Interest

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Borrowers are prepared to pay interest on loans either because

1. The absence of interest free loans.
2. The non-availability of credit from suppliers of material goods and services.

   The material goods may be of a consumptional nature or be for re-sale. Where the goods are for re-sale, expected net profits are supposed to finance the capital + interest of the loans taken. Thus, the cost of borrowing is weighed against the possible greater expected net returns.
3. The expectation of higher net-returns through investing interest-bearing loans.

   Though businesses may present clear and legitimate business plans to justify their need for interest-bearing loans through financial institutions, the reality is that there are many cases where such finance is not used for the purposes outlaid and defined. Where the loans are to be used in specific projects or purchases it is possible for the financing party to gain securities over those very projects/purchases.

Lenders or financers are prepared to extend loans because of the expected returns on capital extended. The rates of interest are generally at a level equal to that which the lenders can receive from other and alternative opportunities in the same risk class. Interest rates are also governed by State departments in order to regulate macro economic variables. In a rather reverse format, it is also true that inflation and other economic variables also govern the rates of interest. The need to market the idea of borrowing on an interest basis is also prompted by, especially in the case of private lenders, economic variables which increase inflation rates that in turn results in the loss of the real value of stagnant fiat currencies. The global money markets which determine currency rates also significantly impacts the avenues where finance is channeled since investing in a foreign currency, though speculative at times, can provide greater returns in comparison to lending that capital on interest to borrowers. In fact, the protection of currency value is now integrated with the politics and economic variables of national states.

In the same manner that banks and other financers re-cycle loans (plus received interest) to maximize the return on investor and deposited capital, borrowers who use the loans for non-consumptional reasons also attempt to maximize the return on such capital in order to make re-payments and profit. In certain cases, e.g. loans taken for

fixed property, borrowers expect the capital appreciation of their investments to ultimately be equivalent of the capital + interest that they are to pay.

The principles of supply and demand dictate the premium at which borrowers are willing to seek loans or at which lenders are willing to provide loans. In the case of banks and financial institutions, these rates are regulated through State organs. Policies of central banks are subject to the economic objectives of States, except in some rare cases where such banks have been authorized to self-regulate their own institutions. The latter allowance, as we have witnessed with the Sept to Nov 2008 economic crises in the US, has been to the detriment of the economy and international offshore investors.

The fact that currencies are regulated in international markets, a state can loose total control of the exchange rate of its own currency due to political and economic factors.

Devaluation of a national currency due to foreign intervention or issues relative to monetary economics and methodologies of backing a currency also determine the worth of a specific currency.

In a rather strange turn of events, the paper currency which acts as a store of value for human effort and production has become the very weapon or victim of circumstances and has in the case of some countries become the very reason why an entire nation can over night be turned into a bankrupt community whose paper money has no value or monetary worth. The truth of the matter is that in the growing global political turmoil, paper currency has indeed, justifiably or unjustifiably, lost its virtue as the absolute mechanism to store the rewards of human labour.

It is very significant, on an Islamic level, to note, that classical Islam has never acknowledged the fractional reserve monetary system nor sanctioned the storage of human effort in a paper currency whose worth can be eliminated by external variables.

It is high time that a new international currency be created which can defend private capital against political and economic variables.

Islam recognizes that lending capital can be risky. It does not deny the need for returns on capital. Rather, it regulates the methodologies through which profit is earned on capital. Thus, though lending capital to borrowers is a means for the latter to earn and gain profits, such profits are not guaranteed and repayment of capital with interest in the case of investment losses is detrimental to the active economic agents of society. It is thus that Islam demands the spread of economic risks between the providers of capital and those who utilize it so that an equilibrium is achieved in regard to the financial positions of every one in society. Capital providers who refuse to share economic risks ensure their own enhancement and economic protection to the detriment of others.

Contemporary fiat currencies differ from the primary Islamic currencies of gold and silver where the inherent metallic value could not be seriously destroyed by external economic and political factors. There is no denial that floatation of actual metallic currencies of such metals have its own problems in contemporary markets. Growth in Islamic economic markets demanded that a copper currency “fuloos” was introduced as a metal of less economic worth to serve for the purchases of goods that were much less in value than the silver coins. This is indicative of some degree of flexibility in economic engineering to serve the monetary requirements of society.