

# A CLIMATE OF CHANGE

## Four Initiatives Islamic Finance Must Undertake to Keep Itself Relevant in Changing Times

*An invasion of armies can be resisted, but not an idea whose time has come. (Victor Hugo)*

The coming years — faced with a confluence of factors ranging from climate change and peak oil to currency crisis and food and water shortage — offer an unprecedented opportunity for Islamic finance to rise to the occasion.

To do so, we respectfully call upon governments, regulators, and the scholars of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), to develop standards, products, and human capital to undertake four major initiatives:

- 1) Launch a gold-based currency
- 2) Develop Shariah standards for the environment
- 3) Support community-based finance
- 4) Regulate Shariah standards

But first, it is worth stepping back to assess the gravity of the problem before we consider the urgency of the response.

According to a growing number of climate scientists, in the next few decades — within the lifetimes of many of us and certainly those of our children — the world will undergo major upheaval, with widespread food and water shortage, energy insecurity, mass migration, and unprecedented weather patterns. All things we already see to varying degrees in different parts of the world. But today is just the harbinger. Many scientists, among whom “The Revenge of Gaia” author James Lovelock is most



notable, now predict that as many as 80% of the world's population will perish amid the cataclysms of the 21st century.

The consequence of global heating in our own lives will not be felt so much in the discomfort of extreme heat during summers or, as for some in coastal areas, rising sea levels, but in the extreme shortage of food, water, and energy, now already being felt across the developing world. While these may seem extreme predictions, a growing body of data shows that successive intergovernmental forecasts about the impact of carbon emissions on climate change fall far short of observable reality.

While the evidence has been around for some decades, with most of us only squirming in vague unease at the data, it is gaining mainstream following especially within the last decade, when the proverbial writing is now on the wall: friends without water, gas, and electricity back home; nasty sheets of ice blanketing cities causing power outages; entire countries facing submergence.

Despite this, mainstream corporate media earnestly repeats the growth mantra ("we must have growth for prosperity") and while it occasionally laments the rise of carbon emissions, the media conveniently manages to avoid asking the obvious "why?" question: why must we have unchecked growth when this is the very thing that causes all our problems?

The answer is becoming plainer for all to see, especially in the wake of the bailout debacle: banks.

In order for banks to survive, there must be compound interest, and in order to keep up with compound interest, you must have compound growth. However, as Margaret Atwood, author of "Payback: Debt and the Shadow Side of Wealth," notes, "Instead of thinking that nature is this huge bank that we can just keep drawing on, we have to think about the finite nature of this planet to keep it alive so that we too may remain alive. Unless we conserve the planet there isn't going to be any 'The Economy.'"

What can Islamic finance do? As it turns out, a great deal.

With conventional finance incapable of thinking outside an interest-based box ("the problem is sub-primes," "corporate bailouts," "actually, the problem is greed," "corporate lobbying needs reform"), the West appears condemned to repeat the mistakes it refuses to learn from. The problem of interest is now so systemic, so deeply rooted, that it may be too close for many to see. Even to this day searching "bank interest and global warming" on the Internet yields almost nothing (except Ethica's webinar "Interest-Based Finance and Global Warming - Making the Connection" from over three years ago).

What is needed is a paradigm shift in our approach to currency, the environment, the community, and Islamic banks.

## 1. Launching a Gold-Based Currency

An idea whose time has long since come — and was once a reality before the United States left the gold standard in 1971 — governments and regulators must develop a gold-based currency and begin circulating it globally. Short of this we are at the mercy of fiat currencies teetering on the brink of collapse. Moreover, there are serious Shariah implications for continuing to deal in currencies based on debt rather than on assets. For many, Islamic finance remains an empty claim as long as the very currency upon which it operates is itself predicated upon questionable standards.

Because the fractional reserve banking system enables banks to lend money they do not possess — often much more money — we are always caught in a precarious bubble of varying size and consequence. This bubble is based on the creation of ‘wealth’ without a commensurate creation of assets, enabling countries, companies, and individuals to demand more of the environment than it is naturally equipped to handle.

And lest our ambitions carry us away, we do not need a multi-country agreement to launch a globally recognized gold-based currency. Just one central bank. Dubai, with its stated ambition to become the capital of the Islamic economy, and Abu Dhabi, with the respect it commands regionally as a cash rich hydrocarbon center, would be well suited to jointly launch a parallel gold-based currency based on a gold dinar. Interests are far too deeply entrenched to ever expect fractional reserve banking to simply go away on its own. Rather, demand for a viable alternative may better hasten its undoing.

## 2. Environmental Shariah Standards

Scholars must develop Shariah standards for the environment. A detailed, more nuanced ijihad that explains the environmental limits of transactions and products. What are the limits of consumption? What are the limits of production? Is the connection between a given product and its ultimate impact on the environment tenuous or direct?

Islamic finance now finds itself at a crossroads. On the one hand, it offers a world free of interest. Yet on the other hand, its often single-minded focus on economic growth seems anachronistic amid severe climate change.

As fiqh stands today, would it be permissible for an investment bank based in London to issue Sukuk to fund a rubber company that further destroys the Sumatran rainforest; or for an Islamic bank in Dubai to finance the construction of a dam in China that floods a fragile ecosystem; and so on?

Fiqh does bear upon the general interests of society and, increasingly with the planet’s environment hanging in delicate balance, what happens in one part of the world affects all society.

The environment is a fiqh issue.

### **3. Supporting Community-Based Finance**

Exxon is bigger than Thailand, Conoco Phillips is worth more than Pakistan, and Walmart's revenues now put it ahead of 157 of the world's 182 countries. Large companies grow larger as milquetoast public policy gives free rein to corporations with questionable environmental standards.

Governments, regulators, and scholars must support localized, small-scale, community-level finance. At the outset, this means developing Shariah standards for products that promote these efforts: microfinance, small-scale Musharakah and Mudarabah investment companies, Waqf-based finance, community land trusts, and the like. At the governmental level, supporting such efforts means providing a favorable legal, tax, and regulatory environment with incentives and disincentives that protect these efforts from large, institutional interference.

Case in point: when a Walmart or Carrefour superstore moves into a neighborhood, small and medium businesses in the area suffer. In fact, real estate prices actually drop because consumer demand is expected to decline as the larger business hollows out the spending power of the residents who have now lost their jobs. As our present scholarship stands, there is nothing wrong with providing Islamic finance to a Walmart or a Carrefour; it might even be heralded as a breakthrough. But a more thoughtful reading of it shows that putting a retail giant in the middle of a small economy has far reaching deleterious effects.

Similar other examples abound. This is the kind of thinking that governments, regulators, and scholars must now begin to make if we are to reverse some of the damage wrought by a blind growth economy.

For their part, activists, practitioners, and academics already advocating community-based finance should begin working with governments, regulators, and scholars to develop Shariah standards. As a starting point, Ethica proposes convening a meeting between a delegation of those already active in community-based finance and members of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the leading standard-setting body in the world and the de facto standard in ninety percent of the world's Islamic finance jurisdictions

### **4. Regulating Shariah Standards**

Governments must now empower regulators to begin revoking Islamic banking licenses for Shariah non-compliance, just as they revoke Islamic banking licenses for violating conventional law. At the moment, in most jurisdictions around the world, for something to be labeled "Shariah-compliant," it merely has to be called that, regardless of the qualification of the one making the claim.

This is unacceptable.

Unless we are prepared to relive the phantasmagoric mess the financial crisis of 2008 left us, complete with paperless, assetless, fly-by-night projects vanishing overnight, and unless we understand that there is a connection between bad banking and environmental degradation, we would do well to put some teeth into Shariah regulation.

Despite its economic woes, Pakistan does an excellent job of fostering Shariah compliance in its burgeoning Islamic finance sector where the specter of license revocation looms ever large and has on occasion been used to good effect. To this end, AAOIFI's "Shariah Standards," a document compiling rulings agreed upon by some of the world's leading Islamic finance scholars, offers a minimum fiqh a product or practice must comply with and could be a good starting point for a given jurisdiction's financial services authority to deem mandatory.

## **The End**

A once common problem with explaining environmental degradation to the common man was the abstractness of it: outwardly, everything seemed fine in the 1970s, 1980s, and into the 1990s to the casual observer even though closer inspection revealed otherwise. But by the turn of the 21st century, and especially in the last five years, events are unfolding at a pace that makes environmental problems hard to ignore.

To use examples from Ethica's own team, lifelong farmers we spoke with once predicted seasons down to the week. Now they have trouble timing harvests to the nearest month. Relatives who once enjoyed basic energy security throughout the year now regularly go days without gas and electricity. Forests we once played in as children have been wiped out forever by palm oil companies, and so on.

Given the inadequacy of the present world response to environmental degradation, it is unlikely that we will avert some of the more major disasters like global heating, which many climatologists already declare an inevitability even if we reduced carbon emissions to zero today. But better late than never. Some things are still very much in our control, and they do bear upon the shape of the world to come: currency, environmental standards, community-based finance, and the Shariah compliance of our institutions, to name just some of those mentioned in this article.

How can Islamic finance make a difference in the sweep of such global events? History is filled with examples of small tipping points making disproportionately large impacts. Though the Islamic finance industry accounts for only a fraction of global transactional volume, the real power of Islamic finance is in being able to galvanize the world's 1.5 billion Muslims by providing them and their non-Muslim brothers and sisters with real solutions.

*This article was approved by Mufti Ismail Ebrahim Desai.*