1. Defining the issues in religion and finance

THE CHANGED GLOBAL ENVIRONMENT

At the time of writing (September 2018), it is ten years since the onset of the global financial crisis in September 2008. Ex-Chairman of the Board of Governors of the Federal Reserve System, Alan Greenspan, commenting in December 2008, stated: ‘in the wake of the Lehman Brothers default on September 15th, 2008, the system cracked’ (Greenspan, 2010). In fact, many, including ourselves, trace the beginnings of the crisis to much earlier, ranging from February 2007 to August 2007. But whatever was the starting date, there is no question that the decade since has been dominated by the aftermath and its economic and financial consequences; moreover, in ways that were not foreseen at the time.

Three examples suffice to illustrate the point. First, there appears to be an increasing acceptance, albeit reluctantly, that the world economy since 2008 may have slipped into what former United States Treasury Secretary Larry Summers calls ‘The Age of Secular Stagnation’, a description that borrows from the concept of secular stagnation first put forward by the American economist Alvin Hansen in the 1930s. The failure of economies fully to recover from the 2008 financial crisis has left a legacy of weak economic growth, low or negative interest rates, rising asset prices, low wage growth, greater inequality and weak investment. In the particular case of interest rates, Jaime Caruana, former General Manager of the Bank for International Settlements, wrote in 2018:

> From a historical perspective, the protracted period of low nominal interest rates that we are currently experiencing is unprecedented. Since 1870, nominal rates in the core advanced economies have never been so low for so long, not even in the wake of the Great Depression of the 1930s. (Caruana, 2018, p. 1)

In an article published in *Foreign Affairs*, Summers (2016) considered that there is a risk that the current slowdown may prove to be enduring rather than cyclical, and that the world might still be only part way through a slow-growth era ‘shaped by previously unthinkable and far-fetched policies’ such as ultra-low interest rates, noting that at least two dozen

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countries have central bank policy rates just above or below the zero level, a position considered inconceivable even a few years ago. So as to bring about and sustain such low rates in their own countries, central banks in the G-7 collectively expanded their balance sheets since the onset of the financial crisis by a staggering $5 trillion. This figure is roughly twice as large as the gross domestic product (GDP) of the United Kingdom, and just less than one-third of the GDP of the United States (US). And this position has to be unwound without jeopardizing growth prospects.

On the same point, in an address in Frankfurt in April 2016, International Monetary Fund (IMF) Managing Director Christine Lagarde also expressed concern that the risks had increased of economies becoming trapped in what she called a ‘new mediocre’ of growth, the danger being that low growth can be self-reinforcing through ‘negative effects’ that are hard to reverse. In her words, ‘the good news is that the recovery continues; we have growth; we are not in a crisis.’ However, ‘the not-so-good news is that the recovery remains too slow, too fragile, and risks to its durability are increasing’ (Lagarde, 2016) – still the case in 2018.

Christine Lagarde’s solution is to invest more in infrastructure. The policy mix that has driven monetary policy to such experimental, unprecedented extremes needs to change. ‘While [monetary] accommodation should continue in most advanced economies, it is clear that monetary policy can no longer be the alpha and omega to recovery.’ Rather, according to Lagarde, investing in badly needed infrastructure is an ‘obvious area’ of potential, boosting global aggregate demand today while laying the building blocks for future growth – how badly needed is illustrated dramatically by the collapse of the Polcevera river bridge in Genoa in August 2018.

Yet, and this is the second example, the advanced countries have not heeded the call. Only China keeps on building infrastructure seemingly without limits, and its experience is instructive, albeit controversial. No country has invested as much so quickly in infrastructure as has China over the past two or three decades. Moreover, it is encouraging other countries in Asia to follow its path via the Asian Infrastructure Investment Bank, which Larry Summers (2016) thinks is ‘a valuable step forward, that should be strongly supported by the global community’ (p. 8). Earlier in July 2014, China set up the Shanghai-headquartered BRICS New Development Bank, together with the other four members of the BRICS club: Brazil, Russia, India and South Africa (The Economist, 2014b). With these two new banks, along with the Silk Road Fund (a government body which takes minority equity stakes in infrastructure projects), China is seeking to export its infrastructure-led development model to the rest of the world under the ‘One Belt, One Road’ strategy (now ‘Belt and Road’).
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of President Xi Jinping, whereby the Chinese economy is bolstered by building physical infrastructure not just with its immediate and near neighbours (for example, the port facilities and motorways built in Sri Lanka), but in places as far afield as Europe, Africa and the Middle East (Wong, 2016).

When the market reforms began in 1979, China was predominantly agrarian, and the urban population was 19 per cent of the total (and only 10.6 per cent when Mao Zedung and the Communist Party came to power in 1949). By contrast, as of 2016, 779 million of China’s 1.4 billion people (or 56 per cent of the population) lived in cities (Salt, 2016), and the 50 per cent watershed for defining an urbanized country was crossed in 2010. China now has seven cities with more than 10 million residents, 37 with at least 3 million, and no less than 170 cities with a population of at least 1 million (Wall Street Journal Custom Studio, 2016). Trillions of dollars spent on infrastructure ($300 billion alone on high-speed rail) has transformed China into an exemplar of modern urban transit, with a platform of expansive highways (such as the 65 000 km National Expressway Network), intercity rail networks and efficient ocean ports (Grimsey and Lewis, 2017).

Much of the differences reflect the reordering of the world economy, as the Chinese (and many East Asian economies) have forged ahead, while the West has been stunted by the overhang of the global financial crisis. In purchasing power parity (PPP) terms, China is already the largest economy, while in 2030, China’s GDP in PPP measures is forecast to be 16 per cent larger (ABS Treasury, 2017). Even in US dollar terms (that is, using market exchange rates rather than PPP adjusted rates), China seems likely to pass the United States between 2025 and 2030 (Iley and Lewis, 2013). Again, these data projections reinforce how dramatically the advanced world (Australia exempted) has been held back by the slow recovery from the financial crisis.

Third, a lot of the blame for the financial crisis is attributed to regulatory failures. Regulation is seen as being not only too lax, with authorities catering to private markets in order to reduce costly adherence to rules, but also poorly designed and inconsistent across countries, institutions and market segments (Kodres and Narain, 2012). Others point to ‘systems failures’, especially in the credit transfer process by which subprime and other low-quality mortgages were packaged into ‘toxic’ securities and the risks distributed across the globe, infecting banks in many countries (Weber, 2008). In response, there have been massive changes in most countries’ bank regulation. A valuable summary, on a global basis, is provided by Six Shadow Financial Regulatory Committees from around the world in Litan (2011). In fact, the international dimension was immediately apparent as
widespread failures occurred in risk management systems when evaluating the threats posed by the global chains of counterparties underlying derivatives, notably credit default swaps (CDSs) and securities such as synthetic collateralized debt obligations (CDOs) built on them (Das, 2011). Nor have the extra layers of regulation added recently stopped banks from behaving badly. For example, some large international banks appear to have been attempting to ‘game’ the system by manipulating interbank market rates such as the London Interbank Offered Rate (LIBOR).

It is on this basis that Gordon Brown, former Chancellor of the Exchequer and British Prime Minister, described the global financial crisis as ‘the first crisis of globalization’ (Brown, 2010). This is an important point, for as Iley and Lewis (2013) document, the US subprime crisis was most certainly not solely a US phenomenon and European (and other overseas banks) poured massive amounts into the mortgage market, and generated much of the excess liquidity that fuelled the crisis.

As Figure 1.1 illustrates schematically, most of the money flowed to the US banking sector via the ‘shadow banking system’, with the international linkages completed by the wholesale (interbank) funding markets. The shadow banking system was the creation of banks such as Citigroup, UBS and Goldman Sachs. They established specific-purpose highly geared investment vehicles (conduits, structured investment vehicles – SIVs) off-balance sheet, and these subsidiaries or funds invested in assets with a high

![Diagram](shin2011)


**Figure 1.1 European banks in the US shadow banking system**
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return and long duration (for example, structured finance products) and financed themselves by issuing asset-backed commercial paper, typically highly leveraged, 15–20 times the equity capital (Nyberg et al., 2008).

In fact, the whole purpose of this shadow system was one of deception. Employing off balance sheet vehicles in order to avoid regulatory capital meant that in practice the core banks were more highly leveraged than they appeared. SIVs set up by banks to pool loans into asset-backed securities borrowed short-term commercial paper and conduits for constructing mortgage-backed securities (MBSs), in effect enabling banks to develop extensive assets off balance sheet. While investors were presumably aware that these vehicles were autonomous legal entities with little or no formal recourse to the parent, when it came to the crunch the banks were unwilling to abandon the investment companies because of reputation risk. In any case, overlapping shareholders and officeholders, and the stream of management fees paid to the parents, complicated the legal standing of the bank-owned subsidiaries.

According to one observer: ‘Few outside the banks themselves knew about the growth and extent of the grey, or shadow, banking system in the guise of conduits, SIVs etc., and since a main rationale for this shadowy sub-system was regulatory arbitrage, the banks were not loudly advertising such activities’ (Goodhart, 2008, p. 3). ‘Regulatory arbitrage’ is a polite way of saying that the banks were again gaming the system by means of highly dubious financial practices; in short, misbehaviour. Banks which used to be seen as paragons of financial virtue have seemingly lost their way.

AN ALTERNATIVE PERSPECTIVE

Undoubtedly, the international, cross-border linkages described above demonstrate that globalization indeed was an integral part of the story. But to put the blame on globalization is to miss the point. There is an alternative interpretation, operating at a more fundamental level, that gets us closer to the heart of the matter, namely the role of greed and a faulty moral compass. From the viewpoint of the Holy religions a very different perspective emerges, and the crisis is the first of a very different kind. Aaron Levine, editor of the Oxford Handbook of Judaism and Economics (Levine, 2010a) calls it ‘the first post-World War II recession that has its roots in widespread moral failure’ (Van Biema, 2008). This is a position, as we shall see, with which Christianity and Islam are most definitely in agreement with Judaism. The starting point, according to all three religions, is that economic and financial activities cannot be divorced from ethics.
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and morality. In this respect, the financial crisis stemmed from a lack of morality and a failure of conscience or sense of self-restraint on the part of those involved.

This alternative vantage point effectively defines our agenda. This book is not concerned with the global financial crisis as such. Nor is it focused on the global reordering of the world economy, or the policy responses that have ensued, except from the moral dimension. Rather, it examines ethical perspectives on such matters from the viewpoint of the three major religions in the Abrahamic tradition, namely Judaism, Christianity and Islam. Ethics can be considered to consist of general principles which help to determine rules of conduct. Any economic system requires a set of rules, a belief system to guide them, and a conscience in the individual which makes them carry them out. Rules can be based on natural law; they can also derive from religious laws, such as those which shape the business ethics for Jews, Christians and Muslims.

According to these religious laws, economic activities ought not to be separated from ethics and morality. In this respect, events in the last decade can be seen as having their roots in moral failure and a lack of conscience or sense of personal responsibility, for the history of morals is a movement from an almost unquestioned uniformity of conduct to an ever-increasing reliance on personal responsibility. Viewed in this light, the crisis can be seen to have had its origins in greed, deception, misleading contracts, excessive speculation, inappropriate incentives and bonuses, a lack of leadership and governance, usurious behaviour, and what has become known as ‘financialization’. These faults have been compounded by monetary policy responses over the past decade (for example, ultra-low interest rates) that arguably do not pass the fairness test.

In view of the strong disapproval by the religions of the banks’ behaviour, it is more than a little ironic – although not surprising – that the welfare and charitable services offered by the churches have been called upon and put under heavy demand by the hundreds of thousands, perhaps millions, of citizens in the Western world who have been forced into mortgage default and indebtedness by the actions of the banks. For example, in Australia the Brotherhood of St Laurence, the Salvation Army and the Protestant Uniting Churches have offered financial counselling services to distressed borrowers. Indeed, the Brotherhood of St Laurence has even provided small loans to low-income households to prevent them having to resort to the often exorbitant rates charged by the ‘payday’ lenders (Abraham, 2011).
OUR AIMS

The main objectives of this book are to:

1. explain the teachings of the Abrahamic religions, especially towards various social and moral values which are relevant to financial issues;
2. compare the religious attitudes of Judaism, Christianity and Islam with regard to the prohibition of usury and the role of interest;
3. explain possible reasons behind the institutional shift in Europe and Islamic countries from anti-usury laws towards usury-supportive contracts;
4. explore various partnership-based instruments, sale-based debt instruments and benevolent loans allowed and previously used in Judaism, Christianity and Islam; and
5. revive/develop some old/new concepts in finance which would be equally beneficial for all the stakeholders.

In order to explore these matters, the book is organized along the following lines.

Chapter 2 provides a detailed account of the three religions, in terms of history, denominational composition and fundamental beliefs. While the religions are examined separately, the links between them are outlined. Next, Chapter 3 examines why interest financing, and usurious behaviour generally, was so disfavoured by all three religions, and how they grappled with the problem in what appear to be very different ways (although the end result seems not so very different). Chapter 4 then sets out the social policy recommended by the Holy religions in terms of aspects such as brotherhood, justice, business ethics, private ownership, benevolence and charity, and so on.

Following on from this analysis, Chapter 5 outlines the recommended economic framework, and covers the principles and the practices of the three religions towards various sources of income and expenditure, to which is added the comments and views of various researchers. This chapter ends by comparing the economic teachings of each religion to highlight similarities and differences.

As intimated earlier in this chapter by the assessment of Aaron Levine (2010a), Judaism, Christianity and Islam differ markedly from conventional ‘technical’ and ‘regulatory’ explanations of the causes of financial crisis. There is, of course, a rich history of financial manias and crashes, but we do not need to move far beyond the events of the ‘great recession’ starting in 2006–2008 to illustrate most of the characteristics that typify a crisis. However, the Holy religions take a distinctive view of the basic
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causes in terms of human fallibility and what either was, or verged upon, immoral behaviour. This is the topic of Chapter 6, which also assesses post-crisis policies from an ethical standpoint.

An evaluation of non-interest financing arrangements forms a core subject matter of this study, and to this end we consider various partnerships and equity-based financial instruments and their acceptability by religions. Chapter 7 provides a detailed discussion analysing and exploring similarities and differences in the equity-type financial instruments used in the Jewish, Christian and Islamic worlds.

Chapter 8 is developed on similar lines to the previous chapter, except that it analyses the various sales-based debt instruments permitted in the Holy religions. This chapter is further extended to the issue of public debt financing, and the debt instruments used by Islamic and Christian governments to finance their budget deficits and other spending policies. It ends by taking up the earlier brief analysis of Chapter 5 of what religious aspects and financial arrangements may have contributed to Muslim countries falling behind the West in recent centuries, an issue raised by Kuran (2011) and Rubin (2014) amongst others.

Chapter 9 attempts to pull some of the threads of this volume together in order to analyse the future of interest-free financing. It asks, first, why the ban on usury has been such an uphill battle for all three religions. The key question under examination here is why interest-based finance has been so seductive and difficult to resist. Then, because Islamic finance is the last bastion of the prohibition of usury, it seeks to establish the question marks that continue to hang over the authenticity of Islamic investment funds, the legitimacy of Islamic sales-based financing modes, and the shari‘ah acceptability of most sukuk (Islamic bonds). Additionally, the chapter traces the evolution of modern Islamic financing from its beginnings to the present day, and asks whether current practices are pushing the system closer to or away from, the ‘ideal’.

Finally, Chapter 10 takes all three religions to task for failing to deal effectively with what is, for them, the core issue of the abolition of interest/usury/riba. Judaism takes advantage of what can only be called a double standard, and legitimised pseudo-interest arrangements. Christianity owns up to abandoning the prohibition, but in doing so the Christian West has, in effect, thrown the baby out with the bathwater by divorcing financial behaviour from ethical concerns. Islam, for its part, uses a variety of Islamic instruments to support the ban on usury. The reality is that Islamic banking appears to have chosen appearance over substance. Of course, the religions stand for much more than the prohibition of interest. But on this one point of comparison, none of them can really hold their heads high with any conviction.
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NOTES

1. There is no doubt that 15 September 2008 was a seminal date. On the very next day, 16 September 2008, the Federal Reserve (virtually concurrently with the Lehman Brothers collapse) had to provide massive financial support to the insurance giant American International Group (AIG). In the words of Takeo Hoshi (2011), ‘the government’s decision to let Lehman Brothers fail in September 2008 led to the collapse of the entire financial system’ (p. 124). More blunt is Charles Goodhart’s (2011) observation that ‘what was hideously expensive to all of us was the botched failure to rescue Lehman Bros, which instigated the panic and downturn’ (p. 119). Notwithstanding the significance of September 2008, others such as Maurice Obstfeld (2011) have opted for August 2007 as the ‘kick-off’ date of the global crisis. Similarly, William Cline (2010, p. 261) argues that:

Two events marked the onset of the crisis. In July 2007, the investment bank Bear Stearns closed two MBS funds, and in August, the French bank BNP Paribas temporarily suspended withdrawals from three investment funds on grounds that the seizing up in the MBS market in the United States made it impossible to determine a fair valuation for withdrawals.

While not denying that these events came as a considerable shock to investors, the obvious question to ask of Cline’s dating is why, as he said, the mortgage-backed securities market had seized up. For this reason we are persuaded by Ian King of The Times that an earlier, seemingly inauspicious event ‘lit the fuse of the financial crisis’ (King, 2009). Just before midnight on 7 February 2007, HSBC issued the first profit warning in its 142-year history. Its statement admitted that slowing house prices had led to higher delinquency rates among American mortgage customers and that bad debts in the business would be 20 per cent worse than expected. As King notes, ‘from there, the red ink started to flow’. Within days, shares in New Century Financial, Fremont General and Nova Star Financial, all specialist subprime lenders, went into freefall, as the true impact of problems in the subprime mortgage market started to become clear. On 2 April 2007, New Century Financial filed for bankruptcy when its ‘warehouse’ lenders ceased to provide new funding and margins calls by them could not be met (Frankel, 2009). By May 2007, UBS had closed its hedge fund division because of subprime-related losses, and a month later in June 2007 there was speculation that Bear Stearns was struggling due to its exposure to mortgage-backed bonds. Thus we see a strong case for February 2007 as the start of the crisis.

2. The main methods currently used to convert a country’s national income in local currency to internationally comparable measures are the exchange rate and purchasing power parity (PPP) approaches. The exchange rate approach simply converts an economy’s GDP into foreign currency (usually US dollars) at the official exchange rate. The PPP approach uses converters to adjust money incomes better to reflect the ability of a unit of local currency to purchase goods and services in its country of issue. It converts GDP in national currency to a PPP measure applying international prices for a standard basket of goods and services in the countries involved. In low-income countries, PPP measures of income per capita are usually higher than the official exchange rate measures and more accurately reflect actual living standards, as they adjust for the undervaluation – essentially because wages are low – of non-tradables (goods and services not traded internationally) in these countries (Iley and Lewis, 2013).

3. In this respect, this volume is a continuation of research originally commenced and initially reported in Kaleem and Lewis (2014).