The Problem With Interest - Tarek El Diwany

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ABOUT THIS BOOK
The Problem With Interest is now in its second edition. Since the publication of the first edition in 1997, the book has been revised with new information and ideas, and continues to provide a practical commentary on the extent to which usury is now affecting humanity. Technically detailed but highly readable, it provides a genuine alternative to the conventional understanding of financial economics that appears in much of the media and mainstream academia.

ABOUT THE AUTHOR
Tarek El Diwany was born in London in 1963. He graduated in Accounting and Finance from Lancaster University in the United Kingdom in 1985. Tarek has worked as an interest rate derivatives dealer in the government bond market, and as head of Islamic finance for a major financial institution based in London. In 1997, he completed the first edition of The Problem With Interest, and in the same year launched www.islamic-finance.com, where he is now the Editor. In addition to his work as a writer, Tarek is a partner at Zest Advisory LLP, a London-based firm providing consulting services in Islamic banking and finance, and is a frequent speaker on the topic of Islamic banking at conferences throughout the world. He can be contacted by e-mail on tarek@zestadvisory.com.

CHAPTER HIGHLIGHTS

Chapter 1 Interest and the Physical System
Entropy is a word that is used to describe the amount of disorder in a physical system. A feature of the world around us is that physical systems decay, in other words that they experience increasing entropy. Fruit rots and buildings become dilapidated, unless energy is expended in order to maintain them. Left to itself, the physical world follows the path of compound decrement towards, but never quite reaching, zero. Meanwhile, loans at interest are often structured so as to follow the path of compound increment towards infinity. This chapter contrasts interest and entropy and highlights the contradiction between the laws of interest and the laws of nature. It is proposed that ‘short-termism’, pollution and resource depletion can be encouraged by the use of interest in the financing of industry.

Chapter 2 The Production of Money
In this chapter, two forms of money are identified. One is the money produced by the modern state in the form of notes and coins, the other is the money that is produced by commercial banks. The technique of fractional reserve banking, whereby banks create money, is examined and the history of its development described. Banking is seen as an industry and money as its product. The consequences of allowing private firms the authority to manufacture money and lend it at interest are analysed.

Chapter 3 The Currency Game
A review of the modern foreign currency market is given, focusing upon the means whereby central banks seek to control it. The impact upon economic activity of these various attempts at control is described, with reference to the international gold standard era and the Bretton Woods agreement. Precious metals are proposed as being a better foundation than state and bank money for a monetary system. Conventional bankers and economists often blame the gold standard for economic failures of the past. In fact, these failures resulted from the practice of fractional reserve banking.

Chapter 4 Wealth Creation and Wealth Transfer
Gambling on a roulette wheel employs resources and people, and so does farming. But whilst farmers produce the food that allows man to live, casinos simply transfer wealth from losers to winners. It is because wealth rots that new wealth must constantly be produced in order to replace portions of the old stock of wealth that have suffered from decay. If mankind were to engage solely in wealth transfer processes, the stock of wealth could not be maintained let alone increased. Wealth creation is therefore fundamental to the survival of mankind. Mechanisms of wealth transfer are examined, in particular the parts played by collateral and leverage. It is proposed that these various mechanisms conspire to promote speculative booms, which in turn can have a dangerous impact upon the allocation of resources.

**Chapter 5 Value Judgements**

In this chapter, the normative and positive approach to economics is reviewed. Positive economics tries to be free of value judgements but is not. Normative economics deliberately highlights its value judgements and makes them central to its discussions. The most essential question that must be asked is “where do our value judgements come from?” Revealed knowledge is contrasted with deductive knowledge. It is proposed that economic activity cannot be based solely upon the foundation of materialism. The value judgements of Islamic economics are introduced and their implications for a variety of economic policies are discussed.

**Chapter 6 Trade or Interest?**

Here, the Islamic approach to trade and finance is introduced. The prohibition on usury is discussed and the concepts of gharar and maisir outlined. The various forms of Islamic contract that are of particular relevance to economics are summarised and categorised under contracts of exchange, contracts of charity and contracts of investment. The manner in which these contracts are applied in the modern world of Islamic finance is reviewed and criticised. Particular attention is given to a comparison of murabahah and interest. A description follows of the way in which Islamic contract laws might operate so as to prevent some of the economic evils described in the preceding chapters.

**Chapter 7 Banking and Money under Islam**

An Islamic banking structure is outlined here. The system relies upon profit-sharing and the eradication of fractional reserve banking. It allows investment and other financial activities to continue in line with the demands of both modern life and the principles of Islam. ‘Monetary policy’ becomes redundant under this approach. The chapter concludes with a brief discussion of money in Islam and it is proposed that Islamic banking, in conjunction with a precious metal currency standard, would form the basis of a fair and stable wealth creating economy.