

Non-Interest Resource Mobilization for Public Capital Projects: The Use of Islamic Endogenous Loans

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Islamic opposition to ribā opens the path to an immensely creative possibility – a non-interest way of mobilizing resources for public capital projects. The way uses Islamic endogenous loans (repayable, interest-free loans issued by the central bank) which are counter-inflationary and always directed at productive capacity. Because they bear no interest, the loans allow the building of bridges, hospitals, schools, sewage works, tsunami warning systems etc. at one half or less of the present cost.

The loans can also be used for other aspects of the real economy:–

- *Private capital investment in large corporations if new owners of capital are created*
- *Environmental capital investment (e.g. clean energy)*
- *Small and start-up businesses thereby freeing them from the crushing pressure of interest-bearing debt.*

Above all, the use of the loans will enable Islamic societies to give an intellectual, material and moral lead to the rest of the world.

1. Introduction

There is always a need for more public capital projects – anything from a road or hospital to housing or sewage works – but there is never enough money. Consequently, faced with a demand to build a capital project, a government will always start by saying that its income is insufficient and then add that, in any case, there are other, more pressing, claims on its resources.

Which is not unreasonable because there is a limit to the amount that can be raised by taxation and there are always many urgent things needing to be done. Besides, the government will say, even if we do agree to build the project, we will have to borrow the money which, because of the associated *ribā*/interest, will increase our already huge, and debilitating, National Debt.¹ Then, as a last

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¹ National Debt is usually incurred by the central government of a country selling interest-bearing bonds. In the UK, in order to raise money, the government issues Exchequer or Treasury bonds i.e. government stocks or securities. The buyer of these stocks is given a commitment to repay the stock plus interest at a given date or dates. When banks buy the

afterthought, it will say that if a government prints money for its spending, the inevitable result is inflation.

Yet, whatever a government says, there is an undoubted need for public capital projects and much pain and misery results when they are missing or inadequate. A terrible recent example is the December 2004 death and destruction caused by tsunami (tidal waves) because countries surrounding the Indian Ocean did not have proper warning systems in place.²

So, is there a solution? Is there any new way of funding necessary public capital projects without raising taxation, increasing the National Debt – or causing inflation?

Yes, there is. It can be summarised in the phrase Islamic endogenous loans. While not being a magic wand capable of solving all problems, the loans do have the practical consequence of either:–

doubling the amount of public capital projects obtainable for the present cost

or

allowing the existing amount of projects to be obtained at half the present cost.

2. *Ribā*/Interest is Not Only Wrong but Unnecessary

In order to understand the new way it is first only necessary to remind that *ribā* (interest) is wrong. The Qur'ān forbids *ribā* and that, for Muslims, is the end of the discussion.

Yet Muslims should also recognise that, leaving Qur'ānic injunction aside, there could be another, separate, argument against interest – namely, that interest is not necessary. If correct, the argument is peculiarly powerful because Western neoclassical economics (and the worldwide finance capitalism it generates) generally assumes interest to be something that exists, has always existed, and always will exist because it is, as it were, an integral part of nature.

Moreover – and this is being blunt – the argument that interest is wrong is not likely to carry much weight with the non-Muslims who may view Islamic religious belief as of little relevance to themselves. However, if interest is stated to be unnecessary then the ears of non-Muslims begin to prick up. After all, everybody knows interest imposes a considerable financial cost and the possibility of avoiding

stocks, money is created by the banking system to do so. However, pension funds etc. also buy the stocks.

² The December 2004 earthquake off Sumatra, Indonesia had a magnitude of nearly 9.2 on the Richter scale. It resulted in tsunami directly killing at least 180,000 people and causing massive destruction. A large proportion of those deaths would have been avoided if a proper tsunami warning system had been in place.

it is something which has appeal to all sane people, be they Muslim or non-Muslim.

3. Since Nowadays The Banking System Creates Money Out of Nothing There Is No Justification For The Imposition of Interest

Of course, those of a cynical turn of mind will say that it does not matter if interest is necessary or unnecessary because interest is simply an imposition by those who own money and have the power to dictate the terms on which others can borrow.

Which cynicism is not unreasonable if people really are lending their own money. But suppose they are not lending their own money and, instead, are creating the lent money out of nothing simply by pressing computer buttons (which is what the banking system does today)? Where, then, is the justification for the imposition of interest?

There are, of course, the traditional justifications for the imposition of interest. Thus Nassau Senior³ invented the term ‘abstinence’ seeing interest as the reward for abstaining from immediate consumption. Rather similarly, Alfred Marshall spoke of ‘waiting’.⁴ And the principle of time-preference was stated by Eugen von Bohm-Bawerk⁵ who viewed a loan and the associated interest as a real exchange of present goods against future goods. Again, the underlying idea is of paying a price for getting something now rather than having to wait.

But if somebody creates the money to be lent out of nothing by pressing computer buttons why should that person be allowed the additional privilege of adding interest? That person has done no ‘waiting’ or ‘abstaining’. And who said that person has the right to create the money in the first place? Indeed, those who create money out of nothing are normally deemed to be guilty of forgery and counterfeiting (for which there is always serious punishment).

Yet, today, money is created out of nothing by the banking system which has, in practise, been allowed not only to usurp society’s prerogative to create money⁶ but also to usurp society’s right to impose tax – for a tax, in effect, is what interest is except that the benefit of the ‘tax’ does not go to the government. Thus we have reached the crux of the matter which can be expressed in the question – Who

³ 1790 – 1864.

⁴ Principles of Economics.

⁵ 1851 – 1914.

⁶ In 1694 the founder of the Bank of England gave £1.2 million (@ 8% interest) to King William III to fight the war with France. This was the first UK National Debt and, in effect, the government’s inherent right to issue money had been sold to the banking system. The National Debt principle has been copied worldwide.

(society or the banking system) has the ultimate right to create money (and, if wished, to impose interest)?

Of course, on hearing the question, there is an immediate flurry of objection, for example, pointing to the everyday cost of financial administration as being a reason for imposing interest. Which is not denied because the cost of administration can be a part of interest⁷ as can provision for default.⁸ And every investment – at least in the private sector – must in principle pay for itself. However, when the administration cost is minimal and when the collateral (security for a loan) is adequate or largely not involved,⁹ and when there has been a scrutiny to establish whether the investment can pay for itself, it can then be clearly seen that interest itself is not necessary. Rather it is like a tax – and an unnecessary one at that – imposed, simply, by those who have the power to impose it. And, like taxes, it can go on being gathered for evermore, bleeding a country to death (as heavily indebted countries know only too well).

The conventional economist will then try to make another defence of the imposition of interest. In another version of the ‘abstinence’ argument he will articulate conventional savings doctrine. This says that, before there can be investment, there must be financial savings and physical savings. Indeed, at first it sounds reasonable to say that, before there can be investment, money must be obtained, and physical things (e.g., bricks and cement) must be available. But suppose the money is created out of nothing by the pressing of computer buttons¹⁰ and suppose the bricks and cement are easily available (even though, when in short supply, their prices can rise or, if necessary, alternatives are available)? Where, then, is the justification for conventional savings doctrine?

So the question stays with us – Why should there be interest at all? Indeed, Muslims should recognise that, apart from being wrong, interest can be viewed simply as an unnecessary ‘tax’, and a very large one, whose receipts go only to a small percentage of the population and to foreigners.¹¹ In fact, it is hard to see any

⁷ In the case of public capital investment the administration cost can often be low, even minimal. This is because the administrative cost is substantially borne by the borrower and not by the lender (e.g., as when a local government body collects fees and taxes with which to repay its debts).

⁸ The provision might be for the default of the borrower or the default of other borrowers in general.

⁹ For example, when a government undertakes the obligation to repay, or when specific provision is made for collateral.

¹⁰ Nowadays, the international banking system creates the original principal of a loan out of nothing – by the pressing of computer buttons. It then imposes interest.

¹¹ Overall, the cost of interest causes 80% of the population to pay out much more than they receive; 10% are in balance; and the last 10% receive very much more than they pay out. Internationally, of course, the effects of compound interest are such that whole societies are trapped into an ever-increasing debt which they can never repay, and the attempt to repay in

justification for the imposition of interest since the original principal is created out of nothing and interest generally has hugely deleterious effects on the economy and society as a whole.¹²

Muslims, therefore, should beware of outdated concepts such as the time value of money and conventional savings doctrine which are generally presented to the populace as unchallengeable slogans and everlasting truths. In reality, of course, they are cynical deceptions designed to maintain the malignant grip of money-lenders and other undesirable features of finance capitalism such as rich-poor division and economic colonialism.

4. The Cost of Capital Projects Can be Halved or More

Furthermore, in making the recognition that interest is not necessary, Muslims will easily come to a further recognition – that, if interest is eliminated, the cost of capital projects can be halved or more. This is because interest, particularly when compounded, adds hugely to the cost of a project. Indeed, in many cases, due to the accrual of interest, the money owed becomes incapable of ever being repaid. This is the basic mechanism which has caused the National Debt of most countries to rise to astronomical levels.¹³

5. The Conventional Definition of Endogenous and Exogenous Money is A Perversion and A Lie

Conventional Western economics and neoclassical finance capitalism, however, intent on maintaining the existence of interest, will still come up with one more attempted defence of interest (and of the banking practise of creating money out of nothing by pressing computer buttons). For them, interest is at the heart of everything that is materially successful and this can be understood by considering the conventional definition of endogenous money (which is alleged to be the key to all material growth and success) as that which issues from the banking system. Conventional economists then get very excited – indeed, give yelps of triumph – as

practice results in their economic resources being ripped off to outsiders. Kennedy (1995).

¹² The effects of interest are complex but in Aachen, Germany, interest on capital is 12% of the cost of rubbish collection; 38% of the cost of drinking water; 47% of the cost of sewage; and up to 77% of the cost of public housing. Indeed, it has been estimated that an amazing 50% of the price of all goods and services relates to borrowing costs (principal and interest). Kennedy (1995). See also Diwany (2003).

¹³ But there is a remarkable exception – the Channel Island of Guernsey which, in the early nineteenth century, and having insufficient income to fund borrowing for an essential sea wall, decided to create its own money to build the sea wall and then take back the money (via fees and taxes) with the option of cancelling it. The practice has been continued so that, today, largely free of National Debt, Guernsey is prosperous (although the fact that Guernsey is a tax haven tends to mask the true source of prosperity which is freedom from National Debt).

they add that loaned money issuing from the banking system is especially virtuous because it serves the needs of the economy – particularly the need for productive capacity – and efficiently allocates resources.

But that is untrue. Firstly, a visit to any dictionary reveals that 'endogenous' has the meaning of 'coming or growing from within' (and 'exogenous' has the meaning of 'coming from without'). Thus the conventional claim that money coming from the banking system is endogenous (and money coming from the state is exogenous) is a disgraceful twisting of words for it is essentially being claimed that government and other institutions at the heart of society are in reality outside society, and only the banking system is inside. That is a perversion of vocabulary.

Secondly, the claim of efficiently allocating resources, particularly for productive capacity, is a complete lie. Nowadays, the banking system does not allocate money to new productive capacity and, instead, allocates it to derivatives, to the bidding up of existing asset prices, to consumer credit, to putting individuals, companies and whole societies into debt, indeed, to anything but the real, productive economy.¹⁴

The perversion and lie are further compounded when interest is considered. Conventional endogenous money issuing from the banking system) bears interest and, very generally, interest doubles, or more than doubles, the cost of a capital project. Something which doubles the cost of a project cannot honestly be called something causing a 'growing from within' and something that hampers growing cannot honestly be claimed to be promoting growth.

6. All of The New Money Supply can be Directed at Productive Capacity

The perversion and lie, moreover, are seen to be outrageous when it is understood that a government, using the banking system and generally insisting on market and private property principles, can ensure that all of the supply of new money to an economy can go towards new productive capacity. In other words, by using what is summarised as Islamic endogenous loans, government can do what the banking sector claims to do, but does not.

The mechanism for the loans is simple. In the case of public capital projects (e.g., roads, bridges, hospitals, schools, waterworks, sewage works etc.), the national central bank (in Islam, Bete el Mar) lends interest-free money to the government for the purposes of the government's own capital expenditure. In due course, the lent money is repaid by the government to the central bank which can cancel the repaid money. No interest is involved, thereby halving at least the cost.¹⁵

¹⁴ Today, only a tiny percentage of the money supply goes into new productive capacity.

¹⁵ Interest-free loans for public capital projects have been used by the Channel Island of Guernsey over the years. Guernsey has minimal national debt. Malaysia is believed to be

In the case of the private sector, the central bank (Bete el Mar) lends interest-free money to the banking system which then lends it on to businesses on market principles including the ability to repay the money, and the existence of collateral. NB. In the case of large corporations, a key condition for the use of interest-free loans is that the investment is associated with the creation of new shareholders.¹⁶

The linkage of the money supply with the real economy (and at half the present cost) is something which can never be done by the banking system as it exists today, indeed, is incapable of even being understood by the present banking system. The linkage not only halves the cost of public capital projects but it is also important to note that the public projects can still be:–

built by the private sector

managed by the private sector

and even, for that matter, owned by the private sector.

And since the loans are repaid and cancelled, there can be no inflation.

7. Islamic Definitions of Endogenous and Exogenous Money

Thus it can be seen that Islam is able to give true definitions to endogenous money and exogenous money – definitions which are completely different from the present perverse conventional definitions. Completely unlike conventional economics, Islamic economics is able to define Islamic endogenous money as state-issued interest-free (repayable and cancellable) loans which are always directed at new productive capacity. The loans are capable of being administered by the banking system on market and private property principles.

And Islam is also able to define exogenous money as interest-bearing money either coming from abroad or created by the international banking system operating within a country.¹⁷ Such money, of course, if at all possible, is to be avoided.

8. Islamic Endogenous Loans Are Directed at the Real Economy and Cannot be Inflationary

experimenting with such loans and, of late, has achieved some remarkable feats of construction. Over the period 1939 - 1974 – a prosperous period – Canada used the loans and, today, many Canadian municipalities are demanding their use. In the USA, 3,400 governmental bodies (local boards, towns, cities etc) and six State governments support the idea – a Bill (HR 1452) reached Congress but was defeated by powerful vested interests. New Zealand has used such loans in the past.

¹⁶ Ashford and Shakespeare, (1999).

¹⁷ The usual conventional form of this money is that of interest-bearing loans which are not necessarily directed at productive capacity and furthering the needs of society; and which hand control of society either to a narrow elite or to outsiders.

Islamic endogenous loans combine efficiency with social and economic justice. Taking the form of state-issued, interest-free loans (administered by the private banking system) they are directly related to the real economy, made repayable and, when repaid, are cancelled or cancellable thus ensuring that productive assets always back a society's currency.

The cancellation of the money on its repayment ensures that there can be no inflation because a productive asset has been created and the money used to bring it into existence is eliminated. Indeed, Islamic endogenous loans create a counter-inflation i.e., more wealth and economic activity are created but with lowered prices.

9. Non-Interest Resource Mobilization for Public Capital Projects: the Use of Islamic Endogenous Loans

The first main use for Islamic endogenous loans is now easily seen – for public capital projects. Hospitals, roads, bridges, sewage works, waterworks, fire stations, schools and tsunami warning systems can be constructed for one half, or even one third of the present cost. Over time, the National Debt would reduce.

Moreover, the public capital projects can still, if wished, be built by the private sector, managed by the private sector, even owned by the private sector. The key point is that the cost, at the very least, is halved.

10. Other Uses of Islamic Endogenous Loans

There are, moreover, three other main uses for Islamic endogenous loans:–

Private capital investment in large corporations if such investment creates new owners of capital and is part of policy to enable all individuals, over time, on market principles, to become owners of substantial amounts of productive capital. By using state-issued interest-free loans, administered by the banking system on the market principles of binary economics,¹⁸ a large company/corporation would get cheap money as long as new shareholders are created.¹⁹

¹⁸ The main textbook on binary economics is *Binary Economics – the new paradigm*, by Ashford and Shakespeare (1999). The word 'paradigm' is important because without a new paradigm – a fundamentally new way of understanding reality – the present conventional paradigm of neoclassical 'free market' finance capitalism will continue to dominate. If the present paradigm is to be successfully challenged, the new paradigm must comprehend three key matters:– a new justice; a new monetary system; and a new understanding of how wealth is created.

¹⁹ The techniques for doing this are those of binary economics. 'Binary' means 'composed of two' and there are two factors in production – labour and capital. Thus there are also two ways of genuinely earning – either through owning your own labour and/or through owning capital. The main object of binary economics is to ensure that all individuals in the population have access to both ways of earning. All really does mean all – carers, retired,

Environmental capital investment, particularly for clean, renewable energy. At present, using interest-bearing loans, a lot of green technology is not financially viable. With interest-free loans, however, it would become viable. Thus we could have, for example, clean electricity generation through tidal barrages, dams, windmills, wave machines, solar electricity, and geothermal power stations. It is a shocking thing that clean, green electricity generation is not at present substantially in existence and thus the world could destroy itself through global warming all because of the insidious grip of usury.

Small and start-up businesses thereby freeing them from the crushing pressure of interest-bearing debt. There would be no requirement for wide ownership. However, there would still be a requirement for collateral as security against the possible loss of the loan and it might be desirable for eligibility for the loans to be confined to socially beneficial businesses. That said, the key point is that interest-free loans could be used for small businesses in exactly the same circumstances as today except that the small businesses would not be suffocated by interest payments.

Together with the use for public capital projects, these three uses – for private capital projects if wide ownership is involved; green capital investment; and small business – would back the currency with assets, break the grip of usury and, because they are directly related to productive capacity, would be counter-inflationary. They would, moreover, would implement a genuine free, fair and efficient market; throw off foreign and financial elite control, address social and economic justice through the spreading of wide capital ownership and its associated capital income; and give hope for the environment.

11. Islamic Endogenous Loans Implement Jean-Baptiste Says's Theorem (Often Called "Say's Law")

Neo-classical economics upholds Say's Theorem (often called "Say's Law"). The Theorem says that, in a market economy, the total market value of the wealth produced is equal to the total purchasing power created by the process of production and therefore that supply creates its own demand. The Theorem also requires that producers and consumers must be the same people.

sick, unemployed, women, children and men. Everybody, over time, on market principles, comes to own an increasing amount of productive capital paying out its full earnings. Binary economics gives a capital acquisition right, to every individual. Operating on market principles, using trust mechanisms, this right enables any individual to acquire efficient, income-generating capital assets. The assets pay for themselves out of their earnings and, thereafter, with full payout of earnings, provide capital income to the owners. See Binary Economics – the new paradigm, by Ashford and Shakespeare. See also the website of the Centre for Economic and Social Justice, Washington, D.C., USA, at www.cesj.org

But, at present, there is undoubtedly a huge potential supply which does not create its own demand. Moreover, producers and consumers are not the same people. That is to say, at present, Say's Theorem (Law) most certainly does not work in practise.

However, Islamic endogenous loans are capable of distributing future productive capacity, over time and on market principles, to everybody in the population thus ensuring that producers and consumers really are the same people. For the first time in history, the use of Islamic endogenous loans can ensure that Say's Theorem really does, in practise, become a true Law.

12. Benefits of Islamic Endogenous Loans

A supply of Islamic endogenous loans for both public and private sector (binary) projects is of immense importance because it is capable of ensuring, among other things:–

- economic and social justice²⁰
 - a great lessening of *ribā*/interest
 - a direct linking of new money to productive capacity
 - a widespread ownership of productive capital
 - an increase in political freedoms
 - an efficient wealth creation
 - a basic income for all inhabitants
 - policy to unite inhabitants who have different linguistic, religious, geographical and ethnic backgrounds
 - an ability of a society to control its own destiny as opposed to being ruled by outsiders and others
 - a new economic system which, by a proper use of interest-free loans, spreads productive capacity to all individuals in the population so that they produce (and thus earn) independently of whether or not they also have a conventional job.

13. Giving A Lead To The World

Islamic endogenous loans have huge beneficial potential. They will be central to ensuring that the Ummah becomes a new comity of proud, self-reliant societies giving a moral, intellectual and material lead to a world sorely in need of such a lead.²¹

²⁰ Shakespeare and Challen, Seven Steps to Justice (2002). See also the website www.globaljusticemovement.net

²¹ Choudhury (1997), (2004) points to the need for Islam to find a new, distinctive way

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forward. Choudhury leads the movement for an Islamic worldwide transformation using 100 per cent reserve, gold-backed endogenous loans directed at productive capacity and has made a series of publications on endogenous money and Islamic capital markets including *Islamic Economic Co-operation* (1989); *Economic Cooperation Among Islamic Countries* (1990); *Reforming the Muslim World* (1998); and *Islamic Money Against the Euro and Dollar* (1999).

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