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## *The Role of Money in Capitalistic and Islamic Economic Systems: A Comparative Study*

Naeem Ur Rahman M. Yahya\*

### **Abstract**

*Money has a great role to play in the economic system. It is a backbone of all commercial and financial transactions. Its role is well defined and established since ages; the fundamental role as a medium of exchange and standard of values. Furthermore, if the functional role of money is positive and productive, it leads to the economic growth and expansion of economic activities. Likewise, the injudicious role of money created several economic fluctuations and frequent financial distortions in the economic history. The article suggests that the injudicious role of money created economic disorder and caused financial crisis in the global economy. The research paper attempts to explore the role of money from Islamic and Capitalistic perspectives. In the capitalistic system, the money is being used as a tradable commodity in the banking and financial sector. The Islamic perspective is based on the teachings of Quran and Sunnah, and jurisdictions of Muslim scholars, in this context, money is only a means of exchange and measure of value. The qualitative research approach has been applied to the discussion and based on the literature review and available data, it is recommended that there is a dire need to review the role of money. The role of money as a tradable commodity caused distortions in the existing system. It is recommended that the banking business needs to be operated on profit and loss sharing rather than the trading of money as a commodity.*

**Keywords:** Money, Role of Money, Banking, Economic System, Islamic Economics.

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### Introduction

The global financial crisis of 2008 persuaded the economists and financial personnel to review the role of money. A renowned economist and former head of the Bank of England, Mervyn King (2016)<sup>1</sup> said, 'Failure to tackle the disequilibrium in the world economy makes it likely that a crisis will come sooner rather than later'. He explicitly mentioned that the world crisis was the fault of the financial system and not individual greedy bankers. He said, 'the crisis was a failure of a system and the ideas that underpinned it, not of individual policymakers and bankers, incompetent and greedy though some of them undoubtedly were. He reiterated that only a fundamental rethink of how we, as a society, organize our system of money and banking will prevent the repetition of the crisis that we experienced in 2008'. The former president of the European Central Bank, Jean-Claude Trichet (2010)<sup>2</sup>, also expressed similar views in a lecture at Bocconi University Milano, saying 'we have an absolute obligation to make the global financial system more solid and sustainable'.

The financial crisis of 2008 was one of the worst of its kind since the Great Depression of the 1930s. The financial crisis caused titanic losses of trillions of dollars, as well as an enormous amount of tangible properties and jobs becoming insecure in many parts of the western world. Within a short period, more than 400 banks and credit unions went into failures or entered receivership and declared bankruptcy in the USA. Giant business organizations and financial institutions lost more than 15 trillion US dollars. The economic setup was in the grip of the crisis that is estimated to have wiped out 45% of the wealth of the world<sup>3</sup>.

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<sup>1</sup> Mervyn King, "New Financial Crisis is Certain Without of Banks," *The Guardian* (28 February 2016), <https://www.theguardian.com/business/2016/feb/28/mervyn-king-new-financial-crisis-is-certain-without-reform-of-banks>, accessed on 3 June 2020.

<sup>2</sup> Jean-Claude Richet, "Shaping a |New World: The Crisis and Global Economic Governance," *Milano* (2010), [https://www.ecb.europa.eu/press/key/date/2010/html/sp100409\\_2.en.html](https://www.ecb.europa.eu/press/key/date/2010/html/sp100409_2.en.html), accessed on 12 July 2020.

<sup>3</sup> Mohammad Taqi Usmani, "Post Crisis Reforms: Some Points to Ponder," *WEF-Faith and Global Agenda Report* (2010), [www.weforum.org](http://www.weforum.org), accessed on 12 July 2020.

The governments in different countries had to take steps to save the global financial system and announced bailouts in different countries. In the USA, the government decided to put the liquidity of \$700 billion to bail out the banks.<sup>4</sup>

The economists always endeavour to solve economic problems, as in the Great Depression of 1930s, the British economist, Lord J.M. Keynes (1936)<sup>5</sup> came forward with his thoughts. He discussed the failures of 'market economy' and he presented the alternative approach known as Keynesian Revolution. Adam Smith (1776)<sup>6</sup> suggested that invisible hand would fix every problem and undesirable economic fluctuations in the economic system. So, the role of the government has to be at minimal level. Lord Keynes' book 'The General Theory of Employment, Interest, and Money' first published in 1936, was an attempt to explore the factors that caused the Great Depression.<sup>7</sup>

The pursuit to change the prevailing role of money is not a strange concept even in the western world, as 'Positive Money' and 'Occupy Wall Street' movements have gained the attention of the people and the proponents of these movements want the policymakers to realize that there is a need of change in the prevailing financial and monetary system. In Iceland, in the wake of the financial crisis of 2008, there was a debate in the parliament on sovereign money to discuss the role of money. So, there have been attempts even in western economies to discuss the role of money. Among other factors, the role of money in the financial system was discussed distinctively that lead to the disruption in the global economy. In this scenario, this article aims to discuss the nature and the role of money from a comparative approach, Islamic and capitalistic perspectives.

## **Research Methodology**

The qualitative research method and analytical and critical approach has been used in this research paper. The published authentic data and material in the form of books, articles, reports, and research papers from periodical journals, newspapers and the literature

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<sup>4</sup> Robert Winnett, "US Economy: \$700 billion Wall Street bail-out rejected on Meltdown Monday," *The Telegraph* (29 September 2008), <https://www.telegraph.co.uk/finance/financailcrisis/3105094/US-economy-700-billion-Wall-Street-bailout-rejected-on-Meltdown-Monday-2.html>, accessed on 23/7/2020.

<sup>5</sup> Keynes, J.M. *The General Theory of Interest, Employment and Money* (Palgrave: Macmillan, 1936), 11-25.

<sup>6</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Penguin Classics, 1982), 79-108.

<sup>7</sup> Keynes, *The General Theory of Interest, Employment and Money*, 11-25

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from academic circles have been reviewed carefully and the information has been utilized in the discourse of the critical subject matter, after the authenticity and reliability of these resources have been confirmed. The internet resources have also been used and the originality of the materials has been assured from their original resources on the web pages. Moreover, consultations and discussions with senior faculty members and researchers were also taken into account and their deliberations have been benefitted from while writing this paper. The comparative analysis was carried out while discussing the role of money from an Islamic perspective and capitalistic viewpoint.

### Literature Review

The topic of money is one of the most significant topics in the discipline, therefore there is extensive literature written on the subject. We focused on those books and articles which were directly related with the nature of money and its role in the banking and business sector. The Islamic teachings are based on the revealed knowledge of the *Quran* and *Sunnah*. The traditional and capitalistic point of view and the history has been discussed in other resources like the work of Davies Glyn<sup>8</sup>, who gave a detailed discussion of its history from ancient times to the present. Burnt Callander<sup>9</sup> also gave a brief history of money from the barter system to the latest development of digital money, particularly the bitcoin. Frederic Mishkin<sup>10</sup> and Geoffrey Crowther<sup>11</sup> discussed the definition, functions, types and role of money. Andrew Jacson and Ben Dyson<sup>12</sup> in their book *Modernising Money* suggested what went wrong in the monetary system and how it could be rectified from a capitalistic perspective. Also, Stephen Zarlena<sup>13</sup> mentioned the drawbacks of the prevailing monetary system in the market economies. Farhan Ali<sup>14</sup>

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<sup>8</sup> Davies Glyn, *A History of Money from Ancient Times to Present Day* (Cardiff: University of Wales Press, 2002), 34-679.

<sup>9</sup> Rebecca Burn-Callander, "The History of Money: From Barter to Bitcoin," *The Telegraph* 20 (October 2014).

<sup>10</sup> Frederick Mishkin, *The Economics of Money, Banking and Financial Markets* (Boston: Addison Wesley, 2007), 43-60.

<sup>11</sup> Crowther, Geoffrey, *An Outline of Money* (Alcester: Read Books, 2007), 35-36.

<sup>12</sup> Andrew Jackson, and Ben Dyson, *Modernising Money: Why our Monetary System is Broken and how it can be Fixed* (London: Positive Money, 2012), 213-269.

<sup>13</sup> Stephen Zarlena, *The Lost Science of Money* (New York: American Monetary Institute, 2002), 277-575.

<sup>14</sup> Farhan Ali, "Money and its Compensation: An Analysis of Capitalism and Islamic Economic System," *Al-Milal, Journal of Religion and Thought* 1, no. 2 (2019): 1-28.

critically analysed the concept of money and its compensation from both Islamic and capitalistic viewpoints and also discussed the issues of inflation and indexation from a traditional, Islamic perspectives. Mufti Mohammad Taqi Usmani<sup>15</sup> in his famous book '*Fiqhi Maqala't*' discussed the nature of money and its role from a *fiqhi* point of view as well as the history of money in detail. Dr Rafiq Al-Misri<sup>16</sup> described various important aspects of money from an Islamic perspective in the light of the *Quran* and *Sunnah* as well as the rulings and opinions of the Islamic jurists thoroughly. In the predecessors of Muslim scholars, Ibn Taymiyyah, Ibn Qayyam, Ibn Rushd, Imam Ghazali, and Ibn Khaldoon are some of the prominent Muslim jurists and scholars who described and explained the role of money and related issues in their scholarly written books. The previous research work is a discussion of the nature of money but the trading of money in banking sector and its adverse impact on the economy has not been discussed thoroughly, particularly in the recent financial crisis. The article is an exploration of the role of money from Islamic perspective which is only a medium of exchange and a standard of value. The trade of money in banking and financial sector is the major cause of disruption in the macro economic imbalances. The article develops the argument that Islamic ruling on prohibition of trade of money can bring a major change in the financial sector and hence the stability of the economic system.

### **Money: From Capitalistic Perspective**

Money is an economic unit that functions as a medium of exchange for transactional purposes in an economy. In ancient times life was very simple, and self-reliance was the major source of satisfaction of essentials and basic economic needs.<sup>17</sup> With the passage of time, the division of labour and specialization in different occupations caused the surplus of production. Here arouse the need of exchange of goods and services, as not everyone was producing everything he/she required of the general goods and services but rather was specializing in his/her own relative specialty and occupation. Initially, there was exchange of goods and services, and arguably the origin of 'money', in what is known as 'the barter system' and people were exchanging their goods and services for other goods and services

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<sup>15</sup> Mohammad Taqi Usmani, *Fiqhi Muqalat* (Karachi: Memon Islamic Publications, 1994), 1-6.

<sup>16</sup> M. Rafiq Al-Misri, *Al Islam Wa Naqud* (Jeddah: Markaz Al Nashr Al Ilmi KAU, 1981), 41.

<sup>17</sup> Glyn, *A History of Money*, 34-61.

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i.e. sheep, cattle, animal skins, vegetables and food grains<sup>18</sup>. To tackle with the problems of barter system, those commodities were used which had divisibility and durability.

Later, there was the trend of using relatively cheaper minerals and then subsequently, expensive and more valuable metals were used, and the governments also began to intervene by making and supervising the moulding of coins. The use of metals was the third stage of money evolution. This money was called 'the metallic money' and metals like copper, bronze, silver and gold were used in various forms and shapes. The history of coinage on government level started some 7th century BC in Ionia (in western Turkey) and in China where the Bronze coins were made and used as currency. The rare and valuable and relatively more expensive metal, gold was used as money in Byzantine Empire in the form of coins and was driven from Roman originals. In Damascus, Abdul Malik Bin Marwan started the Islamic dinar, from the Latin word *denarius*, in 690 AD. The temples were used for safeguarding the money as the buildings of these temples were concrete and solid and congregational gatherings were more frequent there, hence reducing the risk of stealing and loss, but the money remained idle and not used for lending or economic activities<sup>19</sup>. Gold was the preferred form of money due to its value based on rarity, durability, divisibility, fungibility and ease of identification. It remained in circulation in one form or another for thousands of years.

The introduction and circulation of 'the paper money' was a major development in the evolution of money. The goldsmiths started accepting money for safekeeping and gave paper receipts to the depositors. These receipts later were recognised as paper money.

The use of paper money and banknotes in Europe started in 1661, in Stockholm Sweden. Later in 1694 the private banks issued banknotes and it continued until 1850 in Scotland. The credibility and authenticity came under discussion. Therefore, the authority was handed over to the central bank to issue the currency in most of the countries. The Bank of England was authorized in 1694 to issue banknotes and The Federal Reserve of America received a similar authority in 1913.<sup>20</sup>

The currency issued by the central banks and monetary authorities was also known as the 'legal tender' and the 'fiat money' and it was fully backed by the government to

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<sup>18</sup> Burn-Callander, 'The history of money

<sup>19</sup> Glyn, Davies, *A History of Money from Ancient Times to Present Day*, 41-112.

<sup>20</sup> Usmani, *Fiqhi Maqalat*, 15-19.

convert into gold when the gold standard was in practice in 19th and early part of the 20th century. The gold exchange standard was an arrangement and agreement of Bretton Woods's system after 2nd World War in 1944 and US Dollar was convertible to gold until 1971, when the US President Nixon declared the end of US Dollar's convertibility into gold after the Vietnam War.<sup>21</sup>

Having discussed the evolution of money, now we can look at various definitions of money. Money has been defined differently by different economists. Frederic Mishkin (2007)<sup>22</sup> defined it as "any item or verifiable record that is generally accepted as payment of goods and services and repayment of debts, such as taxes, in particular country or socio-economic context". Geoffrey Crowther (2007)<sup>23</sup> says, "Money can be defined as anything that is generally accepted as a means of exchange and at the same time acts as a measure and a store of value".

The role and nature of money as it has been discussed in this section, is from capitalistic point of view. The economic activities among the buyers and sellers as economic units in the market are aligned with the profit motive which is the main incentive for the producers and customers<sup>24</sup>

The role of money in the capitalistic scenario began primarily as a medium of exchange, and later money itself became a tradable commodity. When the conventional banking industry developed enormously and interest-based advancement of loans created huge profits for the shareholders of the banks, the role of money changed, and it became an objective and tradable commodity rather than a medium of exchange. The financial crisis in the banking sector had numerous factors behind but the role of money was a major one. The housing bubble and candyfloss economies were the result of those financial operations in which money was a tradable commodity. In the following section we discuss the money from Islamic perspective.

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<sup>21</sup> Richard G. Lipsey, *An Introduction to Positive Economics* (London: Weidenfeld & Nicolson, 1975), 59-129.

<sup>22</sup> Frederick Mishkin, *The Economics of Money: Banking and Financial Markets* (Boston: Addison Wesley, 2007), 8.

<sup>23</sup> Crowther, *An Outline of Money*, 35.

<sup>24</sup> Chris Rogers, *Capitalism and Its Alternatives* (London: Zed Books Limited, 2014), 4-25.



### The Concept of Money in Islam

The word '*naqad*' means money and its plural is '*nuqu'd*' and these terms were in use in Islamic books as an alternative for money. The other terms Mal, Gold and Silver were also in use to denote money in Islamic literature. Dirham and Dinar were also in use to represent money. In the following paragraphs we discuss how the term money has been used in Islamic literature.

The jurists and scholars like Uthman bin Ali Al-Zailaei (d. 743 A.H.)<sup>25</sup> have the opinion that term money means gold and silver, while another opinion by Yahya bin Sharaf Al-Nowwavi (d. 676 A.H.)<sup>26</sup> is that it means *dinar* and *dirham* and a broad opinion is that money is not only gold and silver and *dinar* and *dirham* but also includes other valuable things which can be converted into money with ease and convenience. This opinion was mentioned by Abu Bakar bin Masood Al-Kasa'ni (d. 587 A.H.)<sup>27</sup> in his famous book on *fiqh* known as *Bada'i Al-Sana'i* and he has wider concept of money, including gold and silver and the coins made of gold and silver, like *dinar* and *dirham* and additionally, other commodities like dates and cattle were also included because these were convertible into liquid money and *zakah* was levied on these valuable things. The mention of term '*Ma'l*' has been more frequent in the *Quran* in various chapters and it included other commodities as well rather than just gold and silver or the coins made of them. Ibn Rushd, (d. 595 A.H.)<sup>28</sup>, the renowned jurisprudent from Andalusia, in his famous book *Bidayatu al-Mujtahid wa Nahayatu al-Muqtasid* also mentioned that gold and silver are money in the form of *dinar* and *dirham*.<sup>29</sup>

During the time of Prophet Mohammad (pbuh) *dirham* and *dinar* were in circulation as liquid money in Arabian Peninsula. These coins came from outside Arabia, for example, *dirham* was made of silver and its origin was Persian Empire, while *dinar* was made of gold and its origin was Roman or Byzantine Empire. Before the advent of

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<sup>25</sup> Uthman bin Ali Al Zailaei, *Tabyeen Al Haqaiq Sharah kanz Al Daqaiq* (Cairo: Al Matbah Al Kubra, 1313 AH), 1-28.

<sup>26</sup> Abu Zakariya Yahya Bin Sharaf Al Nowwavi, *Tahrir Alfa'dh Al Tanbih* (Damascus: Dar Al Qalam, 1408 AH), 114.

<sup>27</sup> Abu Bakr bin Masood Al Kasa'ni, *Badaie Al Sanaie* (Beirut: Dar Al Kutb Al Ilmiyah, 1406 AH), 5-185.

<sup>28</sup> Abu Al Waleed Muhammad bin Ahmed Ibn Rushd, *Bidayatu Al Mujtahid Wa Nahayatu Al Muqtasid* (Cairo: Dar Al Hadith, 1425 AH), 2-12.

<sup>29</sup> Farhan Ali, '*Money and its Compensation*,' 1-28.

Islam in Arabia, these coins were in use and the Prophet Mohammad (pbuh) did not change them but he approved these coins and also confirmed their weight. Ali bin Abu Talib, (may Allah be pleased with him) got married to the daughter of Prophet Mohammad (pbuh), Fatima (may Allah be pleased with her), and gave her dowry 480 *dirhams*. In the 2nd of year of *Hijra*, when the obligation of *Zakah* was revealed, the newly established State of Madinah was in need of revenue. So, the Prophet Mohammad (pbuh) implementing the obligation of *Zakah* and levied on every 5 *oqiyah* five *dirhams* and half *dinar* on every 20 *dinars*. The ratio between *dirham* and *dinar* was 7/10. For the first time in Islamic history, the Umayyad caliph, Abdul Malik bin Marwan introduced the Islamic *dinar* and its weight was 4.25 grams, the same weight as in the time of Prophet Mohammad (pbuh) (See Al-Shehavi, 2000, also, Al-Jaber, 1994, also, Al-Misri, 2013)<sup>30</sup>. He insisted and decreed to complete the transactions based on Islamic *dinar* and warned the people of execution if they use any other currency. Apparently, *dirham* and *dinar* were the prevailing form of money throughout Islamic history in various parts of Muslim world with some difference on the basis of issuance and ruling authority. The following verses from Quran make the concept clear about different meanings of money.

In Quran there is mention of the word '*darahim*' which is plural of '*dirham*' and has come in *Sura Yousuf*; "And they sold him for a reduced price – a few dirhams - and they were, concerning him, of those content with little."<sup>31</sup> The word '*dina'r*' has been mentioned in *Sura Al-Imra'n* in the following context;

"And among them is he who, if entrust him with a single coin '*dina'r*' he will not return it to you unless you are constantly stand over him (demanding it)."<sup>32</sup>

The words '*zahab*' and '*fidha*' meaning gold and silver have been mentioned in the *Quran* in different chapters like (*Al-Imra'n*; 14);

"Beautified for people is the love of which they desire- of women and sons, heaped-up sums of gold and silver, fine branded horses, and cattle and tilled land. That is the enjoyment of worldly life, but Allah has with him the best return."<sup>33</sup>

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<sup>30</sup> Salem Al Shehavi, "Al Nuqud Abr Al Tarikh," *Sahifa Tashreen As Sooriya* vol, no. issue (3<sup>rd</sup> December, 2000): 9; Al Jaber, Ibrahim Jaber, *Al Naqud al Arabiyah al Islamiyah* (Qatar: Dar al Kutub Al Qatariyah, 1992), 10-13; Rafiq Younus Al Misri, *Al Nuqud Fi al Islam* (Damascus: Dar al Maktabi, 2013), 35-50.

<sup>31</sup> Al Quran, 12:20

<sup>32</sup> Al Quran 3:75

<sup>33</sup> Al Quran 3:14

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Also, in (*Al-Tawbah: 34*): "And those who hoard gold and silver and spend it not in the way of Allah-give them tidings of painful punishment."<sup>34</sup>

The scholars, while commenting, had the opinion that these words meant money, as gold and silver in the form of *dina'r* and *dirham* were in use and circulation as medium of exchange in those days when the *Quran* was revealed. The term '*Ma'l*' also used in the *Quran* in many chapters like (*Al-Tawbah: 103*) "Take, [O Mohammad], from their wealth a charity by which you purify them and cause them increase and invoke [Allah's blessings] upon them. Indeed, your invocations are reassurance for them. And Allah is Hearing and Knowing."<sup>35</sup> Having discussed various concepts and different meanings of money in *Quran* and the views of Islamic scholars, now we critically examine the role of money from capitalistic and Islamic perspectives.

### The Role of Money: A Comparative Analysis

Having discussed the basic meanings, concepts and definitions of money, now we can discuss the role of money from a comparative perspective. The fundamental role of money for which it has been invented is a medium of exchange and means of distribution. If it is considered as a tradable commodity and traded in the financial institutions and capital markets, then the whole economy will be affected and will cause macroeconomic imbalances and fluctuations as it happened in the past. In the Great Depression of 1930, Economic Crisis Committee formed by the Southampton Chamber of Commerce declared in its report that 'In order to ensure that money performs its true function of operating as means of exchange and distribution, it is desirable that it should cease to be traded as commodity' (Southampton Chamber Report, 1930)<sup>36</sup>

The financial crisis of 2008 was also linked with the existing nature and injudicious role of money. For example, Mufti Mohammad Taqi Usmani, states in his paper presented to the annual meeting of WEF (The World Economic Forum) in 2010 held at Vegas said, "Diverting money from its basic function as a medium of exchange and make itself as an object of trade that turned the whole economy into balloon of debts and over debts".<sup>37</sup>

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<sup>34</sup> Al Quran 9:34

<sup>35</sup> Al Quran 9:103

<sup>36</sup> "The Report of Economic Crisis Committee, Southampton Chamber of Commerce," <http://www.freecriticalthinking.org/courses-by-category/154-southampton-chamber-of-commerce-r-e-p-o-r-t-of-the-economic-crisis-committee-1933>, accessed on 12 July 2020.

<sup>37</sup> Usmani, "Post Crisis Reforms: Some Points to Ponder,".

The problem with the current traditional capitalistic monetary system is that it takes money as a tradable commodity and its role as a medium of exchange has been almost neglected. The Islamic view of money is that it is a medium of exchange and not a tradable commodity.

Ibn Taymiyya, (661-728 A.H.) the great Muslim theologian and jurisprudent of 14th century described the nature of money as follows:

As far Dirham and Dinar are concerned they have no particular definition; natural or legal but they are taken into account according to the custom and norm, and because originally they are not intended for themselves, but the objective is that they are used as a means of interaction (medium of exchange) and these are the prices (athma'n, standard and measure for transactions) being different from other valuable and useful commodities, as the objective of other valuable things is getting benefit out of them.<sup>38</sup>

Imam Ghazali (d. 505 A.H.) the great philosopher of Islam, wrote in his famous *book Ihya' ul Uloom*:

"These both (gold and silver) are metals and have no benefit in them as commodity, there is not any in them as commodity, the money is not an objective, but it is a means to an objective." Ibn Qayyem (d. 751 AH), another great scholar and student of Ibn Tamiyyah,<sup>39</sup> also said: The money (gold and silver) is not intended as an objective, but it is intended as a means to get any other commodities, so when it becomes a commodity intended itself as an objective then the system is contaminated.<sup>40</sup>

The role of money in the statements of these prominent and renowned scholars has been mentioned as a medium of exchange. The capitalism has gained some strength as an economic system in the capitalist economies of Western Europe and America, Canada and Australia. The banking industry has obtained a considerable socio-political and economic power in these countries. The banking business in the conventional financial system is based on an interest-based mechanism. Money is treated as a commodity and commercial banks are the traders of the money. They buy and sell money; they buy money from the depositors who have surplus funds and sell to the borrowers who have deficit. Some definitions of the commercial banks state that they are not only traders of money but also manufacturers of money since they create credit, and this is in turn a creation of money. If

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<sup>38</sup> Al Misri, *Al Nuqud Fi al Islam*, 42.

<sup>39</sup> Ibid., 23.

<sup>40</sup> Ibid., 24.

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the money is considered as a commodity and traded like any other goods and commodities, then it creates huge problems for the real economy. The real economy will not gain any benefit from the trade of money and there will not be any increase or production in real wealth of the economy. This accumulation of money will create only concentration of wealth and cause more disparities and inequalities in the distribution of wealth in any society. Other goods and services have usufruct, which is why they are traded and moved from one place to another and people use them to fulfil their economic needs and satisfy their material wants and desires. But money itself does not have any usufruct and hence is unable to fulfil any materialistic want or need of human beings and instead can satisfy only their greed. That is the reason why the Messenger of Allah (pbuh) said: "If the son of Adam has two valleys of money, then he looks for the third one and nothing will fill the belly of Adam except the dust of grave."<sup>41</sup>

Islam is a complete code of life and the teachings of Islam are inclusive to all the spheres of life. So, there is guidance and teaching for keeping and holding money as well. The hoarding of money or what has been called *Iktina*'z in *Surah Al-Tawbah* verse 34 has already been mentioned in previous section. If the money does not circulate in the economy, then it does not encourage economic activity. It is essential to know in how many hands and how many times money has circulated in a particular unit of time. In Fisher's 'Equation of Exchange', it has been defined as the velocity of money (Irving Fisher, 1911)<sup>42</sup>. The more a unit of money is used in any number of hands and transaction, the more useful it is and productive for economic activity. Therefore, the Messenger of Allah (pbuh) laid down many remedial measures so the wealth does not concentrate in few hands. In contextual meaning, the verse in *Surah Al-Hashr* is related with booty collected in the war without fighting, from the disbelievers (*Ma'l faiy*) as Allah swt mentioned: "So that it will not be a perpetual distribution among the rich from the among you."<sup>43</sup>

Moreover, Abu Zar Ghifari narrates from the Messenger of Allah (pbuh), saying: "And if someone raises dinar and dirham or gold and silver and does not account it for the needy

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<sup>41</sup> Abu Al Hassan Muslim bin Al Hajjaj, *Al Musnad As Sahih* (Beirut: Dar Ihyah Al Turath Al Arabi, 2010), Hadith No. 1048

<sup>42</sup> Irving Fisher, *The Purchasing Power of Money*, (New York: Macmillan, 1911), 16-28.

<sup>43</sup> Al Quran 59:7

and also does not spend it in the cause of Allah, then it is hoarding, and he will be punished with this on the Day of Judgment."<sup>44</sup>

Virtually, the meaning of verse 3 in *Surah Al-Hashr* is not restricted only to this special kind of money or the wealth that is called '*Ma'le Fay*' but it is extended to everything valuable that someone wants to keep and accumulate as money. Rather than hoarding money and allowing the subsequent concentration of wealth, Islam has emphasized on spending and participating in economic activities. There are numerous commandments to get involved in business and trade, so the money does not remain idle or unutilized. The obligatory charity (*zakah*) and inheritance (*irth*) and optional charities (*sadaqa't nafilah*) and recompense (*kaffara't*) are some of them. Islam has encouraged the earning of sustenance and provision of life and it is mentioned in the *Quran* that if wealth is obtained in a *Halal* and permissible way then it is the bounty (*fadhal*) of Allah. It means that you have to spend money to get the benefit, interestingly, money gives you benefit only when it leaves you. As long as you are keeping money in your custody and not spending it, then you will not gain any real benefit from it.

Money in Islamic economic system is considered as a means of transaction and medium of exchange. Imam Ghazali (450-505 AH) the great philosopher of Islam, has mentioned the nature and functions of money long before the western economists had defined and developed such a concept. According to him:

It means that Allah created Dirham and Dinar as measure of value and medium of exchange in all the transactions, even the value of valuables is determined in terms of Dirham and Dinar. For instance, the price or the value of this camel is hundred Dinar.<sup>45</sup>

Imam Ghazali also mentioned in his famous book '*Thya'a ul Uloom*'

It is from the blessings of Allah the Almighty that he created Dirham and Dinar and the whole world depends on them in commercial transactions. They are nothing but two metals and there is not any usufruct in both of them, but all the humanity tends to them for their transactions because they have several needs in terms of food, dress and other sustenance.<sup>46</sup>

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<sup>44</sup> Ahmed bin Muhammad Hunbal, *Musnad Al Imam Ahmed bin Hunbal* (Beirut: Muasasah Al Risalah, 2001), Hadith No. 21557

<sup>45</sup> Al Misri, *Al Nuqad Fi al Islam*, 37.

<sup>46</sup> *Ibid.*, 36.

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Another great scholar and renowned historian, Abdur Rahman Ibn Khaldoon (732-808 A.H.) wrote: "Allah the Almighty, created two minerals: gold and silver and they determine value of everything valuable."<sup>47</sup>

Bill Clinton (2009)<sup>48</sup> in the meeting of World Economic Forum rightly pointed out that 'I believe that when we get through this we shall have a 21st century finance system that will make money the old-fashioned way by investing in goods and services that are needed for the modern world. So, I think it will be quite a modern economy, but I think we'll go back to a lot more traditional finance. People will still make money, but it won't be like it was in this decade; I think that will be a good thing'.

The use of money as a commodity when it does not have usufruct, created the bubble. In particular when the commercial banks advanced huge amounts of credit as a result of credit creation, it caused the financial crisis. The Islamic teachings and the prophetic guidance are manifest that money must not to be used in unproductive, useless and harmful transactions. These teachings were laid down long time ago, when there was no concept of a financial crisis, as these occurred later in modern economic history. There are two uses of gold and silver; as commodity and as money. For both of these uses the sayings of Prophet (saw) guided the followers of Islam on how to do so effectively. If these precious metals gold and silver are used as money, then it is a trade of money and Prophet (pbuh) laid a rule about this trade saying: "Do not sell one dirham for two dirhams and one dinar for two dinars."<sup>49</sup>

Also, there is another saying of the Messenger of Allah (saws) which is clearer about the trading of the money: "Dinar is exchanged for dinar and dirham for dirham, there is not extra charging and also not sold on credit."<sup>50</sup>

These sayings of the Prophet (saw) explicitly mention that one *dirham* cannot be sold for two *dirhams* and one *dinar* cannot be sold for two *dinars*. It implicates that any monetary transaction which is based on the surplus (getting extra) of the same kind of

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<sup>47</sup> Ibid., 53.

<sup>48</sup> Bill Clinton, "WEF Global Risk Report (2009)," <https://www.zurich.com/.../WEFDavosreport2009Deepdivereportexternal>, accessed on 6 August 2020.

<sup>49</sup> Al Hajaj, *Al Musnad As Sahih*, Hadith no. 33

<sup>50</sup> Abu Bakr Abdullah bin Muhammad Abi Shaibah, *Musanaf Ibn Abi Shaibah* (Al Riyadh: Maktaba Al Rushd, , 1409 AH), Hadith no. 21883

money is not allowed. If the money involved is used through trade transaction as a medium of exchange and there is some surplus in the money, then it is a *Halal* profit. For example, the Messenger of Allah (pbuh) once gave one *Dinar* to one of his companions, Urwah Al-Barqi and asked him to buy a sheep for the Messenger of Allah (pbuh). He took one *Dinar* and bought two sheep and sold one of them for one *Dinar* and came to the Messenger of Allah (pbuh) with one *Dinar* and also one sheep (Sahih Bukhari-Hadith No. 3370)<sup>51</sup>. So if there was not trade transaction then the increase in the *Dinar* was not permissible. But once the money has been used in the trade transaction and it is increased then it is allowed, and the surplus is a legitimate profit from a *Shariah* perspective. In the literature, the value of money is linked with inflation and some scholars have the opinion that based on indexation or rate of inflation, the compensation of money has to be paid in the deferred payments or paying off debt.<sup>52</sup> But this point of view is not accepted by the *Jamhoor Ulama* and they say that any extra amount based on any monetary transaction would be considered as *Riba*. Contrarily, if the money is used as a commodity then the explicit ruling of the Prophet (pbuh) gives a clear and significant indication as following:

The gold with gold, silver with silver, barley with barley, wheat with wheat, dates with dates and salt with salt with equal amount and weight and on the spot hand in hand, if anyone paid or demanded extra then involved in interest, the payer and receiver are equal.<sup>53</sup>

It means that the trade of gold and silver (along with other commodities mentioned in the *Hadith*, as barley, wheat, dates, salt) has to be on the spot and no difference in the weight can be given or taken if it is homogeneous commodity. If someone demands extra, then he is dealing with interest and in that case both the one who is paying and the one is gaining are equal in committing sin.

So, the use of gold and silver as money or as commodity is only permissible if they are in equal amount, weight, quality and quantity. Thus, Islam discouraged any monetary transaction if it does not involve real transaction of trade of goods and services. It means that Islam has closed all kind of possible doors from where somebody can make money without any effort or going through any physical fatigue or taking any real and considerable

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<sup>51</sup> Muhammad bin Ismael Al Bukhari, *Sahih Al Bukhari*, Hadith no. 3370

<sup>52</sup> Ali, "Money and its Compensation," 1-28.

<sup>53</sup> Al Hajjaj, *Al Musnad As Sahih*, Hadith no. 1584



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risk. Also, the possession of the goods and commodities and their movement from one place to another is one of the essential conditions in trade transaction. The Messenger of Allah (saw) has declared very explicitly that somebody must not sell any commodity unless he has taken the commodity in his possession and he has changed the storage of commodity from a seller's storage to a buyer's storage. There are more than one sayings of the Messenger of Allah on this issue. The *Hadith* of Zaid bin Thabit explains the importance of economic activity and the use of money in trade transaction and movements of the goods and commodities.

Ibn Umar says, I bought cooking oil from the market and I wanted to keep it for myself, a man came to me on the way and offered me a good profit, I was likely to complete my transaction with him but someone caught my arm from the back, I saw he was Zayd bin Thabit, he said the Messenger of Allah (pbuh) forbade from selling the commodities where they are bought from, until the traders have moved them to their places.<sup>54</sup>

This Hadith lays a profound emphasis on economic activity which is based on trade transaction and it discourages merely the monetary transaction where the commodities are not transferred. In the light of this *Hadith*, I found an interesting discussion in the book called "Tragedy and Hope" by Carroll Quigley (1966)<sup>55</sup>, wherein certain things related to money were mentioned and how it is being used in modern times and particularly what is the relationship between value of goods and money and how it impacts the equitable distribution of income.

In the Islamic spectrum, money should be used as a medium of exchange and store of value. It is a means to attain and achieve other goals or objectives and it is not a goal or objective in itself. It is not a tradable commodity and it does not have utility or usufruct and so, does not have any ability to fulfil any human needs like hunger, thirst or other necessities. It cannot be used to provide heat and shelter. It cannot be processed in any way to fulfil the basic needs of human race. So, money is a servant of the human race used to facilitate trade transactions and it is not to be taken instead as a master. If humans take money as their master and live and die for it then it has been pointed out by the Messenger

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<sup>54</sup> Suleman bin Al Asha'th Al Sajistani Abu Dawud, *Sunan Abi Dawud* (Beirut: Al Maktabah Al Asariya, 2010), Hadith no. 3499

<sup>55</sup> Carroll Quigley, *Tragedy and Hope* (New York: The Macmillan Company, 1966), 1197-1313.

of Allah (pbuh) in the following hadith: "The worshiper of dirham and dinar is always unhappy and unsatisfied."<sup>56</sup>

The saying signifies that the one who worships the *Dirham* and *Dinar*, meaning lives and dies for it and makes it the only purpose of his life, then he is relapsed and deteriorated and never satisfied or successful in achieving his goals. It has already been mentioned that there is not any end to the human greed. Only the dust of the grave can fill the belly of mankind.

### **The Commercial Banks and Role of Money**

The existing banking system has a long and interesting history over 600 years. It started from goldsmiths who were safekeeping money of the people and writing certificates for the depositors. It is also worth mentioning that the word 'bank' is from Latin language meaning 'bench/table'<sup>57</sup>. The goldsmiths found that all their deposits were not demanded by the deposit holders and there was a lot of money which remained idle. Through various stages and evolutionary developments, the modern banking system emerged in its existing format in 16th and 17th century where the financial intermediation, money exchange, accepting deposits and advancing loans became the main functions of banking institutions.

The fractional reserve system is the structural foundation of the modern banking system along with an interest-based mechanism. The central bank of the country determines the minimum reserve ratio and the commercial banks are obliged to maintain this reserve ratio in terms of deposits and advance new loans and offer finance as a financial intermediation to the borrowers who face a deficit in funds for running their business and trade. Or it could be personal finance required for some personal needs and basic necessities. Based on the inflationary situation and needs of the credit creation in the economy the central bank determines the minimum reserve ratio, for example, 10 % or 15% etc or less and more.<sup>58</sup>

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<sup>56</sup> Bukhari, Sahih *Al Bukhari*, Hadith no. 6071

<sup>57</sup> Pyatt, Elizabeth, "Banks and Benches - A Complicated Linguistic Transaction," [www.personal.psu.edu/ejp10/blogs/thinking/2009/04/banks-and-benches---a-complicated.html](http://www.personal.psu.edu/ejp10/blogs/thinking/2009/04/banks-and-benches---a-complicated.html), accessed on 8 July 2020.

<sup>58</sup> Zubair Hasan, "Credit Creation and Control: An Unsolved Issue in Islamic Banking," [http://mpira.ub.uni-muenchen.de/8130/1/Credit\\_creation.pdf](http://mpira.ub.uni-muenchen.de/8130/1/Credit_creation.pdf), accessed on 6 August 2020.

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The excessive advancement of loans and huge credit creation by commercial banks created problems in the Great Depression of 1930s as mentioned in Southampton Chambers of Commerce report.<sup>59</sup> The Financial Crisis of 2008 was also caused by the banking sector as mentioned by various economists explaining 'Housing and Credit Bubble' and 'Candyfloss Economy' that caused crisis (Gross Daniel, 2010, Maridusmita, 2020, Morgan Tim, 2018).<sup>60</sup> To rectify the role of money and banking sector, some legendary economists presented the Chicago Plan in 1933 and suggested certain proposals as a memorandum containing the essential reforms for the correction and proper functioning of monetary, banking and financial system to avoid any financial crisis in future. Paul Douglas and Irving Fishier (1939)<sup>61</sup> and their colleagues were the initial authors of this plan which was based on economic theory and historical evidence. In 2012, after the financial crisis of 2008, the Chicago Plan was revisited, and a Working Paper was published by the IMF, written by Jaromir Benes and Michael Kumhof (2012).<sup>62</sup> This indicated that the contents of this plan and the proposals still have got a lot of significance and weight among the academia and literary circles of the discipline while discussing the role of money.

The eradication of the speculative use of money, considering money as a commodity and not as medium of exchange, elimination of credit creation through fractional reserve system in the private commercial banks, complete control of money supply in the hands of government and central bank and adaption of 100 % reserve system,

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<sup>59</sup> The Report of Economic Crisis Committee, Southampton: Chamber of Commerce, 1933, part 3, (iii) paragraph 2, <http://www.freecriticalthinking.org/courses-by-category/154-southampton-chamber-of-commerce-r-e-p-o-r-t-of-the-economic-crisis-committee-1933>, accessed on 4 August 2020.

<sup>60</sup> Daniel Gros, and Cinzia Alcidi, "The Impact of the Financial Crisis on the Real Economy" in *Inter-economics: Review of European Economic Policy* 45, no. 1 (2010): 4-20; Mridusmita, "The Financial Crisis 2008 Explained Simply," *Economyria*, <http://economyria.com/the-financial-crisis-2008-explained/>, accessed on 25 July 2020; Tim Morgan, "Candyfloss Economics," *Surplus Energy Economics*, 2018, <https://surplusenergyeconomics.wordpress.com/2018/01/17/117-candyfloss-economics/>, accessed on 3 June 2020.

<sup>61</sup> Paul Douglas, et. al, "A program for Monetary Reform," <http://savingcommunities.org/docs/douglas.paulh/chicagoplan.html>, accessed on 24 June 2020.

<sup>62</sup> Jaromir Benes and Michael Kumhof, "The Chicago Plan Revisited," *IMF Working Paper WP/12/202 International Monetary Fund*, 2012, <https://www.imf.org/external/pubs/ft/wp/2012/wp/12202.pdf>, accessed on 13 June 2020.

and separation of commercial and investment banks were some of the major and fundamental points of this plan. The new Chicago Plan was an echo of the original plan. It contained a number of chapters and discussed the origin and the nature of money from the very beginning to various stages of history till date.

The basic idea of the revisited Chicago Plan is that banks should be required to have full coverage for money they lend, known as 100% reserve banking, instead of the currently prevalent system of fractional reserve banking. Under this proposal, banks would no longer be allowed to create new money in the form of credit in connection with their lending activities. Instead, the central bank should be solely responsible for all the creation of all forms of money, including paper money and coins. The authors of the plan rely on both economic theory and historical examples, and state that inflation, according to their calculations, would be very low.

The leading economist and mastermind behind the original Chicago Plan, Irving Fisher, discussed great advantages of state-controlled issuance of money compared with the private money creating activity of the banks through credit creation:

1. Increased control of market fluctuations
2. Increased financial stability due to elimination of risk of bank runs
3. Dramatic reduction of public debt
4. Great potential of minimizing private debt

The most important feature of the new Chicago plan is that the banks are not allowed to create private credit based on fractional reserve system and they are supposed to follow the policy of a 100 % reserve system. The government has to be responsible for creating money (CEPR, 2012)<sup>63</sup>. It is quite alarming that the private banks create 97% of the money and only 3% is created by the government and is called sovereign money (Bramhall, 2014)<sup>64</sup>.

The Chicago Plan and other monetary reforms proposals have suggested that the banking system should be based on 100% reserve system. The saving account deposits are

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<sup>63</sup> Centre for Economic Policy Research "The Economic Crisis: How to Stimulate Economies with Increasing Public Debt," 2012, <http://cepr.org/pubs/PolicyInsights/PolicyInsight62.pdf>, accessed on 13 July 2020.

<sup>64</sup> Stuart Jeanne Bramhall, "An IMF Proposal to Ban Banks from Issuing Money," 2014, <https://www.veteranstodayarchives.com/2014/03/29/an-imf-proposal-to-ban-banks-from-issuing-money/>, accessed on 7 July 2020

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sometime time-deposits, but current account deposits are the demand deposits which could be withdrawn at any time. The separation of commercial and investment banking and adoption of 100% reserve systems will save the economies from many unwanted fluctuations and financial crisis. It will decrease the ability of the banks to create money out of nothing. In the report published by Bank of England (2014)<sup>65</sup> it has been discovered that 97% money was created by the commercial banks and the Bank of England did not have any control on this money supply. The economics textbooks suggest that the central bank and the government control money supply through monetary policy using open market operations, reserve system and interbank interest rate; in short, they control fluctuations in the economy. The Bank of England report published in 2014 and Mervyn King (2016)<sup>66</sup>, ex-Governor of the Bank of England said clearly that the role of money and its use as a tradable commodity created problems. The need of reformation of the monetary and financial sector through banking system is only way forward. But as it has been mentioned in the Chicago Plan for Monetary Reform that it is not so easy. The president of the United States, Franklin D. Roosevelt expressed his wish to change the role of money and control the banking system on numerous occasions, but he was unsuccessful in doing so. Carroll Quigley (1966)<sup>67</sup> mentioned in his book how a 'secret mafia' is controlling the financial system of the world which constitutes of a network of families who own the international banks. The commercial banks make huge profits based on fractional reserve system.

The Islamic banks are based on PLS (profit and loss sharing) principle and Shari'ah compliance and showed more resilience in 2008 financial crisis. It was due to asset-based financing. But the problem of fractional reserve system is also existing in Islamic banks.

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<sup>65</sup>The Bank of England Report, "Money Creation in Modern Economy," 2014 [www.bankofengland.co.uk/.../qb14q1prereleasemoneycreation.pdf](http://www.bankofengland.co.uk/.../qb14q1prereleasemoneycreation.pdf), accessed on 3 June 2020.

<sup>66</sup> Mervyn King, "New Financial Crisis is Certain without of Banks," *The Guardian* (28<sup>th</sup> February 2016), <https://www.theguardian.com/business/2016/feb/28/mervyn-king-new-financial-crisis-is-certain-without-reform-of-banks>, accessed on 15 June 2020.

<sup>67</sup> Carroll, *Tragedy and Hope*, 1085-1313.

Asad Zaman (2014)<sup>68</sup> and Zubair Hassan (2009)<sup>69</sup> have pointed out such important issues in their writings, like the fractional reserve system but unfortunately the Islamic banking practices have been on the same pattern. The legal practice of *Shari'ah* in Islamic banks will not make much difference if the foundational structure of the money has not been rectified. The *Shariah* governance has a great honour and a significant role in Islamic financial institutions and it is the moral and religious obligation of those who are responsible for *Shariah* compliance to ensure the Islamic rulings are not nullified.

## **Conclusion**

The article is purely theoretical and comparative analysis of two divergent approaches. It is related with the nature and role of money, the impact of money and its role on the financial sector and creating fluctuations in the economy. However, based on the discourse of the previous studies, the author of the research paper has attempted to develop the argument that:

1. The invention of money is a great achievement in economics, but its role is to serve the humanity by facilitating the trade and commercial transactions. It is a means to achieve the objective. Whenever money is used as a commodity and traded for itself, it creates bubbles and a fake economy which may burst into financial crisis.
2. There is a dire need to change the current role of money, and hence, also the monetary and banking and financial systems. The abolition of *riba* is not the only requirement of Islamic banking system. The replication of conventional system will not make it Islamic unless the *Shari'ah* based and *Shari'ah* compliance both are realised.
3. The revealed knowledge of the *Quran* and *Sunnah* can play a significant role in finding out the solutions of these problems which repeatedly are causing distortion in global economy. The human intellect is a great blessing of Allah (SWT), but it needs the guidance from the revealed knowledge.

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<sup>68</sup>Asad Zaman, "On the Nature of Modern Money," 2014, [http://www.academia.edu/11383900/On\\_the\\_Nature\\_of\\_Modern\\_Money](http://www.academia.edu/11383900/On_the_Nature_of_Modern_Money), accessed on 28 July 2020.

<sup>69</sup> Zubair Hasan, "Credit Creation and Control: An Unsolved Issue in Islamic Banking," 2009, [http://mpira.ub.uni-muenchen.de/8130/1/Credit\\_creation.pdf](http://mpira.ub.uni-muenchen.de/8130/1/Credit_creation.pdf), accessed on 12 June 2020.

### Recommendations

Based on the discussion and conclusion of the article, the author suggests the following recommendations.

- Money has to be used as a medium of exchange and standard of value and should not be used as a tradable commodity because it cannot satisfy any materialistic human wants directly, like food, etc. It can only be used in exchange to get those commodities which satisfy human wants.
- Commercial banks should not be allowed to practise on the basis of fractional reserve system. Instead, the hundred percent reserve system has to be applied for stable and smooth banking operations.
- The supply of money has to be controlled by the government; either a monetary authority or a central bank, and it should not be given in the hands of commercial banks in terms of credit creation or unknown sources as in case of cryptocurrencies.
- It is recommended to keep a separation between investment banking and commercial banking institutions.
- The banking and financial institutions are recommended to run their business on profit and loss sharing, rather than trading money as a tradable commodity and selling the debts on the basis of securitization and causing credit bubble and candyfloss economies.

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