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Islamic Finance – The Solution To Bank Fraud

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By Alexander Baron

Currently, a former city trader (so-called) is standing trial at Southwark Crown Court accused of manipulating LIBOR. Banks worldwide lend money to other banks at interest for short periods constantly, and LIBOR is at the centre of that. So was Tom Hayes, who is said to have boasted about keeping the 3 month LIBOR rate artificially high. He is not a lone wolf, and whether or not he is convicted, more trials are likely to follow. He and other alleged conspirators are said to have acted on a global scale. The big question here should be not how was this sort of thing allowed to happen but why should it be able to happen, in short, why are banks permitted to charge interest on their loans?

If that question sounds odd, that is because people in the West have been conditioned to believe interest is necessary, even desirable. The perceived wisdom is that interest is the fee charged on a loan; this is justified partly by the element of risk – if you lend money to someone, he might not pay you back, he might abscond, die, or simply lose it all. The other element is that if you had not loaned this money to X, you would have been able to invest it elsewhere, so interest is also a form of compensation. On the face of it, this sounds reasonable, if you use anything for any period of time, you expect to pay a fee, be it for a taxi ride, office space, an electric lawn mower…However, charging interest on money is most definitely not reasonable, not the way the banks do it, and there is in any case an alternative system.

Banks do not in fact lend money, rather they create it with the stroke of a pen or today with a computer entry. A simple explanation for this was given by the great Major Douglas way back in the 1920s. If you are not *au fait* with the mechanism of credit creation, the three screengrabs below will explain it as comprehensively as any layperson needs to know. If you want to learn more, you will find the works from which both the explanation and the mathematical proof are extracted at the Douglas Internet Archive. You will also find some excellent videos about it on YouTube.

This begs the question, if banks are permitted to create credit at the stroke of a pen, why isn't everyone else? The short answer is because they have stolen this right and have obtained a legal monopoly by way of deception. Without going into complex conspiracy *theories*, it is impracticable to allow everyone to create his or her own credit, but it is not impracticable for a sovereign nation to do so under the control of its parliament. Which brings us finally to Islamic banking.

Under Islam, interest is *haram*, instead, banks lend real money and the lender becomes a partner in the venture for which it is applied. So where does new money come from? This should be issued debt-free, and could be done so in the UK by the Bank of England, in the US by the Federal Reserve and in other countries by their respective central banks. In practice, the UK, the US and other countries *have* been issuing money debt-free for some time. And giving it to the banks! This is what quantitative easing is all about; they may dress it up with fancy language claiming the central bank purchases securities from the commercial banks who then lend this money (ie sell it at interest), but the bottom line is the banks are given this money for nothing. With an Islamic banking system and the central banks under the control of Parliament, Congress, the National Diet (Japan) etc, the entire system of lending at interest could be abolished, and most of the graft associated with banking with it. How do we go about this? Perhaps we should ask Anjem Choudary?

Imagine a new bank to be started—its so-called capital is immaterial. Ten depositors each deposit £100 in bank-notes with this bank. Its liabilities to the public are now £1,000. These ten depositors have business with each other and find it more convenient in many cases to write notes (cheques) to the banker, instructing him to adjust their several accounts in accordance with these business transactions, rather than to draw out cash and pay it over personally. After a little while, the banker notes that only about 10 per cent of his business is done in cash (in England it is only 0.7 of 1 per cent), the rest being merely

bookkeeping. At this point depositor No. 10, who is a manufacturer, receives a large order for his product. Before he can deliver, he realises that he will have to pay out, in wages, salaries, and other expenses, considerably more "money" than he has at command. In this difficulty he consults his banker, who, having in mind the situation just outlined, agrees to allow him to draw from his account not merely his own £100 but an "overdraft" of £100, making £200 in all, in consideration of repayment in, say, three months, of £102. This overdraft of £100 is a credit to the account of depositor No. 10, who can now draw £200.

The banker's liabilities to the public are now £1,100; none of the original depositors have had their credits of £100 each reduced by the transaction, nor were they consulted in regard to it; and it is absolutely correct to say that £100 of new money has been created by a stroke of the banker's pen.

Depositor No. 10 having happily obtained his overdraft, pays it out to his employees in wages and salaries. These wages and salaries, together with the banker's interest, all go into costs. All costs go into the price the public pays for its goods, and consequently, when depositor No. 10 repays his banker with £102 obtained from the public in exchange for his goods, and the banker after placing £2, originally created by himself, to his profit and loss account, sets the £100 received against the phantom credit previously created, and cancels both of them, there are £100 worth more goods in the world which are immobilised— of which no one, not even the banker, except potentially, has the money equivalent. A short mathematical proof of this process is given in Appendix I.

Let Deposits = D
Let Loans, etc. = L
Let Cash in Hand = C
Let Capital = K

Therefore Assets = L + C
and Liabilities = D + K

Therefore L + C = D + K

Assuming Capital to be fixed and differentiating with respect to time we have:

$$dL/dt + dC/dt = dD/dt$$