History of Islam

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The Rise of the Global Credit Economy

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Civilization moves in epochs. In each epoch, the rules of competition are different. What drives the global civilization today is economic centralization, and the aristocrats of this drive are the bankers. The merchant, the industrialist, the soldier, the teacher and the *mullah* are all beholden to the banker, and more specifically, to the global credit system.

There is a great deal written about interest and usury by Muslim scholars. It is a complex issue and continues to be the subject of much controversy. There is always the risk of oversimplification because modern banks discharge a variety of services and cannot be lumped into one category. Nonetheless, in the caldron of global ideas, the Muslim point of view about usury must be put forth as clearly as possible so that one may evaluate it on its merits. Islam maintains that usury is debilitating to civilization. It saps the strength of individuals and nations, encourages greed, and discourages trade. It works in the direction of economic centralization, makes the rich richer and the poor poorer, creates instability in the society and ultimately destroys it. ("Those who devour usury will not stand except as stands one whom Satan by his touch has driven to madness", Qur'an, 2:275-276). Another way to state the Islamic position is that zero interest is the best guarantor of sustained economic growth. Islam is not the only religion that looks askance at usury. The Christian church also frowned upon usury in medieval times.

Interest and usury are not new to the modern age. They have been practiced in practically every civilization from times immemorial. In India, the village moneylender has been known for ages. The function of these intermediaries in the cycle of trade and commerce was well understood and accepted. In the village milieu, the moneylender provided liquidity to the poor farmers who offered gold and silver jewelry as collateral. A discount rate was agreed upon between the lender and the borrower. Since the borrower was usually in dire need of cash, the discount rate was exorbitant, sometimes as high as 8% *per month*. More often than not, the farmer was unable to pay the interest, and lost his jewelry to the lender within a year. The difference in the value of the jewelry and the original amount lent was the "profit" made by the lender. This "profit" was about one hundred per cent per year!

In the Byzantine world, where trade routes from many nations crossed, moneychangers were active in the temples down to the times of Jesus. Their primary function was to buy and sell currencies from the various kingdoms depending on the amount of precious metal in the currency. A discount was applied to the transactions. The moneychanger also provided cash at interest to merchants against the collateral of their goods. If the merchant was successful, he paid back the loan; if he was not, he forfeited his goods to the moneylender.

From the perspective of Islamic history, an understanding of the role of interest takes on importance because the economic institutions that grew up in Europe in the 18th and 19th centuries accumulated further clout in the 20th century, and came to dominate the globe. The issue transcends the Islamic world, and affects it only because it is now a part of a global community of poorer nations. Whether it is coffee, coconut, spices or oil, the international banks have a major influence on the economic sinews of the world. Interest payments are a major factor in the enormous flow of capital from the poorer countries of the world to the richer nations. In our own times, between the years 1980 and 1990, no less than 1.3 trillion U.S. dollars were transferred from the poorer countries to the richer countries. The interest economy rules the world, and whether the *mullah* or the alim likes it or not, he is a part of it.

The rise in the power of commercial banks in the 18th century was directly related to the Industrial Revolution in England. It was a convergence of several historical events that transformed England from a mercantile society to an industrial society and finally led to the triumph of the bankers. The arrival of fresh capital from Calcutta and Oudh (1757-1767) enhanced the substantial wealth that was flowing in from the Atlantic slave trade, and enabled the funding of innovative ideas. Inventions need capital to see the light of day. Without it, they wither and die. The first thrust of British innovation was the replacement of cotton goods from India. The spinning jenny went through rapid modifications and was "perfected" in 1767 by Hargraves. The colonization of Bengal provided a large captive market of thirty million consumers. The British East India Company slopped on a hefty 70% duty on Indian made goods while opening the floodgates to imports from England. British cotton goods inundated the Indian market, displacing the traditional products of Bengal.

The use of coal and the invention of the steam engine speeded up mechanization. Economies of scale dictated that large farms were more efficient than small ones. The small farmers lost out in the economic competition and moved to the cities in hordes where they became maids, butlers and laborers manning the engines of the industrial revolution. Consolidation of capital intensified. Investment increased, industrial production rose driven by demand from the colonies, profits shot up and merchant entrepreneurs transformed themselves into industrialists.

Behind this profound transformation was a change in the social paradigm. The Battle of Plassey (1757) demonstrated that the age of soldier-kings was over. From times immemorial, the merchant had depended for his protection on the soldier. After the Battle of Plassey, the tables turned and the soldier was to be a servant of the merchant and his hired hand. Civilizational initiative passed from the soldier to the merchant. Robert Clive, the shrewd merchant, had outfoxed Siraj ad Dawlah, the soldier-king. Henceforth, money and manipulation would triumph over the sword, and the genius of the age would turn its attention to the accumulation of wealth, not the conquest of territory.

The British rapidly consolidated their hold on the Indian subcontinent after the Battle of Plassey. Tippu Sultan and his father Hyder Ali resisted the British for more than 40 years. But from a global perspective, it was only a rearguard action. The tide of power had inexorably turned in favor of Europe. Tippu fell in 1799 at the Battle of Srirangapatam, the same year that Napoleon occupied Egypt. By the year 1806, the Moghul court in India was all but a vassal of the East India Company. Tippu was the last soldier-king in Asia. He fell, defeated by merchants or their mercenaries, whose principal weapons were money, bluff, and duplicity, which were often packaged as diplomacy.

The wealth of Bengal did not stay in the hands of English entrepreneurs for long. Within a span of 50 years, the keys to the treasuries of capitalist England passed from the merchants to the bankers. This transformation was so profound that it affected not just Europe but the entire globe.

The Industrial Revolution and the acceleration of international trade required an increase in monetary liquidity. The value of a currency was determined by its gold or silver content. In the halcyon pre-industrial age, an international merchant, upon completion of his sale, would deposit his money in local currency with a banker and receive from him a note. Upon returning to his own country, the merchant would cash in his note from an agent of the banker. For his service, the banker charged a discount. Such banks were well established in the principal cities of Europe, in London, Antwerp, Paris, Florence, Venice and Genoa. Since currency was based on gold and silver, an increase in the amount of currency in circulation required an increase in the supply of the precious metals. The availability of gold and silver thus put a limit on monetary liquidity, and hence on the amount of trade.

New mechanisms were therefore devised to reduce the liquidity crunch and to enhance trade. The bankers had found from their experience that their depositors required only a portion of their deposits for their current use. The difference between deposits and withdrawals was available to be loaned to customers on a short-term basis. A banker could thus lend out a sum larger than the amount of deposits and earn interest on it. This was the origin of the credit system in England. The assumption in these transactions was that the depositors would not cash in their deposits all at the same time. If they did, the bank would be unable to pay them, and would go under.

Historically, the credit system was not a new invention. In the year 1280, Kublai Khan of China minted leather coins to increase liquidity and enhance trade. In 1335, Emperor Muhammed bin Tughlaq did the same in India. We know from the accounts of the Tughlaq dynasty that the Delhi experiment was a failure because the Indians, Hindus and Muslims alike, sabotaged the effort by minting bogus coins and flooding the market. The Emperor had to abandon his innovative idea and redeem the leather currency at enormous expense to the royal treasury.

The leverage on capital that the credit system provided the bankers was not popular with everyone. Not only could the banker lend out money that he did not own; he charged interest on it. One could see that it enabled the bankers to increase their wealth in relation to the merchants. The payments that were made to retire the credit came back to the banks as additional deposits. The process worked in the direction of economic centralization, with money gravitating towards the banks. Political battles were fought between the merchants and the bankers on the issue of whether credit instruments should have legal recognition. History was on the side of the bankers and provided them with plenty of opportunities to win their case.

The wars between Britain and France, fought on and off between 1689 and 1815 for control of trade routes, were enormously costly. England was broke and approached the bankers for financing. In 1694, by mutual agreement, the Bank of England agreed to offer a perpetual loan of 1.2 million pounds at 8% interest to the British Crown, in return for certain privileges. These included the authority to handle public lotteries, accept deposits, discount bills, and most important, put its own notes into circulation.

This was the first recognition of the negotiability of credit. In effect it meant that the Bank could create money, a privilege that had hitherto resided only with the kings.

Monetary policy passed on to the bankers who could either fuel an expansion by increasing the supply of money and easing credit, or cause a contraction by withholding credit. *This was a fundamental paradigm shift*. From times immemorial, one of the essential privileges of a sovereign soldier-king was his authority to mint coins. This privilege now passed on to the bankers, although they printed money in the name of their sovereign. While the expansion of credit encouraged spending and expanded trade, this very action could fuel inflation. Conversely, the withholding of credit, and a tightening of the money supply, made it difficult for debtors to make payments on their debt, and they were forced to sell their assets at a discount to meet their debt obligations. In addition, as long as the standard of currency was gold, the bank could demand payment in gold whose supply was affected by war and was subject to monetary manipulation by the bankers themselves.

This is what opens up banking to charges of exploitation. The merchant makes his money when the value of his goods relative to the money he has borrowed goes up over time. The usurer, on the other hand, makes his money when the value of the credit he has advanced goes up in relation to the goods that are held in mortgage. Thus it is in the usurer's interest to ensure that your property is worth less tomorrow than it is today so that he can get more of it when payment is due.

A credit advance of 1.2 million pounds in 1694 did not solve the cash requirements of the British throne. The protracted struggle with France for control of trade routes in India and America required enormous funds. England tried increased taxation and lost the American colonies in the process (1776-1783). The French revolution (1789) and the Napoleonic wars (1797-1810) were enormously expensive and financially exhausted the nations of Europe. The countries of Europe borrowed heavily from the bankers who were more than willing to fund the wars with cheap credit thanks to the gold from India and the silver from the Americas. The system worked to the advantage of the bankers.

By 1810, the merchants, the landowners, the producers and the governments were all beholden to the bankers and at their mercy. But when the Mexican War of Independence erupted (1810-1813), the flow of American silver suffered a disruption, a scarcity of precious metals developed, and there was a credit crunch in Europe. The bankers demanded payment in precious metal, which was in short supply. Panic set in and individuals as well as nations were brought to their knees.

The merchants and the old landed aristocracy put up a fight against the gold standard. But the legislative battles in the English Parliament were finally won by the bankers with the Bank Act of 1846, which conferred legal recognition on the negotiability of credit documents.

For more than a century, until 1972, when the United States abandoned the gold standard, those who controlled the gold, controlled the monetary veins of the world. The concentration of wealth with a few bankers increased. The banks literally controlled the jugular veins of the economy. In principle, the process worked like this: First, easy credit enticed borrowers who received advances against collateral goods and real property. But when credit was tightened, liquidity suffered, and there was insufficient currency to make payments on debts. The debtors dropped prices on their properties, so that they could sell their real assets and continue to make debt payments. The economy thus moved in boom-bust cycles, in which each bust cycle devoured the fruits of human labor and created additional poverty. Major contractions in the British economy were recorded in 1815, 1825, 1847, 1857, 1866, 1893 and 1929. The last one caused a global depression and was a contributory cause for the Second World War.

The disengagement of the world monetary system from the gold standard did not change the fundamental relationship between creditor and debtor. Whether the standard is gold, the American dollar, the British Pound or the Japanese Yen, the process remains unchanged. Credit, with interest, works to the advantage of the lender in favor of economic centralization. The rich keep getting richer, while the poor sink deeper into poverty. Critics may suggest this position as too simplistic inasmuch as governments can and do tax concentrations of wealth. But taxation mitigates the concentration of wealth; it does not eliminate it. In addition, as Ibn Khaldun pointed out more than six hundred years ago, taxation is regressive; it dampens initiative. Excessive taxation kills the economy; it brings down dynasties and empires. By contrast, interest and credit continue to favor the creditor at the expense of the debtor.

What is true for individuals and nations is also true at the international level. Bereft of capital, the emerging countries of the world turned to international bankers for loans after the Second World War. The credit system increased the span of control of the international bankers over the entire globe. New mechanisms of international credit were created through the World Bank and the International Monetary Fund. Loans were offered against the natural wealth of the borrower nations (commodities such coffee, jute, oil, bananas, spices) as collateral. Commodity prices fluctuate in response to natural causes, war, pestilence, man-made disasters or political manipulation. Should commodity prices go down, the borrower nations couldn't make payments on their debt. The result is the same should the bankers tighten credit. To encourage their exports, and earn foreign currency, the debtor nations drop the prices of their export goods. The richer nations move in and acquire more of the poor nation's resources at bargain prices. To continue debt financing, the bankers often force the poorer nations to devalue their currencies and accept international oversight of their economies. The cycle continues. The poorer nations keep getting poorer while economic centralization proceeds at the global level. The case history of the Suez Canal and its takeover by international banking interests (1856-1876) illustrates this observation.

The issue of credit and interest is a major element in the continuing negotiation between the civilization of Islam and the global economic system. Indeed, it is a major item of negotiation between the richer and poorer nations of the world. The issues are complex and require a deep understanding of the inter-relationship between economics, finance, commodities, employment, trade, legal and political frameworks governing the world. Suffices it to emphasize here that in the contemporary dialectic between the civilizations of the world, the credit economy is perhaps the single most important issue for negotiations. It requires sagacity and wisdom to negotiate this ocean.

Based upon a lecture given by Dr. Nazeer Ahmed as legislator in Bangalore, India in April 1978. Submitted, with modifications and added citations, to the Encyclopedia of Islamic History on March 1, 1995 and published in the Minaret Magazine, New York, NY.

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