International Conference

Sunday 19th & Monday 20th December, 2004

at

International Islamic University,
Chittagong,
Bangladesh,

Contact:–
Professor Masudul Alam Choudhury,
School of Business,
College of Cape Breton,
Sydney,
Nova Scotia B1P 6L2
Canada
Email: **mchoudhu@uccb.ns.ca**

Fax: 902-562-0119
Tel: (office) (968) 515-845: (home) (968) 513-445

Or

Professor Abubakr Rafique Ahmad,
Pro-Vice Chancellor,
International Islamic University,
Chittagong,
Bangladesh.

on

Harmonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration

----

Islamic Endogenous Loans

Rodney Shakespeare
(Christian Council for Monetary Justice, United Kingdom,
London Global Table
www.globaljusticemovement.net)

Private address:
11, Charman House,
Hemans Estate,
London, SW8 4SP,
United Kingdom.

Tel: (UK) 020 7771 1107.
email: rodney.shakespeare1@btopenworld.com

Islamic Endogenous Loans

Rodney Shakespeare

Abstract

The present options for an economy all have serious weaknesses and, in any case, the way forward for Islam must be completely distinctive.

Fortunately, Islamic opposition to *riba* enables a distinctive new way which addresses the real economy, furthers justice and ends foreign financial colonialism.

The new way uses Islamic endogenous loans. These are state-issued, repayable, interest-free loans which are generally administered by the banking system on market and private property principles. The loans are counter-inflationary and are **always** directed at productive capacity. Because they bear no interest, the loans create productive capacity at one half, or less, of the present cost for:–

- **Public capital investment** – hospitals, roads, bridges, etc.
- **Private capital investment** as long as such investment creates **new** owners of capital and is part of policy to enable **all** individuals to become owners of productive capital.
- **Environmental capital investment**
- **Small and start-up businesses**

----

1. The present options for an economy have serious weaknesses

At present, the broad options for an economy are:–

a) **Unfree, unfair and inefficient market finance capitalism (i.e., 'free market' capitalism).**

Among its many weaknesses are:–

- the inflationary creation of money which is largely *not* directed towards productive capacity
- widespread *riba*
- huge amounts of personal, corporation, city, local government and national government debt
- rich-poor division
- economic colonialism
- plutocracy

b) **Social democracy.**

This is a form of unfree, unfair and inefficient market finance capitalism. Although it has a greater sense of social justice it also has a greater inefficiency.

c) **Socialism and communism.**

Socialism and communism have inefficient command economies, dictatorial political structures and are atheistic.

The weaknesses of a), b and c) above are obvious and so if Islam were to embrace any of a), b), or c), it would also be embracing the known weaknesses.

2. The way forward for Islam must be distinctive

If Islam is to give a moral, intellectual and material lead to the world its economy must be completely distinctive (Choudhury, 1997 & 2003).[1] Without that distinctiveness, the *ummah* will never free itself from control by others.

Fortunately, Islamic opposition to *riba* enables a distinctive new way forward which addresses the real economy, increases productive capacity, furthers justice, enables environmental capital projects and ends foreign financial colonialism.

3. *Riba* / interest is not necessary

Riba is wrong. Which is why Islam opposes it.

Yet there is another, separate, argument against *riba*, namely, that interest is ***not*** necessary. The cost of administration can be an element of interest but such cost can often be low, even minimal. In the case of public capital investment, moreover, the administrative cost is often substantially borne *by the borrower* and *not* by the lender (e.g., as when a government collects fees and taxes with which to repay its debts). Furthermore, part of interest payments can be in effect a guard against loss. But if collateral is adequate or largely not involved (e.g. when a government undertakes the obligation to repay, or when specific provision is made for collateral), interest is *not* necessary.

Moreover, as is well known, the effects of interest are hugely negative. For example, in Aachen, Germany, interest on capital is 12% of the cost of rubbish collection; 38% of the cost of drinking water; 47% of the cost of sewage; and up to 77% of the cost of public housing. Indeed, it has been estimated that an amazing 50% of the price of *all* goods and services relates to borrowing costs (principal and interest). Overall, the cost of interest causes 80% of the population to pay out much more than they receive; 10% are in balance; and the last 10% receive very much more than they pay out (Kennedy, 1995).[2] Internationally, of course, the effects of compound interest are such that whole societies are trapped into an ever-increasing debt which they can never repay, and the attempt to repay in practice results in their economic resources being ripped off to outsiders.

So the question arises – Why should there be interest at all? For a start, the original principal of the loan is *created out of nothing* by the pressing of computer buttons (as all bank loans are) and then interest is added. Why should something created out of nothing give any right – any right at all – to receive interest?

It is time for Muslims to recognise that interest can be viewed as a tax – a very large tax – which is not only wrong but also unnecessary. Moreover, in making that recognition, Muslims will easily come to a further recognition – that, if interest is eliminated, the cost of productive investment can be *halved* or more.

4. The conventional definition of endogenous and exogenous money is a lie

Conventional economics and neoclassical finance capitalism, however, are intent on maintaining the existence of interest. For them, interest is at the heart of everything and this can be understood by considering the conventional definition of endogenous money as that which issues from the banking system.

But a visit to any dictionary reveals that 'endogenous' has the meaning of ‘coming or growing from within’ (and 'exogenous' has the meaning of ‘coming from

[1] Choudhury, Masudul A. (1997), *Money in Islam* (Routledge, London and New York) and (2003), *The Islamic World-System: A Study in Polity-Market Interaction* (RoutledgeCurzon). Choudhury spearheads the call for Islam to have a distinctive way forward and use endogenous money. See also (1989), *Islamic Economic Co-operation;* (1990), *Journal of Economic Cooperation Among Islamic Countries*; and (1998), *Reforming the Muslim World*.

[2] Kennedy, Margrit I. (1995), *Interest and Inflation-free Money*, New Society Publishers.

without'). Thus the conventional claim that money coming from the banking system is endogenous (and money coming from the state is exogenous) is a disgraceful twisting of words for it is essentially being claimed that government and other institutions at the heart of society are in reality outside and only the banking system is inside.

The conventional justification for this twisting of the meaning of words, however, is that it is referring to the economy (and not society) and that the banking system efficiently allocates resources to the productive economy while the government cannot be trusted to do so.

But supposing it is true that – as happens today – the banking system does *not* allocate money to new productive capacity and, instead, allocates it to derivatives, to the bidding up of existing asset prices, to putting individuals, companies and whole societies into debt, to anything but the real economy? Then it is only too clearly seen that the conventional claim that it puts endogenous money towards productive capacity is a lie.

And the lie is seen to be worse when it is realised that a government, using the banking system and insisting on market and private property principle, can ensure that *all* of the supply of new money to an economy can go to new productive capacity (in a way which can never be done by the banking system today, indeed, which is incapable of even being understood by the banking system).

Which leaves one other aspect to the conventional claim that it issues endogenous money for the purposes of productive investment. That aspect is interest. Conventional endogenous money bears interest and, very generally, interest *doubles*, or more than doubles, the cost of a capital project. So how can something which *doubles* the cost of a project really be something which causes a "growing from within"? Something that hampers growing *cannot* be claimed to be promoting growing.

Therefore the conventional claim that only the banking system can issue, and does issue, truly endogenous money for new productive capacity is a lie.

5. Islamic definitions of endogenous and exogenous money

Islam, however, is able to define endogenous money quite differently – as state-issued (ultimately from the central bank) interest-free (repayable and cancellable) loans, capable of being administered by the banking system on market and private property principle, which are *always* directed at new productive capacity. A supply of Islamic endogenous loans is of immense importance because it is capable of ensuring, among other things:–

- economic and social justice (Shakespeare & Challen, 2002)[3]
- an end to the imposition of interest
- a direct linking of new money to productive capacity
- a widespread ownership of productive capital
- an increase in political freedoms
- an efficient wealth creation
- a basic income for all inhabitants
- policy to unite inhabitants who have different linguistic, religious, geographical and ethnic backgrounds
- an ability of a society to control its own destiny as opposed to being ruled by outsiders and others
- a new economic system which, by a proper use of interest-free loans, spreads productive capacity to all individuals in the population so that they produce (and thus earn) independently of whether or not they also have a conventional job.

In contrast is the Islamic definition of exogenous money as *either* money coming from abroad *or* money created by the international banking system operating

---

3 Shakespeare, Rodney & Challen, Peter (2002), *Seven Steps to Justice*, New European Publications, London.

within a country. The usual form of this money is that of interest-bearing loans which are *not* necessarily directed at productive capacity and furthering the needs of society; and which hand control of society either to a narrow elite or to outsiders.

6. Islamic endogenous loans combine efficiency with social and economic justice.

Islamic endogenous loans combine efficiency with social and economic justice. Taking the form of state-issued, interest-free loans (administered by the private banking system) they are directly related to the real economy, made repayable and, when repaid, are cancelled or cancellable thus ensuring that productive assets always back a society's currency. Islamic endogenous money has four main uses:–

Public capital investment thereby allowing hospitals, roads, bridges, sewage works, fire stations, schools etc. to be constructed for one half, or one third of the present cost. Over time, the National Debt would reduce. However, the capital projects can still, if wished, be built by the private sector, managed by the private sector, even owned by the private sector. The key point is that the cost, at the very least, is being halved.

Private capital investment if such investment creates new owners of capital and is part of policy to enable all individuals, over time, on market principles, to become owners of substantial amounts of productive capital. By using state-issued interest-free loans, administered by the banking system on market principles, a large company/corporation would get cheap money as long as new shareholders are created (Ashford & Shakespeare, 1999).[4]

Green capital investment, particularly for clean, renewable energy. At present, using interest-bearing loans, a lot of green technology is not financially viable. With interest-free loans, however, it would become viable. Thus we could have, for example, clean electricity through tidal barrages, dams, windmills, wave machines, solar electricity, and geothermal power stations.

Small and start-up businesses thereby freeing them from the crushing pressure of interest-bearing debt. (In the case of small and start-up businesses, there would be no requirement for wide ownership.)

7. Islamic endogenous loans implement Say's Theorem (Law)

Neo-classical economics upholds Say's Theorem (Law). The Theorem says that, in a market economy, the total market value of the wealth produced is equal to the total purchasing power created by the process of production and therefore that supply creates its own demand. The Theorem also requires that producers and consumers must be the same people.

But, at present, *there is undoubtedly a huge potential supply which does* ***not*** *create its own demand.* Moreover, producers and consumers are **not** the same people. That is to say, at present, Say's Theorem (Law) most certainly does *not* work in practice.

However, Islamic endogenous loans distribute future productive capacity, over time and on market principles, to *everybody* in the population thus ensuring that producers and consumers really are the same people. For the first time in history, the use of Islamic loans can ensure that Say's Theorem really does, in practice, become a true Law.

8. A genuine Islamic banking system

---

[4] Ashford, Robert & Shakespeare, Rodney (1999), *Binary Economics – the new paradigm*, (University Press of America).

Since Islamic loans address all the main aspects of the real economy, the banking system can become genuinely Islamic and have no need to be involved with either the creation of money or the imposition of *riba*.

References

Ashford, Robert & Shakespeare, Rodney (1999), *Binary Economics – the new paradigm*, (University Press of America).

Choudhury, Masudul A. (1997), *Money in Islam* (Routledge, London and New York) and (2003), *The Islamic World-System: A Study in Polity-Market Interaction* (RoutledgeCurzon). Choudhury spearheads the call for Islam to have a distinctive way forward and use endogenous money. See also (1989), *Islamic Economic Co-operation;* (1990), *Journal of Economic Cooperation Among Islamic Countries*; and (1998), *Reforming the Muslim World*.

Kennedy, Margrit I. (1995), *Interest and Inflation-free Money*, New Society Publishers.

Shakespeare, Rodney & Challen, Peter (2002), *Seven Steps to Justice*, New European Publications, London.
