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Islamic Relief Debt Policy

Islamic Relief is dedicated to alleviating the poverty and suffering of the world's poorest people.

Published by Islamic Relief Worldwide
19 Rea Street South
Birmingham
B5 6LB
United Kingdom
www.islamic-relief.com

Send feedback and comments on this material to pru@irworldwide.org

"If the debtor is in difficulty, grant him time till it is easy for him to repay. But if you remit it by way of charity, that is best for you if you only knew."
(Al Baqarah/ The Cow [2], verse 280)

Introduction

According to the IMF's World Economic Outlook, Africa as a region has paid 12.6bn USD in '08 and in '09 will pay 13.7bn USD in interest alone on its foreign debts. 'Developing Asia'[1] has paid 50bn USD in '08 and in '09 will pay 57.4bn USD in interest alone. According to the Jubilee Debt Campaign[2], in 2005, 'developing' countries paid a combined US$513.8 billion in debt repayments, while in the same year they received a total of US$106.8 billion in official aid. The very poorest of them[3] paid a joint US$43.2 billion in debt repayments, while they received a combined US$40.4 billion in development aid. This means that, despite significant amounts in aid, the net result is that the countries end up poorer every year.

The countries where IR works in[4] had a combined debt of 1.36 trillion USD in 2006 and spent on average 3.08% of GDP on servicing these debts. These staggering amounts, paid to service debts often incurred by previous regimes and not invested in long-term development of the country, are amounts that cannot be spent on health and education[5], key means to support countries' escape from poverty. In comparison, the UN estimates it would cost only USD 11bn annually to achieve universal primary education by 2015 (goal 2 of the UN's Millennium Development Goals [MDGs][6]).

Debt and Poverty

Having significant debts and non-compassionate lenders means several poor countries are paying significant percentages of their GDP in servicing their debts. This means this money cannot then be invested in health and education (acknowledging that debt relief alone will not be sufficient as for example corrupt regimes may spend the available money in other ways), leading to the next generations continuing to suffer, not only from continued debt, but also from lower health and educational attainments, leading to challenges in escaping poverty. For comparison, some countries IR works in pay more of their GDP in debt servicing than they (can) do on health and education. Ethiopia, for example, pays 4.4% of its GDP in debt servicing, while only 2.7% on health. Bangladesh pays 1.3% of its GDP in debt servicing and only 0.9% on health. The Russian Federation pays 5.5% of its GDP on debt servicing and 3.8% on education. Indonesia pays 6.3% in debt servicing, 1% on health and 0.9% on education. Lack of significant expenditure on health services contributes for example to, in 2005, more than 500,000 women dying during pregnancy, childbirth or in the six weeks after delivery. Ninety-nine per cent of these deaths occurred in the developing regions, with sub-Saharan Africa and

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[1] Vietnam, Pakistan, India, Thailand, China, Sri Lanka, Indonesia, Philippines, Malaysia, Bangladesh
[2] *Unfinished Business: Ten years of dropping the debt* was released on the tenth anniversary of the 70,000-strong human chain in Birmingham on 16 May 1998, http://www.jubileedebtcampaign.org.uk/download.php?id=729
[3] Low income countries as defined by the Worldbank, having a per capita income of US$875 or less in 2005
[4] Africa (Chad, Congo (D.R.), Ethiopia, Kenya, Malawi, Mali, Niger, Somalia, South Africa, Sudan); Middle-East/ Eastern Europe (Albania, Bosnia Herzegovina, Egypt, Iraq, Jordan, Kosova, Lebanon, occupied Palestine, Russian Fed, Yemen) and Asia (Afghanistan, Bangladesh, China, India, Indonesia, Pakistan, Sri Lanka)
[5] Of course it also greatly depends on who runs the country on whether any available funds are spent on education, health or less useful matters.
[6] The eight Millennium Development Goals have been adopted by the international community as a framework for the development activities of over 190 countries in ten regions; they have been articulated into over 20 targets and over 60 indicators.

Southern Asia accounting for 86 per cent of them. In sub-Saharan Africa, a woman's risk of dying from treatable or preventable complications of pregnancy and childbirth over the course of her lifetime is 1 in 22, compared to 1 in 7,300 in the developed regions (improving maternal healthcare is goal 5 of the MDGs). For more information see IR's policy on reproductive health.

Note that external debt has to be repaid in foreign currency so even if the debt is used for an investment project which has a high social return but no direct or indirect effect on a country's ability to increase its foreign exchange earnings it will be a challenge for such country to repay the debt. As the countries IR works in are already amongst the poorest they do not have much choice as to how to pay for these debts, often ending up selling natural resources, like tropical forests, which then lead to increased landslides etc, further impeding escape from poverty (see IR's environment policy for more on this).

A highly indebted poor countries (HIPC) debt relief programme was introduced in 1996 with a goal to "ensure deep, broad and fast debt relief and thereby contribute towards growth, poverty reduction, and debt sustainability in the poorest, most heavily indebted countries." It aims to reach a certain ratio of debt-to-exports earnings, a point at which the rest of the debt burden is considered to be sustainable. In 2002, the Monterrey Consensus[7] noted that "external debt relief could play a key role in liberating resources that could then be directed towards activities consistent with attaining sustainable growth and development. Debt relief measures should, where appropriate, be pursued vigorously and expeditiously." In practice, however, countries that do have their debts cancelled or reduced are often forced to implement harmful economic policies (referred to as 'structural adjustment') such as privatisation and other conditions, leaving the country exposed to cheap imports or dumping and often hitting the poorest hardest as local manufacturing collapses and privatised water becomes unaffordable.

A dangerous more recent phenomena has been the appearance of 'vulture funds', private companies that specialise in buying up cheap debts from heavily indebted countries and pursuing them for profit - even when that means taking money from countries that cannot afford to feed their own people. At least 54 companies are known to have taken legal action against 12 of the world's poorest countries, for claims amounting to US$1.5 billion.[8] Of relevance with Islamic Relief being headquartered in Birmingham, is that one-fifth of these cases are or will be tried in UK courts.

Causes and consequences of poor countries' indebtedness

Incurring a loan can be a very good thing. If incurred wisely, loans may enable a country, company or individual to initiate or expand economic activities, or may bridge a period of unusual hardship. The resultant debt is not difficult to repay.

Unfortunately, much of the debt that is burdening poor countries today is 'odious': it is the result of money that was recklessly lent by banks and recklessly borrowed by corrupt regimes. Much of this debt was incurred in the aftermath of the global petrol crisis of the 1970s. Private

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[7] The Monterrey Consensus was the outcome of the 2002 Monterrey Conference, the United Nations International Conference on Financing for Development. It was adopted by Heads of State and Government on 22 March 2002. A follow-up conference, on the implementation of the Monterrey Consensus, was held in Doha, Qatar from 29 November to 2 December 2008 which was critisised by European Network on Debt and Development (EuroDAD), a network of 56 non-governmental organisations from 17 European countries, for lack of progress.
[8] Time to tame the vultures, January 2009, Jubilee Debt Campaign, www.jubileedebtcampaign.org.uk/download.php?id=796

banks, awash with oil profits from the OPEC nations, were compelled to lend money in order to meet the dividend payments owed on their deposits. Large loans were made to very poor countries whose governments were expected to and indeed did misappropriate the money. Such debts have not led to sustainable economic growth. In absence of an expanded economic base, these debts are very difficult to repay on schedule and, as a consequence, have ‘mushroomed’ due to interest charges.

Decades later, many countries continue to struggle to service the interest on their debts. Had these countries been companies, they would have been declared bankrupt; but unlike bankrupt companies, which are legally protected from their creditors, international law offers no ‘fresh start’ to bankrupted countries. Instead, debt has been ‘rescheduled’ and new loans have been issued, partly to enable repayment of old loans. These new loans have been less odious, but have instead been highly conditionalised. Often, they are linked to ‘structural adjustment programmes’, which aimed to cure structurally weak economies. Three elements of these structural adjustment programmes have been particularly devastating.

- First, these programmes came with austerity measures that led to reduced government expenditure which was largely dedicated to various types of public services and social safety nets. Health care, education, water supply and security payments to the countries' most vulnerable people have suffered as a consequence.[9]
- Second, these programmed imposed free trade measures that opened the doors for products that the domestic producers could not compete with (partly because, in the case of agriculture in particular, these products have been subsidised by the export countries' governments).[10]
- Third, these programmes encouraged privatisation of public companies, including the privatisation of companies that provide public goods such as water. Privatisation has often resulted in an increase in the prices charged for public goods, making it relatively more expensive for poorer customers.[11]

Economic thinking changes over time, and the structural adjustment programmes have now been replaced with more country- and situation-specific economic revitalisation attempts. That is progress, but it has not ended the indebtedness, and countries trapped in onerous repayments continue to be insufficiently able to invest in their economies or to fund basic services such as health and education. Indeed, the poorest 49 countries have debts totalling between US$290 and 375 billion, whilst for the poorest 144 countries, it is over US$ 2.9 trillion. The total external debt of the very poorest countries (the 'low income countries' which have an annual average income of less than US$935 per person) was US$375 billion in 2006. During 2006, these countries paid over $34 billion to the rich world in debt service (payments of interest and principal) – that is $94 million a day.

For all ‘developing’ countries, total external debt owed in 2006 was US$2.9 trillion, and over the course of that year they paid US$573 billion servicing these debts. These are the latest figures available - there has been some debt cancellation in 2007 and 2008, but new debts have

[9] Note that this compromises the Islamic imperative of caring for the needy.
[10] Note that this compromises the Islamic concepts related to fairness in trade (see the separate policy paper on trade).
[11] In addition, in cash-trapped countries such monopolisation often leads to foreign investors ‘walking off with the family silver’. Note that, in Islam, monopolisation of public goods is impermissible.

also been incurred.[12] Exact figures change over time and it is to be seen what impact the global recession will have, but the principle will remain.

Without having benefited from the loans, this indebtedness has crippled the poorest people in the poorest countries for decades**.** Escaping from the cycle of indebtedness is an issue of justice.

Given the Islamic call to work for justice and to assist the poor, it is a logical step for Islamic Relief to add its voice to, and engage energetically with, campaigns that aim to eradicate the debt of the world's poorest countries.

International campaigns against debt

The central problem facing countries that have sunk into debt is that countries cannot go bankrupt. Campaigners, organised in the Make Poverty History coalition, the Jubilee Debt Campaign, and the New Economics Foundation, propose a new banking system, in which nations *can* escape their debtors and effectively start again. The main demands are that:

- Bankruptcy procedures are created and applied to countries that have no possibility of repaying their loans.
- All un-payable debt is to be cancelled by fair and transparent means. The resources that are freed up should be carefully monitored to ensure that they are put to use for the development of the social welfare infrastructure of the country in question.
- All 'odious debt' is cancelled. Odious debt is debt that has recklessly been incurred by corrupt regimes, and that has brought no benefit to their citizens but does leave them with the obligation to shoulder the burden of repayment.[13]
- Creditor countries and institutions such as the World Bank and the International Monetary Fund re-evaluate their past and current lending behaviour. Most campaigns focus on de-linking lending and demands to open up markets. Instead of 'free trade', these campaigns lobby for 'fair trade'. Among other things, 'fair trade' includes the permissibility of countries to maintain some degree of protection to nurture home industries in order to level the international trading playing field.

Debt and Islam

In Islam, excess and waste are condemned, and humanity is warned not to consume more than individual means permit. Borrowing to fund luxury and extravagance is contrary to core Islamic values, especially when this is done on behalf of an entire country.

Conversely, responsible loans that are used to finance economic activities or to bridge a period of unusual economic hardship, are allowed. These loans are issued on the basis of an equitable, risk-sharing partnership between the lender and the borrower, in which reward and failure are shared by both parties. This system of risk-sharing results in a mutually cautious approach to debt creation.

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[12] For example[12], developing countries repay on average US$456 billion a year in debt service while an estimated US$619 billion disappears in illicit capital flight. US$130 billion is lost to the developing world every year through multinationals remitting profits back to their home countries (see also IR's trade policy). US$250 billion vanishes through tax dodging because US$11.5 trillion of global assets are currently held in tax havens, like the UK, one of the centres of financial globalisation. The most recent figure of US$106 billion in aid to developing countries (in 2006) is dwarfed by these huge sums.

[13] Partly as a consequence of large-scale campaigns, the UK government has agreed to conduct a debt audit in order to identify which debt owed to it is 'odious' and which can then be urgently considered for cancellation.

If debts are incurred responsibly, paying them off is important. Prophet Muhammad (PBUH) said the:

"best amongst you are those who are best in paying off debt".[14]

If, however, a person falls hopelessly into debt, then the creditor should show compassion. The Qur'an states:

"If the debtor is in difficulty, grant him time till it is easy for him to repay. But if you remit it by way of charity, that is best for you if you only knew." (Al-Baqarah/ The Cow [2] 280)

If the creditor fails to alleviate the burden of indebtedness, then the debtor is eligible for zakah (for more on zakah, see the paper on 'Islam and Charity').[15]

Indeed, the misery that debt can inflict upon the debtor was fully acknowledged by the Prophet (PBUH), hence his prayer:

"Oh Allah! I seek refuge in You from sin and from being in debt."[16]

This misery is aggravated by the charging of interest. As interest tends to exacerbate debt, Islam does not allow for it. The Qur'an is emphatic:

*"Oh you who believe! Fear Allah, and give up what remains of your demand for usury, if you are indeed believers. If you do not, take notice of war from Allah and His Messenger: But if you turn back, you shall have your capital sums: deal not unjustly, and you shall not be dealt with unjustly." (Al-Baqarah/ The Cow [*2] 278-279*)*

In essence, Islam condemns both exploitation and the concentration of wealth. As loans have the risk of causing both, they should be issued with caution, and lenders and borrowers should share the risk of the loan. Usury is not allowed as it tends to aggravate indebtedness. Unfortunately, the international banking system does not work in line with these principles. Instead, the bulk of the loans that have caused the indebtedness that many developing countries are in has been issued irrespective of the spending objectives, without risk-sharing clauses, and with interest rates that have spiralled much of the developing world into a debt trap that has impacted negatively upon the lives of many millions of people.

Islamic Relief's Debt Policy

Islamic Relief seeks to alleviate the poverty and suffering of the poorest people and, as such, must do what it can to remove the root causes of poverty. One of these root causes is international debt. Obviously, Islamic Relief cannot single-handedly change the international banking system. It can, however, advocate for what the organisation believes this international banking system should look like. In particular, Islamic Relief can:

[14] Khan, M.A, *Economic Teachings of Prophet Muhammad*, Islamabad, International Institute of Islamic Economics, 1989, p.164
[15] The 'gharimun', indebted people, form one of the eight categories of people that zakah can be given to.
[16] Mannan, M.A., *Islamic Economics: Theory and Practice*, Cambridge, The Islamic Academy, 1986, p.215

- Wherever and whenever possible, speak out against the obligation to repay odious and interest-inflated debt. Undue indebtedness is a key pillar in Islamic Relief's analysis of poverty, and debt cancellation for the world's poorest countries is one of the principle advocacy goals.
- Increase awareness about and stand up against so called 'vulture funds'
- Be a partner in debt-related inter-agency campaigns. Current international campaigns, and most notably the Jubilee Debt Campaign, advocate for the world's bilateral and multilateral creditors to waive odious and un-payable debt. This finds a ringing endorsement in the Islamic approach to be relenting to the debtor and the insolvent. Similarly, efforts to ensure that un-payable debt is cancelled on the condition that freed-up funds are used for social welfare purposes sit comfortably with Islamic calls for financial responsibility, mercy, and a meaningful social safety net. It is befitting that Islamic Relief collaborates with this and other initiatives and, thereby, benefits from the added momentum. In that context, Islamic Relief UK's current membership of the Jubilee Debt Campaign board of trustees should be continued and encouraged.

Whether acting alone or as part of a coalition, Islamic Relief could enrich the debate by emphasising that:

- Loans should be interest free. It means that debtors will not spiral into ever-worsening indebtedness as a consequence of accumulative interest charges. It does not mean that lending cannot be profitable, as is illustrated by the recent expansion of profit-based Islamic banking.
- Risks should be shared between creditor and debtor. Such risk-sharing helps to ensure a cautious lending regime.
- Complete cancellation of debt should be readily considered in the event of project failure.
- Repayments should be eased in the event of the debtor falling on hard times, even if these hard times are unrelated to the project or business for which the loan was issued.
- Justice in trade and banking is crucial. Finding ways out of indebtedness is only part of the solution. *Avoiding* undue indebtedness in the future is crucial. This requires major modifications in the world trade and world banking systems (see IR's trade policy).
- In the foreseeable future, the advocacy focus will be on debt cancellation and a revision of the global banking system. In the longer term, Islamic Relief may call for partial payback of the odious debt and interest payments that developing countries have made in the past decades.

The Qur'an commands a Muslim to advocate the pursuit of good and forbids doing wrong. Following those principles, Islamic Relief has to advocate and campaign tenaciously against unjust debt repayment and the most pernicious causes of debt. It cannot do so without credibility, and part of that credibility could be derived from following the Islamic maxims of justice, equity and risk-sharing in its own loan programmes (see the Islamic Relief micro-credit manual, which is available upon request, for guidance) and procurement policy.

"Let there arise out of you a band of people inviting to all that is good, enjoining what is right, and forbidding what is wrong." (Al-Imran/ The Family of Imran [3] 104)

In the words of the Jubilee Debt campaign: it is not a matter of charity; it is a matter of justice.

References

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