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SOVEREIGN DEBT CRISES WITH SPECIAL REFERENCE TO EURO ZONE: VIEWED FROM AN ISLAMIC PERSPECTIVE

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ISLAMIC ECONOMICS INSTITUTE

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In (1976) King Abdul Aziz University (KAU) organized the first international conference on Islamic Economics in the world in which a number of Finance Ministers of Muslim Countries participated, (along) with a number of Shar'ah scholars and economists. The Conference came up with number of recommendations, including the establishment of a research centre in Islamic Economics at KAU. In 1977, the University responded positively to the recommendation by establishing Islamic Economics and Research Center (IERC).

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After 35 years of academic research, the University took an important decision to expand the scope of the Centre's activities to include education and training. In 2011, the Centre was transformed into the Islamic Economics Institute. During the period 2007-2012, the institute`s researchers published fifteen books, forty research papers and presented research papers in more than sixty conferences around the world. During the same period, thirteen academic meetings were held, more than 140 weekly dialogues were organized and number of dissertations of students were examined and supervised by the researchers at the Institute.

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Prof. Dr. Munawar Iqbal, is Professor, Islamic Economics Institute, King Abdul Aziz University, and Chief Editor *King Abdul Aziz University Journal: Islamic Economics*. In his career spanning more than thirty-five years, he held many top management positions in addition to his teaching, research and training activities. He became a full Professor and Dean at the International Islamic University Islamabad (IIUI), of which he was one of the founders, in 1984. He has also served as Chief of Research in Islamic Banking and Finance at the Islamic Research and Training Institute (IRTI), a Member of the Islamic Development Bank Group, Jeddah, Saudi Arabia. Professor Iqbal has also served as Economic Adviser to Al-Rajhi Banking and Investment Corporation, Saudi Arabia (now Al Rajhi Bank). Earlier, he served as the Founding Director General, International Institute of Islamic Economics, Islamic University, Islamabad, Pakistan. He has taught at IIUI and McMaster and Simon Fraser Universities, Canada. He has published/edited more than twenty-five books/monographs and published more than thirty papers in the field of Islamic banking and finance in international journals or by renowned international publishers, such as Palgrave MacMillan, Edward Elgar, and Edinburgh University Press. He was the founding Editor of the *Review of Islamic Economics,* the Professional Journal of the International Association for Islamic Economics and also founding Editor of the *Islamic Economic Studies,* the professional journal of the IRTI, and remained its editor until he retired from IRTI. He was founding Secretary General of the International Association of Islamic Economics. He organized and executed scores of conferences/seminars on Islamic banking and finance throughout the World. He has delivered lectures and conducted training sessions extensively in the field of Islamic banking and finance throughout the World. He has won Quid-e-Azam Gold Medal for his services for Pakistan from All Pakistan NGOs Association. He also won Best Performance Award by IDB. His name has been included in American Marquis Who's Who in the World.

نبذة عن الكاتب

أ.د. منور إقبال، يشغل حالياً في المعهد الإقتصاد الإسلامي ، جامعة الملك عبد العزيز وهو أيضا رئيس التحرير لمجلة الإقتصاد الإسلامي لجامعة الملك عبد العزيز. في مسيرة حياته التي تمتد أكثر من خمسة وثلاثين عاما، قد عمل في العديد من المناصب الإدارية العليا إضافة إلى أنشطته التدريسيه والتدريبية وكتابة البحوث. أصبح أستاذ دكتور وعميدا في الجامعة الإسلامية العالمية إسلام آباد، الذي كان من أحد مؤسسيه في عام ١٩٨٤م. وقد شغل أيضا منصب رئيس البحوث في الصيرفة الإسلامية والتمويل الإسلامي في المعهد الإسلامي للبحوث والتدريب، عضو مجموعة البنك الإسلامي للتنمية، جدة، المملكة العربية السعودية. الأستاذ إقبال قد عمل أيضا كمستشار إقتصادي لشركة الراجحي المصرفية للاستثمار بالمملكة العربية السعودية (الآن مصرف الراجحي). وقبل ذلك قد عمل مديرا عاما ومؤسسا، للمعهد الدولي للاقتصاد الإسلامي، الجامعة الإسلامية العالمية، إسلام أباد، باكستان.وقد قام بالتدريس في الجامعة الإسلامية العالمية، إسلام أباد، و جامعات ماكماستروسايمون فريزر، كندا.وقد نشر/ حرر أكثر من خمسة وعشرين كتابا/دراسات علمية وكذلك نشر أكثر من ثلاثين بحثا علميا في مجال الصيرفة الإسلامية والتمويل الإسلامي وذلك في مجلات دولية أو من قبل الناشرين ذوات الشهرة العالمية مثل بالغريف ماكميلان ، إدوارد إلغر، ومطبعة جامعة ادنبره.وكان رئيس التحرير المؤسس لمجلة "استعراض الاقتصاد الإسلامي"، المجلة الإحترافية للجمعية الدولية للاقتصاد الإسلامي وأيضا رئيس التحرير المؤسس لمجلة "دراسات في الإقتصاد الإسلامي"، المجلة الإحترافية للمعهد الإسلامي للبحوث والتدريب ، وبقي رئيس تحريرها حتى تقاعده من المعهد. وكان الأمين العام المؤسس للجمعية الدولية للإقتصاد الإسلامي. نظم وأنجز إقامة عشرات من الندوات والمؤتمرات حول الصيرفة الإسلامية والتمويل الإسلامي في جميع أنحاء العالم .وقد القى وأقام العديد من المحاضرات والدورات التدريبية على نطاق واسع في مجال الصيرفة الإسلامية والتمويل الإسلامي في جميع أنحاء العالم. فاز بجائزة "قائد أعظم" الميدالية الذهبية لخدماته لباكستان من قبل منظمة جميع المؤسسات غير الحكومية باكستان. منح جائزة أفضل أداء من قبل البنك الإسلامي للتنمية. أدرج في قائمة "هوز هو" (قائمة كبار وأهم الشخصيات في العالم) لشركة ماركيز الأميريكية.

بسم الله الرحمن الرحيم

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Dean’s Message

I feel great pleasure in launching Islamic Economics Institute (IEI) Working Paper Series. The major objective of this series is to encourage those among us who have some good idea on a particular issue which has not yet reached a stage of fully crystallized thoughts to put it into writing. Almost every research starts from that stage. If the author is sure of the originality of his thoughts, some hints here and there may click and after some promising discussion of his Working Paper among peer researchers the idea will mature and can become a good piece of research. Peer review is an essential element in development of raw ideas into a refined research product. Presenting the idea in a Working Paper will ensure author’s rights over the idea which will encourage him to present it for peer review.

In addition, Working Paper Series of an institution ensures that scholars at other sister institutions keep abreast of what is happening at a particular institute and communicate among one another. Historically, debates through Working Papers among scholars working at different seats of higher learning led to many significant developments in economics.

In order to ensure that a Working Paper meets ‘minimum’ standards of quality and originality and has sufficient relevance for research in the area of Islamic economics and finance, an Editorial Committee for the Series has been constituted. I take this opportunity to encourage and invite the academic community at the King Abdul Aziz University and other sister institutions to participate in this series by submitting their ‘Work in Progress’ for publication in the series. In addition, I request them to help their colleagues by commenting on their papers with a spirit to improve the quality of the final product.

All Working Papers will be put on the website of the Institute and can be freely downloaded. A limited number will be produced in hard copy. The Editorial Committee will welcome any ideas to make this experiment more useful.

Abdallah Qurban Turkistani

Dean, Islamic Economics Institute

كلمة العميد

أشعر بسرور كبير لإطلاق معهد الاقتصاد الإسلامي (IEI) سلسلة أوراق عمل.الهدف الرئيسي من هذه السلسلة هو تشجيع أولئك الذين هم بيننا الذين لديهم بعض الأفكار الجيدة عن مسألة معينة والتي لم تصل بعد إلى مرحلة من النضج لكي تتبلور تماما لوضعها موضع الكتابة . وتبدأ تقريبا كل البحوث من تلك المرحلة .

إذا كان المؤلف يريد التأكد من أصالة أفكاره، عندما يصبح هناك تعليقات هنا وهناك قبل وبعد نقاش ورقة عمله بين الباحثين مقابل فكرة سوف تنضج ويمكن أن تصبح جزء جيد من البحوث.

استعراض الأفكار يعتبر عنصرا أساسيا في تطوير الأفكار الأولية إلى منتج البحوث .وطرح الفكرة في ورقة عمل تتضمن حقوق المؤلف والتي سوف تشجعه على تقديمها لاستعراض الأفكار.

وبالإضافة إلى ذلك، سلسلة أوراق عمل تؤدي إلى أن العلماء في المؤسسات الشقيقة الأخرى يواكبون ما يحدث في معهد الاقتصاد الإسلامي والتواصل بين بعضهم البعض.

تاريخيا، المناقشات من خلال أوراق عمل بين العلماء العاملين في أمكان مختلفة أدت إلى العديد من التطورات الهامة في الاقتصاد.

ومن أجل ضمان ورقة عمل تلبي معايير 'الحد الأدنى' من الجودة والأصالة ولها أهمية كافية للبحوث في مجال الاقتصاد والتمويل الإسلامي، تم تشكيل لجنة لتحرير سلسلة ورقة العمل.

وأغتنم هذه الفرصة لتشجيع ودعوة المجتمع الأكاديمي في جامعة الملك عبد العزيز والمؤسسات الشقيقة الأخرى للمشاركة في هذه السلسلة من خلال تقديم أوراق عمل تقدم "للنشر في السلسلة.

وبالإضافة إلى ذلك، أطلب منهم مساعدة زملائهم عن طريق التعليق على أوراقهم لتحسين جودة المنتج النهائي.

سوف تنشر السلسلة أوراق باللغتين العربية والإنجليزية . وسيتم طرح جميع أوراق العمل على الموقع الإلكتروني للمعهد، ويمكن تحميلها مجانا، وسيتم إعداد عدد محدود في نسخة ورقية وترحب لجنة التحرير بأي أفكار لجعل هذه التجربة أكثر فائدة.

عبدا لله قربان تركستاني

العميد

Abstract

European countries are in a deep debt crisis since 2011. That closely followed on the steps of 2008-2010 economic crisis. Since 2011 many European governments in Euro Zone countries have fallen due to this crisis but the new governments also could not do much. Politician and economists alike are trying their best to control or minimize the adverse effects of the crisis. Various policy measures have been suggested, of which some have been implemented. However, unfortunately, the situation has not improved. In fact, it is going from bad to worse in most of the cases. It seems options available to policy makers are limited. In this paper, we suggest that a really ‘radical’ approach needs to be taken. Unconventional solutions may have to be considered. In this respect, we believe that Islamic approach to public sector economics may have something to offer. We present some basic tenets of that approach and taking examples from the present Euro Zone debt crisis, make an attempt to show how those could be helpful.

ملخص

الدول الأوروبية في أزمة متفاقمة للديون منذ عام ٢٠١١ وتابعت عن قرب هذه الأزمة من ٢٠٠٨-٢٠١٠ والتي هي الأزمة الاقتصادية. ومنذ ٢٠١١ تراجعت العديد من الحكومات الأوروبية في دول منطقة اليورو بسبب هذه الأزمة ولكن الحكومات الجديدة أيضا لا يمكن أن تفعل الكثير. السياسيين والاقتصاديين على حد سواء يحاولون قصارى جهدهم للسيطرة أو الحد من الآثار السلبية للأزمة وقد تم إقتراح عدة تدابير سياسية منها ما تم تنفيذها. لكن للأسف، الوضع لم يتحسن. في الواقع، نسير من سيء إلى أسوأ في معظم الحالات. يبدو أن الخيارات المتاحة لصانعي السياسات محدودة. في هذه الورقة، فإننا نقترح أن المنهج الحقيقي هو ‹الراديكالي› ينبغي أن يؤخذ. وقد تكون هناك حلول غير تقليدية للنظر. وفي هذا الصدد، ونحن نعتقد أن المنهج الإسلامي الاقتصادي للقطاع العام عنده ما يقدمه. وفي هذه الورقة نقدم بعض المبادئ الأساسية لهذا المنهج مع أخذ أمثلة من أزمة الديون في منطقة اليورو الحالية، وهي محاولة لإظهار كيف أن هذا يمكن أن تكون مفيد.

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"When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid."

Adam Smith, Wealth of Nations

1-Introduction

The economic and financial crisis (2009-date) is the hottest economic and political topic making news headlines around the Globe. Several reasons for the crisis have been presented and discussed in the literature. It has given rise to many controversies both in areas of economic theory and policy. All of these controversies hover around the role of debt in the economy, especially in the public sector.

Taking debt has always been a controversial issue. The decision has historically been viewed differently in different cultures. Perceptions about the extent of its benefits and harms have also varied in various economic situations. In the last fifty years, debt-taking has been on the rise due to an increasingly tolerant view by economists, commending its advantages and dismissing its well known macroeconomic disadvantages. This school of thought considers that leveraging is a useful way of increasing wealth. Debt can open up many opportunities for individuals, corporations and governments to meet their needs or capture opportunities that their present incomes cannot afford and can also increase national income by putting idle resources into use.

Another school has since long advocated that debt (except in very exceptional cases) leads to many long term problems such as heavy debt servicing burden, debt-addiction, higher interest rates, crowding out and creation of false expectations leading to speculation and economic "bubbles" in various sectors, which ultimately burst and cause huge loss of wealth, recession and socio political unrest.

Perhaps both of these are extreme views. However, the 2008 debt crisis has raised a number of questions about the tolerant view and many of those who took liberal stands with respect to debt were forced to reconsider their opinions. The public debate about the Euro Zone debt crisis is part of a worldwide overhang of debt. Global financial crisis (2007-date), the worst since the Great Depression, is having a deep impact on the economic and social thinking about the role of debt and the risks involved. It is also generally agreed that the root cause of the Euro Zone crisis is 'excessive' debt. Many governments have fallen in Europe, partly due to their election platforms on the issue of public debt problem and proposed solutions. The very existence of Euro Zone is at stake. We believe that the world is ready, per force, to consider alternative solution.

Our understanding of Islamic rulings about debt inspires us to suggest that those rulings can be of an immense help in determining the proper role of debt and help avoiding situations like the debt crisis of 2007-09 and the ongoing Euro Zone economic crisis (2009-date). This paper makes an effort to determine the role of debt in wealth creation and its appropriate limits. It endeavors to derive some principles from Islamic teachings that can help solving the problems created from excessive debt. In section 2 we discuss the role of debt and its limits for household, corporate and public sectors. In section 3 we explain the anatomy of a financial and economic crisis based on historical experience. Section 4 gives a brief account of the rescue operations being undertaken by governments and central banking authorities. In section 5, we present components of a non-conventional approach for solving the problem. Six principles for handling debt derived Islamic teachings are expounded. Last section lists conclusions of the paper in the form of eight axioms on debt and economic stability that emerge from the analysis presented in this paper and other literature on Islamic economics and finance.

2-Role of Debt and its Limits

"Living within one's means" is a golden principle that applies to individuals, corporations and governments alike. This does not mean that there is absolutely no role for debt. However, it must be realized that debt is a double edged sword. There are circumstances when debts may become unavoidable. Furthermore, if used in 'moderation' and 'wisely', it may have some benefits. Except for exceptional cases of disability, the general rule is that if one expects a future stream of income (or assets), fairly assured, that will enable one to pay off past debts, incurring debts (leveraging) can be a useful *short run* technique to improve one's economic conditions. This rule applies to individuals, corporations and governments alike. Before discussing public debt, which is the main focus of this paper, brief comments on consumer and corporate debts may be helpful because of the inter-linkages between these and public debt.

Consumer Debt:

For individuals, economic justification for the rule (that leveraging can improve one's economic conditions) was provided by theories of consumer behavior propounded by Milton Friedman and Modigliani and Blumberg i.e., the 'Permanent Income Hypothesis' and the "Life Cycle Hypothesis" respectively. According to these theories of consumer behavior, consumers can borrow money to finance expenditures (particularly housing and schooling) earlier in their lives and pay back that debt in later years which are usually higher-earning periods. Assets built through higher earnings and leveraging in early working ages allow a smoother consumption pattern including post retirement periods. This can be useful only if the rule stated above is strictly adhered to. Unfortunately, due to liberal consumer loans policies and practices, especially the emergence of "plastic money" the 'consumer leverage ratio', the amount of debt outstanding versus the consumer's disposable income has risen to unsustainable levels in most advanced countries.

The number of households who carry consumption debt is quite high in advanced countries including Euro Zone and so is the amount of debt. Is consumer debt too high? A number of parameters are used to determine that. The most commonly used measure to answer that question is the debt/disposable income ratio, the so-called "Consumer Leverage Ratio". It is generally believed that a ratio of more than 0.6 indicates household debt to be high. In this perspective, the following table shows the statistics for the Euro (17) for the period 2000-2011. It is clear that the levels of household debt have been quite high throughout the period reaching almost 1.0 by 2011. In UK also it is close to 1.0[1]. In United States, the statistics released by Bureau of Economic Analysis and the Federal Reserve show that the Consumer Leverage Ratio has been between 1.2 to 1.3 throughout the 2005-2009 period. It continues to be higher than 1.

[1] Creditaction.com, Debt Statistics released in April 2013.

Table 1

Ratio of Household Debt to Disposable Income in Euro (17)

Year	Debt/GDP Ratio
2000	0.749
2001	0.751
2002	0.771
2003	0.796
2004	0.830
2005	0.876
2006	0.915
2007	0.940
2008	0.950
2009	0.976
2010	0.998
2011	1.000

Source: Eurostat (http://ec.europa.eu/eurostat)

Another indicator used to determine whether or not consumer loans are within safe limits is the debt servicing as a percentage of gross household income. In this respect, a study[2] on New Zealand household debt defines 'vulnerable household' as those having a debt servicing obligations exceeding 30 percent of their gross income. The same study found that in 2008 the percentage of vulnerable household was more than 16%. That means one in every six households was in the vulnerable household category. In UK a report by BIS[3] published in June

2011 showed that 12% of households were defined as being in financial difficulties and another 11% of households were considered to be 'at risk' of financial difficulties. Another report[4] on UK household debt reported that 6.2 million households are 'financially vulnerable'. In US households Financial Obligations Ratio (FOR) peaked at 17.7 % of disposable income in 2007. Thereafter it has had a downward trend. In 2012 it was around 14.0%.[5]

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[2] New Zealand Treasury Working Paper 09/03.

[3] Department of Business Information and Skills, "Credit, Debt and Financial Difficulty in Britain (2009/10)", June 2011.

[4] Report on debt and household incomes, 2011, Financial Inclusion Centre.

[5] Data released by the Federal Reserve Board, March 2013.

Easy access to credit may have some benefits, but once one lifts the guards, debt sneaks in like a snake and quickly grows into a serpent. The worst part of it is that most, if not all, debt is unnecessary and can be avoided. Hardly anyone will question the undesirability of what is known as 'gambling debt'. Yet the volume of such debt runs into billions of dollars. The average (gambling) debt in US is between $55,000 and $90,000 and is increasing[6]. We know gambling is an addiction but easy access to debt plays an important role in facilitating and continuing in that addiction. *It would be no exaggeration to state that debt itself is addictive.*

Let us consider a more 'benign' type of debt, credit card debt, whereby one can charge one's dinner(s) and holidays to credit cards, not to speak of furniture, televisions and almost every consumer durable. According to Nelson Report[7], which reports credit card data for US consumers on regular basis, the volume of credit card purchases in 2011 amounted to $2050 trillion.[8] Benjamin Franklin, who earned the title of "The First American" for his foundational role in defining the American ethos, once said: "Rather go to bed without dinner than to rise in Debt." Now as one of the famous American columnist Earl Wilson said: "modern man drives a mortgaged car over a bond-financed highway on credit-card gas". Among the 185 million card-holding U.S. consumers, the average person carries three bank-issued credit cards, four retail credit cards and one debit card, according to CardWeb.com. According to a survey by the American Bankers Association and Dove Consulting conducted in 2005-06, plastic payments accounted for 53 percent of consumer purchases, compared to 43 percent in 1999. The average credit card debt per card holder is estimated to be more than $6500.

Access to easy money, does not allow people to make their calculations right. Some circles claim that with credit card one can track one's expenses more easily. That may be true. But what it makes easy to track is one's past expenses. At the moment of making the expense, one hardly thinks whether she can afford that $500 purchase or not. It is like putting one's car on 'cruise', with the brakes not working. Would that not put one to a big risk of crash?

Corporate Debt

In the area of corporate debt, the natural point to begin discussion is the famous Modigliani-Miller Theorem (MMT). This theorem states that a firm's value is independent of how it is financed, i.e., leveraging does not affect its value. It only determines the distribution of expected cash flow streams from operations among creditors and owners. In the literature the MMT has been extensively studied. Even though, the results are not conclusive, the debt proliferators have conveniently ignored its main message. Without

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[6] Debt.org
[7] http://www.nilsonreport.com/
[8] Nelson Report, February 2012, Issue No. 989

any conclusive evidence, they have relied on some partial and conflicting results to justify borrowing as heavily as their credit rating would allow.

The school of thought that advocates leveraging as a mean of increasing wealth often advocates using other peoples' money (OPM) to prosper. This school believes that it is the easiest way to get rich. That is attractive in theory, but when it comes to practice, it is quite different. When someone takes a loan to start a new business instead of equity, he alone faces the risk if the business fails. That risk is quite substantial. As shown in Table 2, in the US twenty five per cent of new businesses (average of business and industrial sector) fail within the first year and fifty percent in the first four years.

Table 2

Failure Rates of New Businesses

Year	Percent Failed
1	25
2	36
3	44
4	50
5	55

Source: Statisticbrain.com
Verified by University of Tennessee Research

After the financial crisis of 2008-2009, there have been influential voices questioning the usefulness, or at least the level of, corporate leveraging that we see today. It would be useful to quote here some statements from an ongoing dialogue that started from the discussions at the Brookings Panel on Economic Activity 2010. At that forum Alan Greenspan, the famous former Chairman of Federal Reserve of the United States (1987-2006, the second longest tenure in that position), presented a paper "The Crisis". He made a number of reform proposals in that paper. One of those was raising capital requirements and reducing leverage. However, he suggested that there are limits to how much we can do so. He was of the opinion that if we reduce leverage too much, financial intermediaries will be not be sufficiently profitable to remain viable. In other words, he (a) believes that in principle reducing leverage ratios is good economics but (b) considers the scope of such reduction in practice to be limited[9]. His proposals have generated a lot of debate. In that debate, a large majority agrees on reducing leverage. Furthermore,

[9] That is practicing bad economics for so long has made getting out of it very difficult.

there are a number of influential voices which question Greenspan's reservation on the limits to such reduction.

One such voice is that of Harvard economist Greg Mankiw which is worth quoting. He says, "Indeed, I think it is possible to imagine a bank with almost no leverage at all. Suppose we were to require banks to hold 100 percent reserves against demand deposits. And suppose that all bank loans had to be financed 100 percent with bank capital. A bank would, in essence, be a marriage of a super-safe money market mutual fund with an unleveraged finance company. (This system is, I believe, similar to what is sometimes called "narrow banking"). It seems to me that a banking system operating under such strict regulations could well perform the crucial economic function of financial intermediation. No leverage would be required." Another recent study[10] states: "the fact that banks choose high leverage does not imply that this is socially optimal, and, except for government subsidies and viewed from an ex ante perspective, high leverage may not even be privately optimal for banks"[11] .

These views are and will of course spur a lot of debate. However, abstracting from the 'value of a firm' and considering the interests of the economy in general, we believe that if we factor in the above-mentioned risk factors (and not all have been mentioned), in contemporary world, they will far outweigh any benefit that could be gained by leveraging not securely linked to the real sector in an economy. If and when leveraging is to be considered, it must be considered keeping in view 'sustainable' growth in the real economy.

Public Debt:

Economic justification for governments to borrow comes from the purported growth-boosting potential of debt. The Keynesian theory of aggregate demand is behind that supposition.

Lord Maynard Keynes, one of the most influential economists in the history of capitalism, had suggested in the so-called "Theory of Aggregate Demand" that governments can use fiscal policies (budget deficits) as well as monetary policies (lowering the interest rates) during depressions to boost aggregate consumer and investment demand which will in turn increase employment and national income. Other economists drew attention to many loopholes in the Keynesian theory but in the depth of Great Depressions, his theory became popular among policy makers.

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10 Anat R. Admati et al, "Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive", Graduate School of Business, Stanford University, Manuscript, March 2011.

11 http://gregmankiw.blogspot.com/

In recent years, witnessing the worst depression after the Great Depression, his followers, named by some economists as 'vulgar Keynesians' have been recommending similar measures. Once again, due to the burden of recession policy makers followed many of those policies. As a result government debt increased sharply hoping that the conventional (but unreliable) pump priming technique will help them getting out of the crisis. In Table 3 we present data released recently by the Bank of International Settlement on gross government debt as a percentage of GDP for the period 1990-2013[12].

However, the relationships between low rates of interests - high budgetary deficits and growth have all been questioned. According to Leigh Skene of Lombard Street Research[13], each additional dollar of debt is associated with less and less growth. From early 2007 onwards there were signs that economies were reaching the limit of their ability to absorb more borrowing. Debt-addition prevented them to return to economic fundamentals. The debt pile up went on too long. It seems that many rich countries have exhausted the growth-boosting potential of debt. With ageing populations and shrinking workforces, their economies may grow more slowly than they have done in the past. They may have borrowed from the future, using debt to enjoy a standard of living that is unsustainable. Greece provides a stark example. Standard & Poor's estimates that its GDP will not regain its 2008 level until 2017[14].

The prevailing uncertainty in the markets created an opportunity for the gamblers (speculators) to fish in troubled waters. The derivatives market ballooned and crossed quadrillion dollars mark in 2012. That is 20 times the World economy. According to many analysts the global financial crisis of 2007-2009 was caused in part by the proliferation of non-performing derivative products tied to U.S. home loans that triggered hundreds of billions of dollars in write downs. Lehman Brothers Holdings Inc., bankruptcy in September of 2008, the largest ever in US history, was only tip of the iceberg. Derivatives caused havoc all around the world. The worst part of the story is that the derivatives market is largely un-regulated.

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[12] Statistics for 2013 are estimations.
[13] Leigh Skene "Repent at Leisure", The Economist, May 24, 2012.
[14] ibid. p 14

Table 3

Gross Government Debt as Percentage of GDP

Year	Advanced Economies	US	UK	Ger-many	France	Italy	Spain	Greece	Portugal	Ireland	Japan
1990	58.90	63.14	32.31	37.02	38.57	97.17	47.68	74.71	60.52	108.78	63.89
1991	61.67	67.88	32.80	37.69	39.46	99.94	49.55	77.15	63.10	110.38	63.21
1992	65.49	70.27	38.97	40.81	43.85	106.24	52.08	82.42	56.56	106.89	67.58
1993	70.45	71.88	48.73	46.11	50.80	115.55	65.54	103.37	61.40	109.89	73.86
1994	71.52	71.08	46.84	46.48	60.08	120.35	64.31	101.31	64.51	103.52	78.97
1995	73.99	70.67	51.58	55.68	62.60	122.03	69.28	102.03	66.77	95.89	86.24
1996	75.54	69.90	51.20	58.82	66.37	128.13	75.98	104.07	66.55	85.84	93.81
1997	75.14	67.43	52.02	60.36	68.93	129.62	75.00	100.92	65.32	75.18	100.45
1998	75.48	64.21	52.53	62.33	70.40	131.67	75.33	98.57	63.27	62.60	113.17
1999	73.93	60.50	47.39	61.83	66.86	125.50	69.39	102.42	60.51	51.69	127.04
2000	71.19	54.52	45.16	60.85	65.73	120.97	66.51	116.35	60.23	39.96	135.38
2001	71.36	54.45	40.40	60.10	64.30	120.12	61.89	119.16	61.68	37.44	143.67
2002	73.67	56.82	40.84	62.50	67.54	118.74	60.32	118.64	65.04	35.72	152.28
2003	75.81	60.16	41.50	65.87	71.74	116.34	55.34	113.34	66.76	34.51	157.98
2004	77.53	61.25	43.79	69.26	74.11	116.66	53.34	115.80	69.29	33.14	165.54
2005	79.22	61.50	46.39	71.78	76.04	119.44	50.74	113.35	72.84	32.94	175.27
2006	77.48	60.93	46.04	69.83	71.21	116.87	46.20	116.91	77.61	29.19	172.15
2007	76.27	62.12	47.17	65.57	72.96	112.12	42.35	115.04	75.42	28.65	167.05
2008	83.42	71.40	57.43	69.74	79.27	114.69	47.70	118.07	80.69	49.59	174.10
2009	96.37	85.03	72.45	77.44	90.82	127.10	62.86	133.47	93.27	71.11	194.05
2010	103.33	94.17	82.19	87.06	95.18	126.12	67.06	149.07	103.58	98.46	199.97
2011	107.85	97.60	89.95	86.88	98.62	127.74	74.13	165.10	111.94	112.57	211.73
2012	112.67	103.64	97.20	87.34	102.35	128.11	77.23	181.24	121.93	118.82	219.05
2013	116.19	108.45	102.28	86.44	104.05	126.59	78.97	183.89	123.68	122.42	226.82

Source: Bank of International Settlements, Annual Report, 2012.

3-Making of Financial Crises

Many researchers believe that interest-based borrowing, especially speculative borrowing (derivatives) and budgetary deficits are among the root causes of the Euro Zone Crisis and for that matter almost all financial crises in the past. The history of financial and economic crises is centuries old. However, the intensity of these crises has been increasing over time. In economic literature, causes of past crises have been studied in great detail. Reinhart and Rogoff (2009)[15] provides an excellent survey going as back as eight centuries. Though there are some unique features of every financial crisis and within it special aspects for each country affected, there are some characteristics that are common. In the opinion of the present author, among these three are most prominent in all crises occurring in the last 40-50 years. These are: reliance (rather

over-reliance) on interest-based borrowing; excessive public sector involvement in the economy; and speculation in stock, exchange and commodity markets. The problems are compounded because these three elements have strong inter-linkages among them.

Let us review the 2007-date financial crisis as a case study. Immediately before the crisis the interest rates were low. Individuals increased their borrowing in the form mortgage loans, many of those being 'sub-prime' mortgages. Real estate prices started rising. Since real estate is one of the most commonly used collateral for bank loans, banks were ready to offer other types of consumer loans. Moreover, with higher real estate prices, property owners' net worth also increased. That encouraged them to take higher credit card loans. The consumer leverage ratios in all advanced countries increased. In Euro Zone the ratio increased from below 75% in 2001 to 95% in 2007[16]. By that time it had become obvious that many countries around the globe including Euro Zone countries, UK, Japan and US were experiencing "Property Bubble".

In the corporate sector, enterprises encouraged by low interest rates increased their borrowing with the result that their capital asset ratios sharply fell. Many mega banks and other financial enterprises relied on the theory of "too big to fail" to went on a borrowing spree. Banks having the ability to create credit by the stroke of a pen and profiting by interest rate margins and multiple credit creation were obliging. Low interest rates, reducing the cost of borrowing, also provided a golden opportunity to speculators. Easy money encouraged speculation in the commodity and stock markets. They were earning handsome returns, not through dividends, but mostly through short selling. That led to a phenomenal growth of the derivatives market. Making of a bubble was quite

[15] Reinhart, Carmen M. & Kenneth S. Rogoff (2009), This Time Is Different: Eight Centuries of Financial Folly, Princeton: Princeton University Press.
[16] Eurostat

obvious but rising stock markets generally considered being a sign of a booming economy, governments turned their eyes the other way. As early as June 2005, the Economist magazine, had warned, "the worldwide rise in house prices is the biggest bubble in history. Prepare for the economic pain when it pops."[17] As in the case of earlier bubbles, the property prices started decreasing and by 2007 the property bubble had burst like an economic bomb. While the value of the properties decreased, the level of debt did not. By 2009 the ratio of household debt to disposable income in Euro Zone countries had crossed 97%. The burden of repaying/defaulting on the loan depressed aggregate demand, which in turn reduced rates of growth in GDP around the World making things more difficult for governments. The number of bankruptcies and bail outs increased putting a heavy burden on tax payers. The holders of household debt, mortgage companies and commercial banks had increasing bad debts.

4- Rescue Operations by Governments

Fearing a collapse of the financial sector, many governments stepped in to rescue the ailing financial institutions. On October 3, 2008, the United States passed the "Emergency Economic Stabilization Act of 2008" authorizing the U.S. Treasury to buy risky and nonperforming debt from various lending institutions. In Europe a mix of policy responses were undertaken at about the same time.

In UK, the government announced a £500 billion bailout package on 8 October. The initial British plan had three pillars: (1) recapitalization through a Bank Recapitalization Fund, for £50 billion; (2) a Credit Guarantee Scheme, a government loan guarantee for new debt issued between British banks for up to £250 billion; (3) liquidity provision through short term loans made available through a Special Liquidity Scheme operated by the Bank of England, for £200 billion.

In France, a rescue plan was enshrined into law on October 16, 2008 (*loi de finances rectificative pour le financement de l'économie*, no. 2008-1061). It created two *ad hoc* institutions: the *Société de Financement de l'Economie Française* (SFEF), set up to raise capital on financial markets and provide liquidity to ailing financial institutions, and the *Société de Prise de Pariticipation de l'Etat* (SPPE), through which the government would buy equities from the French banks and thus help to recapitalize them. The government agreed to guarantee bank bonds issued by the SFEF up to €360 billion. At the same time, the SPPE would invest €10.5 billion to recapitalize French banks by January 2009.

[17] The *Economist*. June 16, 2005.

The combination of rescue measures for the consumer and the corporate sectors, spilled into public sector. Government had to borrow from the market issuing interest-based bonds or from the Central banks and ran excessive budget deficit in an attempt to pump prime the economy. They hoped that the supposed positive link between budget deficit and growth in GDP will increase rates of growth, which will in turn increase tax revenues and help balancing the budget over the business cycle. However, several empirical studies have now shown that the positive relation between high budget deficit and high growth rates is not as simple as previously believed[18]. Based on empirical evidence, the maximum that can be said that if the 'initial' public debt levels are low, budget deficits, in very special cases and for short periods of time, can be helpful in pump priming the economy. However, in present circumstances, that is not the case.

IMF Fiscal Monitor, 2013 states: "Most studies find that high debt levels (above 80–90 percent of GDP) have a negative effect on growth (some 0.15–0.20 percent per 10 percentage points of GDP). High debt also makes public finances more vulnerable to future shocks, because it constrains governments' ability to engage in countercyclical policies and because the larger the initial debt ratio, the bigger the increase in the primary surplus required to stabilize that ratio after an adverse shock required to stabilize that ratio after an adverse shock to growth or interest rates. Indeed, when debt is high, there is a risk of falling into a bad equilibrium caused by self-fulfilling expectations. High debt is unsustainable because markets believe it is so".

Table 3 presents average data for the 17 countries in the Euro Zone. It may be seen that the averages given are more than the threshold. As a matter of fact, in some individual countries the ratios are much higher.

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[18] For example see, Ursua, J and D. Wilson (2012), "Risks to Growth from Build Ups in Public Debt", Global Economics weekly, No 12/10, New York: Goldman Sachs; Baum, A, C. Checherita-Westphal and P.Rother (2012), "Debt and Growth: New Evidence for the Euro Area", Working Paper C34 No.1450, Frankfurt: European Central Bank.

Table 3

Debt/GDP Ratios in Euro (17)

Year	Debt/GDP
2000	74.91
2001	75.14
2002	77.12
2003	79.60
2004	83.01
2005	87.60
2006	91.54
2007	93.99
2008	94.96
2009	97.56
2010	99.76
2011	99.36

Source: Eurostat

As stated above, from an economic point of view budget deficits, except in very special cases and for short periods of time, are bad economics. However, the shackles of debt once on, are not easy to break out from. Strong lobbies are created as is evident in most Western countries. Political parties; Right, Left and Center, all agree on the need to reduce budget deficits in the shortest period of time. The signing of "The Fiscal Compact" on March 2, 2012 by all member states of the European Union (EU), except the Czech Republic and the United Kingdom was hailed as a landmark towards European fiscal integration. The treaty entered into force on January 1, 2013 for the 16 states which completed ratification prior of this date. For subsequent ratifiers, it will enter into force on the first day of the month following the deposit of ratification instruments. German Chancellor, Ms Merkel, main proponent of the fiscal discipline school was buoyed. She said at that time that the pact, which binds Euro Zone countries to keeping their deficits below 3pc, was "non-negotiable" and would "last forever". Later developments showed that her statement was a wishful thinking.

In 2012, French President Nicolas Sarkozy, seeking re-election went to the extent to promise that he intended to insert the «balanced budget» rule into the French constitution, subject to approval by French electorate in a referendum on the issue. Electorate did not buy that and he lost the election. François Hollande won the French Presidency on an anti-austerity platform. He pledged to pursue efforts to trim the country's budget deficit to avoid fueling the euro-zone sovereign-debt crisis. However, once his honeymoon in power ended, he had to face the tricky balance between appeasing the tax payers and the benefit seekers. With France's sluggish economy, the Euro Zone's second-largest after Germany, running short of growth-stimulating power of its own, he was forced to seek help from the European Central Bank. He faced fierce opposition from the most influential and the richest member of the Euro Zone, Germany. However, the European Central Bank (ECB) is trying to find ways to keep France afloat.

Across the Atlantic, in the American Presidential elections of 2012, both front runners, Barack Obama and Mitt Romney, worried about the reaction of the electorate who considered budget deficit to be their top worry, tried to lure voters promising to cut the Federal deficit, though through different plans. They were forced into this by a public outcry after Standard & Poor's downgraded the US credit rating and raised the fears that the United States may default on its obligations. If that could happen to a "currency issuer", who pockets billions of dollars annually in 'seigniorage', simply by running the printing press, the other countries are much more vulnerable.

5- A Non-Conventional Approach to Handle Debt Crises

Balancing the budget in present situations of most advanced countries is easier said than done. It requires austerity measures or tax increases both of which are politically unpopular. Dissenting voices about austerity plans as a solution of the crisis are already being heard. Street protests against austerity plans began in many countries. Because of political expediencies, rather than economic fundamentals, most governments are now thinking of other alternatives.

Several 'solutions' to the sovereign debt crises have been recommended and tried in the past. Some of these have merits. However, by and large they are only *ad hoc* adjustments; temporary pain killers rather than permanent cure. As in the case of medicine, most often, these temporary pain killers aggravate the disease. Dosage of 'pain killers' is increased and, in many cases, the end result is terminal illness of the patient. In case of the Euro Zone debt crisis, per force, economists and politicians alike are ready to consider non-conventional measures to handle the crisis. This author believes that Islamic teachings and principles can be helpful.

The best place to start any discussion on Islamic principles relating to finance verses 278-280 of Chapter 2 of the holy Quran. These verses state:

"O you who believe! Be afraid of Allah and give up what remains (due to you) from riba (usury) (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 but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums). And if the debtor is in a hard time (has no money), then grant him time till it is easy for him to repay, but if you remit it by way of charity, that is better for you if you did but know". [2: 278-80]

These verses establish three important principles with respect to borrowing and lending which we discuss below briefly.

I- The Principle of 'Principals':

This principle specifies that the creditor must get his principal back (except in exceptional circumstances discussed below). Justice demands that to be done. If the principal emerged from a loan contract, the lender did him a favor (expecting a reward only from God) and if it emerged from a sales contract he earned a profit once but thereafter his money has the same status as that of a lender.

There are a number of Islamic texts that enshrine this principal. The most important of these is the Quranic verse:

وَاِنْ تُبْتُمْ فَلَكُمْ رُءُوْسُ اَمْوَالِكُمْ ۚ لَا تَظْلِمُوْنَ وَلَا تُظْلَمُوْنَ

"If you repent, you are entitled to your principal. Deal not unjustly nor shall you be dealt with unjustly"

The principle of principals is also established from the following Hadith:

قَالَ رَسُولُ اللَّهِ صَلَّى اللهُ عَلَيْهِ وَسَلَّمَ: «الْعَارِيَةُ مُؤَدَّاةٌ، وَالْمِنْحَةُ مَرْدُودَةٌ، **وَالدَّيْنُ مَقْضِيٌّ**، وَالزَّعِيمُ غَارِمٌ»

[سنن أبي داود (٣/ ٢٩٦)]

"Anything given for benefitting from its usufruct is to be returned, a she-camel given temporarily for milking must be given back, **a debt must be discharged**, and one who stands surety is responsible to honor it". [Sunan Abu Dawood]

There are deposit insurance schemes in many advanced countries. However, as pointed out by Askari et.al. (2012), "while deposit insurance can deter runs on solvent banks that may be temporarily facing a liquidity crisis from an asset-liability mismatch, banking crisis come about also because of insolvency (loan losses exceeding bank capital) resulting from bad (mispriced) loans, speculation, and even fraud on the part of banks. Insolvencies can either be allowed to run their course, leading to bankruptcies and loss of shareholder value and creditor loans, or the government can bail out its banks. Bailouts could be ominous and shift bank losses to the taxpayers, workers, pensioners and the poor."[19]

II-The Principle of 'Non-Principals'

This principle requires that any addition to the principle amount that is not exposed to risk-taking, must not be protected. Once a capital owner has earned a return having exposed his capital to risk, that should be the end of the deal. If an investor wants to earn continuing returns, he must also share in risks. The two principles: (a) as a matter of principle, capital must earn a return in order for the economic growth to be sustainable and (b) as a matter of principle also, the capital owner must participate in risks which are part and parcel of everyday business. Insisting on the first principle and disregarding the second is unjust and are at the core of generating economic instability.

If the purpose is to establish justice, principals and non-principals must be treated differently. It is not only the careless (or carefree) debtor alone who is to be blamed, the insatiable (reckless) creditor must also share part of the blame and the results. Non-Principals need not be guaranteed. Economics tells us that and history gives us that lesson.

One of the prominent writers in Islamic finance, Umer Chapra, comments on the verses quoted above as follows:

"The principal reason why the Quran has delivered such a harsh verdict against interest is that Islam wishes to establish an economic system where all forms of exploitation are eliminated, and particularly, the injustice perpetuated in form of the financier being assured of a positive return without doing any work or sharing in the risk, while the entrepreneur, in spite of management and hard work, is not assured of such a positive return. Islam wishes to establish justice between the financier and the entrepreneur"[20].

In this respect, we may draw attention to several research studies that have shown that risk-sharing contracts are superior to interest-based contracts. One such study by

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[19] Askari, Hossein, Zamir Iqbal, Noureddine Krichene and Abbas Mirakhor, (2012), Risk Sharing in Finance: The Islamic Finance Alternative, Singapore: John Wiley and Sons (Asia) Pte. Ltd.

[20] Chapra, Umer (1985), p.64.

Hossein Askari et.al[21] makes a convincing case for risk sharing contracts as opposed to interestbased contracts. Analysing several studies on the causes of financial crises, they opine that "debt is at the core of all these banking and financial crises". They also point out the reasons why in practice interest-based contracts have dominated the global financial markets. Referring to the Modigliani Miller Theorem that states that in the absence of frictions (e.g., taxation, information asymmetry, transaction costs), a firm's financial structure would be indifferent between debt and equity, they point out that "in the real world there are a number of frictions that bias financial structures in favour of debt and debt-based contracts, with the two most important being tax and information. The tax treatment of equity returns and interest in industrial countries is heavily biased against equities. Informational issues (information asymmetry and the subsidies and policies that encourage moral hazard and adverse selection) are conceived in favour of debt and debt-based contracts. Broadly speaking, legal-financial systems in advanced countries are structured in favour of debt and debt-based transactions"[22]

Another recent study [23]by Anat R. Admati Peter M. DeMarzo, Paul Pfleiderer et.al concludes that:

"Policies that subsidize debt and indirectly penalize equity through taxes and implicit guarantees are distortive. Any desirable public subsidies to banks' activities should be given directly and not in ways that encourage leverage. And while debt's informational insensitivity may provide valuable liquidity, increased capital (and reduced leverage) can enhance this benefit. Finally, suggestions that high leverage serves a necessary disciplining role are based on inadequate theory lacking empirical support. We conclude that bank equity is not socially expensive, and that high leverage is not necessary for banks to perform all their socially valuable functions, including lending, deposit taking and issuing money-like securities. To the contrary, better capitalized banks suffer fewer distortions in lending decisions and would perform better. The fact that banks choose high leverage does not imply that this is socially optimal, and, except for government subsidies and viewed from an ex ante perspective, high leverage may not even be privately optimal for banks."

At this point, let me mention some misconceptions about sharing contracts vis-à-vis interest-based contracts.

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21 Askari, Hossein, Zamir Iqbal, Noureddine Krichene and Abbas Mirakhor, (2012), Risk Sharing in Finance: The Islamic Finance Alternative, Singapore: John Wiley and Sons (Asia) Pte. Ltd.

22 Ibid. page 57.

23 Anat R. Admati et. Al, "Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive", Graduate School of Business, Stanford University, Manuscript, March 2011.

Some Misconceptions about Sharing Contracts:

A. Sharing contracts suffer from "moral hazard" problem while loan contracts don't.

It is commonly believed that sharing contracts suffer from the problem of moral hazard, while loan contracts don't. In fact this is not true. The problem of moral hazard in sharing contracts vis-à-vis loan contracts is exaggerated to say the least.

In financial contracts, moral hazard problem is said to exist when one party acts in a way which harms the interest of the other party or leads to the violation of some of the conditions of the contract. The problem arises from asymmetric information, i.e., one party having less information than the other which can be exploited. The famous example given in Islamic finance, is that in a *mudarabah* contract (a sharing contract), *mudarib* (investment manager) may engage in activities which will maximize his own profit at the cost of ultimate profit of the enterprise or he may under-declare the true profits. In both cases, the profit received by the capital owner will be lower.

The problem of asymmetric information and the concomitant moral hazard problem, however, exists in loan contracts as well. After obtaining the loan, the borrower may engage in highly risky or unproductive activities which will increase the probability of default and hence greatly harm the interest of the lender. Now, whether the problem of moral hazard is relatively more serious in sharing or loan contracts is hard to determine *a priori*. Suffice is to say that the problem of moral hazard in loan contract is very serious. To quote only one example, many countries which borrowed huge funds from multinational banks and governments, used these in unproductive investments or their rulers simply embezzled a good part of them which led to default. The situation could have been different if the funds were given on sharing basis.

B. A loan contract eliminates interference in the business by the financiers and hence is preferable from the borrowers' point of view.

It is also alleged that since in a *mudarabah* contract, it is possible for the *rab-a-mal* (capital provider) to impose restrictions on the way the funds of *mudarabah* can be used, while in a loan contract, the borrower can use the funds, the way he wants. Since firms do not like interference in their business, a *mudarabah* contract is therefore, inferior to a loan contract from the point of view of businesses.

Once again this is a misconception. In modern financial markets it is very common that the financiers impose very stringent conditions on the borrowers. These are called "restrictive covenants" (the so-called conditionalities) and are part of almost all loan contracts. Some of these are so stringent that they actually harm the interests of the borrower. To give an example, it is well known that many lenders from the developed countries, both governments and multinational banks, imposed conditions that the borrower must import from the “donor” countries. It is equally well-known that these countries charged higher prices. This could not have been the case, had the funds been provided on *mudarabah* basis. This is so because, while the financier in a *mudarabah* contract can also impose certain conditions, no condition can be imposed which reduces the profitability of the enterprise.

C. A loan contract minimizes the needs for monitoring the project, and hence the monitoring costs.

This is another myth. Monitoring is needed whenever there is risk of moral hazard. As shown above, loan contracts are also subject to moral hazard. Therefore, there is need for monitoring in their case also. The most obvious example is the monitoring teams being regularly sent by IMF to the debtor countries. But there are several other examples. As mentioned above, the moral hazard problem arises because of asymmetric information. To overcome that problem, lenders regularly monitor the performance of the borrowers through obtaining additional information. They are required to submit periodic reports. In addition, there are “rating” agencies which provide information on performance and credit ratings. Banks also send inspectors to financed projects. Therefore, on the basis of monitoring costs also, a sharing contract is not inferior to a loan contract. As a matter of fact, it could be the other way round. There can be no better way to overcome the problem of asymmetric information than by placing members on the Board of Directors. This is not an impossible option either. In Germany and Japan the practice is very wide spread. Their experience shows that it pays heavy dividends.

D. Sharing contracts are too risky. For better risk management, contracts based on fixed returns are better.

This line of argument ignores that variability in the rate of return is only one of the risks faced by the financier. The other risks include non-performing debts and the risk of outright default. The problem of outright default in many cases is a more serious risk than the risk of lower or negative rates of return in sharing contracts. Anyone who has studied the anatomy of major financial crises is well aware that equity interests are a small percentage of the assets of these institutions. Loan defaults have been the major cause of failures of banks and other financial institutions.

Assuming that debts were incurred with valid justifications, yet there are circumstances when despite genuine efforts on the part of debtor, he is unable to fulfill his obligations. At that point, a third Islamic principal becomes relevant.

III- The Principle of Relief:

As stated above, once incurred debt must be discharged, except in very exceptional circumstances. This principle explains the need, rationale and the rules for providing relief to debtors who are in temporary and genuine difficulties. In general, creditors' right to get their principals back must be protected, but they cannot go beyond certain limits. An important distinction must also be made between a "delinquent debtor" and a "distressed debtor". The former is a debtor who has enough assets or fairly certain flows of future income or wealth to discharge his debts. Such debtor must be dealt with strictly. Later in the paper, we will mention legal measures to do that. The latter is a debtor who despite his willingness to pay and sincere efforts made to discharge his debt, is not in a position to honor his payment liabilities. Such a debtor deserves to be provided relief.

This principle is also well-established in Islamic law. Two *nusus* (Islamic texts) are quoted below, one of which has already been quoted but is repeated to draw the attention to this principle:

(a) "And if the debtor is going through a hard time (has no money), then grant him time till it is easy for him to repay, but if you remit it by way of charity, that is better for you if you did but know." [2:280]

"During the time of Prophet (PBUH), the fruits of one Companion's garden got destroyed due which his debts piled up. Prophet (PBUH) asked the Companions to collect funds to help him pay his debts. They did, but the collection was not enough to pay the debts. Upon that he told the creditors "take this and you do not have any more claim against him." [Sahih Muslim]

Some important points that emerge from the Hadith quoted above need to be noted. These are:

1. The right of the creditor to his principal was recognized [Principle of Principals].

2. All possible efforts were made to discharge the debt in full. For this purpose, even charity was collected.

3. Having done that, when 'available' money was not enough, debt write-off was granted.

However, it has to be ensured that the 'Principal of Relief' is not misused. In that respect the distinction between a "delinquent debtor" and a "distressed debtor" becomes important. The principal applies only to the latter. As for delinquent debtors, Islamic law provides very strict penalties. These include:

1. Delinquent debtor can be jailed (given physical punishment by a Judge). Delinquent debtors can be stopped from using their assets for buying or selling, gifting, transferring through can or in any other manner until they pay their debts.

2. Delinquent debtors can be declared "Persona non Grata".

3. Names of delinquent debtors can be published in public media.

4. Names of delinquent debtors can be included in the "Exit Control List".

5. Creditors will have the FIRST claim over the inheritance of the debtor.

For distressed debtors, Islamic system has many "positive action" provisions also. These include:

A. Prohibition of Interest

That the amount of debt cannot be increased, whether it originated from a loan or an exchange transaction, gives the debtor time to put his house in order. Tolerance shown to the distressed debtor by not increasing the amount of debt and extending the period of repayment is good not only for the debtor. It is also good for the creditors and the economy in general. It has both ethical and economic justification. When markets turn down, decline of collateral value triggers downward spiral as creditors try to protect their positions. However, this would make the market self-destructive, transforming a downturn into a crash. Forbearance relieves debtors, giving them better chances for repayment which will go to the advantage of the creditors. Preserving the value of collaterals and preventing market crash will benefit the entire economy and the society.

B. Hawalah (Reassignment of Debt):

This is voluntary and charitable act where someone undertakes to pay the debts of another person. No fee, compensation or benefit can accrue to the one taking up this responsibility[24]. In this regard it is stated in Sahih Bukhari that Prophet (pbuh) said, "Procrastination (delay) in paying debts by a wealthy person is injustice. So, if your debt is transferred from your debtor to a rich person, you should agree."

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[24] This may not be confused with 'money transfer', whereby an institution transfers money from one place to another against a fee. Charging such a fee is permissible.

C. Share of *gharimeen* (those in debt) in *zakah*

As is well-known, *zakah* is a compulsory levy imposed by God on every Muslim who has a net-worth above a minimum level called '*nisab*'. Of the five 'pillars of Islam', *zakah* is the third one. It is an earmarked levy. Its beneficiaries are fixed who are grouped in eight categories. One of these eight relates to those who have debts that they are unable to pay. In this way, the rich people in the whole society contribute to payment of debts, in case of distress.

D. *Given enough available resources,* the state is responsible to discharge the debt. Prophet stated (as a head of the state) that:

«أَنَا أَوْلَى بِالْمُؤْمِنِينَ مِنْ أَنْفُسِهِمْ، فَمَنْ تُوُفِّيَ مِنَ الْمُؤْمِنِينَ فَتَرَكَ دَيْنًا، فَعَلَيَّ قَضَاؤُهُ، وَمَنْ تَرَكَ مَالًا فَلِوَرَثَتِهِ»

[صحيح البخاري (٣/ ٩٧)]

«I am more rightful than other believers to be the guardian of the believers, so if a Muslim dies while in debt, I am responsible for the repayment of his debt, and whoever leaves wealth (after his death) it will belong to his heirs.»

[Sahih Bukhari]

While selective and well-deserved debt write-off is perfectly in line with Islamic principles, the temptation that it provides to unscrupulous debtors is very strong. A debtor can choose to default intentionally if he so desires. Despite legal provisions in most countries that try to prevent that, bankruptcy fraud is rampant and calls for reform are loud and clear. Such fraud may take the form of concealment of assets by the debtors, multiple bankruptcy filings in different legal jurisdictions, intentional inaccuracies in bankruptcy petitions in order to prolong the proceedings to the disadvantage of creditors and similar other acts of camouflaging.

Bailouts like the one of Fannie Mae and Freddie Mac raise the expectations of future bailouts. That would lend support to the "too big to fail" theory. In this and other similar cases, rescue operations by central banks by reducing interest rates encouraged corporations to 'make hey while the sun shines'. They are tempted to delay putting their house in order in time to avoid eventual collapse. The creditors will get deeper in the abyss by advancing further loans to them considering them safe. The financial institutions will take a happy ride on their low cost debt to leverage even more. That vicious cycle has no bright side to it. It is an established fact that enterprises like Fannie Mae and Freddie Mac expanded substantially their holdings of subprime mortgages concealing facts on their balance sheets. Such experiences could be avoided by another principal derived from Islamic teachings.

IIII-The Principle of Transparency:

This principle provides safeguards to ensure that the principle of relief is not misused. If the greed of creditors is insatiable, that of debtors is obsessive. 'Debt Handlers' make billions out of this cheating game. It MUST be ensured that relief is not misused. It requires strict laws to punish unscrupulous debtors, especially those who manipulate evidence to win relief from the courts. Islamic stance in this regard is very strict. In an authentic Hadith, Prophet (PBUH) stated:

قَالَ رَسُولُ اللهِ صَلَّى الله عَلَيْهِ وسَلَّمَ : لَيْسَ مِنَّا مَنْ غَشَّ

"One who cheats, does not belong to the community of Muslims." [Sunan Abu Dawood]

The cases of corporate cheating to win relief are very frequent. For example, in the case of the Lehman Bankruptcy in September of 2008, the largest ever in US history, it became clear that Lehman had manipulated its balance sheet. Accounting of financial risks, were stuffed with fictitious valuations through Hudson Castle, an entity set up to get the bad stuff off Lehman's balance sheet. In 2006, Merrill Lynch used a technique known as a total return swap; to hide it's riskier than declared CDOs[25] through firms like Pyxis. Citigroup used similar arrangements that the Security Exchange Commission now says should have been disclosed to shareholders in the summer of 2007. In all these cases the CEO admitted the facts in court proceedings but pleaded making mistakes and being wrong is no crime. The court appointed 'Examiners' have been alleged to have been bribed to help these concealments. The "buy now, pay later (or never)" culture plagues consumer and corporate borrowers alike.

The above four principles deal with post-debt situations. Islamic teachings also provide guidance for pre-debt circumstances. Taking debt is not prohibited in Islam in recognition of the fact that there may be circumstances under which taking debt becomes inevitable. However, three conditions are prescribed:

1. Debts have to be non-interest bearing.
2. Debtor has a firm intention to repay the debts and strives for that.
3. Debts are taken only to the extent that is inevitable.

The last condition gives us the fifth principle with respect to debt taking.

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[25] CDO stands for 'Collateralized Debt Obligation'. It is a security; backed by a pool of bonds, loans and other assets. It includes different types of debt, often referred to as ‹tranches› or ‹slices›. Each slice has a different maturity and risk associated with it. The higher the risk, the more the CDO pays.

V- The Principle of Restraint:

This principle prescribes that while taking debt is permissible, may even desirable in some cases, the reasons of incurring debt and its aftermath must be carefully considered. Exercising restraint is the rule. This is perhaps the most important of the principles with respect to the role of debt derived from Islamic teachings that are presented in this paper. Huge debt has several disadvantages; it dishonours; it disables and kills people and worst, it enslaves people. In this respect, it is pertinent to draw attention to books/stories and terminology that has gained currency, e.g., "Debt is Slavery[26]"; "Debt is Virus[27]"; "Debt Bondage", "Debtor's Prison"; "Wage Garnishment", etc.

Being in debt limits one's decision-making power. Consider a person William, who has no debts to pay. He is laid off. He has to find a job. His friend Peter is also laid off. Unfortunately, he has a lot of debt to pay. He also has to find a job, but his need for a new job is much more urgent than that of William. He will most likely accept a job that may not fit his career ambitions. Urgency of his debt instalments will force him to accept something that he does not like. William also has to find a job, sure, but he can wait for something to come up that fits his priorities.

To see the consequences of 'easy' money, let us see some statistics:

- According to Fitch Ratings, the number of credit card defaults hit 11.37 percent, the highest level since a record 11.52 percent in September 2009. (Source: Associated Press, March 2010)

- Twenty-six percent of Americans, or more than 58 million adults, admit to not paying all of their bills on time. Among African-Americans, this number is at 51 percent. (Source: National Foundation for Credit Counseling, 2009 Financial Literacy Survey, April 2009)

- Penalty fees from credit cards were about $20.5 billion in 2009, according to R. K. Hammer, a consultant to the credit card industry. (Source: New York Times, September 2009)

If "living beyond one's means'" is bad for an individual, it is equally bad for corporations and for governments. In resorting to debt finance, restraint is the rule for *all*, individuals, corporations and governments alike. 'Easy money' leads people to ignore the precautions that one must take even when taking debt is considered to serve some useful purpose or becomes inevitable. When must *never* forget that once incurred, debt

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[26] Mihalik, Michael (2007).

[27] Jaikaran, Jacques S. (1992); The Independent, Friday, April 13, 2012. "Now Euro zone debt virus starts to overwhelm Italy".

must be discharged, except in very exceptional circumstances mentioned above. When debt reaches crisis proportions, which it invariably does if restraint is not exercised, attempts are made to 'sell-off' debt which creates bubbles. Sooner or later these bubbles burst and the resulting 'burns' wreck not only the debtors but the economy in general.

In the Wealth of Nations, Adam Smith speaking of public debts stated, "When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid."[28]. Though the actions given in the legal measures against delinquent debtor stated above generally do not apply to governments, the six principles given in this paper equally apply to governments as they do to individuals and corporations. Reducing budget deficits is the most important issue in elections in the US and European countries including France. Election promises aside, balancing the budget in present situations of these countries is easier said than done. It requires austerity measures that the electorate cannot digest after they have got used to public supports. Dissenting voices are already being heard, because of political expediencies, rather than economic fundamentals. From an economic point of view budget deficits, except in very special cases and for short periods of time, are bad economics. However, as we hinted above, the shackles of debt once on, are not easy to break out from.

Strong lobbies are created as is evident in most Western countries. American President, and the author of 'United States Bill of Rights', James Madison, once said, "I go on the principle that a public debt is a public curse, and in a Republican Government a greater curse than any other". Today the US national debt stands at $15.7 trillion. The Democrats hold Republicans responsible for the massive increase and blame them to be big 'spenders', but the fact remains that total Federal debt grew by about US $4.6-trillion under Obama's first regime. During the US 2012 elections, the issue of "fiscal cliff" became a major a major topic of debate. It was a program of simultaneous increases in tax revenues and across-the-board government spending cuts scheduled to become effective Dec. 31, 2012. The debate went on during the election campaign with Democrats resisting expenditure cuts and Republicans resisting tax increases. The Congress could not reach an agreement before the November 2012 elections. In January 2013 a compromise was reached and on January 2, President Barack Obama signed the compromise bill into law. However, the most important matter of debt ceilings to be imposed on the government could not be resolved. Noble Laureate Maurice Allais pointed out that one of the bad features of debt is that it permits postponement of the decision to adjust[29]. By the time one realizes the severity of the situation, it is already too late.

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[28] Smith, Adam, (1904) An Inquiry into the Nature and Causes of the Wealth of Nations, London: Methuen and Co., Ltd., ed. Edwin Cannan, Fifth edition.

[29] Maurice Allais (1993), The Monetary Conditions of an Economy of Markets: From the Teachings of the Past To the Reforms of Tomorrow, Jeddah: Islamic Research and Training Institute.

Everyone knows that debt has not grown for economic reasons. A large majority of American citizens, each one of whom shares around US$50,000 in the national debt, believes that the reason for the huge debt built up was the so-called 'War on Terror', not the economy. In the light of the above discussion, *it is safe to conclude that reasons for high public debt are largely political not economic*. Therefore, it will be useful at this point to discuss the role of state and the Islamic view on that.

On the Role of State:

The role of state in any society depends on the prevailing philosophy that it follows. The subject has been one of the most controversial issues in economics. Until 1930s, the dominant philosophy was *laissez faire*, whereby governments were advised not to intervene in the operation of market. It was believed that "rational" individuals pursuing there "self-interests" in "competitive markets" will achieve both private and public interest simultaneously. The "invisible hand" of market forces would ensure symmetry between public and private interests and the best allocation of resources. Hence there was no need for the government to assume any economic role accept to set the rules of the game according to the requirements of perfect competition. Government intervention could be accepted only to remove market distortions or to offset "market failures".

From 'Market Failure' to 'Government Failure'

In the aftermath of "Great Depression" this paradigm was challenged by Keynesian economists on the grounds that markets are generally characterized by imperfections and rigidities and hence may not always ensure full employment and the best allocation of resources. Moreover, the market forces left to themselves, may not produce the distribution of income desired by the society. Partly due to rising levels of unemployment and income inequalities and partly as a reaction to communist philosophy, governments started taking upon themselves the responsibility of supporting the unemployed, the disabled, the old and the very young. The period starting from early 1940's and stretching well into 1970's was in general dominated by big government philosophy all over the world.

A more serious challenge to the *laissez faire* paradigm came from Marxist economists who argued that the interaction of the institutions of market and the private property perpetuates injustice and exploitation leading to class conflicts. Hence markets were replaced with central planning and private property with public control of the means of production.

The collapse of socialism in the Soviet Union and Eastern Europe around 1990s shifted the balance once again in favor of economic liberalism. This, however, proved to be short lived. The imperfections of the market, the unrest created by wide disparities in the distribution of income and wealth, the pressing concerns for social justice, unethical use of the enormous powers that the market bestows upon the transnational corporations, and non-sustainability of long run economic growth without active monetary and fiscal policies have once again focused the attention of economists and policy makers on the need for some critical role for the state in economic matters.

As a matter of principle, governments should only 'govern'[30]. They should not do business. Except for exceptional cases, business should be left to individuals and corporations. Because governments are non-profit organizations and use tax payer's money to provide services, they do not pay as much attention as required to cost-benefit analysis. There are also issues relating to good governance. There are severe problems in that area also. Three of these are of critical importance.

a) Governments do not use money wisely (economically).

b) Governments use money to gain political advantages.

c) Government officials and politicians may be corrupt.

It is interesting to note that in the Corruption Perceptions Index (CPI), prepared annually by the Transparency International, many Euro Zone countries, particularly those affected by the financial crisis, including Greece and Italy, are doing worse and worse. Many of the lowest-scoring European countries are those hardest hit by the financial and debt crises. *It seems that we have moved from 'market failure' to 'government failure'*. Does that imply moving from bad to worse?

Lessons from Islamic Teachings:

In Islamic economic literature also, the role of state has been a subject of debate. The importance of the institution of state has never been under-estimated. It is seen to be absolutely necessary to continue the mission of the Prophet (peace be upon him), i.e., achievement of the *maqasid al-shariah* (i.e., objectives of Islamic law). The distinction from conventional economics is obvious. The state is seen to be an agent of God for the realization of *maqasid al-shariah*. For example, in an Islamic state any allocation of resources that hinders the realization of *maqasid* would be treated as inefficient. Similarly achievement of equity and justice become essential components of public policy.

The controversy among Islamic scholars arises when it comes to specifying the economic functions of the state. The institutions of *bayt al-mal* and *hisbah* have been the two indispensable components of the institutional set up of Islamic states in the eco-

[30] That of course includes the area of regulation and supervision.

nomic sphere. *Bayt al-mal* looked after the welfare functions of the state while the institution of *hisbah* was to ensure that all economic agents fulfilled their obligations to one another on the one hand and worked within the rules prescribed by the *shariah* on the other hand. Beyond that there are two major schools of thought among Islamic scholars. Some writers have argued that in an Islamic economy a clear distinction must be made between the subsistence welfare and the desired welfare. Provision of the subsistence level is not only an objective of economic policy, but is also an obligation, whereas the provision of an adequate standard of living is only desired. Included in the first category are aids and services provided to people stricken by a natural calamity, war, famine, or lack of production to below subsistence level, etc. The second category includes social services aimed at improving the economic living of the poor. Some scholars believe that in fulfilling what is required, the state has to acquire the necessary resources while in providing what is desired, it is limited to the use of the available resources only. Many earlier writers were not in favor of a pro-active developmental role for the state. Similarly, these scholars were reluctant to allow the rulers to impose taxes other than the conventional ones. This view is based on (a) the unequivocal guarantee of individual freedom and the sanctity of private property right in the Islamic system and contends that any compulsory government charge is a violation of private property rights and (b) relies on several *ahadith* against *mukus* (plural of *maks*). However, other scholars point out that *mukus* were either unjust taxes imposed by dictatorial regimes for personal benefits or tolls collected by tribes against passage of *karvans* carrying tradable goods with security through their jurisdictions.

Most modern Islamic scholars, therefore, see a more pro-active role for the state. The authority vested in the rulers has two aspects. First and foremost they are the "viceroy" of Allah and have to discharge the powers delegated to them by Him for to continue the function of Prophethood. It is agreed by all that the state has to strive for the fulfillment of the *maqasid*. Secondly, rulers are "agents" of the society for the achievement of objectives that the society sets for itself. Citizens may assign any duties to the state through the process of *shura* (in modern parlance, through parliaments). Even under the first role, the achievement of the general welfare of citizens in contemporary context would require the state to take up some developmental functions. Therefore, modern writers in general envision a broader role for the state.[31]

However, a confusion in terminology must be removed here. Many Islamic writers brand Islamic state to be a 'Welfare State". Indeed Islamic state is a welfare state in the sense that in its Vicegerancy role it has to ensure that individuals' welfare is maximized in the light of maqasid al-shariah which, in turn, are meant to guarantee his welfare in

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[31] These writers include Shah Waliullah, Abu Yusuf, Baqir Sadr, Sayyid Mawdudi, Umer Chapra and Nejatullah Siddiqi. Siddiqi (1996) provides references to many writings on this point. Also see Ahmed, et al. (1983a), pp. 154-161.

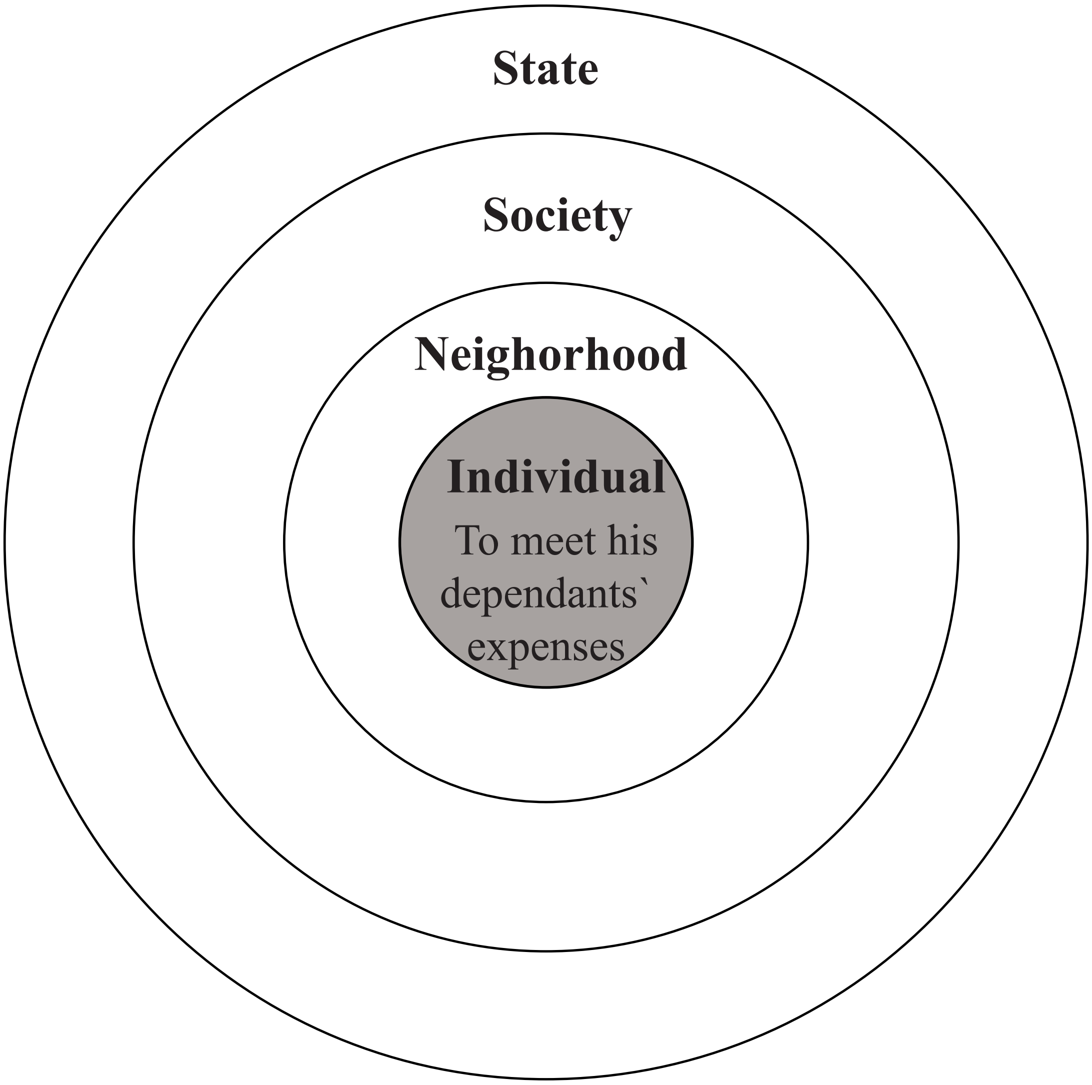
this life and the life Hereafter. That concept is quite different from the modern concept of a welfare state, whereby the state guarantees certain welfare benefits to individuals. These benefits become addictive and political reasons prevent the governments touching white elephants in the area of health care, unemployment benefits etc. Any cut in 'welfare benefits', even if parasitic, is very hard to carry through. Welfare benefits cannot fall, the government can fall instead. I call it "Downward Rigidity of Welfare Benefits". A classic and most recent example is the on-going protests by workers, police, doctors, judge and even military against the salary cuts agreed as part of the 'austerity measures' against €130 billion rescue package granted to Greece. The so-called modern states are facing so many problems that a new 'workfare model' as an alternative to the social welfare systems currently in vogue in many advanced countries is being proposed. Other studies for reforming the welfare benefit system are also being discussed in the literature.[32]

Under the Islamic system, a hierarchal schema for fulfillment of basic needs is designed implementation of which is overseen by the state. In such a schema, first and foremost it is the individual who is responsible to meet his and his dependents' expenses. The role of state here is to provide individuals with education, skills and employment opportunities. Then the neighborhood is charged with the responsibility of fulfillment of basic needs of households living in a particular area. After that responsibility falls on the society at large. Here Islamic system provides a blueprint for Public Private Partnership for achieving economic welfare goals. Islamic institution of waqf which mobilizes resources on non- governmental basis has historically played an important role in achieving social and economic goals of a society. Rich individuals and not for profit organizations (NPOs) have been active throughout the Islamic history. Going from below to the top, ultimately, it is the state which guarantees the fulfillment of basic needs. Islamic Schema is presented in Chart 1 below.

[32] For example, see "Causes and Effects of Welfare Dependency", Chris Bisaillon, Illinois Wesleyan University, Honours Project (993).

Chart 1

Public Private Partnership for Welfare



In the area of corporate finance, banks only tell us of their 'bad debts'. What we are trying to argue in this paper is that *almost* all debt is bad?[33] If "living beyond one's means'" is bad for an individual, it is equally bad for corporations and governments. In resorting to debt finance, restraint is the rule for *all*, individuals, corporations and governments alike. 'Easy money' leads people to ignore the precautions that one must take even when taking debt is considered to serve some useful purpose or becomes inevitable. When must *never* forget that once incurred, debt must be discharged, except in very exceptional circumstances that we will mention under the next Principle. When debt reaches crisis proportions, which it invariably does if restraint is not exercised, at-

[33] That is not to say that debt has no role whatsoever. The issue is discussed in detail in section 2.

tempts are made to 'sell-off' debt which creates bubbles. Sooner or later these bubbles burst and the resulting 'burns' wreck the debtors down to their souls.

Another problem is created by evaluation process used by creditor institutions who being keen to improve their deployment ratios[34] rely more on collateral than on careful project evaluation. Chapra (2000)[35] correctly argues that: "interest-based lending makes the banks rely on the crutches of the collateral to extend financing for practically any purpose, including speculation. The collateral cannot, however, be a substitute for a more careful evaluation of the project financed. This is because the value of the collateral can itself be impaired by the same factors that diminish the ability of the borrower to repay the loan. The ability of the market to impose the required discipline thus gets impaired and leads to an unhealthy expansion in the overall volume of credit, to excessive leverage, and to living beyond means". Thus the principal of restraint is important for the creditors also.

VI- The Principle of M-R Linkage

This principle makes debt creation contingent upon linking the monetary and the real sectors of the economy. If there is a grain of truth in the argument that leveraging can be a mean to increasing wealth, it *must* necessarily be qualified. Money creation, whether through borrowing from the central bank by a government (running the printing machine) or through credit creation by commercial banks must be linked to the real sector. In the words of the Position Statement of the International Association for Islamic Economics, "to build a sustainable system, debt must grow in tandem with real (as opposed to financial) wealth; leverage must be capped by productivity potentials. This allows for real wealth to grow without being hurdled with too heavy debt". One of the most prominent Islamic economists, Khurshid Ahmad explains the issue more clearly:

"The delink between money and production activity has led to the emergence of two parallel economies, a money economy and other the real physical economy. Money that was an instrument of exchange and a measure of value became the sole embodiment of value. An instrument that was designed to facilitate exchange and production became an object in itself. Real economy slumbered but financial economy expanded beyond all limits, enriching those alone who were engaged in the business of finance. This created a fiduciary world of its own. Money generating more money without producing

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[34] Deployment ratio is a performance evaluation measure to see how best a bank is using its resources. Its defined as Total Investment/Total Equity + Total Deposits. For details please see Iqbal (2001), p. 15.

[35] Chapra, M. Umer, (2000) "International Financial Stability: The Role of Islamic Finance", *Policy Perspectives,* Vol 4, No.2, Islamabad: Institute of Policy Studies.

goods and services in the economy, without increasing the stock and flow of assets in the society. In this new fangled economic order money became the main player as well as the prize. The process of real value-addition in the economy has been slowed if not disrupted. Money and creation of fiat money became the real game, resulting in the creation of wealth that only produces billionaires without adding much to the well being of the people. The result is that the system has succeeded in creating an economy wherein presently while the world GDP in current prices is around $60 trillion, we have an ever expanding realm of fiduciary money, wherein annual trade in derivatives now exceeds $900 trillion. In this game the real players and also beneficiaries are only a few thousand pseudo-investors while the whole global economy is at the suffering end. The same is true of the foreign exchange markets where daily trade in foreign currencies is fifty times more than the volume of daily movement of trade and tourists. The present day vulnerability and instability of the capitalistic economy owes much to this fatal delink."[36]

[36] Ahmad, Khurshid, "Global Economic Crisis and the Role of Islamic Economics", IDB Prize Laureate Lecture, April 21, 2012.

6- Conclusions

The discussion in the paper has pointed out a number of factors that interact to build up into an economic and financial crisis like the one going on in the Euro Zone. We present our conclusions in the form of “Eight Axioms on Debt and Economic Stability”

(i) Borrowing/lending on the basis of interest is the root cause of most economic and financial crisis.

(ii) Sharing contracts are superior to debt contracts. The later dominate in practice largely due to unfair tax treatment of equity.

(iii) Economic instability is a result of a delink, fueled by speculative short-selling between production of credit and production of physical wealth.

(iv) Welfare benefits are downward rigid.

(v) Budgetary deficits are largely politically motivated.

(vi) Participation of ‘society at large’ is necessary for achieving welfare goals. [We call it Private Public Partnership for Welfare (PPPW)]

(vii) “Government Failure” is as bad as “Market Failure” and has been a major reason of debt crisis.

(viii) “Too big to fail” theory in the corporate sector has a parallel in the public sector, namely “Too big to manage” and the two are interlinked.

معهد الاقتصاد الإسلامي

معهد الاقتصاد الإسلامي مؤسسة علمية تسعى للإسهام بفاعلية في بناء فكر اقتصادي عالمي يحقق الرفاهية والعدالة الاجتماعية، من خلال تهيئة مناخ بحثي وعلمي نشط تتكاتف فيه موارد المعهد لتحقيق مستوى علمي رصين وتكوين أجيال رائدة في الاقتصاد الإسلامي.

أقامت جامعة الملك عبدالعزيز أول مؤتمر عالمي للاقتصاد الإسلامي في عام 1396هـ شارك فيه عدد من وزراء المالية بالدول الإسلامية مع العلماء الشرعيين والاقتصاديين وكانت من توصيات هذا المؤتمر مجموعة من التوصيات منها: إنشاء مركز بحثي في الاقتصاد الإسلامي بجامعة الملك عبدالعزيز.

واستجابت الجامعة للتوصية في منتصف عام 1397هـ وأُنشيء المركز العالمي لأبحاث الاقتصاد الإسلامي.

ومنذ ذلك الحين أخذ المركز في تعزيز مكانته البحثية فتكونت له بنى بحثية قوية؛ كالمكتبة المتخصصة والمجلة المحكمة والسمعة العلمية الرصينة، وبعد 35 عاماً من البحث العلمي اتخذت الجامعة قراراً مهماً بتوسيع دائرة عمل المركز لتشمل قطاعي التعليم والتدريب فتم تحويل المركز إلى معهد في عام 1432هـ.

ومن إنجازات المعهد خلال الفترة 1427هـ - 1433هـ إصدار خمسة عشر كتاباً و أربعين بحثاً محكماً وعرض ستين ورقة علمية في مؤتمرات وندوات وعقد 13 لقاء علمياً وأكثر من 140 حواراً أسبوعياً وقد ناقش باحثو المعهد أو أشرفوا على 20 رسالة علمية.

معهد الاقتصاد الإسلامي

سلسة أوراق عمل

محدودة الإصدار

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