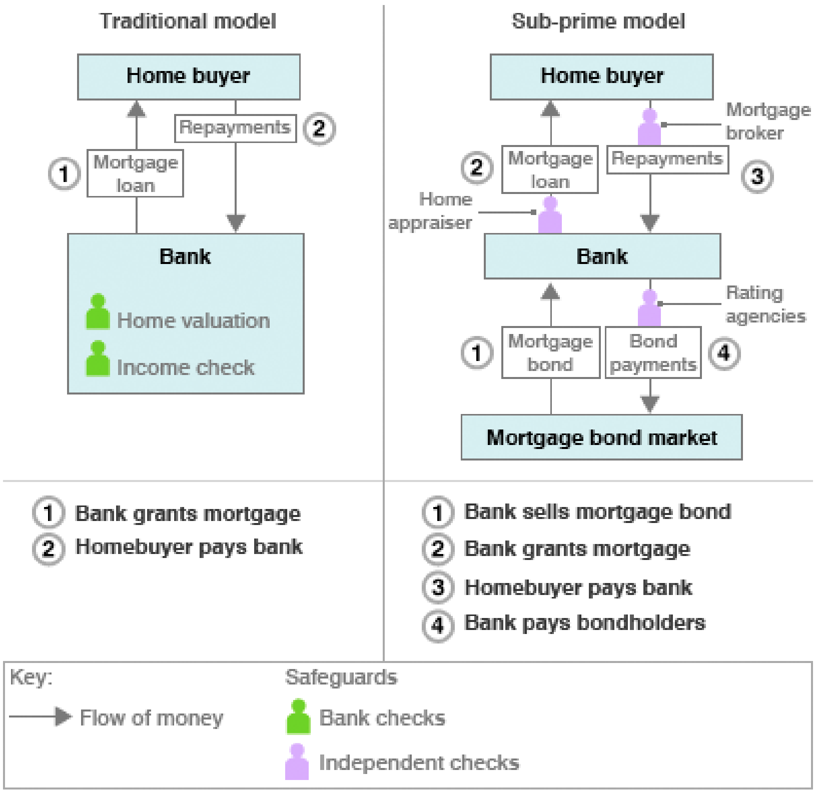
Weak corporate governance: Weak corporate governance never helps institutions, which most CEOs or sponsors never fully recognise and appreciate. This is reflected in institutional decisions of different failed or failing institutions in the USA or elsewhere in the world. Reliability, transparency and disclosure are among the most critical elements of corporate governance practices.

It began in the sub-prime mortgage crisis in mid 2007 when two Bear Stearns hedge funds collapsed. During boom times, mortgage brokers tempted by big commissions convinced buyers with poor credit worthiness and high risk to accept housing mortgages with little or no down payment. Lenders sought additional profits through these higher risk loans, and they charged interest rates above prime in order to compensate for the additional risk they assumed. Consequently, once the rate of sub-prime mortgage foreclosures skyrocketed, many lenders experienced extreme financial difficulties, and even bankruptcy.

**Is sub-prime mortgage and sub-prime lending the root of the crisis?**

The US sub-prime crisis has led to plunging property prices, a slowdown in the US economy and billions in losses by banks. It stems from a fundamental change in the way mortgages are funded.

**THE NEW MODEL OF MORTGAGE LENDING**




Traditionally, banks have financed their mortgage lending through the deposits they receive from their customers. This has limited the amount of mortgage lending they could do. In recent years, banks have moved to a new model where they sell on the mortgages to the bond markets. This has made it much easier to fund additional borrowing. But it has also led to abuses, as banks no longer have the incentive to check carefully the mortgages they issue.

In the past five years, the private sector has dramatically expanded its role in the mortgage bond market, which had previously been dominated by government-sponsored agencies like Freddie Mac. They specialised in new types of mortgages, such as sub-prime lending to borrowers with poor credit histories and weak documentation of income, who were shunned by the "prime" lenders like Freddie Mac.

The business proved extremely profitable for the banks, which earned a fee for each mortgage they sold on. They urged mortgage brokers to sell more and more of these mortgages. Now the mortgage bond market is worth $6 trillion and is the largest single part of the whole $27 trillion US bond market, bigger even than Treasury bonds.

The wave of repossessions is having a dramatic effect on house prices, reversing the housing boom of the last few years and causing the first national decline in house prices since the 1930s.

There is a glut of four million unsold homes that is depressing prices, as builders have also been forced to lower prices to get rid of unsold properties. And house prices, which are currently declining at an annual rate of 4.5 per cent, are expected to fall by at least 10 per cent by next year - and more in areas like California and Florida which had the biggest boom.

**Behaviour of Lenders and identification of problems**

Lenders moved more into real estate financing, even lending to risky borrowers. Essentially credit history and capability were the forgotten features. Banks and financial institutions often repackaged these debts with other high risk debt instruments.

These were sold to worldwide investors creating financial instruments such as collaterised debt obligations (CDOs) and mortgage backed securities (MBSs). In fact, in other words, banks and financial institutions securitised mortgaged assets as collateral to investment banks – shifting risks to investment banks and investors. Around 80 per cent of sub-prime loans were securitised.

Credit rating agencies (CRAs) were not efficient and provided inaccurate assessments. Rating did not reflect the real value of assets as assets backed securities are insured by big insurance companies, like AIG.

Consequences of falling housing prices have knock on effects on the increase in default and foreclosure, illiquidity and credit crunch at the bank level and eventual loss, and default to investment bankers, loss, and eventual plummeting stock price and world stock markets. The crisis was felt with the collapse of Lehman Brothers, one of the biggest investment banks, through bankruptcy; Merrill Lynch was taken over by Bank of America Corporation and American International Group (AIG), the world's top insurer, scrambles for capital because of losses on its mortgage-related debt. The governments in the wealthiest nations came up with rescue packages to bail out their financial systems.

The problems that we identified as the cause of crisis are as follows:

- Cheap fund creates distortion in allocation of resources, and encourages lenders to lend in more risky loans; [Politicians were the initiators with no guarding of potential risks];
- Lenders through securitisation increase risks of other investors if assets are more risky and credit rating agencies provide inaccurate assessment;
- Lending standards declined more in areas with higher mortgage securitisation rates;
- The repackage of debt instrument involves complex financial engineering in primary and secondary markets of mortgaged securities with innovative financial instruments, which in turn, creates lots of leverage in the financial system and economy;
- Despite more than 60 regulatory recommendations drawing on national and international regulatory authorities by the financial stability forum (FSF) and rules concerning capital requirements for international banks by the BASEL committee on Banking Supervision, the securitisation trends of sub-prime mortgages have been left out of these requirements;
- The attempts by banks to move part of their securities activities to newly created structured investment vehicles (SIVs), which remain off balance sheets are also attempts to escape existing capital requirements partly.

**Crisis led to Global Economic Slowdown/Recession**

The property crash is also affecting the US economy, with the building industry expected to cut its output by half, with the loss of between one and two million jobs. Many smaller builders will go out of business, and the larger firms are all suffering huge losses. The building industry makes up 15 per cent of the US economy, but a slowdown in the property market also hits many other industries, for instance makers of durable goods. Moreover, many US consumers have spent beyond their current income by borrowing on credit and the fall in the value of their homes may make them reluctant to continue this pattern in the future.

One reason the economic slowdown could get worse is that banks and other lenders are cutting back on how much credit they will make available. As a result of the sub-prime crisis, the banking industry is facing huge losses. The world's leading investment banks and financial institutions collapsed.

The financial crisis that originated in the United States and Europe is now hurting the real economies and the crisis has spread to most parts of the world. As the financial crisis has turned into an economic recession in nearly all OECD countries, governments are pumping money into the banking and real sectors in ways never seen before. Pakistan has had to seek an International Monetary Fund (IMF) bailout to withstand the external shock.

Prospects for global growth have deteriorated over the past month, as the financial deleveraging has continued and producer and consumer confidence have fallen. Accordingly, world output is projected to expand by 2.2 per cent in 2009, down by some ¾ percentage point of GDP from the projections in the October world economic outlook (WEO). In advanced economies, output is forecast to contract on a full-year basis in 2009, the first such fall in the post-war period. In emerging economies, growth is projected to slow appreciably but still reach 5 per cent in 2009. Rapidly weakening prospects for global growth calls for global action to support financial markets and provide further fiscal stimulus and monetary easing can help the decline in world growth.

**Economic Implications for Bangladesh and Pakistan**

The global economic slowdown emanating from the global financial crisis fuels the adverse effects of severe terms-of-trade shock already confronted by South Asia. The adverse effects of these terms of trade losses have been substantial, reflected in a slowdown of growth, worsening of macroeconomic balances and huge inflationary pressures. The adverse trends are compounded by the slowdown in the global economy on the growth and balance of payment front in particular. In the words of Professor Sakiko Fukuda-Parr,

> "…Impacts on developing countries are not so much from the financial crisis but more from the recession in the global economy…The effects include fall in commodity market prices, contraction of markets for export product, decline in capital flows including remittances".

Recession in the global economy will adversely affect South Asian exports and could hurt income from remittances. Lower foreign capital flows and harder terms will reduce domestic investment. Both will lower growth prospects.

**Terms of Trade Shocks**

South Asia suffered a significant loss of income from a severe terms-of-trade shock originating from higher food and petroleum prices in recent years (Figure 1). Within South Asia, term-of-trade loss is 7.7 per cent for Bangladesh, while it is 11.3 per cent for Pakistan (Figure 2). Much of the loss came from higher petroleum prices, where all South Asian nations lost. On food, Bangladesh lost most, while being significant rice exporter, Pakistan actually gained.

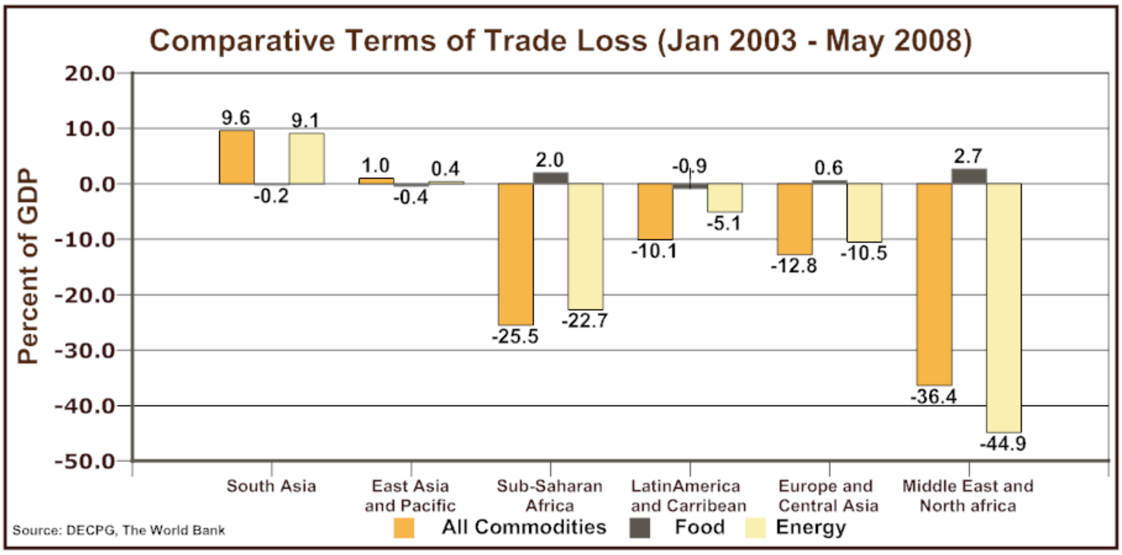



**Figure 1**

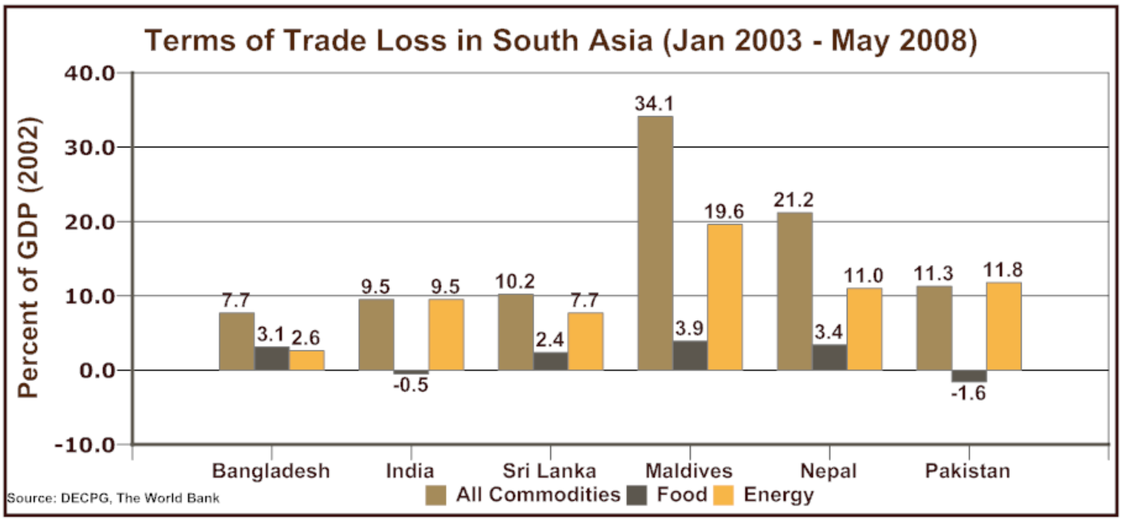



**Figure 2**

The huge loss from the terms-of-trade shock, however, was largely met by compensating growth in remittances and Bangladesh enjoyed a satisfactory current account balance. Pakistan suffered the most deterioration in the current account balance, which turned from a surplus of around 4 per cent of GDP in 2003 to a deficit of over 8 per cent in 2008 (Figure 3). The tremendous growth in remittances enabled Bangladesh to continue to enjoy a surplus in its current account balance. Pakistan has been facing balance of payments pressures from expansionary fiscal and monetary policies; the terms of trade shocks accelerated the deterioration.

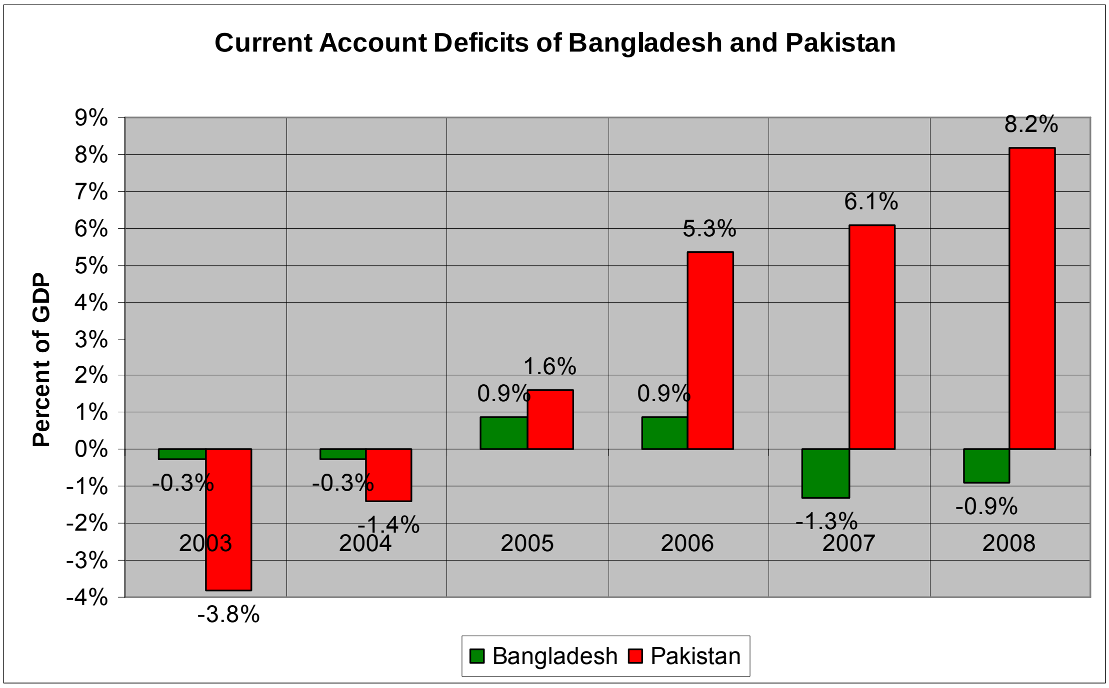



**Figure 3**

Concerning fiscal balance, Pakistan registered sharp deterioration increasing the deficit to 7.4 per cent of GDP in 2008 from 2.4 per cent in 2004. Bangladesh also struggled quite a bit. Its fiscal deficit widened to 4.2 per cent in 2008 mostly due to increases in food and petroleum subsidies. Rising food and fuel prices have been a major source of inflationary pressure in Bangladesh and Pakistan.

Prices of staple food have started to come down in all South Asian countries owing to good harvests in 2008 and following the financial crisis, the fall in actual demand and market speculations have lowered commodity prices. The global oil prices have also come down sharply to around $40/barrel as compared with the spike at $150/barrel. The combined effects of lower food and fuel prices along with demand management are reducing inflationary pressure in Bangladesh and all other South Asian countries except Pakistan. The price difference of commodities between the international and domestic market remains high due to the sticky nature of prices. The point-to-point inflation that reached 11.59 per cent in December 2007 has come down to 10.19 per cent in September 2008, to 6.12 percent in November 2008 due to falling prices of commodity items in international and local markets.

**Are Bangladesh and Pakistan vulnerable to the Global Financial Crisis?**

Vulnerability, to a great extent, depends on whether the economy is 'credit oriented' or 'saving oriented'. US economies focus on the consumption of future incomes by relying more on the credit card. The economies of Bangladesh and Pakistan are more savings oriented. As the overall financial leverage in Bangladesh is low, while it is moderate for Pakistan, the external shocks stemming from the global financial storm are unlikely to spell a major credit crunch not only in Bangladesh but also in Pakistan to some extent.

Bangladesh's resilience to the global economic woes lies in large part on its relative insulation from international capital market and a trivial foreign portfolio investment.

Unlike the global financial institutions, Bangladeshi banks have no exotic or toxic derivative engagements that could make overnight default of the financial sector. The off-balance sheet items are mostly very basic swap contracts, which should not create any significant unexpected losses.

Given the above-mentioned factors, Bangladesh is not at all vulnerable to the global financial risk, while Pakistan is to some extent.

**Effects of Global Economic Slowdown**

The reduction in global petroleum and food prices observed over the past few months provides a silver lining for South Asia in an otherwise difficult external environment**.** Yet this silver lining is now heavily clouded by the emerging global recession that poses tremendous downside risks to South Asia including Bangladesh and Pakistan.

The potential channels of transmission of these risks are multiple. The financial risks include the lower foreign capital flows and its price including the inflow of foreign aid. In addition, a number of risks in the real sector emanate from global slowdown in growth covering adverse effect on exports, possible downward pressure on remittances and slowdown in investments and growth.

**(a) Financial Sector Effects**

The Bangladeshi banks and other financial institutions had limited exposure to banks and investment firms in the United States and Europe. As a result, the country's banking sector is largely insulated from the banking sector troubles in the West. Hence, the banking sector has only very limited exposure to international financial markets mostly in the form of foreign currency reserves. Moreover, with timely steps of Bangladesh banks, most of the funds in international banks are shifted to safer accounts. As foreign equity investment accounted for only three to four percent of market capitalisation, the shocks through the stock markets in Bangladesh have also been limited.

Bangladesh's exposure to the contagion effects of the global financial markets has been low. The country's financial sector is reasonably resilient mainly due to the implementation of financial sector reforms since the 1990s. These reforms have led to significant improvement in the regulatory framework along with rapid development of financial sector activities and improved health of the financial system. For managing credit and liquidity risks in the financial market and promoting healthy competition and efficient performance, Bangladesh Bank has been providing prudential guidelines and implementing reforms for ensuring proper financial regulation and supervision. The financial sector is mostly insulated from foreign markets because of very low private capital inflows. External debt is low and reserves are comfortable. As such Bangladesh's financial sector has remained largely immune to the recent global financial sector turmoil and the effect of the global financial crisis on the financial sector is likely to be negligible in this environment. Bangladesh is relatively more exposed from the real economy effects of a possible slowdown in exports, especially garments, and from remittances.

Pakistan, the second largest economy in South Asia, is much more fragile and faces the most vulnerability in the region. High fiscal and current account deficits, rapid inflation, low reserves, a weak currency and a declining economy put Pakistan in a very difficult situation to face the global financial crisis. Efforts are now underway to arrest the decline of the macro economy through appropriate demand management including tightening of monetary and fiscal policies. Pakistan's ability to borrow externally is already heavily constrained and bond spreads are very high. The global financial crisis means that non-official foreign capital flows would be even more expensive than now. The contagion effects on domestic financial sector could be substantial, but stress tests suggest that the banking sector as a whole is likely to withstand the shocks. This is mainly due to the improved health of the financial sector based on past reforms.

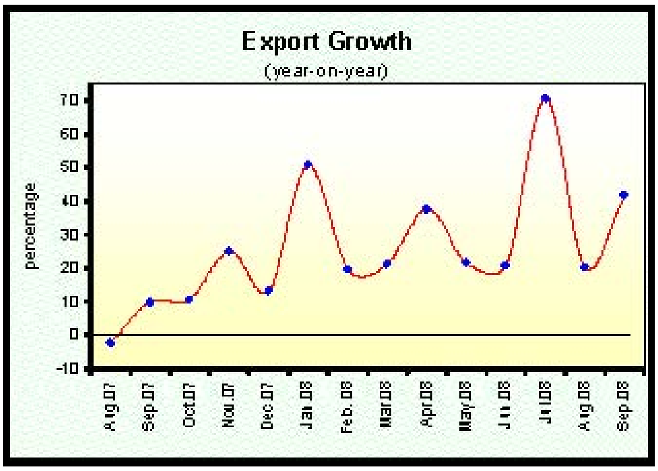
**(b) Economic- Real Sector Effects**

The possible negative effects of the global slowdown are much more direct and substantial from the perspective of implications for the real economy. These will work through external trade, remittances, investments and growth.

**(i) Exports**

Because of reforms in external trade, Bangladesh and Pakistan have become much better integrated with the rest of the world than in the early 1990s. Exports are a major source of growth stimulus to both the countries. The recession in OECD countries will almost certainly lower the export prospects for all South Asian countries. Bangladesh and Pakistan are also a major exporter of textiles and garments that are vulnerable to the recession in the OECD economies. Depending on the depth, severity and period of this recession, the adverse effects on exports can be large but are still unfolding.

Bangladesh's external sector has maintained a positive growth when most economies have experienced a contraction of trade and of other sub-sectors in their current accounts. The growth in Bangladesh's imports and exports has been positive as shown in the following graph:




Export receipts in November 2008 stood higher at US$1051 million compared to US$867.83 million in October 2008, according to EPB data. Export receipts during July-November, 2008 increased by US$1172.21 million to US$6300.21 million as compared to US$5128.00 million of July-November, 2007.

Bangladesh's export growth recorded an impressive 26.87 per cent in the first five months of the current fiscal year (FY2008-09). However, exports declined in October and November 2008 by 7.8 and 8.6 per cent respectively compared to exports receipts in October and November 2007. This fall in exports is due to the recession in US and Europe; major trading partners.

Exports of Bangladesh in FY09 are projected to grow by 16.3 per cent to US $ 16.4 billion. She exported US $ 6.3 billion in the first five months of current fiscal. To achieve the target, exports need to grow by 8 per cent in the remaining 7 months of FY09.

The export basket of Bangladesh comprises around 39 per cent knitwear and 37 per cent woven garments as of June-July 2007-8, according to Bangladesh Export Promotion Bureau. Despite the phasing out of MFA, quota withdrawal by the USA and intense competition by other Asian countries such as China, Bangladesh RMG industry has shown resilience and excellent growth in the last few years. This is probably because of the cheap production cost available here. The current global recession has led to a severe decline in the demand for ready made garments worldwide particularly the major RMG importing countries including the US, UK, France, Germany etc. More than 50 per cent of Bangladesh's garment exports go to the countries of the European Union and 25 per cent to the United States.

The textile and readymade garments (RMG) sector which drives the country's exports has not, to-date, been affected by the recessions in the United States and Europe. This is reflected by the fact that knitwear garments received roughly 38 per cent higher export orders in November 2008 than the corresponding period last year. In addition, RMG products have low price elasticity and are targeted towards relatively lower income groups.

The current economic crisis in the United States has increased the demand for Wal-Mart products as consumers switch from high-end fashion clothes to low-end apparels. The US-based Wal-Mart, the world's largest retailer of clothing, buys RMG products worth $1.7 billion a year from Bangladesh. The major products that Wal-Mart purchases include T-shirts, shirts, polo shirts, pullovers, home textiles, bed sheets and trousers. Bangladesh's labour cost is one of the lowest in the world. It is expected that demand for Bangladesh's RMG is not likely to fall; indeed it may increase, during this downturn period, owing to the 'Wal-Mart' effect.

It is seen from the monthly trends in exports of Pakistan that during July-November 2009, it exported US $ 9.72 billion registering a growth of 13.2 per cent against exports totalling US $ 8.6 billion in the same period of the last year. Though the sharp fall in exports took place in October and November 2008 compared to exports of US $ 1.8 and 1.5 billion in October and November 2007.

During November 2008, exports of Pakistan increased by 0.54 per cent marginally to US $ 1.53 billion against the exports of US $ 1.52 billion in October 2008. However, it is lower by 0.76 per cent from the exports worth of US $ 1.54 billion in November of the last year. However, it registered an impressive growth of 30 per cent over November 2007 in terms of the value of Pakistan's rupee. This increase in exports in terms of rupee is absolutely attributed to the depreciation of Pakistan's rupee vis-à-vis dollar and other major currencies.

**(ii) Imports**

Both Bangladesh and Pakistan are import-oriented economies. The downward trend in commodity prices, especially food and fuel, emanating from the recession in OECD countries will have a positive impact on the reduction of import bills on these accounts. The terms of trade will improve and have positive implications for the current account of the balance of payments.

Bangladesh imported goods and services worth US$ 9.44 billion in the first five months of the current fiscal having a growth of about 25 per cent. Against exports totalling US$ 6.3 billion, the trade gap widens to US $3.08 billion in July-November 2008. This is due to the fact that the country is still making payments against earlier imports, i.e. payment obligations of the by-gone fiscal year. The import bills due to falling commodity prices are likely to fall in the coming months.

Monthly trends in imports to Pakistan show that import bills decline in October 2008 and continue to decline further in November 2008 by one-seventh over that of November 2007. The reduction of import bills would enable Pakistan to reduce the trade-gap.

The downward trend of commodity prices in the international market, especially fuel and food, drives down inflation in Bangladesh to 6.12 per cent in November 2008, while its effect is being obscured by the depreciation of the Pakistani rupee.

**(iii) Remittances**

Foreign remittances have grown rapidly in South Asia over the past few years. These have not only provided an offsetting cushion on the balance of payments, but more importantly they have been a huge source of income and safety net for a large number of poor households in South Asia, especially for Bangladesh.

Wage earners' remittances, which are the second-most foreign exchange earners in Bangladesh, registered 33.89 per cent growth to US$ 3.75 billion during July-November 2008, compared to the corresponding period last year. Remittance growth of Pakistan stood at about 15 per cent during July-November 2008. Monthly trends in remittances to Pakistan shows that there is a fall in remittance in October 2008 and then it rises again.

The flow of remittances is not likely to be adversely affected in the short term, especially for Bangladesh as more than 60 per cent of remittances come from low-skilled workers engaged in the oil-rich countries of the Middle East; while 51 per cent of the remittances of Pakistan come from the Middle East. These earnings do not face an immediate risk as these economies have huge earnings and reserves from the oil price boom.

Only 17 and 12 per cent of total remittances of Bangladesh are from USA and the EU respectively, while 27 and 11 per cent of remittance of Pakistan are from USA and EU respectively. Remittances from USA and the EU can be adversely affected by the global economic recession. In this context, Pakistan is particularly exposed to this recession in OECD countries. On balance, the risk of substantial lower earnings from the remittances appears low.

The strength of Bangladesh in the current account balance and foreign exchange reserves are reflected in the country's exchange rate which faces virtually no pressure, unlike Pakistan. In recent months, the Pakistani Rupee, has witnessed a free fall, whereas the Bangladesh Taka has remained stable against the United States dollar, and it has experienced modest to significant appreciations vis-à-vis some major currencies, including the Euro and the Pound Sterling.

The exchange rate of Bangladesh Taka per US$ increased to Tk.68.6450 at the end of October 2008 from Tk.68.5150 at the end of June 2008. Taka depreciated by 0.19 per cent as of end October 2008 over end June 2008. The slightly stronger dollar opens up opportunity for exporters of Bangladesh.

**(iv) Investment**

Potential decline in aid flow may be expected in the awake of ongoing global economic shocks.

The main risk to growth comes from the likely adverse effects on investment of the combined effects of a slowdown of foreign funding and a possible increase in non-performing assets of domestic banks owing to lower profitability of firms producing for export markets. At the same time, higher inflation has required tightening of monetary policy. All of these factors will reduce the availability of domestic financing of private investment. Public investment is already constrained by rising fiscal deficits. Overall, there is likely to be a slowdown in the rate of domestic investment. Improvements in saving rates in South Asian economies have been an important cushion. But inadequate adjustment to the losses from terms of trade, combined with a possible slowdown of exports earnings and foreign capital flows will almost certainly deter investment and consequently reduce growth.

On a note of the impact on macroeconomic balances, the fiscal scenario will improve from lower subsidies due to falling prices, but revenue earnings can decline from lower growth.

**Conclusion**

In my candid opinion, Bangladesh can remain resilient to the external shocks stemming from global economic slowdown, while for Pakistan it may be a struggle.

The economy of Bangladesh may not be affected in the short run. As the oil and other commodity prices have declined significantly, the authorities in Bangladesh are under less pressure to proceed to accommodative monetary policies and expansionary fiscal measures so that the economy maintains the target GDP growth more or less without worsening its inflation.

On the contrary, having high fiscal and current account deficits, rapid inflation and a weak currency, Pakistan does not have the option of riding out further shocks with expansionary fiscal and monetary policies. Hence, growth will need to fall for Pakistan in the short term to absorb the shock from the global economic slowdown.

To withstand the shock emerging from global economic slowdown and ultimately its impact on growth depends on how long the recession lasts and the depth and severity of the recent global crisis.

**Mahmood Osman Imam**
**Professor of Finance and Chairman, Department of Finance, University of Dhaka**
**7th Muharram 1430 Hijri / 3rd January 2009**

# The impact of the global financial crisis on the Arab countries

All those interested in economics as well as world experts agree that the world financial crisis doesn't spare any from its repercussions, although the extent of the damage may differ from one region to another and from developed nations and developing ones.

Analysts disagree on how the crisis has developed, its depth, and the possibility of providing a remedy to it, in addition to the most effective means to do so, and the time span of the crisis treatment response.

As we look into the consequences of the financial crisis on the Arab countries, we find ourselves in a bitter situation because of the existence of many obstacles and hindrances that others don't have. These include:

1. The scarcity of the financial information about the Arab countries, which is due to the prevailing lack of transparency.
2. The absence of independent decision-making, which is necessary for rectifying the crisis.
3. Many decision makers are not qualified to take those decisions.
4. The artificial division of the Arab countries into state-like entities, the overwhelming majority of which don't possess the full capacity of a state.

It is evident that all the aforementioned drawbacks impede researching and exploring the effects of the current financial crisis on the Arab countries.

Since World War II, the United States has imposed its hegemony on the world's economy, starting from the Bretton Woods agreement, then the abolition of the gold standard in 1971, and the collapse of the communist economic system in what was known as the Eastern Bloc, and ending with the emergence of the globalisation era, which exceeded all limits of control. This resulted in America looting the world's resources and wealth and sucking up peoples' savings, even those of the poor people from the impoverished nations around the world. For us living in the Arab world, we have been no exception. In fact, we were particularly targeted because of what Allah (subhanahu wa ta'ala) endowed upon us in terms of wealth, specifically oil, raw materials, a huge young and resourceful population and the special geography and climate we enjoy.

The bitter fact is that the Arab countries are divided into impotent states and state-like entities after the application of the colonial Sykes-Picot pact, which the partisan Arab League maintains. This makes us an easy prey for the greedy. If the Arab countries were united, we would be spared a lot of calamities. The financial surpluses of the Arab oil countries are so huge to the extent that they are unable to invest them locally, and instead resort to investing them in foreign countries such as the United States. In addition the relations between Arab states are very bad, which means that we lose again for the western countries' benefit.

The Arab gross investment in foreign countries is estimated at 14 trillion dollars while the inter-Arab accumulative credit has reached almost 30 billion dollars in the last eight years. Thus, the financial crisis has had a negative impact in the Gulf states for example. The financial surpluses in these states, which have accumulated in what is called 'sovereignty funds' and in corporations as well as individuals are estimated in trillions. Surely, a lot of these are invested in various bank bonds and stocks in corporations existing in America and Europe. This simply indicates that part of the wealth of the Arab countries, especially the Gulf States, are investments that have suffered whole or part losses in value. Available data suggests that financial and bank sector losses in Arab countries are estimated at 800 to 900 billion dollars. As for rich individuals' investments, speculating losses can't be measured; however, it is estimated to be in the billions. There are also estimations that 50 per cent of the1.5-2.5 trillion dollars of Arab investments in American banks, 90 per cent of which come from the Gulf States alone have been lost. In the Gulf States region, the bonds market capital has come down to $250-300 billion since July 2008. This equates to one third of the gross national income for the Gulf States.

It is very painful that Arab money is lost while hundreds of thousands, if not millions, suffer from unemployment and hardship in the region. It is no secret that non-oil Arab money, estimated at tens of billions of US dollars, most of which come from looting public money by corrupt Arab officials, is not spoken of. A report by the World Transparency Organization indicated that 90 per cent of the money given by donating countries to Arab countries resurfaces as private investments and bank accounts in western countries for the benefit of corrupt Arab officials.

Sectors affected by the world financial crisis:

The impact of the current world financial crisis on Arab countries encompasses various domains, some of which are positive which we will address later. As for the negative areas, they can be summarised as follows:

**The economic impact of the crisis**

1. Reduction in oil prices as a result of the world's falling demand, especially for the demand from developed countries that have started to suffer recession.

This leads to a negative influence on the trade balance for oil countries; this also applies to raw materials and other minerals exported to industrial states. Looking at the reduction in oil barrel price, we can conclude that oil states will lose two thirds of their oil revenues if the price of oil stabilises at $50 a barrel.

2. Reduction in money transfer from the Arab workforce in the Gulf states and western countries especially that coming from Morocco and north Africa.

The Arab workforce is concentrated in the Gulf region and influences mainly Jordan, Egypt, Syria and Lebanon. This money transfer reduction contributes to the slowing down of the economic cycle in the states receiving the transfers, and reduces hard currency in such states which has a negative effect in their foreign trade.

3. Reduction in exports:

The developed countries' state of recession led to lower demand for many products which meant fewer exports to these countries from Arab states. For example, Egyptian exports of clothes to western countries is estimated at 60 per cent to America and 35 per cent to Europe. The Egyptian Export Council indicates that food exports will go down this year by 12 per cent and in Morocco, exports to the European Union will go down by 60 per cent.

4. Losses in Arab investment in western countries:

Undoubtedly, a huge percentage of the mammoth Arab investment in western countries was in the financially troubled corporations or the ones that announced bankruptcy. As previously mentioned, a lot of these investments can't be known because corrupt Arab officials and politicians never reveal their investments. However, losses of official investments such as those of the Arab banks are huge; an example is the Kuwaiti Gulf Bank which lost around 375 million dollars in the third quarter of 2008 alone according to an announced bank report, which accounts for 79 per cent of stock holders rights in the bank. As mentioned before, the total losses in the banking sector alone, in Arab states, including those in the Gulf, are estimated at $800-900 billion. A lot of these losses were the result of dealing in what are known as 'financial products' (Ref: Jordanian newspaper Al-Dustoor, in an article by Dr. Al-Najatee Al-Taieb Ibrahim - 11-12-2008).

As for the investment reports of sovereignty funds, the overwhelming majority of them are not revealed by Arab countries.

5. Losses on the Arab stock markets:

These have lost a lot of their value; almost all citizens have been severely affected by the continuous collapses in these markets. An example is the Egyptian market which lost more than 75 per cent of its value. The book value losses of the trading companies brokering in the Egyptian stock market have reached 315 billion Egyptian pounds. The stock markets of the Gulf States are no better; the Kuwaiti stock market was subject to huge losses which made officials rush there to close it down. Some reports in the Gulf region indicated losses of $155 billion in a single week of brokering (stock market trading) at the peak of the financial crisis. What is particularly painful are the losses ordinary people had to suffer, many of whom committed suicide while many others suffered psychological and physical ailments as a result of the Arab stock market collapse – this is according to many Arab media reports.

6. Arab and Foreign investments lagging in the Arab region:

There are two types of investments:

First: Investment by countries; these are related to countries' budgets. The current financial crisis, with the accompanying reduction in oil prices and export revenues in addition to workforce money transfers, have caused the halting or freezing of all or part of these countries' investments in the infrastructure and other vital national projects. Many Arab countries are working on reforming their budgets to cope with the financial crisis they suffer from, e.g. in Yemen, the budget for the year 2009 has been reformed and altered five times for the purpose of applying austerity measures.

Second: Investments by individual and companies aiming at profit. These also will be affected by a multitude of factors including global recession and cash fluctuations in these companies as an effect of the financial crisis.

7. The decrease of assistance money provided by donor countries:

It is normal that these donations will be reviewed in light of the crisis; donors have started to think about the local issues of their countries. We must not forget that these money aids are offered originally for political and not ethical or humanitarian reasons, which make donations subject to fluctuations.
Many of these donations are used in developing projects and in infrastructure spending in the Arab countries where, if implemented, the working class may benefit.

8. Individuals' savings loss or evaporation:

One can conclude from the previous negative impacts of the financial crisis that peoples' savings will vanish. On the one hand, those who invested in stock markets in Arab countries or outside have suffered whole or part bonds and stocks losses. On the other hand, people have to spend on their daily needs which exhausts their savings; those who will be affected most are the ones who work for companies, and in sectors, shrinking economically. The result, consequently, is loss for company owners as well as employees, and the more the crisis persists, the more savings evaporate.

**The social impact of the crisis**

It is normal that the financial crisis has negative social effects; these of course differ from one state to another depending on the state's ability to cope with the crisis and whether it provides proper responses and remedies. Generally, the following are some social effects of the financial crisis:

1. Unemployment, poverty, and crime:

Unemployment results in more poor people; poverty is a terrible monster. Ali Bin Abi Talib (radiallahu anhu) spoke of it and said "If poverty were a man, I would kill it", to show how it affects the society negatively in the form of increased crime and the emergence of newer crimes which were not there before. All know that poverty is a great incentive for crime that doesn't care for the consequences. Abu Thar Al-Ghafari (radiallahu anhu) once said, "I would wonder if one doesn't find anything to eat, what could prevent him from waving his sword in peoples' faces".

2. The emigration of the qualified ("brain drain"):

The Arab world has always suffered from this phenomenon. The economic motive is not the only motive for qualified people to leave for the West; political persecution is another. In the absence of proper economic solutions by most Arab regimes, many look for better opportunities outside the Arab world.

3. The increase in celibacy among men and women:

This phenomenon is on the increase in the Arab countries; in fact, it has reached alarming rates. Many factors contribute to it including that of the financial crisis. This has led many young men and women to lose hope, especially as orthodox Islamic teachings are absent in the society and as the western capitalist lifestyle is prevailing. This phenomenon accompanies many unpleasant effects in the society particularly with what the directed media (mainly the visual) is doing in corrupting the society's values concentrating on the youngsters, which aims at making them nothing but delinquents and losers.

**The positive influences of the crisis**

The global financial crisis has some positive impacts on the Arab region and the world as a whole. The first positive effect is that many economic experts and politicians have started to reconsider the core principles upon which Capitalism is built. Capitalism has led the world economically and caused the crisis all are suffering from; a crisis whose chapters are still unfolding. Western and Eastern experts have agreed that it is necessary that alternatives to Capitalism are now a must and a necessity. Many even voiced a call for implementing the Islamic monetary financial system although Islam is not implemented in life. Many heads of European newspapers have spoken openly in their editorials of this. The Challenger and The Journal De Finance are two examples.

With respect to the positive effects in the Arab countries, the following are examples:

1. Many Arab capitalists are now convinced that it is a mistake to invest in the West, and that the western economy is much more fragile than they previously believed.
2. The import bill of many Arab countries, especially non-oil ones, has decreased.

**Do Arab regimes offer protection for the local economy?**

These regimes have been abiding by the World Bank prescriptions for economy for a long time now; the prescriptions that have always spread poison into the economically crippled Arab states' economies. The disaster is that these regimes never learn and the people get poorer and poorer with nobody saying "enough is enough".

Some of the practices of the Arab regimes, in this regard, include:

1. Commitment to free trade and continuing what they call 'economical reforms.'
2. Maintaining privatisation policies.
3. Continuation of encoding legislations which protect foreign investors through big tax exemptions while many local investors are suppressed by taxes.

Committing to these terrible economic practices will lead to more unemployment rates as a result of privatisation; thousands and thousands are going to lose employment. Also, lifting the protection on the local products for the benefit of the imported competitive goods will make many businesses collapse and close. It is of course needless to say that the Arab local products can never compete with those of foreign corporations. Relieving foreign investors from taxes makes them economically strong at the expense of local companies and businesses.

It is no coincidence that the Jordanian phosphate company suffered losses when it was a state owned company, and when privatised it made huge profits. The privatised Egyptian cement companies have also become lucrative. However, who benefited from that? The foreign investors made money, but the poor Arab people can't buy cement because the prices have multiplied.

It is worth mentioning that Arab countries have secured bank deposits for banks working in Arab countries, as stipulated by the law. However, capitalist laws relieve banks from their liabilities in their capacity as public stocks corporations which secures protection for their owners from suffering in case they declare bankruptcy.

**Available Capabilities and Limitations**

We have briefly discussed the impact of the global financial crisis on the Arab countries which should be considered in light of the prevailing limitations including the fact that the Arab countries are not united and each works alone, despite the many common factors that should unite them. Economically, Arab countries have also failed to issue a single currency.

The means necessary for the emergence of an economically, politically and militarily strong state exist in the Arab region and in the Muslim world as a whole. We therefore mention some of these powers:

1. The thinking bond which ties all Muslims; Islam is a power and everybody knows what it can do.

2. Workforce:

The Arab society constitutes a sterling workforce especially the young who have a high level of academic achievement but require practical training which can be attained very quickly.

3. Energy and raw materials:

The Arab region possesses almost all the world's oil reserves; Saudi Arabia alone has 25 per cent of the world's oil reserves and Algeria comes next to Russia in gas. As for other raw materials and minerals, they are abundant in various Arab regions although some have not been mined yet.

4. The capital:

We have mentioned that the oil-producing Arab countries couldn't invest their surplus money inside and invested it in foreign countries. This money is more than sufficient to establish a strong and solid economic region.

5. Geography:

It goes without saying that the Arab countries are situated in the most important and influential positions around the globe and constitute the heart of the world. This offers diversity in climate and possibility for real economic revival. In addition, Arab countries possess other invaluable capacities including a good market volume, closeness to huge markets such as Europe and Africa, naval passages and long shores.

Unfortunately, all these capacities couldn't result in political and economic unity or luxury for the common person in the Arab countries. All this, in fact, can be attributed to the impediments which prevent us from achieving our aspirations.

The most important limitations are the following:

First: The loss (non-existence) of political and economic independence:

Political independence is not a national anthem played to an Arab despot; it is decisions taken by governments in all realms of life. It is political independence that should give answers and take action over situations such as the Gaza siege, the occupation in Iraq and towards Ethiopia's invasion of Somalia.

One pillar of political independence is the economy. In fact, political independence entails a solid economy. We have discussed how Arab currencies are tied with the dollar, for example, and how Arab countries invest their money surpluses in American and European banks. Was it not necessary and important that Arab countries take economic decisions which benefit their people such as building solid infrastructure that would serve as a platform for industry and technology? Was it not considered sound to invest money surpluses in such projects instead of stashing it in foreign banks? South Korea didn't have what Arabs possess as means of power, and could have never compared to the multiple wealth resources available in the Arab region. However, South Korea had one important thing that Arabs don't: the political will that was sufficient for it to provide resources to make it a pioneering economic power, competing at a global level.

Second: Public corruption

In many Arab countries, one can't do something without offering a bribe. This can be even harder in the case of establishing a plant or embarking on a business project where all those involved demand a share of the enterprise even before it starts. More strangely, bribery is widespread in oil-producing states; one might not be surprised that officials in a poor country like Yemen live on bribes, but what could we say about those in richer states who thrive on bribes and who are loaded with money deposited in their fat bank accounts which suffice them forever. The talk about public corruption can never end.

Third: Absence of security

We don't mean by that theft and looting of national bounties – rather what is meant is that the Arab investor can't secure himself or his money in his country and in other 'brotherly' Arab states. Ready made and fabricated political accusations are always there, and give Arab regimes the right to take whatever measures they choose against investors including that of confiscating your money for no reason. As for an Arab investor in another 'brother' state to his home state, the stability of his investments is contingent upon the political relationship between the two countries, which is, as everybody knows volatile and subject to fluctuations. This pushes even the sincere Arab investors to invest outside the region as an act of precaution.

Finally, the Arab region is heading towards an uncertain future of repercussions as the world crisis unfolds. Even the experts can't predict the consequences; these will encompass all aspects of life including the economy which will increase poverty and unemployment, decrease production and give rise to negative social consequences. The crisis might lead to drastic political changes and developments on the horizon where the official Arab systems will not continue to exist. There are huge doubts as to the ability of Arab regimes to continue. The upcoming change will be massive and its impact will inevitably arrive in the Arab region. The existing regimes which draw power from the West and not from the Ummah will perish for certain.

The Arab resources and capacities have to be used to build an independent and solid economy even if it takes a complete fundamental political change in the region.

The capitalist system has become unacceptable even to capitalists themselves. It has to be prevented from leading and administering the world economically. The alternative is called for in the West as well as the East and no alternative can rescue the world except Islam as an ideology and a system of life and not as a religion in its limited meaning. Arabs are the core of Muslim countries and we pray to Allah (subhanahu wa ta'ala) that they will be at the pinnacle of the upcoming change by Allah's (subhanahu wa ta'ala) will.

**Yousuf Abu Ahmad**
**7th Muharram 1430 Hijri / 3rd January 2009**

# The economic, social and ideological impact of the credit crisis in Europe

Distinguished Audience,

Although the current "credit crisis" originated in the United States, Europe has also been affected by it. How exactly, and to what extent, I will try to explain to you in this talk, going beyond the impact on the European economy and also discussing the impact on societal affairs and on philosophical, or rather ideological thinking. For the credit crisis is more than strictly an economic problem. Its impact has crossed the boundaries of the field of economics, into the fields of sociology, and from there into philosophy, shaking the very pillars of western civilisation.

Before we delve into the details of the credit crisis' impact on Europe, there is some more general information regarding the European economy that I need to discuss, as otherwise the European perspective on this crisis might not be accurately understood.

During the twentieth century the western European nations developed a form of Capitalism that was distinctly different from the Capitalism of America. In the western European model, governments played a much larger role in economic affairs than in America. For instance, through direct ownership in companies the European governments controlled many sectors of the economy, especially the sectors that provide social services to the people such as health and education, the sectors in which a few companies employed large numbers of people such as mining and steel production and the sectors which were considered vital to the national economy, such as oil and gas, aerospace and automobile manufacturing. In addition to this, the European governments had limited the economic freedom of companies and individuals through regulation, such as laws that made it very difficult for companies to lay off personnel or that gave employee councils a veto right in the board of directors of companies. And lastly, the European governments had policies in place that aimed at wealth redistribution. Very high taxes were levied on companies and individuals with higher incomes and this income was used to finance an elaborate welfare system.

This form of Capitalism bore the name "social democracy". It combined elements of the capitalist and the socialist/communist ideologies. It was founded on the ideas of the free market, laissez faire economics, but at the same time ensured a limited form of material equality amongst the people through socialist style government intervention in the economy. Some say this form of Capitalism developed in continental Europe as there, historically, the socialist/communist ideology was of much stronger influence on the people than in America, and that in such an environment it was only natural for an economic system to emerge which combined elements of both the capitalist and the socialist/communist ideology. Others say it developed in continental Europe as Capitalism had to really protect itself against the socialist/communist ideology, much more so than in America. They say that the western European capitalist nations adopted some elements of the socialist/communist ideology such that all people were guaranteed a respectable living standard, with the goal of being able to prevent any further influence of the socialist/communist ideology on the people. Whatever the explanation might be, it is clear that Europe's "social democracy" was not a pure capitalist system but a deviation from the pure capitalist "free market" philosophy. It was influenced by ideas coming from the socialist/communist ideology.

Later, in the 1980s and 1990s, European politics took the direction of the so-called "Third Way", led by politicians such as Tony Blair in the United Kingdom, Gerhard Schroeder in Germany and Wim Kok in The Netherlands. Under the "Third Way" Europe went through a process of economic liberalisation where everything in the economic system that had not come forth from the capitalist creed was removed. This was done for two main reasons. Firstly, by the end of the 1970s it had become apparent that the system of social democracy was unsustainable. When compared to America, the countries that had implemented this system that merged Capitalism with certain elements from the socialist/communist ideology were shown to have much less economic development and much higher unemployment. In addition, they were much more indebted as the welfare system asked for more resources than the state was able to collect through taxation. So Europe felt that something had to be done. This brings me to the second reason for Europe to go down the path of economic liberalisation during the 1980s and 1990s. That same era, you might recall, was also the era of the demise of the socialist/communist ideology. In its downfall the Soviet Union took with it the belief in the socialist/communist ideology. This caused a wave of euphoria to sweep through the western world, as belief in the correctness of Capitalism increased to unprecedented heights. The belief in socialism/Communism became outdated, backward and old; and the belief in pure capitalist laissez faire economics became hip and trendy. In other words, it was really felt that the answer to the problems that had occurred during social democracy was in pure Capitalism. That is why during the 1980s and 1990s most of the European capitalist countries moved away from the form of Capitalism they had engineered themselves, towards the American form of pure, uninfluenced Capitalism.

So why has the credit crisis impacted upon Europe, when in essence it is a problem with American household debt? The process of economic liberalisation in Europe also affected the banking industry. Where during the times of social democracy the European governments had used legislation to control banking, during the era of economic liberalisation it was believed that it would be best to let the industry regulate itself using the price signals coming from the free market. Therefore legislation in the banking industry was avoided and government oversight over the banking industry minimised. This effectively allowed and enabled the European banks to get involved in the American subprime credit market, which they did. Therefore, when in the early summer of 2007 it became apparent that the American economy had gradually, over time, overburdened itself with debt and that on most loans in the subprime market no servicing of debt took place, which was when the credit crisis erupted, many in the European banking industry were in a similar situation to the American banks. They had invested heavily in the subprime mortgages market in America with the expectation that this would earn them a steady stream of income, but when none of this materialised, these European banks found themselves strapped for cash. With their share prices going down after suffering tremendous losses due to write offs on their investments in the subprime market in America, they began to struggle to service their own debt and threatened to go under.

Exactly how serious and extensive an economic problem the credit crisis is considered to be in Europe becomes apparent when looking at the response of the European governments to the crisis. Germany, for example, reserved €500 billion for support to the German banking industry: €400 billion in loan guarantees for the banking sector, €80 billion in the form of direct capital injections into the banking sector and €20 billion in loans to the banking sector. The government of the United Kingdom also reserved close to €500 billion for support to the British banking industry: €250 billion in loan guarantees, €37 billion in the form of direct capital injections and €200 billion in loans. And France too reserved €360 billion: €320 billion in loan guarantees and €40 billion in the form of direct capital injections. Even relatively small economies like Ireland, The Netherlands and Spain reserved huge amounts of money to help their banking industry through the credit crisis: €400 billion in Ireland, €220 billion in The Netherlands and €150 billion in Spain. In total the European governments reserved over €2 trillion, that is €2,000 billion, to support their banking industry. In addition to this, the Central Banks in Europe, operating under the umbrella of the European Central Bank, made loans worth hundreds of billions of Euros available to the banks and other financial institutions.

The European governments undertook this immense effort in support of their banking industry because of the role banks play in the economic system of Capitalism. To a very large extent, economic activity in

Capitalism is based on credit, with loans financing most investment and consumption. In Capitalism, banks are the source of these loans. This means that if banks run into financial trouble, or worse even go bankrupt, then the financing that is required for economic activity becomes unavailable. The economy then comes to a grinding halt. The European governments understood this appropriately once the credit crisis became apparent. A collapse of their banking industry, which was a real threat after emergence of the credit crisis, would have dragged down with it the entire European economy. That is why in response to the credit crisis the European governments went against the philosophy of laissez faire they had been professing to the people for the last two decades, and bailed out the banks using billions of Euros.

Now, although this seems to have avoided a wholesale collapse of the European banking industry, it has not prevented the credit crisis from impacting other sectors of the economy. Other sectors of the economy, outside of banking, have also been affected. This is due to the fact that even as generous support was provided to them by the European governments and Central Banks, the European banking industry has still severely restricted the availability of credit to both companies and consumers over recent months. This has depressed economic activity in Europe significantly. But this mechanism in the capitalist economy has not only taken place in Europe. Of course the banking industry in America and the Gulf countries is also suffering from the credit crisis and they are experiencing the same phenomenon that is curtailing activity in European economies. Restricted credit availability has caused their economies to shrink as well. Because Europe is a very open economy in which many countries are dependent on foreign trade, on exports, effectively therefore it has been hit twice by the credit crisis. Internal demand has evaporated due to the crisis, but in addition the external demand from America has decreased significantly.

This explains why in October 2008 industrial output in Europe fell dramatically. In France it was down 7.2 per cent versus October 2007. In Sweden it was down 7.1 per cent. In Italy 6.7 per cent, in Greece 4.5 per cent and in Germany 2.1 per cent. Although the data for November and December is not yet available at the time of writing, the expectation is that these numbers will be even worse. In Spain, for example, November industrial output is expected to come in 12.3 per cent lower than November 2007. These are decreases in economic activity that have not been witnessed in Europe since the days of the Great Depression. It is hard to find an industry in Europe that is not affected by the credit crisis. The automobile industry seems to be hit especially hard with car sales in the United Kingdom down around 37 per cent. Car sales are down in Sweden by 36 per cent, in Italy by 30 per cent, in Germany by 18 per cent and in France by 15 per cent. Partially in response to this the demand for steel is approximately 30 per cent lower than it was before the credit crisis hit. In the chemicals industry the current situation is so dire that the German giant BASF decided to temporarily shut down or slow down 180 production locations, both inside Europe and across the rest of the world. DOW Chemical will temporarily shut down or slow down 200 production locations and DuPont will do the same at 100 locations. As far as consumer electronics is concerned, Philips, Europe’s largest producer of consumer electronics, stated that it was facing an "unprecedented decline in demand".

Because of this decrease in economic activity the number of bankruptcies in Europe is strongly on the rise, as is of course unemployment. In Spain the construction industry has shed 354,000 jobs since the start of the credit crisis. In The Netherlands, due to the credit crisis, unemployment is expected to increase to around 200,000 people by the end of 2008. With a total working population of just 7 million people that is a full 3 per cent of the working population being unemployed. In the United Kingdom, unemployment is expected to be 700,000 people higher than before the credit crisis started. The country would have approximately 2.5 million people unemployed, 7.1 per cent of the working population. In France the total number of unemployed is expected to have increased by 400,000 people at the end of 2008. The German insurer Allianz is even expecting the number of bankruptcies in Europe to increase even further during 2009, to a record number of around 200,000. These increases in unemployment should therefore be seen as just the beginning.

The second dimension of the impact of the credit crisis is the impact of the crisis on societal affairs. There is a social dimension to the economic crisis caused by the credit crisis as well. Behind economic statistics are real people. The devastating impact of unemployment on the lives of people, as well as on society in general, has already been documented extensively. For instance, it has been established that unemployed people suffer more from depression than employed people. Research suggests that even the partners of unemployed people suffer more from depression, use more tranquilisers, smoke more and drink more alcohol than the partners of employed people. Unemployment, in other words, causes a great deal of psychological distress. Also, there is a clear relationship between unemployment and morbidity, mortality and suicide. Simply put, unemployed people tend to be depressed more often, sick more often, commit suicide more often and typically die younger than the employed. It is not only unemployment that has been shown to have these effects - even job insecurity, the fear of losing one's job, is shown to have these adverse effects. As if this were not enough, analysis of historical data has also shown that increases in unemployment are typically followed by increases in various forms of crime, such as robberies and burglaries.

For a large part all of this has to do with the material consequence of being unemployed, namely poverty. Now as it is sometimes believed that there is no or only very little poverty in Europe, even amongst the unemployed or the people physically unable to work, people might say that the impact of the credit crisis on the European societal affairs will not be as bad. It is important to address this idea briefly, as it is build on an absolute misconception.

It is true that during the years of social democracy the European states ensured a respectable living standard for all people, through their governments interfering in the markets using legislation and through providing the people extensive welfare programmes. Indeed, during those days even the unemployed of Europe lived lives of prosperity that most people on this planet can only dream of. But as mentioned already, this was shown to be unsustainable. The government interference in the markets through regulation obstructed economic development, and the welfare programmes were financed by governments through borrowing huge amounts of money which could not be paid back. Therefore, as part of the programme of economic liberalisation under the Third Way, most of the government interference in the markets and the state funded welfare programmes have been abolished in favour of the policy of "laissez faire" economics. In response to this, real poverty, with people not being able to feed themselves and their families sufficiently, has re-emerged in Europe over the last decade. This is especially the case amongst the unemployed. As an indication of this fact, today in Europe a large and growing number of people are homeless. The homeless number more than 3 million it is thought, even more than in the United States, of which a third are families. In my own country, The Netherlands, so called food banks have been set up where poor people can buy basic foodstuffs at discounted prices. Otherwise they would not be able to buy sufficient food at all. So in the present day Europe as well, if you lose your job you lose everything. Unless you are able to find yourself new employment, eventually you will be forced to live life in the misery of poverty.

At this stage one should be better able to appreciate the real significance of the economic statistics cited earlier and hence be better able to appreciate the impact the credit crisis is having and will continue to have in Europe. Poverty and all of the problems this causes, psychological problems, health problems, criminality, exploitation and so on and so forth, will be amongst the results of the credit crisis. As the credit crisis sends Europe into economic depression, it will impact not only upon the material well being of the people but also their psychological and physical well being, as well as the relationships between the people.

Interestingly enough, the people of Europe know this. That is why there exists in society today a heightened sense of fear and anxiety which manifests itself in various ways. In Spain for example, one of the countries in Europe that so far has been hardest hit by the credit crisis, the national organisation of psychologists rang the alarm bell as since the start of the credit crisis more and more people have sought professional psychological help. According to the organisation of psychologists economic concerns have increased stress related problems amongst the people, such as communication problems between spouses and between parents and children, and sleep disorders. On average 6,750 patients are now being treated every day in Madrid alone for such problems. Far more people are thought to suffer from these problems, as many are not able to able afford professional psychological help. In the United Kingdom it is reported that calls to a relationship counselling service have increased by 70 per cent from October to November, at about the time the credit crisis became really felt by the people. Families are falling apart due to the stress caused by financial worries and a fear of what the future might bring. In The Netherlands almost half of the children between the ages of 9 and 14 say they are worried about the impact the credit crisis might have. This shows just how deeply the credit crisis has affected family life.

This brings me to the impact of the credit crisis on philosophical, or as I prefer to call it, ideological thought. The fear and anxiety that the people are feeling now when they see the economic devastation that the credit crisis has brought to Europe, has triggered in many of them thinking about their current situation. To be more precise, it has led them to think about the economic liberalisation that was implemented on them and their societies during the last two decades. During this process it was never hidden from the people that the measures taken would be painful for some, if not for all. The people knew this would be the case, but they accepted the process of economic liberalisation nevertheless as they were willing to sacrifice. For they had been told that economic liberalisation was necessary to preserve the prosperity that had been build up during the preceding years and to enable future growth of this prosperity. So the people accepted job security to decrease. They accepted decreases in the benefits paid to the unemployed and the ill. They accepted increases in the prices of social services such as health and education. They even accepted decreases in their real wages as these were kept flat nominally while inflation made everything more expensive. They accepted all of this, even while they could see the rich and the corporations getting richer all the time, because their governments made them believe there was simply no other option but economic liberalisation and because their governments promised them that economic liberalisation would bring great rewards in the future. But now, because of the credit crisis, the people look back on what has been accomplished through the economic liberalisation and they fail to find in their lives these great rewards they were promised in return for their sacrifice. So now they ask themselves: "For what did I sacrifice? For whom did I sacrifice?" And at the same time they see their government doing the exact opposite of what they have been preaching to the people under the banner of economic liberalisation. While the people were asked to sacrifice, as the governments said they could no longer take care of them and that it would be in the best interest of the people if everyone looked out for themselves, these same governments are now suddenly spending billions of Euros to bail out the banks! In response the people ask themselves: "I thought the government could no longer afford to interfere in the economy? I thought government interference in the economy was bad for the economy? Why then are the banks given billions of Euros? Why did the government say my welfare payments were too expensive to continue, while apparently they do have billions of Euros available to support the bankers?"

In other words, the credit crisis has caused many people to lose faith in their governments and in the policies they have implemented over them. They have now lost faith in Capitalism, if they ever had any, and that is why during November and December 2008, Europe saw a string of protests against the handling of the crisis. All over Europe, protests and demonstrations have taken place, such as in Spain where people protested in various cities as the G20 met in Washington to discuss the credit crisis. In Italy, student organisations have organised protests in all of the main cities. And Greece was in the grip of a civil unrest for weeks in response to the government bail out of the banks, all the more after police shot to death a young protester early on during the protests. This civil unrest caused by the credit crisis became an issue on its own, to the point where influential political thinkers began to warn the European governments. "Europe has to guard democracy amid crisis" was the title of an opinion piece in the Financial Times, in which was said "The risk is that contempt for our discredited economic model will fuse in various parts of the world with contempt for our political model, democracy. Indeed, if the global downturn is as severe as most analysts predict, political systems in many economically fragile states will be in danger from unrest".

The intellectual leaders in Europe have realised that the dissatisfaction amongst the average people of Europe is wholly justified. The highly influential German philosopher Jurgen Habermas was interviewed in response to the credit crisis and said: "What worries me most is the outrageous social injustice. The socialised costs of system breakdown hit the most vulnerable groups the hardest. Those not among the globalisation winners are asked to pay for the concrete economic consequences of a malfunction of the financial system that was foreseeable." So for those intellectual leaders in Europe who already held the conviction that Capitalism is incorrect, the credit crisis is seen as proof that they had always been correct. As in the case of the French philosopher of the postmodern school Alain Badiou who responded to the crisis in Le Monde newspaper saying "Capitalism is nothing but robbery, irrational in its essence and devastating in its development". For those intellectual leaders in Europe who believed in Capitalism, they see that the credit crisis has been a cause to rethink their beliefs. Such as in the case of Arnold Heertje, arguably the most influential of the contemporary economists in The Netherlands, who said "In feite gaat het om een eenvoudige les. Je mag mensen wel vrijlaten, je mag economische activiteiten liberaliseren, je mag overheidstaken afstoten en de rol van de centrale overheid verzwakken en die van de lokale overheid versterken. Maar als dat het enige credo is, gaat het in de samenleving de verkeerde kant op en loopt het met de mensen slecht af." Which loosely translates as: "Essentially, it is a simple lesson. One may set people free, liberalise economic activity, privatise government responsibilities, weaken the authority of central government while strengthening that of local governments. But, if this is one's only creed, then things will go wrong in society and with the people it won't end well". It is a response to the credit crisis that echoes that of Alan Greenspan, who for many years was the driving force behind economic liberalisation in America and hence the rest of the world. When Alan Greenspan was called before the American Congress and was asked "You found that your view of the world, your ideology was not right, it was not working?", he answered "Absolutely, precisely".

Therefore, the credit crisis can be said to have caused in Europe a crisis of identity. The average European never believed in Capitalism like the average American does. Whatever shallow belief he had in this system has now been shattered by the credit crisis. At the same time the intellectual leaders of Europe have nothing to argue against the average European leaving his belief in Capitalism. In fact, they agree with him that Capitalism has failed. But, and this is very important, they are not able to provide the people with an alternative.

With no apparent alternative for the failed system of Capitalism at hand, the people are now willing to think outside of the established parameters to find a solution. Some are proposing a return to social democracy, but with only little conviction, as they too have seen how the European governments had to run up billions of dollars of debt to keep this system afloat. This means that deep down they know that this is not a real solution. That is why the people are willing to consider systems proposed by other ideologies as alternatives, instead of just changes to the established system. The alternative proposed by Islam has their particular attention. That is what we, as Muslims, must realise when we learn of what caused the credit crisis and how it has impacted the economies around Europe, the societies of these countries and the people within these societies. Allah (subhanahu wa ta'ala) blessed mankind with His Guidance, the only true solution to the problems that are part of life. He obliged the Muslims to invite the people to this Guidance, to lead humankind from darkness into light. Today in Europe we have an audience; people eager to listen and learn about what Islam has to offer as they have realised the faults in what they used to believe in. Today, therefore, we must be there to explain to them the alternative of Islam.

**Andreas di Fress**
**7th Muharram 1430 Hijri / 3rd January 2009**

# The effects of the financial crisis in the West

Global Capitalism has faced no lack of criticism since its inception, always controversial and never dull. From Das Kapital in the nineteenth century to the Anti-Globalisation movement in the late twentieth century, there has been no shortage of predictions that the global capitalist system was about to fail, and was on its last legs driven by excess and greed.

Some may try to argue that the crisis of late 2008 is not the end for Capitalism. They will argue this was a bubble, like many before. However, the fact that major western nations, led by the United States and Britain, have injected record amounts of capital to save the banking sector from complete collapse is unprecedented. Banks have been nationalised – something repugnant to those who believe in the free market – rather than see them collapse like Lehman Brothers. Stock markets around the world have plummeted by record levels. The effect on pensions, inflation, taxation, home repossession and unemployment will be dire, but the eventual extent is as yet unknown. The human tragedy that may occur as the ripple effect affects economies in poor countries is frightening to contemplate. The geopolitical implications of the crippled US economy will unfold over the coming years in a way that is as yet hard to predict.

This unfolding crisis marks nothing less than the beginning of the end of Capitalism. For what is certain is that a foundational element of capitalist belief – an absolute trust in the free market – has been irrevocably damaged. Those who continue to argue the usefulness of the current system, who say there is no alternative and who seek greater regulation (a tweaking of the system) cannot defend the very key principle upon which the system was founded and under which it flourished.

Moreover, not only has the free market ideology failed, certain fundamental principles of Capitalism are central to the cause of this current crisis, yet no one has proposed any change to these fundamentals. These, include the interest (usury) based banking system, the fiat currency model and the system of trade in the stocks and derivatives markets.

Furthermore, people around the world outside of the West - who were dazzled by the brilliance of Capitalism's light, now see that light fatally diminished. What little faith they had in this western model, which for decades they have tried to emulate, now raises more questions than provides answers. Can this be the only way to trade, create wealth and see economies grow? Can it be right for business that trade occurs in such an inherently unstable system? Where is the fairness if profits largely remain in private hands and based on massive bets in financial markets and that the risks and losses accumulate such that they have to be shared by the taxpayer and consumer?

People are now looking for an alternative. People are now looking for leadership. It is only in Islam that such an alternative exists. For Islam has a system, tried and tested over centuries which has certain pillars rendering it as not only a system capable of producing economic growth but of sharing that growth more fairly – something that Capitalism has manifestly failed to do.

What is clear is two things lie in a huge state of flux: the future of the world economy and where political influence in the world will lie in the years ahead. In that state of flux opportunity for change exists. Moreover, it is a duty upon the Muslim world to establish the Islamic system, under the Khilafah, to lead that change and to provide the alternative that will end, not only the inevitable cycle of boom and bust, but also the intractable gap between rich and poor - a misery that Capitalism has utterly failed to address while it dominated the world.

Let us look at how this crisis is affecting western society. We need to examine this question from the economic, political and ideological angles.

**Economic impact**

The US is the most indebted country in the world, with government debt of over 10 Trillion dollars. This figure will rapidly increase as they bail out their bankrupt banking system. The NY Times reported in late November that the level of US government commitment to the banking crisis by way of direct bailouts, guarantees and loans had reached 7.8 trillion US dollars. Some put the figure higher and it is growing rapidly with every new problem. The full size of the whole US economy is $14 trillion dollars, so this is an unprecedented expansion of money.

As the US is unable to tax more or spend less on social/welfare it either borrows this money or prints it. As its major creditors, China, Japan and the oil rich Gulf are limited in what they can contribute to this spending spree, the solution is to literally print more money. This has always been the solution for bankrupt economies, and is no different for the US and indeed UK/EU today.

Therefore we can expect massive printing of dollars; this is known as "quantitative easing" and will mean a big uptick in inflation. This is the cruellest form of taxation as it eats away from the assets or wealth of all – and is only for the benefit of the banks which have effectively gambled away their own wealth.

There is a quadrillion ($1,000 trillion) derivatives mountain which is still looming over the financial sector and the future losses from this disaster look likely to overwhelm the real economy of goods and services worldwide which is only $50 trillion in size.

With banks sitting on such large losses, the bailout money is merely going to cover losses and strengthen their balance sheets. Lending has frozen because the banks cannot afford to continue lending as the economy worsens and credit risks rise. The central banks cut interest rates but this has had little effect on spending. The intended "trickle-down effect" of the central bank interest rate cuts didn't work at all; many companies have kept their interest rates at the same level or even raised them by two or three percentage points. This depression like position means many businesses will fail, many will lose their jobs and many will lose their homes as bank repossessions. Yet the bailouts are of "faceless" corporations – the banks - and not the people that lose their jobs and homes!

The US has even sanctioned the use of bailout money to be used for dividends - to keep "confidence" in the system high!

Despite the bailouts a November report by the Federal Reserve revealed that nearly 60 per cent of banks severely tightened their lending standards on credit card loans and 65 per cent on other consumer loans in the last three months. As unemployment and delinquency rates go up and lenders are trying to minimise their risk, the average American all of a sudden finds himself cash strapped – and this comes at a time when home equity has dried up and the stock market is plunging.

But the problem is not limited to the banks. "We've been hearing about the liquidity crisis affecting banks for quite a while," Joe Ridout, spokesman for the advocacy group Consumer Action, tells the Washington Post. "Now we're seeing it transform into a crisis affecting people's personal finances as well. The next wave of the financial crisis may well be a credit-card-related crisis."

Business activity and sales are also plummeting: electronics and appliance sales dropped by 25 per cent in November 2008, luxury goods by 24 per cent and sales at clothing and department stores by 20 per cent. Foot traffic decreased by 19 per cent from 2007, meaning shoppers visited fewer stores (US data). This abysmal data will push the cycle of further business losses, greater uncertainty, more job losses, more stringent lending criteria and then further contraction in the economy. All of these matters the capitalist heads of state had trumpeted as being under control.

There will be a risk of serious social disorder in these economies when inflation rockets and employment plummets. It is for this reason that governments are acting on an unprecedented scale to pump in fiat money to the system, to try and re-generate growth. But acting against them is the sheer scale of the run up in credit created and the derivatives mountain of the past 10 years. The size of the problem is far greater than any previous recession they have faced.

With the three largest US automakers now on the brink of collapse that will cause greater havoc in the credit default market (gambling on which companies will collapse) and raise unemployment rates to 1930s levels.

In summary a damning indictment on those politicians that are tasked with providing economic stability to its citizens. With the levels of personal indebtedness in the major western economies, most are merely 2 pay cheques from being out on the streets.

**Political implications of the crisis**

For decades since World War Two the US economy has been the largest in the world. The US dollar became the de facto world reserve currency particularly when the US came off the gold standard in 1971. But this primacy is now severely compromised by the crisis. Confidence in the US economy and its leading position is rapidly declining for several reasons:

1. The Chinese economy which has been based on manufacturing growth is set to eclipse the US economy which is overly dependant on financial services (including growth in credit and derivatives) and its dominant position in controlling Middle East oil reserves. Other major economies such as Brazil, Russia and India are less dependent on Middle East oil and have alternative sources for energy.

2. While the US economy was growing and maintaining the position of the dominant world power it was easy for the US to maintain a trade deficit, particularly as major trade partners such as China and Japan were happy to fuel US spending by taking on board US debt in the form of US Treasury bonds. These have now reached saturation levels of $2.7 trillion dollars – but with the risk of the dollar dramatically losing value post the US government commitment to "print money" to spend their way out of the problem – a solution that will only kill the value of the dollar – this means that foreign countries like China, Japan and in the Gulf will make massive losses on their dollar holdings as a result.

3. The US managed to package up low quality sub prime mortgage assets and other dubious positions into "derivative" contracts and sell them globally, effectively setting other countries up for large losses. These losses are still working their way through these economies. As a result, scepticism and distrust is now the norm when viewing US investment proposals.

4. Chinese officials are already making noise about the stability of the dollar and US policies. Although they will not want a run on the US dollar as the US injects several trillion dollars of made up money into its economy, they are reticent about taking on more US debt at a time that the US purchase of Chinese goods is also stagnating.

5. Slashing the 2009 forecast for Chinese growth in half to just 5 per cent recently, Dominique Strauss-Kahn, head of the International Monetary Fund (IMF), told an audience in Madrid in early December, that without huge stimulus spending by major governments "it will be difficult to avoid a long-lasting crisis that everyone wants to avoid. If we are not able to [get $1.2 trillion, some 2per cent of global GDP], then social unrest may happen in many countries – including advanced economies". At the height of the crisis it is worth remembering that respected commentators in the UK have highlighted that people are only 5 missed meals from having anarchy on the streets.

Not only is American leadership waning internationally but also domestically as the recession bites. The mismanagement of its own economy, the dollar, and its trade imbalance are all leading to a stance of derision rather than respect for the US. It is also worth stressing that the UK as home to the leading financial centre in the world (London) is also suffering in a similar manner through this crisis.

The new Obama administration is being looked to for leadership out of the quagmire, but to date his policies show continuity with the existing Bush regime. He has made economic appointments (Paul Volcker and Laurence Summers) who were heavily involved in previous administrations (Reagan and Clinton) and his stimulus package may get some spending and lending moving again next year, but still at the cost of many trillions of dollars that the US does not have.

There is a great opportunity for a new leadership on the world stage as a result of the almost total breakdown in trust and confidence in the existing political leadership as offered by the US, UK and EU powers. A period of sustained and high inflation will show the weakness of the fiat money system implemented by the US since 1971 and cast severe doubts over whether the US dollar can remain as the defacto world reserve currency.

**Ideological impact of the crisis**

Perhaps the greatest damage to the US leadership is to the thoughts they advocate.

The contradictions with capitalist free market policies and principles provide clear signs of an ideologically bankrupt West - these signs have been numerous in the current crisis:

1. Previously profitable failed private companies have been nationalised (e.g. Northern Rock and the Royal Bank of Scotland in the UK and Fannie Mae, Freddie Mac in the US)

2. Monopolies and anti-trust (or anti-competition) laws have been disregarded (e.g. the merger between Lloyds and HBOS in the UK)

3. Hundreds of billions of taxpayers' money has been poured into the private banking system to lend money to bail out commercial profit making financial institutions, effectively nationalising losses and privatising profit making concerns.

4. Interest rates have been cut despite relatively high inflation, contradicting so called 'sound' monetary policy (e.g. US, UK and Europe).

5. Taxes have been cut despite high public borrowing and debt (e.g. US) contradicting 'prudent' fiscal rules.

6. 100 per cent of the financial liabilities of private profit making companies (banks) have been guaranteed by governments (e.g. Ireland).

7. Car manufacturing private corporations have been given credit guarantees to stimulate investment (e.g. US).

8. Governments have used taxpayers' money to buy shares in insolvent private corporations (e.g. the UK bank rescue plan).

9. The suspension of accounting rules including fair value (mark to market) within financial accounting standards.

The systematic failure of financial markets is a clear indictment of Capitalism because the financial system epitomises Capitalism in its thoughts, values, policies, culture and outlook more than any other capitalist institution. The capitalist principle of freedom of ownership once sacrosanct has proved disastrous and ruinously damaging for society in the West.

The embers of Capitalism may still glow and provide heat for some time yet, but they are only embers. Just as freedom and democracy have been near fatally undermined by Abu Ghraib, Guantanamo Bay and extraordinary rendition, free market Capitalism has been near fatally undermined by this financial meltdown. The financial crisis exposes the failure of the much vaunted free market capitalist system. Its failure is down to systemic failure to regulate markets which have deteriorated into a global gambling casino of epic proportions (the derivatives market) and an out of control usury system which enables commercial and central banks to effectively create money from thin air!

There is an ideological vacuum waiting to be filled and it is time that Muslims took the opportunity to fill that vacuum with the only way of life suitable to meet the needs of the people.

{كُنتُمْ خَيْرَ أُمَّةٍ أُخْرِجَتْ لِلنَّاسِ تَأْمُرُونَ بِالْمَعْرُوفِ وَتَنْهَوْنَ عَنِ الْمُنكَرِ وَتُؤْمِنُونَ بِاللَّهِ }

*"You are the best nation (O Muslims) brought out for mankind, because you enjoin what is right and forbid what is wrong, and you have faith in Allah."*
*[TMQ Ale-Imran: 110]*

**Jamal Harwood**

**7th Muharram 1430 Hijri / 3rd January 2009**

# The failure of the current solutions to the financial crisis

It is known that the capitalist ideology - which is based on separating religion from life and from which the notion of the public freedoms emanate, including the freedom of ownership from which the free market economic system emanates - holds 'relative scarcity' to be the basis of the economic problem. The goods and services are said to be insufficient to meet the needs of the people, because these needs are unlimited whilst the goods and services are limited. Therefore there must be a means to solve this problem. The originators of the capitalist ideology adopted the 'price mechanism' as the means to distribute the goods and services between the people to satisfy their needs in accordance with what they have of money that equals the required price of the goods and services. The price would also be the organising means of the relationship between the producer and the consumer.

The capitalist ideologues also held it necessary to increase production so that the goods and services are abundant in the market. Consequently, they focused all efforts on the question of production, to the extent that most of their studies revolved around this matter of production and its related issues of economic growth, progress and boom. Economic reports are almost always about issues like the increase of economic growth, the increase of public income, the increase of the capital of companies and banks and the opening of financial and commercial markets. In turn, the role of the capitalist state became facilitating the way for companies to increase their output.

However, we see that goods and services are abundant and aplenty. In fact in totality they exceed the need of the people in all fields, particularly in industrial and technological advancement. Yet despite this the number of poor and needy around the world is increasing. This indicates the incorrect nature of the idea that the goods and services are not sufficient.

In reality the resources on Earth are more than sufficient to satisfy the needs of its inhabitants. The prevalent policy to reduce the production of a certain commodity to maintain the price at a sufficiently high level to achieve large profits is proof of this. Even the secondary, non-essential commodities are widely produced, but the problem is that most people do not have access to them and are not able to possess them. The number of poor and destitute in the world has increased to more than a quarter of its population. Two quarters or more hardly possess their daily food needs, and less than a quarter live moderately. On the other hand, in the world that has a population of more than six billion, a very small minority, numbering in the thousands, possess (have usurped) most of the wealth. The wealth of some of them is millions of dollars, some billions, and some of them are owners of tens of billions of dollars.

All this indicates the failure of the capitalist ideology in diagnosing the economic problem, and this is the underlying cause of the misery for the majority of people in the world and of the wealth being monopolised in the hands of a few. Reliance on the price mechanism is at the core of the problem. It is not a correct mechanism for distribution of wealth. Its erroneous nature is clear to all who possess insight, but the capitalists ascribe the problem instead to those people who, having been given the freedom, do not stand up to compete in enterprise, production and profit! It is as if economic freedom makes everyone equally strong, intelligent and able, and miraculously rids the world of those who are weak or incapable in one respect or another, or who do not possess the opportunities that are granted to others, which they themselves selectively grant to some and deprive from others.

And if all people are equally strong and intelligent then they should sacrifice each other for the sake of material gains and hoarding. The capitalist ideology is such that either you gain the loaf of bread or I acquire it; either I survive or you do. Survival is for the most able, nay for the most strong, and, as Levi Strauss - one of their philosophers, whose theory the American administration adopts - said, the stronger one is right. Therefore I must compete with you; nay I must step over you to gain the loaf of bread before you. I must possess billions of dollars, even if you remain without a single dollar, even if you and millions of people like you do not possess anything, writhe with hunger and die of disease because they did not have access to food or medicine!

This capitalist ideology believes in individual freedom, freedom of ownership and in competing and fighting over wealth out of greed, even if this leads to wars. The wars that America recently waged on Iraq and Afghanistan, the wars the European states waged for hundreds of years in Asia, Africa, and the Americas, even the World Wars between the capitalist states are because of their adoption of these inhumane thoughts which make hegemony over others and the exploitation of others the natural course for the capitalists, granted to them by God because of their strength, intelligence and superiority!

Capitalism affirms freedom of commerce without restrictions, and "the necessity of freeing the market from the claws of authority and the freedom of competition in the market for the advancement of the economy" (Adam Smith, The Wealth of Nations). It also believes in opening all the world markets without restrictions. To this end globalisation is favoured by the capitalists and for this purpose the World Trade Organization (WTO) was established.

Hence the capitalist system in origin does not allow the state to interfere in the markets. The interference of the state we see currently in the banks, companies and financial institutions, and in the financial and commercial markets, contradicts the capitalist ideology. Therefore the state interference in the market and in buying shares and bonds from banks and companies and turning them into state properties is in contradiction of the ideology and it indicates its failure and its inability to function in accordance with its original ideas.

The capitalists themselves have perceived this, and have started calling for change in its foundations. Nicolas Sarkozy, the President of one of the biggest capitalist states, in the wake of this latest crisis has called for change to the foundations of the capitalist system, saying, "The turmoil provoked by crises in the American subprime and finance markets has put an end to the free market economy…The idea of the all-powerful market which wasn't to be impeded by any rules or political intervention was a mad one. The idea that markets are always right was mad." (Al-Jazeera, 02/09/2008).

Thus the President of one of the major capitalist states in the world announced that free-market Capitalism is a mad idea, that is, an idea contrary to the intellect, contrary to the reality and unsuccessful when implemented and he clarified that it has failed in actuality. The state interference in the markets and financial institutions indicates this clearly. In reality, it is impossible for the markets and financial institutions, and the economy as a whole, to function without the interference of the state, in the form of setting restrictions, guidelines and laws for them, and more generally, overseeing and leading it.

As for the idea that a crisis should be left alone to treat itself without the interference of the state, its fallacious nature and failure are proven by the confession of its own advocates as the American and European states have interfered in the market in various ways. The occurrence of this latest crisis and the capitalist states' interference in it shows the invalidity of this claim and in doing so shows that Capitalism is only a illusory philosophy just like Communism before it, which claimed the necessity of the withering away of the state, and that people should be left alone to work and produce and obtain what covers their needs, so every one of them takes as much as he needs not as much as he produces, and he leaves the rest of his produce for the society. Indeed the Capitalism of today is as weak and intellectually bankrupt as the Socialist Communism of yesterday!

The capitalist states stood up and warned of the consequences of leaving the crisis to grow and declarations came from the highest levels calling to review the basis of the capitalist system. Nicolas Sarkozy said, "…the sickness runs deep…there has to be a root and branch revision of the whole global financial and monetary system" (BBC, 25/09/2008). Summits were convened to discuss the crisis, studies were undertaken and seminars were held. All of that was finally crowned with the American Rescue Plan, which itself contradicts the capitalist ideology. Its architect, Henry Paulson, until recently was against the measures of the plan.

In summary, the plan was to pump $700 billion to buy shares and bonds of the companies and the banks that were defaulting on their debts and are related to the property mortgage market. This was to be done through the state purchasing their distressed or bad assets as mentioned in the beginning of the plan. Further the state was to have a share in the principals of the companies that are benefitting from the plan, as well as their profits.

The plan in effect is for the state to interfere in companies and banks, either through buying bad assets (shares and bonds), elevating the depositors' guarantee level, granting specific tax exemptions or by appointing a council to supervise the companies that benefit from the plan. All of these are merely different forms of state intervention which contradicts free market capitalist thought which demands the non-interference of the state in the market and in whoever partakes in the market, be they companies, banks, investors, depositors or employees. Following America, the rest of the capitalist states in Europe, Japan, Asia, the Gulf and Russia also pumped money into their banks and companies.

These so called salvation plans are failures in that which they were made for, because they discuss the remedy of the consequences and not the foundations of the capitalist system itself, which they contradict.

**Pumping money into the market**

The method of pumping money by the state into the market did not begin with the current crisis. It started in the US after the incident of 11 September 2001. The interest rates in America started to fall so the American Federal Reserve pumped money into the markets to create liquidity. This facilitated the obtaining of loans and their repayment. This was the first stage of the current economic crisis, because the Americans realised that it will not solve the problem but will be the beginning of a severe crisis. At the beginning of 2005 the Federal Reserve adopted a stricter monetary policy to combat inflation, causing the interest rate to rise and in turn resulting in higher debt costs and loan instalment payments, precipitating the starting point of the difficulty in the repayment of these loans, specifically the mortgages. As people started defaulting, banks' funds began faltering, putting a halt on financing activity; this being the second stage of the crisis.

As for the third stage, it was the American real estate mortgage crisis which affected various economic sectors in the US and Europe and led to countless severe losses. The banks suffered huge losses. Some declared bankruptcy and collapsed, whilst others began to stumble on the verge of collapse. (These three stages were mentioned in al-Ittihad, 01/12/2008, sourced from economic reports).

The policy of pumping money into the market on a large-scale appeared on the surface in the middle of 2007 as the central banks in America and Europe spent billions to salvage the two real estate mortgage companies Fannie Mae and Freddie Mac, but they failed. Their combined losses were more than a $1200 billion. As they were on the verge of collapse the government stepped in and took control of them. Global Insight has estimated the losses of the real estate mortgage companies overall to be $2.5 trillion. As an aside, these two companies were like governments. Fannie Mae was established in the sixties of the last century and in 1967 its profits reached $26 billion (an enormous amount for that time). As for Freddie Mac, it was established in 1970 by a decision of Congress and its capital was from the federal budget. The investment value of these two companies up until the end of the year 2007 and the beginning of 2008 had jumped to $7.6 trillion. The share of foreign central banks in these two companies is $1.541 trillion. The Chinese Central Bank has $400 billion and the Gulf Central Banks approximately $30 billion (Federal Reserve Council & Economic Analysis Office, al-Hayat, 07/09/2008).

Further, most of the remaining foreign capital in these two companies is from European Central Banks. Thus the Europeans were the angriest at America on the crisis of these two companies and what followed of financial and economic collapse in the stock markets, banks and companies. They put all the blame on America. In turn, America took control of them in order to maintain the confidence of foreign investors in China, Europe, Japan and elsewhere. Otherwise it would have lost confidence as a leader of the free capitalist world and with that its domination and economic influence over the rest of the world. On the other hand, Lehman Brothers was left to collapse so that Congress would approve the plan of the American Treasury Secretary Henry Paulson which the American President had adopted. It is worth mentioning, as reported by AFP (16/09/2008), which after repeated restructuring Lehman Brothers became the smallest financial investment bank on Wall Street after Goldman Sachs, Morgan Stanley and Merrill Lynch, as the value of its shares dropped down over the year to less than 85 per cent. If Congress did not approve the plan other large companies such as Goldman Sachs would follow in collapse. Merrill Lynch was also on the verge of collapse but the government salvaged it by merging it with the Bank of America.

It is worth mentioning also, as reported by The Middle East (19/01/2008) and Washington Post, that Henry Paulson, the American Secretary of Treasury, is a business man and investor from the share market and specifically from the Wall Street Stock Exchange. He is a strong defender of the free market economy. He does not accept government interference in the market, but was compelled to change his opinion on finding that this approach was not possible! He had a stern message for more than two dozen of the nation's most powerful hedge fund managers gathered in the third-floor conference room near his office. These funds are funds of the elite and wealthy exclusively. Each fund takes five hundred investors and the minimum amount for admission in it is $1 million, and they are not subject to the inspection that normal investment funds are subject to, so these funds have considerable economic weight. Despite that he gathered them and told them that it was time to begin regulating the opaque realm of hedge funds, reversing his long-held opposition.

In that meeting, as it has been reported, he wanted to impose his opinion strongly upon them saying, "You should not be thinking about how to fight it but how to make it work." "With his 30-month tenure nearing its end, Paulson is leaving behind a legacy of federal interventionism that few would have expected from this former head of the investment giant Goldman Sachs." He used to refuse any governmental interference in the market before he became the first defender of it as he said in one of his interviews, "My thinking has evolved a lot to the point where I've seen regulation up close and personal…I've realised how flawed it is and how imperfect, but how necessary it is." "In reflecting on his term, which comes to an end in January, Paulson said his biggest regret was not seeing the extent of the financial crisis as it developed. But he defended every major action he took." And he said, "We were always behind. We saw the problem, but it took us a while to see the severity of the problem…But even if we had been more clairvoyant, we wouldn't have been able to do much differently that what we have done." Paulson said he never imagined when he took the post that he would end up proposing far-reaching regulatory programs. (A Conversion in 'This Storm', Washington Post, 19/11/08)

These are the words of a man who previously headed one of the giant financial institutions on Wall Street. He is a trusted personality in elite business and finance circles and the American administration gave him an important position to rescue the free market economy and to prevent the aggravation of the financial crisis, and indeed to avoid the destruction of the whole capitalist system. But suddenly he abandons his long-held ideas, and acknowledges the failure of the free market policy, and that no one could have stopped the crisis even if they interfered earlier, because it is bigger than them, and they are too weak to find a solution for it except by following the solution that contradicts the capitalist ideology and that is inserting the market in the claws of the authority!

The pumping of moneys in the companies, that is, buying shares in them, buying bad bonds or assets by the state, does not solve the problem. Billions of dollars were pumped to rescue the two giant real estate mortgage companies Fannie Mae and Freddie Mac but to no avail. Thus pumping money does not rescue financial companies and institutions.

This strategy of pumping money into the economy was not limited to America but it was also implemented in Europe, Canada, Japan, Russia, China, South Korea and the Gulf states. During the last short period of the current crisis approximately $4 trillion were pumped into economies all over the world, and in spite of this the developed countries will enter a deep recession in 2009 if the credit crunch persists for a long period and the confidence in the financial sector is not restored in the coming months as it is mentioned in the newest report about the current financial crisis issued by the United Nations (1/12/2008) under the title "The International Economic Situation and the Horizons of 2009" (The Middle East, 2/12/2008).

**Interest rate measures**

The interest rate is defined as the rate paid by the central bank for the deposits of commercial banks whether it is an investment for one night, one month, or more. This becomes an indicator for the commercial banks so their interest rate does not exceed the rate determined by the central bank. The central bank determination of the interest rate helps to cast the cash flow on the middle range when it raises the rate or lowers it. Raising the interest rate, in order to reduce inflation, suppresses loan activities on the part of the banks and reduces liquidity in the market. It also encourages the owners of financial surpluses, particularly the international ones, to benefit from the profits of the equivalent of high interest rates. When the interest rate is lowered, those who possess financial surplus do not place their savings in banks, but rather search for other investment projects. Similarly, a reduction in the interest rate is used to reduce the rate of production if a surplus of product is found so that the supply of the commodity does not exceed the demand, reducing the price. The high liquidity will lead to weakening its buying value, thus increasing the prices, erasing any benefit from the high liquidity. The reduction of the interest rate increases liquidity and thus encourages investment, increasing economic growth and production as well as consumption in order to achieve economic recovery.

This is the capitalist theory in increasing or reducing the interest rate. The interest rate is considered to be one of the main factors affecting the crisis in the financial markets. It increases the burden on borrowers by increasing the cost of debt and consequently leading to higher prices. The borrowers of the housing crisis (the mortgage owners in the United States) had to pay interest of 7 per cent for the first year, which increased after two years to 9.5 per cent, which was a heavier burden on the mortgage holders as their instalments increased. It was estimated that the number of those who were unable to pay their monthly debts was 3 million. In order to encourage growth, the American Federal Reserve, after the events of 9/11 in 2001, reduced the interest rate for banks to 3 per cent and this reached 1 per cent in mid-2003. Given the availability of liquidity, the banks began lending to homeowners. Subsequently, the central bank raised the interest rate.

The factor which helped the Federal Reserve do this was the flow of foreign investment into America. In turn, the real estate companies slackened on mortgage lending conditions. The reason for foreign investment in America was trust in strong and sophisticated American financial markets. Subsequently, the house prices began to rise, as did the inability of debtors to pay their instalments, and the banks started reducing their lending, tightening liquidity. In 2006 the crisis started to show, and in 2007 it began to worsen.

Since the autumn of 2007 the Central Bank started to reduce interest rates to prevent an economic recession and help the faltering banks. Subsequently, speculators moved from the real estate market to the market for commodities and foreign currencies. As a result, oil and gold prices jumped to the highest level historically, and the value of the dollar fell to unprecedented levels as the value of the Euro reached 1.6 after it was only 0.9 in January 2002.

The capitalist economy is based on interest-based banks and it works to encourage depositors to put their money in the banks in return for interest. The banks deposit this money in other financial institutions where they earn a higher rate of return. The reduction of the interest rate works on the one hand to withdraw funds from banks in the form of loans and on the other hand works to stop attracting funds to the banks due to the lower interest depositors would receive. Thus so long as the capitalist economy is based on interest, reducing the rates will not solve the problem, because it is a double-edged sword. It encourages the taking of loans to stimulate the market but at the same time denies the banks liquidity. In turn, the banks are less able to offer loans. So the only resort is to raise the interest rate, but this is not possible in a time of crisis. This leaves the banks being pushed toward bankruptcy, leaving the problem unsolved.

This is apparent in the current crisis. The capitalist states have tried several times to reduce the interest rate, despite knowing that the banks are in need of deposits, to the extent that it "reached the lowest level in America, at 3 per cent at the beginning of this year," (Al-Jazeera, 31/01/2008) and after successive cuts by the Federal Reserve it reached 2 per cent on 09/09/2008, and on 09/10/2008 the Federal Reserve cut the interest rate to 1.5 per cent in coordination with the central banks of Europe, Britain, Sweden, Switzerland and Canada (Al-Jazeera, Saudi Arabia, 10/10/2008). According to this newspaper the economists of international banks said that the global decline in interest rates announced by many of the world's central banks did not have any demonstrable impact on the decline of the crisis, pointing to the continuing drain of most global stock markets after the reduction of the interest rates! Thus, with the confession of those managing the situation the reduction in the interest rates did not improve the situation nor did it prevent the occurrence of the crisis. It is not able to and will not treat it. The best they can do is to mitigate its severity for a few days or hours!

This shows the failure of their theory in the strategy of reducing interest rates. The reduction does not result in increased liquidity in the market and investment in other projects. What it does do is increase unemployment, halt companies’ investment, reduce production and lead to many workers being laid off and forced to reduce hours of work. Unemployment is compounded and the number of unemployed people is increasing every day. In December 2008 it was reported that in a one month period in the United States half a million people lost their jobs. (Der Spiegel, 05/12/2008)

**Purchasing 'bad' assets**

As for the subject of the purchase of bad assets, let us look firstly to the meaning of assets according to the capitalists as stated on the official website of the International Monetary Fund, where 'economic assets' are said to be, "divided into two parts: i) financial assets, and ii) non-financial assets. Financial assets are defined as everything that can achieve commercial gain or is able to achieve economic benefits. Financial assets include any financial claims of a person or company upon others of financial benefits and withdrawing rights allocated by the International Monetary Fund and also includes monetary gold, cash and bonds, loans and deposits. The non-financial assets are everything other than the above-mentioned things which accrue commercial gain, such as commercial buildings, housing and machinery used in the production of goods and services as well as the land which realises benefit or commercial gain. For example, mineral deposits are not assets, unless they achieve commercial gain now or in the near future."

In light of this, non-performing or bad assets are non-financial assets because at the present time there is no commercial gain achieved from them; they are not traded on a regular basis or productive at the present time, or they are in the form loans and bonds whose repayment is not possible at the present time. What is intended here by 'bad assets' specifically is the purchase of loans or bonds which are due but the bank was not able to pay the investors, such as what occurred with Lehman Brothers. Henry Paulson announced the futility of purchasing the bad assets and left the idea of purchasing them after including it in the rescue plan adopted by the US administration and approved by Congress. He said that, "our assessment at this time is that this is not the most effective way to use Tarp funds." The value of the bad assets, which he originally wanted to save from default, was $350 billion. So he effectively had a rethink and reverse half of his original plan!

The Financial Times, which reported this news on the 13/11/2008 ("US drops plan to buy toxic assets"), and which was subsequently cited by Al-Jazeera, further noted that, "The decision to drop asset purchases marks a stunning reversal by Treasury Secretary Hank Paulson, who made the plan the centrepiece of his pitch for the $700bn troubled asset relief programme (Tarp)." The minister said that "it was clear by the time Congress passed the Tarp legislation that the plan to buy assets would 'take time to implement and would not be sufficient given the severity of the problem'", emphasising that, "I will never apologise for changing an approach or strategy when the facts change." This news made the stock market panic and led to a decline in stock prices and lower stock market indices.

Importantly, the value of the bad assets overall reaches $1.25 trillion (Global Insight, 22/9/2008). Global Insight also said that the proposed rescue plan would not solve half the problem. It is not easy to buy the bad assets, not the totality of them, nor the ones specified by the Secretary in his plan. The architect of the plan himself declared the policy ineffective and abandoned it, indicating clearly its ineffectiveness and failure. It is not possible that he made this decision by himself, without the approval of the US administration and without the knowledge of Congress. It is worth mentioning that "the public debt of the US is $11.3 trillion. The federal budget deficit rose on the first of October 2008 to $482 billion, a record number, and this is in addition to the amount committed for Fannie Mae which is $200 billion. The government does not have any part of the $700 billion to purchase the troubled mortgage-based securities" (The Middle East, 22/9/2008, quoting the Associated Press). It does not have $700 billion to spend but "will rely on foreign funds", according to The Middle East (22/9/2008), citing ABC, in an announcement by Secretary Paulson that foreign banks are able to get rid of the bad debts in the framework of the plan.

It is worth mentioning that a fund was established in the late eighties in the United States for the liquidation of bad assets and debts from a savings or loan crisis. This cost the state $400 billion, paid from public funds and taxpayers. Now this crisis has occurred again, but this time because of the real-estate mortgages, the banks have claims against them which instead of paying, they are asking the people to pay, by seeking money from the public funds. This is effectively stealing the people's wealth. This crisis or its like will occur again with ease as banks and financial institutions dispose of investor's wealth howsoever they wish, and on not realising profits or on making losses, simply seek support from the government.

The American government claims now that it will return the money to the Treasury from the companies and banks after the situation improves but this is a lie to the people who are enslaved to the new feudal lords of this age. Proof of this is the saying of their President, Bush, who resorts to lies in all matters, when he said in this regard, "What is happening is not possession and we do not aim to undermine the free economy. In the crisis of the eighties, the government left the shares which it purchased from the faltering financial institutions and we will do the same thing." (al-Jazeera, 18/10/2008).

Thus Bush announced that he would pay for the companies' and banks' bad shares and then not recover it from the financial institutions. The matter will be considered closed. Effectively then, people's money which is collected in taxes for the purpose of serving them, and of the funds for retirees, which were collected at the height of their youth, will be given to the banks and companies as loans which will then be gone with the wind! This is a deception of the people by the state. Instead of lowering the tax burden on people or using excess funds to serve them and feed the poor (who number about 13 per cent in America) their money is given to the rich, to never be recovered, as the collection of taxes continue. The Institute of Annual Statistics issued an annual report on income levels, poverty and health insurance services in the United States, pointing to the high increase in the number of poor from 36.5 million in 2006 to 37.3 million in 2007. The report said that more of those who are over 65 will suffer from poverty if they do not receive social assistance, and that the highest incidence of poverty is in the southern states, with a ratio of up to 30 per cent (BBC, 08/08/2008).

The involvement of the State in financial institutions through the purchase of their shares and bonds is in effect partial nationalisation of these institutions, and is a socialist measure which contradicts Capitalism, being in violation of individual economic freedom. The founders of the free market system, starting from Adam Smith (d. 1790), who is considered the father of free-market economics, through David Ricardo (d. 1823) and Robert Malthus (d. 1834) and others, all rejected state intervention in the free market, until the late Milton Friedman (d. 2006), who received many local and international awards, who also rejected state intervention in the market. He was an economic adviser to the Reagan administration in the eighties, which, on the back of his ideas, called for the liberalisation of trade and market liberalisation and adopted the path of privatisation.

The objective of the rescue plan, which is based on pumping in money to buy stocks and bonds of financial institutions burdened with debt is to try to restore confidence in the lending market between these institutions. The capitalist state is not able to run the banks and companies as they hold that state intervention in the market hinders production and in turn hinders economic growth, progress and prosperity. In the light of this, the financial institutions under state control will not make progress, but will be unproductive. The object of these institutions is increasing profits through commercial activity which results in economic growth. But they will become like government institutions whose object is to manage the affairs of the people and not profit. Therefore they will fail to achieve economic growth. In turn this solution would be a failure, but they do not have any other way as they say: they are forced to this method and there is no other solution.

Europe has adopted another approach in pumping in money: 're-capitalisation' of banks and companies. It is pumping more money into the banks and financial institutions in the form of huge loans in order to restore confidence in the markets. This does not differ much from the purchase of the assets of troubled financial institutions. It is still giving the taxpayer's money to banks and institutions but in the form of loans, whose repayment is not sought by the state in most cases. But the matter remains as it is. At any moment the crisis can recur. It does occur often, only this time it was very large to the extent of nearly toppling the capitalist system.

**Shares and the Share Market**

The system of stocks and stock markets in the capitalist system is erroneous from its basis. The shares of the participants are considered their part and capital of the company, with profits being distributed partially to the shareholders of ordinary and preferred shares and the remaining profits used to increase the capital of the company. However when the shares enter the stock market (stock exchange) they become merely like financial papers which are bought and sold, including the so-called treasury shares and registered and unregistered shares. Hence there is no real participation in the company on the part of the shareholder. He is only considered a legal partner in the company because he is a shareholder, but he is not a real partner and has not concluded any contract with the other partners. At times he will not even know them or know the conduct of the business except from the news. Hence because there is no partnership of body the shareholder arrangement is invalid. Those who manage the joint-stock companies and take salaries and other allowances are not as partners of body, but are employees. They are the ones who exploit the company and take the lion's share.

Further, share prices rise and fall not only because of abundance or the lack of the company's profits, but by the fluctuations of the market because of increased demand caused by economic or political news. The purchase and sale of shares on the stock market resembles gambling. A person buys a stock today, and sells it after a night or a week or a month or more. He acts on the basis of his belief as to how the share price will move, giving little consideration to the state of the company itself.

As for bonds, they are debts on the company from which it raises capital. They are also offered for purchase and sale on the bond markets. They earn profits from the interest accrued from them.

The stock market relies on speculation and neglects real production, as its main activity is the buying and selling of stocks and bonds. Funds are not provided for real production, but to buy shares whose values are expected to rise because of some political or economic news, or to buy a bill to achieve a profit by a rise of interest due to the same reasons. In this there is a great risk and a squandering of the people's wealth and their efforts. It has been clearly shown that the mortgage companies made bad mortgage loans which made the people lose confidence in the global banking system, and depositors and investors lost money; nay, entire nations and peoples lost money!

This is because the nations' and peoples' money is deposited in banks and invested in companies. So when the share values of companies fall or when banks go bankrupt, the wealth of people disappears with them. Al-Hayat reported from Bloomberg (19/09/2008) that the estimated loss incurred by shareholders was of the value of $3.6 trillion in the 72 hours after the announcement of the bankruptcy of Lehman Brothers on 15/09/2008. Bloomberg also reported that up to $19 trillion have been written off the value of shares in the various global financial markets during the ten months since October 2007 when the market indices were at their peak. It mentioned also that the loss of the Gulf States reached $1.4 trillion, in direct losses from owning shares in institutions and banks in the US and Europe.

Is this then the success of Capitalism or its failure? Nay, it is wholesale destruction which has hit the entire world, starting in the United States. Billions woke up in the wake of the disaster to find their wealth wasted, becoming distressed or for some not being able to earn their daily provision or even losing their jobs! This is because what happens in the financial markets affects the economies of the world and in turn the people by increasing the number of sick and hungry and the number of unemployed, and by increasing prices, stopping business projects and stopping construction of infrastructure and agricultural activity. If the lost trillions had been distributed amongst the people of the world, would you then find amongst them the hungry and sick without medicine? Or if the money had been used to set up for them facilities for real production or to reform the land so they can cultivate it, would there remain amongst them any poor or needy? Indeed if such money was used properly all the people of the world could benefit.

However the capitalist system does not concern itself with the distribution of wealth. It only focuses on the accumulation of wealth and its monopoly, such that a cartel is the agreement of the large companies to share the global market with each other, which gives them the opportunity to monopolise the market, and blackmail people in complete freedom. Hence this system does not target the distribution of wealth amongst the people. Rather it wastes the wealth in folly. Yes, they are like gamblers who play with money. They play with the money of people in order to increase their own wealth, and they are not concerned with the loss of this wealth, nor do they intend to stop such games. The game does not end even if all the nations of the world go hungry because the love of gambling makes them blind! A letter from the Food and Agriculture Organization (FAO) to 34,000 commissions on food security around the world said that the collapse of the financial markets will result in a real famine for 36 countries in Asia, Africa and Latin America by 2009 (BBC, 25/09/2009).

Many international conferences have been held about the financial crisis. Countless have been held, be they among European countries - between two, four or five (the Euro-zone countries) or seven nations (summits of the European Union) - or between nations in Europe and America, or between the eight industrialised countries (G8), or between the twenty-one nations of APEC, or 43 nations (ASEM in Beijing), or between the developing nations (G-20 in Brazil), to discuss the current financial crisis and try to find solutions. This shows the gravity of the crisis!

No period in history has witnessed so many conferences held at the highest levels on one subject as this short period has witnessed. The latest conference was the so-called G-20 Summit in Washington, which did not come up with any solution. Hopes were high that this meeting would outline a solution to the crisis. Europe sent delegations of the highest levels and even held preliminary meetings between those heads of state who were to attend the summit.

The European Commission President Jose Manuel Barroso was optimistic when he said that, "the Washington summit has to be a real historic meeting to launch a genuine process of reform not only to the global financial system, but also to the global economy." (Voice of Germany, 7/11/2008). However nothing of this sort was achieved. Rather the result was a compromise between Europe and America as they wailed over their disaster. America continued to defend the free market stubbornly whilst Europe called for overseeing of the market, having lost hope in it. Nothing new came out of the summit. It was a resounding failure. Had anything come of it, there would be little need for having another conference in March 2009 and they would not continue the redundant strategy of pumping in money and playing with the interest rate.

It is apparent that the capitalist leaders have lost hope in a proper solution and are content with simply living with the crisis until Capitalism comes to its natural end, like the sick man who has lost hope in a cure and simply awaits his death. Thus does Capitalism remain on a life line with fatal diseases penetrating its body, only living because its time of death has not arrived. Its wounds are merely patched with bandage solutions and lies to the people of the world because the capitalists have no alternative system.

The European states, particularly the larger ones, have tried to exploit the crisis politically in an attempt to remove America from the pedestal of world leadership, or at the least to force it to share the leadership with Europe. To this end, Sarkozy said, "It is upon Obama to uphold international justice, by cooperation with Europe." (Voice of Germany, 07/11/2008). It is as if international justice is upheld by the cooperation of the iniquitous amongst each other without only one oppressing the people and exploiting them. Sarkozy said, "It is a mistake to regard the crisis a passing phase", adding, "A new world will arise from the current fluctuations, not only in terms of money or economics, but also in all matters relating to politics and society." (Al-Watan and Al-Quds, citing AFP, 17/10/2008)

Sarkozy's Prime Minister, Francois Fillon, said, "The world is on the brink of the abyss." (BBC, 04/10/2008). Angela Merkel, the Prime Minister of Germany, said, "The era of the domination of the economy and one currency has gone forever." (al-Arabiyyah, 04/10/2008) Previously her finance minister, Brooke Stein, said, "it is upon America to accept that she has lost her status of superpower in the world order, the crisis will have profound implications, and the world will not be as it was before." (26/09/2008, The Middle East, and German Media sources). At the same time the Prime Minister of Canada "which still follows the British Crown", Stephen Harper, vented his anger towards America, criticising her and describing the crisis as a disaster (CNN America, 08/10/2008). The International Monetary Fund chief Dominique Strauss, who is European, described the situation as a "baptism of fire" (BBC 4/10/2008). Gordon Brown, the Prime Minister of Britain, said, "The disdain inside the United States towards the global system has led to the credit crisis affecting the world…The problems began in America, and what will be needed now is a comprehensive global review of the international system." (BBC, 30/09/2008).

Thus Europe took advantage of the crisis, not being satisfied at being given the crumbs by America in world politics, in an attempt to destabilise the status of America as the world's superpower with the objective of taking its place, or at least to be a partner with America in deciding the matters of the world and having an equal share in the booty won from the oppression of vulnerable peoples. Europe does not want Capitalism as it is, as it is afraid of the consequences because she has experienced the catastrophic consequences in the past. America on the other hand is still trying to implement it as it is, through the liberalisation of financial and commercial markets and the liberalisation of world trade. Therefore America calls for globalisation and free market economics and for the liberalisation of world trade the US established the World Trade Organization in 1995. America also called for privatisation in the eighties in order to end state intervention which contradicts the capitalist ideology, in which the role of the state is only to oversee and protect the public freedoms.

But America's attempt to apply Capitalism "as it is", failed miserably with the result being the current crisis. This is also what happened in the famous crisis of 1929 which lasted for a number of years forcing the capitalist states to intervene in the market. In the wake of that crisis, capitalist thinkers, like John Maynard Keynes, emerged, advocating state intervention in the market. Such contradictions with the ideology in response to a crisis, also occurred with Communism as some communist thinkers began to allow private property within specific limits.

Thus the wailing of Europe towards America did not provide a solution to the problem. Nor did any of the solutions attempted by the capitalist states, individually or collectively, succeed in addressing the crisis. The reason for this is that these countries did not have the courage to admit that the crisis was in the capitalist system itself and that the system must be uprooted from its foundations. Patchwork will only be overwhelmed as the holes get bigger and bigger.

The problem is the core of the capitalist ideology, for it is a completely materialist ideology as it separates religion from life and thereby separates religion and morals from economics. This leads to the love of money, greed and selfishness dominating society, as people turn to fraud, deception, cheating, exploitation, monopoly and the hoarding of wealth. In turn we have a huge gap between the rich and the poor as the wealth ends up circulating amongst the rich only to the exclusion of others, who can only look on in awe and amazement. Some people do not even see money in their life or only see very little of it. We have seen people in Germany amazed when they saw the 500 Euro note which they wanted to eagerly touch and feel. This is the same paper which is like toilet paper to the rich. Many people will not ever possess more than the 50 Euro note. As for the so-called 'middle class', they attain their wealth with great difficulty and much effort, and still only enough to live a very low standard of life. This status quo is what the capitalist system determines and naturally leads to. These are only some of the bitter fruits of Capitalism which come to fruition in capitalist states themselves.

As for the effects of Capitalism on other nations – what they call the 'third world' – they are much worse but of no concern to the capitalists. The German Minister of Finance Peer Steinbrueck launched an attack on the capitalists in the country, saying, "The biggest threat to the system of social market economy comes from the greed of senior enterprise managers…Selfishness, the lack of cooperation, and lack of empathy towards others amongst the German elite has affected the emotions of the middle class in society and made her lose faith in the presence of social justice." (al-Jazeera, 19/11/2008). He also criticised the greed of the owners of the American and British banks and their quest for high profits, which led to this crisis.

Hence the capitalist ideology is a completely materialistic ideology, just like Communism, without a difference. Both of them remove all spiritual, moral and humanitarian values in society and make the material value dominant. Hence Capitalism is a danger to humanity. It is imperative therefore to fight Capitalism and to remove it from life, nay to remove it from existence, just as the communist ideology before it came to an end.

It is essential for humanity, if she wants a secure and stable economic life, to implement Islam and its economic system. Islam was applied for over 13 centuries and its success has been without parallel. The Islamic state established justice among the people, spread safety and stability around the globe, distributed the wealth amongst all the people in consideration of them all as individuals, removed poverty and destitution and created the economic balance in society. It also enlightened the world with knowledge, light and thought and created prosperity and progress. The capitalist West acknowledges that she took the roots of the sciences, upon which she revived, and the roots of civilisation and systems from the Muslims. She benefited from all this at a time when the West was drowning in the darkness of oppression, ignorance and injustice for centuries.

It is only the Islamic ideology, embodied in the form of the Khilafah state, which will liberate the people from the bondage of wealth and the enslavement of capitalists, and take them from the narrowness of this world to the vastness and contentment of the world and the hereafter.

{مَنْ عَمِلَ صَالِحًا مِنْ ذَكَرٍ أو أنْثَى وَهُوَ مُؤْمِنٌ فَلَنُحْيِيَنَّهُ حَيَاةً طَيِّبَةً وَلَنَجْزِيَنَّهُمْ أجْرَهُمْ بِأحْسَنِ مَا كَانُوا يَعْمَلُونَ}

*"Whoever works righteousness, male or female, and is a believer, verily, to him will We give a new Life, good and pure, and We will bestow on such their reward according to the best of their actions."*
*(TMQ, An-Nahl: 97)*

**Abid Mustafa**
**7th Muharram 1430 Hijri / 3rd January 2009**

# Only the Islamic economic system under the Khilafah State can provide crisis-free economic justice

The importance of the economic aspect in man's life is becoming more and more acute in the present times, so much so that nations consider the economic might as a parameter of their strength which can influence resolutions on global issues. Some nations even regard the economic weakness of the erstwhile Soviet Union as the reason for its breakdown and falling from its position of being the second most powerful nation in the world. Economics is so strongly linked to the global politics that the colonial powers aspire to plunder the resources of the weaker nations and this is amply manifest in the General Agreement on Trade & Tariffs, the GATT.

The most prominent of these examples is the United States of America whose political domination is a direct result of its economic stronghold through American control of capital in industry, utilities and services over the weaker nations' production and manipulating them to suit its own economic agenda. Crises like the global financial crisis, globalisation in all its forms including economic globalisation, financial globalisation, monetary globalisation, privatisation, alliances and economic unions have emerged in the present times. The European Union (EU), the annual summit of the industrialised nations or the Group of 8 (G8), the North-South conferences, the meetings of the nations of the Mediterranean Sea, several other economic conferences and the GATT are all examples of this trend. Then there are the multinational and trans-continental companies, etc.

Yet, despite the several disasters caused by the capitalist system, the West is convinced of its achievements, living conditions and committed to its systems. They are overwhelmed by its glimmer and shine more than it deserves and are smitten by its civilisation and systems and follow it blindly. They believe that this system has no competition and cannot be replaced by anything else. This has resulted in them losing a clear perspective and their own sense of identity.

A keen observer of the capitalist system would notice that the people who are beholden to it are the ones described by Allah (subhanahu wa ta'ala) in the Quran:

{ لَهُمْ قُلُوبٌ لَا يَفْقَهُونَ بِهَا وَلَهُمْ أَعْيُنٌ لَا يُبْصِرُونَ بِهَا وَلَهُمْ آذَانٌ لَا يَسْمَعُونَ بِهَا }

*"They have hearts wherewith they understand not, and they have eyes wherewith they see not, and they have ears wherewith they hear not (the truth)." [TMQ Al-A'raf: 179]*

If one were to observe its reality, one would see all its past failures ever since its inception and not merely after the emergence of the current international financial crisis alone. One can clearly see that the foundations of the capitalist system are rotten and decayed from its very beginning like Solomon's stick which remains erect just because no one ever touched it with his hands!

**Distinguished audience,**

You have listened to the reality of the capitalist system and how the seeds of its failures are intrinsic to it, especially when confronted with a crisis when its foundations tremble. You have also seen that nations actually tinker with its very basis and that this contradicts its own principles which reject state interference. The capitalist system is founded on the market freedom or liberal economy and the classical view is opposed to state interference. This view talks of the 'invisible hand' and self-balance of economy. The capitalist system carries the famous slogan given to it by Adam Smith, the concept of laissez faire which requires that the states do not interfere in the markets. When the crisis of 1929 occurred, Keynes, the noted economist, argued in favour of the need for modifying this classic slogan of the system and advocated that states can and should intervene. And surely they did…then came the 80s and the states refrained from market intervention, and now again they have returned to intervene. This state intervention has not been resisted or decried by the western thinkers; rather they have welcomed it as in their opinion this state intervention will salvage their economy from the present dangerous mess. The western scholars, instead of saying that the capitalist system has failed miserably in solving the economic crisis, are arguing that this is the best system, and further they say that if not this, what else?! The reason for their stand is that they are either ignorant of the Islamic economic system or are pretending to be ignorant. They compare their reigning capitalist system with the collapsed system of Communism and argue that their system which is still alive and surviving is the best. This may be alright as long as their competing system was the collapsed Communism. If they were to consider the issue on its merits, even without being a believer of Islam, they would certainly come to the conclusion that the economic system of Islam alone can provide a secure economy free from disasters. Indeed the great Islamic economic system has been designed by Allah (subhanahu wa ta'ala) who is the Creator, the Sustainer, who is all Knowing and Aware of the needs of His creations and what is good for them. They could see that this system would achieve for them a secure and prosperous life:

{ أَلَا يَعْلَمُ مَنْ خَلَقَ وَهُوَ اللَّطِيفُ الْخَبِيرُ }

*"Should not He Who has created know? And He is the Most Kind and Courteous (to His slaves), the Well-Acquainted (with everything)." [TMQ Al-Mulk: 14]*

Since the ruling class who control the affairs of the world today and dictate its policies and the politicians have chosen to ignore the economic system of Islam and have confined their sights to just the two systems; the collapsed communist system and the capitalist system which is on the verge of collapse; their ignorance will only harm them and will certainly not harm Islam's economic system which continues to state the truth in anticipation of the re-establishment of a Khilafah State very soon by the grace of Allah (subhanahu wa ta'ala) which will apply and implement it just as it had done so for over thirteen centuries. The people will be blessed with it and will again live an economically secure and prosperous life.

**Distinguished audience,**

The short duration of this conference does not permit an elaborate description of economic policies of Islam, however, I would sketch the broad outlines, which Allah (subhanahu wa ta'ala) willing will be sufficient to drive home the point that the economic system of Islam alone is capable of ensuring crisis-free and secure economic life for the people. This is the broad outline:

**First: The Economic Policy in Islam**

Administering of the economy is the focus of the rules that address the management of human issues and the economic policy in Islam ensures complete satisfaction of all basic human needs and then to enable man, as a member of a particular society and a given way of life, to satisfy his luxuries which he can earn. The economic policy in Islam does not merely aim at raising the living standard or GDP of the country as a whole irrespective of whether every single individual has actual access to this raised living standard. Nor does the economic policy of Islam remain content with raising the living standard of the country as a whole and leaving them free to partake from this to the extent they can without ensuring that every single individual has his share in it. Rather, the economic policy of Islam addresses the basic problems of every individual in his capacity as a man who lives under particular relations and empowering him to raise the standard of his life and achieve prosperity for himself in his particular way of life. This unique aspect distinguishes the economic system of Islam from any other system.

While laying down economic rules for the mankind, Islam focuses it towards the individual and Islam, while ensuring his share in life and empowering him to prosper, ensures that he achieves this in his specific society with a particular way of life. Thus one finds that the Shar'i rules guarantee that every single individual citizen of the Islamic State is able to fully satisfy all of his basic needs of food, clothing and shelter. This, it achieves by mandating that every single, able man engages in work to earn the basic needs for himself and for those who are dependent on him:

{ فامشوا في مناكبها وكلوا من رزقه}

*"so walk in the paths thereof and eat of His provision." [TMQ Al-Mulk: 15]*

And as has been reported in a Hadith that the Prophet (sallallahu alaihi wa sallam) shook hands with Sa'ad ibn Mu'adh (radiallahu anhu) and found them to be rough. When the Prophet (sallallahu alaihi wa sallam) asked about it, Sa'ad said: "I dig with the shovel to maintain my family." The Prophet (sallallahu alaihi wa sallam) kissed Sa'ad's hands and said: "They are two hands which Allah (subhanahu wa ta'ala) loves." It is also reported that 'Omar bin al-Khattab (radiallahu anhu) passed by some people who were known as readers of the Qur'an. They were sitting with their heads bent; he asked about them and was told that they were dependents (al-Mutawakkiloon) upon Allah (subhanahu wa ta'ala). 'Omar replied: "No, they are the eaters who eat people's properties. Do you want me to describe those who are the Mutawakkiloon? People said: "Yes." 'Omar said: "He is the person who throws the seed in the earth and then depends on his Lord, The Almighty, The Exalted."

Similarly, work has been mandated upon the father and his successor if he is unable to work, Allah (subhanahu wa ta'ala) said:

{ وَعَلَى الْمَوْلُودِ لَهُ رِزْقُهُنَّ وَكِسْوَتُهُنَّ بِالْمَعْرُوفِ لَا تُكَلَّفُ نَفْسٌ إِلَّا وُسْعَهَا لَا تُضَارَّ وَالِدَةٌ بِوَلَدِهَا وَلَا مَوْلُودٌ لَهُ بِوَلَدِهِ وَعَلَى الْوَارِثِ مِثْلُ ذَلِكَ }.

*"but the father of the child shall bear the cost of the mother's food and clothing on a reasonable basis. No person shall have a burden laid on him greater than he can bear. No mother shall be treated unfairly on account of her child, nor father on account of his child. And on the (father's) heir is incumbent the like of that (which was incumbent on the father)." [TMQ Al-Baqarah: 233]*

Further, it been mandated that the treasury (bait ul-maal) take care of those if they have no one who are legally enjoined to provide the necessities, the Prophet (sallallahu alaihi wa sallam) said:

«الإمام راع وهو مسؤول عن رعيته»

*"The Imam is in charge (ra'i) and he is responsible for his citizens."*

Also, the Prophet (sallallahu alaihi wa sallam) said:

«من ترك مالاً فلورثته ومن ترك كلاًّ فإلينا»

*"If somebody dies (among the Muslims) leaving some property, the property will go to his heirs; and if he leaves a debt or dependants, we will take care of them."*

In another version, the Prophet (sallallahu alaihi wa sallam) said:

«ومن ترك مالاً فليرثه عصبته من كانوا، ومن ترك ديناً أو ضياعاً فليأتني فأنا مولاه»

*"If anyone leaves property, it goes to his heirs, and if anyone leaves debt and dependants, let the matter come to me and I shall be responsible."*

Thus Islam has ensured that every single individual in his capacity as man is able to fully satisfy his essential needs of food, clothing and shelter. Islam then urged this individual to enjoy the bounties and take his share of the luxuries of this world's life which he can afford, Allah (subhanahu wa ta'ala) said:

{قل من حرم زينة الله التي أخرج لعباده والطيبات من الرزق}

*"Say (O Muhammad [sallallahu 'alaihi wa sallam]): "Who has forbidden the adornment with clothes given by Allah, which He has produced for His slaves, and At-Tayyibat [all kinds of Halal (lawful) things] of food?" [TMQ Al-A'raf: 32]*

And He (subhanahu wa ta'ala) said:

{ وكلوا مما رزقكم الله حلالا طيبا}

*"And eat of the things which Allah has provided for you, lawful and good," [TMQ Al-Maidah: 88]*

These and other similar verses of the Qur'an clearly indicate that the economic rules and commands of the Shari'ah are focused on earning of wealth and enjoying the bounties within its rules. Islam has urged individuals to work and earn and ordered them to benefit from the wealth they earn. This is aimed at achieving economic prosperity in the land, to satisfy the essential needs of every individual and to empower him to pursue his luxuries.

In order to allow a Muslim to earn wealth, we find that while Islam has legislated rules pertaining to how he may possess wealth, it has not complicated such rules but has kept them very simple indeed. Thus Islam has laid down means of ownership and it has specified the types of contracts one may enter into to transfer such ownership. Islam does not intervene in creation of wealth and has liberated man to be creative in adopting means and methods in this regard. Thus it provides every individual sufficiently to fully satisfy his basic needs. Islam has not been content at merely urging the individual or restricting this satisfaction within the individual's earnings, it has further mandated that the bait ul-maal spends on them from its means and has also mandated that the state takes responsibility of those who may be unable to earn for themselves. The state has been tasked with the responsibility of providing the essential needs of the people because they have a right to it. Bukhari reports on the authority of ibn 'Omar (radiallahu anhu) that the Prophet (sallallahu alaihi wa sallam) said:

«الإمام الذي على النّاس راع وهو مسئول عن رعيته»

*"The Imam who has been put in charge of the people is the shepherd and responsible for his herd."*

And he (sallallahu alaihi wa sallam) said:

«من ولاّه الله شيئاً من أمر المسلمين فاحتجب دون حاجتهم وخَلّتهم وفقرهم احتجب الله عنه دون حاجتِهِ وخَلّتِهِ وفَقْرِهِ»

*"Whoever is placed in charge of any affair of Muslims and he abandons them without delivering their needs, and leaves them and their poverty, Allah (subhanahu wa ta'ala) will also abandon him without fulfilling his needs or alleviating his poverty."*

In this regard, the instructions of Sayiddina 'Ali (radiallahu anhu) to Malik bin Harith al-Ashtar, the governor of Egypt are regarded as model for the role of state. He asked the governor to levy taxes and fight its enemy, train and culture its people and build the land. He said: "Your sight should remain focused on building the land, more than concentrating on collecting revenues; he who wants to extract taxes from people without building their land, destroys the land and impoverishes its people. His rule lasts only a while."

Apart from this, Islam has placed great stress on cooperating in matters of piety and fear of Allah (subhanahu wa ta'ala). He (subhanahu wa ta'ala) said:

{وَالَّذِينَ فِي أَمْوَالِهِمْ حَقٌّ مَعْلُومٌ، لِلسَّائِلِ وَالْمَحْرُوم}

*"And in their properties there was the right of the Sa'il (the beggar who asked) and the Mahrum (the poor who does not ask others)." [TMQ Adh-Dhariyat: 7]*

Further, the Prophet (sallallahu alaihi wa sallam) also emphasised this and said:

«أَيُّما أهل عَرْصةٍ أصبحَ فيهم امرؤٌ جائع فقد برئَت منهم ذمة الله ورسوله»

*"Any community who wakes up while they have a hungry one then Allah and his Messenger will curse them"*

And he (sallallahu alaihi wa sallam) said:

«ليس المؤمن الذي يبيت وجاره إلى جنبه جائع»

*"He is not a believer who has his fill and his neighbour on his side goes hungry."*

Moreover, the Prophet (sallallahu alaihi wa sallam) praised those Muslims who share their belongings in times of scarcity and famine and said:

«إن الأشعريين إذا أرمَلُوا في الغزو، أو قَلَّ طعام عيالهم بالمدينة جمعوا ما كان عندهم في ثوبٍ واحدٍ ثم اقتسموه بينهم في إناءٍ واحد بالسَّوِيَّة، فهم مني وأنا منهم»

*"When the people of Ash'ari tribe ran short of food during the holy battles, or the food of their families in Medina ran short, they would collect all their remaining food in one sheet and then distribute it among themselves equally by measuring it with a bowl. So, these people are from me, and I am from them."*

**Secondly: Islam's view of Wealth**

Wealth is generally used for 3 purposes: To accumulate or save, to invest or spend and to transact business.

Then Islam has legislated rules governing each of these aspects in such a way that wealth is used for service of mankind so that he benefits from it himself and benefits others with it too, and not in such a way that man is reduced to being its slave whereby he harms himself and others with it.

For instance, man accumulates wealth in order to build his house or to make purchases or accumulates money to pay his hajj journey or for any other that requires him to accumulate money. There is no harm in this so long as the person continues to pay the mandatory Zakat at the end of each year passed if the amount exceeds the nisab amount. However if a person were to hoard wealth for the sake of hoarding, then it is forbidden in the Qur'an. Allah (subhanahu wa ta'ala) said:

{وَالَّذِينَ يَكْنِزُونَ الذَّهَبَ وَالْفِضَّةَ وَلاَ يُنفِقُونَهَا فِي سَبِيلِ اللَّهِ فَبَشِّرْهُمْ بِعَذَابٍ أَلِيمٍ}

*"And those who hoard up gold and silver (Al-Kanz: the money, the Zakat (obligatory charity) of which has not been paid) and spend them not in the way of Allah, announce to them a painful torment." [TMQ Al-Taubah: 34]*

Similarly, Islam has specified rules for investing or spending that wealth. It has permitted spending of wealth as sadaqah and with respect to kinship relations, while it has made it obligatory to pay Zakat, spend on the blood relatives or to prepare for jihad in the path of Allah (subhanahu wa ta'ala) and prohibited spending wealth on wine, gambling and drugs.

As for using money to transact business, Islam has organised this from two different aspects:

First: Laid down fixed standards for wages and prices, which is the 'cash money' and which has been confined to gold and silver alone.

Second: Clarified the correct and valid Shar'i transactions like the rules of companies in Islam which can be: al-'Anan, al-Abadan, al-Mudharibah, al-Wujooh and al-Mufawidhah. Further, rules related to leasing, business, agriculture, share-cropping, sale, forward buying, issue of money, agencies or representation etc. are illustrated. Manufacturing production facilities for forbidden products are prohibited because production facilities are discussed in terms of what they produce, thus if their produce is forbidden, the production will also be consequently prohibited. Hence wine manufacturing facilities are prohibited since wine is forbidden. As for those facilities that extract oil and refine it or extract minerals and produce raw materials from them, they are based on assets that are owned by the public and it is prohibited for the private sector to own these assets. Rather, they can only be owned by all the people under the state's management which distributes the accrued revenue to the people in kind.

Islam has prohibited invalid company structures which do not comply with conditions of establishment and validity like the public limited companies, risk and insurance companies, etc. It also prohibited their shares, products, etc. Moreover it has also prohibited interest based mortgages and mortgage companies and credit cards issued by banks to their customers to pay for purchases they make and pay interest to the issuing bank. Islam has also prohibited hoarding and monopolies which stash away goods to sell later at a higher price.

Further, Islam has prohibited transactions for the sale of goods that are not in possession or selling those goods whose possession is not yet taken as is the practice in commodities exchanges where goods are bought and sold many times over without taking possession of goods and transferring them to the purchaser.

Islam has prohibited the sale of gold and silver and cash on deferred payment (it can only be a hand to hand cash transaction) and speculative trading where goods are stashed away with the aim of creating scarcity and a rise in their prices in the market and not for the purpose of genuine trade.

Thus Islam has forbidden the practice of the multinational companies and the financial markets and stock exchanges through decisive rules elaborated upon in the chapters of fiqh. Three of these rules are of vital importance:

The prohibition of selling goods not owned by the seller, prohibition of selling goods not in possession of the seller and prohibiting the purchase and selling of six key commodities on a non-immediate (spot market) basis. Islam obliges an immediate hand to hand transfer for purchases and sales of these commodities, while if there is a trade of the same commodity (of these 6), the sale will be invalid unless the quantities are equal and without immediate transfer of possession. These commodities are gold, silver, wheat, barley, dates and salt.

Thus interest in all its forms is forbidden and consequently banks do not exist in Islam; not even those banks will exist that are nowadays known as the Islamic banks which sell products that are not owned by them at all and they invest in public limited enterprises and real estate mortgaging companies. Instead there will be a department within the bait ul-maal which will dispense loans for trading, industries and agriculture without any interest.

**Third: Islam's Monetary view**

The Prophet (sallallahu alaihi wa sallam) specified gold and silver as the monetary medium of cash and made these as the only standard benchmark to measure goods and wages of work. All transactions were based on this standard, the units of which were the ounce, dirham, daniq (1/8 of dirham), carat, mithqaal and dinar. All of these were well known during the era of the Prophet (sallallahu alaihi wa sallam), the people used them and it is established conclusively that the Prophet (sallallahu alaihi wa sallam) approved the usage of these units. All trade and dower were measured in gold and silver as the monetary standard and this is proved by the authentic Ahadith. The weight of these was laid down on a specific system of the people of Makkah, the Prophet (sallallahu alaihi wa sallam) said: "the standard of weight is the standard of the people of Makkah." In comparison to the units of cash under Islam, the units of this period are: 1 dinar=4.25 grams of gold and 1 dirham=2.975 grams of silver.

Thus the Shar'i rules have linked the monetary system to gold and silver and under this monetary system there was never a fiscal crisis as opposed to the current practice where the currency of one country is tied to a currency of another country. Ever since gold was removed as the sole monetary standard and was taken jointly with the dollar as the standard under the Bretton Woods system at the end of the World War II, and finally replaced with the dollar as the sole monetary standard in the 1970s, the US dollar became the overwhelming defacto currency of the world and as a result of this, any tremor in the US economy caused a fatal blow to the economies of all other countries. This is because most if not all the cash reserves of these countries is covered by the paper dollar whose intrinsic value does not exceed the value of the paper it is printed on! So much so, that even after the European Union's Euro entered the arena and nations began to buy currency other than the dollar, the US currency generally retained its position of the overwhelmingly dominant currency.

Therefore so long as gold is absent as the sole monetary standard, economic upheavals will repeatedly occur. Not only this, any crisis related to the dollar would adversely reflect on the economies of other countries, and even any action that America takes to create a political upheaval will reflect on the dollar and therefore the entire world. This can happen with any other paper currency of any influential country.

**Fourth: Strong Prohibition of Interest**

The Shar'i texts have prohibited usury in the strongest of terms and this prohibition is conclusive both in its implication and narration with no scope at all for any other interpretation or ijtihad. In fact dealing in interest amounts to waging war against Allah (subhanahu wa ta'ala) and His Prophet (sallallahu alaihi wa sallam). He (subhanahu wa ta'ala) says:

{يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِنْ كُنْتُمْ مُؤْمِنِينَ * فَإِنْ لَمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِنَ اللَّهِ وَرَسُولِهِ}

*"O you who believe! Be afraid of Allah and give up what remains (due to you) from Riba (from now onward), if you are (really) believers. And if you do not do it, then take a notice of war from Allah and His Messenger [sallallahu 'alaihi wa sallam]" [TMQ Al-Baqarah: 279]*

The intensity of this prohibition comes in such strong terms that the Prophet (sallallahu alaihi wa sallam) cursed usury and those who indulge in it. It has been reported in an authentic Hadith:

«لعن رسول الله آكل الربا ومؤكله وكاتبه وشاهديه»

*The Prophet (sallallahu alaihi wa sallam) cursed the person who takes interest and its payer, and one who records it, and the two witnesses. [Sahih Muslim]*

This curse implies that the cursed person is denied Allah's (subhanahu wa ta'ala) mercy. A proper understanding of the realities of the interest based capitalist economy, reveals that it leads to exploitation and subjugation because of the interest based loans and the consequences are misery, hardship and distress. Therefore the denial of Allah's (subhanahu wa ta'ala) mercy to those who indulge in usury is easily comprehensible. Even the capitalist West has now come to realise that profit through interest was the culprit behind the recent economic crisis and this is the reason that they are now advocating a reduction in the interest rates on loans so that the reduced interest rates will stimulate economic activity - if only they had realised the truth and done away with it altogether!

For these reasons, the economic system in the Khilafah State will be free of banks and interest based financing funds which are the prominent symbols of Capitalism. The ensuring of a secure economic life for Muslims has three aspects:

**The First Aspect:** This will focus the attention of Muslims on the production economy or the real economy which will result in an abundance of goods in the Islamic state in terms of production, imports and exports and thereby will result in real competition. This, over a period of time will warm up the markets which have suffered from the communist/socialist system and make the markets of the Khilafah state greatly prosperous.

**The Second Aspect:** This system will protect the Muslims and non-Muslims in the Khilafah state from the loss of their wealth by way of interest. This Islamic system will eliminate the strong protectionism and inflation which encourages people to mortgage their wealth and cash in banks in the hope of being rewarded with a small margin of interest. The banks thereby accrue huge profits by impoverishing others through interest based loans and reap huge deposits from the local as well as international markets including from the poorest of the people who suffer endlessly under the clutches of interest and who suffer toil and hardship over a great part of life trying to repay the accumulated interest. As a result of this we see misery in the capitalist countries which results from the control of the banking sector over all other sectors since all sectors are intricately entangled with the banking sectors and the interest regime which causes economic threats. All these perils will be unheard of and non-existent in the Islamic context under the Khilafah state. Also the richest of the rich who have amassed enormous wealth mainly through fleecing other people's wealth will be an unheard of phenomenon in the Islamic economic system. The wealth of the Muslims and non-Muslims will be protected under the system sent down by Allah (subhanahu wa ta'ala) which forbids usury and the temptations of the banks which will soon be exposed as a mere mirage which impoverished people and robbed them of their wealth by treacherously invalid means.

**The Third Aspect:** The long and endless queues that you come across in front of the capitalist banks are of people whose wealth has evaporated and they have been hopelessly impoverished. This is far from the reality under the system of Islam which forbids and eliminates all banks. Thus it does away with interest based lenders and protects the wealth of people from being fiddled away by the usury eaters. There are no laws in the Khilafah state to protect interest based banks and invalid companies who declare bankruptcies and continue to indulge in corruption.

Thus by forbidding interest and prohibiting it conclusively, Islam has completely blocked any chance of these economic upheavals and crises from leaking into those lands which comply with the Islamic system. Therefore the economic life is made safe, secure and impervious from such crises.

However, Islam has encouraged Muslims to lend to their brethren and urged them to do so, the Prophet (sallallahu alaihi wa sallam) said: *"No Muslim lends to another Muslim twice except that one of this would be like a sadaqah."* This is not only at the level of the individual alone; in fact there is a separate economic department within the Khilafah state which will disburse loans to farmers and entrepreneurs within the framework of the state's economic policy and this will be to eliminate poverty by finding gainful employment and providing goods. But of course, these loans will have no interest attached and their purpose will not be to make profits because the Khilafah state is a welfare state and not a revenue collecting state.

**Fifth: Distribution of Wealth and Ownership in Islam**

The wealth under the Khilafah state is in three categories: private property, public property and state property. It is the state that maintains and protects these in accordance with the laws of the Shari'ah. Public Property: This category does not merely comprise the highways and roads, etc. but also includes what was explained by the Prophet (sallallahu alaihi wa sallam) in two noble and authentic Ahadith:

First Narration: The Prophet (sallallahu alaihi wa sallam) said:

«المسلمون شركاء في ثلاث: في الماء، والكلأ، والنار»

*The Muslims are partners in three (resources): Water, Pastures and Fire.*

The term 'fire' here includes all forms of energy used as fuel in industry, machines and plants as well as the gas plants which use gas as fuel. All of these are under the public ownership category.

Second Narration: The saying of the Prophet (sallallahu alaihi wa sallam) to Abyadh ibn Hammal who was refused ownership of a salt-laden land on the ground that this land contained replenishable of water as has been reported in the Hadith. What is meant is a source that replenishes in time. This category includes all minerals whether they are solids like copper, iron or gold, liquid like oil or gaseous like natural gas. It also includes such categories which are obvious and hence easily discovered e.g. antimony, sapphire, etc. or is found in the depths of earth and not easily discovered like underground mines – all of these fall under public property and the Khilafah state alone manages and supervises their extraction, sale and distribution. In addition, it is the state that ensures that every Muslim gets his rightful share in public property. So the oilfields and the mineral mines in the Khilafah state are not owned by the state as was the case in the communist system where the state exercised its will over such resources as it wished and nor are they owned by individuals, as is the case in the prevalent capitalist system which makes it acceptable for the large capitalists to own the enormous resources and who boast such personal wealth that exceeds that of entire nations!

Public property is not similar to state property which the ruler dispenses for the interests of the state - it is for the Ummah and the revenues generated by public property are to be disbursed among them after the incurred costs are adjusted. These revenues are to be distributed to the citizens and they have rights over it. It also has to be spent on their protection and making them a force to be reckoned with. This can be done by spending on military capabilities and ammunition. You can imagine the huge amounts generated from crude oil and minerals in the Islamic lands and how they would be spent on alleviation and elimination of poverty when the Khilafah state disburses these revenues and services to its citizens. This Shar'i understanding along with other concepts goes well to consolidate the economic lives of the Muslims and prevent their rulers from falling for the deception and intrigue of the kafir colonialists who have managed to transfer the oil revenues from the Islamic lands through the so-called sovereign funds of the Gulf states for the development of Europe and America, while at the same time denying the same funds to this Ummah. These revenues now count in trillions of gold dinars and they are enjoying them at the cost of this Ummah while the Ummah is condemned to suffer further from the financial crises of their making!

The state property is different from public and private property. State property can be spent by the Khalifah as per his discretion and ijtihad and it includes the Fai, Kharaj and the inheritance of those who leave behind no successor, etc. This is on the condition that the Shari'ah does not specify where such revenues may be spent. In case the Shari'ah does specify, then it has to be spent on that for which it was specified; this is similar to Zakat which can be spent on the 8 specified categories.

The state property may be spent by the Khalifah as per his discretion and ijtihad in matters of state and citizens. For instance he may spend in order to create balance in the society so that the money transactions are not confined to the rich alone. Allah (subhanahu wa ta'ala) says:

{كَيْ لَا يَكُونَ دُولَةً بَيْنَ الْأَغْنِيَاءِ مِنْكُمْ }

*"in order that it may not become a fortune used by the rich among you." [TMQ Al-Hashr: 7]*

Therefore the Khalifah may grant these to the poor and destitute as the Prophet (sallallahu alaihi wa sallam) did with Fai from the Banu Nadheer tribe which he (sallallahu alaihi wa sallam) distributed only among the immigrants from Makkah and not among the Ansar of Madinah except for two of the poor Ansar who were as destitute as the immigrants; they were Abu Dujanah and Sahl ibn Hunaif. This was in compliance with the Ayah so that the circulation of wealth did not remain confined amongst the rich. As for the private property, it is dispensed by the individual and is different from public property and the state prevents any violation on it. It is not allowed for a person to usurp this forcibly; not even by the state. Consequently, the so-called nationalisation actually amounts to exploitation of individual property by the state and this is a grave crime.

Certainly, categorising these forms of property into just one category under the state's management will invariably result in crisis leading to failure and breakdown. This is how the concept of Communism failed in economics because all properties were owned by the state. Even under Communism, certain sectors were immensely successful like the heavy industry and petroleum industry, while those that must be managed by individuals, like agriculture and medium industry failed miserably under Communism and under the weight of these failures, Communism came to be extinct. Similarly, the capitalist system failed and is nearly on the threshold of collapse shortly. This is because on grounds of free market economy, privatisation and globalisation it allowed individuals, enterprises and companies to own what is supposed to be public property, like petrol, gas and other energy sources. The result of this is the recurring upheavals and rapid crashes in the financial markets and companies, one after another.

This is how the Socialism/Communism collapsed and this is how the capitalist system is on the verge of collapse.

**Sixth: The Stock Exchanges and the Islamic Perspective**

In the capitalist system, the stock exchanges play the same role as the interest system which confines and concentrates wealth within a small circle of people. The stock exchanges are even more harmful because they turn the economy from trading in real goods and services to mere numbers and papers from which people profit and incur losses. In this system, wealth is inflated multifold without any real production of goods or services. When the markets rise the people get the illusion that the economic growth is high and similarly when the markets plunge low, people are shocked because their wealth which they possessed or thought they possessed is blown away while the financial speculators take away the real wealth. An ordinary investor makes a profit by buying shares and selling them off when the prices increase, while a speculator earns his profits through the so called short term trading wherein he buys shares and disposes them in order to bring down the prices.

Indeed, the stock exchanges and financial markets are the cradles of capitalist crises which leave behind scores of people poorer having exposed them and their wealth to severe losses.

However, under Islam the buying and selling markets are regulated by the laws of Shari'ah which are a guarantee against conflicts and ensure that no one usurps the wealth of others by invalid and wrongful means. Some of these regulations are:

A: Any goods not owned and possessed by the seller are not allowed to be sold. Therefore any good that has been bought but not taken possession of, is prohibited to be sold. The practice of the stock exchanges is that shares and goods are bought and sold many times over while they remain in their place, neither in the possession of the seller nor of the buyer.

B: These rules forbid speculation whereby the prices surge up not because of an actual demand or selling of the goods, but because it is meant to cause an increase in price. This is the practice in the stock markets currently. The increase in the prices of crude oil in 2008 is proof of this.

C: These rules also prohibit the purchase and sale of the six commodities unless it is with immediate effect, hand to hand transfer, while if it is for the same commodity, the sale will be invalid without the quantities being equal and without immediate transfer of possession. These commodities are gold, silver, wheat, barley, dates and salt.

Therefore the selling of these commodities against each other is not valid unless it is done with immediate transfer of possession, and selling of these commodities (the same commodity) is not valid if done without taking possession and with equivalent quantities. For instance in selling of gold for gold or wheat for wheat. Differences in quantity and deferred delivery is not allowed.

But the practice in the commodities exchanges is in contravention to this and hence invalid. Any delay in taking possession of these commodities especially during exchange leads to problems. The crises emerge as a result of high volatility, price differentials and deferred possession, driven falsely as possession is not required for initiating the trade. Consequently it becomes similar to gambling and its adverse affects like manipulation of prices, losses and crises are obvious.

D: The Shari'ah rules prohibit transactions of shares because the public limited companies and as a result their shares are invalid. These shares are certificates which comprise mixed amounts of permitted (Halal) capital and prohibited (Haram) profits in the invalid contract and transaction where the principal amount and profit get mixed up. Each share certificate represents an equity share in the assets of the invalid company and such assets have been amassed as a result of invalid transactions prohibited by the Shari'ah. This becomes prohibited (Haram) money and the shares of the company would include Haram assets. This renders the shares Haram, whose sale, purchase and transaction is prohibited. This applies both to the ordinary shares as well as to the preferential shares which accrue profits under all circumstances and which have access to priority payment in case of the winding up of the company and disbursement of profits.

Similarly, it is also not allowed to purchase shares on interest based loans offered by the share broker or others to the buyer against mortgage of shares itself. This is because it is akin to interest and shares are mortgaged. These actions are prohibited by the Islamic texts for the one who consumes interest, the one who pays interest, the one who records the transaction and the one bears witness to the transaction.

It is also not permitted to sell shares that are not owned by the seller and are 'acquired' by way of the promise of the broker that a loan would be given at the time of delivery of shares. This amounts to selling what is not in possession of the seller (the broker in this case). This prohibition becomes all the more severe when a condition is stipulated that the price is to be paid to the broker so that he gains profits from it through deposit with usury/interest, so he gains money for his lending the shares.
It is also not permitted to sell or transact shares because the shares are a debt to the company which invests this money for interest and also because it is prohibited to sell debt with debt.

Thus the sale and purchase markets in Islam achieve Halal and secure trade free from the threat of crises, disputes, speculation, gambling and cheating. They are clean markets with clean hands which comply with the rules of the Shari'ah in all transactions.

**Seventh: The Economic Welfare the State carries out:**

The state guarantees work for each of its citizens because the Prophet (sallallahu alaihi wa sallam) said:

«الإمام راع وهو مسؤول عن رعيته»

*"The Imam is the care taker and he is responsible for his herd."*

And he (sallallahu alaihi wa sallam) said:

«من ترك مالاً فلورثته ومن ترك كلاًّ فإلينا»

"*If somebody dies (among the Muslims) leaving some property, the property will go to his heirs; and if he leaves a debt or dependants, we will take care of them."*

And he (sallallahu alaihi wa sallam) said:

«ومن ترك مالاً فليرثه عصبته من كانوا، ومن ترك ديناً أو ضياعاً فليأتني فأنا مولاه»

*"If anyone leaves property, it goes to his heirs, and if anyone leaves debt and dependants, let the matter come to me and I shall be responsible."*

Thus for a destitute and poor person who is unable to work and has no close relatives who are liable for his maintenance or a poor person who can work but does not find employment and has no close relatives who are liable for his maintenance, the state is liable for their maintenance in compliance with the above Ahadith. The state has the responsibility to find employment for the one who is capable to work and fulfil the responsibility of the one who is unable to work with funds from the bait ul-maal. It has been reported in an authentic Hadith:

A man of the Ansar came to the Prophet (sallallahu alaihi wa sallam) and begged from him. He (the Prophet) asked: Have you nothing in your house? He replied: Yes, a piece of cloth, a part of which we wear and a part of which we spread (on the ground), and a wooden bowl from which we drink water. He said: Bring them to me. He then brought these articles to him and he (the Prophet) took them in his hands and asked: Who will buy these? A man said: I shall buy them for one dirham. He said twice or thrice: Who will offer more than one dirham? A man said: I shall buy them for two dirhams. He gave these to him and took the two dirhams and, giving them to the Ansari, he said: Buy food with one of them and hand it to your family, and buy an axe and bring it to me. He then brought it to him. The Prophet (sallallahu alaihi wa sallam) fixed a handle on it with his own hands and said: Go, gather firewood and sell it, and do not let me see you for a fortnight. The man went away and gathered firewood and sold it. When he had earned ten dirhams, he came to him and bought a garment with some of them and food with the others. The Prophet (sallallahu alaihi wa sallam) then said: This is better for you than that begging should come as a spot on your face on the Day of Judgment.

These rules also cover the dhimmi who lives in the Islamic State and is a citizen of it; he is as well entitled to state welfare. A dhimmi is one who professes a religion other than Islam and becomes a citizen of the Islamic state while remaining on his non-Islamic deen. The term dhimmi is derived from the word dhimmah which implies a covenant of protection. They have the right upon us to treat them rightfully, deal with them and take care of their affairs in compliance with the rules of the Shari'ah. Islam has come with several Ahkam for the dhimmis which guarantee them rights and duties as citizens. They receive justice and equity, similar to the Muslims.

The dhimmis have the same rights for the guarantee of their welfare and livelihood, just like the Muslims - Abi Waa'l and Abi Moosa report that the Prophet (sallallahu alaihi wa sallam) said:

«أطعموا الجائع، وعودوا المريض، وفكوا العاني»

*"Feed the hungry, visit the sick, and set free the captives."*

This covers all citizens of the Islamic state, Muslims and non-Muslims alike.

**Eighth: Accounting of the State Employees of their non Shar'i possessions:**

The Islamic state does not permit its employees to economically exploit their employment. Rather, it accounts them just as the Prophet (sallallahu alaihi wa sallam) would do.

The Prophet (sallallahu alaihi wa sallam) used to account the governors and 'aamils on their earnings and said in this regard:

«من استعملناهُ على عملٍ فرزقناه رزقاً فما أَخَذَ بعد، فهو غُلُول»

*"Whomever we appointed in his job and we provided him (some funds), so whatever he took unduly would be ghalool (misappropriation)."*

The Prophet (sallallahu alaihi wa sallam) appointed Ibn al-Lutbiyyah over the sadaqah of Bani Saleem, "When he returned back to the Prophet (sallallahu alaihi wa sallam) and he revised accounts with him, he said, 'This is what is yours, and this is a gift to me.' The Prophet (sallallahu alaihi wa sallam) said, "Won't you stay in your parents home and see if you get your present, if you say the truth?" Then the Messenger of Allah (saw) stood preaching to the people. So he praised Allah and glorified Him and said:

"After all I appoint some men of you over some affairs in which Allah gave me authority. Then someone amongst you comes and says: This is for you and this is a gift given to me. Had he not sat in his fathers' and mother's home so as his gift comes to him if he says the truth. By Allah, no one of you would take of them (the Sadaqat) anything unduly but comes to Allah carrying it on the Day of Judgement. Beware, I will know any man who comes to Allah with a camel that brays and a cow that is mooing and a sheep that bleats. Then he raised his hands till I could see the whiteness of his armpits. Didn't I convey?"

It is reported of 'Omar bin al-Khattab (radiallahu anhu) that he used to account the properties of the 'aamils before appointing them as well as after their terms and take away any unreasonably extra wealth found with them. He also accounted the possessions of some of the governors and took away parts of the wealth of others because of suspicion about the means of their earning such wealth (e.g. exploiting their position and influence). He would take possession of such wealth and put it in the bait ul-maal.

Thus the employees are first of all encouraged to fulfil their duties with a sense of Taqwa and then it is enforced with the Shar'i rules which require that the employees be accounted fairly to ensure that the wealth of the Ummah is protected and not violated.

**Ninth: Monitoring /Supervision of the Economic System in Islam:**

The monitoring apparatus of the state may be summarised as follows:

The Muhtasib or the judge of the markets: He monitors the markets for fair weights and measures and guards against cheating and deception in markets and public places in addition to monitoring other offences and violations as well.

The Judge: He rules in matters of all disputes including financial and economic which may emerge between people in their daily lives.

The Administrative apparatus: This is the mechanism to control the movement of money in the bait ul-maal in its various categories like the Zakat money, state money or the public sector revenues. This monitors income and expenditure and ensures that money is placed in its rightful category.

The Madhalim Court: This is the court of the unjust acts and takes up complaints raised against the ruler if the citizens' rights are violated in any way, whether in matters of finance or economy.

These are the monitoring or accountability apparatus which ensure fairness in the economic system as required by the Shari'ah.

**Distinguished Audience,**

These are the broad outlines of the economic policy in Islam.

If the Khilafah state distributes the net incomes from the public properties among its citizens right from their birth;

And if the Khilafah state fulfils the basic needs of the poor and destitute like food, clothing and shelter by providing work to the able-bodied among them and taking responsibility of those who are not capable of undertaking work, through funds from Zakat and public wealth to cover their basic needs;

And when the Khilafah state distributes from the public money to a poor person and not the very rich person, in order to create a balance in society and reduce disparities between peoples wealth;

Then the Khilafah state gives interest free loans to those who need it for the purpose of agriculture, industry or trading;

When the state prevents invalid transactions, whether the invalid contracts that do not comply with proper contracting regulations or the multinational companies, the limited liability companies or the insurance companies.

If the state prohibits sale and purchase, both internally and externally, of goods that are not owned and not possessed as in the stock exchanges and ends speculation;

If the state prevents the sale of gold and silver and all other cash forms without taking possession, in case of different categories; and without taking possession and equal quantities in case of similar items, as is the practice in the stock markets currently;

If the state prohibits interest based credit cards and transactions in financial instruments and interest bearing bonds and trading of the invalid shares;

If the monitoring departments of the state exercise control over all those who manipulate, violate, cheat, hoard, monopolise or gamble;

And then, the implementation of this system in the Khilafah state does not alter or reverse depending on the 'mood' or inclination of the ruler; rather it is the system mandated by Allah (subhanahu wa ta'ala) implemented on the basis of Taqwa, fairness of legislation in the state which is a welfare state and not a revenue collecting state;

Is it not the duty of the one who alone can deliver a life of security and prosperity free from crises to stand up to the task?

**Distinguished Audience,**

It can be said that this system is indeed just, fair and secure. But it is only in the pages of books and to establish the Khilafah state is a mammoth task in the current times or at the very least a very difficult task. Then why engage ourselves in the attempt to pluck the fruits from a high tree and expose ourselves to its perils? Why not feed ourselves with the fruits that fall from the tree, clean them of the dirt as much as we can and close our eyes to any dirt remaining on them that we cannot clean, and eat the same!?

**Distinguished Audience,**

As for the first excuse that the task is an impossible one, it is clear to any observer that it is not so. In fact it is not an impossible task – indeed the Khilafah state is about to be formed soon with permission of Allah (subhanahu wa ta'ala) and the evidence for this is as follows:

**The First:** Allah (subhanahu wa ta'ala) has promised authority to those who believe in Him (subhanahu wa ta'ala) and do good deeds:

{ وَعَدَ اللَّهُ الَّذِينَ آمَنُوا مِنْكُمْ وَعَمِلُوا الصَّالِحَاتِ لَيَسْتَخْلِفَنَّهُمْ فِي الْأَرْضِ كَمَا اسْتَخْلَفَ الَّذِينَ مِنْ قَبْلِهِمْ وَلَيُمَكِّنَنَّ لَهُمْ دِينَهُمُ الَّذِي ارْتَضَى لَهُمْ وَلَيُبَدِّلَنَّهُمْ مِنْ بَعْدِ خَوْفِهِمْ أَمْنًا يَعْبُدُونَنِي لَا يُشْرِكُونَ بِي شَيْئًا وَمَنْ كَفَرَ بَعْدَ ذَلِكَ فَأُولَئِكَ هُمُ الْفَاسِقُونَ}

*"Allah has promised those among you who believe and do righteous good deeds, that He will certainly grant them succession to (the present rulers) in the land, as He granted it to those before them, and that He will grant them the authority to practise their religion which He has chosen for them (i.e. Islam). And He will surely give them in exchange a safe security after their fear (provided) they (believers) worship Me and do not associate anything (in worship) with Me. But whoever disbelieved after this, they are the Fasiqun (rebellious, disobedient to Allah)." [TMQ An-Nur: 55]*

**The Second:** The Prophet (sallallahu alaihi wa sallam) has given glad tidings for the return of the Khilafah on the pattern of the Prophethood after a period of forcible governance that we are under currently. The Prophet (sallallahu alaihi wa sallam) said:

«تَكُونُ النُّبُوَّةُ فِيكُمْ مَا شَاءَ اللَّهُ أَنْ تَكُونَ ثُمَّ يَرْفَعُهَا إِذَا شَاءَ أَنْ يَرْفَعَهَا ثُمَّ تَكُونُ خِلَافَةٌ عَلَى مِنْهَاجِ النُّبُوَّةِ فَتَكُونُ مَا شَاءَ اللَّهُ أَنْ تَكُونَ ثُمَّ يَرْفَعُهَا إِذَا شَاءَ اللَّهُ أَنْ يَرْفَعَهَا ثُمَّ تَكُونُ مُلْكًا عَاضًّا فَيَكُونُ مَا شَاءَ اللَّهُ أَنْ يَكُونَ ثُمَّ يَرْفَعُهَا إِذَا شَاءَ أَنْ يَرْفَعَهَا ثُمَّ تَكُونُ مُلْكًا جَبْرِيَّةً فَتَكُونُ مَا شَاءَ اللَّهُ أَنْ تَكُونَ ثُمَّ يَرْفَعُهَا إِذَا شَاءَ أَنْ يَرْفَعَهَا ثُمَّ تَكُونُ خِلَافَةً عَلَى مِنْهَاجِ النُّبُوَّةِ ثُمَّ سَكَتَ»

*"The Prophethood will be among you as long as Allah wills, then he will eliminate it if he so wills. Then a Khilafah on the model of Prophethood will prevail so long as Allah wills, then he will eliminate it if he so wills. Then there will be a biting monarchy as long as Allah wills, then he will eliminate it if he so wills. Then there will be an oppressive monarchy as long as Allah wills, then he will eliminate it if he so wills. Then a Khilafah on the way of Prophethood will prevail and he kept silent."*

**The Third:** The effective and aware Ummah will accept and appreciate the work to re-establish the Khilafah and it will support it until the promise of Allah (subhanahu wa ta'ala) takes shape and then it will guard and nurture it as well, because the Ummah is fast moving in the original direction for which it was created by Allah (subhanahu wa ta'ala). He (subhanahu wa ta'ala) said:

{ كُنْتُمْ خَيْرَ أُمَّةٍ أُخْرِجَتْ لِلنَّاسِ تَأْمُرُونَ بِالْمَعْرُوفِ وَتَنْهَوْنَ عَنِ الْمُنْكَرِ وَتُؤْمِنُونَ بِاللَّهِ}

*"You are the best of peoples ever raised up for mankind; you enjoin Al-Ma'ruf (i.e. Islamic Monotheism and all that Islâm has ordained) and forbid Al-Munkar (polytheism, disbelief and all that Islam has forbidden), and you believe in Allah." [TMQ Ale-Imran: 110]*

**The Fourth:** The Hizb is sincere and dedicated to Allah (subhanahu wa ta'ala) and truthful to His Prophet (sallallahu alaihi wa sallam) and is fighting its way day and night until the promise of Allah (subhanahu wa ta'ala) and the glad tidings of His Prophet (sallallahu alaihi wa sallam) materialise by it. The Hizb is not afraid of the blame from the blamers and is not weakened by the task and will remain steadfast until the end just as the Prophet (sallallahu alaihi wa sallam) said in a Hadith reported in Muslim on the authority of Thauban (radiallahu anhu):

«لا تزال طائفة من أمتي ظاهرين على الحق لا يضرهم من خذلهم حتى يأتي أمر الله وهم كذلك...»

*"So long as a group of my Ummah remains on the truth, they will not be harmed by those who are feeble and frustrated, until Allah (subhanahu wa ta'ala) comes up with His command and so will they…"*

Indeed, any one of these sufficient to state that the matter of the Khilafah state being established is not an absurd or difficult task. It is not merely possible, rather it is on its way shortly by the permission of Allah (subhanahu wa ta'ala). If just one of these evidences is enough, then consider that there are four of these.

As for the other option of being content with picking the dropped fruits and cleaning and eating them just as the capitalists do with their capitalist system which they keep on trying to patch up to erase its failures. In response to this attitude, I would say that this is not the characteristic of Muslims who desire the best of this world and the hereafter. Similarly this attitude is not of those who are thinkers and strive for a better life; even those thinkers who are not Muslims.

Indeed, the Islamic economic system ensures a blessed economic life to all people, Muslims and non-Muslims alike, so long as they live under the shade of the Khilafah which protects their life and safety irrespective of their origin, deen or descent. Whoever follows it is guided to the right path and a blessed life and whoever chooses other systems, then you can see them suffering its consequences. Allah (subhanahu wa ta'ala) said the truth when He stated:

{فَإِمَّا يَأْتِيَنَّكُمْ مِنِّي هُدًى فَمَنِ اتَّبَعَ هُدَايَ فَلَا يَضِلُّ وَلَا يَشْقَى* وَمَنْ أَعْرَضَ عَنْ ذِكْرِي فَإِنَّ لَهُ مَعِيشَةً ضَنْكًا }

*"Then if there comes to you guidance from Me, then whoever follows My Guidance he shall neither go astray nor shall be distressed. But whosoever turns away from My Reminder (i.e. neither believes in this Qur'an nor acts on its teachings), verily, for him is a life of hardship," [TMQ Ta-Ha: 123-4]*

والسلام عليكم ورحمة الله وبركاته

**Abu Khalil Ibrahim Othman**
**The official spokesman of Hizb ut-Tahrir Wilayah of Sudan**
**7th Muharram 1430 Hijri / 3rd January 2009**