International Seminar on

The Global Financial Crisis and the Strength of Islamic Banking System
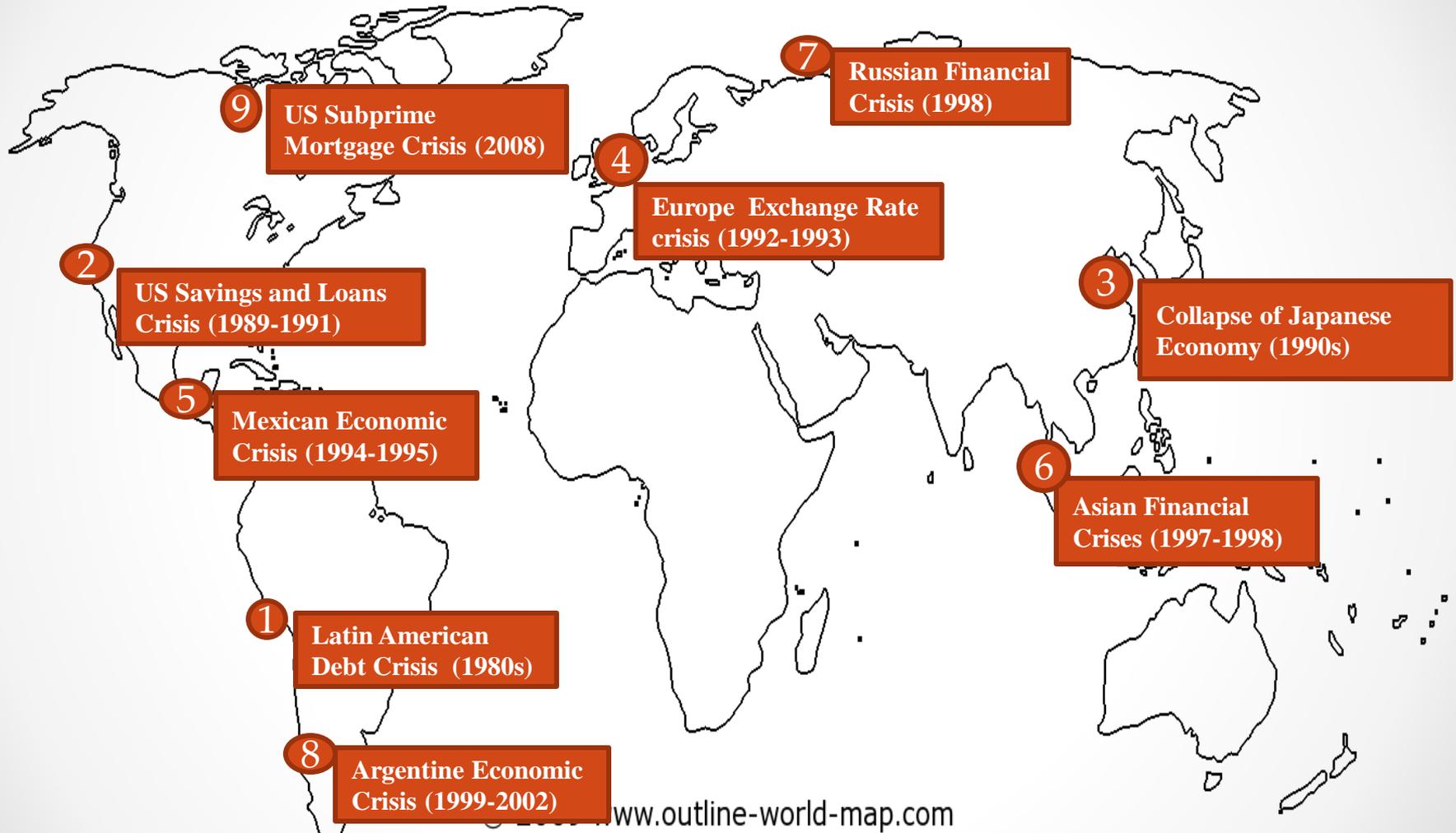
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Grand Ball Room, Pan Pacific Sonargaon, Dhaka
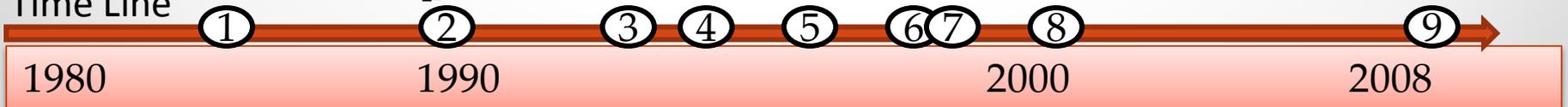
Discussant

Dr Shariq Nisar

The Prologue

9 US Subprime Mortgage Crisis (2008)

7 Russian Financial Crisis (1998)

4 Europe Exchange Rate crisis (1992-1993)

2 US Savings and Loans Crisis (1989-1991)

3 Collapse of Japanese Economy (1990s)

5 Mexican Economic Crisis (1994-1995)

6 Asian Financial Crises (1997-1998)

1 Latin American Debt Crisis (1980s)

8 Argentine Economic Crisis (1999-2002)

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Time Line

① ② ③ ④ ⑤ ⑥⑦ ⑧ ⑨

1980   1990   2000   2008

Discussion

The Global Financial Crisis:
Some Suggestions for Reform of the Global Financial Architecture in the Light of Islamic Finance

By: Prof. M. Umer Chapra

Author is one of the most senior and respected Islamic economists and perhaps the only Islamic economist of the first generation who has so much real life experience in monetary policy and research. He has worked at the highest level in the Saudi Central Bank – SAMA (for about three and half decades). Currently he is advisor at Islamic Research and Training Institute (IRTI) of IDB Jeddah. He has written more than 15 books & monographs and presented more than 100 research papers in the field of economics, finance, Islamic financial system and the current economic problems, etc.

Abstract

The paper has twofold objectives:

1. Explaining the reasons of the financial crises faced across the globe in recent years. It also deftly unfolds the mechanism of the crises.

2. The paper also aims at providing solutions to these recurring economic and financial crises in the light and guidance of Islam. It makes a strong case for an economic and financial system that is more disciplined, humane and stable.

Structure of Paper

The paper is divided into three sections;

1. Part one makes an elaborate analysis of the current financial crises and its causes.

2. Second part of the paper outlines the architecture of the Islamic financial system.

3. The third part, evaluates the current practices of Islamic finance in the earlier portion and highlights the lessons that conventional finance can learn from Islamic principles of finance in the later portion.

Highlights of the Paper

1. The Causes of the Crisis

2. Role of Rating Agencies

3. Role of Hedge Funds

4. Role of Regulator/Supervisor

5. Role of Depositors

Islamic Finance Architecture

Objective: Justice in Society

Principle: No risk no gain

Prerequisites:

1. There must be real asset transaction not imaginary or notional;

2. The seller must own and possess the goods being sold or leased;

3. The transaction must be a genuine trade transaction; and

4. The debt cannot be sold and thus the risk of default associated with it must be borne by the lender himself.

Islamic Finance Practice

1. Islamic finance does not genuinely reflect the ethos of Islamic teachings;

2. The use of equity and PLS is still very small

3. Debt-creating modes is preponderant and developed through the use of legal stratagems (hiyal).

Why Islamic finance could not stick to its core principles;

1. lack of proper understanding of the ultimate objective of Islamic finance;

2. the non-availability of trained personnel;

3. the absence of support institutions needed to minimize the risks associated with anonymity, moral hazard, conflict of interest;

4. consumerism has also been rapidly expanding in Muslim societies.

The Relevance of Islamic Finance

1. Increased proportion of equity in total financing;

2. Control on leveraging;

3. Credit expansion to be linked with the growth of the real economy;

4. No trading of debts;

5. Ensuring that the swaps do not become instruments for wagering.

6. Proper regulations and supervision of all financial institutions;

7. Some arrangement needs to be made to make credit available to poorer sections of society at affordable terms

Some Points to Ponder

❑ One of the important points that Prof. Chapra has chosen not to discuss in this paper is the role of the interest-based system in credit creation opportunities for banks. It is for the same reason that banks are encouraged to shift/transfer the risk (by selling it) to anyone but to them.

❑ The paper innocuously argues that failure in the west lies in their system while in Islamic it is lack of understanding, commitment and ability of the people who are running it. Many people may not find this very plausible.