

ON THE FINANCIAL AND MORAL SUPERIORITY OF ISLAMIC FINANCE

MUGHEES SHAUKAT

Head of Islamic Finance in the College of Banking & Financial Studies, under Central Bank of Oman,
Muscat, Oman and Research Scholar, in Islamic finance, INCEIF, Kuala Lumpur, Malaysia

ABSTRACT

Evidence has been mounting that the interest-based debt financing regime is under increasing stress. The financial sector has assumed an independent identity delinking itself from the real sector. As a result, the system has become increasingly fragile and there is an unprecedented increase in the risks to global economy. This appears to be a demonstration of the validity of verses 275-276 of chapter 2 of Quran as it can be argued that this is the result of the existence of an *ex-ante* fixed rate of return in the form of ‘interest’; turning debts into unmanageable and unsustainable super cycles. Empirical research suggests that the average debt-to-GDP ratio of the richest members of the G-20 will reach 120% mark by 2014 while by 2020 the U.S. and other major European centers would amass a ratio of at least 150%, with Japan and U.K. going to 300% and 200% respectively. Even more alarming is the projected interest rate path on their debts which would increase from 5% to 10% of GDP in all cases, and as high as 27% in U.K (BIS, 2010). It is difficult to see how this massive debt can be validated by the underlying productive capacity of the global economy, particularly when the state of global economic growth is anemic at best. The unprecedented levels of debt are creating debilitating fears of contagion and the possibility of an even bigger crisis (IMF, 2012). As a result, there is increasing uncertainty surrounding the survival of the system. Thus far the search for ways and means of reducing the instability of the system has focused only on improving regulatory/supervisory structure of financial system. Much less effort has been devoted to find a more suitable financing regime. The paper argues that Islamic finance, with its core characteristic of *interest-free risk sharing based financing*, may well serve better the global economic needs. Enshrined on the divine rules of Quran and Sunnah, the Islamic financial system is supported by a complimentary institutional framework that assures the financial as well as moral superiority. Before explaining ‘risk sharing’ based Islamic finance as a more reliant financing mechanism, it is important to first gain a brief understanding of the Islamic approach towards money and finance. Section two will provide, a succinct understanding of the Islamic position in distinguishing between capital, money, profit, and interest. Section three explains Islamic finance as a risk sharing and a rule based system and discusses the implications of the rules based mechanics that necessarily renders it more stable and superior. Section four establishes Islamic finance as a two tiered system based on a 100 percent reserve depository and safe keeping banking system and an equity based risk-sharing investment banking. Section five concludes the study.

KEYWORDS: Financial and Moral Superiority