THIS IS NOT CREDIT CRISIS!

Mansoor Durrani*

Past: When Mr Warren Buffet, the richest man in the world, called some financial instruments like the Derivates and Credit Default Swaps (CDS) 'financial weapons of mass destruction' over three years back, few of us took notice. The world economy was on the roll. European realty and financial markets were booming. US was 'winning the war on terror'. And rest of the world was blindly aping this mirage called 'American Dream'.

Some high level articles on alternate perspectives of the present crisis have recently been published. For a commoner to understand this mess, we need to go back to basics. Derivatives can be described as like putting a mirror in front of another mirror, allowing a physical object to be reflected into infinity. Australian Prime Minister Kevin Rudd has identified 'comprehensive failure of extreme capitalism' as a cause of this economic crisis. He attributed greed and fear as the 'twin evils' at the root of the financial sector collapse. Interest and speculation based capitalism has been around for a long time, but the seeds of this 'extreme capitalism' were sowed by the US when neo-cons made their debut in White House under Ronald Reagan. Their objective was to accelerate the theft of global resources at a much faster pace than they did over the previous seven decades.

This 'richest nation' in the world has 'borrowed' trillions of dollars from external and internal lenders to fund, among others, research and development of weapons of mass destruction and wars. The Republican Presidential candidate said he would be content to continue the war for 100 years. With what resources? The fact of the matter is that the US is bankrupt. David M. Walker, Comptroller General of the US and head of the Government Accountability Office, in his December 17, 2007, report to the US Congress on the financial statements of the US government noted that 'the federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2007.'

The GAO report further pointed out that the accrued liabilities of the federal government 'totaled approximately $53 trillion as of September 30, 2007.' No funds have been set aside against this mind boggling liability. Why? Because there is no intention to repay! Just so the reader understands, $53 trillion is $53,000 billion. Frustrated by speaking to deaf ears, Walker recently resigned as head of the Government Accountability Office. Such a precarious state of US economy is reflected in dollar's declining value against other currencies. As of March 17, 2008, one Swiss franc is worth more than $1 dollar. In 1970, the exchange rate was 4.2 Swiss francs to the dollar. In 1970, $1 purchased 360 Japanese yen. Today $1 dollar purchases less than 100 yen.

In 2007 alone US borrowed $739 billion – majority of it to completely destroy Iraq on the pretext of searching weapons of mass destruction which it never found and Afghanistan on the excuse of hunting one single individual who again it failed to find. It did succeed though in killing hundreds of thousands of their citizens. Other 'rich' crusaders that have joined this global bully in its 'war against terror' also borrowed heavily in 2007. For instance, Spain borrowed $146 billion, UK $136 billion Australia $56 billion and Italy $47 billion. America's 2008 borrowing has already crossed one trillion dollar. Although these insane amounts are theoretically 'borrowed', lenders will not be able to recover their exposure from this 'borrower' for at least two reasons (a) the borrower is not honest as it has not built any reserve to repay and (b) for now, it is militarily too powerful. At least 'third world' lenders, except China, will find it hard to retrieve their 'investments'.

Successive neo-con presidents aggressively 'de-regulated' financial markets and left them at the mercy of greedy speculators. Let us take the recent example of surge in oil prices which triggered worldwide inflation and made hundreds of million human beings poorer. US regulatory body Commodity Futures Trading Commission (CFTC) recently reported that financial firms speculating for their clients or for themselves account for about 81 percent of the oil contracts on New York Mercantile Exchange – the world's biggest commodity exchange. Using swap dealers as middlemen, investment funds have poured into the commodity markets, raising their holdings to $600 billion this year from $13 billion in 2003. During that same period, the price of crude oil rose unabated every year. This reality throws Mr Bush's argument to the wind that oil price rose due to China's economic growth and food prices increased because Indians are eating more!

While these speculators called 'bulls' or 'bears' played havoc in equity and commodity markets by buying without money in their pocket (bulls) and selling what they did not posses (bears), their commercial and investment banking cousins began lending aggressively to buy cars, homes, clothes, TVs, refrigerators and even holidays to those who did not have means to repay. Because of their low ability (which later became no ability) to pay back debt, they were classified as 'sub-prime' customers and therefore were charged much higher interest rates. Even after making such reckless and greedy lending decisions, banks were not prepared to take any risk. So they insured these risky loans through CDS. Thus widening the scope of potential destruction and putting even insurers' money at risk. With slight increase in interest rates, these sub-prime customers began defaulting. This led to large-scale defaults. Banks having big exposure to such customers panicked. They tried to sell collateralized properties to recover their money. But there were no takers. This turned out to be the final nail in the coffin of dangerous game that was being played under this 'extreme capitalism'.

Present: The 2007 annual report of top British bank Barclay's shows total customer loans - their core business - at Great Britain Pound (GBP) 345 billion. However, trade portfolio and derivatives together stood at GBP 541 billion. Such a high investment in speculative non-core business is bizarre and inexplicable. Greed and recklessness appear to be the only answer! At the most basic level, interest based financial instruments attract a fixed return on the original amount provided for business or consumption. The capital provider (banks and other financial institutions) under this system care less if the recipient is economically benefiting out of their money. Even if recipients incur losses, they are legally required to pay back more money than they took. Islam views this as gross injustice and even 'an act of war against Allah and His prophet'. Therefore, the destruction of interest based system was predestined. And this is what is happening.

Plilip Stephens aptly illustrates in the Financial Times of 10th October this year, 'for more than two centuries, the US and Europe have exercised an effortless economic, political and cultural hegemony. That era is ending.' Big books and articles are being written on why and how this crises set in. Thousands of jobs are on the block. Depression and suicides are on the rise. Hundreds of billions of tax-payers dollars are being thrown in to save the developers and marketers of financial weapons of mass destruction. These steps by free market champions are leading us to believe that this system privatizes profits and socializes losses. This is in stark contrast to what these 'rich' proponents have been preaching to the 'third world'.

Commentators predict that the sun will shine again. Sure it will; but never with the same brightness. And it shouldn't. For extreme 'brightness' was making life difficult for billions of inhabitants on this planet. This capitalism has created two sections in our societies: super rich and super poor. In this system, a UK based Indian industrialist buys GBP 300 million (SAR 2.4 billion or Indian rupees 2,400 crore) house for his wife while more than 300 million Indians survive on less than half a Pound a day! Moreover, thousands of Asians, Africans and who knows even Americans and Europeans (as media owned by the same greedy business houses may not report) are starving to death. Economic disparity is not confined to industrialists alone. The gap in income inequality is also widening between top executives and the average employee, with the CEOs of the 15 largest companies in the United States, for example, earning 520 times more than the average worker in 2007, up from 360 times more in 2003. Therefore, I refuse to call it an economic or financial crisis. In my view, this is a catastrophe of human values.

Future: There is no 'financial economy' in Islam; only real economy. Islam does not permit debt to be traded, discounted or securitized. About Islamic banks, Chris Wright wrote in September 2008 Asiamoney 'these institutions have come out of the sub-prime credit crunch crises in better shape than many of their conventional counterparts.' Life is simple. We have made it tough by breaching our commitment with our Creator. When Qur'an declares 'Allah destroys interest and increases charity' in verse 276 of chapter 2, it essentially encourages Muslims with surplus capital to share both risk and reward with capital deficient entrepreneurs and businessmen; and at the same time support their 'sub-prime' brothers and sisters - both Muslims and non-Muslims - to lead a humane life. Former (business objectives) must be attained through equity based investments like various structures of private equity, venture capital, leasing etc. and later (social objectives) must be achieved by institutionalizing *zakah* (obligatory annual charity) and encouraging even additional charity. This was the practice of Prophet Muhammad (peace and blessings of Allah be upon him).

Similarly, Islam does not permit its followers to sell something that they do not possess. This is speculation. And enormously risky. Future is unpredictable. We never know we will surely possess what we are selling in advance! Over the last several years, I have expressed deep concern about the availability of even 'Islamic equity funds'. I do not challenge the concept of equity. It is perfectly Islamic if invested in permitted sectors and I am a strong supporter of this method of investment. My concern is excessive volatility experienced by equity markets. This volatility is not accidental. It is well planned and executed by bulls or bears. Their heavy buying (without money) and heavy selling (without possession of stocks) puts even Islamic equity funds at great risk. For this reason, on top of whether stock itself is *shari'ah*-compliant, we need to think whether current rules of stock trading in global capital markets are *shari'ah*-compliant. Trust me, they are not!

There are no bull and bears in Islamic financial architecture. We have only investors, preferably medium to long term. This is aimed at providing financial and economic stability which results in political and social calm. Obviously neo-cons were not saints. They wanted to capture all the global wealth, if possible without wars. At the same time they wanted to destroy social and political systems of those societies (whom they viewed as mere markets) that did not agree with their values.

I see silver lining – for only those who have no greed and fear – in this catastrophe. Qur'an expects its followers to be free of these two characteristics. Financial system based on justice and fairness (free of interest and speculation) will survive now and thrive in future. After receiving an international award in 2002 from Sheikh Muhammad – current Prime Minister of UAE – I requested Islamic bankers and scholars not to pursue unabated 'innovation' and 'sophistication' in aping conventional institutions. Taking a dig at 'Islamic credit cards' and 'Islamic hedge funds', I had said that the day may not be too far when we will see 'Islamic casinos' and 'Islamic pubs'. I would once again like to warn Islamic bankers and scholars who crave for 'innovation' and 'sophistication' in Islamic finance. While not harmful *per se*, the present crisis teaches us to avoid uncalled-for 'innovation' or 'sophistication'.

The color of money is same. So is its function. And value. Whether money comes in the form of equity, debt, preferred stock, leasing, commercial paper or bond, it serves the same purpose. In other words, 100 dollars of equity will buy the same amount of plant, machinery or land as 100 dollars of commercial paper or complex bonds. In terms of economic value-addition, it will make little difference. Therefore, I always believe in simple structures which are understandable by all. Or at least many. This, together with selfless and fearless life, will help us avert similar crises in future, *insha'Allah*.

---

*Head of Project Finance at Saudi Arabia's largest bank – The National Commercial Bank. Views expressed are his own.