

## **Interest-Based Banking Generates Inflation and is the Principal Cause of Economic Imbalance (1996)**

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One of the economic imbalances, i.e. inflation, in Western developed countries especially after the great depression is the focus of this paper. The author believes that it is hard to digest such a prolonged imbalance to persist despite the incredible developments made in science and technology in these countries. Western economists' answer to this dilemma seems, to him, mostly unconvincing. However, some slight clues can be found in writings of a very few of them, confessing that capitalism suffers from some internal fallacies.

The prime fallacy causing inflation in capitalistic countries, according to the author, is speculation in money market caused by interest rate fluctuations and expectations, which can also be used to explain unemployment. Demand-pull theory of inflation supported by many economists seems to him, incapable to explain it. Because it focuses upon a variable which itself is a function of another variable, often ignored by Western economists. The ultimate variable, i.e., the prime fallacy, according to the author is the rate of interest which causes speculation in money market; this in turn causes excess demand. This causality chain has been mostly ignored by these economists. Speculation in money market is a channel to what the paper termed "money whirlpool" which has been substantiated by U.S. data; the whirlpool changes directly with the size of GNP.

Interest income received by speculators of the money market causes demand for goods and services to increase for which they have had no contribution; hence excess demand and finally inflation. This is the hypothesis proposed by the author, which is open to be tested against statistical evidences. The author further claims that the preliminary results for few Western countries support this hypothesis. It is also argued that in a pure Islamic state with no interest, the money whirlpool will, at least in theory, disappear. Its nonexistence will eliminate one of the main, if not all, causes of inflation in such a system.