

## ***Triple Bottom Line Investing Conference***

*4 November 2005*

*Does Interest Threatens Sustainability ?*

*Is the Financial Economy Disconnected  
From The Real Economy?*



## *Profits from Capital rather than for Capital*

*What is the forbidden "Riba" about?*

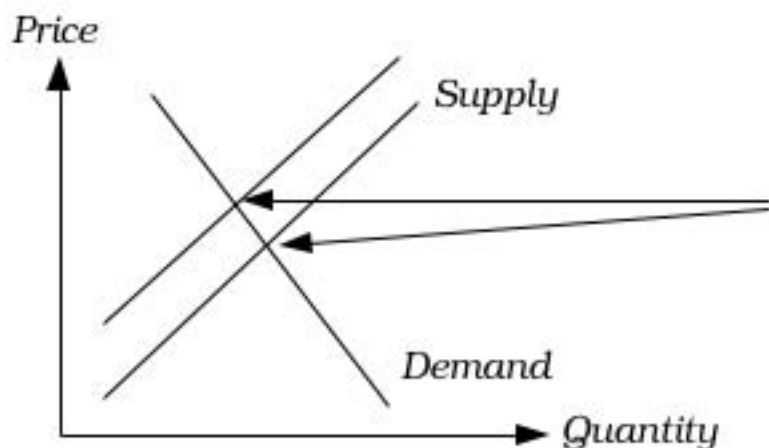
- Return of money for money independent of any undertaking and time – distinction made between "money capital" and "capital goods"

*What are the Islamic alternatives?*

- Returns on joint business with profit/loss sharing
- Returns such as rent for underlying asset transactions
- Returns defined as profits added on installment purchases – is this different from banking interest at all?

## *Profits on Assets versus Interest on Money*

*There is an economic impact of pricing assets rather than money:*



*A 10 % increase because of financing costs does not lead to 10 % higher equilibrium price*

*Provocative thesis: Pareto-inefficient pricing caused by money credits leads to reduced wealth in the society.*

## *Mechanics of Poverty - Access to Finance Methods*

*What causes that “the rich getting richer, and the poor poorer” ?*

- How should bank interest increase poverty? If interest is higher than my profits I would not take it!

*A possible answer:*

- Selection of borrowers: Good credit standing results in easy access for debts, while the poor get no start to accumulate wealth
- Selection in partnerships: Poor entrepreneurs in need to give more equity away which reduces their part (no credit access); Rich entrepreneurs will maximise their profit with credits instead of giving equity away (leveraging)
- Interest on interest in times of difficulties transfer wealth

## *Improvements in Wealth Distribution*

### *Instruments to improve fair distribution of wealth:*

- Late payment treatment (no interest in times of hardship) avoids transfer of wealth in these periods – partly same logic like contemporary insolvency regulation (Chapter 11) – let people recover!
- Zakat – obligatory social tax – right of the poor towards the wealthy (and not gratitude) for the most disadvantaged – more than the minimum is recommendable Sadaqa
- Asset Finance – asset as collateral improves access of poorer borrowers
- Social and ethical bound acting as custodian of supreme ownership – individual and mutual – avails poverty and supports sustainability
- General position to wealth: „Blessed is the pure wealth for the righteous“

## *Financing Methods and Exploitation of Resources*

*Why are interest based modes exploiting resources stronger than others?*

- Lack of Debt Sustainability lowers acceptance of long term thinking
- Vicious circle of debt reduces freedom of action (state level and household level) – sustainability in the wider sense becomes wishful thinking
- Exponential growth needs a pause – “Limits of Growth”; Interest does not recognize this reality
- Money credit induced price bubbles leading to resource exploitation without real need

## *Derivatives – hedging or causing bubbles ?*

### *What is the Muslim point of view regarding Derivatives?*

- Early derivatives like Salam, Forward Lease, Istisnaa but tight conditions
- Principles like “do not sell what you do not own” are restricting usage of Futures
- Where trade ends (exchange of utility for mutual benefit) and gambling (transfer of wealth without compensation) starts?
- If we all would be “homo oeconomicus” then derivatives might have more good than bad, but in real world the opposite seems to be true
- Desire for gambling, especially of risk-positive (“irrational” or “blind by greed”) participants, leads to price shifts and misallocation of goods
- Derivatives increase dangers of “lemming” effects resulting in price bubbles tremendously

## *Real Economy versus Financial Economy*

*Summarizing the issues discussed, Islam advocates that real economy and financial economy are closely connected:*

- Returns only from capital goods not for money capital
- “do not sell what you do not own” restricting derivatives which could lead to impossible trade transactions
- Trade is recommendable, gambling prohibited
- Any good related to trade needs to be of utility
- Prohibitions of hoarding and other price manipulations
- No finance without trade or business activity; pragmatic solutions for project finance, and restricted variant for forward sales

*How we do control in the conventional sector price bubbles? Are the Central Banks sufficiently prepared to solve upcoming crisis?*



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Please do not hesitate to contact us with any further questions you may have