In this first of the two-article series Patrick O’Neill critically evaluates the current financial system, arguing that the paper-based money is a primary reason for the financial crises that have affected different countries of the world in the past.

Patrick Mahdi O’Neill
Independent Financial Adviser

Patrick Mahdi O’Neill from Ireland is an Independent Financial Adviser specialising in Shari’a Wealth Management at Holborn Assets based in Dubai. In 2009, he played a pivotal role in establishing Simply Shari’a Ltd as a leader in the UK of Islamic financial planning solutions and investment portfolios. In addition to Business Studies & Japanese degree he holds the Chartered Insurance Institute (CII) Advanced Financial Planning Qualification and the Chartered Institute for Securities and Investment (CISI) Islamic Finance Qualification. Recently, he has started the Islamic Financial Education initiative; The aim is to educate and inform on the principles, benefits and ethics of financial planning from an Islamic perspective.
To fully appreciate the wisdom, beauty and justice of an Islamic based financial system we must first hold up a mirror to the current financial system which currently dominates across every corner of the globe and sphere of human financial interaction. In the West (at least for the last few centuries), religion (and its moral authority and guidance) has been completely divorced from financial and economic theory and practice. Therefore as soon as we start talking about Islamic finance or Shari’a compliant products we are inevitably taking the moral high ground.

To Muslims we can easily advocate an Islamic financial system and products on purely religious grounds. However, such arguments will not be listened to by non-Muslims. Indeed they may well ask “What’s wrong with our current financial system”? Or they might say “Surely if our current financial system was so bad, our democracies would have fixed it by now”. Also, for many Muslims their understanding of the rationale behind the religious injunctions will reinforce the practice of their financial lives in observance of the Shari’a. Muslims believe that an Islamic financial system will benefit all of humanity. Therefore, we should do our best to offer the best of arguments for an alternative to the current financial system which is in harmony with the Divine guidance.

It is interesting and practical to have this discussion in light of the recent financial crisis, i.e., the ‘Credit Crunch’. We live in a world dominated by financial weapons of mass destruction, one or maybe a few steps away from financial chaos and economic ruin. The world now is very interconnected and interdependent – a financial catastrophe in one corner of the globe can quickly ripple across the rest of the globe destroying all wealth and livelihoods caught in its path.

There have been many programmes, articles and books on the recent financial crisis attempting to explain how this financial disaster happened, the lessons learned and how to avoid such a terrible fate again. The fingers are usually pointed at the US sub-prime mortgages market coupled with the failings of regulators. However, neither can be blamed – they are merely symptoms of much deeper and structural flaws in the very fabric of our global financial system. It does not matter how much or how well the regulators oversee such a system – the DNA of our financial system is hardwired for instability and failure.

What are these financial weapons of mass destruction? The common bogeyman accused are financial derivatives. It is estimated that size of the global derivatives market stands at $1,200 trillion dollars - 20 times larger than the global economy!

Without doubt these are definitely a problem, but we need to dig deeper to get to the roots of the global financial system. In actual fact, you do not need to look too far – just look inside your wallet or your purse! The very money we use, the lifeblood of business, economic and financial transactions across the entire world is inherently unstable and fraudulent. Our money today has no intrinsic value, i.e., it is not backed by gold or silver or anything else of any value. This means money especially electronic money can be easily and artificially created. All of our wealth is measured using a monetary value. Money forms the medium of exchange for every transaction. Therefore whoever controls the process of creating money holds huge power over the wealth of nations and how that wealth is distributed. One might expect such huge power to lie in the hands of government. This is not the case - what the government prints and mints only forms a very small percentage of the money supply, typically 3%. The overwhelming amount of money supply is electronically created by banks by issuing of debts charged at interest. Under fractional reserve banking (FRB), banks only have to hold in reserve a small percentage of the deposits they receive. This allows the banking system to make loans at a very high multiple of their deposits, i.e., they are effectively allowed to lend money which they do not in reality actually possess!

A system which allows an elite few to wield huge power and amass great fortunes on the back of lending money created out of thin air at interest sounds incredibly unfair and unjust. In our modern, civilised and democratic society with its human rights values – can this be really true? See Box 1 for some interesting quotes on the subject.

William Paterson, founder of the Bank of England in 1694, then a privately owned bank

“The bank hath benefit of interest on all moneys which it creates out of nothing.”

Mayer Amschel Rothschild (1744-1812), founder of the House of Rothschild.

“Let me issue and control a nation’s money and I care not who writes the laws.”

The Rothschild brothers of London writing to associates in New York, 1863.

“The few who understand the system will either be so interested in its profits or be so dependent upon its favours that there will be no opposition from that class, while on the other hand, the great body of people, mentally incapable of comprehending the tremendous advantage that capital derives from the system, will bear its burdens without complaint, and perhaps without even suspecting that the system is inimical to their interests.”

Sir Josiah Stamp, Director of the Bank of England (appointed 1928). Reputed to be the 2nd wealthiest man in England at that time.

“Banking was conceived in iniquity and was born in sin. The bankers own the earth. Take it away from them, but leave them the power to create money, and with the flick of the pen they will create enough deposits to buy it back again. However, take it away from them, and all the great fortunes like mine will disappear and they ought to disappear, for this would be a happier and better world to live in. But, if you wish to remain the slaves of bankers and pay the cost of your own slavery, let them continue to create money.”

The banking establishment not only has huge economic power to enrich itself, it also has huge political power and control, effectively having a stranglehold over nations and their resources. Amidst the recent crisis, governments across the world were forced to bailout their banks, which meant taking on colossal debts in the name of its citizens. For example, the United States public debt increased from $6,369 trillion by the end of 2008 to $11,917 trillion by the end of July 2013. These debts and their interest will have to be paid by current and future generations of tax payers. The poorer in society will also suffer from both cuts in welfare benefits and increases in the basic costs of living. The latter is due to the ongoing corrosive effect of inflation as a result of the expansion of credit.

Unfortunately, the recent financial crisis was not a one off event, to be blamed on unforeseen and extraordinary events. See Box 2 for some of the crises faced by economies around the world.
What's wrong with the current Financial System

Our fiat currencies which are inextricably linked to FRB and the easy manufacture of interest, have not enjoyed a glorious past either. Since the 15th century there have been over 600 currencies no longer in circulation! Many destroyed by over issuance leading to hyperinflation. Even the mighty US dollar - the world’s “reserve” currency - has lost about 98% of its purchasing power since 1900. The current financial system is structurally unsound and inherently unstable. As surely as night follows day failures will follow in the future.

Next let’s take a look at some of the problems caused or made worse by the current financial system. The first and overriding consequence is inflation – over time periods there has been a continuous increase in prices as a result of the loss in value and purchasing power of fiat currency. This has an especially detrimental effect on the poor in society – their cost of living is steadily increasing whilst they possess little or no assets which benefit from inflation. For the wealthy, i.e., those who have assets, inflation is not a problem – their properties, their businesses, their stocks and shares, their land etc. will benefit from rising prices. So inflation effectively acts as a transfer of wealth from those without assets to those with assets. The property market is an example where this problem is acutely felt. In many parts of the world it is a huge struggle for young people to buy their own home – they are forced instead to rent for long periods.

Secondly, small business often struggle to get finance to grow and develop. Banks favour the wealthy, both individuals and large companies. This is because they have collateral. Bank lending is already a highly leveraged and high risk business. They are not necessarily interested in profitable or productive ventures – they need to guarantee their returns. Hence their primary concern is the debtor’s ability to repay the principal borrowed and interest. Therefore the well off and big companies which can offer collateral find it much easier to borrow to acquire ever more assets. As already mentioned, there has been a massive increase in sovereign debt to bailout the banks - effectively a transfer of income from current and future taxpayers to banks! In the case of the US alone that has been estimated by Bloomberg at an astounding 59.7 trillion!

Related to the last and other points, the financial system represents an attack on democracy and freedom. Obviously tax payers and citizens were not invited to vote on approving bank bailout packages in their respective countries. Big finance and big business have always sought to control political power. This has been recognised and acknowledged by figures of power and authority in the past. For example, Pope Pius XI wrote in his Encyclical Letter Quadragesimo Anno, in 1931:

“[T]hose who, because they hold and control money, are able also to govern credit and determine its allotment, for that reason supplying, so to speak, the lifeblood to the entire economic body, and grasping, as it were, in their hands the very soul of production, so that no one dare breathe against their will.”

Similarly, US President Theodore Roosevelt said on April 19, 1906:

19th Century

- Panic of 1796-1797 - Britain and United States
- Danish state bankruptcy of 1813
- Post-Napoleonic depression (post 1815)
- Panic of 1819, a U.S. recession with bank failures; culmination of U.S’s first boom-to-bust economic cycle
- Panic of 1825, a pervasive British recession in which many banks failed, nearly including the Bank of England
- Panic of 1837, a U.S. recession with bank failures, followed by a 5-year depression
- Panic of 1847, started as a collapse of British financial markets associated with the end of the 1840s railway industry boom
- Panic of 1857, a U.S. recession with bank failures
- Panic of 1866, was an international financial downturn that accompanied the failure of Overend, Gurney and Company in London
- Long Depression (1873–1896)
- Panic of 1873, a US recession with bank failures, followed by a four-year depression
- Panic of 1884, the investment firm Grant & Ward, Marine Bank of New York, and Penn Bank of Pittsburgh along with more than 10,000 small firms failed
- Panic of 1890, near insolvency of Barings Bank in London
- Panic of 1893, a US recession with bank failures
- Australian banking crisis of 1893
- Panic of 1896 an acute economic depression in the United States precipitated by a drop in silver reserves

20th Century

- Panic of 1901, a U.S. economic recession that started a fight for financial control of the Northern Pacific Railway
- Panic of 1907, a U.S. economic recession with bank failures
- Wall Street Crash of 1929 and Great Depression (1929–1939) the worst depression of modern history
- OPEC oil price shock (1973)
- Secondary banking crisis of 1973–1975 in the UK
- Bank stock crisis (Israel 1983)
- Black Monday (1987)
- Savings and loan crisis of the 1980s and 1990s in the U.S.
- 1991 India economic crisis
- Finnish banking crisis (1990s)
- Swedish banking crisis (1990s)
- 1994 economic crisis in Mexico
- 1997 Asian financial crisis
- 1998 Russian financial crisis

21st Century

- Late-2000s Financial Crisis or the Late-2000s recession, including:
  - 2000s energy crisis
  - Sub-prime mortgage crisis
  - United States housing bubble and United States housing market correction
  - 2008–2012 Icelandic financial crisis
  - 2008–2010 Irish banking crisis
  - Russian financial crisis of 2008–2009
  - Automotive industry crisis of 2008–2010
  - European sovereign debt crisis

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“Behind the ostensible government sits enthroned an invisible government owing no allegiance and acknowledging no responsibility to the people. To destroy this invisible government, to befoul the unholy alliance between corrupt business and corrupt politics is the first task of the statesmanship of the day.”

Easy credit tempts people to spend beyond their means and create future financial trouble for themselves and their families. However there are also many people who fall on hard times that are then forced to resort to high interest credit cards and payday loans just to provide the basic necessities for their families. The effect of spiralling high debt and out of control interest repayments causes huge problems to society, leading to stress, mental health problems, family break ups and so on. Studies in the UK have shown the detrimental effect on children in such situations. The Debt Trap Report from Step Change Debt Charity findings include:

- 5.3 million families in the UK suffering from problem debts or struggling to keep up with repayments.
- Nine out of ten families in problem debt say they have had to cut back on essentials like food, clothing or heating for their children in order to keep up repayments.
- Children are at increased risk from bullying, worry, family arguments and going hungry or cold.

The Mental Health Foundation (UK) has shown 86% of those suffering from debt stress experience moderate or severe mental health issues. Studies in the US (August 2013 issue of Social Science and Medicine) have linked debt levels to increases in blood pressure associated with a 17 percent higher risk of hypertension and a 15 percent higher risk of stroke.

Some of the poorest countries in the world are also the most indebted. These are indebted by the International Monetary Fund (IMF) and World Bank who then impose harsh Structural Adjustment Programmes (SAP). Economies are opened up rapidly, in socially, politically, environmentally and economically destructive ways. Prioritisation on debt repayment results in cut backs on health, education and other critical services. Another undesirable effect is “industrial agriculture,” i.e., countries are forced to concentrate on cash crops to meet their debt obligations. This in turn reduces biodiversity and damages the environment.

The SAP problems have been highlighted by many economists and social scientists. For example, Ross Bukley writes in one of the frequent quoted journal articles of him:

“According to UNICEF, over 500,000 children under the age of five died each year in Africa and Latin America in the late 1980s as a direct result of the debt crisis and its management under the International Monetary Fund’s structural adjustment programs. These programs required the abolition of price supports on essential food-stuffs, steep reductions in spending on health, education, and other social services, and increases in taxes. The debt crisis has never been resolved for much of sub-Saharan Africa. Extrapolating from the UNICEF data, as many as 5,000,000 children and vulnerable adults may have lost their lives in this blighted continent as a result of the debt crunch.”(*)

Other countries are forced into natural resource stripping resulting in huge environmental degradation. For example, Brazil is cutting down huge swathes of its Amazon rain-forest every year to help meet its international debt obligations. Deforestation in Nepal and Bangladesh is increasingly resulting in devastating floods.

Unfortunately war, big business and finance are inextricably linked. Wars are huge endeavours and very costly to finance. The elite banking establishment makes huge profits from financing them. This is confirmed by US Secretary of State, William Jennings Bryan who stated, “The large banking interests were deeply interested in the world war because of the wide opportunities for large profits.”

Smedley Butler (1881 - 1940) was a United States Marine Corps major general, the highest rank authorised at that time, and at the time of his death the most decorated Marine in US history. He wrote:

“I spent 33 years and four months in active military service and during that period I spent most of my time as a high class muscle man for Big Business, for Wall Street and the bankers. In short, I was a racketeer, a gangster for capitalism. I helped make Mexico and especially Tampico safe for American oil interests in 1914. I helped make Haiti and Cuba a decent place for the National City Bank boys to collect revenues in. I helped in the raping of half a dozen Central American republics for the benefit of Wall Street. I helped purify Nicaragua for the International Banking House of Brown Brothers in 1902–1912. I brought light to the Dominican Republic for the American sugar interests in 1916. I helped make Honduras right for the American fruit companies in 1903. In China in 1927 I helped see to it that Standard Oil went on its way unmolested.”

But perhaps the single most destructive aspect of our financial system is the resultant gross inequality of global wealth and income distribution. The following facts must illustrate the point:

- Almost half the world, over 3 billion people live on less than $2.50 a day.
- 1.6 billion people, a quarter of humanity live without electricity.
- The 10 richest men in the world have more wealth than the 48 poorest countries.
- The GDP of the 41 Heavily Indebted Poor Countries (567 million people) is less than the wealth of the world’s 7 richest people combined.
- In 2005, the wealthiest 20% of the world accounted for 76.6% of total private consumption; the poorest fifth just 1.9%.
- 0.13% of the world’s population controlled 25% of the world’s financial assets in 2004.
- For every $1 in aid a developing country receives, over $25 is spent on debt repayment.
- The wealthiest nation on Earth has the widest gap between rich and poor of any industrialised nation.
- According to UNICEF, 22,000 children die each day due to poverty.
- The poorest 40 percent of the world’s population accounts for 5 percent of global income. The richest 20 percent accounts for three-quarters of world income.

These and other grim global poverty statistics can be found at www.globaltrends.org (article 1). The poorest in our society are living in a perpetual financial crisis. In the words of Mahatma Gandhi, “There’s enough on this planet for everyone’s needs but not for everyone’s greed”.

However, not everyone is sleepwalking and unaware of the injustices of the global financial system. Some prominent and distinguished figures throughout history have said about different aspects of the global financial system. See Box 3 for what some of the influential writers and politicians have said in this respect.

Norm Franz in his Money and Wealth in the New Millennium

“Gold is the money of kings, silver is the money of gentlemen, barter is the money of peasants...”

“I believe that banking institutions are more dangerous to our liberties than standing armies.”

“If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks…will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered…. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs.”

“…The modern theory of the perpetuation of debt has drenched the earth with blood, and crushed its inhabitants under burdens ever accumulating.”

“The Government should create, issue, and circulate all the currency and credits needed to satisfy the spending power of the Government and the buying power of consumers. By the adoption of these principles, the taxpayers will be saved immense sums of interest. Money will cease to be master and become the servant of humanity.”

On 5 March 1997, in a speech in the House of Lords in London, the Malcolm Ian Sinclair, 20th Earl of Caithness, a British Conservative politician and member of the House of Lords

“...it is also a good time to stand back, to reassess whether our economy is soundly based. I would contest that it is not for the reason to which the noble Lord, Lord Eatwell, alluded, which is that it is the Government’s fault, but our whole monetary system is utterly dishonest, as it is debt-based. “Dishonest” is a strong word, but a system which by its very actions causes the value of money to decrease is dishonest and has within it its own seeds of destruction.”

President of Nigeria Obasanjo at the G8 summit in Okinawa in 2000

“All that we had borrowed up to 1985 or 1986 was around $5 billion and we have paid about $16 billion yet we are still being told that we owe about $28 billion. That $28 billion came about because of the injustice in the foreign creditors’ interest rates. If you ask me what is the worst thing in the world, I will say it is compound interest.”

Jörg Guido Hülsmann, Professor of Economics at the University of Angers in France in his Ethics of Money Production - 2008

“There is no tenable economic, legal, moral, or spiritual rationale that could be adduced in justification of paper money and fractional-reserve banking. The prevailing ways of money production, relying as they do on a panoply of legal privileges, are alien elements in the capitalist [i.e., true free market] economy. They provide illicit incomes, encourage irresponsibility and dependence, stimulate the artificial centralization of political and economic decision-making, and constantly create fundamental disequilibria that threaten the life and welfare of millions of people. In short, paper money and fractional-reserve banking go a long way toward accounting for the excesses for which the capitalist economy is widely chided.

We have argued that these monetary institutions have not come into existence out of any economic necessity. They have been created because they allow an alliance of politicians and bankers to enrich themselves at the expense of all other strata of society. This alliance emerged rather spontaneously in the seventeenth century; it developed in multifarious ways up to the present day, and in the course of its development it created the current monetary institutions.

…The driving force that propelled the development of central banks and paper money was the reckless determination of governments, both aristocratic and democratic, to increase their revenue, if necessary in violation of good faith and of all established rules of commerce.”

Antal E. Fekete, Professor of Mathematics and Statistics at Memorial University

“The world economy, sagging as it is under the weight of its debt tower and fast depreciating irredeemable currencies, is clearly on its way to self-destruction…... Unless we stop the proliferation of debt, the world is facing prolonged deflation, depression, continuing capital destruction, bankruptcies and unprecedented unemployment. It is leading to a breakdown of law and order. It could spell the end of our civilization.”


“It is actually not in the least surprising that nations are chronically in debt, governments have inadequate resources, public services are under-funded and people are beset by mortgages and overdrafts. The reason for all this monetary scarcity and insolvency is that the financial system used by all national economies worldwide is actually founded upon debt. To be direct and precise, modern money is created in parallel with debt…...

The outrageous financial debt which Third World countries have actually paid many times over, but which, due to interest, is now larger than ever before - a debt which forces those impoverished nations to compete to supply goods already in surplus....

If a monetary system is invalid or flawed, then the entire economy is based on the mathematics of error......

Returning to the recent financial crisis, many would argue if the governments across the world did not step in by incurring vast debts to bailout the banks, the whole financial system would have collapsed tearing apart the economic fabric of the world. The resultant financial chaos and destruction from widespread worldwide banking failures would have caused huge levels of corporate and personal bankruptcies, surge in unemployment, asset prices and investments plummeting i.e. another Great Depression resulting in financial misery for all. I do not deny this – if governments had not stepped in, the outcome would have been financial catastrophe on an unprecedented scale. And herein lies the problem. Akin to a drug addict who needs his fix to feel good, the global financial system can only survive on increasing debt levels. The problem is too much debt, but the only solution is more debt to pay the previous debt and compound interest. This cannot continue indefinitely. Can an interest based system be regulated enough, reformed or modified to the betterment of mankind? Unfortunately, the analogy that comes to mind is that of a malignant cancer – if you could speak to it and tell it to stop growing, otherwise it will destroy its host body and ensure its own destruction – will it stop?

In summary the 3 key overriding features of the current financial system are fiat money, fractional reserve banking (FRB) and interest based debt. These combine to create a financial and economic cocktail of instability, injustice, world poverty and environmental degradation. Greed, not charity is the hallmark of current financial system. In a saying of the Prophet Muhammad (Peace be upon him):

“If a son of Adam were to own a valley full of gold, he would desire to have two......” Surely, there has got to be better way. In the second part of this series we look at a financial and economic system based on the tenets of Islam.