On the current financial crises

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While a narrative of what happened and who did what is useful, what is important is to understand, the core of the problem.

In a nutshell, what went wrong was the fact that the system was creating financial assets many times the size of the real sector. The size of financial derivatives reached more than $60 trillion in 2008, when the GDP of the USA in 2007 is a mere $14 trillion. AIG (American International Group) alone was holding in its books close to half a trillion dollar worth of CDS's.

This is the first financial crises in a world that has become a truly "global village". It took years for the 1927 crises to be felt in all corners of the world. The 2008 crises was performed live on T.V screens all over the world.

This crisis is coming at a time when "Islam", "Islamic" and "Muslims" is something that can't be ignored, dismissed or undermine. During the 19th century, the world was following the gold standard. Gold standard was capable of facilitating growth in international trade of unprecedented scale. When it becomes impossible to continue on gold standard, the world was able to extract the secret of the gold standard and re-create it through the independence and mandate of central banking.

The world doesn't miss the fact that "Shari'ah banking" as it is called in the western media, was less involved in this "toxic assets" debacle compared to the rest of banking institutes and they can see that the word “Shari'ah” is key in this unique position.

We are part of this world. This means that there is not one culvert in this crises. All the participants in the world financial system bear some responsibility. By the same token, they should all work together to build a new system that can truly be called a “world” system. World means designed and owned by the whole world and supervised on the word by political and economic desire.

We certainly do have a lot to offer to the world. It is incumbent upon us to fully participate in the rebuilding of a truly new world system.

The first positive thing we need to start with is to refrain from the “I told so” approach.

1- Form and Substance:

   Islamic banking is frequently accused of being too formal. Shari'ah concern with procedural aspects of finance is looked at by some as in effecting compared to conventional finance, Islamic products require more elaborate procedures and relatively more detailed documentation. Unlike Islamic banking conventional finance is “substance driven”. However this relentless drive for substance reached a level that undoubtedly contributed to the crises. Everyone was reduced to how much will you get on the dollar, everything else is lumped into what is termed as “risk”. Unfortunately even that important aspect, risk, we left almost completely to rating agencies. After sometime it became sufficient to just have two parties and a rating agency, otherwise had can one imagine buying a CDS on debt you are not even an owner (i.e. a partly speculative factor, if the debtor goes bankrupt you receive for the CDS issuer when you are not even a creditor to that for years it has been nothing but a disaster waiting to happen. In Islamic banking proceeds is essential. You must know what you are buying and selling for how much and how it is delivered….etc. these procedures define permissibility or other wise. A mere jumping fro step 1 to 3 may render the transaction null and void. Had people in conventional bank been following such an approach they would have realized very early that when they did with the "form" they also lost the "substance".

A different concept of mortgage:

It is permissible in Shari'ah to use collateral to secure debt. However, this collateral serves only one purpose and that is to secure the obligation (debt). The debt is place in the "dhima", a virtual pool rights and obligations which was premised by Shari'ah and assured for every living individual.

The collateral remains the ownership of the debtor. Creditor has only one right and that is to sell it in case of default so has to cause the debt to be settled. So when the debtor default and the mortgage is liquidated, the creditor remains entitle to the full face value of the debt. If the mortgage decrease in value and were able to only fetch 75% of that debt, creditor has recourse on the debtor to recover the remaining. In no way the debtor can be relived from his obligation without the full consent of the creditor. Neither death nor bankruptcy is sufficient grounds for such relief. A fully real estate price must have no impact of debt obligations for the debt is not in the “mortgage” but in “dhima”.

In the United States most mortgage are now with no recourse. This simply meant that if the mortagagee fails to pay the creditor loses .

- Islamic Contracts justice and fair plays:

  Any observer can see that contractual relationship between consumers and banks in the field of housing finance is tilted towards the former. This is due to the fact that owning your home is central to what is called the “American Dream”. Therefore, it politically rewarding for politicians to stand for the interest of the individual. Many aspects of regulatory intervention in the house finance market are to appease the “voter”, even if such appeasement on the account of justice and fair play. For example:

  Prepayment of a loan is a “right” for the individual business where ever requested by the borrower, lender must oblige. In this case, lender is entitled to principal only.

  In Islamic law, a prepayment can only be effected with the consent of the two parties. Furthermore, when debt is created, there is no separation between principal and profit. Hence, creditor is not under any obligation to deduct anything from the loan if a prepayment is requested by the debtor let alone write off all the profit. It is subject to mutual agreement. Such agreement will take into consideration the interest both parties making prepayment a right resulted in what is called mortgage refinance.