ISLAMIC DEVELOPMENT BANK
ISLAMIC RESEARCH AND TRAINING INSTITUTE

LESSONS IN ISLAMIC ECONOMICS

Volume [1]

ISLAMIC RESEARCH AND TRAINING INSTITUTE (IRTI)

Establishment of IRTI

The Islamic Research and Training Institute was established by the Board of Executive Directors of the Islamic Development Bank (IDB) in 1401H (1981). The Executive Directors thus implemented Resolution No.BG/14-99 which the Board of Governors of IDB adopted at its Third Annual Meeting held on 10 Rabi Thani 1399H (14 March 1979). The Institute became operational in 1403H (1983).

Purpose

The purpose of the Institute is to undertake research for enabling the economic, financial and banking activities in Muslim countries to conform to shari'ah, and to extend training facilities to personnel engaged in economic development activities in the Bank's member countries.

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The functions of the Institute are:

(A) To organize and coordinate basic and applied research with a view to developing models and methods for the application of Shari shin the field of economics, finance and banking;

(B) To provide for the training and development of professional personnel in Islamic Economics to meet the needs of research and shari'ah-observing agencies;

(C) To train personnel engaged in development activities in the Bank's member countries;

(D) To establish an information center to collect, systematize and disseminate information in fields related to its activities; and

(E) To undertake any other activities which may advance its purpose.

Organization

The President of the IDB is also the President of the Institute. The IDB's Board of Executive Directors acts as its supreme policy- making body.

The Institute is headed by a Director responsible for its overall management and is selected by the IDB President in consultation with the Board of Executive Directors. The Institute consists of three technical divisions (Research, Training, Information) and one division of Administrative and Financial Services.

Location

The Institute is located within the headquarters of IDB in Jeddah, Saudi Arabia.

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LESSONS IN ISLAMIC ECONOMICS

VOLUME I

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"Teaching Islamic Economics at University Level"
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FOREWORD

The agreement that establishes the Islamic Development Bank which was signed in 1974 (Rajab 1394H) charges IDB with the responsibility of carrying research in the areas related to the application *of Shari'ah* in the fields of economics, banking and finance. The implementation of this article culminated in the establishment of the Islamic Research and Training Institute which had played over the past 15 years an important role in encouraging research in Islamic economics and dissemination of these studies in the academic circles of the universities in the member countries.

Research in Islamic economics is about half a century old with the early writing beginning just after the end of the Second World War. However, since the first international conference on Islamic economics held in Makkah Al-Mukaramah in early 1976, research in Islamic economics took a new important turn by becoming more specific and more identified as a separate branch of the Islamic studies and mainly conducted by professional economists trained in Western universities. Teaching of Islamic economics at the university level began in the late 70's. Nowadays Islamic economics is taught in many universities throughout the IDB member countries where many universities have adopted one or two courses on Islamic economics within the framework of the economics department curricula. Some of these universities provide full-fledged degrees in Islamic economics including Bachelor's, Master's and PhD's. Additionally Master's theses and PhD's dissertations are being written in universities both in Western countries and in the Muslim countries studying different aspects of Islamic economics, banking and finance.

As the universities are some of the most important focal institutions in generating research and culminating theoretical and applied know-how, IRTI has put special emphasis on conducting seminars for university professors in the member countries in order to introduce to them the contemporary studies in Islamic economics with the hope that these seminars would provide an incentive

for enhancing and deepening the teaching of Islamic economics at the university level in the member countries as well as encourage specialists in economics, finance and banking to further the research in Islamic economics.

The seminar of which we present the proceedings in this book is the third of its kind. Two similar previous seminars were held in Islamabad in (1987) and Abu Dhabi in 1989 in cooperation with the International Islamic University in Islamabad and the Central Bank of the United Arab Emirates respectively. This third seminar was held in Dhaka in collaboration with the Islamic Foundation of Bangladesh in the period July 23 - August 5, 1991.

In presenting this book "Lessons in Islamic Economics", IRTI hopes to motivate university professors to work further to develop suitable teaching materials. It is also hoped that this book would help senior officials of institutions, working in the fields of economics, finance and banking, obtain an overall perception of Islamic economics in a systematic way. Needless to say that students, especially graduate students, would also be among the beneficiaries of this publication.

Finally, I pray to Allah to make it a step in the way of the cause of understanding Islamic economics as an integral part of the Islamic studies, and to make it an accepted effort that serves in promoting the application of *Shari'ah* in the fields of economics, finance and banking.

Dr.Mabid Ali Al-Jarhi
Director, IRTI

INTRODUCTION

*by **the Editor***

This book is the proceeding of the seminar on "Teaching Islamic Economics at University Level". Its objective was to give a broad overview of the issues of Islamic economics. Over the last four decades, literature in Islamic economics has developed a great deal to become an independent sub-discipline within economics. Even some people like to call it an alternative approach to the study of the economic behavior of men and women.

The book covers twenty six chapters divided into six parts. Part one deals with the *Shari'ah* foundation of Islamic economics or the *Shari 'ah* background out of which Islamic economics emerges. This part has four chapters that deals with the general objectives of *Shari 'ah,* the major Islamic concepts related to wealth, its management and utilization, the principle of exchange and lending and the Islamic contractual market relationship.

Part two is devoted to the study of the methodology and significance of Islamic economics. It includes five chapters that discuss the issues of importance and relevance of Islamic economics, its methodology, the Islamic economic system and the place of the State in that system and, finally, the principles of private and public ownership in Islam.

Part three looks into the technical analysis of Islamic economics at the macro and micro levels. This part covers eight chapters that deal with macro consumption theory, macro economic modeling in Islamic economies, investment demand function, issues related to growth and inflation. On the micro level, both the consumer and the producer's behaviors are studied in addition to market characteristics and distribution of wealth and income.

Part four covers the area of public and private finance. Hence, its four chapters deal with public finance and fiscal policy in Islam, *Zakah* and

obligatory personal transfer expenditure, Islamic banking and project evaluation.

Part five has two chapters that deal with the area of international economics from Islamic perspective. Respectively, they discuss international. economic relations and international debt problem.

Finally, part six deals with issues and problems arising from and connected to research and teaching of Islamic economics. The three chapters of this part make a case for the teaching methods of Islamic economics and how to develop a curricula for it, as well as issues related to empirical research in this discipline.

The seminar addressed university level teaching staff and aimed at familiarizing them with the Islamic economics issues and literature in an effort of enhancing their willingness and abilities to take up teaching courses in Islamic economics. Back in the mind of the organizers was to provide material that can be used, wholly or partially, in teaching at the higher undergraduate level.

Therefore, contributors to the seminar were selected from university professors and other experts in Islamic economics. Ten contributors have their own chapters in this book in addition to several others who participated in the panels' discussion. The. seminar was also enriched by more than forty university professors from Bangladesh and several other IDB member countries who were instrumental in providing intellectual insight through the discussion periods that followed each presentation.

OVERVIEW OF THE BOOK'S CHAPTERS

Chapter one deals with the general objectives of *Shari'ah* (Al-Maqasid AI Ammah li al *Shari 'ah).* The first thing it mentions is that based on Quranic Verse men and women are only created for the sole purpose of performance of worship to God, The Almighty Creature. A trust is given to the human race the upholding of which was declined by heaven and earth. Humans are thus vicegerents of Allah in implementing his law on earth and in utilizing the earth and its resources for their welfare. The guidance is given by revelation and dealing with new situations and problems is embodied in the *Shari'ah* itself on the basis of its texts of Qur'an and *Sunnah,* its general objectives and the rules *of Ijtihad namely: ljma',Qyas, Istihsan, Masaleh Mursalah,* etc.
Prelalance

The conduct of human life on earth and the organization of human association in groups and societies must thus be governed by the *Shari 'ah* which is enacted by the Lord for the purpose of promoting and protecting the basic five aspects of humans, that are: religion, life, mind, prosperity and economic wealth.

The implementation of justice is very vital in all human association. It is also essential from the *Shari'ah* point of view. Justice should be the controlling force for all interpersonal relations both at the individual and societal levels. The corpus of *Shari'ah* consists, of norms of behavior at the level of worshipping Almighty God *(Ibadat),* laws and rules related to transactions and other contractual relationships, between human beings *(Mu 'amalat)* and points related to purification of faith and doctrine *(aqidah).* All these are derived from and founded on the revealed text of the Qur'an and the authenticated statements of the Prophet *(Hadith).*

Chapter two deals with very essential Islamic concepts related to economics of human activities. Here the lecturer emphasizes that the essential

objectives of *Shari 'ah* is to protect, improve and promote the welfare of human beings. The earth is a huge platform for men and women to rove through and seek the bounties of Allah. In that sense human beings are given the authority to use and exploit land and its resources for the purpose of their sustenance and welfare, and are required to Pray to The Lord, the true giver of the *rizq.* On the other hand, the texts in the Qur'an and *Sunnah* that belittle the *Dunia* (earthly life) must be understood in the meaning to keep the hearts and human efforts exclusively purified to The Lord, The Creature, and having the whole *Dunia* under their hand but not in their heart. This is where we reach a balanced position between worshipping God and working towards human welfare. As a result of that, one should always be ready to give at least the obligatory *Zakah* to the unlucky ones, and men and women should always use their wealth in a moderate and reasonable manner.

In **Chapter three** the lecturer deals with the issues of loans, exchange and interest. The loan implies a goodly transfer of ownership of certain replicated assets. The purpose of the loan is to help somebody else, but not to invest. Therefore, the reward on a loan is only from God and then from enhanced inter-personal relationships.

Riba is prohibited in the Qur'an and *Sunnah.* It is an increment on a loan above its principal. The prohibition of *Riba* is mentioned in the Qur'an and in the *Sunnah.* However, *Sunnah* adds the prohibition of exchange related to *Riba* which is called *Riba al Fadhl. Riba al Fadhl* is the excess in certain transactions related to gold and silver (money) and other four food items mentioned in the Sayings of the Prophet (wheat, barley, dates and raisin).

Bay' (sale) is exchange between people. Bay' implies transfer of ownership of the object of the sale against a transfer, in the opposite direction, of the price of that object. Sale contracts must always be based on clarity, transparency, justice and balance between the object and its price. Sales are also conditional on freedom of economic behavior i.e. they are the manifestation of the economic freedom or deliberate choice.

Chapter four discusses the issues of *Mudharabah, Musharakah* and *Ijarah.* These are kinds of interpersonal economic relationships based on cooperation between the agents rather than exchange. In *Musharakah* (Partnership) cooperation is practiced by putting together economic resources as well as human abilities and expertise from all partners. Thus *Musharakah*

requires sharing capital, management, profit and loss. There are four types of *Musharakah:*

1. *Shirkat al Mufawadah* in which capital and decision making are shared equally, so are profit and loss.
2. *Shirkat al Anan* where the shares of the partners may not be equal in both management and capital; therefore their shares in profit and loss may not be the same as their shares in capital in order to accommodate differences in management.
3. *Shirkat al-A'mal* or *Sana'i'* which is a cooperation between craftsmen who basically work with their hands and small tools with little capital investment.
4. *Shirkat al Wujuh* (Faces) in which the partners do not have initial capital and they depend on their creditability to buy goods on credit when they inter the market for the first time.

Mudharabah is the cooperation between owners of capital, who do not participate in management, and managers or entrepreneurs who want the needed capital for their business. In *Mudharabah,* the entrepreneur *(Mudharib)* receives a share of the profit as reward or compensation for her/his work, but all losses are born by the capital owner.

Finally *Ijarah is* also a cooperation between investors in long- living fixed assets and users of such assets who like only to pay for the cost of their current use without owning the asset itself. *Ijarah* implies a payment of periodical rent against the use or usufruct of the fixed assets.

In addition to these three major forms of cooperation the writer gave a brief description of the definition and basic characteristics of *Kafalah* (Guarantee) and Tort *(Daman).*

Chapter five deals with what distinguishes Islamic Economics from mainstream economics. Islamic economics is based on experience of two kinds of truth; one coming from the Divine revelation and other coming from observation of behavior and historical experiences of human beings. Thus Islamic economics is based on a world view that denies the secularist view point which is based on the irrelevance of God-given knowledge. In other words, in Islamic economics the final source and eternal criteria of values and moralities are the God given revelation. Human beings are not only motivated by an

economic impulse. There are other facets of their behavior and they can be looked at as abiding by the revelation given norms or disobedient to God. The behavior of both groups can well be interpreted by a wider scope or approach that encompasses all aspects of human behavior. The thing which is lacking in conventional economics because it adheres to its secularist socio-philosophical background.

Chapter six is devoted to the study of Islamic economic methodology. The basic point of focus of this chapter is derived from an essential stipulation, i.e. what is the background of sending down of *Shari'ah* to regulate human behavior. Sending down *Shari 'ah* by Allah implies that there are regularities in the behavior of men and women, individually and in groups. As Muslims, the very fact that God sent *a Shari'ah* and sets common norms for all men and women implies an essential fact that the behavior of all human beings, generally speaking, can be looked at as embodied in certain regularities and normalities. The fact that implies that there are universal patterns of behavior that can be understood, analyzed and reformulated. Economics is a study of such kind of regularities in a defined area of human behavior. It is a mixture of positive and normative statements that do not separate the ideas of the analyst from the analyzed observations. This intermingling of positive observations with the norms and values of the researchers is not dealt with in a transparent manner by the conventional economics, and very often value loaded positions are presented as being result of positive or natural observations of human behavior. Examples of this kind of mixup are many and go deep in the very foundation of conventional economics such as the concepts of utility, preference, and efficiency. On the other hand, Islamic economics explicitly derives its normative statements from *Shari 'ah* and its basic sources, the Qur'an and *Sunnah.* Additionally those sources have also several revelations of positive economic statements as can be seen in the examples of love of accumulation, greed of men and women, desire to grab things from other, etc.

Chapter seven goes straight to the monetary features of the Islamic Economic System. This system consists of the rules, norms and values that, put together, attempt to answer the three basic economic equations of what, how and for whom to produce.

The Islamic economic system is based on a world view derived essentially from a given fact that God created men and women in order to fulfill His Will on earth, and for them to adhere to the performance of worshipping God.

On the basis of this basic principle the Islamic Economic System is essentially a market system that believes in the efficiency of the market in creating fair primary distribution of the benefits of the economic activities and the bounties of the Lord while that very system is insufficient for a final distribution of the fruits of economic efforts, simply because there are needs to be fulfilled for those, who cannot work for them. Also conditional on a pre-requisite for efficiency in exchange, that economic transactions between men and women be performed with the observation of justice and the social interests rather than being limited to individual desires and loopholes of tricks and cheats. The chapter also reviews the failure of both capitalism and socialism in performing human economic welfare with dignity and adherence to the values and justice.

The mechanism of the Islamic economic system goes through four basic ingredients that are :

a) A moral based filtration of human behavior.

b) Strong morality and motivation to induce men and women to give their best abilities and efforts.

c) Socio-economic and political instructions that are consistent with the general objectives of the system, and

d) Strong presence of a goal oriented government.

Chapter eight discusses the economic role of the state in the Islamic economic system. The main postulate of this chapter is that the role of Islamic State "Khilaphah" is enlarged to cover looking after the interests of its people both in this life and in the after life, since according *to Shari 'ah* men's and women's welfare in the worldly life is directly related and linked to their success in the after life. The approach of Islamic state in performing this task is governed by the Islamic rationalism which is derived from *Shari 'ah* and its basic texts, the Qur'an and *Sunnah.*

This concept implies that the priorities of Islamic State are reformulated so that success in the after life gets first, the scope and the foundation of the state are expanded to cover supervision of social institutions and their direction towards the services of its people in both lives and that there are limitations on the authority of the state derived also from the *Shari 'ah.*

The basic economic objectives of the Islamic state include: utilization of the public resources for the peoples' welfare; enhancing and encouraging the economic capabilities of the society to reach a level of strength and excess production that can be devoted for the promotion of religion and for charity; the fulfillment of basic needs of people and protecting the moral and legal norms called for by the religion on the basis of both justice and efficiency, etc.

These objectives can be fulfilled by means of:

- commitment to the implementation of *Shari'ah,*
- working in accordance with the *Shari* 'ah-set priorities,
- enriching available resources with planned activities,
- adherence to and protection of the Islamic economic system,
- promotion of social justice and individuals well being,
- providing training and guidance to mobilize the individual abilities and resources.

Chapter nine goes on to discuss the concept of ownership in Islam. This is basically a dual intermingled concept, in which certain properties are left for the public ownership while others are given to the private domain.

From a doctrinal point of view, wealth and economic means belong to Allah, the Creator and the Real Owner of everything that He creates. His many overwhelming Mercies include granting the human race rights of private ownership on what they earn by means of their own efforts as well as by succession of beloved ones after they deceased. On the other hand, certain areas are left for exclusive public ownership in order to be used for the promotion of social, welfare and to carry on those who failed to sustain themselves by their own means. This demarcation of public and private ownerships is essential to *Shari 'ah* in order to provide sufficient resources for the Islamic State that allow it to fulfill its objectives. On the other hand, the *Shari 'ah* also regularizes human behavior in the area of how to earn private property and how to dispose of it. These regulations are basically derived from the moral norms and values
of *Shari 'ah.*

Part II is Devoted to Macro and Micro Analysis in Islamic Economics

In **Chapter ten**, macro consumption theory is discussed with the arguments on both sides of whether the introduction of *Zakah* would make a difference in the macro consumption function.

It is argued by some Islamic economists that the introduction of *Zakah* in the macro analysis results in an upward shift of the consumption function. Underlying this argument are two basic assumptions:

1. A Keynesian consumption function; and
2. A marginal propensity to consume for the poor higher than its rich counterpart. On the other hand, it is also argued that since the claim that marginal utility of the money of the poor is higher than the marginal utility of the rich cannot be substantiated the direction of the effect of introduction of *Zakah* on the macro consumption function is undetermined.

However, if we add the concept of moderation in consumption and avoidance of extravagant and conspicuous forms of personal consumption; one may find strong arguments for a reduction in consumption at the macro level as a result of the introduction of *Zakah* in an economy along with other Islamic substantial ideas and attitudes.

In all cases, there may be strong instigation in support of the conclusion that *Zakah* would create a shift in aggregate demand in the direction of goods that satisfy the basic needs of the poor and away from luxurious goods.

In **Chapter eleven** the writer discussed the attempts of model creating in Islamic economic analysis. Islamic writers attempted to formulate macro economic models on the basis of the famous IS-LM model with two variations: the elimination of interest and the introduction of *Zakah.* The paper calls for clear and explicit identification of variables and presentation as well as defining the assumptions.

Chapter twelve deals with the investment demand function under the assumption of profit and loss sharing. The main crux of this chapter is the proposition that the introduction of the principle of profit and loss sharing creates a demand function for investment that is determined and characterized with being actively related to profit sharing ratio - specially with the desire to avoiding any loss resulting from keeping idle one's inevitable funds which is intensified by the zakatability of such idle funds.

In **Chapter thirteen** important issues of Islamic macro models are discussed namely those resulted to growth, inflation and stability. The presentation argues that an Islamic economy will be characterized by a higher demand for investment along with higher supply of inevitable funds. This leaves the equilibrium at a higher level of rate of return to investment than interest rate in a comparable interest-ridden economy.

Furthermore, the paper argues that the substitution of the prefixed interest rate by a variable expected rate of return will move potential investors closer to reality, since the expected rate of return is what really matters in investment decisions rather than a pre-fixed rate of interest (which is only taken as a cost element for investment in interest-ridden economy). In a profit and loss sharing system the banking sector will be given more dependable cushion to relay in case of decline in return or of investment opportunity because under such assumptions losses are transferred to funds owners (depositors).

The paper proceeds to develop an Islamic macro model on the basis of profit and loss sharing and concludes that an initial stage of development with low return to both capital and labor that do not allow for substantial potential taxation proceed that helps the government to take lead in development, thus forcing it to rely on monetary policy alternatives. But as development begins to role on increases in the taxation base in terms of both income and wealth allow a gradual increase in taxation proceeds and a shift to fiscal policy.

In **Chapter fourteen** the consumption behavior in an Islamic economy is studied. After surveying a. few papers on the consumer behavior in a framework of the Islamic values and norms, the paper argues that conventional consumer behavior theory is insufficient to explain the behavior of the Muslim consumer. Furthermore, the Islamic injunctions related to consumption and consumable goods should be integrated within a socio-legal behavioral framework. The main pillars of faith and belief in the Message and in the hereafter are essential part of the mentality of a Muslim consumer so that a

Muslim consumer's utility function must express these ideas in terms of propensity to spend for the sake of God and the mode of rational attitude towards conspicuous and extravagant consumption as well as towards utility maximization.

Islamic alternatives suggested by Islamic writers on consumption behavior focused on three dimensional alternative uses of one's income: consumption, spending in the way of Allah and saving. The choice a Muslim consumer makes depends on the relative strength of the incentives and inculcated values of a specific consumer with regard to strength of altruistic care for others, depth of faith in the hereafter, degree of reliance on the sustenance promise given by the Creator, and immediate need of the consumer and her/his immediate members of the family. The chapter is concluded with the suggestion that there is a need for empirical study on consumer behavior in Muslim countries as well as deepening the analytic studies of the relationships between spending on consumption per se and spending in the way of Allah.

Chapter fifteen studies the theory of the firm in Islamic framework and the forms of production organization. Production is organized in *Shari 'ah* on the basis of single proprietors, *Musharakah, Mudharabah* and *Ijarah.* The paper goes on to study the different forms of *Musharakah* and different conditions of *Mudharabah.*

It proceeds to present the basic elements of an Islamic theory of producer's behavior. Accordingly a Muslim producer devotes her/his activities to a useful production with certain targets in mind, as distinguished from the single profit maximization formula, and to devote part of one's production and activities for good deeds. Thus the firm's behavior in an Islamic setting can be summarized by an equation in which its output is a function of the targeted profit and the amount of good deeds the firm aims at.

Chapter sixteen - The distribution theory is discussed in this chapter whereby the writer extends his presentation to cover the distribution of both wealth and income. Essentially, the market mechanism creates the first or conventional distribution of income. However, this distribution alone is not sufficient to create equity based on justice nor efficiency based on satisfaction of basic needs. Therefore, two schemes of redistribution of income and wealth are required. These two schemes are introduced by the socio-legal framework of the Islamic economy.

The first redistribution scheme relates to income, and it is two folds; one is the moral and legal responsibility of the rich towards kinds, relatives, neighbors and other needy persons. This redistribution is essentially based on ethical attitudes integrate within the Muslim personality. It is, however, also supported by the Islamic law under the title of obligatory personal expenditures on others. The second fold is the redistribution of income and wealth which is essentially a task given to the Islamic government through its role in the collection and distribution of *Zakah.* The second redistribution scheme in the Islamic framework is an intergenerational one, with aims that provide for the offsprings and the close relatives of the deceased to benefit from the deceased's savings and estate in proportions that are given in detail in the Divine revelation, Qur'an, in such a way that almost does not leave any room for personal or societal judgment *(Ijtihad).* This intergenerational re-distribution has built in mechanism of dividing big wealth in small fragments, so that wealth will be circulated among all people rather than concentrated in the hands of a few "that it may not merely make a circuit between the wealthy among you" (Qur'an 59:7).

Chapter seventeen presents an open discussion on the characteristics of market behavior in the Islamic economic framework. Market in the Islamic framework is characterized by certain degree of altruism and morality that adds a human element to transactions so that prices of goods and services are related to what is good and driven away from what is bad. Besides, the market in Islamic framework is a place where producers call for the prices they want and consumers call for the goods they like to buy and the equilibrium price is that which clears the market. All this is done within a moral framework that is supported and supervised by market functionary called, in *Shari 'ah,* the *Muhtasib* whose role is to see to it that the principles of mercy, cooperation, and other moral values are observed by all participants.

Furthermore, the market is left to function and discover the equilibrium prices leaving the final satisfaction of those whose basic needs could not be fully satisfied through the market to complete the satisfaction of their needs through the schemes of redistribution discussed in the previous chapter.

In **Chapter eighteen** the writer discusses public finances and fiscal policy in Islamic economics. The paper begins with historical survey of the public finance elements in the early Islamic state during the time of the Prophet (Pbuh) and his four successors. Public finance in that era was characterized by the appropriation of certain, and sometime huge payoff, land to be a permanent

source of public revenues to finance the government activities and functions. Otherwise, private property is permitted and protected even against taxation.

Zakah was also introduced as a fiscal institution, of a permanent nature to make continuous transfer of wealth and income from the rich to poor.

Public borrowing was also practiced by the early Islamic government, certainly without interest. The objective of fulfillment of basic needs was achieved through heavy dependence on private initiatives and private resources of development. The functions of the state were relatively limited. Also priorities were clearly set for the socio-political functions of the State. Most important among them comes the establishment of religion, justice and elimination of poverty.

On the side of revenue, income from public property comes first and foremost. Next comes the voluntary contributions from the public in support of the government activities and functions. Public borrowing was sometimes activated and there were no taxes during that era, except for the obligatory *Zakah* which was distributed to the poor and needy on the spot in most of the cases.

The tools of fiscal policy consist essentially of manipulation of the amount of the *Kharaj* and collection and distribution of *Zakah.*

Chapter nineteen studies the case for Islamic Banking whose rationale is derived from the principle of prohibition of *Riba.* This means that Islamic Banking is to be founded on account of transactions that do not depend on extending loans to investors.

Islamic finance is thus based essentially on three broad approaches, each one of them comprises several variants. The first approach is financing through sale which is based on the simple idea of buying cash and selling on credit. The variants of this approach include deferred payment sale, installment sale, *Salam* and *Istisna'.*

The second broad approach is based on the contribution of the financier with the investors (entrepreneurs) on the basis of sharing the profit that results from the deal. Variants that we have of this approach are *Musharakah, Mudharabah* and *Muzara 'ah.* The third approach is based on *Ijarah* whereby

the financier keeps the ownership of the asset and the investor uses it against periodical rental payments to the financier.

The practice of Islamic Banking began in 1973 with the establishment of Islamic Development Bank as an inter-governmental Islamic financial institution. This was followed by the Dubai Islamic Bank in 1974. Many other Islamic Banks were established over the past three decades. In Islamic banks, deposits are received from savers on the basis of *Mudharabah* in the case of investment deposits, or simple loan (goodly) in the cases of the demand deposit in the current account.

Funds are used by Islamic banks to finance entrepreneurs and businesses on any of the three broad approaches mentioned above. Though in practice the sale-based approach is predominant.

Chapter twenty discusses the issue of *Zakah* and obligatory transfers in the Muslim economy. At the emergence of Islam, some fourteen centuries ago, one of the greatest achievement in the history of mankind was to create an **institution** of *Zakah. Zakah* is perhaps the greatest humanistic achievement in the history of mankind ever witnessed after the revelation of the Qur'an to Prophet (Pbuh). Human history exercises charity, all over human societies, but the establishment of *Zakah* represents the first time in human history **an institution is created for formal obligatory transfer of income and wealth from the rich to the poor.** Thus *Zakah,* one of the greatest features in the history of human race, rightly deserves to be the very first pillar of the Islamic economic system. It implies that the market process is not sufficient to provide full justice and complete care of the poor and needy. There ought to be an added mechanism intrinsic to the system and supported by the law enforcement power of the government to take from the rich and give to the poor.

Zakah is an obligatory financial duty and a form of worship at the same time. It aims at major forms of income and wealth to be redistributed to poor and needy and the rest of the eight categories mentioned in the Qur'an.

In addition to *Zakah,* a principle of socio-economic charity is also manifested in an obligatory transfer exercise. This includes a financial responsibility on the rich to support needy kin relatives (on an extended family concept), neighbors, guests and the poor in the society at large. Obligatory transfers are also institutionalized in the Islamic system through the concept of

extended family responsibilities, *Kaffarat* for minor violations of regulations of certain worships, caring about guests and neighbors, etc.

The final chapter of Part IV which is **chapter twenty-one.** It deals with project evaluation and discounting. The issue of discounting in the process of project evaluation is a simple one, in *Shari 'oh,* because it does not represent any interpetsonal transaction. In other words, in a framework of project evaluation and for comparison reasons, one may utilize the concept of discounting for comparing costs and benefits at a unified time denominator. The rate that can be used in discounting in this regard may be any rate even, picked up from thin air. However, the most appropriate rate for discounting, in the process of project evaluation is the expected rate of return of alternative uses of funds, i.e. for private investors it may be an expected rate of return different from that of government alternative investments, while for public investment it could be an alternative social rate of return to the whole society.

In project evaluation one may have to distinguish between social or public projects and private sector's projects. For public projects social funds must be used in accordance with the *Shari'ah-set* property that are usually discussed by Muslim scholars under the title of general objectives of *Shari 'ah* (al Maq_asid al Ammah li al *Shari'ah)* that consist of protecting and promoting the five essentials: religion, life, mind, posterity and economic resources. However, a private investor may be a profit maximizer, i.e., producing perfume because it is more profitable than corn or wheat. Although the whole system of *Shari 'ah* promotes a kind of mentality, for all Muslim investors and consumers that is socially oriented and generally altruistic. But public projects must aim et the social benefits within the above mentioned priorities.

Chapter twenty-two discusses the basic principles of international economics in Islamic framework. This can be summarized in two major concepts. The first is the concept of Islamic *Ummah* and profound Islamic brotherhood between the different Muslim societies, and the second concept is derived from verse 60:8 that reads: "Allah forbids not with regard to those who fight you not for your faith nor drive you out of your homes, from dealing kindly and justly with them, for Allah loves those who are just". This means that international trade with the rest of the world must always be based on justice and mutual respect. In application of this verse, Islamic history witnessed an unprecedented expansion of trade throughout the Mediterranean-and between the Far East and the Europeans where caravans over land and fleets overseas

used to carry the trade between the Far East and the West through the Muslim land and by Muslim merchants.

Chapter twenty-three deals with the international debt problem, observing at the outset that the international debt problem is caused by governmental non-Islamic practices in most of the third world countries and a huge appetite for interest-bearing loans providing in the lending countries and international institutions. It is a problem that relates to practices far away from the Islamic system.

The Islamic principles to deal with international credit basically depend on liberalization and promotion of trade, limitation and restriction on national borrowing and prohibition of *Riba* and other exploitative practices at the international level as well as at the national level.

Part VI, in its three chapters, deals with the issues of teaching curriculum and empirical research in Islamic economics

Chapter twenty-four presents the experiences of three pioneering schools of teaching Islamic economics, namely; Faculty of Islamic Economics at Imam Muhammad Bin Saud University, Riyadh, The School of Economics of the International Islamic University, Islamabad and the College of Economics in the International Islamic University of Malaysia.

Chapter twenty-five deals with the workshop held during the seminar on Empirical Research in Islamic Economics. Panelists discussed areas of emphasis in Empirical Research specially in the consumer behavior in Muslim society, effects and implementation of *Zakah,* the effects of Islamic values and moralities on the producer and testing the several theoretical models of Islamic economies specially in the area of finance and banking.

Chapter twenty-six came as a result of panel discussion on problems and issues arising from teaching Islamic economics and establishment of department for Islamic economics in the Muslim countries. It was pointed out that several universities now-a-days offer bachelors degrees in Islamic economics and a few of them have Master's and Ph.D. Programs in this field. Moreover, many universities through the Muslim world have established course(s) in Islamic economics within their bachelors program in economics. The panelists emphasized that objectives of teaching Islamic economics should always be rescheduling and reformulating the practical issues in our economic

life in accordance with the Islamic teaching and to equip the Muslim intelligentsia throughout the Muslim countries and societies with adequate knowledge and tools of analysis that enable them to achieve this ultimate goal.

The Editor

PART I

SHARI'AH INTRODUCTION TO ECONOMICS

CHAPTER ONE

GENERAL OBJECTIVES OF ISLAMIC *SHARI'AH:* THE REALITY OF THE DIVINE

***Muhammad Ata** Al **Sid**[*]*

The most basic and fundamental idea, or you can say, the very essence of *Shari'ah is tawhid:* to affirm action that Allah is one, absolute, transcendent, creator, Lord and Master of all that is. He alone is God and nothing is like unto Him. He remains forever absolutely unique and devoid of partners or associates. The ninety nine names *(asma'Allah al husna)* are intended to introduce the reality of Allah in a manner to be comprehended by the human mind. All humans are under an obligation to partake of this great truth and no censorship or restriction may be imposed by anyone. The *Shari'ah* recognizes that all humans are entitled to inquire, to search, to learn, and to teach one another, and prescribe the gain of knowledge as a universal duty from which no one is exempt, particularly in regard to this basic reality.

In fact, the whole culture, the whole civilization, or the whole edifice of the *Shari'ah* lies compressed in the *kalimah* (pronouncement) or *shahadah* (witnessing) that there is no god but Allah. This statement, brief to the utmost limits of brevity, underlines everything to be said or done or to strike the Muslim mind.

THE REALITY OF REVELATION

Allah has not created the world and abandoned it as some Greek philosophers claimed. To believe such a thing is to misunderstand and to underestimate Allah. Allah condemned those who denied the reality of the revelation.

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"No just estimate of God do they make when they say: Nothing did God send down to man (by way of revelation). Say: Who then sent down the Book which Moses brought? [1]

The Shari'ah, therefore, confirms Allah's communication with man which can be through His makings in the universe (ayaht):

"And say: Praise he to God who will show you His signs so that you shall know them; and thy Lord is not unmindful of all that you do. [2]

And we read:

"Behold! In the creation of the heavens and the earth, and the alternation of night and day, are indeed .signs for men of understanding. "3

There are other great ayaht (verses) and reminders *of* Allah's *greatness,* wisdom, omnipotence, omniscience, oneness and of the glorious majesty of God and His goodness to man.

Revelation can also be through a direct communication with men as in the case of our Prophet Muhammad (Pbuh) to whom the Qur'an was dictated by the angel Gibril on behalf of God. This had continued for generations before Prophet Muhammad (Pbuh) and culminated in the revelation of the Qur'an and the *inspiration of the Sunnuh.* Muslims *are fortunate that* Allah *has* preserved, absolutely intact, the purity of the text of the Qur'an.

"We have, without doubt, sent down the zikr (the Qur'an) and We will assuredly guard it (from corruption) '[4]

In addition to communicating the Qur'an to men exactly as revealed to him, Prophet Muhammad (Pbuh) had the real undertaking and obligation to

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1 The Qur'an. 6 : 91

2 The Qur'an, 27 : 93.

3 The Qur'an, 3:190.

4 The Qur'an. 15: 9.

explain the meaning of the revelation, as he was the first and the only appointed *mufasir.* A greater burden on him was to translate the revelation into precepts of action, to give an example of the life on earth willed by Allah.

> "And We have sent down unto thee the zikr that you may explain clearly to men what is sent for them and that they may give thought. "[5]

The *sunnah* which is the second source of *Shari'ah is* a collection of the Prophet's (Pbuh) sayings *(ahadith),* deeds, and approvals. Its function as mentioned above is to clarify the Qur'an's pronouncements, to exemplify and illustrate its purposes.

THE REALITY OF CREATION

A major reality is that the world is not created in vain or in jest.[6] It has been created in a perfect condition.7 Our world is indeed a "cosmos", an orderly creation, not a "chaos". The most dignified of all creatures are humans[8] who are endowed with understanding which includes all the gynoseological functions of memory, imagination, reasoning, observation, intuition, apprehension, and so on. Men are made capable of understanding the will of Allah as expressed in words, directly by God to man and as being deductible through observation of creation by pondering the whither and why of its realities and conclude with certainty that they must have a creator, designer and sustainer who deserves to be fully heeded.

All creation will cease to exist and will be followed by a day of judgment, a day of absolute justice and mercy as a result of which the destinies of people are determined to an eternal joy in the gardens of Eden or to an eternal misery in hell.

REALIZATION OF THE DIVINE WILL

The will of the Creator as epitomized in the *Shari'ah* has to be realized. All creation other than man can only act and exist in the way the Creator has ordained for it. They can only act according to the innate patterns vested in them

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[5] The Qur'an, 16:44.

[6] The Qur'an, 3: 191; 23:115.

[7] The Qur'an, 32 : 7; 67 : 3,4.

[8] The Qur'an, 17:70.

by the Creator. In nature, fulfillment of the divine will is built-in and necessary. Nature's compliance with the divine will is precisely what scientists call "natural laws".

Man is the only creature in which the will of God is actualized not necessarily, but with man's own personal consent. He is given the freedom of compliance with the divine commandments. We read in the Qur'an:

> *"We did indeed offer the Trust to the Heavens and the Earth and the Mountains; but they refused to undertake it, being afraid thereof But man undertook it."* [9]

While the physical function of man is integral to nature and as such obeys the law pertinent to it with the same necessary obediences as all other creatures, the spiritual functions, namely, understanding and moral action, and consequently the psychological function fall outside the realm of determined nature. They depend on the determined will of their subject.

Man's success or failure are results of his own efforts. Muslims should know this *sunnah* (cause and effect law) of Allah as it is mentioned in about fifteen places, in the Qur'an.[10] Only when all efforts and potentialities are exhausted, faith in Allah and sincerity to Him will be a true advantage to the believers in terms of a blessed success to those efforts.

Allah's justice is absolute, one which never loses an atom's weight of good works or of evil works without any favoritism to anyone. All men are from Adam (Pbuh), and Adam (Pbuh) was from clay and the most honorable in the sight of Allah and deserving of His support and dignifying is the most righteous.

The order of life, be it the legal, the moral or the spiritual, is not a visionary idealistic expectation. It is not left to the caprice or pleasures of anybody. It has been laid down in the *Shari'ah,* the system of laws and directives, as well as an embodiment of information, advises, admonishments which cover the human life from the cradle to the grave. Allah, the giver of the *Shari'ah,* intended the legal aspect therein to enjoy the full force of established law and its universal and objective elements to become the facts of everyday life. Knowledge

9 The Qur'an, 33 : 72.

10 See the Qur'anic ayah: 3:137; 4:26; 8:38; 15:13; 17:77; 18:55; 33:38; 33:62, 35:43; 40:85; 48:23.

"ilm" of the realities of the *Shari'ah* is of paramount importance and a great act of *'ibadah'* (worship). But knowledge which is not put into the reality of actions is vain, useless and condemnable.

The *Shari'ah* has provided legal realities that are not alterable. The illegal acts of killing, stealing, robbing, illicit sex, undutifulness to parents, severing of blood relationships are absolutely unalterable postulates while the modes of applying many directions are intended to be left to the changing realities of life. The best example here is the *shura* (mutual consultation) which is ordained by Allah and His Messenger and which must be employed in the running of the affairs of the *Ummah.* However, the mode of executing *shura is* completely left to the ever-changing conditions and situations of human life. The scholars of the *Shari'ah* must have the insight and wisdom to utilize the readiness of the *Shari'ah* to meet the changing actualities of life in pursuit of its eternal objectives.

The mechanism to meet new situations and problems is imbedded in the *Shari'ah* itself and which is epitomized by capable Muslim scholars in the science of *Usul al Fiqh* whose dynamic nature lies in its ability to establish criteria of validity for the necessary *ijtihad* to be made. Usual instruments like *qiyas, istihsan, masalih mursalah, sadd al dhara'i, al istiqra' al naqis, al urf wa all 'aadah* proved extremely effective in making valid decisions.

It is the *Shari'ah,* in its totality, which gives Islamic civilization its identity. Refusing to implement the *Shari'ah* in its totality is a mutilation of the integral constituents of its one organic body. It will give a distorted image of the Islamic civilization. This is why Allah condemns such a practice as a cause of disgrace in the two worlds.

THE *SHARI'AH* AND THE CONCEPT OF LIFE

The world is not created in vain or for people to suffer under the name of misconceived religiosity. Life, the *Shari'ah* maintains, ought to be lived, the world developed, instincts satisfied, talents, faculties, and potentialities ought to be realized, and happiness sought and achieved.. Every human is entitled to the vocation of his choice, to partake of God's bounties on earth, to marry and raise a family, to acquire and enjoy wealth.

The Qur'anic invitation to all children of Adam to wear their beautiful apparel at every time and place of prayer: eat and drink without extravagance as Allah loves not the extravagant. Nobody is allowed to forbid the bounties and

beauties which Allah has given to His servants.[11] It is for this reason that the *Shari'ah* did not overlook the importance of property and free possession in this world. Men are admonished to utilize all chances so as to get the best of the bounties of Allah. This is highly praised in the Qur'an.[12]

Such struggle will indeed entail many dealings among men in trade, agriculture, exchanges which are all made *ha/al* (permissible) but should be free from any taint of *riba.* Clear and sound legal provisions are, therefore, needed to govern contracts, trading, *muzara'ah, murabahah,* renting, borrowing, bequests, truss, partnership, companies and many related areas. The *Shari'ah* is replete with such provisions and our forefathers spared no effort in elaborating the chapters on "*mu'amalat*".

It is a misconception of Islam to think of it as a religion in the limited sense of the word, interested only in spiritual salvation. It is a complete way of life dealing with the entire fabric of human life and culture. The social welfare of the *Ummah* depends on a well established economic system drawn according to the values of Islam. The *Sufi* tendencies to overlook this fact caused the *Ummah* to suffer an eclipse from which it has been struggling, painfully, to recover.

An important aspect of the value laden Islamic economy is to take care of the needy, the weak and underprivileged and to seek, voluntarily, to improve the quality of life for all. The *Zakah* is prescribed to alleviate the suffering of the have-nots. Furthermore, a voluntary *sadaqah* (charity) which is always personal and infinite in scope, nature, variety and application, is vehemently recommended by the *Shari'ah.*

THE *SHARI'AH* AND THE PURSUIT OF JUSTICE

A fundamental objective of the *Shari'ah* is to uphold what is right, just, or lawful in all aspects of life: Towards parents, wife, children, brother Muslims, non-Muslims, the state, animals, neighbors or in dealing with any affair. This can only be achieved by following the directions given by the *Shari'ah.*

The Muslim believers everywhere and every time are commanded to uphold the norms of justice. We read in the Qur'an:

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11 The Qur'an, 7 : 31-32.
12 The Qur'an. 73 : 26.

"O you who believe! Stand out firmly for justice, as witnesses to God, even as against yourselves, or your parents, or your kin, and whether it be against rich or poor. For God can best protect both. Follow not the lusts (of your hearts), lest you swerve, and if you distort justice or decline to do justice, verily God is, well-acquainted with all that you do. "[13]

The Qur'anic call in the above *ayah* searches the innermost motives more than the Latin saying : "Let justice be done though heaven shall fall."

Justice in Islam must be meted out freely and swiftly in order for it to be readily available to all. Of all the contributions of Islam, the universal right to justice which the *Shari'ah* has upheld throughout its fourteen centuries of history is perhaps the greatest. It was so hallowed and cherished that it should be absolute: free from all personal influences:

"O *you who believe, stand out firmly for God as witnesses and upholders of justice and let not the hatred of others to you make you swerve to injustice. Be just as that is approximate to piety and fear God who is well acquainted with all that you do."* [14]

Justice must be accessible to everybody. There are no fees and no costs which will deprive the poor of getting his rights. It is a prime duty of the Islamic state to ensure this accessibility or must expect destruction if justice is not done. This is indicated in the *hadith* of the Prophet (Pbuh) that previous nations were destroyed on account of their disregard for justice and their discrimination between the noble and the lowly; between the strong and the weak.

Giving witness is regarded by the *Shari'ah* as an obligation and must be true to the least detail:

"The witnesses should not disdain when they are called on (for evidence). "[15]

13 The Qur'an. 4 : 135. See also 5 : 42.49 : 9. 7:29.
14 The Qur'an, 5 : 8.
15 The Qur'an. 2 : 282

All people are equal under the *Shari'ah.* Claims of favoritism or choosiness of any humans are rejected by the *Shari'ah.* Neither race nor ethnicity, neither sex nor position in the society, neither wisdom nor wealth can alter this equality before the law. This notion of egalitarianism applies to all humans on earth entitling them - Muslims or non-Muslims to apply to any Islamic court for redress and the Islamic state is duty bound to execute the judgment even if it leads to violent confrontation. A very noble declaration of the Qur'an which is known to all Muslims is :

> *"0 mankind! We created you from a single (pair) of a male and a female and made you into nations and tribes that you may know each other. Verily, the most honored of you in the sight of God is the most righteous of you. And God has full knowledge and is well acquainted (with all things)."'* [16]

THE *SHARI'AH* AND PERSONAL FREEDOM

Everyone is free to choose the career that suits him but must be within the wide folds of the *Shari'ah* and nobody will be allowed to regiment or coerce another's life in any way. He is free to move his person, family, goods and wealth anywhere and to reside wherever he wishes within the limits of the Islamic state. The *Shari'ah* protects him against any interference in his affairs and offered him its Courts of Law to lodge his complaint free of charge and to receive vindication. No man is responsible for the deed of another being, his son or daughter, father or mother.

THE *SHARI'AH* AND MORALITY

The *Shari'ah* embodies extensive codes of morality which are represented by the word *taqwa* (piety). The Muslim is required to lead a moral life in all aspects and walks of life, privately or openly. In fact, it's the morality of one man as compared to the other which determines the degree of his dignity and worthiness in the sight of Allah.

The *Shari'ah* prohibits any word, action or even a mere thought that disgraces or wrongs another human. Any act of this nature will constitute *zulm* and *zulm is* most dreaded in the sight of Allah. The Muslim should be truly

16 The Qur'an. 49 : 13.

positive towards another Muslim: to uphold his honor rather than obstruct or envy him, to look for him if he is sick, in need of help, greet him and return his greetings with a better one:

> *"When a greeting is offered you, meet it with a greeting still more courteous, or (at least) of equal courtesy. Allah takes careful account of all things."*[17]

To that extent, Muslims are commanded to cultivate sweetness and cordiality in their manners and at all times. Kindness and courtesy should be offered without asking and to be returned in even better terms than we received, or, at least, in equally courteous terms.

The *Shari'ah* prohibits spying, lying or being deceptive. It forbids speaking without knowledge, loud speech and the assumption of airs of pride and superiority. It commands cleanliness, to put one's best when in congregation, to fulfill one's promise under all conditions, to maintain one's decorum at all times, to greatly revere and keep duty to parents and elders, to men of knowledge and those in authority.

THE *SHARI'AH* AND FAMILY LIFE

The Creator, the Qur'an asserted, has constituted humanity into male and female, established mutual affection between them, and prepared them to final quiescence and love in each other. The *Shari'ah* proclaimed the divine pattern as consisting of their cohabitation under the legal bond of marriage which is regarded as noble and universally necessary because it brings quiescence, progeny, and continuation of life with purity and responsibility. Sex and procreation carry no stigma, being in themselves natural like food, growth and death, having been instituted by God as integral elements of the process of existence and life, the very medium and material of ethics and religion.[18] If an unmarried man is capable of marriage and raising a family, his celibacy is then a vice.

The *Shari'ah* has extensively dealt with the rights and mutual obligations of husband and wife, parents and offspring, brothers and sisters, uncles and aunts, grandparents and grandchildren, and cousins. Such relationships are considered sacred and it is a great sin to sever a blood relationship. *Silatu al arham* which is

17 The Qur'an, 4 : 86.
18 The Qur'an. 2 : 223.

the compassionate and merciful links between blood relations is basic in Islam. Lengthy elaborations are made by the Muslim jurists in regard to family law.

THE ISLAMIC *UMMAH*

The family in its extended form and in its Islamic mould is the constitutive unit of the *Ummah* which is the society of believers in Allah and His Messenger, Muhammad bin 'Abd Allah (Pbuh). The essence of the civilization of this *Ummah* is Islam. It is the vicegerent of Allah on earth and bears the responsibility of His trust. Its purpose being the obedience of Allah, the fulfillment of His command and the realization of His will on earth. The fate of the *Ummah* would ultimately rest on the accomplishment of that trust.

The norm: Islam is a religion and state, is well-known. The *Ummah* must have a government to direct the order of its affairs and must have a constitution to define the shape of the state, the rights and obligations of its citizens and the functions of its officials.

> *"O you believers' Obey Allah, and obey the Messenger and those charged with authority among you. If you differ in anything among yourselves, refer it to Allah and His Messenger, if you do believe in Allah and the last day: that is best, and most suitable for final determination."* [19]

Non-Muslims cannot be part of the *Ummah* but can be part of the Islamic state as citizens. The Islamic constitution protects the non-Muslim minorities and any disregard of their rights is prohibited by the religion. The Prophet (Pbuh) of Islam declares:

> *"Whoever oppresses any dhimmi (non-Muslim citizen of the Islamic state), I shall be his prosecutor on the Day of Judgment. "*

This is the reason that nowhere in Islamic history had any group of non-Muslims been singled out for oppression in terms of their faith. Suffering under the hands of evil rulers cannot be denied in some instances of Islamic history, but both Muslims and non-Muslims had taken their share of such suffering.

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19 *The Qur'an 4:59. This* and many *other verses* and *ahadith* strongly command *the* Islamic government *to be* righteous and Muslims *as citizens of that state* to obey *the directives of uli a! amr.*

The nucleus of the Islamic constitution is *tawhid.* All constitutional supremacy belongs to Allah and nothing contrary to, His will should be entertained or allowed to exist. *A* qualified Imam and an effective *shura* process are important clauses in the Islamic constitution. All other details are well expounded under the topic *siyasah shari'ah* or what is known as Islamic constitutional law.

THE CORPUS OF THE *SHARI'AH*

The objectives mentioned above are major landmarks of the *Shari'ah.* They can fall either under *daruriyyat* (universal necessities), *hajiyyat* (personal needs), and *tahsinat* (desirables). Nothing can fall outside the realm of *mubah* (permissible), *haram* (prohibited), *wajib* (obligation),mandub (recommended), *makruh* (recommended against). Detailed otherwise, the corpus of laws constituting the *Shari'ah* can be as follows:

1. Rituals
2. Personal status
3. Contracts
4. Torts
5. Criminal Law
6. Constitutional Law
7. Taxation and public finance
8. Administrative Law
9. Land Law
10. International Law
11. Ethics of personal conduct.

In addition to these legal boundaries, and as discussed above, the *Shari'ah* recommends the noble and most benevolent attitude *(ihsan)* in all dealings and as much as possible.

DISCUSSION

Question

It has been mentioned that heaven, earth, mountains rejected the offer of *amanah* or responsibility and man has accepted it. This rejection and acceptance both are willful ' actions. How can we differentiate between the nature of creation and acceptance of man. We are going to establish that man has accepted the offer willfully and willingly, but naturally man could not fulfill it. I understand from these *Ayah* that this is the narration, explanation of the nature which was expanded in different *Ayah,* but the willful action of man or rational behavior of man is not properly established by these *ayah.* I would like to request the learned author to explain this fact to us.

Ata al Sid

I want to point out that definitely man has his approach to fulfill his role on this earth. The most important point, as you mentioned yourself, is that there is a moral obligation that he accepted to take up this change; this moral obligation to fulfill the commandments of Allah *Ta'ala is* revealed to him.

Of course there is a lot of discussion here. Generally we know that Allah has made man responsible in this world. There is a matter of choice and freedom given to man to choose, of course, into the right path revealed to him by Allah *Ta'ala. So* other creations are not like man. They eat, they drink, they sleep, they procreate. They do whatever they like as nature has vested in them. But one has to distinguish between two aspects of man. First, he is a materialistic being, a physical being, thus he eats, drinks, sleeps and procreate. These aspects are also guided by general natural laws. For example, if he chooses not to eat, he knows he is going to die. If he chooses not to sleep, he is going to suffer, to be sick. This is also subjected to natural laws. But the morality to fulfill the trust vested by Allah *Ta'ala* in him, is only guidance not a decision. I mention the will of God. This is actually not necessarily by forcing man to morally behave according to certain predeterminations. In this respect, man is given the freedom to choose. Of course the organization of his movement and the general environment of his behavior is determined by Allah *Ta'ala.* I tried to discriminate between man and other

creatures, to specify the role of man that he has obligation and he is responsible for fulfilling this obligation.

Question by Sulaiman Mandal

I have two questions : first about the implementation of *Shari'ah* at the level of the state; and the second is that *Taqdir* is predetermined in Islam. *Taqdir* is virtually predetermination, but in your article it is laid down that success or failure results from man's efforts. How can these two ideas be reconciled?

Ata at Sid

The first question is of course very easy to answer. Definitely, to be Islamic the state must implement *Shari'ah.* It is not an Islamic state and the constitution is not Islamic if the whole *Shari'ah* is not implemented. A country which is not living by an Islamic constitution is obviously not Islamic. In fact in the paper I tried to emphasize this very important point. Not only have a lot of application of Islamic *Shari'ah,* but to apply any part of *Shari'ah* for any reason that is in my opinion a terrible dichotomy in the life of a Muslim and this is the reason in the part of the paper I indicated the need that *Shari'ah* should be taken in totality. Allah *Ta'ala* indicates that a partial application of the *Shari'ah* is a terrible sin. It will need no proof to indicate that it is not acceptable in the word of Allah *Ta'ala* to refrain from applying any part of the *Shari'ah.* This contradicts the principle of *Tawhid,* as I mentioned. That one does not apply for fear of some thing, or because of this and that, this indeed will contravene the basic constitutional clause that all supremacy is to Allah *Ta'ala.* Hence, to answer your first question, definitely, there is no point that any part of the *Shari'ah* should alone be applied and the design should be realized in peacefulness without neglecting or not applying any part.

The second question is about *taqdir. I* am not the person who denies the view of the mainstream *Sunnah* Muslims. I am not really in a position to deny the *taqdir.* The matter is complicated. What I want to indicate here is something which nobody can dispute that definitely success or failure depends on one's *effort* no doubt. The Muslim *effort* is very essential, because Allah *Ta'ala* commands us to work, to ask for work, and to endeavor. So this kind of Qur'anic commandment means that man should work and he should expect the result of one's work.

The Prophet (Pbuh) and his companions themselves had to work, to pray all night, and to spend their time and effort in the way of Allah *Ta'ala.* For this

reason, it would have been in my opinion, a terrible mistake in Islamic history if the Prophet (Pbuh) and Companions, while their people were tortured, went to encourage gathering material gain. It isn't very necessary in a Muslim's life; it is something which may prevent the Muslim from *Ibadat* and *zikr*. This definitely is not acceptable in Islam because it makes the Islamic *Ummah* suffer. And for this reason I only want, in the paper, to remind you of the *Sunnah* or law of Allah *Ta'ala* is that any result must have a cause. The only thing I mention is that we resolve our problems, fully, and we should really benefit from the resources Allah *Ta'ala* has given to us, in case of potentialities, in case of resources, in case of anything. Then we are in a privileged position than others. Allah's blessing would make our efforts more fruitful. Allah guides these efforts to make them more successful.

By *tawakkul,* we do not mean that things can be attained without endeavor or without efforts. Without *'amal (work),* goals can never be achieved because it will be contrary to life; and this is a very essential point which must be understood by Muslims individually and statewide.

Question by Sulaiman Mandal

Is man's success or failure merely a function of his own effort? Or are there other factors to help or guide man's effort?

Ata Sid

Let me clarify again that I did not deny the blessing of Allah: In the interpretation of Allah's blessing, one part must be underlined that Allah's pattern in this universe is that efforts achieve a result. You must put on the efforts and then depend on Allah *Ta'ala* that he will be blessed and will produce something. Allah finally surrounds everything. It is our understanding that He wants us to work for good result and good life.

Question

Is creation simply a function of mere order from God without involving a process of transformation of matter from one form to another (theory of evolution)? What is the role of man in the process of creation on earth? Is this role passive or active in the process of creation, evolution or development?

Ata Sid

If we define creation as making something out of nothing, then creation, of course, is one of Allah's attributes and His privilege which is Divine. Man cannot do something out of nothing; man cannot create. I will never say that man can create, but man can cause things to have a different shape. *Ayah* indicate, very clearly, that if all humanity come together to create one's life they cannot create a life, they cannot create even a mosquito. So man according to these *ayah* has no ability to create, newly, to find the life, to find something original in the sense of creating for the first time. This absolutely belongs to Allah *Ta'ala,* that is, He is the Creator.

Question by Shamsul Alam

Shell we understand by *Shari'ah a* legal system? what would be the nearest equivalent term of *Shari'ah* in English and Western system?

Ata Sid

Many people just understand the *Shari'ah* as a legal system. What I tried to present in this paper is that the body of *Shari'ah is* so comprehensive that it covers everything in the life of human beings, comprising morality, economics, family, *Ummah,* individual freedom, etc. So the *Shari'ah is* comprehensive of all the secular and spiritual aspects of life. But to translate the term *Shari'ah* as being the law of Islam is definitely a limited interpretation. The *Shari'ah is* a full system which comprises all the basic aspects of life. By the way, applying the Islamic laws is a must in an Islamic state, but making people's life miserable is not an Islamic way of affairs. An Islamic life means "sickness of one Muslim is sickness to all other Muslims". It is life of cooperation, a life of real gain to others, to the poor, to the people who need help. I mean Islamic life is definitely the first kind of social excellence. It is an excellent social life rather than thinking of application of laws. This is my opinion.

There is a terrible misunderstanding in the minds of many Muslims today that, Islamic state will only mean application of Islamic criminal laws; and this is not correct. Islam charges an Islamic state with. responsibility to create the whole infrastructure of a new life. Nobody should, in one's eating or drinking, enjoy while another Muslim is suffering. This, is the kind of Islamic life in the Islamic state as indicated by the Prophet (Pbuh) and his companions. Not merely an application of laws cutting hands or severing life.

Question from Shamsul Alam

When we say *Al* Qur'an and *Sunnah* we mean more or less specific ideas though there are questions about *Hadith* but *Shari'ah* of various denominations sets to differ? Is it not better to speak of Qur'an and *Sunnah* rather than *Shari'ah* of Shia and Sunni, then again of various groups of Sunni *'s?* The question is: Qur'an and *Sunnah* are specific but *Shari'ah* of various denominations differ, is it not better to speak of Qur'an and *Sunnah* rather than *Shari'ah* of Shia, of the Hanafi, of the Hambali, etc.? So many *Shari'ahs* are there, but Qur'an is one far all, *Hadith* is one.

Ata Sid

This is definitely a misunderstanding of the *Shari'ah.* In the Qur'an we have the source of *Shari'ah,* for all what Allah *Ta'ala* says in the Qur'an and the *Sunnah* are the sources of *Shari'ah.* What the Shia thinks is not the *Shari'ah* what the *Sunni* Muslim thinkers think is not *Shari'ah* itself. This is calledfiqh. *Fiqh* means to expand the *Shari'ah* proceeding. Abu Hanifa's *fiqh,* we don't say the *Shari'ah* of Abu Hanifa nor *Shari'ah of* Malek, nor *Shari'ah of* Ahmed Ibn Hambal. So in this question unfortunately there is a kind *of* confusion in *Shari'ah.* In the Shia system, they have their own thinking which has historical background. They *Sunni* Muslims have their base, as you know. Other-different sects are there in the history of Islam.

One thing that nobody can deny is that the Qur'an and the *Sunnah* are the sources of Islamic *Shari'ah.* I tried to indicate the *Sunnah* as an important source of *Shari'ah,* and some people at least today are writing that we only depend on the Qur'an as being the sole source of Islam. This is, in my opinion, a terrible and unacceptable position so far as *Shari'ah* is concerned. Nobody will accept it, nobody denies the *Sunnah* of the Prophet (Pbuh), his position in the Islamic legislation. So, the call for taking Qur'an as the only source *of Shari'ah* is wrong. The *Shari'ah* contains the Qur'an and the *Sunnah* both, not what Abu Hanifa says, that is not the *Shari'ah,* although he tried his best. Imam Malek and Imam Ibn Hambal, all of them, tried to explain the *Shari'ah.* They have given the best understanding in the *Shari'ah. So* for this reason, the *Shari'ah* is not the idea of the Shia or X or Y or Z of the people. The *Shari'ah* is quite the content that is found in Qur'an and the *Sunnah.* May Allah *Ta'ala* give us good and deep understanding.

Question by Shamsul Alam

Living and values of the Muslims in the 19th century might have been closer to the *Shari'ah.* Still they lost their political power and economic and military superiority for which Kama! Ataturk and many others abandoned *Shari'ah* and many leaders in the governments cannot stand the so called fundamentalism, even now. How can you assure us that greater conformity to *Shari'ah* will not make us more backward?

Ata Sid

The first point you mention about the 19th century or the 20th century? These are times of decline in Islamic history. It is not now the time to go with the details of the factors behind the decline. It appears that the stagnation period of Islamic life started when people really tried to be far away from the real Islamic life. And as a result, we fell in this decline which is still continuing and which Muslims are struggling to overcome today. By the way, if you are asking me about our life in the 18th, 19th or 20th century, it is a pity to know that while some Muslims feel to be in an apologist position about their sticking to Islam, the events which took place in the last world war may indicate that we Muslims were the secularists, while other people, for instance, Americans were more religious. And this is the reason they are leading the world. For example, President Bush, from the very beginning, called on all Christians to pray, when the war was to start and he held prayer in the White House as well. He requested all Americans to pray for success in the war without inflicting many causalities on American lives. After success they had five days of celebration for prayers to Allah *Ta'ala.* Brother, who is really the secular?

I don't think that the life we had in the 19th and 20th centuries is an example of real Islamic living. No I don't think so. That is a time of decline which is continuing today. Some Muslims ask not to apply *Shari'ah.* That is a stigma; it is something to be changed. Many Muslims now are like that; I know for sure that in a country like mine when we try to apply *Shari'ah,* some Muslims will be telling that they don't want to accept it. This is the backwardness. This is not acceptable. So definitely there is a terrible misunderstanding. There is a terrible decline in our understanding of religion. We have been brainwashed in many situations. So definitely to answer this question very frankly I can't think that our life in the 18th and the 19th centuries is an example of Islamic life. And of course as a Muslim, I call for one hundred percent application of *Shari'ah* in its totality from the government and the people. This will definitely change our life.

Question by A. A. **Sarkar**

Shari'ah itself can be established in the Muslim countries, but we have to try. But what will be the correct method to establish *Shari'ah* in full manner in the Muslim countries? Is it revolution against the vested interests, i.e. government, or mobilization of the people to participate in the struggle against the government?

Ata Sid

It is a valid question. Many of the Muslim thinkers around the world really wander about this question, what to do in order to restore Islam. I don't want to venture in the revolution or whatever it is but generally I would say Allah *Ta'ala* when He gave the Qur'an and the *Sunnah* He prescribed the way to achieve the *Shari'ah.* It definitely needs sacrifice, a full devotion and *ajihad* in the cause of Allah *Ta'ala. Ilm* and *jihad* in the cause of Allah are essential to restore the *Shari'ah.* Some kind of confrontations may be indispensable, but every Muslim should try to realize the *Shari'ah* in the best possible way without creating a weakness or a division within the Muslim *Ummah.* This is my view. But the *jihad* is this and it should continue until the day of victory. There is no time when the *jihad* will stop. So we will continue *jihad* forever until we realize this objective. Everybody has his own understanding of the Qur'an and the *Sunnah* with full examples of how we can achieve our target.

Comments and Question by Monzer Kahf

The question relates to pages where he talks about *daruriyat, hajiyat* and the *tahsiniyat.* Is there any correspondence between *hajiyat* and *tahsiniyat* on the one hand and *Halal* or *Haram,* desired or disliked on the other hand. Can you say that every *daruri* is obligatory or every obligatory is *daruri?* Also by the same way every *haji* among the *hajiat* is only desired and every desired is among the *hajiat?* Is there correspondence between the *ahkam* of *Shari'ah* and this concept of *daruriyat, hajiat* and *tahsiniat?*

Hijab, for instance, is known as obligatory. What is it and how we refine the *hijab* is something outside the scope of this discussion. So this *hijab* for men, or for women is not *daruri* though it is obligatory. It is obligatory, we know, from *Shari'ah Satrulawra* is required. Then is it *haji* if not *daruri.* On the other hand, wearing perfume by men, women, specially on Fridays is desired as we know from the *Shari'ah.* Now does it mean wearing perfume is *tahsini* or it could be *haji?*

Now, I have two comments which I like to put in the form of questions. *Shari'ah,* and please correct me if I am wrong in my understanding, is the Islamic relations put in the form of laws, or stipulations of do this or don't do that, but not put in the form of economic analysis, or social arguments, etc. In economics we look into the inner motives of behavior, programs, producers and consumers. Hence, you cannot see economic analysis in *Shari'ah. Shari'ah* is a special form of relations in Islam. Now, *Shari'ah* contains the totality of *Zakah,* not any specific view of it, but a totality. Where it is adapted by the right or proper authority, it takes the form of s*hari'ah* and becomes obligatory . The state through the proper decision-making adopts a view that may be the Sunni's or Shia's, Hanafi's, or *Maleki's,* etc. We can talk of *Shari'ah* in that sense. Otherwise the *fiqh* view becomes effectively an opinion as long as it is not totally adopted. Once a view is adopted by the society, then it becomes *Shari'ah.* Consequently, as we study ethics independently and economics independently as aspects of Islam, or as disciplines within the banner of Islam, similarly *Shari'ah* in that sense is one of the disciplines because it is the same thing put in the form of legality, consisting of what is desired, permissible, undesired or obligatory.

Ata Sid

I hear you saying that what the people adopt and accept becomes the *Shari'ah.* But in my view, what is *Shari'ah* and what is not *Shari'ah* does not depend on choice of the people. Your explanation of *Shari'ah* being the body of laws is only a part of *Shari'ah.* I mentioned in the paper; this is only legal aspect of the *Shari'ah.* What I consider as *Shari'ah* is the full body of anything derived from the Qur'an and *Sunnah.*

This is the general wide concept of *Shari'ah,* but there are many things in Islam you cannot change. The *Shari'ah* tasks cannot always be formulated as laws. While law, in my opinion, is an essential part of the *Shari'ah,* we also find the concept of *ihsan* in Qur'an. The Qur'an calls for *Qard Hawn* that you should give a loan for those who are in need, those who want to work but they don't have the means. This is an *Ihsan* that you have to give a *Qard Hasan.* So there are certain cases of *ihsan* that cannot be formulated as a law in the sense that if you don't do it you will be criminally responsible. My position in this paper is to present the whole body of Islam as *Shari'ah* which contains the legal aspects, ethical clause aspects, moral aspects and many other aspects.

Comments by Monzer Kahf

The third point is about the partial application of *Shari'ah.* Can we make a distinction between partial application and adapting a position that you want to take one part on a gradual application. Gradual application is by definition partial but your aim is at implementing it all. Why are you setting certain obstacles against graduation in application?

Ata **Sid**

This is a very good distinction. I think it comes as a very legitimate point to me that applying part of the *Shari'ah,* for example, many countries now adopt Islamic *ahwal sakhsiyah* (family and personal law); marriage, divorce, inheritance. This is a very easy part of Islam as you know, yet it is very basic to life of the people. But will criminal part in a peculiarly chosen social structure of the Islamic state be also applied? This kind of discrimination as happens in many countries is what I mean. But the gradual application of *Shari'ah* as has been done by many people that means *Shari'ah* cannot be applied instantly within one day. This graduality is acceptable but we have always to be careful to implement as much *Shari'ah* as we can without allowing any misconception or misunderstanding of the graduality. I finally agree with your point that the first part is the gradual application of *Shari'ah.* The second point is controversial. Some people think that the *Shari'ah* should be applied fully as happened in Sudan. For example, they declared that *Shari'ah,* from tomorrow, is applicable after giving a full notice to the people. This is acceptable, but wait and tell me that I have to cor[r]ect the society in order to apply Islamic laws. As Mohammed (Pbuh) confronted a cruel *jahilliyah* with and he tried, with graduality, to implement the *Shari'ah. You* know it was gradual. Many other ways the *Shari'ah* followed too. It was sometimes soft with acceptable practices, in other instances the *Shari'ah* was strong and firm as I told you by "don't kill way" for the *jahilliyah* practices of having terrible war for very light criticism. "Don't kill and if you kill you will be killed".

Comment and question by K.T. Hussain

Thank you, Mr. Chairman. My comments arise from the presentation by Mohammed Ata Sid on account of the wide range of its coverage.

The range of material actually is very wide in this presentation. If it is to be published, I would say that the curiosity of readers could be furthered by treating each of the sections in more detail. I certainly appreciate very much the

statements made but some of them have not been substantiated adequately where some of the ayahs of the Qur'an have been just mentioned and have not been adequately discussed. So I would suggest that the writer may elaborate further the statements made under different heading of this presentation. I would be interested in a more elaborate statements of the things and a more analytical statement for each of the sections particularly Islamic *Shari'ah* should be distinguished from the statement relating to the institution of the Islamic *Shari'ah.*

Ata Sid

Thank you very much for this note. But by elaboration as per your suggestion the paper will be very long for which I am already cautioned from the organizers of the seminar. So I took it to present something at least for students of economics for few to understand and this has the boundaries of the *Shari'ah* which I would like to introduce to the students of economics. I cannot provide detail here of everything otherwise this will be a problem. So I think what I tried to do here on speech, that I tried, as much as I can, to give general outlines of the understanding of things. Elaboration definitely can be done. Let us just create curiosity in the students of economics. Let them understand the important problems, solutions to problems which the life faces and let them go and study. I mean I tried to point out the importance of *usul al fiqh* for any student of economics because I did intend to create a comprehensive body of the *Shari'ah* which in my view will be important.

Comments and Question by M.A. Hamid

Brother Ata Sid has made a very good document on the principles of Islamic *Shari'ah.* I think I can use it and we can use it as an important source material. He was describing the principles of the Islamic *Shari'ah.* I was thinking of the obligation from the point of view of a chief executive of university. Brother Sid has mentioned that fundamental objective of *Shari'ah* is to act upon what is right, just, etc. towards both Muslims and non-Muslims. Again he said that non-Muslims cannot be part of the Islamic state as a full citizen, etc. I have a problem to apply this principle. As vice chancellor of the Islamic University, my previous vice chancellor of the university had admitted some non-Muslim students in the Islamic university, and I have taken over only a few weeks back. A section of the people is putting pressure to make a way out for that non-Muslims, or ask them to leave the university. Can you give me a suggestion from the *Shari'ah* point of view?

Answer

So I am to *Sunnah's* your Muslim within admission of non-Muslim student into.

Chairman

Mr. Hamid says that they have different departments in the *Shari'ah* faculty as well social studies and economics faculties. They have departments of economics, English literature, Arabic literature, Accounting, Management, etc. In those departments non-Muslim students have heavy presence and this section of the people is giving a heavy pressure.

Ata Sid

This is a very standard question. It is a question of Muslim and non-Muslim. I don't know that a law or any constitution gives as much protection to minorities as documentated in Islam. Minority protection in the United States, in Britain, in Africa, or in Asia is only legal and it is left to the will of the legislative body. In Islam the right of the minority is protected by the very religion itself. Any violation against a non-Muslim is the violation against the religion and simply the word *zimmis* which is used for non-Muslim minorities in the Islamic state come from *zimmah* which is "pledge of honor". The Prophet (Pbuh) said. "I will be the defendant in the Hereafter against him who makes harm to *a zimmi.*

There is no Christian in the Islamic state who may be compelled to change religion. This has been the very basic constitution of the *Shari'ah* and is not allowed. As I mention in the paper, there happened in the history of Islam that some people violated the right of minorities. This suffering of non-Muslims was applied with suffering for the whole society on the hands of these dictators who violated *Shari'ah.* Regarding your point, I have a practical experience regarding admitting non-Muslim students. I was in Nigeria responsible of faculty of law and Islamic *Shari'ah* and having that I would admit non-Muslim students because the state itself makes it necessary to admit Muslims and non-Muslims in the programs of the university. Also my experience in the International University of Kuala Lumpur. This is, I would say, a beneficial matter, for a Muslim, to allow non-Muslims. So that they themselves can be there in a very good way and become advocate to their people. Prophet (Pbuh) showed what Islam is to new Muslims and then they went back to their people as guides and teachers in the way of religion. I have in my experience as I told you that some of the students, whom we

admitted there, studied Islam and *Shari'ah* and came out of the university carrying good knowledge about Islam and its message to all humanity.

Chairman

The subject of the seminar is teaching of Islamic economics at the university level. We don't have any department of Islamic economics at the university level in this country. This would have been a very relevant topic in those countries where they have a department of Islamic economics at university level. We have an Islamic university outside of Dhaka or somewhere. Now those who are coming from abroad, one of the points we agreed on that there will be recommendations at the end of the seminar that in our education system at the university and college level there should be Islamic economics departments. Ideas would come from the floor that would be helpful for framing the recommendations and if the foreign scholars who are associated with Islamic economics departments in foreign universities can talk something during this course of the problems that may be faced.

The request I want to make and that today's discussion on *maqasid* of *Shari'ah* be linked to Islamic economics. If we can have foundations of Islamic. economics linking *Shari'ah* to Islamic economics. But I find that our discussion is moving towards culture, society and other things and flowing away from economics. So Islamic economics and *Shari'ah,* in this question, shall be connected. We are discussing *Shari'ah* here, and objectives of *Shari'ah. So* far as its relation to Islamic economics is not fully explored, I appreciate if we can confine our observations and questions to this important issue.

Ata Sid

I think it is an excellent insight from organizers of the seminar that this paper be included because it is essential that a discussion about the general objectives of the *Shari'ah* be part of a seminar on teaching of Islamic economics, just to have a very deep understanding of the *Shari'ah.* This comprehensive idea of *Shari'ah* is very important. I tried my best to cover every point, I think, related to economics. But originally the paper intended to give the general objectives of *Shari'ah.*

Question or comment

I would like to thank brother Syed Mohammed Sid for his good presentation. The paper has actually provoked some comments on two fundamental points: one point has been the center of the paper. This concept was relating to *Shari'ah* and Islamic economic system. I would like to mention the foundations of the Islamic economic system are closely related to. some major points mentioned in this paper. One of the core points of any economic system is property and this can be clearly seen from Qur'an and *Sunnah.* Another point also important for the economic system is the contractual arrangement between people and this can be also related to the concept of contract *Shari'ah.* Also the prohibition of *riba is* there in the Qur'an and *Sunnah,* the concept of *Zakah.* All these things are very basic, and can be directly related to Qur'an and *Sunnah* and in fact this is a major difference between the Islamic economic model and the mainstream economic model. So it is not difficult to present the Islamic economic system and the major contributions in relating economic model to the Islamic teaching.

Another point also raised in the paper I would like to comment on is the concept of the artificial Islamic economics; and here brother Ata Sid mentioned that the requirement for an Islamic economics is to be derived from *Shari'ah.* I think we all are trying to come up with a curriculum for teaching Islamic economics for our departments. You cannot find that simply if you look back into literature; though you find somehow the good *faqihs* helpful in serious analysis of economic issues. I would like to take brother Ata Sid's good suggestion, how this plan of critical look into Islamic economics can be achieved.

Ata Sid

All right, thank you very much for your kind comment. Regarding the last point, now in many universities basic *Shari'ah* studies are now adopted. Many universities exposed students to general studies and then after that they specialize. I still maintain the point that teaching Islamic economics will be a great job. It will give a generation of excellent courses on *fiqh* generally and then they will be trained in the proper economics related to Islamic economics.

I support the point that as much as possible, and within the boundaries I mention generally in the paper, we should have a detailed studies of Islamic economics on the basic ideas of the *Shari'ah.* I am not saying that one should really complete of course in *Shari'ah* and have a degree in *Shari'ah* then, comes

studying economics. In our Department of Economics, I mean economics faculty in Muslim universities, we should really expose the students of economics to very important basic programs in the *Shari'ah.*

Comment by Azaharuddin

There are some people who think that perhaps there is very little relationship between *Shari'ah* and economics. I think there is a close relationship between *Shari'ah* and economics in Islamic system. For example, Monzer Kahf mentioned that whether you can see that consumption or production should come into the purview of *Shari'ah* or not. Yes, why not? For example, you cannot produce wine which is prohibited in Islam. So far as the economics is concerned we cannot produce wine and production of wine is strictly prohibited and this is a part of Islamic economics as well as part of *Shari'ah,* and so is the *riba.* Therefore anything which is prohibited by Allah that is a part of *Shari'ah* and we cannot accept all those activities and we cannot do that. Therefore it is a part of *Shari'ah* and such examples are there, many things which are part of *Shari'ah* are also part of economic activities. Also there are some people who think that everything is predetermined by God. That means *taqdir* and there is *a Hadith* that is sometimes interpreted this way, because to say otherwise is to say man is the architect of his own fortune. Yes, why not? Allah says that until and unless you change your position, that means the nation as a whole world or the human beings, Allah will not change their position. Therefore the *taqdir* and *tadbir* will go together and we cannot say that there is only the *taqdir,* that is the predetermination. Therefore we cannot say anything and we cannot do anything. Yes, we can change our position in that and Rasulullah (Pbuh) and *Shari'ah* also actually allow us to do that.

Ata Sid

This is not only a question merely as you mentioned. You are correct. Not only there is a relation between the *Shari'ah* and economics, I think there is a real, full, adequate Islamic economics in *Shari'ah* which has been used in the path of Islamic challenge. There exists not only a relationship between *Shari'ah* and economics, but there is a full-fledged Islamic economic system within the *Shari'ah.*

Question by Sulaiman Mandal

In what ways will Islamic *Shari'ah* affect economic theory and laws of economics?

Ata Sid

Next time or in future.

Question

Will you please explain the inability of the experts in *Shari'ah* in the Muslim countries in developing *Baitulmal* or any other alternative of modern banking and insurance? How will you react when someone says that the *Shari'ah* is inadequate to provide for any alternative of modern banking system? Is not Islamic banking being organized by people who are western and have very little knowledge of *Shari'ah?*

Ata Sid

No, I would say the answer is no. Islamic banking is an excellent venture in modern Islamic economics. No doubt we are facing a very major problem that *riba is* prohibited in a strongest sense in the Qur'an and *Sunnah.* I don't know of any crime or sin in Islam against which a war has been declared as in the case of *riba.* In the sense that *riba is* a serious and terrible sin and we should really try to clear our practices from all usury influences.

For this reason the item for an Islamic banking is an excellent example. I mean, people tried to put Islamic solutions based on *Shari'ah* ideas such as *mudharabah, murabaha* and *musharakah.* All this is a systematic development. Just a short time ago, people thought that it is almost impossible to change the interest banking system, and we have made it a reality in our life and based on *Shari'ah.* The enemies of Islam are now feeling that the development of Islamic banking is a threat to them and they think that this is a real issue now. I hope and pray that brothers in the Muslim countries will take the initiative in introducing Islamic insurance in the same way as the Islamic banking.

Ten years ago, I remember some people like doctors, engineers and economists, if we tell them that there is a system of Islamic medicine, they will say what are we talking about?! If you tell them that there is an Islamic engineering, they will tell you what do you mean? Of course what is it? *Alhamdulillah,* in our Islamic education when we talk about Islamic economics not many people will be surprised; if you talk about Islamic engineering not many people will be surprised, and if you talk about Islamic medicine not many will be surprised? This is an important development in the field of Islamic education.

Question

Income tax reaches sometimes the rate of 50% and 60% and various other taxes. How would poverty be eradicated with *2.5% Zakah.* Is it not too much to expect and too unrealistic?

Ata Sid

This particular question about the rate will be answered in my paper tomorrow, Insha'Allah. The question of **additional** *Zakah* and the additional practices over the *Zakah is* coming with us in my next paper.

Question

You have mentioned in your discussion about the Satan. What is the role of Satan in the economic development of west and the **backwardness** of Muslims? Is he alone responsible or to what extent the Muslims themselves are responsible for their own backwardness?

Ata Sid

Well, we don't deny in Islam the existence of Satan but one must be very sure that Satan only operates through men and women. It does drive and instigate people and it has an access to them, but Allah *Ta'ala* promises us that if you are strong believers, fully dedicated to Allah *Ta'ala,* Satan would not have big effect. So it is ourselves to blame. No doubt the difficulties we had in our life are caused by following the western standards of behavior and culture, which is, in my opinion, a big reason of our backwardness. We must realize a very important fact that Muslims are not allowed to follow the standards of disbelievers. This is where Satan really attacks, and this is because of our weakness. We are not allowed to follow other systems and we should try to follow the Islamic system like the adoption of *Shari'ah* in our life. There are many enemies from outside or from inside who will be coming in order to hinder such endeavors and to do many *Haram* things.

Question

Muslims of the sub-continents and some other countries are very much *Shari'ah-bound* more than many other groups at least externally about dress,

beard, regular performance of prayers, going to the mosque, etc., but they are also the poorest. Does that not indicate that the conformity with the *Shari'ah* keep a community poor and economically backward?

Ata Sid

Well, this may be an observation of many people but it is not at all those points of personal appearances that matter most. By the way, this is a very important point. In fact this is the first point which will be discussed in my paper tomorrow. I believe that Muslims should lead a most excellent life on earth **and** I am against the trend that one should be poor or putting on dress in a very simple manner. But a Muslim must be the strongest economically.

Chairman

On behalf of all of you and on my own behalf, I want to express my gratitude and thanks to our brother Ata Sid for his brilliant exposition and his passions. We have filed up so many complicated questions, but he maintained his passions and answered those very courageously and not loosing temper. The paper is something very good and I particularly liked him whenever he talks of anything to make anything scholarly with the language very simple. So I think that is a scholarly type.

CHAPTER TWO

SOME *FIQH* CONCEPTS RELATED TO ECONOMICS

***Muhammad Ata Al Sid** **

This chapter is not an specialized research in Islamic economics but aims to survey the Islamic view of worldly possessions. To what extent is material gain allowed? In other words: What is the Islamic view of wealth and richness? Does it contradict religiosity? This is not hypothetical or polemical but a real controversy which preoccupied the Islamic consciousness throughout history.

The controversy originates in the interpretation of the Quranic *ayah* which urge the Muslims to make a struggle for his living, to live a good life by acquiring the beautiful bounties of this world, to eat of the good things that are provided, to enjoy lawful and good sexual life and the other *ayah* which belittle the *dunya* (lower life on earth) and all its false glitter and adornments. There are also many *ahadith* which add to each side of the controversy.

TEXTS IN FAVOR OF GOOD LIVING AND WEALTH

Examples of the first kind of *ayah* are:

> *"And when the salah is finished, then may you disperse through the land and seek of the bounty of Allah".*[1]

After relating the burden of long *qiyam* at night, Allah mentioned, as one of the considerations for that, the struggle to seek the bounties of Allah on earth.

> "...He *knows that there may be some among you in ill-health; others struggling on earth seeking of Allah's bounty; yet others fighting in*

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1 The Qur'an, 62:10.

Allah's cause. You read, therefore, as much of the Qur'an *as may be easy for you" 2*

Ibn Masud, a great companion of the Prophet (Pbuh), was reported to have hoped for death while struggling for his means of living if he was not lucky enough to meet death as a martyr.

"It is out of His mercy that He has made for you night and day - that you may rest therein, and that you may seek of His bounty and in order that you may be grateful. "[3]

"0 you who believe! Eat of good things that We have provided for you and be grateful to Allah, if it is Him you worship ".[4]

"And among His signs is the sleep that you take by night and by day and the quest that you make (for livelihood) out of His bounties. [5]"

"And seek with the wealth which Allah has bestowed on you the Home of the Hereafter, nor forget your portion in this lower life, and you do good as Allah has been good to you and seek not mischief in the land "[6]

Allah has indicated the great value of *mal* (property) in life by commending us to be careful in spending and not to let our properties fall in the hands of the irresponsible.

"Make not your hand tied to your neck, nor stretch it forth to its utmost reach, so that you. become blameworthy and destitute. "[7]

"To those sufaha (who lead an irresponsible life) give them not your property which Allah has made a means of support for you.

2 The Qur'an, 73:20.
3 The Qur'an, 28: 73.
4 The Qur'an 28:73.
5 The Qur'an, 02: 172.
6 The Qur'an, 30: 23.
7 The Qur'an, 28:77.

Feed them and clothe them therewith, and speak to them words of kindness and justice. "[8]

A confirmation of this Divine notion of preserving and protecting *mal is* to be found in the prohibition not to deliver *mal* to the orphans until we make sure of their sound judgment.

"Make trial of orphans until they reach the age of puberty: If then you find sound judgment in them, release their property to them."[9]

Our Prophet advised Sa'd saying:

"To leave your inheritors well off is better than to leave them destitute asking favors from people."

He is also reported to have said:

"No mal (funds) availed me as that of Abu Bakr."

In another *hadith,* he said to 'Amr bin al 'As:

"Blessed is the pure mal for the righteous man."

The Prophet made *a du'a* for his most beloved helper and companion Anas saying:

"Allahumma multiply his mal and posterity, and lengthen his life, and bless what is given to him, and forgive his sins."

And when Ka'b bin Malik was relieved of the great trial he went through as a result of his lethargy which caused him not to follow the call for Tabuk, he wanted to give away all his property as charity. The Prophet (Pbuh) said to him:

"Keep some of your ma!, it is good for you."

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8 The Qur'an, 17: 29.

9 The Qur'an, 4: 5.

TEXTS THAT BELITTLE *DUNYA*

On the other hand, there are the *ayah* and *ahadith* which condemn engrossment in the vanities of this world and the accumulation of temporal goods.

> *"What is the life of this world but play and amusement. And the best is the home of the Hereafter, for those who are righteous. Will you not then understand"*[1]

All properties of this world are ephemeral and all that will be left is dust and ashes.

> *"The likeness of the life of the present is as the rain which we send down from the skies. By its mingling arises the produce of the earth which provides food for people and animals. (It grows) till the earth is clad with its ornaments and is decked out (in beauty): the people to whom it belongs think they have all powers of disposal over it. There reaches it Our command by night or by day and We make it like a harvest clean-mown, as if it had not flourished only the day before! Thus do We explain the signs in detail for those who reflect."*[11]

A wholehearted sole desire to gain the vanities and glitter of this world shall have it in full measure but they would have nothing in the Hereafter except fire.

> *"Those who desire the life of the present and its glitter - to them We shall pay the reward of their deeds therein without diminution."*

> *"They are those for whom there is nothing in the Hereafter but the fire: Vain are the designs they frame therein and of no effect are the deeds that they do."*[12]

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t0 The Qur'an, 6: 32.

12 The Qur'an, 2: 15, 16.

11 The Qur'an, 10:24

The true servants of Allah are those who remember Allah during the day and night and whose concern in this life is not worldly gain but the grace of Allah. Allah directed His Prophet (Pbuh) to be content with these rather than to long for the ephemeral vanities.

> "And keep your soul content with those who call on their Lord morning and evening, seeking His face; and let not your eyes pass beyond them, seeking the pomp and glitter of this life"[13]

The glitter of this world is fleeting but it is ephemeral. But good deeds have a lasting value and they will be graciously rewarded later on.

> *"Set forth to them the similitude of the life of this world: It is like the rain which We send down from the skies. The earth's vegetation absorbs it, but soon it becomes dry stubble, which the winds do scatter. It is only Allah who prevails over all things. Wealth and sons are the allurement of life of this world, but the good deeds of remembrance are everlasting and honorable in the sight of Allah. "*[14]

Any of the temporal goods given are an enjoyment and ornament of this world but they are nothing as compared with the good of the Hereafter. They are given to the just and the unjust as a test and trial and in any case will pass away. The life of the Hereafter is everlasting.

> *"The (material) things which you are given are but the conveniences of this life and the glitter thereof But that which is with Allah is better and enduring. Will you not then be wise.* "[15]

When some of the spectators prayed for a boundless wealth as that of *Qar'un,* the Qur'an reports the reply of the wise:

> *"So he went forth among his people in the (pride of his worldly) glitter. Those whose aim is the life of this world said: Oh! that we*

13 The Qur'an, 18: 28

14 The Qur'an, 18: 45, 46.

15 The Qur'an, 28:60.

had the like of what Qar'un has got for he is truly a Lord of Mighty good fortune.

But those who had been granted (true) knowledge said: Alas for you! The reward of Allah is best for those who believe and work righteousness. But such a wisdom can only be attained by those who are steadfast and perseverant. "[16]

This World's bounties are to be taken as instruments for the good deeds that can help us gain the real life of the Hereafter. They are to be taken for their worth and not to be allowed to deflect our minds from the fulfillment of the trust and the eternal good awaiting the righteous.

"What is the life of this world but amusement and play. Verily the home in the Hereafter, that is life indeed, if they but knew. "[17]

"..Let not then this wordly life deceive you, nor let the chief deceiver mislead you away from Allah. "[18]

Surrounding circumstances will never be accepted as an excuse to live a wordly life. Believers should pull themselves out of such environments even if it means suffering ostracism or even exile.

Say: "O ye my servants who believe! Fear your Lord. Good is (the reward for those who do good in this world Spacious is Allah's earth those who patiently persevere will truly receive a reward without measure! " [19]

"0 my people! This life of the present is nothing but (temporary) convenience. It is the Hereafter that is the Home that will last."[20]

"To any that desires the filth of the Hereafter, we give increase in his tilt; and to any that desires the filth of this world, We grant somewhat thereof but he has no share or lot in the Hereafter." [21]

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16 The Qur'an 28: 79, 80

17 The Qur'an, 29:

18 The Qur'an, 31:33

19 The Qur'an,

20 The Qur'an. 31:33.

21 The Qur'an, 40:39.

"And on the day that the unbelievers will be placed before the fire (it will be said to them): You received your good things in your lower life and you took your pleasure out of them. Today you shall be recompensed with a penalty of humiliation for your arrogance on each without cause and for your corruption. "[22]

Besides these *ayah* there are many *ahadith* on *zuhd* (renunciation of all material joys). In an authentic *hadith,* the Prophet (Pbuh) is reported to have said:

"Those who have much in this world are those who will have less in the Hereafter except the one who will disperse it (in charity) here and there."

In another *hadith,* the Prophet (Pbuh) is reported to have said that this lower world would not equal a wing of a mosquito in the sight of Allah.

There appeared the Sufis who emphasized the apparent meaning of the last *ayah* and *ahadith and* advocated renunciation of this world as the required path for the true Muslim. They produced a lot of literature to that effect and acted according to it. Al Qurtubi, in his *tafsir* reported some of the most unacceptable stories forged in order to give authority to their stand [23] They maintained that wealthiness is a veil between the creator and the Muslim and that it was actually a punishment. That investment negates *tawakul* and prevents the heart from being fully occupied with *zikr*.

THE BALANCED POSITION

Imam al Qurtubi came with an excellent analysis of the Islamic situation regarding material gain and wealthiness.

First: Working to gain the necessities of life such as the necessary food, drink, clothes, medicine etc. is a duty on any capable Muslim. If he does not make such a struggle to provide for himself and his dependents then he is sinful. As the Prophet (Pbuh) said:

"Enough sin for a man to neglect his dependents."

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22 The Qur'an, 46: 20.

23 *Tafsir a! Qurtubi,* Vol. 3 pp. 418-419.

Second: If a struggle is made to gain a lot of *ma!* by permissible *(halal)* means then we have to look at one's intention. If one intends to show off and boast and to feel lofty, that is an unacceptable endeavor.

But if one intends to provide for one and one's family, to guard against the vicissitudes of days and to provide for one's needy relatives and destitute Muslims or to spend in the ways of charity then one will be rewarded for such a gain and struggle and this can be better than many of other acts of worship. 24

Imam of Qurtubi then gave examples from Sunnah. The Prophet gave Zubair as much land as his horse could run. When the horse stopped, Zubair threw his whip to take a longer reach in the land. The Prophet approved this and gave him to wherever his whip reached. The brothers of Yusuf, as reported in the Qur'an said:

> "...So we shall get food for our family, We shall take care of our brother and add a full camel's load (of grain to our provisions)."[25]

It was reported that Prophet Ayub, after full recovery from his application, got plenty of gold pieces spread for him to collect. He gathered as much as he could and when he was asked: "Are you not satisfied", he continued to collect and said: "0 Lord! A poor like me can never be satisfied from your grace." AI Qurtubi then commented: "This is a matter well imbedded in our nature."[26]

Imam al Qurtubi reported that Sa'id bin al Musayybib, a renowned scholar of the *tabi'un* as saying: "There is no good in the one who does not struggle for a material gain to . repay his debt, protect his honor and to bequeath property for his posterity." At his death, bin al Musayyib left behind four hundred dinars.[28] Sufian al Thawri[29] had two hundred dinars in his estate and he used to say that *ma!* in his time was a weapon. Our predecessors were known to honor property and collected as much for emergencies and as help for the unable. Only some of these avoided, such an activity and preferred pre-occupation with *ibadah.*

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24 See *Tafsir al Qurtubi,* Vol. *3 pp. 419.*

25 The Qur'an 12:65

26 Tafsir al Qurtubi. Vol. *3,* p. *419.*
27 !bid , p. 420.
28 That was a huge sum of money in those days.
29 Sufian al Thawri was known to be an Imam in *Zuhd.*

Imam Qurtubi added that it was enough honor for property that our Prophet said: "Whoever is killed in the cause of defending his *mal* is a martyr". [30]

The most important conclusions we have here are:

1. That Allah created the world for man and made it subservient to him. They are to benefit from it and lead a good life as much as they can.

2. Muslims are particularly encouraged to note the above fact and to struggle for the fine bounties of Allah as He has provided for us on land, sea and air, in the vegetable, animal and mineral kingdom. Nobody is allowed to restrict any Muslim or to limit his understanding regarding such a struggle.

3. Similarly, the Islamic state is under an obligation to adopt and execute a policy which will encourage the Muslims to highly improve their standard of living, their defence and to highly maintain the dignity of its citizens against any exposures to famines or sicknesses or a subjugation by the enemies of the Muslims.

4. The Islamic state is under an obligation to benefit from any available material and to make every possible research to be militarily highly prepared.

5. Doing all that, individuals and the state are to be mindful that material wealth and material power should be gained in a halal (permissible) way and that all are ephemeral and should not fill us with pride or to veil our understanding from the resounding and living message of Allah.

6. It is the duty of the *ulama* (scholars of Islam) and the state to inculcate the Muslims in the right intentions and goals behind material wealth and to be very mindful of their duties towards the state and other Muslims.

This, in my opinion, is of great economical importance which will affect the infrastructure of all economic policies and plans, both on the individual levels and the social level.

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30 Tafsir at Qurtubi Vol. 3, p. 420.

DUTIES OF THE WEALTHY

The major obligations on any Muslim regarding his wealth are:

I . The *Zakah:* It is the regular and obligatory charity in an organized Muslim community, usually 2.5% of merchandise and 10% on the fruits of the earth. There is vast body literature on the subject which is well researched and gathered by Muslim scholars. *Zakah* is to be given to the poor and the needy and those who are employed in collecting it. The state has the right to administer collection of the *Zakah* and any attempt not to give it or cheat regarding its amount is punishable by law.

The most important is that the *Zakah* should be collected from the rich and returned into the poor people of the same area. The Prophet **(Pbuh)** when he sent Mu'az to Yemen directed him to take *a Zakah* from their rich and to return it in their poor. The rich should be paying *Zakah* with full pleasure that he is actually sanctifying and purifying himself in the due course of his duty to Allah and his fellow Muslims and the diligence of his state to redress his problems.

> *"Of their properties take a Zakah that you may purify and sanctify them and pray for them, verily your prayers are a source of security for them and Allah hears and knows. Know they not that Allah does accept repentance from His votaries and receivers their gifts of charity and that Allah is verily He, the oft-returning, most merciful".31*

If the state has well administered *Zakah* department, well organized and well computerized as the requirement of *ihsan* demands it to be so, the *Zakah* system could prove to be a very viable economic institution. The present situation of the *Zakah* systems in our Muslim nations is far from being perfect or tenable to fulfill the hopes of Muslims everywhere. Within the *Zakah* institution, there must be a group of *ulama* specialized in the field and who would be ready to tackle any issue that may arise in the conduct of *Zakah.*

The *fuqaha* discussed whether there are any rights on *mal* beyond the *Zakah.* This can be in their comments on the Quranic *ayah:*

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[31] The Qur'an 9: 103. 104.

"... And those who hoard gold and silver and spend it not in the way of Allah: announce unto them a most grievous penalty."[32]

The majority of the *fuqaha* are of the view that religious duties are satisfied by the payment of *Zakah.* Beyond that, it is left to voluntary charity and the needs of the community as *ulu al amr* may justly require.

But Abu Zar, the reputed companion of the Prophet (Pbuh), is reported to have said that anything beyond necessities is *kanz* (hoarded treasure) and the Muslim will be responsible not to hold it back.

Imam Qurtubi, in his precious *tafsir,* made an important attempt in interpreting Abu Zar's extreme view. He said that the *ayah* was revealed in times of severe financial hardship and the lack of funds in *bait al-mal* to meet the needs of the new immigrants from Makkah to Madinah. Consequently, the wealthy among them were warned not to hold to their riches in the face of such difficult circumstances. Gold and silver, symbolizing wealth, should not be cherished more than the good pleasure of Allah. Lofty behaviors like those of Abi Bakr and Uthan b. Affan are to be noted here. Each of them gave up all his property and put it at the disposal of the Head of the state, the Prophet Muhammad (S.A.W.).

From an economic point of view, the *ayah* indicates the right of the Islamic state to take from citizens more than the *Zakah* in way of taxes in order to protect the *ummah* and to maintain a high standard of living for all citizens in terms of utilities, education, transportation, hospitals, etc. Taxation must only be in proportion to the governmental needs to build a strong economy and the tax-payer must always feel that his taxes are well returned in terms of public service.

The *ayah* has another deeper economic value. Misuse of wealth, property, and resources is condemnable. Muslims are advised not to hoard or buy or amass wealth for its own sake but use it freely for the general good ourselves, neighbors or the community at large.

2. Second is the concept of voluntary *sadaqah* (charity). It is made clear, from the very beginning that all properties belong to Allah and all bounties proceed from Him and men are only *mustakhlafun.* Bounties are of three kinds: the physical such as food, clothing, houses, gardens, wealth, etc., or intangible gifts such as influence, power, birth and the opportunities flowing from it, health,

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32 The Qur'an 9: 34.

talents, etc., or the spiritual gifts such as insight into good and evil, understanding of men, the capacity for love, etc. Allah's commandment is to spend out of everyone of them something that contributes to the well-being of others. The Qur'anic *ayah* and *ahadith* encouraging *sadaqah* and the reward for it are many.[33]

Charity, in the *Shari'ah,* has its standards and values:-It must be in the way

of Allah.

a) It must be the giving of something valuable which has been honorably earned or acquired by the giver. The Islamic economic code requires that every gain should be honest and honorable. There is no place in it for trained property. This basic notion in Islamic economics would have great effect in purifying the society from the dangerous crimes and deviant behaviors of the materialistic world.

b) The giver of charity must expect no reward in this world. "And they feed, for the love of Allah, the indigent, the orphan and the captive. They feed them for the sake of Allah alone without expecting a reward or a word of thanks".[34]

c) References or reminders to the act of charity, still less should any annoyance, or injury be caused to the recipient such as boasting or disregarding the gestures of sweetness expected from a Muslim to the other. Any such an act will render the charity without value and rewardless.[35]

d) It is more valuable and good for the giver to make his *sadaqah* secretly rather than openly for other people to see.

3. The opposite of *sadaqah, riba,* is prohibited. *Riba* is a manifestation of selfish grasping greed against those in need or distress. The benevolence and the goodness of charity which invites satisfaction and social security is to be contrasted with the degradation of the grasping usurer.

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33 See for example 2: 271-280.
34 The Qur'an, 76: 8, 9.
35 See the Qur'an, 2: 261-270.
36 See the Qur'an, 2: 271.

Usury is condemned and prohibited in the strongest possible terms. The Sunnah has explained various kinds of usurious practices and how to guard against them. The *'ulema* and the legislators in the Islamic state are under a binding duty to keep a constant watch against any creeping usurious practices in the economic system of the Islamic state.

According to Islamic teachings, any excess on the capital is *riba* (interest). Islam accepts no distinction, insofar as prohibition is concerned, between reasonable and exorbitant rates of interest. Similarly as is between returns on bonus for consumption and those for production purposes and so on.

Owing to the fact that interest occupies a central position in modern economic life and specially since interest is the very lifeblood of the existing financial institutions, successful modest attempts are being made in the field of Islamic banking. Perfecting this system of banking, and fully adopting it, would have tremendous repercussions on the economic life of the Muslim societies.

4. Another important component of the obligations on wealth is what is called *al yard al hasan* (good loan which is free from any interest or reward). Such loans are encouraged and they should be reduced to writing as much as possible to protect against any loss or detriment in such a benevolent act [37] . The very intention of taking the loan must be to repay it back. To harbor the intention of not paying it, would invite Allah's wrath and destruction. As the Prophet said:

> *"Whoever takes a loan intending to repay it, Allah will assist him to repay. But whoever takes a loan with the intention of not paying, destruction from Allah will be on him."*

The *Shari'ah* gives protection to the lender of a good loan. The Prophet (Pbuh) refused to make the *janazah* prayers on a man who died with an unpaid debt, an act which indicates how the *Shari 'ah* value and respect the fulfillment of obligations. The criminal laws of Islam allow the imprisonment of the borrower who is capable of paying but refuses to pay.

37 The Qur'an 2: 282.

OTHER *FIQH* CONCEPTS RELEVANT TO ECONOMIC BEHAVIOR

1. Another important concept relevant to Islamic economics is that fulfillment of obligations is a binding religious duty and not only a civil requirement. In an active economic life, mutual obligations, express and implied, are undertaken. They must be fulfilled to the letter and any breach is sinful.

On the international level, the Islamic state will make agreements and treaties with other states. The state and every citizen therein are bound to see that as far as lies in their power, such obligations are faithfully discharged. The commandment of the *ayah* to discharge contrast will include tacit obligations such as between partners, employer or employed, wayfarer or companion and they must be fully respected unless they are morally wrong. Truth and fidelity is a motto in all Islamic dealings.

2. No one has special privileges or special facilities will be accorded in terms of wealth, the rank or social status. The basic criterion of judgment for all is *taqwa* i.e. the fulfillment of all obligations to the best of one's ability. Janitors are in no way inferior to ministers in terms of treatment, rights or duties. In fact, they are deserving of special attention and kindness.

> *"The most honorable in the sight of Allah are the most righteous".*[38]

If this attitude prevails in an Islamic state, it will make a real difference between it and the ruthless suppression of the poor by the rich, or of the weak by the powerful as in the contemporary materialistic systems.

3. The divine commandment not to have any gain of property *bial batil* (falsehood), i.e., by false means, pretences or in false or vain things, whether that property is held in trust or whether it in one's name or belongs to the community at large. Muslims are encouraged to increase their property by traffic and trade. There must be natural goodwill and consent in all transfers of title.

No owner of property should be compelled to part with his property in anyway. This directive is of particular importance in government policies of

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38 The Qur'an 49: 13.

pricing or confiscation of property. The Prophet, in his refusal to impose specific prices *(tas'ir),* was clearly guided by the Quranic injunction. Everything should be free trade and honest competition.

> "0 *you who believe, consume not your properties among you in falsity, but let there be among you traffic and trade by mutual good* will."[39]

4. Moderation in spending. We read the *ayah:*

> *"Make not your hand tied to your neck, nor stretch it forth to its utmost reach so that you become blameworthy and destitute. Verily your Lord does provide sustenance in abundance for whom He pleases and to others in just measures for He knows and He is mindful of all His creatures. "*[40]

On the individual and the state levels, spending should not be so lavish as to weaken our economy which can lead to many vexing problems nor it is becoming to keep back our resources from meeting the legitimate demands of others and the well-being of the *ummah.* If this Quranic direction is well adopted and wisely implemented by the citizens and the state, the Islamic economy will be much safer from the contemporary economic sicknesses such as inflation and depression.

5. All property should be in the hands of those with impeccable honesty and who have insight in the economic development. We read:

> *"Do not let to the sufaha' (the irresponsible) your properties which Allah has made a means of support for you but feed and clothe them therewith and speak to them words of kindness and justice"*[41]*.*

As it is well known by now that any negligence or recklessness in trusting properties to the unwise is catastrophic. It is the responsibility of the *ummah* to

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39 The Qur'an 4: 29

41 The Qur'an 4: 5.

40 The Qur'an 17: 29, 30.

make sure that the officers holding economic posts, high or low, must be of an impeccable caliber and honesty. A constant watch on them must be maintained.

The *ayah* has another important economic import. As all property belongs to Allah and is intended for the support of the community, it is only held in trust by the individuals who have it in their hands. If such individual is incapable, he is put aside gently and with kindness. While his incapacity remains, the duties and responsibilities devolve on his guardian who will be strictly responsible for every bit of that property.

Owners of property are not absolutely free to do what they like: their rights are limited by the good of the community of which they are members, and if they are incapable of respecting such a right, their control should be removed. However, their interest must be protected, their basic needs met and their emotional welfare soothed by good words. This, of course, can only happen to the few among the owners of property.

6. The *Shari'ah* provided for a specific system of distributing wealth through inheritance. This should be well systematized. Help and advise should be available to avoid some of the fragmentation in property.

CHAPTER THREE

QURUD (LOANS), *BUYA'* (EXCHANGE) AND *RIBA* (INTEREST) IN ISLAM

Muhammad Ahmad A. Hadi Siraj*

INTRODUCTION

1. Islam is a system governing all the aspects of human life.

2. The Qur'an lays down the basic principles for Muslims to conduct and organize their individual life and collective relationships according to these principles. The *Sunnah of* the Prophet explains these principles and helps their application in practice.

3. The Muslim jurists and lawyers have endeavored to ensure the application *of* these principles in our societies.

4. These great jurists were not successful in their societies only but they were admired every where in the civilized world. They helped a great deal in the advancement *of* legal thinking in the world. Their role is deemed necessary to understand the history *of* western legal thinking. As an illustration the word "Cheque" was originated in Islamic legal books and was spread throughout. The Arabic word is صك (cheque or bill *of* exchange is proved to have been taken first by the Italians in the 13th Century from the Islamic legal books).

5. There is no difficulty whatsoever in reshaping our activities and dealings in every walk *of* life according to the principles *of Shari'ah.* All modern transactions and commercial aspects are being under examination to determine their positions from *Shari'ah* perspective. *Fiqh* scholar continuously give legal opinions from *Shari'ah* point *of* view in the recent and modern issues and matters. This may prove that the basic principles of *Shari'ah* enshrined in the Qur'an and the *Sunnah of* the Prophet, peace be upon him, embrace the past, the present and the future of Muslims.

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PART I: SALE

1.1. **Definition**

Unconditional and final transfer of the ownership of a certain property that has a legal value capable of being delivered for a fixed price.

Basic Elements

i) Transfer of ownership
ii) On the will of the two parties of the contract
iii) The object matter of the contract must be known for purpose of eliminating the possibility of disputes at the time of delivery.
iv) The price must be known for the same purpose.

1.2. The will of the parties is the essential element in the contract of sale. This is illustrated in the following concepts.

Existence of options (whether stipulated in the contract -b ,:-.11 or for defects or deception).

Having combined contracts in one single transaction (purchasing a piece of cloth from a tailor and asking him to sew it).

Having stipulations and conditions included in the contract of sale.
The power of the will of the parties to the contract has recognition in *Shari'ah* also in all the principles and maxims of interpretation and in the principle of contracting, i.e., the transaction can not be separate or disintegrated.

Restriction: The will of the parties is regulated by the principles of *Shari'ah.*

1.3. **Property to be sold**

• Land, goods, etc.: concrete or material items
• Rights related to properties (sale of the air above the house of the vendor) (the author's right)

• Preemption right is allowed to be sold according to Malikites and Hambalites.

1.4. **Categories of Sale**

a) Currency exchange صرف which means exchange of currencies in the same session. However, it is allowed to make exchange between outstanding debts for a present currency.

b) *Salam* in which the commodity sold is not present or is not even in existence. This type of transaction is badly needed in an economy free of interest for the producers to meet at least part of their current budget. The need of the dealers or trader is not less.

The condition which is agreeable to all the jurists of the past is the immediate delivery of the price to the vendor. According to them, the aim of having this contract is to secure financial assistance to the producer so that he can fulfill his current liabilities. If the immediate delivery is not stipulated the very purpose of having this contract would be defeated.

c) *Istisnd* بيع الاستصناع/ Sale of certain goods with the condition of manufacturing them. if the maker makes the goods according to the specification then the buyer is bound to accept delivery and pay the price. This is the more prevailing opinion among *fuqaha* in the modem times. The price in this contract can be deferred.

d) Deferred payment of price بيع مؤجل and immediate payment of the price بيع مؤجل. In case of *Bai Mu'jjal* بيع مؤجل the price could be paid on installments. In this case, it is allowed to set the price higher than the cash payment of price.

e) *Bai' 1 Murabahah* which means the price agreeable to the parties was fixed with reference to the cost plus an agreed upon margin. As if A agrees to purchase B's car and the price is what was paid for the car by the seller plus 10%.

f) *Bai' al Wafa* بيع الوفاء means the transfer of the property with the condition that the purchaser's right of reselling it is restricted and the seller preserves the right to get it back if he pays back the price.

g) Hire purchase contract or declining *Sarah.* This is an *Sarah* combined with periodical purchase of certain proportion of the hired asset.

1.5. Comparison

Islamic Law is very much particular about two principles which distinguish it from the present day western legal systems. First is *Gharar* or uncertainty, and second is *Riba,* both of them are prohibited.

PART II : RIBA

2.1. Definition *of Riba* and its Prohibition

i) *Riba* in the Qur'an and *Sunnah:*
Definition: taking more than the principal in any debt for the time allowed.

ii) Methodology of graduation adopted by the Qur'an in the prohibition of *Riba.* in the first place, Verse 39 of *Surah al Ahzab,* the Qur'an indicates that *Riba* does not lead to the increase in the property while *Zakah* does so. In the second place, the Qur'an expresses the condemnation of the jews for their indulgement in *Riba (al Nisa',* 160). In the third place the Qur'an elucidated emphatically that Muslims should not indulge themselves in this type of transactions in which the creditor used to get twice as much as his capital for the postponement of the payment *(Surah al Imran* 130). Finally the verses of *(Surah al Baqarah 274-280)* which stressed the prohibition of any transaction of *Riba.*

iii) In the speech of farewell made by the Prophet (Pbuh) during Hajj of the year 9 of Hijrah, he put the injunctions of the Qur'an in practice and expressed that all kinds and practices of *Riba* are eliminated including the *Riba* of his uncle al 'Abbas which he declared null and void.

2.2. The Scope *of Riba*

The scope of *Riba* is determined by the principle stated by al Imam al Suyuty in his book al *Ashbah.* This principle is as follows :

الربا يجري في المعاوضات لا في الغرامات

i.e., *Riba* applies in exchange contracts not in the fines fixed by a judge. This principle may be construed to mean that there is no *Riba* in case of charity.

2.3. **Categories:**

i) *Riba al nasi'ah* which is based on the delay of debt with the agreement of the two parties to increase in the amount of debt due to be paid to the creditor later on.

ii) *Riba al Fad/* is prohibited because it leads to the other type of *Riba* which was prohibited for itself.

iii) Hadith 'Obadah Bin al Samit on *Riba al Fandl.*

iv) Muslims did well in the past and ran commerce all over the world without interest.

v) Islamic banks and Muslims are endeavoring to replace interest with a system compatible with *Shari'ah.*

vi) Prohibition of interest in banks' transactions may raise certain objectives. There is a need for cooperation among Muslim states to get rid of the foreign debts and to create our own plan for developing our countries.

vii) Influence of Muslim legal thinking concerning *Riba* over the western jurists in the middle ages.

viii) Who sustain the damage is to have the profit. الخراج بالضمان

ix) The problem of ضع وتعجل which means the creditor wants to get a premature payment of the loan by way of reducing the amount of debt. Most of the jurists did not allow such a practice. However, it was permitted by al Shari and Ibn' Abbas.

x) Barter of goods for goods of the same kind but at different quantity and quality. This may best be explained by referring to the man who purchased good dates against larger quantity of bad date for the Prophet, peace be upon him. The Prophet, (Pbuh), ordered him to void the transaction as being prohibited.

PART III : LOAN

3.1. Definition (a contract of exchange on one hand and a contract of charity on the other).

- It is not considered a vehicle for investment but for extension of assistance to those who need it at certain occasion.
- *Qard hasan* قرض حسن is not restricted to loan or debt but it includes all aspects of charity. It is used in our days to mean loan without interest.

3.2. Contract of Loan for a certain period is not binding according to the majority of the Muslim jurists. According to the Malikis, the creditor is bound by the period specified. This is the prevailing opinion. As a result if A lends B $ 2000 for 24 months he will have no authority to have it paid back before the lapse of the specified time.

3.3. The treatment of the debtor in *Shari'ah*.

"وإن كان ذو عسرة فنظرة إلى ميسرة" البقرة 280

This reflects the nature of this contract on one hand and the supremacy of *Shari'ah* over these systems which do not have any soft corner for the debtor.

3.4. Involvement was legislated for in *Shari'ah* to transfer the authority of the creditor from the body of the debtor as it used to be in ancient legal systems to his property only (the case of Mu'adh Bin Jabal).

3.5. The distinction between loan and gift, *'aryah sadaqah* and deposit.

3.6. Loan in the recent legal thinking.

CHAPTER FOUR

MUDHARABAH, MUSHARAKAH AND *IJARAH*

Muhammad Ahmad A. Hadi Siraj*

INTRODUCTION

1. Development of our societies and investment of our wealth are considered to be our task ordained by Allah in the Qur'an.

2. Sources of *Musharakah* and *Mudharabah* are found in the general order of the Qur'an وتعاونو على البر والتقوى ولا تعاونوا على الإثم والعدوان , So, cooperation is considered to be the basis for the legality of these two contracts. The Sunnah gives details of the application of this principle.

3. Custom العرف of the people helped the jurists in the past to elaborate the rules of these two contracts.

4. *Mudharabah* was reportedly known in Arabia before Islam but the Islamic Law was the first legal system in which the legal rules of *Mudharabah* emerged.

5. Muslims had mastered and controlled the world trade in the past due to the techniques introduced by Islamic law which enabled the Muslim traders to finance their activity and to transfer the money from one country to another through the very advanced mechanism of سفتجة or Bill of Exchange. *Hawala* (transfer of debt) which was introduced in German Law about the end of the 19th century, served for advancement of trade in the Muslim world.

6. It should be emphasized that Islamic Law supported the Muslim trade by providing it with the legal concepts and techniques necessary for the needs of the trade. Again, it can do the same at present.

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7. Islamic banks have, no doubt, succeeded to prove the practicability of these institutions in the modem times.

8. *Mudharabah* and *Musharakah* have a wider connotation than partnership in the technical meaning of English legal system. Some authorities in the West (Holdsworth: A History of English Law) considered to commend the institution which paved the way for the emergence of the concept of company.

PART I : MUSHARAKAH

9. Definition: An agreement between two persons or more sharing the obligations and profits as well. The shares offered by each one can vary. In general, it may be money or labor and can be the trust of the people.

10. Objectives of *Musharakah*

The objective of *Musharakah* is to achieve profit for the parties. The loss must be shared by the parties proportionate to their shares in capital. Profits are allowed to be distributed in a different manner.

11. Types of *Musharakah*

Mufawadah مفاوضة It is a type of *Musharakah* in which the capital or obligations are equally shared by the parties to the contract. It is very likely to take place among family members who inherit certain project and prefer to work together. Every partner works as *wakil (an* agent) for the others and he is also considered to be *kafil* or liable for the obligations caused by other partners. Ahnaf accepted this type of *Musharakah* while it was rejected by others.

b) *'Inan jLc* is a type *of Musharakah in* which the shares *of* the partners are not equal and every one works as *wakil* for others. The loss is to be distributed in proportion to shares in capital. As to profits, partners are free to distribute it in the manner they like according to Ahnaf.

c) Business type *of Musharakah* which is called JAS شركة الأعمال In this case two or more workers (carpenters, tailors, lawyers) want to work together sharing the risk and benefits. They are

allowed to institute *a Musharakah* on their will. Every partner is liable for the contracts concluded by the other. Profits are distributed according to the terms and conditions stipulated by them.

d) *Musharakah of* persons without capital which is called شركة الوجوه Or شركة المفاليس In this type *of Musharakah* the partners are normally *of* good reputation in the market and can buy goods on a delayed payment until after they sell them. According to Malikites this type is called شركة الذمم.

e) Composition *of* more than one type *of* these *Musharakahs*

The Hanbalite jurists voiced the principle that it is permissible to have one type *of Musharakah* or more in one single transaction provided that each is permitted.

12. Administration

In case of *Musharakah* every partner is entitled to participate in the running of the affairs of the *Musharakah* by way of taking decisions or by any other way agreed by the partners. As to *Mudharabah* according to the three schools the capital owner is denied the right of intervening in the business of the *Mudharib* or entrepreneur. However, the Hanbalites permit sharing the management in *Mudharabah* too.

13. Nature of *Musharakah* Contract

It is not a binding contract and any partner is allowed to quit or sell his share to others unless this harms any partner or customer.

14. *Musharakah* in Islamic Banks

It is the life blood for the activities of these banks. Its role may be well compared with that of interest, in the traditional banking system. Therefore, the Islamic Banks succeeded to create certain forms and types of *Musharakah* to meet their various objectives and circumstances. An example is the *Musharakah* to finance one single transaction. This is used in the import/export business. Another example is the declining *Musharakah* which ends by shifting full ownership of the project to one party. *Musharakah* certificates for limited or unlimited period are

types of *Musharakah* innovated by the Islamic banks to raise funds needed for the creation of business and projects.

PART II : *MUDHARABAH*

15. Definition: A contract in which a party provides capital to the other party who offers his labor with the hope of getting profits which will be distributed among the parties according to the ratio agreed on between them in the contract. Any loss in the capital is the liability of its owner and the entrepreneur will only lose his work for which he will not be paid.

- Making the contract of *Mudharabah* in writing is not a must as it is the case in *Musharakah.* This is only considered recommended by the majority of our jurists.
- The parties to one *Mudharabah* can be more than two persons and it can be combined with a contract of *Musharakah.*
- *Mudharabah* is not restricted to commerce but it may be extended to other activities like industry and agriculture.
- It is a unanimous opinion that the shares of the owner of the capital and the entrepreneur must be determined in a ratio form or percentage of the net profit. If certain return has a fixed amount to any of the two parties, the *Mudharabah* will be rendered void according to *Ahnaf* and null according to the majority. As a result the entrepreneur will be entitled to a fair wage according to the market rate.

16. **Liabilities**

The liability of the owner of the capital is limited to the value of his capital. He is not under any obligation to pay the debts or losses accrued in the *Mudharabah* activities. So, the concept of limited liability is given recognition in Islamic Law. Yet the entrepreneur may be made liable if he causes harm or loss to others due to his negligence or wrong act.

17 **Entitlement of the Entrepreneur**

Apart from his share (a fixed percentage) in the profit, the entrepreneur is entitled to a stipend or نفقة if this was stipulated in the contract of *Mudharabah.*

According to Shafiites and Zahirites, he is not entitled to only a par of subsistence. Their fear was to eat up the whole of the profit if he is made entitled to take it as his subsistence.

18. Practicability of *Mudharabah*

- *Mudharabah* is heavily used by Islamic Banks.
- A system of insurance to guarantee the rights of the bank and the depositors or investors is needed.
- Certain *Ijtihad* must evolve to make it possible for the banks to check dishonesty of some entrepreneur مضارب It could be said the burden of proof may be assigned to the entrepreneur if he claims unjustifiable loss or less profits as it appears from the circumstantial evidences.
- Supply and demand along with the experience of the bank with the entrepreneur are the factors determining the percentage share of the *Mudharib* in the profit.

PART III : *IJARAH*

19. Definition: Hiring of the services of human being or renting certain property.

- This contract transfers the services or the use of a property for certain period.

20. **Conditions**

- Services or benefits stipulated in the contract must be known for the purpose of eliminating disputes.
- Fare and rent must be known too.
- No violation of any principle of *Shari'ah* is permitted. Therefore, in case of hiring a person the work assigned must not be harmful to him. The *hadith of* the Prophet (Pbuh) lays down that, your slaves (or employee servants) are your brothers. When you engage them in any work it must be within their limits. Yet if the work assigned is

difficult, then assistance must be extended. Clothe them and feed them in the manner you do for yourself.

إخوانكم خولكم، جعلهم الله تحت أيديكم، فمن كان أخوه تحت يده فليطعمه مما يطعم، وليلبسه مما يلبس، ولا تكلفوهم من الأعمال ما لا يطيقون، فإن كلفتموهم فأعينوهم.

21. *Ijarah* in the Islamic Banks: There is a wide scope for using *Ijarah* in these banks to purchase expensive equipments and rent it for those who need them and can not afford purchasing them or not willing to extract their value from its budget. Certain forms of *Ijarah* have been introduced by these banks like **الإجارة المنتهية بالتمليك** or hire purchase.

PART IV: GUARANTEE ail4S

22. Definition: Guaranty is a contract of charitable nature in which a person agrees to make himself responsible before the creditor for the satisfaction of the debts.

Kafalah is different from *Hawala.* In case of *hawala* the debt is transferred from one person to another. As to *kafalah* both the original debtor and the guarantor are liable.

23. Nature *of* the Contract *of Kafalah*

- It is a charity contract and no reward for doing *kafalah is* allowed.
- It is a binding contract once it is concluded.
- Uncertainty in this contract is tolerated. It is permitted if A says I am liable for the debts incurred by B in certain transaction though these debts are not known at present.

PART V: TORT

24. **Basic principles**

a) Every-one is responsible for one's acts and no one is made liable for the acts of others. (This principle is repeated so often in the Qur'an.)

b) Harm and injuries are to be redressed. The Prophet (Pbuh) says no harm or causing loss is allowed even in retaliation. The words of the Prophet (Pbuh) are: no Harm and no injury لا ضرر ولا ضرار

b) The maxim in Islamic law is that Harm must be removed الضرر يزال

c) The Prophet says لا يطل دم في الإسلام which means blood shed can not go unnoticed. This requires that if blood is not shed as a rightful legal punishment, there must be compensation.

d) If the harm inflicted by a person can not be compensated by the injurer and is proven to be harmful to transfer it to him/her, then the Muslim society in part or in general should accept the distribution of the burden of compensation among them. Indeed this is the function and the duty of the institution of *'Aqilah* العاقلة

25. **Elements of Tort**

1. Injurious act whether being a commission or omission. That includes any violation of a duty or prohibition. So if one does not fulfill one's duty with the result of causing any harm to others, one shall be made liable for compensation.
2. Harm or loss: compensation in Islamic law is limited to the actual harm or loss.
3. Causation between the *ma/* act and the harm or loss.

26. Certain concepts related to tort have been developed in Islamic law (negligence, contributory negligence-shifting the burden of proof-distribution of harm in the society if it can not be afforded by the wrong doer, etc.).

27. Concluding Remarks

A clear distinction must be made between *Shari'ah, Fiqh, Fatwa* and *Qada'*. While *Shari'ah* represents the permanent and eternal principles and concepts enshrined in the Qur'an and *Sunnah, Fiqh* is merely an interpretation of these principles. *Qada'* is a binding decision in a certain case which has its own characteristics. *Fatwa* is an opinion of a scholar that is not to be enforced by the authorities.

28. Islamic Law has been able to cater for the needs of the Muslim societies through ages and ages until it was removed from the scene by the military western forces.

29. Teaching of Islamic Law in the Muslim world needs enormous efforts to improve and to regain the previous status which it had in the past. Still memorization of the old texts is common. Illustration of the concepts and principles are far away from the experience of students. Lack of organization is felt by the students. All students of Islamic law at the University level need to be taught in a more systematic manner. The need for such an approach is tremendous.

PART II

METHODOLOGY OF ISLAMIC ECONOMICS AND ISLAMIC ECONOMIC SYSTEM

CHAPTER FIVE

RELEVANCE AND IMPORTANCE OF ISLAMIC ECONOMICS

*Muhammad Umar Chapra**

After nearly three to four decades of the development of Islamic Economics, it may be useful to examine its relevance and importance. Such an exercise should help us not only to understand the subject better and to know where it stands at present, but also to provide a correct perspective to the development of the subject in the future. However, since Islamic economics reflects a worldview which is in sharp contrast with that of western mainstream economics, we could understand and appreciate Islamic economics better if we look at it against the backdrop of mainstream economics.

MAINSTREAM ECONOMICS

The subject matter of all economics, irrespective of whether it is mainstream or Islamic, is the allocation and distribution of scarce resources which have alternative uses. However, every activity of rational human beings has a purpose and the primary purpose of mainstream economics is to describe, analyze and predict.[1] Its purpose is not to pass a judgment on the nature of allocation and distribution or to suggest policies for changing these with the objective of solving the problems faced by human societies. However, as long as economists live in human societies where people face problems and wish to solve them, they can not remain unconcerned. They have to help diagnose the problems, and to suggest remedies for solving them. This would necessarily get them into the sphere of policy.

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1 There is a difference of opinion among economists on the goal of economic method. Positivists and operationalists, like Samuelson, emphasize that the role of economics is only to describe. Logical empiricists however insist that explanation is the goal of economics. In contrast with both of these, instrumentalists, like Friedman, emphasize that prediction is the primary function of economics (See Mark Blaug, 1980; and Bruce Caldwell, 1982). Since I do not wish to get into this controversy in this brief address, I have mentioned all three in the text.

There are a number of problems faced by mankind. These include: poverty, lack of need-fulfillment, inequitable distribution of income and wealth, unemployment, macroeconomics and external imbalances and economic instability. No country around the world, irrespective of whether it is rich or poor, has been able to solve these problems. The sad truth is that some of the problems are becoming more and more serious, and if the success of a body of knowledge is to be measured by its ability to solve the problems faced and not by the complexity of its formal edifice, then it must be admitted that economics has not been very successful. It is now being increasingly recognized that mainstream economics has failed "to provide convincing explanations of many economic phenomena, and to generate policy prescriptions which manifestly can solve outstanding economic problems", in spite of "an explosion of publishing activity since the Second World War." [2] It is also being asserted that "economic theory, if it is to be viable, must propose rational solutions to problems".[3]

The primary reason for this lackluster performance of mainstream economics is the absence of an agreed and uniform perspective for its theoretical discussions and policy prescriptions. Theory and policy are so closely related that it is hard to separate them. It is policy which provides a direction to theory, but policies can not be formulated unless there is agreement on their ultimate objective. Only an undisputed acceptance of an ultimate objective could provide a sense of direction to both theory and policy. While human well-being should be goal of all scientific inquiry, the idea of human well-being has "become vague, ambiguous, even protean"[4] in mainstream economics. Consequently, the general complaint leveled against economics is that its dominant 'scientific' model has drifted away from reality so that inference for economic policy are difficult.5

THE FALSE WORLDVIEW

The primary reason for this drifting away of mainstream economics from reality is its false worldview. The worldview explains the origin of the universe and the nature of human life. Differences in worldview lead to differences in conclusions about the meaning and purpose of human life, the ultimate ownership and objective of the limited resources at the disposal of human beings, the relationship of human beings towards each other (their rights and responsibilities)

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2 Geoffrey Hodgson (1988), p. xiii.

3 David Bell and Irving Kristol (1981), p. xii.

4 Irving Kristol, "Rationalism in Economics", in Bell and Kristol (1981), p. 215.

5 Ibid., p..217.

and their environment, and the criteria for well-being. The worldview controls, in the words of Lovejoy, "the nature of man's reflections on almost any subject.[6] Given such a far-reaching influence of the worldview on human thought and behavior, it is not far to see why a false worldview would lead to false prescriptions.

The worldview of mainstream economics has been inherited from the Enlightenment move of the 17th and 18th centuries. Since this worldview has been basically secularist, the paradigm of mainstream economics has also been secularist. It is this secularist paradigm which led to an unrealistic view of the individual, his goals in life, and his behavior pattern. There is an undue emphasis on individual freedom, self-interest, and material pursuits of life. There is an anathema to value judgments and an insistence on the individual being left free to take whatever decisions he considers to be in his self-interest. Since the serving of self-interest has a social stigma attached to it, it is unrealistically assumed that the serving of self-interest by the individual necessarily serves social interest. It is also assumed that the larger the individual's wealth and consumption, the greater is his well-being. Such reasoning has led to the cherished concept of Pareto optimality in welfare economics and to the treatment of tastes and preferences and socioeconomic institutions as exogenous variables.

It is this secularist paradigm which led Lionel Robbins to assert that "economics is entirely neutral between ends. [7]" This neutrality of economics between ends has become an indispensable part of the economics paradigm. It is treated as non-controversial and docilely accepted by the rank and file of the economics profession[8]. There is no other option for any economist who wishes to be accepted into the fraternity of the profession. The emphasis on neutrality in the inner core of mainstream economics has remained unchanged since the seventeenth century despite the neoclassical and the Keynesian revolutions. Within this context, Guy Routh is right in observing that: "It is misleading to think of a flow of ideas. Basically, the ideas have remained where they were and the economists have flowed. Every now and then there has been a change in decor, a new coat of paint, sometimes new wallpaper to hide the cracks, but the beams, bricks and mortar are (conceptually) what were laid down by William Petty and completed by Locke and North three centuries ago.[9]" In spite of protests made by a number of scholars, the belief continues to be that "the-economic-technician

6 Arthur Lovejoy (1960), p. 7.

7 Lionel Robbins (1935), p. 24.

8 Sec, Thomas S. Kuhn.

9 Guy Routh (1989), p.19.

should be no more concerned with moral values than the motor mechanic with the route of the bus he is required to repair. As soon as moral values obtrude, he has ceased to be a technician and has become politician, propagandist, moralist, preacher, interfering with the prerogative of the sovereign consumer."[10]

This has engulfed economics into self-contradictory positions. On the one hand, there is the commitment to neutrality between ends and abstinence from value judgments and, therefore, to the concept of self-interest, consumer sovereignty and profit maximization. On the other hand, there is commitment to the goals of reducing poverty, fulfilling needs, and realizing full employment, high rate. of growth, and economic stability. The realization of these goals, however, requires policies and the parameters of policies can not be defined without value judgments. Since value judgments are not welcome, there has been a near-paralysis of policy making, leading, the words of Solo, "to inaction, to non-choice, to drifting.) Moreover, if the goals specified by economists are to be realized in spite of scarce resources, then the resources must be utilized in conformity with what is necessary to realize these goals. However, value neutrality does not allow economics to discuss ways of molding consumer tastes and preferences and of reforming socioeconomic institutions in conformity with the needs of goal realization. Emphasis, therefore, gets placed primarily on the variables of prices and costs which, it is argued, are 'objectively' determined in the market place by the free interaction of market forces. But, is it possible for prices and costs by themselves to help allocate resources in conformity with the needs of goal realization? This would happen only if incomes and wealth were equally distributed so that all consumers, whether rich or poor, had an equal number of votes to influence the decision-making in the market, and if consumer preferences always reflected social priorities in resource use. Since there are glaring inequalities of income and wealth and since every one is able to act in accordance with his own preferences and self-interest in a value-neutral, secularist environment, economics has not been able to come to a grip with the problems faced.

THE IMPASSE

To understand the implications of what I have been saying, let us look at the macroeconomics and external imbalances which constitute one of the major economic problems of the day. The root cause of this problem is, as every one

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10 Ibid., p. 278.
11 Robert A. Solo (1981), p.38, See also Amartya Sen (1987), p. 32.

agrees, excessive domestic absorption. By domestic absorption, I mean the aggregate consumption and investment spending of both the public and the private sectors. The result is budgetary and current account deficits, excessive domestic and external borrowing and monetary expansion, accompanied by high rates of inflation, economic instability and inability to service the debt.

The solution, every one again agrees, lies in reducing domestic absorption. The crucial question, however, is how to accomplish this task without jeopardizing the realization of socioeconomic goals. The goals of full employment and sustainable growth require that the reduction in absorption be primarily in consumption and not in investment. The goals of removing poverty and of fulfilling needs require that the reduction be primarily in that portion of consumption which is not related to need fulfillment.

Can domestic absorption be reduced in this manner by recourse to the strategy of liberalization, which is the main plank of neoclassical economics and which the developing countries are now being almost forced by the IMF and the World Bank to adopt. This strategy essentially implies that government intervention in the markets be minimized and that prices (including interest rates and exchange rates) be allowed to rise to their equilibrium levels. This will undoubtedly help the countries concerned reduce the domestic absorption and remove their imbalances. The higher prices will however lead automatically to a compromise of the goal of equity in a value-neutral environment. While the rich are able to afford whatever they wish at the higher prices, the real income of the poor gets further squeezed and their well-being suffers. Hence, the well-known IMF-induced riots. Even the high rates of interest do not help. The relationship between interest rates and savings is not yet well-established. Commitment of funds for long-term speculative investments may not necessarily be affected. Moreover, the higher and fluctuating interest rates may accentuate instability in the financial, commodity and stock markets, and tend to vitiate the investment climate. This may hurt the overall performance and stability of the economy.

THE BASIC FLAW

Hence, the basic flaw lies in not discriminating between 'necessary' and 'unnecessary' spending. Such a classification would make it possible for us to cut down unnecessary and wasteful spending and to promote saving, productive investment and need fulfillment simultaneously. This is however not possible to do without injecting tastes, preferences and institutions into the analysis. But tastes, preferences and institutions can not be made a part of the system without

socially-agreed values and criteria to which every one stands committed. This raises two questions.

The first question is: Who can formulate such values and criteria? If human beings propose them in a system which gives maximum weight to individual freedom and self-interest, there is little chance of reaching a consensus. All individuals or groups may tend to weigh these criteria against their vested interest. The possibility of reaching a consensus would be negligible. Divinely revealed values and criteria have however been oriented towards general well-being and have also commanded the status of social contract.

The second question is: What will motivate people, particularly the rich, to abide by such values if these hurt their self-interest? Any system which hurts a person's self-interest may not work. These values do not, however, hurt a person's self-interest. They give it a longer-term perspective by stretching it beyond the span of this world to the Hereafter. While the pursuit of this worldly self-interest by an individual does serve social interest as Adam Smith argued, it does so only where self-interest and social interest are in harmony. However, if there is a conflict, it is necessary to have some other motivation. The concept of Hereafter has proved to be helpful. While an individual's self-interest may be served in this world by being selfish in the use of resources, his interest in the Hereafter can not be served except by fulfilling his social obligations. It is this longer-term perspective of self-interest along with the individual's accountability before the Supreme Being which has the prospect of motivating him to hold his claims on resources within the limits of general well-being. Every consumer will thus be under an inner constraint to weigh his claims on resources against the moral criteria before he expresses them in the market place through his purchasing power. Effective operation of the moral filter can thus complement the price mechanism in reducing excessive absorption by reducing consumption not related to need-fulfillment.

ISLAMIC ECONOMICS

Islamic economics is based on a paradigm which is not secularist and value-neutral. It treats all human beings as vice-regents of God and brothers unto each other. All resources at the disposal of human beings are a trust and must be used for the well-being of all in conformity with the values provided by the *Shari'ah.* However, well-being in Islam is not a function of just material possessions and unlimited consumption. It is rather a function of the balanced

satisfaction of both the material and the spiritual needs of the human personality. This can be done by actualizing the *maqasid al-Shari'ah* (goals of the *Shari'ah).*

The *Maqasid a!-Shari'ah*

But, what are the *maqasid al-Shari'ah?* Instead of going into a long and detailed discussion on this subject, I find it sufficient to quote Imam Ghazali, who has put them tersely by saying: "The objective of the *Shari'ah* is to promote the welfare of human beings, which lies in safeguarding their faith, their life, their intellect, their posterity, and their wealth. Whatever ensures the safeguard of these five fundamentals serves public interest and is desirable." [12] It is however necessary to be clear in our minds that "safeguarding", as used by Imam Ghazali, does not imply merely the preservation of these five in their present state; it implies the continued enrichment of these so that they reach their ideal state.

In keeping with a prayer of the Prophet, may the peace and the blessings of God be on him, in which he sought the refuge of God from knowledge that does not benefit, actualization of the *maqasid* may also be considered to be the goal of all branches of knowledge, including physical and social sciences. The criteria for judging the success or failure of any branch of knowledge, may then be the extent of its contribution towards the realization of the *maqasid.* Islamic economics could in this case be defined as that branch of knowledge which helps in the use of relatively scarce resources at the disposal of human beings for realizing the well-being of all in accordance with the *maqasid al-Shari'ah* without creating continued imbalances or damaging the environment.

The objective of realizing the *maqasid* within the framework of scarce resources would no doubt provide a firm direction to both theoretical discussions and policy prescriptions in Islamic economics. It would remain confined to just a description of 'what is' or to analysis and prediction; it would also be concerned with 'what ought to be' in the light of the *maqasid* and how to get there within the constraint of available resources. This implies that Islamic economics would not only be positive and normative, it would also be prescriptive. This would help prevent the drifting away of Islamic economics from reality as has happened in the case of mainstream economics.

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12 Abu Hamid al-Ghazali (1937). Vol. I. pp. 139-40. Leicester. U.K.

The Wider Scope

If we involve Islamic economics in the realization of an allocation and distribution of scare resources that is in conformity with the *maqasid,* we will undoubtedly expand its scope beyond that of conventional economics. We will have to concentrate on the human being who is the end and means of all allocation and distribution. But if we focus on the human being, as we should, then all aspects of his behavior that affect allocation and distribution should come under discussion and not merely prices and markets. His tastes and preferences and the socioeconomic institutions that affect his behavior can not be left out as exogenous. They have to be cast into the mould of Islamic values to create an enabling environment.

Once we make the human being as our focus for analyzing allocation and distribution, then the first four *maqasid* of Ghazali - faith, life, intellect and posterity, which he has very wisely put before in terms of their significance, acquire significance. Only by including these in our analysis will we be able to explain better the important economic variables of consumption, saving, investment, work, production, wealth accumulation and distribution, which mainstream economics is unable to do because of unrealistic assumptions about human beings and their behavior. This need not, however, make Islamic economics unmanageable.

When a Muslim economist talks of 'faith', he need not necessarily get into all aspects of faith. He will rather study those values and institutions of faith which help provide a firm foundation for the establishment of an efficient and equitable economic order. He will discuss the values that would serve as a filter for the allocation and distribution of resources in a way that would lead to need-fulfillment, full employment, equitable distribution of income and wealth, and greater economic stability. He will talk about values and institutions that affect tastes and preferences and, through these, consumption, earning, savings, investment and production. He will also discuss policies that would help Muslim countries use scarce resources efficiently and equitably and to maintain their aggregate claims on resources within the limits of availability so that continually rising imbalances do not become a permanent feature of their economies. He can not avoid examining the impact of *riba* and *Zakah* and other Islamic institutions on the efficient and equitable use of resources. The moral obligation of the state to help realize the *maqasid* also gains importance.

It may be emphasized here that efficiency and equity can not even be defined without resort to the moral filter that faith provides. As Frank Knight has rightly argued, the most important principle of physical science is that matter can neither be created nor destroyed. Total output will therefore always be equal to total input in physical terms. The correct definition of efficiency would hence be the ratio, not between total 'output' and total 'input', but rather between useful output and total input. This means that a measure of 'usefulness' is needed to measure efficiency.[13] Individual preferences are undoubtedly based on an individual's personal measure of 'usefulness', but this measure may not necessarily be in harmony with the scale of social priorities necessary for realizing the well-being of all. If it is difficult to define efficiency without a scale of social priorities, then it would be even more difficult to define equity without such a scale because of its greater subjective content.

Conventional economics lacks social criteria for measuring both efficiency and equity. In fact, it argues against the need for such criteria and assumes that individuals operating in a competitive market in keeping with their personal preferences and self-interest will automatically help optimize efficiency and equity.

When a Muslim economist talks of life', he will not get into its biological, genetic and medical aspects. He will rather talk about those aspects of resource allocation and distribution that help in the development of the total human potential and the enrichment of life on earth. This will get him into a discussion of the kind of consumption, production, income distribution and collective goods (including education and health) that will enrich life by enabling a Muslim to fulfill his obligations towards God, himself and his society.

When he talks of 'intellect', he need not get into a discussion of the biology and chemistry of the human mind. He will rather confine himself to a discussion of the kind of intellectual development, education, research and technological innovation that will help realize the *maqasid.* He will also examine here the nature and significance of market failure and the role of the state.

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13 Frank H. Knight, "Social Economic Organization", reprinted from his, . *The Economic Organization,* pp. *3-30* in W. Breit, *et. al., Readings in Macroeconomics* (St. Louis: Times Mirror/Mosley, 1986), p. 4. This argument of Frank Knight was brought to my attention by Anas Zarqa of the Centre for Research in Islamic Economics at the King Abdulaziz University at Jeddah, Saudi Arabia.

When he talks of 'posterity', he will not be concerned with its biological and genetic aspects. He will rather be concerned with its preservation and enrichment. This will take him into an examination of that behavior of the state and the present generation that affects the health and well-being of the future generation through its impact on saving and investment, borrowing and debt servicing, depletion of non-renewable natural resources and environmental pollution.

Hence, it may be seen that the major emphasis of Islamic economics has to be on the human factor for realizing well-being through an efficient allocation and equitable distribution of resources. Values and institutions that affect human behavior more than prices and profits can not be left out as exogenous. If values and institutions are brought in, then the 'sovereign' consumer does not remain sovereign. His sovereignty gets restrained by moral values and the imperative of goal realization. His tastes and preferences do not remain sacrosanct, they become a part of the economic model. Even financial institutions, commercial enterprises and governments become subject to these values, thus injecting a purposeful discipline into their operations. All uses of resources by individuals, firms and governments must first be passed through the sieve of moral values even before they get an expression in the market place. Once the human factor behaves in a manner that is conducive to goal realization, the entire burden of resource allocation and distribution does not fall on prices and markets. These, nevertheless, continue to play a complimentary role and help realize socioeconomic goals without excessive government intervention.

More Difficult

Islamic economics will thus move beyond the frontiers of descriptive, explanatory and predictive function of mainstream economics to a discussion of policies needed for actualizing the *maqasid.* This will provide both theory and policy prescriptions a direction that mainstream economics lacks. One of the implications of this is that Islamic economics will not be able to operate in a water-tight compartment. It will have to adopt a multi-disciplinary approach. A number of variables that Islamic economics will be concerned with may not be measurable, but it may still not be possible to assume them away in the name of precision and objectivity. This will make Islamic economics a more difficult discipline. Nevertheless, Muslim economists can not shy away from accepting the challenge they face. Their success in responding to the challenge will enable them to make a more effective contribution towards the realization of human well-being by solving many of the economic problems that mankind is now faced with.

If this framework is accepted for Islamic economics, then I must admit that Islamic economics has a long way to go. It has so far scratched only the surface. Its theoretical core has been unable to come out of the straitjacket of mainstream economics, particularly in the fields of micro- and macro-economics, monetary and fiscal policies, economic development, and international economics and finance. The result is that its practical wisdom has been unable to come to a grip with the task of analyzing even the problems faced by Muslim countries. It has thus been unable to suggest a balanced package of policy proposals in the light of Islamic teachings to enable Muslim countries to perform the difficult task of simultaneously reducing their imbalances and actualizing the *maqasid.*

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QUESTIONS

K.T. Hossain, Professor of Economics, Dhaka University

Actually this subject has a great importance for us. Particularly, in this world today, the guidance provided by the economic profession has failed so far to solve the great economic problems of mankind. The situation is that the prosperous gets ever more prosperous and these poorer countries are getting more and more importance, and at the international level, there have been proposals for improvement of the situation. But these proposals had not yet been accepted. For example, as for the New International Economic Order, such a proposal is at the center and there are many proposals in the periphery that have been discussed widely. There have been supporters putting forward many data, and then there have been critics of idea. There have been critics of the world system like Samir Amin and many others, who have been criticized invariantly by the traditional western economists and now there is a tendency to suggest that since the socialist system has failed to survive the system based on capitalism and economic imperialism that is prevailing in these days is going to survive. Yet the human rights problem is deepening more and more day by day.

So, here is a possibility for the widespread acceptance of Islamic economics. As a matter of fact even at the institutional level there have been acceptance of some aspects of Islamic economics in the form of banking without interest. Even in Europe, those things are coming up. But I think I should point out, that as Professor Chapra has mentioned in his learned presentation, which is very impressive and thorough the point regarding positive economics verses Islamic economics seems to deserve more detailed discussion.

This is one point and then I think on page-9 he has referred to certain concepts which are metaphysical in nature. Now the modern tendency is to assert the influence of logical positivism as a philosophical movement. Logical positivism actually influences all the natural sciences and this influence is there for a long time since the beginning of this century. Particularly under the influence of the Viena circle-I philosophers and logicians. Then of course this movement died down, but in spite of that in economics it seems to be a surviving influence. This is something about anachronism; we notice that this idea of positive economics, that economics can be a positive science void of any acceptance of

metaphysical concepts, it seems to be still an acceptable position. The natural sciences have rejected this movement for the influence of logical positivism, but economics seems to be very much accepting it even today. This seems to be anachronism , and it seems that we in the profession have to wake up to this situation and make economics more workable and more clean.

For example, these metaphysical concepts of the Hereafter, the concept of God, all these are suggested to be irrelevant by the proponents of logical positivism. In natural sciences, the influences of logical positivism is no longer very predominant, but still it remains in economics, so it is a very good point made by Chapra about this, and particularly we could possibly mention the *Ayah* of the Holy Qur'an". This concept of *Akhirah* (Hereafter), this concept of Allah, all these are considered irrelevant to the uphold of mainstream economics. Possibly some discussion on this subject may be outside this paper, it could be another paper itself. Accountability before the supreme being, this idea is very well taken up. And possibly I would suggest that Chapra could devote some more space for this thing.

Another point about *"maqasid* of the *Shari'ah".* I think here I could possibly mention short-term vs. long-term *maqasid* and basic differences between the *maqasid* of the individual and the *maqasid* of the society. Decision making at the individual or personal level and decision making at the social level . How the decision making at the social level could be possibly imposed as opposed to decision making at the personal level. All these have to be considered, and I think the paper could be enriched by taking account of this thing.

Md. Sirajul Haque, Professor of Economics, Chittagong University

First of all, I would like to congratulate Umar Chapra for his good presentation. Br. Chapra, I think you have presented a good critique of the mainstream economics, what we call neoclassical economics. I have a few questions to ask you. It seems that you have tried to criticize self-interest, but my understanding is that this self-interest is very much necessary for the functioning of the market system, and from our experience of last two decades, we know that the functioning of this market system is very much necessary. What we see in socialist countries, they have failed because of the absence of market functioning there. So, if there is lack of self-interest how can a market function? Can you conceive of an alternative from the market if there is no self-interest ?

Abdur Raheem al Sa'ati, Center for Islamic Economics Research, King Abdul Aziz University, Jeddah

My question is about the new economic order which everybody is looking for in this universe, by trial and error which human beings go through and finally they realize that they are in fact one society. They have to look for the global interest of the whole universe and this is probably the new trend of forming a new order. Can they say: have this value realized by the whole universe, that they have to take care of their individual countries, and of individual persons. Can we, Muslims, present some values which can be acquired or searched for, by everybody, Muslim and non-Muslim alike ? The values which we needed to have, this general objective, like facing poverty and taking care of the human beings and concise that concept which they need to economic analysis. So, instead of saying "we have Islam", we say "we have these values".

Sulaiman Mandal, Professor of Economics, Rajshahi University

I have heard Professor Chapra. I am very much impressed to know his viewpoints, but I have some impression about his conception of Islamic economics. It seems to me that, from the point of Islamic view of economics, we have to pass judgment not only on the ends but also on the means of production. I would request Chapra to throw some more light on this aspect, whether he will like to include value judgment on only ends or should he also include value judgment on the means of production also. It seems to me that Islamic economics should make judgment not only on the ends but also on the means of production. We should not produce destructive means of production, nor should men be the secondary creator on this earth. Man should not produce anything that will destroy this planet, as you say environmental issues are all to be taken into account.

Then, the question of resources, how to allocate them in mainstream economics as we know it? Do we call primary resources natural resources ? Would you call them natural resources? Because this seems to be also the way on the mainstream economics. My personal impression is that Islamic economics should not call the primary resources natural resources. Because these are created by Allah. So, I would like to know your viewpoint on this also.

Then, you have some framework of Islamic economics. The role of the state, particularly with regard to up to what extent should the state interfere with the free choice of consumers. Free-choice of producers, you have given the answer possibly, you have given the answer from the point of view of your discussion.

But still possibly it requires some more discussion on actually what the state should do with regard to the value judgment on the aims as well as the means of production. Lastly, I would congratulate Chapra for presenting an excellent paper. I would be very much obliged if he could enlighten me on the points I have raised. Thank you very much.

M.A. Hamid, Professor of Economics and Vice-Chancellor, Islamic University, Bangladesh

Thank you very much, I must congratulate Chapra for giving us an excellent paper on Islamic economics. That is just a simple question on the definition given by Chapra. He defined Islamic economics on page 10 by saying that Islamic economics could in this case be defined as that sense of knowledge we perceive in the use of relatively scarce resources at the disposal of human beings for realizing the well-being of all in accordance with *"maqasid al Shari'ah",* without creating continued imbalances or damaging the environment. Giving this definition may I ask Chapra, does this definition not imply that even if we try to realize the objectives of economic development following *"maqasid al Shari'ah",* still they can create imbalances or damage the environment. It means you want to say that we should not only follow the *"maqasid al Shari'ah"* but also try to see that imbalances are not created or damages are not made to our environment. To my viewpoint probably when you say *"maqasid al Shari'ah"* this is enough. Without the words creating continued imbalance or damaging, we can avoid that. This is my comment.

Second thing is, you have said that in case of Islamic economics we have a new paradigm and you said that we should have conviction, in what you have said and you have also added that although all things between the earth and the sky belong to God but still men as *khalifah* of God, has the right to use them to fulfill their worldly and after-worldly needs. The question is there are people who, say at least we know in Bangladesh, don't like to have this sort of conviction. They first of all want to see the benefit of Islamic economics. They want to see that if we really follow the principles of economics, the problems that we have in the society can be solved, they don't want to have the pre-conception that is possible to solve the problems of the modern world by following the Islamic economics, thank you.

Zahrul Islam, Chartered Accountant and Member Finance, Capital Development Authority, Dhaka

First of all, I like to thank brother Chapra for his excellent paper and throughout his deliberation I was really impressed by his comprehension. But some of the points, I like to mention so that he can make some clarification later on, whenever possible. One point, he has pointed out that resources are scarce, this is the viewpoint of the mainstream economists. Is it the viewpoint of Islamic economists too? Are resources scarce? My second point is, what are the "Ceteris-Paribus" under which you simply express comments or make conception as a thing of Islamic economics. My third point is in clarifying the *"maqasid al Shari'ah",* he has pointed out that Imam Ghazali suggested human betterment, that is, human welfare as the basis of *"maqasid al Shari'ah"?* My point is, what are the basic entitlement of human being or other beings in the society or in the universe and what are the relationship between the two ?

My last point is in theorizing an Islamic framework, whether the basic *maqasid* counts upon the level of entrepreneurship as well as technology ? Thank you.

Abul Bashar Khan, Vice Principal, BDR College, Peelkhana, Dhaka

Many thanks to Umar Chapra for his nice presentation. Just he is introducing Islamic economics. I am very much aware of one of the constants. Hereafter life is the basic concept of Islamic economics, that is right. But this one important constant, that we find in introducing Islamic economics, is that most of the economists at the university level don't believe. Then the definition of Islamic economics that is founded on this belief in the basic *"Tawhid"* and *"akhirah" is* what is lacking in the economic profession today. This very concept is not clear and how this concept can be faced?

Md Azhar Uddin, Professor of Economics, Rajshahi University

I congratulate Chapra for giving an excellent paper. Virtually he mentions Adam Smith. According to Adam Smith that individuals are the best judges for their own activities and according to Islam individuals are not to be judged on the basis of the teachings of Islam until and unless the need arises. Now, he also mentioned that there is a long way to motivate people because their interests in this world and in the Hereafter life may not be clear to them. Now, my question is

how to motivate by giving them the Islamic preaching, or the morality or other means you can motivate the people with ?

Ishaq Ali Khandaker, Govt. B.M. College, Barisal

Thank you for the nice speech given by Umar Chapra. The whole world is economically divided now in the two systems, Capitalism and Socialism . In capitalistic countries poverty which is the part of the system which attracts the main critics of capitalistic system. How, can we bridge the gap between the rich and poor? We have seen the rate of growth of exploitation at which the world resources are exhausted for the benefits of the rich, at the expense of the poor, this is vital. The rich are becoming richer and the poor are becoming poorer and as a result, the gap between the two is getting so wider. Then what system could remove this gap ? In a capitalistic country, there is wastage of resources. How these scarce resources are utilized in the context of modern economy ? What I like to say further is that Islam is a way of life and it is a golden mix between two extreme systems, now prevailing in the world. Capitalism on the one hand and socialism on the other hand**.** To my view Islam can solve the questions. Solve the problems arising out of the two systems. Capitalism has failed in its proper perspective to solve all these economic problems. During the 1930 's capitalism failed to bring out solution to the problems, and during the first world war socialism came as an economic system, and now socialism has failed to solve the problems. I believe the Islamic economic system can solve the problems and how it can? How the system can survive in the face of the capitalism and the socialism which are now prevailing in the world?

Abu Ahmed, Associate Professor of Economics, Dhaka University

We have been hearing about brother Chapra for a long time, for his writings have been around for longer than any one else in Islamic economics. Even when I was a student I was getting his literature. It is a great opportunity for me to see him physically now. Many things have been told but most of us who are gathered here, are convinced about the usefulness or universality or . even the greatness of our Islamic economics. No doubt about it. But something comes to our mind which needs some sort of clarification from a scholar like brother Chapra. He has talked about the crisis in the mainstream economics, we also know there are crises but the talk about the tax and subsidy to make survival for that crises, or to get an economy out of the crisis through taxes and subsidies is not common, the need fulfillment as he talked about it.

Are there any economist in the west or in the mainstream economists, who are talking about coming out of their own mainstream economics.

Some time they fail for a while. Then they say it is the only one. They go back again, as we found in Keynes and after. Again it is the market of capitalistic or many classical systems, not only surviving but going up and up. Now, many economists, who can be counted in the west, are talking about that, you have to go for some sort of a control system, while we have seen one extreme control system which really failed. Br. Chapra was talking about some need fulfillment. In other words, he talks about this issue while the whole Muslim world is divided. The West is also divided on this issue, maybe, not from the Islamic perspective but from their own perspective, about the distributive justice. Is there any difference between our concept of need fulfillment and their concept of distributive justice, which they want to push through capitalistic system ? Second question, as Islamic countries, if we have some sort of curtailment in the self-interest, having in mind the longer perspective of self-interest resulting from the belief in the Hereafter even, then shall we not have a suboptimal economy for ourselves, for our own countries? If there is a suboptimal economy, I mean in the judgment of sub-optimality, if there is a sub-optimal economy in our own country and if there is competition against us in the external market or in the external trade then our imbalances would be more and more, this is just my opinion. They have an open economy with all the emphasis of self-interest, having a market mechanism. Ours should be having an interest-free economy which would curtail on self-interest or some sort of egalitarian or distributive justice, need fulfillment. Then if you go for cut-throat competition against them, I find some time we will be in a loser position in terms of external balances or imbalances. The one solution can be if all the Muslim countries can have our own system, then have our own world and can do business within themselves. As a block, we can deal with them on a united basis. If we go on a country-by-country basis and do business with them, having another system which we call as value dependent and based on our faith, as it is already defined by brother Chapra, i.e.,values to be judged by our faith as ordered by Allah *soubhanahu wa ta'ala.* This is my comment about whether we would be better off if we go for trade on a one-by-one basis. Or if the Muslim countries as a whole can develop our own system, then we can deal with them as a group; that could be a good solution. Thank you brother.

Monzer Kahf

I am sure most of these points will come up again and again during the discussion, specially *"maqasid al Shari'ah",* as it is the subject of our next lecture.

The man is sitting in the corner, there, waiting for his turn in the afternoon. He will talk to us on *"Maqasid al Shari'ah"*.

Umar Chapra

I am very grateful to you for your comments. Of course, I cannot answer all the questions now for the time is limited. Moreover, as brother Monzer has already said, this is the first lecture in the whole series, and the issues which are raised are going to come up again and again in other lectures. Particularly, you know some questions asked about things will come in my next lecture on "The economic system of Islam". What we are talking about today was primarily economics and there is a substantial difference between economics and Islamic economics and Islamic economic system, and we have written more about this. But the subject of Islamic economics has not received as much attention as it should have. So, naturally I cannot answer all your questions. A third lecture on Thursday on "Islam and the International Debt Problems" will also clarify a number of the issues that you have raised.

Brother K.T. Hossain indicated that poor countries are becoming poorer, and he was talking about the relationship between the center and the periphery. Socialism has failed in removing this disparity and capitalism is continuously raising it. Of course, Islamic economic system will help in removing it. There is no doubt. We see when we come to talk about Islamic economic system. I will tell you why we can realize the goods of the society within the Islamic system and no other system can help it. So, if the rich becomes richer in the capitalist society, it is the nature of the capitalistic system. I do not think capitalism can be re-shaped in a radical manner to make the poor people rich nor the rich people poor. The capitalistic system is unable to do this.

He also talked about my raising certain metaphysical concepts in this paper and asked about logical positivism. Mainstream economics is primarily based on logical positivism. They of course reject this ideas. They are having economists who are trying to inject secularism into economics but they are bound not to succeed. It is, no doubt, true that there is a number of fields in economics which have developed, like social economics, and normative economics. Bowlding's optimum, in place of Pareto's optimum and there is a number of other fields which have developed, most of them are talking about the injection of values into economics and about fulfilling need. You can realize that this will not succeed in the West, because the whole society has a certain value structure and these things do not fit into that. When the whole economic science is based on

social Darwinism and the goals of the society are just formulated within this social Darwinist thinking. You cannot change it significantly. So, I can say that those economists who talk about social economics, normative economics, Bowlding's optimum, and so on, will be very happy when they learn about Islamic economics. I am glad to tell you that the draft of my new book, which is now in print, "Islam and the economic challenge" was circulated to a number of western economists for comments, also to some Muslim economists, and they were surprised to hear about this concept of Islam. If read, these comments you will really see how our subject can attract them, and how much they appreciate it if you know. Just it was a "bolt from the blue". But if we want to present our case to them so far, until we write more and more, and you brothers now are the only enlightened part of the Muslim world and if we make it an effort to present our system to the West, they will certainly appreciate it.

Brother Sirajul Haque was talking that I have criticized self-interest. No I have not criticized self-interest. In fact, I said positively that any system that tries to suppress self-interest is not going to succeed. Socialism tried to do this and it did not succeed. But Islam does not criticize self-interest, it rather gives it a longer-term perspective. In other words, we have to serve our self-interest not only in this world but also in the Hereafter; and this makes it different from the other system. Another brother said later on, I think that if we work within this Islamic framework, we will not be able to compete in the international markets. No, we will be able to compete more. Why will we be able to compete more? Because what reduces our competitiveness is our excessive absorption, which leads to imbalances. And you know imbalances are reflected in the society in many ways, we have higher rate of inflation, greater currency depreciation, we have larger current account imbalances, for which we have to borrow more and you are in debt-servicing problems. Now, if you abide by the teachings of Islam you will be able to say that Islam is not only able to compete, you will be able to compete more, because it reduces our imbalances, through reduction of excessive absorption, increase of investment, and reduction of consumption you will be able to work miraculously really. I can say, you can do better than what Taiwan, Japan and South Korea have done. But we cannot waste time to implement our values and our low competitiveness springs not from our values but because we are acting against our values.

Then brother Sa'tti was talking about common values, which are common to us and other countries. No doubt, values in society are the result of religious teachings. They are not the result of social Darwinism. Even when the West talks of fulfilling certain goals in the society, full employment, need fulfillment,

reducing inequalities of income and wealth, where do these values come from? They come from religion not from social Darwinism. If you want to preserve social Darwinism, there is no way to remove poverty, they are poor because the poor are useless .Let them die, they will say this. Their needs will not be fulfilled because they are not working hard. This kind of attitude is not from religion. So, religious teachings and men's responses anywhere in the world are close to ours. What is then the problem in that? The essence: they have changed their religion. They are unable to implement their values. Let me give just one example. The prohibition of interest is common among Islam, Christianity and Judaism, but they somehow changed their religion and removed the prohibition of interest from their value system. Now interest-based system is bound to create inequalities. Interest-based system will not enable the societies to fulfill their needs. That will be discussed tomorrow, *inshallah* in the lecture on the economic system of Islam. Here, I am going to say why Islam alone can help us realize these objectives while no other system can?

Then brother Sulaiman, we should not just talk about ends but also about means. We are closely related with Islam. Islamic values deal with both ends and means as you know. If we abide by the values we will be able to realize the means and the ends. All the textbooks of Islam talk about goals and the means through which you can realize them. He was talking about resources. How do we define resources ? There are natural resources. In Islam, all resources are valuable, you have to use them efficiently. There is nothing free as such in Islam; we have to be accountable for everything before God. Let me give you an example from the Prophet (Pbuh). *A sahabi* was performing *wudu'* and the Prophet did not like it because he was wasting too much water. So, the *sahabi* said, ya Rasulullah (Pbuh), it is in a pond that I perform my *wudu'.* He said, no, even you are performing *wudu'* in a running river, you can still waste water. This forms a habit in a person and may develop a tendency to waste other resources. So, actually, there is nothing free in Islam, we have to account for everything before God and we must use everything efficiently. So, resource in the Islamic sense always carry an accountability before God, and no human being owns them. God owns them. We are the trustees and we have to use them in the manner which *Shari'ah* specified.

Brother M.A. Hamid was talking about the definition of Islamic economics. He was worried about the question which I have said, we should try to realize the *"maqasid al Shari'ah",* if we do not want to increase the imbalances.

He asked whether it is possible to have imbalances in a Muslim economy. Sure, there will not be imbalances in a Muslim economy if we abide by the teachings of the *Shari'ah.* But you know there can be ambitions, objectives and reasons and ways the imbalances may come, even with very pious objectives. Suppose, we want to reduce poverty; and we decide we will create money for this purpose; and try to give loans for developing and establishing small industries; and so on. This kind of course will help them. Ultimately, you cannot increase resources in one place without reducing them from another place. In other words, if you want to fulfill the needs of the poor, you have to bring resources from somewhere, and here is a difference between Islam and other economic systems. That we try to reduce them in a just manner, by reducing the wasteful use of resources, i.e., reducing the resources consumed by the rich on fulfilling their unnecessary desires. So, we define necessary and unnecessary. We define luxuries and necessities and so on, if we wish to increase the use of resources and this is why motivation counts. If you rely on the self-interest in the western paradigm, we can not acquire it. But if we inject the man's accountability before God, there we can induce the rich man to reduce spending, because you have to account before God. Hence, resources can be released for the need fulfillment of the poor. We have to mind our system. Our system is capable of removing imbalances and realizing the goals of all of us.

Brother Sirajul Islam, brother Khan, brother Azhar Uddin and brother Ershad All Khan also raised certain valuable issues. But I am afraid of the hammer of the Chairman on my hand. Thank you very much.

CHAPTER SIX

METHODOLOGY OF ISLAMIC ECONOMICS

Muhammad Anas Zarqa

METHODOLOGY OF ISLAMIC ECONOMICS

M. Anas Zarqa*

My dear brothers and sisters. The methodology of Islamic economics is a very dry but very important subject. I will try my best to focus on a limited number of points on which we may exchange our views. In methodology there is something for everyone to think about. In particular, we should be very tolerant of opposing views because the methodology of Islamic economics is still evolving and we cannot claim that it is a fully settled field. So no one should feel that the questions of methodology are final and closed. In fact, they are very much open for discussion and for the expression of various points of view. Let me start by posing some very basic questions which I raised in the introduction to the lecture.

If we accept the existence of Islamic economics, does this not lead us to reject or deny the existence of universal economic regularities which operate in all human societies? This is one fundamental question which we must answer. Is it logical to talk about economics as universal and at the same time attach to it the adjective "Islamic"? If it is Islamic, does it mean that it belongs to Muslim societies only or only operates in Muslim societies? How can we describe economics as Islamic or non-Islamic? If we usually do not like to talk about Islamic physics or Islamic geology, in what sense are we permitted to talk about Islamic economics and to add the adjective "Islamic" to a social science? This is a question we must think about and answer very clearly and honestly. I am trying to do that in this lecture.

From the beginning let me assert something that may get lost in the detail. It is my conviction that the Islamic *Shari'ah* gives us a clear indication that there are universal laws and social laws applicable to all societies. As Muslims we believe that there are regularities in all human societies and the existence and universality of these regularities are the basic logic behind Allah *(Subhanahu wa*

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Ta'ala) choosing one *Shari'ah* to guide mankind until the day of judgment. If human beings and their societies were so specific, local and heterogeneous, then it would not have been suitable for Allah to send one *Shari'ah* to guide all societies. The fact that He has chosen to guide all human beings at least since Sayidana Muhammad (Pbuh) and to send one universal message for all human beings clearly means that there are certain types of regularities among and across human societies which permit unified guidance. So I do not want whatever I say later to be understood in a way that contradicts this basic fact.

The starting point in this discussion is to recognize that economics has conventionally been studied and taught in a mixture or amalgam of descriptive statements occasionally called positive statements about reality. Also mixed with them in some thorough fashion are prior values and presumptions. Now this is what is called modem economics and by this I would largely mean the modem economics which has developed in Western countries. It is an amalgam, a mixture. When we start studying modem economies we get the impression that modern economics is a universal science. Little by little we come to realize that it is much less than a universal science. It has, in various subtle ways adopted values from some specific cultures, basically Western culture. These values intermingle and affect economics in ways that are sometimes not obvious. The starting point in this whole discussion is to realize that there are sometimes values that are easily identified and sometimes those that are very hard to identify, but these values do operate within the so-called science of economics. Economics contains positive and descriptive regularities which are valid in many human societies. But it also contains the consequences and effects of certain values. To be able to separate these two is a difficult task because modern economics is not simply a physical mixture of the two. You may put some grain and add some rice and then you can patiently separate the two. You spend one or two or three days and you separate the grain on this side and the rice on that side. But if I tell you to make for me a sheet of paper like this which has from the beginning some kind of cellulose provided that it does not contain cellulose in its mixture. If you take it out you may have to make a different type of material because it no longer becomes hard or it no longer becomes resistant. Consequently it is not a simple operation to take Western values out of economics and to put in Islamic values. It is a complex and subtle operation. So we have to appreciate that there are values inside positive economics. We have to train ourselves to discover how these values operate and where they lie. At the same time we have employed a lot of intellectual effort to see how we can replace those values with Islamic values and work out a new economics which contains all the thoroughly descriptive and valuable

contributions of conventional economics in addition to the themes that we transfer out of our own effort as Muslims to insert our values within the economic science.

Let me assume at the beginning that we all recognize the difference between a positive statement and a normative statement. Suppose I said an increase in rainfall positively increases agricultural production. I am making a statement of fact; for a certain crop more rainfall means more output. Now this statement can be right or wrong, but it is a positive statement. It is a statement about reality. It has no values. It may be right or wrong, but it has nothing to do with values.

However, if I say we ought to eliminate unemployment, this statement is a value judgment. Perhaps all of us share this value judgment, but it is still a value judgment. It is conceivable that in a certain situation you are comparing reducing unemployment with reducing inflation. Someone may feel that it is better to tolerate more unemployment in order to reduce inflation. So, clearly this second statement about something being desirable is a value judgment. No matter how universally it is accepted, it is a value judgment. Essentially, most of the time you can identify a statement as being either a description of reality which may be true or false or it is an expression of preference of one situation over another which is what we call a normative statement or a value judgment.

With this in mind, we come to the second point which is that any science, even a physical science, has to depend to a greater or lesser extent on two basic foundations: First, some prescriptions or philosophical stands, some normative assumptions that one would have to hold before undertaking any actual work in this particular science and second, the descriptive content of the science. Take physics for example. We would tell to think of physics as being a science which is completely composed of positive statement of laws connecting variables. We do not think of physics as having any philosophical presumption, but it has. For instance, you have to assume in physics and in all physical sciences (chemistry, agriculture, whatever) that reality is stable. If you discover something about a moving object in this room, it is as valued elsewhere as it is here. If you look at bodies and then figure out certain laws, you assume that these same laws were operating one million years ago. This is a philosophical stand that we take, that reality is discoverable and that it has stable relationships or laws. Now, clearly, a science like physics, most of it, is composed of descriptive statements or positive statements, but it has some presumptions or philosophical foundations. If you move to a social science like economics, you will find the situation to be significantly different. In a social science or any human science, you find that the

proportion of these philosophical presumptions is much greater than in physics. Therefore, we have to agree from the beginning that it is possible to find in economics, within positive economics within economic and analysis certain presumptions and value judgments hidden or obvious. Let us, as an exercise, look at this questionnaire that you have in front of you. One important thing in this area is to be able to communicate and see different points of view. Let us look at the statements on the questionnaire. You may feel that the statements are reassertion of something that can be classified as either being a purely objective, positive statement which is not connected with value judgment, or as a statement where a value judgment is involved. For each statement let us see how many of us classify it with a check mark, as one that has no value judgment involved in it and how many think there is some value judgment. We will leave the discussion for later, but let us see how much we differ on some of these questions.

How about statement number one: utility to the individual is a function of the quantity of goods and services that the individual consumes? How many will put a check mark on this indicating that they believe that this is a rather objective statement? How many would mark this as an objective statement with no value judgment involved? We have one brother who did not think that there is a value judgment involved.

So only one brother believes that this statement has no value judgment in it. How about mathematical economics for a check mark? Do you believe there is a value judgment involved? However many of you would check mark the statement as a value judgment except for brother Ibrahim although it is entirely objective.

What about statement number two: when population grows faster than GNP, then people, in terms of real per capita income, will become poor? How many think this is an objective statement and how many think it is value-loaded? I think most of us would say it is an objective statement, but there are those who feel that it may have a value judgment in it, it is arithmetic. Of course we are assuming, really, because we assume real per capital income is the measure of poverty. So is there anyone who says that this statement contains a value judgment or do we unanimously say that this is objective? So this is unanimously taken as objective. I will save my comments for later. However, statement number three can be said to occur in a country when there is a steady increase in per capital income which is sustained over a number of years. This is the standard definition they give of economic development. If they want to say whether a country has taken off into economic development, this is the criterion. How many of you say

that this is an objective statement and how many think there are value judgments involved in this obvious statement. All of you feel that this contains a value judgment. So do not put a check mark. What about statement four: comparison of the economic efficiency of two methods of production? If we compare two methods of production regarding economic efficiency, is this comparison an objective operation which does not involve a value judgment? We assume that market prices are given from outside. Market prices are given. You are not choosing the prices. You are taking them for granted and the technological production function is also given. You have no influence over it. So, you are given a production function and given factor prices and then you want to compare two methods to see whether one has more externality than the other.

How many of you would say that this is an objective operation? How many checkmark number four? Let us see who thinks this is objective and has no value judgment. We have one brother here, two or three. Let us put it on other way: are there those who think that there is a value judgment involved in this comparison? Are there those who believe there are value judgments involved? So can we assume that we unanimously agree that this has no value judgment?

What about number five: statistical measurement of GNP for a given country? One brother feels that the statistical measurement is objective. It has no value judgment. How many are sure that it is objective? We should checkmark it. How many? Then let us pose the question again. How many would list number five as objective? Since the majority feels that statement five must involve a value judgment, it will not be checkmarked. How about Eagle's law that the proportion of family income spent on food decline, etc.? Does this involve a value judgment? I think Eagle's law is correct and valid for many societies. Does this assertion involve values on any point or can a positive assertion be false or correct but have no value judgment involved? It does not involve a value judgment in your view. How many say it is objective? No, would you believe it to be objective? Ten of those present think that Eagle's law is objective. Of course, you see some take objective to mean it is true, no! If I say that there are people living on Mars, this is an objective statement, a positive statement. You may prove it is impossible for any people to be on Mars. You can show that I am wrong, but my statement is not an expression of preference or values. I am not saying I wish to be on mars. Why are the people on Mars? So in this sense can we assume that Eagle's law is a statement of fact or is it a statement of preference or does it involve preference in any way? So we have ten people who feel that it is a positive statement.

The point I want to raise by this assertion is that if you hold all factors of production constant and let one factor increased by equal increments will the output eventually increase by diminishing amounts? Is this statement a positive statement or does it contain a value judgment? How many of you would say that it is a positive statement? I think probably most of us would think that this is a positive statement. Are there those who think there is a value judgment? No. So let us say unanimously that it is so.

Now let us discuss these statements. Let us take statement number one, where only one brother felt that it was value free. The others were silent. Could someone indicate why he thinks that this statement involves a value judgment and what the value judgment is? Can one of you please explain? I am not expressing any functional form, but am simply saying that when a person consumes more goods and services his utility goes up.

We think that the utility of the individual is dependent on the goods and services he consumes. We ignore deliberately, but perhaps unconsciously, that his utility may also be dependent on what other people consume, that is, if you think of it as an extreme example. If you are a father or mother, could you ever think that the level of your utility is independent of what your children consume. Suppose they are sharing and you have a large quantity of goods and services. In that case your utility will never be high because of the fact that it excludes other peoples' utility. This assumes a value judgment. Either you are saying that this is unimportant or that most human beings would act on the assumption that their own utility is the most important thing in the world or whatever. But clearly you are omitting some aspects of reality, because of some prior judgment on your part. You are excluding variables by prior judgment, by excluding from this utility function the consumption of others. This is a value judgment. It is not a scientific fact that the consumption of others should be excluded, so here the investigator has phrased the statement according to his frame of reference, or his philosophical background, or whatever he/she thinks is correct and valid. So there is a value judgment involved.

How about statement number two? You voted unanimously that it is an arithmetic fact that when the GNP grows and if the population grows faster than GNP, then real per capita income must fall. In fact there is a big value judgment involved in this supposedly arithmetic fact. There is an assumption being made about the number of children. The GNP, as you know, is the sum of utility measured by market values. It does not contain the number of children in a family. Let us put it in some other way. Suppose in my own family, I have two children and suppose my income is stable for a number of years. Now suppose I have another child. The same income is then divided between five people. So

arithmetically the per capita income is down. But this is not an arithmetic fact. I am assuming that my utility did not increase because I had another child and that utility is a measure for all other things excluding children. *If you* assume that the utility *of* this family increased, not only because *of* the goods and services consumed, but it also increases because it has one more child. Then it is not an obvious fact that the high real per capita income has gone down. You have measured the real per capita income by the Western standard which excluded the number *of* children of the family. You are aware that the size of your family does not affect your utility. If, for example, someone has lost a child does that increases his/her total utility, he may feel very happy with an extra child even though his per capita income in the family has gone down. So there is a value judgment involved here although it is not that obvious.

In that measurement we are making a value judgment by assuming that getting another child does not affect the legal status of your utility. In this case *of* course the arithmetic *of* per capita income has gone down, but *if you* think that human beings under certain circumstances derive utility from having one more child, then it becomes a much more complicated matter than the arithmetic rationale.

The point is that by Western standards that measures the GNP, this ratio goes down. *If you* have a different standard *of* measure the GNP which also includes the utility derived from having one more child then the method becomes complicated. It is not easy to say whether it increases or decreases.

Regarding statement number three, I think all *of you* felt that this definition of development clearly involves a value judgment. I will call your attention to just one thing. This is not my own ideas, but, in fact, it is something commonly recognized. Some economists have proposed that as a criterion for observing and measuring the growth *of* GNP you should take the per capita income of the poor at one-quarter *of* the population, make this your yardstick and you look at each country to see what happened to the per capita income *of* the poorest 25 percent. This should be a realistic measure for development. I am not arguing as to whether this is right or wrong, but clearly you can have many different realities. Any one of them expresses some prior value. So I think that we all agree that this statement does involve some value judgment.

We come now to economic efficiency. You unanimously voted that this was free of any value judgment, and you are all wrong. I will tell you why, and it is not my opinion. I bring you the authority of someone no less than Frank Night. Please look at something much more solid and supposedly more objective than

economic efficiency. How about physical efficiency? Suppose you have an electric motor. You apply electric current to it. You give it so much input, and then you see how much power it gives you as output. The actual power you get from this electric motor is 94, i.e., it takes an electric energy of one hundred to give you back mechanical power of 94.

Supposedly, this is the ultimate efficiency of the motor, objectively and as a positive assertion. The very interesting fact is that even physical efficiency is value loaded. Why? By the laws of the conversation of energy, any energy you put in will never disappear. It simply appears in different forms. So you put 100 units electric energy, and get 94 output mechanical engine. What happened to the remaining 6. It went out as heat. Heat is also energy. Now by a prior value judgment which you impose on the experiment, you are saying that you are not interested in heat. Heat for you is a waste product. So you define physical efficiency in a way which confirms your value judgment that heat is waste and mechanical power is valuable. So even in physical measurements, there is a prior value judgment as to the output of the operation. You consider valuable whatever output you consider to be costly, and wasteful or whatever you are not interested in only once you have made this judgment you can define efficiency. This is physical efficiency, imagine!

Now let us go on to economic efficiency. Suppose I derive a lot of pleasure from writing or from saying my prayers. If you define my output per day I will do all kinds of things including, say, praying and perhaps devoting attention to my family or whatever. Then you selectively choose some of these activities and classify them as valuable and the others as not valuable and then you start measuring efficiency by assuming this. Making judgment based on your own values affects your measurement. So clearly, if people somewhere have one method of production where they rest half of the day and work hard the other half, their meaning of the day is not that of another group that works hard all the day. It is not possible without a prior value judgment to say that the second operation is more efficient because the first group got two outputs. One just laughing around, enjoying and self teaching oneself and one's friends, the other is the goods that we produce. The other group produces more goods, and they get less enjoyment of this sort whatever you call it. Clearly we have to bring from outside our value judgment about what is valuable, and what output we calculate and consider, and about what is waste or not value. Only then you can measure efficiency so clearly, as the components of economic efficiency are determined by your prior values in the efficiency measurement. Statistical measurement of the GNP we all agree that it includes value judgment.

Once we realize that values are involved, sometimes even in seemingly objective analysis, then the next step is to see in a systematic way how values enter in the process of analysis. If you think about it for sometime, you find that item number 3 in the measurement of efficiency, the ingredients of output had to be based on prior values, of course that should be the answer. The choice of values and basic concepts, and components verification determine the process of comparison. Let us not elaborate too much on the philosophical aspect of this matter. Let me remind you of some thing we all know and feel and get sometimes, anger. You fell angry what now if you try to analyze why you are angry. It could be one or two things, either the journalist is saying something which is absolutely false. He is making a lie. He says something happened while it did not happen or something did happen but in wrong place, say in fact in Dhaka. This is the list of the reasons that make us angry because usually journalists have learned from long experience that it does not pay to make outright lies. There is something more refined that outright lies. What is it, selective coverage. For instance, you put me to supervise a room where students take an exam. You come after the exam. I tell you the student I caught cheating, and I have a proof. Please punish him and remove him from the university. All are objective facts. These were five other students also cheating but I never bothered to say anything about them. Now my statement that this student cheated is absolutely objective and positive statement, verifiable, but what is there? I said part of the truth rather than the whole truth. So things that anger you are very often enjoyable if looked from a different angle, they are selected coverage. We feel the emphasis is wrong, as one ignores certain important facts and blows up something which we believed to be much less important.

Now in economics it is the same. It is only that we are trained not to feel it. We were trained not to feel the peculiarity of the particular system of economics we grow up learning. It is like atmospheric pressure. I never feel it because I am at all times under it, but if you do some careful experiments you can see how it affects the human body and that it does have some effect. Now, to discover where the values enter the picture. I would say that the greatest avenue for the entry of prior values in economics is in the choice of topics to be researched and the variables to be studied. From the prior cultural conditioning of the researcher, he will naturally go to certain things which are very much in conformity with his cultural outlook. Look at Western economic theory, they emphasize selfish motive. The selfish motive is definitely part of human beings. They are not creating something out of nothing. It is a positive reality and it is a truth. It is there and it is very strong in all human beings. However, they ignore and play down other nonselfish motives. This is cultural bias; it is a value

judgment. When all of the economic models of the consumer behavior of a firm or government are based on the analysis of the selfish motive, as a decision maker, you have a major problem. Suppose you have people wasting too much water. You want to conserve water or some other valuable natural resource. You look at the economic tool and it only contains the selfish variable, because this is what we build theory on. As the decision maker, you hive to choose what is available, what has been researched and use a part of it. So you come to see that perhaps the best way is to use a mechanism to increase the price of this particular resource to make it more expensive to people and in this way to cut consumption. However, if your research program had been wider in scope, you would have long ago recognized other motives of human beings. You would have had different campaigns. You might have decided not to increase the value of water because this will punish the poor man. The rich man will still have a car, a garden and more driving them. He will pay a higher price, but the poor man will feel a lot of heartache.

A different method is to take a normative approach. An educational campaign might convince people that it is immoral to consume too much water even at the same price. You might get some results by educating and influencing the families.

You have other approaches available to you if your initial economics is not narrowly focused on the selfish motive only . There is not really very much time available to go into the details, but the main idea is this: We have to do some very serious thinking and try to remake economics. Conventional economics has to be reworked. A new product has to be fashioned out of Islamic value judgments and conventional economics.

Item number four relates to drawing attention to the kind of relationships that , may exist between economics and the *Shari'ah* in general. Suppose we consider all the statements made in the *Shari'ah.* By the *Shari'ah I* mean the Qur'an, the *Sunnah* and whatever is directly derived from them. Statements in the *Shari'ah* are mostly normative, that is, they are in group number one. For example, Allah *Subhanahu Wa Ta'ala* says: وأحل الله البيع *"Wa Ahalla Allahu al Bay'",* Allah permitted trade, and forbade *Riba.* This is a value judgment. So it is statement number one. It is a value judgment related to economic life. You say that the smaller circle is economic and the larger circle is the *Shari'ah.* All related to economics like, for instance *wa aqimu al salata,* make your payers, or perform prayers. This is a value judgment and it is not economic. *Ahalla Allahu al Bay' wa harrama al Riba,* Allah permitted trade and forbade *Riba* is a value judgment related to economics. The *Shari'ah* is basically a code for guidance. So it is

essentially full of value judgments. The *Shari'ah* contains some positive statements about reality, descriptive statements about reality. There are not many, but they are there and they are very valuable. There are descriptive statements in the *Shari'ah,* or positive statements which are not economics. For instance, what Allah *(Subhanahu Wa Ta'ala)* says about honey is a positive statement, that honey contains a cure for people. Now what kind of cure for what disease is not mentioned. But Allah mentions that honey is a cure for something. So this is a positive statement, but not an economic statement. There are in the *Shari'ah* quite a few positive statements related to economic life. For instance, Allah *(Subhanahu Wa Ta'ala)* and the Prophet (Pbuh) in numerous statements mentioned the idea that: *Inna al Insana la Zaluman Jahul.* When a human becomes wealthy and independent of others, he has a tendency to transgress against others. Now this is mentioned in the Qur'an and in the authentic *Hadith* several times in various ways. There is a tendency in the human being to transgress, when he feels wealthy and independent of others. Now this is a positive assertion about human behavior. There are many others that I can mention. What I want to say is that category number four is not an empty category. It is not a null check. There are some statements in the *Shari'ah,* the Qur'an and the *Hadith,* which are basically positive economic statements about economic behavior or economic life.

We look at normative statements in economics. We even have the tendency to consider price in conventional economics to be free of value judgment. But it is impossible to be completely free of value judgment. You always have to select a topic. Reality is so complicated that it has hundreds of variables operating in it. You must exclude some variables and concentrate on others. This process of excluding some variables is a value judgment process and you have to do it. There is no escape. you cannot study the economic behavior of man looking at 400 variables. You try to cut them down to perhaps five to ten. You cannot operate with 400 variables. Mentally it is very confusing. so the human being usually has to concentrate on only the important aspects. There is a value judgment that has to be exercised in the selection of topics and variables. Of course, there are many descriptive statements in economics. I do not want to give the impression that Western economics or conventional economics is all merely value judgments. It does contain a lot of positive assertions about economic reality. However, we must recognize that it is a part of reality not the whole of reality. It is a part of reality and some other parts are ignored not because they are not there, but because for various reasons they were not drawn to the attention of economics.

Now let me try to explain what the components of Islamic economics are with the help of certain diagrams. My proposition is extremely simple. It is simple

to state but not simple to implement. Let's start with conventional economics. Conventional economics is composed of categories three, four, five and six. Conventional economics, thus, has some value judgments, which are not in contradiction to the *Shari'ah,* which conform to the *Shari'ah.* For example, the emphasis on voluntary market exchange is a value judgment shared by conventional economics and by the *Shari'ah. So* not every value in. conventional economics is contradictory to the *Shari'ah;* some of it is acceptable. Conventional economics has value judgments: some of them conform to the *Shari'ah* and some of them are in opposition to *Shari'ah.*

There are also a lot of descriptive or positive assertions in economics, or you might say economic laws, regularities and behavior, are some of these descriptive statements. Some of the *Shari'ah* also is obtained by observation of human behavior and societies. A lot of modem economists comprehend number six observations as descriptive regularities which have been derived from statistical measurement while observing societies under different conditions. Now in Islamizing economics, my proposition is simply this. Number five has to be dropped completely. There are the value judgments which are not supported by the *Shari'ah.* In their place, we have to put category there, the divine source of knowledge. That, category three, has to dominate all. Whatever value judgment is needed in economics science for Muslims must be derived from the divine source.

What about the positive assertions or descriptive part of economics? This we derive from all sources. Positive assertion in economics I can take from Christian, Muslim, Buddhist or any other descriptive statements. Statement over regularities. Anyone who observed and verified a particular fact of economic life is to me an acceptable part of Islamic economics, that is, a positive aspect. These are numbers four and six. So Islamic economics will be basically composed of three, four and six. Value judgments are only taken from one source of revelation or the divine source of category four. This source also has many positive assertions. Reality is taken from any other source of human knowledge, and observations, whatever we can gain from the efforts of others or from our own efforts. So this, in brief, is my proposition about what the constituent elements of Islamic economics are.

They are different only in their source. In addition, we accept descriptive economic statements like Engle's law. There is no *Shari'ah* source to say that when a man's income, or family income, increases, its part used for consumption stand, still or it will decrease. But this is a positive assertion and in reality if we find that, it is true, we will add it to our depository of useful knowledge

CHAPTER SEVEN

THE ISLAMIC ECONOMIC SYSTEM: NEED FOR IT AND COMPARISON

*M. Umar Chapra**

1. THE IMPERATIVE

Human well-being has been the undisputed objective of all societies. There is however a difference of opinion on what constitutes well-being and how it can be realized. Even though material ingredients are not the only constituents of well-being, the secularist perspective of the present-day, world emphasizes mainly these. It is felt that well-being could be ensured if certain material goals are realized. These include elimination of poverty, fulfillment of the basic needs of all individuals, full employment, equitable distribution of income and wealth and growth with stability. No country around the world, irrespective of whether it is rich or poor, has however been able to realize even these material goals.

This failure is made all the more conspicuous by macroeconomics imbalances and economic instability. The developing countries are further plagued by difficult debt-servicing problems, which are threatening not only their future development but also the health and survival of the international financial system. In addition, practically all countries are experiencing environmental pollution which is endangering life on earth. There is also the specter of a rising level of crime, strife, tensions and anomie.

1.1 Efficiency and Equity

The inability to realize the material goals could not be due to scarcity of resources. Resources are scarce only in a relative sense. It is generally agreed that if the available resources are used 'efficiently' and 'equitably', it should be possible to realize the material goals and to minimize the instability and the imbalances. This brings into focus a host of difficult problems related to 'efficiency' and 'equity' and the way to realize these.

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Efficiency and equity in the allocation and distribution of scarce resources have hence been the principal themes of economics. These have both, however, been defined in different ways. The most logical was to define them would be within the framework of the material goals specified above. An economy may be said to have attained optimum efficiency if it has been able to employ the total potential of available human and material resources in such a way that a maximum feasible quality of need-satisfying goods and services is produced with a long-run sustainable rate of growth and a reasonable degree of economic stability. Optimum equity may be said to have been attained if the goods and services produced are distributed in such a way that the needs of all individuals are adequately satisfied and the inequalities in income and wealth reflect socially-agreed values without adversely affecting the motivation for work, saving, investment and enterprise. The test of such efficiency and equity lies in the ability to attain a socially more acceptable result without creating prolonged macroeconomics imbalances and further deterioration in the environment. Efficiency and equity in this sense have not been realized even in the rich industrial countries irrespective of whether they are capitalist or socialist. The question is why?

1.2 The Three Questions

To allocate resources efficiently and to distribute them equitably it is necessary to have a strategy that enables the economic system to answer satisfactorily the three well-known fundamental economic questions of what, how and for whom to produce.[1] The answers to these questions determine not only the allocation of resources in an economy but also their distribution between individuals and between the present (consumption) and the future (saving and investment).

To answer these questions effectively, an economic system needs to have a strategy consisting of three indispensable ingredients. These are:

i) filter mechanism,
ii) motivating system, and

1 For a clear presentation of the position of conventional economists on the subject, see Milton and . Rose Friedman, Free to Choose (London: Secker and Warburg, 1980, pp. 9-37); and P. A. Samuelson, Economics (New York: McGraw Hill, 1980) pp. 15-18.

iii) socioeconomic restructuring. The filter mechanism must filter all claims on resources in such a way that not only a balance is maintained between available resources and the claims on them but also the desired goals are realized through an appropriate allocation and distribution. The motivating system must be able to induce all individuals to put in their best performance and to use resources in accordance with the dictates of the filter mechanism not only when this is in their own interest but also when it is in the interest of social well-being. The socioeconomic restructuring should enable the prompt transfer of resources from one use to another until the most efficient and equitable allocation and distribution are attained.

1.3 The Worldview

The development of an effective strategy based on these three ingredients is however not possible without an underlying worldview (weltanschauung), which controls, in the words of Arthur Lovejoy, the nature of man's reflection on almost any subject'[2] Differences in worldview lead to differences in conclusions about the meaning and purpose of human life, the ultimate ownership and objective of resources at the disposal of human beings, the relationship of human beings towards each other (their rights anq1d responsibilities) and their environment, and the criteria for efficiency and equity.

Unless the worldview of a system is consistent with its desired goals, it may not be possible to develop the proper ingredients that an effective strategy needs for realizing these goals. Systems which reflect an inherent inconstancy between their goals and their worldview are unable to bring about the fundamental adjustments in lifestyles and to restructure the allocation and distribution of resources in conformity with goal realization. They are thus crisis prone.

2. THE PREVAILING STRATEGIES

The two prevalent systems in the present-day world - the market system and socialism (used here for its central planning model) - have a common

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2 Arthur Lovejoy, The Great Chain of Being (New York: Harper and Brothers, 1960) p.7.

3 For an elaboration of his thesis, see, with respect to capitalism, Edward S. Greenberg, Serving the Few: Corporate Capitalism and the Bias of Government Policy (New York: John Wiley, 1974); and with respect to the secularist welfare state, Claus Offe, Contradictions of the Welfare State, ed., John Keane (London: Hutchinson, 1984).

worldview but different strategies. In spite of the various 'revisions' that have taken place in these systems over the years, and the relative abundance of their resources, the countries following these systems have failed in varying degrees to realize their material goals. Their failure is not a contingent event, external to the systems. It is rather a natural and expected consequence of the flaws in their worldview and strategy. Hence, the existing systems, which themselves need, in
the words of Bunt, 'to rethink a correct philosophy of man,[4] cannot provide a model which may be emulated by Muslims or other developing countries who wish to realize their goals with resources that are relatively much smaller and would take decades to reach anywhere near those of the countries following these systems.

2.1. The Market System

The market system is used here to refer to reformed capitalism, which is a combination of the principles embodied in *laissez-faire* capitalism and the welfare state. It relies primarily on the market mechanism for allocation and distribution of resources, but assigns an 'important' role to the state to improve allocative efficiency and to minimize distributive iniquities. There have however been considerable differences of opinion on the extent to which the state should intervene in the market. These differences have tended to narrow down in the 1980s when mounting fiscal deficits have created a disenchantment with large government role in the economy and led to a backlash against the welfare state. Intensified calls have hence been made from both the intellectual and the political platforms for liberalization or a return, as close as possible, to the classical model with 'minimum' government intervention.

Within the perspective of the prevailing zeitgeist, the market system may be distinguished by its emphasis on:

i) unhindered individual freedom to pursue pecuniary self-interest and to own and manage private property;

ii) accelerated wealth expansion and maximum production and want satisfaction in accordance with individual preferences; and

4 Edwin A. Burtt, The Metaphysical Foundations of Modern Science (Garden City, N. Y.: Doubleday, 1955), p.27.

iii) primary role for market forces in the allocation and distribution of resources and a 'minimum' role for government intervention or collective value judgments.

2.1.1. The Worldview

These features owe their genesis to the worldview of laissez-faire capitalism, which is essentially secularist. It was shaped by the Enlightenment philosophy, which placed great confidence in the power of reason to establish ultimate metaphysical truths, and tried to undermine the hold of religion as a collective force in society. Value judgments based on moral values became an anathema. Their place could not be taken by rationally-derived principles because of the difficulty of reaching consensus on such principles in pluralist societies with conflicting interest groups. Though values still continue to influence individuals in varying degrees, it is mainly in their private spheres of life.

Materialism and utilitarianism took the place of religion. This provided a logical rationale for single-minded pursuit of wealth and sensual pleasures and gave rise to the concept of rational 'economic man', which has served as the kingpin of modem economics. Self-interest was the only well-spring of his action. Consumption was the highest purpose of his life, the supreme source of 'happiness', the ultimate justification for all his effort and toil. Maximizing earnings and want satisfaction became supreme virtues. Everything done by the individual toward this end was justified. Any talk of rights of men was plain nonsense.[5] Social Darwinism thus crept into economics.

2.1.2. The Logic Behind the Strategy

The pursuit of unfettered self-interest, however, had a social and religious stigma attached to it. Unless this stigma was removed the doctrine of self-interest would not have received the social blessings it needed to be considered seriously in a Christian society. This was done by Adam Smith. He showed that if everyone pursued his self-interest, the 'invisible hand' of market forces would, through the restraint imposed by competition, promote the interest of the whole society, thus bringing about
a harmony between private interests and public good.[6]

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5 Bertrand Russel, A History of Western Philosophy (New York: Simon and Schuster, 1945), p.775.

6 Adam Smith, 'Invisible Hand', in L. S. Stepelevich, ed., The Capitalist Reader (New York: Arlington House Publishers, 1977), p. 20. See also, Wilhelm Roepke, 'Ordered Anarchy,' ibid., p.32.

The logic behind this claimed harmony between private and public interest rested on a number of steps. The preferences of self-interested, utility-maximizing consumers are reflected in the market place through their demand or willingness to pay the market price. Producers respond 'passively' in their self-interest to this demand by producing at the lowest cost whatever will help them maximize their profits. The free interaction of utility-maximizing consumers and profit-maximizing producers under perfectly competitive market conditions helps determine market clearing prices for goods and services. These prices (and costs, which are also prices) serve as an impartial, value-neutral filter mechanism and lead to the production of that configuration of goods • and services which is in maximum harmony with consumer preferences. These prices also automatically determine the transfer of resources from one use to another, thus contributing to their most efficient use without anyone's conscious effort or intervention.

Since the resultant configuration of goods and services. reflects consumers' preferences, it is the most 'efficient' - it is not possible to improve upon it. This configuration also determines the incomes earned by the respective factors of production on the basis of their contribution to output and revenue. At the point of equilibrium, consumer satisfactions (utilities) are maximized, supplier costs are minimized, and factor earnings (including wages and profits) are maximized. The market system, it is thus concluded, determines not only the most 'efficient' use of resources but also the most 'equitable' distribution of income in a rational and impartial manner without value judgements.7 It also automatically brings about a harmony between private and public interests. There is no point in raising questions about whether this configuration satisfies basic human needs and whether the distribution is equitable because these questions cannot be answered without collective value judgments which, unlike market clearing prices, cannot be established impartially. Questions about differentials in wealth holdings are also unjustified because the wealth of individuals represents their earnings on the basis of their own or their parent's contribution to output and abstinence from consumption.

Every competitive equilibrium is considered to be a Pareto optimum- it is not possible to make anyone better off without making someone else worse off. It must hence be accepted as both 'efficient' and 'equitable'.Thus the terms 'efficiency' and 'equity' as defined within this framework do not have any relationship with the

7 Few economists would now be willing to support this claim about equitable distribution. It is however a logical outcome of the assumed symmetry between public and private interests and was widely held by economists, like J. B. Clark, who believed that factor incomes in the real world closely approximated the marginal product and its value (See G. Stigler, Production and Distribution Theories: The Formative Period, New York: Macmillan, 1941). This view hence provided the rationale for the much-cherished government non-intervention principle.

objectives of removing poverty, fulfilling needs and reducing inequalities of income and wealth. It is assumed that these objectives would be realized as a 'necessary' concomitant of 'efficiency' and 'equity'. Any outside intervention to change the status quo would necessarily lead to results which are less 'efficient' and less 'equitable'. The only acceptable way to change the status quo is within the framework of Pareto optimality - to make some people 'better off without making anyone 'worse off.

By providing sanctity of self-interest, Adam Smith turned the eyes away from moral intentions and social obligations of individuals to the 'unintended' consequences of the final social outcome of their actions, which would always necessarily serve the social interest. Perfect competition in a free market would be the best guarantee of general welfare. it would keep self-interest within bounds, minimize costs and prices, and thus ensure maximum efficiency and health of the system. Consequently there was no need for value judgments or for government intervention. only if the state did not interfere, only if the private entrepreneur was left free to pursue his economic goals, would optimum welfare be attained and the interest of the nation adequately safeguarded. Everyone was the best judge of his interest and, if left alone, could better not only himself but also everyone else.

2.1.3. Flaws in the Logic

There is no doubt that capitalism led to a long period of prosperity in the countries that pursued this system. High rates of economic growth were generally realized' and there was a vast expansion in wealth. However, in spite of this unprecedented prosperity, it did not become possible to remove poverty to fulfill everyone's needs. Inequalities of income and wealth also increased instead of declining. In addition, there has been a substantial degree of economic instability and unemployment which has aggravated the miseries of the poor. This implies that neither efficiency nor equity were realized within the framework of the definitions given earlier.

The reason behind this failure to actualize the socially-desired goals was the severe conflict between its goals and its worldview and strategy. The goals were humanitarian, based on a moral foundation, the worldview and the strategy were social Darwinist. The claimed harmony between private and public interests was based on certain assumptions about background conditions which were false and so unrealistic that they could never become true.

Individual Preferences and Social Priorities

Firstly, it was assumed that even without certain collectively-agreed moral constraints on consumer choice, the sovereign consumer would confine his claims on scarce resources to only need-satisfaction. There would thus be no conflict between the preferences of 'rational' consumers and the social priorities in resource use. This assumption has proved to be false.

It was not realistic to assume that, even without any moral constraint, the 'sovereign' consumer desires, it may not be possible for him to differentiate between 'need' and 'want' or 'necessary' and 'unnecessary' without socially-agreed criteria and without a complementary role of the state to determine what the society can or cannot afford within the framework of its resources and the goal of universal need fulfillment. It is particularly so when a vast array of unwarranted wants not related to real human needs is created by businesses through advertising in pursuit of their goal of profit maximization.[8] The race for ostentatious consumption, which thus sets in, is supported and further exacerbated by excessive expansion of credit which the interest-based financial intermediation makes possible. This puts tremendous pressure on scarce resources and not only reduces the ability of society to satisfy needs, but also gives rise to deficits, monetary expansion, inflation, external imbalances and burdensome foreign debt..

Prices and Urgency of Wants

Secondly, it was assumed that the urgency of wants of different consumers can be compared by the use of prices because each unit of currency represents a ballot. The willingness on the part of two individuals to spend and equal amount of money is assumed to indicate wants of equal urgency. This premise is questionable. Even though the urgency for milk is the same for children irrespective of whether they are poor or rich, the amount of dollar votes that a poor family is able to cast for milk is not the same as those which a rich family is able to cast for status symbols. Hence the system of balloting through dollar votes leads to a lower than the optimum quality of milk production because of resources being diverted to the production of

8 Vance Packard has expounded this phenomenon at the popular level in a series of books. Typical of these is The Hidden Persuaders (Harlow, Essex, U. K.: Longman, 1957), an expose of the wiles of Madison Avenue. See also Charles Lindholm, Politics and Markets, p. 79. A number of expressions are used by economists to describe the phenomenon of creating unwarranted wants. These include the 'bandwagon' effect, the 'snob' effect, and the 'Veblen' effect. For representative definitions of these, see Harvey Leibenstein, Beyond Economic Man (Cambridge, Mass: Harvard University Press, 1976), pp. 51-2.

status symbols. Arthur Okun hence rightly observes that the markets award prizes that allow the big winners to feed their pets better than the losers can feed their children.[9]

Equal Distribution

Thirdly, it was assumed that there exists an equal distribution of income and wealth in the economy. Given the absence of a filter mechanism and the indiscriminate pursuit of want satisfaction, only an equal distribution of income and wealth would give everyone an equal weight in influencing the decision-making process of the market. But incomes are not equally distributed. This allows the upper strata of income groups getting a share of national income and credit significantly more than in proportion to their numerical size, to divert scarce resources, by the sheer weight of their votes into products which are socially less desirable. The result is, as Tawny has rightly indicated, 'a part of the goods which are annually produced, and which are called wealth is, strictly speaking, waste because it consists of articles which though reckoned as part of the income of the nation, either should not have been produced until other articles had been produced in sufficient abundance or should not
have been produced at all [10]

Market Imperfections

Fourthly, it was assumed that the market operates under conditions of perfect competition, which is said to prevail if there are: many buyers, many sellers, no barriers to entry, and perfect information about the present and the future. The motive to maximize profits forces the entrepreneur in a competitive market to minimize his costs and eliminate waste. Competition prevents him from overcharging. It serves as a stick that enforces order and fair play, thus serving the consumers interest and thereby of the society as a whole. It acts as a self-regulating mechanism for the economy and eliminates wastage, exploitation, and excessive profits without any government intervention.

Perfectly competitive markets have however remained an unrealized dream and will most probably remain so in the future, particularly because of the tendency of capitalism to promote big business and concentration of wealth and power. Competition has been on the decline. Big business has become prominent in all industrial countries through a process of expansion which has continued nearly

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9 Arthur Okun, Equality and Efficiency: The Big Trade-Off (Washington, D.C.: Brookings Institution, 1975), p.11.

10 R. H. Tawney, The Acquisitive Society (New York: Harcourt Brace, 1948), p. 12.

uninterrupted for more than a century. Several hundred giant corporations 'play a preponderant role in the United States, Canada, Japan, and the nations of Western Europe.[11] These giant corporations wield considerable social and political influence in their countries. They account for about 80 per cent of all economic activity in the United States though they comprise only 10 per cent of all business firms. However even the activity of the remaining 90 per cent of business firms is determined in various ways by these large corporations. They dominate the American economy, whether measured in terms of capital, production, investment, new products, consumer impact, or employment.[12] Even in the agricultural sector, traditionally assumed to be the stronghold of family farms, the move is towards the consolidation of farm lands into fewer hands. According to Norm While, 'government policies that favor big operations and cause more and more medium-sized farmers to go down the tube will eventually result in a few huge conglomerates owning most of the land for controlling the food supply".[13] Such a vast corporate growth has far-reaching effects.

Moreover, the giant corporation is not a democratic institution. All control over the policies of these corporations rests in the hands of a few families who hold the controlling stock.[14] In approximately 150 companies on the current Fortune 500 lists, 'controlling ownership rests in the hands of an individual or of the members of a singe family.' [15] Even the professional managers of such corporations are drawn from the upper strata of society. As Andrew Hacker has indicated, the democratic social climate is 'not reflected in the upper echelons of the large European corporations, and there were even signs that the inequality of selection was increasing rather than decreasing.' [16] Wealth and connections are of utmost importance in getting management positions in a large corporation. They are the tickets of admission to the inner echelons of power. Mills indicated the prevalence of the same state of affairs in the US by saying: 'The corporation is the source of wealth, and the basis of the continued power and privilege of wealth. All the men and the families of great wealth are now identified with large corporations in which their property is seated.'[17] Hence there is concentration of power in the hands of a small elite in the major sector of the economy, giving them an immense power to make basic product, price and

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11 See Andrew Hacker, et al., 'Corporation, Business,' The New Encyclopedia Britannica 15th Edition (1973-74), Vol. 5, p.182.

12 See Edward S. Mason, ed., The Corporation in Modern Society (Cambridge, Mass.: Harvard University Press, 1980), for a useful anthology on the subject.

13 Quoted by David Owen, 'Go Broke, Young Man,' Financial Times 31 January 1987, p.1

14 Greenberg, op. cit., p.247.

15 Robert Sheehan, 'Proprietors in the World of Big Business,' Fortune, 15 June 1967, p. 179.

16 Hacker, et al., op. cit., p.187. See also Gabriel Kolko, Wealth and Power in America: An Analysis of Social Class and Income Distribution (New York: Prager, 1964), p.67.

17 C. Wright Mills, The Power Elite (New York: Oxford University Press, 1956), p. 116.

investment decisions that affect the entire nation and , in fact, the world.[18] Large corporations are even able to escape competitive market restraints.[19] Many observers believe that the pricing patterns of the leading firms show a lack of competitiveness.[20] The large size places a limit to the entry of new firms. Huge resources are required for entry and these are difficult to muster because of the greater initial risk to which a new firm is exposed. Only the rich who have an access to vast resources of their own and also of the banking system can plan an entry. However, banks are generally reluctant to lend to newcomers because of not only uncertainty but also their vested interest in protecting their favored large clients.

If corporate expansion had stemmed merely from the search for greater efficiency, then one might have perhaps condoned corporate expansion into vast conglomerates. But even this is not the case. According to many observers, 'the optimum size of the efficient firm is substantially smaller than many people bedevil.'[21] The structures of most large corporations are really the equivalent of a congeries of semi-independent identity.[22] Moreover, 'concentration is enhanced by the heavily interlocked nature of large business firms. Nominal competitors, for instance, usually have directors sitting on one each other's board of directors, raising the suspicion that competition is not the essence of their relationship. Interlock is further enhanced by the trust activities of banks, by trade associations, by the practice of price leadership and, occasionally, by outright collusion and conspiracy.'[23] If profit is an indicator of efficiency, then research has shown profit rates in industries having a large number of smaller firms to be just as high as in those in which a few big companies dominate a market.[24] Largeness does not therefore necessarily contribute to greater efficiency even in the capital sense.

The conventional interest-based banking system has provided impetus and lifeblood to the process of expansion through vertical as well as horizontal expansion and leveraged buy-outs of competitors. Banks prefer to finance a few large business compared with innumerable small ones. This tendency was further intensified by the low rates of interest maintained by central bank fiat during the

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18 See Kolko, op. cit., pp. 68 and 127.
19 Edward S. Mason, 'Corporation', International Encyclopedia of Social Sciences vol. 3, p. 401.
20 David Reisman, Galbraith and American Capitalism (London: Macmillan, 1980), pp. 58-68.
21 Hacker, et al., op. cit., p. 185.
22 Ibid.
23 Greenberg. op. cit., p. 40.
24 Hacker, et al., op. cit., p. 185.

Second World War and for nearly two decades thereafter as a result of the need to reduce the cost of servicing the public sector debt and to accelerate post-war reconstruction and development. The low rates of interest accentuated the built-in bias of giant corporations in favor of capital-intensive techniques of production and aggravated the unemployment problem in practically all industrial countries - a problem which has now become very difficult to solve.

Although theoretically the postulate is true that private ownership of means of production, when combined with health competition, contributes to greater efficiency in the use of resources in practice, the market system has fostered large conglomerates, most of which may Le unnecessary, and greater concentration of power. The result is as Berle has put it tersely: 'The capital is there and so is capitalism. The waning factor is the capitalists.'25 Thus the three central pillars of capitalism have been shaken - the ultimate power of the consumer, the self-regulating tendency of competition, and the creative drive of the entrepreneur. The individual (both as a consumer and an entrepreneur) has become 'increasingly subordinate to the goals of the producing organization.' [26]

Social Costs and Benefits

Fifthly, it was assumed that the profit-maximizing producers would not disregard social costs and benefits in their accounting and that prices would not therefore reflect just private costs and benefits but rather total costs and benefits to society. This has also proved to be wrong. Prices of certain goods or services tend to be out of tune with opportunity costs and payments to resources owners tend to be far above or below the value of their contribution to real output. This has contributed in a significant way to undue depletion of non-renewable natural resources, excessive environmental pollution, and economic iniquities. It was unrealistic to assume that in an individualistic society, where most operators in the market are 'economic men', whose only motivating force is self-interest, whose time horizon is short, and whose social perspective is generally narrow and limited, long-run as well as social costs and benefits would not be disregarded by them in their accounting, even though these costs or benefits are extremely important from the point of view of continued social well-being. The claimed self-correcting tendency of the price system to reduce the divergence between private and social interests takes an extremely long time such that faith in this self-correcting tendency is not meaningful.

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25 Adolf A. Berle, Jr., The Twentieth Century Capitalist Revolution (New York: Harcourt, 1954), p.39.
26 Galbraith, The New Industrial State, (New York: American Library, 1972), p.xiv.

2.1.4. The End of *laissez-faire*

As Britain has rightly pointed out, 'no real world market is likely to be even approximately satisfactory in all background conditions.' The absence of background conditions led to serious distortions in the allocation and distribution of resources. A number of scholars and literary figures criticized the logic of laissez-faire capitalism and drew attention towards its sour fruits. Even though their criticisms ..... number of minor modifications in the system, they could not succeed in bringing about a significant change. They were therefore left behind as towering, but nevertheless 'historic', figures.[27]

Two events, whoever, served to wash the ground away completely from under laissez-faire capitalism and ushered in the welfare state. These were the Great Depression of the 1930s and the socialist onslaught. The depression led to the Keynesian revolution in economics and undermined laissez-faire capitalism's cherished principle of government non-intervention in the economy. Keynes argued that free-market economies could not be expected to maintain full employment and prosperity at all times. It was necessary for the government to play an important role in removing demand deficiency the government to play an important role in removing demand deficiency through deficit financing to correct the depression. Keynes, however dealt with only one aspect of the welfare state - that of achieving full employment. According to him, the capitalist system failed only in the solution of the unemployment problem; it solved appropriately the problems of allocation and distribution. He did not therefore, believe in the need for changing other features of capitalism which did not interfere with the achievement of full employment.[28] The socialist onslaught however undermined the non-intervention principle further and created irresistible pressures in favor of other welfare functions of the state, even those previously performed by individuals themselves or their families and society.

2.1.5. The Welfare State: The Thorny Path

The primary thrust of both these impacts has been the establishment of the welfare state or democratic socialism, leading to an expansion of varying degrees in the role of the state in all market-economy countries. This has contributed to an exponential rise in government spending. Consequently budgetary deficits have ballooned and persisted in spite of prohibitively high tax rates. These deficits have

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27 See Elizabeth Jay and Richard Jay, Critics of Capitalism: Victoria Reactions to Political Economy (Cambridge: Cambridge University Press, 1986), pp.15-16.

28 See Lawrence R. Klein, The Keynesian Revolution (New York: Macmillan, 1954), Chapter 7 (pp. 165-87).

been financed by monetary expansion and borrowing. This has generated inflationary pressures, balance of payments disequilibria, and higher interest rates followed by lower growth rates and greater economic instability. These difficulties have led to a backlash against the welfare state.

The problem that the welfare state now faces is how to remove the imbalances that it has created? There being no agreed filter mechanism other than prices with the hope of which to regulate aggregate demand, primary reliance is being placed on the market mechanism to remove the existing imbalances. This revival of faith in the market brings back into focus the failures and iniquities of the market and the inability of the poor to fulfill their needs. The welfare state is thus faced with a perplexing dilemma. If primary stress is placed on the market and the welfare role of the state is rolled back to remove the imbalances, then the welfare state is back to square one - the square of capitalism from where it started. So what to do now?

The only major tool that the welfare state is left with to provide relief to the poor is a high rate of economic growth. Economic growth has accordingly received undue emphasis and has become the primary tool for reducing inequalities .However, even though the high rate of growth has raised the consumption level of the poor, it has not helped fulfill all the needs of the poor or improve income distribution. As Adelman and Morris have shown on the basis of a cross section of data, 'development is accompanied by an absolute as well as a relative decline in the average income of the poor.'[29] Higher growth has given a greater boost to the income of the rich because all the capitalist institutions which promote inequalities, particularly the banking system, have continued unchanged. Undue emphasis on growth has also accentuated imbalances and debt-servicing problems, and has led not only to unduly rapid depletion on non-renewable natural resources but also to excessive environmental pollution. Moreover, the prospects for maintaining, much less accelerating, the rates of growth are not very bright in the near future without increasing inflation and aggravating other imbalances.

As a result of the backlash, the welfare state has now lost much of its earlier clan. The ruling thought nowadays seems to be that the continued growth of the welfare state is neither likely nor desirable [30] Harold Wilensky has reported on the

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29 I. Adelman and C. T. Morris, Economic Growth and Social Equity in Developing Countries (Stanford, California: Stanford University Press, 1973), p.189..

30. Bernard Cazes, 'Welfare State: A Double Bind,' in OECD, The Welfare State in Crisis, (Paris: OECD, 1981), p.47.

basis of a study of 64 countries that in the 1970s there was already evidence of growing resistance to further expansion of state services in many rich countries.[31]

2.1.6. Lack of an Effective Strategy

The welfare state is, nevertheless, not an option which may or may not-be adopted; it is rather indispensable in every human society which wishes to realize its humanitarian goals. The secularist welfare state has faced difficulties because it could not develop an effective strategy to realize its humanitarian goals. It did not introduce any fundamental change in the worldview of capitalism. The primary reliance on government interventions and excessive spending was essentially a patchwork to the innate secularist and social Darwinist philosophy of laissez-faire capitalism - a random outcome of the conflict between pluralist groups, each of which is trying to serve its maximum self-interest and to make minimum sacrifice. The anathema to value judgments continued and the self-imposed standard of Pareto optimality remained sacred. If the filtering and motivating role of moral value sin molding consumer preferences is ruled out, then the welfare state is not left with any effective mechanism that could help prevent the use of scarce resources for purposes that obstruct the realization of its egalitarian goals. There was no criterion for distinguishing the 'necessary' from the 'unnecessary', and the 'just' from the 'unjust'. If the moral obligation of family and society in fulfilling the dire needs of its members is also ruled out, then the welfare state becomes loaded with responsibilities it is not capable *of* shouldering. The welfare state did not recognize even means testing. It tried to provide welfare services to all, the rich and the poor alike, through increased spending by the public sector.

Initially this generated a euphoria - a feeling that the problems *of* both allocation and distribution had been ideally solved. They were not; the strategy was inadequate for the task. The swelling budgetary deficits resulting from increased public sector spending, not only to finance Keynesian-style demand management but also to promote higher growth and welfare services, were not accompanied by an offsetting reduction in other claims on resources. In fact the consumer culture also led to a simultaneous rise in private sector spending, leading to a decline in saving.[32]

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31 Harold Wilensky, The Welfare State and Equality (Berkeley, Los Angeles: University of California Press, 1975), p.47.

32 Savings have fallen in all industrial countries from an average of 17.5 per cent of national disposable income during 1960-74 to 10.7 per cent during 1980-87. They have fallen more steeply in the U. S. and France, going down over this period from 10.5 and 19.4 per cent to less than half that level - 4.2 per cent and 8.6 per cent. In West Germany and the U.K. they have dropped from 19.6 and 10.9 per cent to 11.0 per cent and 6.3 per cent. Even in Japan, the source of capital for many Western countries, they have declined from 26.4 per cent to 20.4 per cent (Bank for International Settlements, Fifty-Ninth Annual Report for the period 1988/89, Basle, June 1989, table on 'Saving and Investment: a longer-term comparison,' p.32.

The interest-based banking system has served as an accomplice by its willingness to lend to both the private and the public sectors, without due regard for the ultimate use of credit, on the strength of collateral and the assumption that a sovereign debtor will not default. The excess liquidity that has thus been generated has exacerbated claims on resources and given rise to macroeconomics imbalances and instability in the foreign exchange, commodity and stock markets.

The problems of poverty and depravity have nevertheless continued and become more profound. Needs have remained unfulfilled. Inequalities have in fact risen. Socially desired priorities do not get expressed in the market place with flagrant inequalities of income and wealth. The rich are able to divert scarce resources to the satisfaction of their 'inessential' wants through the sheer weight of their enormous purchasing power. Satisfaction of a maximum amount of wants hence becomes the primary objective of the economic system and the entire machinery of production gets directly or indirectly geared to this goal. The poor get squeezed because of their lower income and their inability to pay the market price. Even their essential needs remain unfulfilled. This lowers their efficiency and their income. They thus get entrapped in the vicious circle of poverty. The greater the income and wealth disparity, the greater the power of the rich to divert resources away from the need fulfillment of the poor if reliance is placed merely on the price mechanism to allocate resources and to remove the imbalances.

Any effort to fulfill needs and to bring about an equitable distribution is bound to hurt the rich in every society where there exists an inequitable distribution. Why would the rich agree to be worse off in a secularist, value-free society committed to the principle of Pareto optimality? To motivate them to be worse off in the interest of the well-being of others, it would be necessary not only to have socially-agreed values to which everyone stands committed but also a motivating system. Any system that overemphasizes pecuniary self-interest cannot have the kind of motivating system that is needed for socially-oriented behavior.

There is thus a built-in tendency on the part of market forces to lead to skewness in the claims on resources in favor of conspicuous consumption. Samuelson has acknowledged this by saying: *'Laissez faire* perfect competition could lead to starving cripples; to malnourished children who grow up to produce malnourished children; to perpetuation of Lorenz curves of great inequality of incomes and wealth for generations or for ever'. He further adds that 'Adam Smith... had no right to assert that an Invisible Hand successfully channels individuals who selfishly seek their own interest into promoting the 'public interest' . Smith has

proved nothing of this kind nor has any economist since 1776'.[33] It is Galbraith's contention in The Affluent Society that the prevailing pattern of resource allocation in the US is biased in favor of the satisfaction of artificially induced consumer wants so that basic needs are grossly neglected. Included among these are education, housing, medical care and public utilities which are essential for individual and social well-being and for future progress.[34]

The market system cannot therefore help the simultaneous realization of both efficiency and equity in the allocation and distribution of resources. It is necessary to change consumer preferences, public finances, investment patterns, and all economic and financial institutions in such a way that resources do not get diverted to uses that obstruct goal realization. The welfare state has been unable to bring about such a change because it did not introduce any fundamental shift in the worldview of capitalism. It relied primarily on increased public sector spending without creating an offsetting reduction elsewhere. This has led to imbalances which have now become a serious problem. Within the perspective of the market system it is not possible to remove the imbalances without either raising taxes or reducing spending. Since taxes are already high in all welfare states, the primary remedy being considered is a substantial reduction in the welfare role of the state. This remedy may not be practical for long in democratic societies where elected representatives of the people are expected to live up to the expectations of their constituencies. The solution does not thus lie in preventing the state from playing its natural welfare role in the economy, but rather in restructuring the economy and injecting a moral dimension into all uses of resources by both the public and the private sector.

Even the introduction of values may not help reduce inequalities of income and wealth unless the financial stem is also radically reformed. Stanley Lebergott explains skewness in income and wealth distribution as the result of 'quite rational' supply of credit to wealth) individuals.[35] This is a natural consequence of the interest-based financial system, which got established in the West after the Judaic and Christian stricture against interest way by-passed. Since the lender, irrespective of whether he is an individual or a banker, does not share in the risk of business, he would naturally be inclined to lend to the rich because in this case he is assured of the repayment of principal with interest. If, however, the lender shares in the risk, as he would be required to do in an interest-free profit-and-loss sharing system, he

33 Paul A. Samuelson, Economics, (New York: McGraw Hill, 1980) p. 591.

34 John K. Galbraith, The Affluent Society (Boston: Houghton Mifflin, 1958); see also, Hwy K. Girvetz, 'Welfare State,' International Encyclopedia of the Social Science, Vol. 16, pp. 519-20.

35 Stanely Lebergott, 'The Shape of the Income Distribution,' American Economic Review, June 1959, pp. 328-47.

would be more concerned about the nature and profitability of the business. In this case even the poor would stand a chance[36] Mishan has hence aptly stated: "Given that differences in wealth are substantial, it would be irrational for the lender to be willing to lend as much to the impecunious as to the richer members of society, or to lend the same amounts on the same terms to each.'[37] The greater flow of credit to the rich in the conventional system is a highly acknowledged fact. Galbraith, for example, says: 'The large corporation of the planning system, when it must borrow, is a favored client of the banks, insurance companies and investment banks.[38] He further states that 'those who least need to borrow and those who are most favored as borrowers are in the planning system. Those who most rely on borrowed funds or are least favored at the banks are in the market system.'[39] Large-scale business and their mentors, the banks, have however become too powerful in the market system that it is doubtful if it can ever succeed in bringing about an equitable distribution of income by means of the cosmetic changes that it is accustomed to making. Vested interests in big business and big finance have become excessively strong both economically and politically and it may not be possible to dislodge them to introduce the radical changes necessary for better results.

2.2. **Socialism**

While the failure of capitalism to realize its goals led to an expansion in the role of the state in the economy in market economy countries, it also led to the socialist revolution in Soviet Russia, Eastern Europe, Yugoslavia and China. However, socialism has also failed to realize both efficiency and equity. It has rather created problems which are beyond the tolerance level of the people. It is therefore important to see the reasons for its failure.

Socialism condemned religion and its values even more than did lassie-faire capitalism. It did not however provide an alternative worldview other than dialectics, which is nothing but a disguised version of social Darwinism based on class conflict. It could not hence develop an effective strategy to realize its goal of a classless society where everyone worked 'according to his ability' and got rewarded 'according

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36 See M. U. Chapra, Towards a Just Monetary System (Leicester, U.K.: The Islamic Foundation, 1985), p.140.

37 E. S. Mishan, Cost Benefit Analysis: An Introduction (New York: Praeger, 1971), p.205.

38 Galbraith, Economics and the Public Purpose, op. cit., pp. 186-7.

39 *Ibid., p.* 297. The term planning system is used by Galbraith in sharp contrast with the classical model of a perfectly competitive market. It refers to a market dominated by a few large oligopolistic corporations, each dominating a significant part of the market and able to exercise control over its prices and products. The consumer plays a relatively passive role by responding to persuasive advertising. (ibid., pp. 11-50).

to his needs'. The main plank of its strategy to remove the exploitation and alienation prevalent under capitalism was to prevent human beings from serving their self-interest. The only way it could think of accomplishing this was to abolish private property and the market mechanism and to replace them by state ownership of all means of production and central planning .

2.2.1. The False Assumptions

Like capitalism, socialism also made certain assumptions about background conditions - assumptions which are false but do not appear to be so until they are clearly specified.

Firstly, while its analysis of the human condition implied a total distrust in the ability of human beings to mange private property within the constraints of social well-being, it was tacitly assumed that, after the introduction of socialism, the same human beings in their capacity as consumers, workers, managers, and government officials, will always be motivated to do their best for the social good without caring for their self-interest. This was highly unrealistic, and facts have amply borne out the unrealism. In a secularist system, where there is not concept of accountability before the all-knowing God and where the total life-perspective of an individual does not go beyond the short span of this world, the inability of individuals to serve their self-interest has adversely affected their motivation and hence their initiative, drive and creativity.

Secondly, it was assumed that the state machinery will be run by a group of persons who have no axes to grind. This assumption has also proved to be false. If human beings cannot be trusted with private property for fear that they will exploit their position of strength to serve their vested interests, how can they be trusted with the responsibility to manage a whole economy and to determine the 'socially-desired' configuration of goods and services? Hence the question posed by Karl Mannheim, 'Who plans the planners?', becomes pertinent.[40] There seems to be no valid rational for giving a few individuals the right to determine what the whole society should produce. If the planners are human beings, as they are bound to be, then their own preferences and vested interests will tend to get an upper hand in a system not steered by a clearly defined set of goals and values provided by Divine guidance. But even if the planners are to operate on the basis of Divine guidance, as some Muslims argued in their simple-minded justification of socialism, vesting the control over all means of production in the hands of a few individuals is too dangerous. Such an

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40 Ben B. Seligman, *Main Currents in Modern Economics* (Chicago: Quadrangle Paperback, 1971), Vol. 1 (The Revolt against Formalism), p.107.

enormous power is apt to give rise to a dictatorial and inflexible bureaucracy interested in preserving its own power and benefits and oblivious to the welfare of the masses.

Thirdly, it was assumed that the central planning machinery will have at its disposal all the information about consumer preferences, production costs, and prices necessary for taking numerous decisions. This was also unrealistic. Such information does not exist and is almost impossible to collect and analyze. Hence Hayek had very rightly predicted that a socialist solution to the problem of resource allocation was impracticable simply because complete knowledge of all
the relevant data would not be available to the authorities[41] But even if the information were available, the task of making decisions about the allocation of resources among thousands of consumer and capital goods and services is too cumbersome and time-consuming. The system is bound to be slow in decision-making and responding to changing circumstances. Decentralized decision-making is in the best interest of society, and the price system, which allows thousand of consumers and producers to interact with each other, is able to respond more. easily and readily to the needs of individuals and firms than the cumbersome centralized planning machinery.

Fourthly, it was assumed that the large general subsidies implied in the socialist pricing system would benefit the poor. This has also proved to be wrong. General subsidies have benefited the rich and the privileged persons far more than the poor whose purchases are limited [42] Large subsidies are natural and implicit in the socialist planning system. According to a Soviet economist, L.M. Gatonsky, there are at least 5 million prices to be fixed in the Soviet Union and it is impossible to fix these prices coherently.[43] Since putting a price tag on everything from nails to tractors is a mammoth job, prices remain unchanged for years, particularly retain

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41 F. A. Von Hayek, *Individualism and Economic Order* (Chicago, 1948), pp. 77ff.

42 See *Gyorgy* Szakolczai, Limits to Redistribution: The Hungarian Experience, in D. Collard, R. Lecomber and M. Slater, eds., *Income Distribution: The Limits to Redistribution* (Bristol: John Wright, 1980), pp. 206-35; see also, Maksymiban Pohorille, 'Collective Consumption in Socialist Countries: A Theoretical Approach,' in R.C.O. Mathews and G. P. Stafford, *The Grants Economy and Collective Consumption* (London: Macmillan, 1982), p. 77. For example, in Poland official car prices are about 40 per cent of the market price, so gains from privileged access are huge ('Stranded Red Elephants', *The Economist,* 30 May 1987, p. 72).

43 L. Sire, *Economic Revolution in Eastern Europe* (Harlow, U.K.: Longman, 1969);see also Russell Lewis, *The Survival of the Capitalist System: Challenge to the Pluralist Societies of* ***the*** *West* (London: Institute for the Study of Conflict, 1977), p.9.

prices, changes in which are also politically sensitive.[44] The existence of large subsidies has brought a criminal waste of scarce resources. As rightly observed by Mr. Valentine Pavlov, Chairman of the Soviet state committee for prices. 'Prices play little role in creating balance between supply and demand, leading to continual shortages both for retail and wholesale goods' .[45]

2.2.2. The Frustrations

The consequences is that even though almost all centrally planned economies were rich in human and physical resources and had the potential to satisfy all the needs of all their people, they have been continually suffering from shortages of many need-satisfying goods. These shortages could not be removed because centralization make the decision-making process slow, cumbersome and inefficient compared with decentralized decision-making in the market system. State ownership, as Weber had predicted, intensified the bureaucratization of economic life and imposed a deadly routine on all participants [46]

By closing most legal avenues for serving self-interest, the system killed individual initiative and encountered difficulties in motivating both labor and management to try to excel in their performance. The large size of state-owned farms and enterprises led to diseconomies of scale. Their monopolistic position implied absence of competition. There was no incentive to economize in the use of inputs or to introduce innovations. Even if the management of a state-owned enterprise was anxious to be efficient, it could not do so without having the ability to make prompt decisions independently, and being able to acquire the best and the cheapest inputs and to hire the most competent and efficient workers and technocrats from wherever they were available. Management thus became an encrusted mass of officialdom used to receiving and transmitting orders. What the market does under the market system - create a link between the consumer and the independently responding producer - was missing under socialism. Also missing were the price mechanism, that emits signals, and the profit, that motivates the entrepreneur to do his best. Without both market signals and socially-agreed values, there was no basis for

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44 Retail prices of bakery products, sugar and vegetable oil were last changed in 1955. Prices of milk and milk products were last raised in 1962 and have been static ever since. The nominal prices of some basic foodstuffs have been the same for some 20 years. (Patrick Cockburn, reporting from Moscow, 'Now for the Prices,' *Financial Times, p.* 16). Soviet rents have not changed since 1928, utility rates for electricity and gas since 1946 (Patrick Cockburn, 'Doubts over Prices: Soviet Prices Chief Calls for Overhaul,' *Financial Times,* 14 July 1987, p. 2, quoted from a pamphlet issued by Mr. Valentin Pavlov, Chairman of the Soviet state committee for price).

45 Cockbum, op. cit.

46 See Ben Seligman, op. cit.,Vol. 1, p.26.

determining efficiently the scale of capital accumulation and its allocation among different goods and services. Decisions were thus made on the basis of political consideration and the whims of the planners.

The inefficiency of the system has now become reflected in low growth rates. The growth rates in the Soviet economy were initially high (5.8 per cent per annum) during the period 1928-1940, followed by low growth rates (2.2 per cent per annum) during 1940-50. The economy picked up after the War and returned to high growth rates of 5.7 per cent per annum during the period 1950-60. This generated an ebullience of confidence in the socialist system, which began to be heralded as the wave of the future and the model for developing countries. There has been a continuing decline in growth rates since then - 5.2 per cent per annum during 1960-70, 3.7 per cent during 1970-75, 2.6 per cent during 1975-80, and 2.0 per cent during 1980-85.47 The 'corrected, but more accurate' estimates produced by Mr. Aganbegyan, one of the persons behind perestroika (restructuring), suggest that there was really no growth at all in the first half of the 1980s.[48] This has reduced the appeal of the system, particularly because the growth record of other countries like Japan, East Germany and South Korea, with vastly smaller resources, has been more impressive. Stalin's famous call in 1931 for making good the distance between the Soviet Union and the advanced countries in ten years has thus proved to be an illusion. Even Khrushchev's dream of closing the gap within the decade of the sixties remained unfulfilled.49 The decline in growth rates has reversed the trend of decline in the absolute gap between the Untied States' and the Soviet economies; the gap has been widening in recent years.50

While the centrally-planned system has reduced efficiency, its contribution to equity has also been limited. Inequalities have been reduced only to a minor extent. The propertyless laborer continues to be a propertyless laborer. Instead of being an employee of the individual capitalist, he has become the employee of a more powerful employer, the monopolist state enterprise, with unhindered powers to punish or reward. The worker is completely divorced from the power centers, far more than in capitalist countries, where the exercises at least some influence through the labor unions and the democratic politically process. His de facto position has in fact worsened. The wage

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47 For growth rates, see Gur Offer, 'Soviet Economic Growth: 1928-1985', Journal of Economic Literature, December 1987, Table 1, p. 1778.

48 See Abel Aganbegyan, *The Challenge: Economics of Perestroika* (London: Century Hutchinson, 1988); see also, 'The Soviet Economy: Survey,' *The Economist,* 9 April 1988, p. 3.

49 See Offer, op. cit., p.1798; and Gregory Grossman, 'Communism in a Hurry: "The Time Factor", 'In Abraham Brunberg, ed., *Russia Under Khrushchev* (New York: Praeger, 1962), pp. 205-18.

50 Offer, op. cit., p.1781

slavery which socialism sought to abolish, continue with greater intensity. In the capitalist system the laborer is at least free to choose his employer, there being so many of them, in the socialist system he is not free to do so. If his immediate boss is benevolent, the worker may be well off; may be, because if he is more competent, works harder, and performs his duties conscientiously, he may not necessarily get a higher quid pro quo reward. If, however the boss is vindictive, he has to suffer in silence. He has nowhere to go. If he fights for his rights, his problems may multiply. State socialism thus turned out to be more tyrannous than private capitalism. Isn't this alone sufficient to increase his alienation? As Crosland, himself a socialist, has rightly indicated: 'The underlying fact of the alienation of workers from the means of production' still remains. This is because 'the control center is separated from the workers and the possibility of exploitation, and of all the other features of 'capitalism, is present.' 52

Social inequalities and class distinctions also continue unabated. As Murray Yanowitch remarked, 'Soviet society may be characterized as a class system.'[53] The higher and better paid jobs go, like under capitalism, to those who come from the higher stratum of society.[54] A number of sociological studies have demonstrated that a great majority of workers' children who had high ambitions are 'destined to remain disappointed'.[55] The once popular equation that state ownership would create a classless society has thus been falsified. There is no logical reason to assume that when the state expropriates all means of production, no one class will control the state.[56] The continuation of the class system is bound to continue in a more intensified form in a centralized system, the underlying philosophy of which is not based on any concept of human brotherhood and accountability before the Supreme Being, but rather on. dialectics and the elimination or domination of one class by the other.

To reinforce all these alienating factors is, as already indicated, the absence of priority to need fulfillment. Hence housing, food and other essentials of life have been in short supply in all centrally-planned economies. The laborer has to wait in long queues to get some of his essential requirements. The powerful and the influential

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51 Norman Furniss and Timothy Tilton, *The Case of the Welfare State: From Social Security to Social Equality* (Bloomington: Indiana University Press, 1977), p.42.

52 C. A. R. Crosland, *The Future of Socialism* (London: Jonathan Cape, 1963 edition reprinted in 1985), p. 37.

53 Murray; Yanowitch, *Social and Economic Inequality in the Soviet Union* (London: Martin Robertson, 1977), p.108.

54 Ibid., Table 4.2, p.109.

55 Ibid., p.131.

56 Cropland, op. cit., p.38.

are however able to have a privileged access to everything through 'lavish perquisites: not only free cars and country houses, but also secret additional salaries and special shops with reduced prices and, in the case of top people, with goods completely. free of charge.'[57]

Even in terms of education and training, the workers' children do not have as great an opportunity to be accepted in institutions of higher learning as they enjoyed by children coming from families of the higher social strata with their greater 'influence' and resourcefulness. The Soviet education system has a strong tendency to transmit economic and social inequalities across generations even when all levels of schooling are tuition-free. The critical link is the family unit and its position in the hierarchy of classes and strata. Yanowitch has observed that 'the more "promising" the future occupational status associated with completion of any given type of schooling, the lower is the share of manual workers' children and the higher the proportion of non-manual strata in the student body.' [58]

The system has been highly unjust in other ways as well. The peasants and laborers did not only lose their lands, they also receive low prices for their products - prices determined by officials. In the Soviet Union and, for that matter, in the entire socialist world, incomes hardly conform to need.[59] Inequality in the USSR may be less than that in France and the Unties States but is certainly not less than that in Norway and the United Kingdom.[60] In fact Sweezy, himself a socialist, views Soviet society as containing large disparities in income and privileges.[61] Under these circumstances, even the use of force has been unable to induce the peasants and the workers to put in their best. Thus the system did not only abolish private property, it has become a great source of injustice to the proletariat producers, by paying the less, as well as the proletariat consumers, by not fulfilling three needs. The 'dictatorship of the proletariat' had to suppress the proletariat himself to 'cure' his alienation. Hence Sweezy was constrained to remark $t_h$at the Soviet Union has not lived up to the principles of a socialist society.[62]

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57 Cited by Russell Lewis, op. cit., p. 27, from Tabor Szamuely's postscript to Sir Tufton Beamish's Half Marx (London: Tom Stacey, 1970).

58 Yanowitch, op. cit., p.69.

59 Abram Bergson, 'Income Inequality Under Soviet Socialism,' Journal of Economic Literature, September 1984, p. 1052.

60 Bergson, op. cit., p.1092.

61 Paul M. Sweezy, 'Lessons of Soviet Experiences,' Monthly Review, November 1967, pp. 9-21.

62 Ibid.

2.2.3. Ineffective Strategy

The reason for the failure is evident. The goals were not in harmony with the underlying philosophy and strategy. The goals were humanitarian - a classless society where no one exploits anyone else, where everyone works for the social good, where needs are fulfilled, where there are no inequalities of income and wealth, and where there is hence no alienation. The underlying philosophy and strategy were however in conflict with these goals. They promoted dialectics - hatred, conflict and elimination - and transferred the management of all means of production in the hands of a privileged few. With the immensely increased power in the hands of a small proportion of the population, no motivating force to rein self-interest and serve social interest, and no socially agreed filter mechanism to guide decision-making, the system was bound to promote privileges and a power struggle to perpetuate these. Socialism had no mechanism other than force to rein human self-interest. The system was hence a non-starter from the very beginning.

Thus, while socialism provided a powerful critique of the capitalist system, it failed to provide a constructive and feasible alternative. After the destruction of the rich heritage of human values, all that has been achieved in a totalitarian state with all means of production under its control, no agreed criteria to guide state policies, no mechanism to restrain human self-interest, and all the power to be cruel, unjust and ruthless. It was wishfully believed that such a totalitarian state will ultimately wither away. How? It was not explained. If the bourgeoisie is not willing to yield power, will the proletariat do so after getting into positions of power, more powerful than those of the bourgeoisie?

The fact is that the state, far from withering away, became ever more powerful and an instrument of oppression in socialist countries; 'the society in balance with nature' could not come into being. The proletariat continued to be wage slaves. So what did they gain by the Marxist revolution - rise in their incomes? But so have they in the capitalist countries like the US, West Germany and Japan, substantially more than in Soviet Russia, Eastern Europe and China, although not as much as those of the bourgeoisie. Nearly all the lessons to be drawn from the socialist experience - economic inefficiency, bureaucracy hierarchy, despotism, and frustration of grass-roots initiative - are negative.[63] Thus, considered against the background of what socialism visualized, the results are no less than frustrating.

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63 See Alec Nove, The Economics of Feasible Socialism (London: George Allen and Unwin, 1983), p. 68 and back cover..

2.2.4. The Complexities of Reform

As a result of all these negative indicators, socialist regimes have been overthrown all over Eastern Europe. Only in China has the regime been able to survive the wrath of the masses so far, but by means of repression. Even in the Soviet Union, the leadership has been forced by circumstances to accept the vital need for political and economic reform - glasnost (openness) and perestroika."[64]

The problem, however, is that nobody is yet clear about the extent of restructuring necessary to enable socialist countries to realize their goals. It is being argued that the remedy lies in decentralization and reintroduction of private property and market mechanism into the socialist economics. While this is no doubt necessary, a number of issues closely related to this subject have not yet been clarified by both glasnost and perestroika. These are: the extent of decentralization, competition, price reforms, privatization and property rights that a socialist economy is willing to tolerate without changing its identity totally. While half-baked reforms and piecemeal changes may be ineffective, bold moves in the direction of capitalism would, giver the absence of background conditions, only aggravate the existing socioeconomic iniquities and lead to a permanent burial of the original raison d'etre of socialism.

The glaring question hence remains whether the patching to socialism certain elements of capitalism, which has itself failed, can bring about the kind of revolutionary restructuring that is necessary to overcome the prevailing economic problems and social unrest and to realize the professed goals of socialism. Unfortunately, the entire debate about restructuring the socialist economies in both the capitalist and the socialist intellectual circles reflects a lack of awareness of the dire need for a change in the socialist worldview. The role of moral dimension in motivation and socioeconomic restructuring does not even get a stray mention, as if it carried absolutely no importance.

It is not realized that if centralized decision-making and lack of private property and market-determined prices were the only factors responsible for shortages of need-satisfying goods and services in the socialist countries, the capitalist countries would certainly have been able to realize their goals. Needs cannot however be satisfied without an immensely larger allocation of resources

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64 See Mikhail Gorbachev, New Thinking for Our Country and the World (New York: Harper and Tow, 1987); see also Abel Aganbegyan, op. cit.; Anders Aslund, Gorbachev's Struggle for Economic Reform (London: Pinter, 1989); and A. Hewett, ed., Reforming the Soviet Economy (Washington, D.C.: Brookings Institutions, 1988).

for this purpose. The essential counterpart of increased allocation for need satisfaction is a substantially reduced allocation for some other purposes - defense, space programs, heavy industries, prestige symbols, luxuries and privileges of the elite, and numerous other economics sectors and geographical areas having an 'excessive' allocation of resources in the past.'

This reallocation is not an easy task. It requires not only socially-agreed criteria but also a strong motivation on the part of the privileged and the rich individuals or geographical areas to sacrifice. Why will they do so in a secularist society with only a short, this-worldly frame of life? If, however, the 'unnecessary' spending which is in conflict with need satisfaction is not reduced, then where will the resources come from? Monetary expansion? This will lead to the same excessive claims on resources and the associated macroeconomics and external imbalances that capitalism and the welfare state are facing. The magnitude of the problem may be appreciated better if the need for substantially reducing the already existing unhealthy fiscal deficits is also borne in mind. These have risen in the Soviet Union from under 3 per cent of GDP in 1980-85 to about 7 per cent in 1987 and 14 per cent in 1988.[65] How will these be reduced without hurting need-fulfillment, employment and growth? This crucial question remains unanswered. If heavy doses of borrowing are used to solve the problem, these countries may, after a few years, experience the same acute-debit-servicing problems that the heavily-indebted developing countries are now facing.

Thus the socialist countries have an impossible task before themselves - that of restructuring their economies to fulfill needs without a filter mechanism of socially agreed values, that of reducing budgetary deficits without generating unemployment and further reducing the rate of growth, and that of containing inflation in spite of introducing realistic prices in economies plagued by suppressed inflation. The introduction of realistic prices and exchange rates and the reduction of subsidies to lower the high budgetary deficits will mean the dismantling of the existing paternalistic system where retail prices bear no relationship with production or import costs, where cheap food, clothing and housing are at least theoretically assured, and where employment is supposed to be guaranteed. Realistic prices are bound to have an inflationary impact. If wages and pensions are not raised simultaneously, there will be a steep decline in the standard of living, particularly of the poor. This will create social unrest and political problems if glasnost is also to be maintained. If however, wages are raised with prices, then perestroika would not be effective. Perestroika would demand that wage increases not be guaranteed or uniform. They will have to be linked rather to labor productivity and enterprise

65 Ibid.

revenues. If this is done, then some workers will be affected more adversely than others by price and wage changes. This will accentuate the differences in real incomes and contribute to greater income and wealth inequalities, thus leading to social unrest, as it did in China. In a market system where such changes occur in small doses every year, they may not be noticed as much as they will be in a system where the errors of decades are designed to be rectified in a few years. Hence moral regeneration and socioeconomic restructuring are now more urgently needed by the privatizing command economies than any other economy in the world.

Moreover, the demand for increased efficiency cannot be meaningful unless the enterprises are also free to select the quality, quantity and sources of their inputs and also to hire and fire employees on the basis of their performance. The privilege of guaranteed market, which enterprises now enjoy, may also have to be withdrawn. This may increase the losses of many of them and lead to unemployment when they stop being paternalistic and fire employees in their quest for greater efficiency. Since the state enterprises are large, the problems resulting from the liquidation of loss-making enterprises will also be great, particularly unemployment. The socialist system is not geared to handle these problems resulting from the move toward the market system. Hence a program of partial restoration of the market is a contradiction in terms as long as the paternalistic goals continue. However, if these goals are abandoned along with central planning and collective ownership to realize greater efficiency then what is it that is left of socialism to identify it as a distinct system?

Even the question of privatization is fraught with serious difficulties. Since all nationalized property now belongs essentially to the people, transfer of property rights through privatization needs to be brought about in a just manner. There seems to be no clear-cut program for this as yet.

The program which seems to be gaining currency is the auction of shares of state-owned industries and farms. However, before such an auction can take place, there has to be a realistic appraisal of value. Such an appraisal is a time-consuming and difficult job in the absence of market-related prices and returns. Without such appraisal, the risks would be too great for those not having insiders' knowledge. Moreover, the auction of shares has the disadvantage of giving an edge to those who had amassed wealth during the socialist period; they are the ones who will be able to buy the shares. Hence, those who were privileged without ownership rights will now add another plume to their hats - that of ownership. So what will happen to the proletariat in whose name socialism was brought about and in whose name it is now being dismantled?

However, if the property rights are to be passed on equitably to the people, then the perplexing question is about how this should be done - who gets a share in what and to what extent? If the workers are to be given shares in farms and enterprises in which they work, how about those who are either not working or working in less fertile areas or enterprises that are, or will soon become, bankrupt. If coupons are to be issued to everyone to purchase, then privatization may have to wait until the appraisal of all salable enterprises and farms has been completed. But those who had amassed wealth in the past will again have an edge if they can use this wealth along with the coupons to purchase.

The social Darwinian weeding out process may also create problems. It has determined the make-up of socialist leadership over the last several decades and created a vested interest in the continuation of the existing situation. Officials of state enterprises may not be psychologically prepared to face the realities of market cooperation. The leadership may hence have to be ruthless to weed out inefficient managers. Since this may tend to create unrest and discontent, the leadership may try hard to pacify the vest interests to keep itself in power. Avoiding over-concentration of power, over-centralization of management, and diseconomies of scale, the major defects of socialism, will hence be an uphill task. 'Virtually everyone in the Soviet Union has an excellent reason to favor reform and an excellent reason to favor reform and an excellent reason to fear it.'[66] The power struggle that is bound to result between those who wish to cling to the existing privileges of power and the revisionists who cannot succeed unless such privileges are brought to an end could not but reduce the speed of reform and also blunt its effectiveness through inevitable compromises.

3.1. The Worldview

In contrast with the secularist worldview of the failed systems, the Islamic worldview is a balanced synthesis of both the material and the spiritual dimensions of life.[67] The synthesis reflects the belief that human beings cannot realize real well-being - well-being that would lead to their physical comfort as well as their mental happiness and tranquillity - until they have attained a balanced satisfaction of both the material and the spiritual needs of human personality. An undue emphasis on one at the expense of the other is bound to create misery in the long run. Islam also takes the position that it is not possible to utilize resources efficiently and equitably even in a material sense until a moral dimension is injected into all aspects of human

66 See 'Alas, Poor Perestroika,' The Economist, 24 September 1988, p.30; and 'Budget Perestroika,' The Economist, 8 October 1988, p.75.

67 See Frithj of Schuon, Understanding Islam, D.D. Matheson (London: Allen and Unwin, 1963).

activity, including the decisions taken in the market place and corporate boardrooms or the politburo and the Gosplan, and until the economy is restructured in accordance with the dictates of goal realization and moral values. Even the imbalances and instability cannot be minimized, crime, strife and tensions cannot .be reduced, and the different symptoms of anomie cannot be overcome.

The Islamic economic system has its roots in the *Tiara* 's which is based on belief in the One God, Who is the Creator of this universe and everything in it.[68] Human beings are His vicegerents and brothers unto each other. They are all accountable to Him for their life in this world, which is infinitesimally small compared with the Hereafter, their ultimate abode. The resources provided by Him are a trust and must be utilized in accordance with the terms of the trust.[69] These terms are defined by the values given by Him through His prophets, the last of whom was Mohammed, may the peace and blessings of God be on them all. These values place a considerable emphasis on socioeconomic justice without which the concept of brotherhood would remain meaningless.[70] Socioeconomic justice cannot however be meaningfully realized unless all the resources at the disposal of human beings are utilized efficiently and equitably to fulfill the needs of all and to bring about an equitable distribution of income and wealth. The Islamic economic system thus derives its goal as well as its strategy from the Islamic worldview, hence removing the possibility of a conflict between the two.[71]

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68 For a more detailed discussion of the concept of unity of God in Islam, see M. Nejatullah Siddiqi, ' Tawhid, the Concept and the Process,' in K. Ahmad and Z.I. Ansari, Islamic Perspective: Studies in Honor of Mawlana Sayyid Abul AI'la Mawdudi (Leiceser, U.K.: The Islamic Foundation, 1979, pp.17-33.

69 For a detailed discussion of the concept of property in Islam, see 'And al-Salam al-Abbadi, Al-Mmilkiyyah fi *al-Tiara's* al-Islamiyyah (Amman, Jordan: Maktabah al-Aqsa, 1975).

70 See Syed Qutb, 'Islamic Approach to Social Justice,' in Khurshid Ahmad, Islam - its Meaning and Message (London; Islamic Council to Europe, 1975), pp.117-30; Majid Khadduri, The Islamic Concept of Justice (Baltimore, Johns Hopkins, 1984); and Munawar Iqbal, ed., Distributive Justice and Need Fulfillment in an Islamic Economy (Leicester, U.K.: The Islamic Foundation, 1988).

71 For an introduction to some relevant aspects of the Islamic economic system, see, Monzer Kahf, The Islamic Economy: Analytical Study of the Functioning of the Islamic Economic System. M.A. Mannan, Islamic Economics: Theory and Practice (Cambridge: The Islamic Academy, 1986); M.U. Chapra, Objectives of the Islamic Economic Order (Leicester, U.K.: The Islamic Foundation, 1979); Islamic Economics Research Bureau, Thoughts on Islamic Economics (Dhaka: Islamic Economics Research Bureau, 1980); M. Akram Khan, Issues in Islamic Economics (Lahore: Islamic Publications, 1983); and Abdul Hamid Abu Sulayman, 'The Theory of the Economics of Islam, in Contemporary Aspects of Economic Thinking in Islam (American Trust Publications, 1976), pp.9-54.

3.2. The Strategy: Main Ingredients

Islam does not however depend merely on this built-in harmony between its goals and worldview for designing an effective strategy. It also specifies certain essential ingredients of the strategy and puts behind them the full force of its moral sanction to bring about the kind of socioeconomic and financial restructuring necessary for goal realization.

Islamic strategy consists of a set of four indispensable and mutually-reinforcing ingredients. These are:

a) a morally-based filter mechanism;
b) a strong motivating system to induce the individual to render his best in his own interest as well as in the interest of society;
c) socioeconomic and financial restructuring with the objective of realizing the desired goals in spite of scarce resources; and
d) a positive and strong goal-oriented role for the government.

It is important to see how these four elements of the Islamic strategy can help bring about the kind of allocation and distribution that goal actualization demands.

It is important to see how these four elements of the Islamic strategy can help bring about the kind of allocation and distribution that goal actualization demands.

3.2.1. The Filter Mechanism

The use of merely the price system as a filter mechanism frustrates, as already discussed, the realization of socioeconomic justice unless the background conditions are fulfilled. The unhindered individual preferences, reinforced by value-free advertising, create unlimited wants, while the highly skewed income distribution and access to credit enables the rich to transfer scarce resources for the satisfaction of their unnecessary wants. This does not only squeeze the resources available for need satisfaction but also widens the savings-investment and export-import gaps and worsens the macroeconomics and external imbalances. Reliance on merely the price mechanism as a filtering device may help restore, though not necessarily, an

equilibrium between demand and supply. If it does succeed, it does so primarily at the expense of the poor, who are unable to fulfill their needs at the resulting higher prices from the limited means they have at their disposal. Their well-being thus suffers.

Replacement of the decentralized filter mechanism of the market system by planning and state control makes the position worse. It makes the system despotic without introducing any improvement in goal realization. Centralizing control over the allocation of resources in the hands of a bureaucracy, which does not have an effective way of getting information promptly about consumer preferences and producer costs, makes the decision-making process cumbersome, slow and inefficient. The bureaucracy does not even have the socially-agreed values or a motivating system to ensure the well-being of all. The only criterion it has for allocation of resources is its own personal judgment which, without the help of both socially-agreed values and market signals, cannot ensure an allocation of resources that takes into account the relative scarcity of resources or the relative urgency of need satisfaction. Moreover, the powerful position of its members gives them all the leverage they need to serve their vested interest. The experience of centrally-planned economies has clearly shown that the resultant allocation and distribution of resources is neither efficient nor equitable.

The best strategy for injecting equity into the allocation of resources is hence not the removal of the decentralized decision-making process of the market. The decentralized system democratizes decision-making by enabling all individual consumers as well as producers) to participate. It also introduces greater efficiency ti enabling prompt decision-making in response to changing circumstances. It would rather be better to complement the price mechanism by some other device that would eliminate or at least minimize unnecessary claims on resources - claims that lead to imbalances and serve as an obstacle in the way of need fulfillment.

This Islam does by introducing another filter. Allocation of resources is to be brought about by a double layer of filters. The first filter attacks the problem of unlimited wants at the very source - the inner consciousness of individuals - by changing the individual's preference scale in keeping with the demands of both efficiency and equity. Islam makes it incumbent upon all Muslims to pass their potential claims on resources through the filter of Islamic values so that many of them are eliminated at the source before they are exposed to the second filter of market prices.

The moral filter does not permit material possessions and want satisfaction to become ends in themselves. Satisfaction remains a function of need fulfillment.

Self-display and vying with each other do not remain an admissible pattern of behavior.[72] If claims on resources are then passed through the second filter of market prices, unnecessary claims can be more effectively eliminated or minimized. If the banking system is also made to play a complementary role, it does not remain possible for the productive machinery of the economy to get directly or indirectly moved toward the satisfaction of a maximum amount of wants. The influence that wealth and power are able to exercise in the allocation and distribution of resources is thus substantially reduced. By thus confining claims on resources to the limits of need fulfillment, it becomes possible not only to minimize imbalances but also to use resources both efficiently and effectively.

One of the basic issues of every society however is, who is capable of providing such a filter mechanism? Must a moral code have a Divine Origin and must it be backed by belief in accountability before God? The Islamic view, as that of other major religions, is that Divine sanction and belief in life-after-death are both necessary. The reasons are not difficult to understand. Firstly, the Divine sanction makes the rules of behavior absolute and beyond dispute. Without the Divine sanction, they become the subject of personal judgment and dispute as happened in the West after its secularization, until their value came to be questioned altogether.[73] After their extensive but deep study of various civilizations, the Durants have drawn a very important lesson from history that: "There is no significant example in history before our time, of a society successfully maintaining moral life without the aid of religion."[74] Secondly, who among human beings could be absolutely impartial and totally committed to the well-being of all? If human beings were to try to develop these norms themselves, there would be a natural tendency on their part to frame norms that are skewed in favor of the powerful and the vested interests and not capable of serving the well-being of all. Even the slightest doubt about impartiality would negate the chances of a consensus. Thirdly, human beings do not have the knowledge to assess the effects of their actions on other human beings, especially those more remotely affected by them . For this, if for no other reason, they need a well-meaning and knowledgeable outsider to provide them with rules of behavior that can save others form the adverse affect of their actions. Fourthly, the Supreme Being Who

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72 For a discussion of the Islamic consumption norms, see, Anas Zarqa,, 'An Approach to Human Welfare,' and Monzer Kahf, 'A Contribution to the Theory of Consumer Behavior in an Islamic Economy,' in Khurshid Ahmad, ed., Studies in Islamic Economics (Leicester, U.K.: The Islamic Foundation, 1980), pp-3-18 and 19-36).

73 J.G.de Beus, Shall We Make the *year* 2000?: The Decisive Challenge to Western Civilization, (London: Sidgwick and Jackson, 1985), p.71.

74 Will and Ariel Durant, The Lessons of History (New York: Simon and Schuster, 1968), p.51.

has created human beings is alone capable of understanding fully their nature, their needs, their strengths and their weaknesses and of serving as the Sole Guide and the Only Source of all values. In His Infinite Kindness He has not left human beings to grope in darkness. He has provided the needed Guidance through a chain of prophets starting from Adam himself – Guidance that can ensure the well-being of all.

Within the context of this logical framework, Pareto optimality is inconceivable. Pareto optimality can be in harmony with only that system which glorifies individualism and self-interest and sanctifies the status quo. It is no doubt in conflict with Islam which attaches primary importance to social responsibility and well-being of all. Values define the terms of reference for all human beings. They have all to act in conformity with these values to actualize the desired goals. Collective value judgments are accordingly indispensable and any attempt to refrain from making such value judgments is bound to create confusion and chaos and frustrate the realization of universal well-being.

3.2.2. Right Motivation

Efficiency and equity cannot be realized by merely having a proper filter mechanism. It is also necessary to motivate individuals to act accordingly. Capitalism assumes that self-interest will induce an individual to maximize efficiency while competition will serve as a constraint on his self-interest and help safeguard social interest. A .harmony will thus be brought about by the market system between self-interest and social interest. Socialism did not agree. It did not trust the individual and assumed that the serving of self-interest by him would necessarily hurt the social interest. Therefore, it condemned private property and serving of self-interest and establishes strict state control over the allocation and distribution of resources to safeguard social interest.

Serving of self-interest by individuals is not necessarily bad. It is rather necessary for human development and an economic system cannot be successful in realizing efficiency unless it allows individuals to serve their self-interest. Serving of self-interest becomes socially destructive only if it crosses certain limits and individuals are not willing to do things that need to be done for creating a society which has brotherhood and socioeconomic justice as its central objectives. However, while a rational individual would in any society be normally willing to render his best in his self-interest, if he is able to get an adequate reward for his contribution, the question is: what would motivate him to work in the interest of society? Why should a consumer hold his claims on resources 'within

the limits of humanity' and make sacrifices for others and why should a businessman not try to stifle competition or use questionable means to enrich himself. This is where the concepts of accountability before God and life-after-death become indispensable.

Self-interest restricted to the confines of this finite world is bound to cultivate the evils of greed, unscrupulousness, and disregard for the interest of others. 'Whenever they get a chance', observes The Economists, rational economic agents try to benefit themselves at the expense of everybody else. So, for many kinds of slipover a market solution is frustrated by the very force that usually makes market work'.[75] Self-interest cannot motivate individuals in a secularist, this-worldly society to fulfill their social obligations conscientiously except where doing so contributes to their this-worldly benefit. Pareto optimality is hence the only logical behavior norm for such a society, irrespective of whether it is capitalist or socialist. Pareto was not wrong within this-worldly framework in which his mind worked, like that of all other secularists.

Capitalism thus does not have an effective mechanism to motivate an individual to work in the interest of society unless the interest of society is served automatically by the serving of self-interest. Since the two interests are not necessarily harmonious and since the background conditions are not satisfied, reliance on the price system alone has made capitalism inequitable. Socialism is even worse. By preventing the individual form serving his self-interest, it has deprived itself of a mechanism to motivate the individual to work efficiently. Moreover, its this-worldly perspective does not even provide the individual with a motivation to work in the social interest. Hence socialism has failed to realize both efficiency and equity.

If, however, the dimensions of accountability before an All-Powerful Being, from Whom nothing can be hidden (Qur'an, 5:3),'and a life-after-death are introduced, another kind of rationality is created. These beliefs provide an entirely different perspective to individual and social thinking, attitudes and behavior. They supply a powerful motivating force for socially-oriented action by giving self-interest an infinitely longer perspective. They imply that an individual's self-interest is not served only by improving his condition in this world but also in the Hereafter. Hence, if he is rational and aspires to serve his self-interest, he will not act merely for his short-run, this-worldly well-being, but will also try to ensure his long-run well-being by working for the welfare of others through a reduction in his

75 Schools Brief,' The Economist, 13 December 1986, p.83.

wasteful and unnecessary consumption in spite of his financial ability to be profligate, and using a part of his income and wealth for helping others (through *Zakah, sadaqat, awqaf* and taxes). The resources which are released by economizing can be diverted to investment, job creation, and increased production and distribution of need-fulfilling goods, thus serving the interest of the poor. Similarly, the belief that life in this world is infinitesimally small compared to that in the Hereafter can prevent a businessman from enriching himself through questionable means, thus helping others by not shrinking their frontiers . of opportunities and depriving them of their independent means of living. These beliefs thus carry the potential to provide an effective mechanism to motivate an individual to respond to the questions of what, how, and for whom, in such a way that allocation and distribution take place in accordance with the dictates of general well-being.

While Islam provides a longer-ruin perspective to human action, it does not ask individuals to neglect their self-interest in this world. This would not have been practical. Any value system that does so cannot work. Islam in fact encourages an individual to satisfy all his essential needs to remain physically and mentally healthy and efficient to be able to perform his responsibilities towards God, himself and his society and to develop his total potential. There is no point in shunning the good things that God has provided (Qur'an, 7:32). However, since resources are limited, it does not befit him, as vicegerent of God, to go to the extreme of becoming an economic man and ignoring the well-being of others. As Alec Nove has rightly remarked, 'Societies concerned only with profit will fall to pieces. Corruption in the literal and the figurative sense can flourish where the making of money becomes the primary aspiration, the dominant criterion of success.[76] Joseph Schumpeter also remarked that, 'No social system can work which everyone is supposed to be guided by nothing except his own short-run utilitarian interest.[77] It is absolutely necessary to create a balance *(mizan* in the terminology of the Qur'an, 55:7-9) between individual and social interests for ensuring social well-being and continued development of the human potential.

What Islam has done to create such a balance is to provide a spiritual and long-run dimension to self-interest. The individual must look after his interest in this world, which is infinitesimally short, as well as the Hereafter, which is eternal. While the interest in this world may be, though not necessarily, served by being selfish and unscrupulous, the interest in the Hereafter cannot be served except by

76 Nove, op.cit., p.7.
77 Joseph Schumpeter, quoted by W. Brus, Journal of Comparative Economics, vol. 4, 1980, p.53.

fulfilling one's obligations towards others, without resorting necessarily to self-denial. The belief in accountability before an All-Powerful and All-Knowing Being can thus play an important role in keeping self-interest within bounds and generating social welfare-oriented behavior. State regulation, although necessary, cannot by itself perform this function because the chances of being detected by the state are not fool-proof and there are possibilities of escaping the adverse consequences of official prosecution through bribing or the use of one's political leverage.

Thus, Islam recognizes, while socialism denies, the contribution that the serving of individual self-interest through profit and private property can make towards individual initiative, drive, efficiency and entrepreneurship. Islam, however, overcomes the evils of greed, unscrupulousness and disregard for the rights and needs of others, which the secularist and short-run, this-worldly perspective of both capitalism and socialism can promote. This it does through the internal self-regulating mechanism instilled in the inner consciousness of the human being himself, with its unrelenting emphasis on belief in accountability before God, human brotherhood and socioeconomic justice. This structure of beliefs can provide a strong motivating force to prevent individuals from pursuing self-interest beyond the limits of social health and well-being.

Competition and market forces are no doubt indispensable for the valuable contribution they can make towards efficiency of the allocative machinery. But these must operate within the constraints of the filter mechanism of moral values if the realization of social goals is to be ensured. Only within these constraints will competition be 'healthy' and market forces 'humane'. Neither competition and market forces nor central planning and regimentation have the potential to instill in human beings the powerful motivating force for equitable use of scarce resources that the belief in accountability before God has. While in both the capitalist and the socialist systems, the powerful and vested interests have no mechanism instilled in their inner consciousness to prevent them from manipulating policies and resources to their undue advantage, or to regulate their spending in accordance with the dictates of social well-being. In the Islamic system, as in any other effective religious system, they would be strongly motivated to do so. If they do not they will be acting against their long-run self-interest.

3.2.3. Socioeconomic and Financial Restructuring

Both the filter mechanism and the motivating system may become blunted if the social consumption pattern, government policies (particularly those related to taxation, expenditure, saving and investment, exchange rates, and trade and

development), and financial intermediation are not geared to goal realization. Hence the first two ingredients of the strategy must be reinforced by a third ingredient - socioeconomic and financial restructuring - to create a proper socioeconomic and policy environment.[78] The absence of such restructuring would not only promote consumption, discourage saving and investment, and accentuate inequalities, but also exacerbate the existing macroeconomics and external imbalances through greater resort to deficit financing, credit expansion and external debt.

It would not be possible to attain such a thorough restructuring by means of random or *ad hoc* measures or by relying merely on the price mechanism. It would rather be necessary to take effective measures addressed to:

a) Invigorating the human factor by motivating and enabling him to perform consciously the tasks needed to be performed not only in the interest of his own well-being but also that of his society;
b) Reducing the existing concentration of wealth and ownership of means of production; and
c) Reforming all social, economic and political institutions, particularly public finances and financial intermediation, in the light of Islamic teachings, to help minimize wasteful and unnecessary consumption and to promote investment for need-fulfillment, exports and increased employment and self-employment.

The human factor cannot be invigorated to perform its socioeconomic obligations conscientiously merely by moral reform, even though this is indispensable. Moral reform must be reinforced by socioeconomic justice, which it is not possible to actualize without enabling the poor to be more productive and to get a just reward for their contribution to output. This demands easier access to better education, training, and investment finance, and removal of all other sources of economic distortions, exploitation and inequities.

It will not be possible to reduce the existing concentration of wealth without tilting the balance of government policies in favor of socioeconomic justice. The power centers in society must be diluted by removing or substantially reforming policies that give an undue advantage to big landlords and large businesses. It is also necessary to place greater emphasis on agricultural and rural

78 For a great discussion of the needed socioeconomic restructuring and its policy implications, see Chapter 6 of the author's forthcoming book, Islam and the Economic Challenge.

development in government policies, to implement land reforms, and to promote a broad-based ownership and control of corporations. Proliferation of small and micro enterprises in both rural and urban areas should help not only in weakening the power centers but also in promoting greater competition, and expanding employment and self-employment opportunities. The preferred goal should be to make income-caring opportunities available close to where people live to avoid hectic and unhealthy urbanization. Implementation of the Islamic institutions of *Zakah, sadaqat, awqaf,* and inheritance is also indispensable.

To reduce consumption and raise savings, it is necessary to inculcate simple living in conformity with Islamic norms and to undermine the unhealthy influence of Western consumer culture and social customs and ceremonies. All these socioeconomic goals cannot be realized merely by means of controls. Controls do not normally work. They accentuate corruption and frustrate grass-roots initiative. Socioeconomic and institutional reform must generally replace the existing tendency of heavy dependence on controls. This is where the injection of a moral dimension in socioeconomic policies becomes imperative.

To promote investment, government policies must be oriented toward freedom of enterprise within the constraints of Islamic values. The policy should be to remove red tape and to encourage and facilitate all economic activity that contributes to goal realization without violating Islamic values. Government taxation and expenditure policies should also be streamlined to promote saving and investment, to realize socioeconomic justice, and to reduce unhealthy budgetary deficits'[79]

Since financial intermediation plays a crucial role in the allocation and distribution of resources, the needed economic restructuring for greater efficiency and equity may not materialize if the conventional financial system continues undisturbed. It must be replaced by a system of financial intermediation based on profit-and-loss sharing, which would force financiers to give greater weight to the ultimate use of credit and the strength of the project and thus make a greater contribution to goal realization. Even the entrepreneurial talent among the poor would thus be harnessed by reducing the weight of collateral in financing and

79 For issues related to fiscal policy in an Islamic economy, see Ziauddin Ahmed, M. Iqbal and M. Fahim Khan, eds., Fiscal Policy and Resource Allocation in Islam (Islamabad: Institute of Policy Studies, 1983).

raising oat of the nature of the project and its profitability and contribution to society.[80]

Some important elements of the needed economic and financial restructuring constitute an integral part of a Muslim's beliefs. His fate in the Hereafter depends on faithful compliance with these. The other elements are or can be, logically deducted from Islamic values. The motivation to comply would thus be stronger. The restructuring in an Islamic economy is hence likely to be more successful than any counterpart in a secularist environment or a religious system not concerned with socioeconomic restructuring. Once such restructuring has been effectively enforced, the resultant system should be different in a revolutionary way from both the market system and socialism.

3.2.4. Role of the State

Such a comprehensive restructuring designed to actualize the desired goals and to minimize the existing imbalances may not be possible without the playing of an active role in the economy by the state. 81 This is because even in a morally charged environment it is possible for individuals to be simply unaware of the urgent and unsatisfied needs of others or to be oblivious to the problems of scarcity and to social priorities in resource allocation. Under such conditions, moral uplift and the price system, no matter how indispensable, cannot be sufficient to realize the kind of restructuring needed for equity as well as efficiency in the allocation and distribution of resources.

The role of the state in an Islamic economy is not, however, in the nature of an intervention, which is an unsavory therm and smacks of an underlying commitment to laissez-faire capitalism. It is also not in the nature of the secularist welfare state which, through its anathema to value judgments, accentuates claims on resources and leads to macroeconomics imbalances. It is also not in the nature

80 See Ziauddin Ahmed, M. Iqbal and M. Fahim Khan, eds., Money and Banking in Islam (Islamabad: Institute of Policy Studies, 1983), and M. U. Chapra, Towards a Just Monetary System (Leicester, U.K., The Islamic Foundation); Mohsin S. Khan and Abbas Mirakhor (eds.), Theoretical Studies in Islamic Banking and Finance (Houston, Texas: The Institute for Research and Islamic Studies, 1987); and M. Ariff(ed.), Monetary and Fiscal Economics of Islam (Jeddah: International Center for Research in Islamic Economics, King Abdul Aziz University, 1982).

81 See the author's The Islamic Welfare State and its Role in the Economy (Leicester, U.K., The Islamic Foundation, 1979) for a more detailed discussion of the obligations, strategy and functions of the Islamic state.

of collectivization and regimentation which suppress freedom and sap individual initiative and enterprise. It is, rather, a positive role - a moral obligation to perform a mission in compliance with the Divinely-bestowed filter mechanism - to keep the economic train on the agreed track and to prevent its diversion by powerful vested interests. The greater the motivation people have in implementing Islamic values and the more effective socioeconomic institutions and financial intermediation are in creating a just equilibrium between resources and claims and in realizing desired goals, the lesser will be the role that the state may be required to play in the economy.

While Islam recognizes individual freedom and the role of price mechanism in promoting efficiency, it does not give any sanctity to market forces. The blind operation of market forces does not automatically reward socially productive effort, curb exploitation or help the weak and the needy. It is therefore the responsibility of the state to ensure realization of the desired goals. The Islamic state would not resort to the use of force to realize its goals, nor would it depend on owning and operating a substantial part of the economy. The abolition of interest would not permit this. It would rather try to motivate and help the private sector play its role effectively within the constraints of social well-being. For this it would have to rely on raising the moral consciousness of people, accelerating social, institutional and political reform, and providing incentives and facilities. It would have to create a proper framework for the interaction of human beings, values and institutions for the realization of goals.

The state could do this more effectively through a long-run strategic policy plan which would enable it to take a realistic account of all available physical and human resources and to establish, in the light of this, a set of well-defined priorities. This will help provide a clear direction to government policies and expenditure programs and initiate effective measures for setting in motion the required structural and institutional reforms to enable the government and the private sector to cooperate in using scarce resources with optimum efficiency and equity for accelerated attainment of socially-desired goals.

3.3. Epilogue

The Islamic strategy thus humanizes the operation of market forces and realizes the advantages of the market system without being encumbered by its iniquities. This it does by creating a balanced synthesis of the spiritual and the material. The injection of a moral dimension into the inner core of human consciousness helps promote the peace of mind, which is indispensable for

creating inner happiness but to which secularism does not even aspire. The Divine origin of goals and values makes them unquestionable, thus increasing the chances of reaching social consensus on priorities in resource use. Recognition of the important role that private enterprise can play in individual initiative and drive makes it possible to realize greater efficiency. Awareness of the trust nature of resources and the unavoidable accountability before God makes it possible to motivate the individual to give a greater weight to social well-being in his decisions and to eliminate, or at least minimize, wasteful and conspicuous consumption even before the demand for this gets an expression in the market place.

If the price system with its decentralized decision-making then takes over, the allocation of resources can be efficient and equitable. The use of a double layer of filters (moral values along with the price mechanism) should help not only reduce aggregate claims on resources but also make possible the allocation of a greater proportion of resources for need satisfaction and investment. This should help accelerate growth, contain inflationary pressures, promote exports, and minimize the external imbalances and the currency depreciation that are pestering most developing countries. If these are further reinforced by the various Islamic redistribution schemes, there will be a greater chance of ensuring the well-being of the poor and low-income families in spite of the resource constraint.[82] The resort to Islamic financial intermediation should further boost the realization of both efficiency and equity.

However, even a moral system may tend to be ineffective if it is not accompanied by socioeconomic restructuring. But socioeconomic restructuring could be introduced more effectively if the moral dimension is injected into the society and the government also plays an effective role. The government could do this more effectively by resorting to strategic policy planning, which would enable it to assess the economy's resources and needs and determine the extent of changes needed in consumption and investment patterns of both the private and-the public sectors. Social, institutional and structural reforms could then be designed to create a proper climate for realizing need-fulfillment and equitable distribution of income and wealth.

Egalitarian policies, if they are followed within the perspective of the Islamic motivating system, are not likely to meet with the same kind of resistance from the rich that they would in a socioeconomic system committed to Pareto

82 See M. Anas Zarqa, 'Islamic Distribution Schemes', in M. Iqbal, op. cit., pp. 163-219. 184

optimality. They should also help dampen socioeconomic unrest and political instability and contribute to higher growth. A better fed, healthy, and properly educated and motivated population cannot but improve the quality of the work force in countries where serious consumption deficiencies and health and educational impairments are holding down the quality of work. Greater social and economic equality along with need fulfillment and moral uplift should also help reduce crime and social tensions.

The inability of the prevailing economic systems to provide even the material ingredients of human well-being, and the fruitlessness of introducing cosmetic changes in these systems or of fine-tuning them, decidedly point towards the need for a new economic system. The economic system of Islam has the potential of responding effectively to this need. It is capable of providing not only the material ingredients of human well-being but also the spiritual ingredients without which it is not possible to realize inner happiness and tranquillity. However, unless the Muslim countries themselves implement the Islamic system and practically demonstrate its great potential, it cannot serve as an example which other countries, and particularly developing countries, may follow.

"O you who believe, Respond to God and His Messenger when He calls you towards that which will give you life."

(Qur'an, 8:24)

"*O* you who believe, Why do you say that which you do not act on. It is most deplorable in the sight of God that you say what you do not do."

(Qur'an, 61:2-3).

DISCUSSION

Question

What is the difference between Islamic state and welfare state?

Chapra

The Islamic government has a role to play in the economy of the nation, and it is an important role especially in case of market failure but it will not be a welfare state. The idea of welfare came as a result of a crisis situation in the western culture during the world war. The sufferance of the poor and destitute was responded to by inventing a new welfare role of the state, instead of restructuring the socioeconomic system in such a way as to create an internal mechanism for eliminating poverty. Thus a welfare state is a state that produces a larger number of public goods by taking into its fold certain goods previously known as private. For instance, health service is provided to everybody rich and poor without any discrimination on the basis of need. The result is a loss in efficiency in health services provision because of lack of incentive on the part of both producers and users of these services as we see it in England and Sweden. Everybody complains about this, still they are not willing to restructure health facilities so as to provide its services to the poor alone. Hence, with smaller resources you can give quality health care to a larger number of poor people instead of offering it to the poor and the rich alike.

The same thing happened in education, all rich and poor get free education, although rich people can afford to pay for their children's education and it is their responsibility to do so. This business of taking charge of private goods' production without distinction between the rich and the poor got the welfare state into series of difficulties, because public expenditures have increased too much beyond bounds, and the imbalances are now bothering. Wherever one goes in welfare states countries, one finds the same difficult situation of imbalances and disequilibrium that caused increases in the rate of inflation. This has reduced competitiveness in the international market and placed several countries face to face with efficiency problems. Thus forcing them to cut on the facilities to the

poor and to get rid of these nationalized services and reorganize them in a way so that less benefits are given to the rich and poor alike.

This is by definition a failure of the welfare state and a step in the direction of formulating the state's functions closer to the teaching of Islam.
Comment

Thank you very much Chapra. I remember one university I do take liberty of telling to you in 1975 and 1976 I did development course in Cambridge University. Abdulfadil of Egypt was one of our teachers there. He used to deliver lecture on economics. One day I asked him what about Islamic economics this sort of thing and Fadil told that when you have come here forget everything about our Islam. May be Islamic economics in books but not in practice, not heard in this university or anywhere else. That hurt me very much as you can very well understand. I was feeling always that pain. Since yesterday I am relieved of that pain. We have seen Islamic economics not only in books, but in practice and also presented by scholars like Chapra. Thank you very much Chapra, due to endeavor of scholars like you and others that Islamic economics has come into practice. I am very much happy to note with this observation that failure of socialism does not necessarily mean the success of capitalism. It is very much apprehended that capitalism has the substitute of socialism but we have to propagate this in all possible quarters that capitalism has not succeeded in the face of failure of socialism. We have got a number of questions here and Chapra would kindly give the answer.

Question

Br. Abdul Awwal Sarker asks whether brotherhood does not mean that resources should be distributed properly among the Muslim countries In this connection, a question arises whether the rich Muslim countries are acting in accordance with the Islamic regulations? If not, why. Explain this?

Chapra

I would say that brotherhood does not mean that resources should equitably be distributed among the individuals in society. But of course you can apply it to nations and there are many reasons why they are not equitably distributed in any specific society. Something is of course from God. Saudi Arabia has larger oil reserves and because of that it is able to earn more. You

cannot blame it for that. But *of* course, there is less cooperation between Muslim countries to bring about a better distribution. This is something that all are to work towards. There is a number *of* factors to explain this and I don't have to go into their details. You know that SAMA pumps a great amount of cash (foreign currency) to the IMF. Is it not justified to divert these deposits to the central banks of the Muslim countries to enhance their international reserves ?

Let me ask one very simple question. I mean within the prevailing conditions in Bangladesh if you have money where you will invest ? Will you give to those people whom you feel they will not be able to return it to you? Whereas you have earned money in a lawful manner and you like to use it first of all with the intention that your money should be safe and that will also give equitable return on it. Now the problem is that in Muslim countries, in all countries, whether Bangladesh or Pakistan or Egypt, the policies pursued by the governments are so unhealthy in a way that they will not be able to return this money, i.e., we have to blame ourselves.

I am talking about the Islamic system too. There has to be proper socioeconomic restructuring in a society to enable the Islamic values to operate. Without that, the filter mechanism, motivation and the government will be ineffective. So in relation to countries, also there has to be socioeconomic restructuring in a way that will induce the richer countries to invest in the poorer countries instead of investing abroad. At the moment, the thing is that what is invested abroad is safe at least; of course it is not safe in a way, because it can be frozen. Iran has a very bad experience in this regard and a number of other countries have seen that whenever we do something against their interest our assets will be frozen. So our assets are not really safe. But how do we realize it? I mean if we start Islamic teaching in a proper way. Let us take the example of Sudan. Sudan can become the great basket of the entire Middle East. It has very fertile land and very active population which can be used for that purpose. But this potential in Sudan is unmaterialized. Why? because the rich countries are not able to invest there, why? Because there are certain problems in Sudan itself and you cannot blame just one country.' We all are to blame for this. Until we organize ourselves in a proper way and set up a proper framework we will not be able to benefit from our own wealth.

How the moral filter can be developed in the face of unemployment which is leading inflation or prices up. The thing is that first of all, proper government policies are absolutely necessary. I indicated that one of the primary things to be done in socioeconomic restructuring is government's legitimacy; and this is what

we have missed in our societies for a long period of time. There were military dictators who were wasting the resources of the countries on wrong pursuits. So there is poverty and we ourselves are to be blamed. You cannot start just with one thing. The economic system of Islam has to be adopted as a whole including the political aspects and the creation of political legitimacy in Muslim countries. Socialism is now under oxygen, it is sadly going to die. By-polar world is coming to a one-polar world. It indicates that capitalism is getting itself as the only dominant power in the world. In this situation to attract the world to Islam, what action should be taken by Islamic intellectuals ? The important thing is to explain Islam; and Islam is so attractive that if you put it across to other people in a logical rational manner it is bound to attract their attention. You can see over the last two decades or so that Islamic economics started to be known more and more and a number of books and articles have been written. These have attracted some attention that are being drawn towards it. How a revolution comes; not the bloody revolution of Marxist style but a peaceful revolution of Islamic type comes by conviction; and the more we work hard to convince others the sooner the Islamic system will come into existence.

Question

There is question by Ferouz Qureshi: Our Prophet said that Poverty is my Pride. In this saying what is the meaning of poverty. Please define the concept of poverty.

Chapra

Well, of course, while the Prophet said this he also said that *Hadith.* Poverty can take you to disbelief. So both things are there. When he says he takes pride in poverty it means simple living, not being very conscious about material possessions, and material show-off. The Prophet lived a very simple life. If we all live simple life like the Prophet, saving in our society will be higher and we will be able to invest more. We will be able to increase our productivity, reduce our imbalances, reduce inflation, and prevent the depreciation of our currency that is taking place. So this is enough. It does not mean that we should all remain poor. No, we should be absorbed by simple living but still work for the material welfare of all our brothers and should like to eliminate poverty from the society.

Question

Mr. Ishaque Ali Chowhdury - Please allow me to speak about some observations. Can the Islamic system replace socialism now ? Can Islamic system meet the challenge from capitalism in the contemporary situation?

This is what I was talking about. Rest may be I have shown that Islam is the only solution. The only system which can realize the goals of society is Islam. Now it is up to us to implement it; but if we want to sleep all over; nobody can do anything.

Question

Md. Farouki asked, shall we give more importance to social interests?

Chapra

This is not right. Did I say in any part of my lecture that social interests would be more important than self-interest? All I am saying is that Islamic values provide a certain framework for serving our purpose, and we cannot exceed the bounds, and we have to try to serve our self-interests in a certain manner. Self-interest is very important because even the life-after lies in our self-interest whether we want to be well off in the hereafter or not, this is our self-interest. What actually Islam has done is that it has included social interest in the parameter of self-interest. In other words, within the Islamic framework if you serve your self-interest you will be automatically serving social interest. I am not saying you should not serve interest but what we have said is that by introducing the concept of hereafter and accountability before God - what we essentially are doing is giving self- interest a longer-term perspective. Such that if you serve your self-interest within this framework you will automatically serve social interest. But if you serve self-interest within the perspective of Adam Smith, you will not be serving social interest in all cases. You will serve social interest only in those cases where self-interest and social interest are in harmony. Should there be a conflict, the social interest will suffer. Whereas in the Islamic perspective, in both cases, we will be serving social interest as well as self- interest.

Chapra

There is no question, but I would like to add that Islamic economic system is based on the vision of creation of man. The nature of man in Islam is that he was created in the *fitrah* of God. In other words, he is not a born sinner in the Christian framework. In Islam he is essentially born good; by *fitrah* he is good.

Of course, you will say how he becomes bad. This is the same way my mother, suppose I was small, gives me a white shirt and tells my son this is the white shirt you keep it white. She understands that the shirt is white and she wants me to keep it white and I can be responsible for that. But instead if she says this is a dirty shirt, keep it clean. This is not possible.

So if man were a born sinner, that means he was born with a fault, but the Islamic concept is different on that; and that is the strength of Islam. An Islamic social scientist is not deterministic. Most of the western social sciences are determinist in their approach; whether it is economics, sociology or other social sciences, they are all deterministic in their approach; i.e., the social factors influence men and take them in a certain direction. Man has no personality of his own. This is the conclusion you get. But this is not the case in Islam. Of course, society affects to a certain extent. In other words, I am as an individual able to do many things in spite of the wrong social influence. If I want, I may not be worst off because society is bad. When we talked about socioeconomic restructuring, I emphasize this. There are individuals you cannot expect them to do many things unless the social environment is congenial. You have to change that.

Question

Talking about Islamic strategy in solving economic problems. May I please know what possibility exists within the realms of the IDB for loan, etc.?

Chapra

This is a question you have to direct to the brother from the IDB. I am not a part of IDB. I work for the Saudi Arabian Monetary Agency and the question asked is ruled out.

Question

Your system of Islamic economics seems to be a static one. This is just a playing upon words. The dimension is static or is it dynamic as any system in society is dynamic ? Static is a construction of the intellectuals. In other words, because you deal with dynamics you get involved in so many different variables so you cannot involve in seeing the technology to overcome resources constraints.

Chapra

No, when we say that resources are limited this does not mean you cannot increase resources. I mean when economists talk about resources being limited it does not mean you cannot increase them. But you keep on increasing them, and still in terms of want,, they are limited; there are too many wants compared with the limited resources. You have to create an equilibrium between the two, but the increase in resources is going to take a halt at a certain level. I mean you talk about economic growth. I mentioned about this thing, growth and stability. When we talk of growth we are increasing the resources of the society. But this comes gradually over a number of years may be 5% or 6% per annum, if Bangladesh can attain such a growth rate it will be very good. But what would that mean in terms of the need to mobilize resources for realizing this goal.

Question

You have not said anything as to how to accelerate the standard rate of economic growth in the Islamic countries?

Chapra

There is no discussion on international cooperation because naturally I do not talk about many things, just no economic development nor international economics. I did not talk about public finance, I did not talk at length about the role of the state, I did not talk about labor economics, I did not talk-about taxation and government expenditure and debt management etc.. Naturally I was talking about economic system as such you mentioned these things because your concern is to focus on certain central idea. If you get into too many things, you loose the focus and the listeners will be confused. So there is no doubt-you are right. These issues should be talked about. These are very important areas, I agree with you.

Question

Thank you Mr. Chairman. It seems to me that the speaker this morning has presented very enlightening speech on the basis of a particular model. In this matter it seems homo-economics is assumed in conventional economics rather than the ordinary type of man. The operation of the Islamic economy is conditional upon the relation of the Islamic man. Now the Islamic man or Islamic usual man will always be minority as you can imagine in the foreseeable future. In such a situation, I wonder if Chapra gives further touch. The scope of operation

of such people who can be described as Islamic-economics. How to ensure that they have more influence and they gain in terms of the society in the face they can influence the people who are just ordinary or even who are ignorant about Islam. Possibly in modem times, we could have a sort of simulation of such a model in computer and the further enlightments. I would suggest that this sort of analysis could be taken up for some sort of simulation study with the help of computer and possibly Chapra could further enlighten us by incorporating in his lectures the operation of such a simulated model.

Chapra

Is it true that the people who stand for this model are few ? Motivation has in any society always a few individuals. When the Prophet (Pbuh) started his *Da 'wah,* he was alone; but he was able to assimilate a few other people with him and gradually it increased and revolution came. So the fact is that as conviction spreads, we talk about the increased conviction in the people, and as we do this more and more, automatically the change will come about in society and people who are opposed to the system will get converted or they will be thrown out by society. You can imagine the Prophet's (Pbuh) society; so many people who were deadly opposed to Islam - what happened to them ? Some of them were finished and others got converted somewhere at a very late date in the future but nevertheless, the revolution came. Marx got up as an individual, and he placed something of course. Socialism had existed even before that, but Marx's approach was different. Gradually he was able to win a number of people and Marxist revolution came and it has now ended.

Islam still continues and even the capitalist system which was opposed by so many people but Adam Smith came and showed that self-interest and social interest are coherent and his system extended and now it is all over the world but we see this is also coming to an end. We should realize its course and we are to work hard. They can work in the interest of their system and we are to work in our system too. We must realize that devil never rests alone. In our axioms we learn that we should always be working very hard and if you want to beat the devil we are to work harder. If the devil never rests we must never rest too if we want to conquer him.

Question

Mr. Shamsul Alam: Strategy requires dealing with unfavorable-aspects of a problem. The actual process of attaining the objective is tactics. The economic system in Islam has been infected with un-Islamic characters to such an extent that

it calls for a positive direction of tactics for attaining the economic strategy. Could you please through some light particularly in the light of conditions obtaining in Bangladesh ?

Chapra

First of all, the question of the use of word tactic or strategy. I don't mean using the word tactic. If you feel that this is a proper word I won't quarrel about the use of a specific word which has a very poor appealing to our brothers, they can use it. If I talk about the Islamic tactics, then, of course, it is a way of trying to bring about the realization of social goals but how would you implement this in Bangladesh. I am afraid, I cannot talk about this. There are brothers more enlightened than me on problems faced by Bangladesh and how to apply Islamic teaching in this country. They could talk on the subject as they would be more enlightened than me.

Question

The question is about filter mechanism from Br. Abu Jafar. It is easy to modify the price mechanism but it is not easy to improve the moral conditions of the society. So there is the possibility of existence of a gap between the two - for emergence of a gap between the two. How to solve this Problem ? How to make Islamic economic system universal and acceptable to all ? In view of the fact that this system is based on Islamic faith and a majority of the people of the world are non-Muslim.

Chapra

As far as the gap between the teachings of Islam and the actual reality in the Muslim world is concerned, we are realizing that Islam is nowhere present in its ideal form, but this is what we are to do and this is the motive of this seminar, i.e., to increase conviction, then you all will go and talk to other people. Most of you are professors and can talk to your students; and gradually as the number of people expands, we can come closer and closer to the reduction of this gap that exists in our society. Of course, we know it very well that this Islamic revival is ultimately going to reduce the gap between the precepts of Islam and the actual practice in the Muslim world. How to make Islamic system universal? Again the same, you write more and more in a rational manner so that it appeals to other people. Just the Prophet (Pbuh) was able to spread Islam through a substantial part of the world. We can do the same. We can convert a number of other

countries to the ideals of Islam. It is possible. There is nothing impossible in this world. If the capitalist world can convert the whole world to its viewpoint, why we are so deviating from this very beginning?

Monzer Kahf

Chapra told us that was perhaps the last question. Yet there are more questions in the hand of the Chairman. It is pleasing for us to note that he has a volume of questions, that also shows the success of his lecture.

Chairman

Thank you from the core of our heart. Chapra, it has been very good and nice of you to agree to meet us at the Islamic Foundation auditorium at 5.15 p.m. Just after Asr prayer, we will be there and it is very nice of Chapra to agree to deliver a lecture on Islam and International Debt Problem. We cordially invite not only yourself but along with you, your friends and colleagues.

Again we have a word of prayer and *marhabah* to Chapra. Thank you.

CHAPTER EIGHT

THE ECONOMIC ROLE OF STATE IN ISLAM

*Monzer Kahf**

SECTION I
ISLAMIC STATE AS A POLITICAL INSTITUTION

I.1. THE ISLAMIC STATE'S FUNCTION

The first Islamic state was evolved in Madinah at the time of the Prophet Muhammad (Pbuh) and his first four successors. The principles of this state are to be found in the Qur'an and the *Sunnah.* The essence of the Islamic state is the notion that "all sovereignty belongs to Allah". The state is one of the means that brings human beings closer to Him. Consequently, we find a Muslim scholar like Al-Mawardi defining the objective of the Islamic state as "to continue the function of prophethood in safeguarding religion and managing the worldly affairs" لخلافة النبوة في حراسة الدين وسياسة الدنيا I b n Taymiyah adds that the objective of statehood is "that all religion be to Allah and that Allah's word be supreme"[2] . In th same line of thought, Ibn Khaldoon explains the relation between "the management of the worldly affairs سياسة الدنيا and "Allah's word being supreme لتكون كلمة الله هي العليا : "because according to *Shari 'ah* worldly affairs are all considered with reference to their benefits in the Hereafter... إذ أحوال الدنيا كلها ترجع عن الشارع لاعتبار من مصالح الآخرة Ibn Khaldoon clarifies the function of the Islamic state as "getting everybody to follow the intent of the *Shari 'ah's* rationale in their worldly and other than worldly affairs .

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1 Abu al Hasan al Mawardi: al Ahkam al Sultanivah, Maktabat al Babi al Halabi, Cairo, 3rd

2 edition, 1973, p.5.

3 Ahmad Ibn Taymiyah: al Hisbah fi al Islam, Dar al Kutub al'Arabiyah, Beirut, no date, p.2. Ibn Khaldoon: al Muqaddimah, Dar al Sha'b, Cairo, no date, p. 169.

هي حمل العامة على مقتضى النظر الشرعي في مصالحهم الآخروية والدنيوية ..

In this definition of an Islamic state's function, two elements can be pointed out as distinct and unique:

First, a system of rationalization is utilized by the state to determine the relevance, usefulness and efficacy of political decisions and the process of their making. However, it is recognized that every political system has its own rationale, and Ibn Khaldoon, himself, distinguishes among three different kinds of political rationalization: monarchic, democratic, and Islamic. The monarchic rationale is based on a set of values that surrounds and nourishes the desire, voracity, and lust of the monarch . مقتضى الغرض والشهوة The democratic rationale is based on the human reasoning without being value-committed or guided by Godly revelation مقتضى النظر العقلي While the Islamic rationale is based on the human reasoning which is committed to the divine revelation in both values and methodology. مقتضى النظر الشرعي

Second, the domain and the scope of the Islamic state covers the worldly affairs as well as the affairs of the Hereafter. The responsibility of the Islamic state towards the members of its society covers their interests in the afterlife in the sense of helping people work toward their own salvation and success in pleasing Allah, in addition to attaining their satisfaction with regard to worldly joys and matters. Imam Shatibi argues that the Islamic state has to make more *effort* in helping its citizens achieve their goals because: "the interests of religion have absolutely priority over the interests of the worldly life

. المصالح الدينية مقدمة على المصالح الدنيوية على الاطلاق.[5]

Having a primarily religious role for the Islamic state is the cornerstone of the Islamic political system. It represents the principal characteristic of the Islamic system and stands in contrast with the capitalistic democracy (rule by people, for people, and from people) and the communist democracy (rule for people)[6] , because both these democracies are limited to the worldly affairs.

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4 Ibn Khaldoon, Ibid.

5 Imam Abu Ishaq al Shatibi: *al Muwafaqat fi 'usul al Shari 'ah,* al Maktabah al Tijariyah al Kubra,

6 Cairo, 2nd edition, 1975, V. 2, p.370.

Uthman Khalil: al Dimuqratiayh al Islamiyah, al Maktab al Fanni Li al Nashr, Cairo, 1958.

Hence, by virtue of its definition and the two fundamental elements arising from it, the Islamic state is uniquely and distinctively characterized as the vicegerent of Almighty Allah, Who is the source of religion. The Islamic state as an institution "represents" Him in promoting religion and administering the world according to His commandments,[7] although obviously, the government is appointed by people and it acts on the basis of their deputation or attorney.

I.2. IMPLICATIONS OF THE NOTION OF ISLAMIC STATE

On the basis of the preceding definition and characteristics of the Islamic state, one may look to studying their implications. This will be done in the following areas:

1. the priorities of the political apparatus of the Islamic state;
2. the scope of the function of the state; and
3. the limitations within which the state operates.

In all these three areas, the discussion will concentrate on the political and economic aspects.

1.3. PRIORITIES

In the Islamic state, the safeguard of religion and the supremacy of the Word of Allah are the primary objectives. This is in contrast to modern democracy where the main objective is servicing the national interest of the people, and the welfare state for which the main objective is providing social services to the poor and bringing the society closer to an "economic equality"

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7 Ibn Khaldoon holds a comparison between three systems: monarchy, democracy and Islamic. Monarchy wants people to fulfil the wishes and veracities of the king. Democracy wants people to fulfil the intent of their rational judgement to manage their worldly affairs, and the Islamic Khilafah wants people to manage the worldly affairs in consideration to their benefit in the Hereafter.

فقد تبين لك من ذلك معنى الخلافة: وأن الملك الطبيعي هو حمل الكافة على مقتضى الغرض والشهوة والسياسة هي حمل الكافة على مقتضى النظر العقلي في جلب المصالح الدنيوية، ودفع المضار والخلافة هي حمل الكافة على مقتضى النظر الشرعي في مصالحهم الأخروية والدنيوية الراجعة غليها، اذ أحوال الدنيا ترجع كلها عند الشارع الى اعتبارها بمصالح الآخرة، فهي في الحقيقة خلافة من صاحب الشرع في حراسة الدين وسياسة الدنياز

Op.cit.. pp. 169-170.

through the use of social services such as health care, education, elderly pensions, etc.[8]

These differences in priorities have several practical implications. For instance, while the welfare state is service-oriented[9] , the Islamic state is geared. Towards the best implementation and expansion of religion. It was such motivations that pushed the poverty-ridden society of the first Islamic state in Madinah to devote the majority of its resources towards: "taking people out of the worship of creatures and into the worship of God, and moving them from the narrow mindedness of the worldly matters to the vast vision of the whole universe, لتخرج العباد من عبادة العباد and from the oppression of religions to the justice of Islam الى عبادة الله، ومن ضيق الدنيا إلى سعتها ومن جور الأديان إلى عدل الإسلام.

Economically, the priorities of the Islamic state represent a clear deviation from traditional welfare economics and policies in terms of objectives as well as measurements. Economic development, economic equality, and economic equilibrium relegate to a secondary place, whereas economic performance in production (of goods and services) in areas that enhance the ability of the society, and especially the state, of defending Muslims and Islam both as a political entity and as a vehicle for worldwide *Da'wah* movement.

It should be noted, however, that there are two levels of social services that are usually provided by the state. The first level of services is provided as a relief to disaster-stricken areas, where the survival of people and the salvation of their properties are at stake. Included in this category are aids and services provided to people stricken by war, famine, production below subsistence level, etc. The second level of social services aims at improving the economic living of the poor.

According to *Shari 'ah,* the first level of social services can be classified as necessities; as such fulfillment of these necessities is one of the functions of the Islamic state. Necessities are defined by al Shatibi as things and services that are "indispensable for the survival of human beings in areas of religion, life, mind,

8 Vic George and Paul Wilding: Ideology and Social Welfare, Routledge and Kegan Paul, London, 1976, pp.106-138.

9 It is noticed that the welfare state originated in the war-tired British society of the late Forties.

10 As declared by Rib'i bin 'Amer, the companion of the Prophet (Pbuh) to Rustum, the commander of the ancient Persian army before the battle of Qadisiyah.

genealogical reproduction and property"[11] Consequently, the Islamic state is obliged to provide these services and to procure the necessary resources for them even to the extent of imposing special taxes in addition to *Zakah.*

The second level of social services aims at improving the quality of life rather than maintaining it; thus, the Islamic state is not obliged to guaranteeing the provision of these services. However, if there are natural resource endowments or any remainder of *Zakah* after fulfilling other necessities, these may be used for this level of social services.

As for the welfare measurements, it should be noted that the yardsticks of per capita income, and per capita public spending on social services are inadequate in the Islamic society, since they lack the spiritual and religious content of welfare. This can be explained by quoting an example from the life of the Prophet (Pbuh) when a woman came to him and said:

> *"I get fits of epilepsy and my body becomes uncovered; please invoke Allah for me. The Prophet (Pbuh) said: 'if you wish, you can be patient and enter Paradise, and if you wish, I will invoke Allah to cure you'. She said: I will remain patient, and added: but I become uncovered, so please invoke Allah for me that I may not become uncovered. So he invoked Allah for her."*

Moreover, the concept of richness . غنى was defined by the Prophet (Pbuh) as self-contentment by what one has [12] . Also, the concept of modesty عفاف is used in the Qur'an as satisfaction with a little to the extent that one appears rich [13] .

With the elements of reward *(thawab),* modesty *(afaf)* and self-contentment *(ghina al-nafs)* entering in the welfare of Muslims there is a need for formulating new criteria to measure welfare in order to include those who do not ask for help although they need it.

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11 al Shatibi, Op.cit., V.2, pp. 6-7.

12 Reported by Bukhari and Muslim; see Kitab al Mardha, "Richness does not mean having a great amount of property, but riches is self-contentment"

ليس الغني عن كثرة العرض، ولكن الغني غنى النفس

13 "The ignorant man thinks that they (who don't ask for charity) are rich because of their modesty" "يحسبهم الجاهل أغنياء من التعفف" . The Qur'an 2:273.

Also, in his prayer, the prophet (Pbuh) used to say":اللهم ارزق آل محمد كفافا "My Lord, give the family of Muhammad only the bare sustenance:. Reported by Muslim.

I.4. SCOPE OF THE STATE'S FUNCTION

The scope of an Islamic state's function goes beyond the worldly affairs of its people. El Awa, and al Mawardi before him, includes into the duties of the state:

- "preservation of faith in its established principles and in the form in which *al salaf* (the predecessors) of the *Ummah* had unanimously agreed;
- *jihad* against those who oppose Islam after calling upon them to embrace it, or to accept protection as non-Muslim citizens, so that the word of Allah is upheld.
- by proclamation of the religion in its entirety"[14] .

Consequently, the Islamic state carries a political responsibility for the establishment of religion, ..Ail x.1 P. Responsibility gives a new dimension to the role of the state which allows it to adopt policies that help Muslims, in the Islamic state, to perform their religious obligations to their best. In reality, this role of the state *may* reach as far as the individual private practice of worship such as prayers and fasting.[15] Besides, an Islamic state is obliged to protect the Muslim minorities outside the Muslim state and to preserve their Islamic identity:

"وإن استنصروكم في الدين فعّليكم النصر".

"... ***But*** *if they seek your aid in religion, it is your duty to help them..."* (Qur'an, 8:72)

Additionally, the Islamic state is responsible to make the "Word of Allah" reach non-Muslims both inside and outside the boundaries of the state. It is further required to exert its best effort to remove any obstacles that may be in the way of the spread of Islam to non-Muslims.

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14 M.S. El Awa: The Political System of the Islamic State, American Trust **Publication,** Indianapolis, 1980, p.77.

15 For example, the *fuqaha'* have discussed that Islamic state is not only required to provide a minimum religious education when not provided by individuals, but it must also punish those who do not establish their own prayers.

The economic implications of this wide function of the Islamic state include the reallocation of resources necessary for the establishment of religion [16], the formulation of anti-moral pollution policies in places and environment of work, and the elimination of the morally-condemned goods and services from both production and distribution.

I.5. LIMITATIONS ON THE STATE OPERATION

In the welfare state, two major constraints impose limitations on the conduct of its affairs. They are: the state's commitment to equality via social policy, and its commitment to democracy by voting. The first constraint distinguishes the welfare state from a nineteenth century capitalist state, and the second distinguishes it from a totalitarian socialist state.

In the field of economic policy, these limitations imply that the welfare state determines the desired social services and their means of finance by way of majority voting. And in the political field, these limitations imply an increase in the consideration of humanitarian concerns and the protection of privacy in shaping the policies and laws of the welfare state. This is very much expressed in abolishing the capital punishment, treating alcoholics as sick rather than sinful, relaxing the traditional prohibitions in marital bonds, and in treating fornication and adultery as private rather than social offenses.

On the other hand, the Islamic state has two major limitations that are derived from the Islamic ideology: the state's commitment to *Shari'ah,* and its

commitment to *shura*.

Shari'ah is the *raison d'etre* of the Islamic state. It can only operate within the boundaries of *Shari'ah.* Muslim thinkers distinguish between two areas of state operations with regard to *Shari'ah*'s boundaries. The first area is where *Shari 'ah* provides complete prescription of Allah's guidance. In this area the role of the state. is limited to a sincere implementation of *Shari 'ah.* This area covers matters like the majority of the rules of inheritance, penal code for major crimes, prohibition of interest, and imposition of *Zakah.* The second area is where *Shari'ah* provides the principles and the guidelines for state operations leaving to it the task of shaping the detailed rules and regulations. The second area which is

16 Mohammad al Mubarak: al Dawlah wa Nizam al Hisbah 'ind Ibn Taymiyah, Dar al Fikr, Beirut, 1967, p.136.

sometimes called "the open area" or "the area of the vacuum"17 covers issues such as penal code of minor crimes, التعزيز taxation other than *Zakah,* capital accumulation, resource allocation, organization of the governmental bodies and division of authorities[18] .

The commitment to *Shura* requires that in all the affairs of the state, the believers (i.e., people) should be involved and consulted [19] . The political decision making must only be done by the people themselves. Islam does not recognize any form of individual or inherited political privileges to any person or group. When facing Allah, "the most honored of you in the sight of Allah is (he/she who is) the most righteous of you" (Qur'an 49:13) and since righteousness can only be known by Allah then all people are equal. The Prophet (Pbuh) said "people are all equal like comb's teeth" الناس سواسية كأسنان المشط

17 Mohammad Baqir al Sadr: Iqtisaduna, Dar al Fikr, Beirut, 1968, p.362.
18 Ibid.
19 El Awa, Op cit., pp. 86-89. For a discussion on whether Shura is binding and its scope, see, pp.90-97.

SECTION II
THE ECONOMIC OBJECTIVES OF THE ISLAMIC STATE

The economic objectives of the Islamic state are derived from its definition and functions. Muslim scholars talk **about** the following functions of the Islamic state:

1. public administration, law enforcement and protection of internal and external security;
2. defence of religion and its territory and the promotion of righteousness, and God fearfulness;
3. guaranteeing a minimum level of living for all those whose own earnings fall shorter than satisfying their basic needs;
4. working towards improving material welfare of the society and its individuals as much as possible within the limits of available resources. This includes objectives of economic stability, equality, increasing of employment, social and economic development; etc.
5. management of public properties for the benefit of all members of the society;
6. ordaining that which is good and preventing that which is bad in general and protection and reservation of moral commitment and requirement of members of the society.

From these functions one may derive the essential economic objectives of the Islamic state as follows:

II.1. ECONOMIC OBJECTIVES OF THE ISLAMIC STATE

1. Achieving of economic capability necessary for strengthening Islamic state in such a way as to allow it to be a safeguard of religion, the protector of the society and its values and a vehicle of spreading Islamic *daw'wa* in the world. This includes adequate level of performance specially in areas of economic development, science and technology, and military might.

2. Working towards securing economic satisfaction of the society in general and promoting general material welfare while guaranteeing the basic needs of its individuals.
3. Maximization of the benefits of public properties, their expansion and use for the benefit of all people.
4. Obtaining necessary financial resources to run the government and spending them in accordance with *Shari 'ah.*
5. Protecting the moral and legal framework and promoting a work environment conducive towards success in the hereafter. This includes ordaining what is good and preventing what is wrong.
6. Maintaining economic justice by preserving social and economic balances, achieving adequate employment for all members of the society and preserving the wealth and income of the people.

Some of the above mentioned objectives may require more elaboration. For instance, attaining maximum level of benefits for the society does not necessarily mean maximum production nor contradicts it. Attaining quantitative maxima is undoubtedly an essential ingredient of the benefits of all people although alone, it is not sufficient; because the Islamic state is also charged with the safeguard of religion and observance of its moral and ethical standards. In other words, material performance should always be coupled with spiritual and moral upliftment.

It may be noted that the concept of asceticism in Islam which is urged in many verses and sayings is only, an individual practice which does not interfere with actions meant to affect other people. For instance, a guardian of a minor may not practice asceticism with regard to the guardian's duty of protection and promotion of the minor's material welfare. A guardian is required to achieve maximum preservation, protection, and promotion of a minor's material interests. By the same way the Islamic state may not proclaim asceticism in its promotion of people's interests. Consequently, achieving highest possible quantitative production is an important element in achieving the interests of Muslims; although it must not encroach on the distributive and moral aspects of the present as well the future generations. This implies that maximization of interests to people includes the moral, social, material, and religious interests of the present and future generations taken all together. On the other hand, this objective also covers matters related to economic stability in general and stability of the value of money in particular, economic equilibrium and creating job opportunities sufficient to achieve full employment for all labor force in the society.

With regard to the second objective, there is a difference between guaranteeing a minimum standard of living and working toward economic sufficiency. The Islamic state is required to guarantee a minimum level of living for those whose own earnings fall short of fulfilling their basic needs and who could not secure bare necessities through individual means of intra-personal solidarity. One has to distinguish between a minimum level of living and an adequate one. There is a lot of discussion among Muslim thinkers and Muslim economists on this concept. What is required, by all means, from the state, from the society, and from the neighborhood is to guarantee the minimum level of living that must be served to everyone and if it is not, i.e., if there is shortage for any person, as you find it in many statements by some *sahabah* and others, then there would be no recognition of any private property i.e. all private properties should be made available towards servicing this objective regardless of any other consideration. All other considerations become secondary in relation to the objective that all individuals or persons in the Islamic society regardless of their race, religion, and what not, should be guaranteed a minimum level of living, which is a subsistence level. Subsistence level of living can be defined in basically biological terms, adding to them some Islamic refinements which includes for example, clothing that is required for the Islamic way of life, protection from the heat of the sun in summer and coolness of the wind in winter etc. Going beyond that minimum level depends on resources. If there are resources available, definitely these resources belong to the owners, i.e. members of the *ummah;* and the government, as a guardian of the resources of the *ummah,* must utilize them in going beyond guaranteeing a minimum level of living. That is, whenever we talk about adequate level and improvement of material welfare of people, that depends on resource availability. Even 'Umar bin al Khattab distributed money to people; and they did not need to work, instead of guaranteeing full employment. But that was only when the state has those funds available. If the state does not have them and if it has to infringe on private property it can do that only for guaranteeing the minimum level of income, but not for the adequate level. The objective of working toward improving material welfare of individuals and society, in as much as the available resources permit, includes economic objectives like stability, improvement of employment both quantitatively and qualitatively, social and economic development, etc. All these come after that.

Now would we consider, for example, education as part of the minimum level of living requirements. My own answer is: I don't know since I can't be sure. As a matter of fact, I expect many people would say: "Yes", obviously. Let me then give you some details. In *Shari'ah* it is a well-known fact that teaching even

Qur'an and prayers is essentially the responsibility of the father or the parents, and not the society. Even teaching the basics of Islam is essentially the responsibility of the parents. Teaching a handicraft to earn income is also the responsibility of the father or the parents and not the state. This has been known in *fiqh* throughout history and we have an example from. the time of 'Umar. When a man came to 'Umar having conflict with his father; and in solving that conflict 'Umar asked: "What was the problem?" The man told him: "Well, whose responsibility is it to teach me Qur'an?". He said: "Your father's". The man said: "But he did not teach me. Whose responsibility is to teach me a craft to earn my living through?" He said: "Your father's". So, the man said: "But he did not teach me that. Whose responsibility is to select for me a mother and a name I feel proud of or at least not be insulted by?" He said: "Your father's". "But he did not do that for me", the man said. So, he said: "He didn't do all that and how would you expect me then to be good to him?" Turning to the father, 'Umar concluded: "You abused your son long time before he abused you".

On the other hand, one may argue that there may be circumstances where leaving education to individuals may lead to gross injustice in the society. This should definitely be taken into consideration. But I would not hasten to answer quickly that education, elimination of illiteracy, university education must in Islam be the responsibility of the state. I would rather say: " The issue needs to be carefully studied and, perhaps, we may reach a conclusion that it is essentially the responsibility of the father, or the family, and only in those cases where they can not provide it or they can not provide it adequately or they can not provide it with justice, then the state may step in and only in as much as required. In other words, I don't have to reach a definite conclusion. It looks that at least for those who are rich, there is no responsibility on the part of government to teach their children even from first grade or to eliminate illiteracy. For them, they should pay for education. It should be at their own cost and not at the society's cost.

Historical considerations tell us that in most cases education in the Muslim society was provided either by the family as the father who is basically responsible for its provision or by the third sector - the charitable sector., i.e., mainly the *awqaf* and sometimes the *Zakah* too. Throughout our history, education was very often offered free by the *awqaf* institution not by the state resources. In other words, if we consider the education as part of the minimum standard of living, then we permit the state to impose taxes to provide it, we permit it to take even from private properties by any means, and in any way in order to fulfill this responsibility. But if we consider it as basically an individual

responsibility of parents, families, or the voluntary sector, then we may not reach the same conclusion.

A third important objective of the Islamic state is to manage the public properties in order to maximize the interests of Muslims derived therein. When we discuss the public property in another lecture, perhaps there we will see whether Islam propagates a big state or a small state. It seems that to take a position whether we are for a big state or a small state before we look at the types of property that is provided for in *Shari'ah* would be like jumping to the conclusion before it is available. But I would say that there is a considerable size of the public property and administering it for the benefits of people is an important function of the Islamic state. So, one of its objectives is to maximize the benefits of people derived out of the public property.

With regard to the fifth objective, one may notice that imam Mawardi distinguishes between two kinds of "ordaining what is good and prohibiting what is wrong": public and personal. He says, "There are two meanings. One, intrapersonal *'khas';* it applies between individuals that you find a person not doing right or doing wrong and you advise him/her to do the right; and you try to prevent him/her from doing wrong. But he adds, "There are also kinds of *ma'ruf and munkar* that belong to the society. For example, drinking requires purified or healthy water. This is the responsibility of the whole people together. The state has that responsibility of ordaining this kind *maruf* and preventing a public wrong such as infringing on a public road, polluting the environment, destroying forests or rivers, placing one's own shop or merchandise on a part of a road and using it as private property, in a way that hinders traffic, etc.

The last point with regard to the objectives of the Islamic state which may require some comment is preservation of overall social and economic balance. You may call it equity, or tendency towards equity. Looking at the relevant texts that we have in the Qur'an, *Sunnah* and *fiqh,* the Islamic economic system has a clear tendency towards more equitable distribution of resources (wealth and income). It has a built-in mechanism to go into that direction. For example, 'Umar bin al Khattab once preserved certain land, a lot of land, for the camels and herds that are collected as *Zakah* and he instructed the officer on it that: "Well, if some poor man comes to you with his few sheep or few camels, let them graze in this land, that is OK. But if 'Usman bin 'Affan and Abd al Rahman bin 'Auf come to you with their herds, don't allow them in. These are rich people. Even-if all their cattle is wiped out because of drought, they can lean back to their wealth that they have in the city. But those poor guys have nothing else to lean on. So, you let

them in and don't ever let the cattle of 'Uthman and bin 'Auf in". This is a tendency toward more equity and there are many other indications in the Qur'anic verses and other sources of *Shari 'ah.*

II.2. BASIC PRINCIPLES RELATED TO THE ECONOMIC FUNCTIONS OF THE GOVERNMENT

While working towards fulfillment of these objectives the Islamic government is required to observe some principles that govern its operations the most important principles are the following:

1. Commitment to the terms of *Shari'ah*

Shari 'ah outlines a framework for action that determines what is permissible and what is not permissible knowing that there is a broad area left by *Shari'ah* itself for human mind to exercise its role is discovering that which is best within the broad guidelines provided by the Divine revelation.

2. Commitment to the order of priorities given in general by the *Shari'ah.*

Most Muslim scholars accept the order of priorities given by *imam* Ghazali and imam Shatibi. Both argue that all things of life may be divided in three categories:

a) necessities that represent indispensable things and actions that preserve religion, life, mind, posterity and wealth,
b) the second category covers what they call needs. Needs are those things and actions without which there may be serious inconvenience in life, religion, mind, posterity and wealth,
c) the third category covers those things and actions that improve and refine the quality and the performance of human beings in those five areas.

These two Muslim scholars also discussed priorities among five axioms related to human beings on earth : religion, life, mind, posterity and wealth. They argue that religion comes first then life then mind then posterity and lastly wealth. Consequently, for necessities related to religion one may sacrifice necessities related to life or wealth whereas, for refinements in religion one may not sacrifice needs or necessities of life. The sacrifice of life and wealth for religion is called *al*

jihad fi sabil Allah. There is certain order in safeguarding these basic axioms and the state must observe that order in all its functions. For instance, if the state has some funds to be used for establishing a factory. And, there is a need for baby milk in the society, and there is also a desire for perfume. Would the state build a perfume factory or a baby milk factory? It seems to me that it must start with those essential projects, those that can be defined within the necessities that safeguard and preserve the five basic axioms.

Let us take the same example and put in front of private individuals. If an individual is interested in producing perfume because it is more profitable for him/her than producing baby milk or even basic food stuff, can the state force this individual to abandon his/her profitable perfume project in order to go into the baby milk? It seems to me that an affirmative answer to this question would be very difficult. It may run in opposition to the basics *of Shari'ah*. Because a private person is free and cannot be forced to alter his/her preferences that do not contradict *a Shari'ah* commandment. Let us remember in this regard, that on the individual level, people were using perfume and the Prophet (Pbuh) even ordained them on Friday to use perfume saying "take some out of your wife's perfume before you go to prayers on Friday". He said this at the time when some companions and the Prophet (Pbuh) himself were putting one or two stones on their stomachs to push it inside out of hunger, and a companion would sometimes fall down in the street out of hunger too. When it comes to forcing individuals against their own will, there is a lot of barriers before the state can infringe on the individual freedom and a lot of justification would have to be presented before such a limitation on private ownership may be permitted in *Shari'ah*.[20] This is not the case, however with public funds. They definitely must be used in accordance with that priority of the people and to serve their best interests following the priority order mentioned earlier.

3. Strong interrelation between the functions/objectives of the Islamic government and availability of resources.

This means a strong link between public revenues and expenditures. It can be observed by looking carefully at the different kinds of public revenues in the

20. It must be noted that there are circumstances in which a necessity for the society becomes an individual obligation of a person, and under those circumstances, the government may force the person to discharge the personal obligation towards the society.

Islamic system. Some of these revenues, e.g., *Zakah is* strictly designated to fulfill certain objectives and it may not be diverted towards others. On the other hand, there are certain public revenues whose utilization is not restricted and they can be utilized to achieve any of the objectives of the Islamic government. These include *kharaj,* and revenues from the public properties. This kind of inter-relation is also found when one looks at the discussions of the Muslim scholars about the permissibility of imposing taxes, e.g., while all Muslim scholars agree that imposing of any taxes to fulfill wishes, pleasures and private interests of the rulers is strongly prohibited, many of them argue that if there are necessities for spending, the Islamic state may impose taxes to the extent of those necessities (See, for instance, Abbadi, Vol. II, pp.288-289 and Qardawi, vol. II, pp.981-982.) In other words, there are functions and expenses for which the government may use any available resources and if there are no available resources then it may take from the private resources. But there are functions for which you cannot do that nor can you take from individuals in order to achieve them. For instance, if there are hungry stomachs in the society or defence needs, they must be fulfilled even if it were at the expenses of confiscating the private property of the rich. On the other hand, you cannot do that for other purposes, such as promoting employment or university education unless related to the security or the defense of the *ummah.*

4. Adherence to the principle of economic freedom and protection of private properties

The Islamic *Shari'ah* emphasizes that human beings are **authorized** over their private properties; they dispose of them the way they like; and they are completely free to take their decisions with regard to their own properties. Private ownership is protected by *Shari'ah* itself and not left to the authority of the government to eliminate, restrict or limit. Private ownership is protected in Islam vis-a-vis the government itself. It must be noted that presence of a few prohibitions in *Shari'ah is* by no means a restriction on economic freedom because any social order requires certain organization of transactions and inter-personal relationships; and those prohibitions are only imposed to the extent that is necessary to preserve the religious values, moral standards and social order. After all, every society has to choose certain for a social organization that put caps on certain individual activities one way or another.

Additionally, let us take a look at what is prohibited on the level of individual behavior, only a few things that are usually harmful. You can produce anything, you can enter any market, you can buy any commodity, you can quit producing, you can be employed, you may select to be self-employed, etc.

5. General interests have priority over private interests

This principle establishes that individual interests may be foregone if this is necessary for preserving the interests of all. However, a public interest for which such a sacrifice may be tolerable should be certain, indispensable and can only be achieved through this sacrifice.

6. The principle of social duties

Shari'ah introduces a unique concept for things that are needed in a society requiring collective action, whereby it establishes individual responsibility and accountability for fulfillment of these social duties, i.e., a social duty is coupled in *Shari 'ah* with an individual responsibility of all those who are capable of discharging of the social duties. Until and unless a social need is fulfilled, individuals are personally responsible for its fulfillment. This personal and individual responsibility is only relieved if the social duty is achieved by any one. This concept is called *fard al kifayah* "فرض الكفاية" it allows the society to dispose of things that require collective action by means of political decision making.

Beyond those social necessities, any obligation that may be created by the government can only be justified by the individuals' acceptance and nothing else. That is, whenever you talk about say a traffic law that is not in *Shari'ah,* and you want to force people to stop at the red light, which is not obviously in *Shari'ah,* such an action can only be justified by the votes of people. It can only be on the basis of people's acceptance either directly or by their representatives, i.e., by the public vote. This public acceptance, while discussed in some detail in my other lecture, was in the early Islamic state very much binding with regard to voluntary public revenues. The Prophet (Pbuh) did not collect any tax except *Zakah.* He depended on voluntary contributions, and whenever he had any project, he would call for people to volunteer to finance that project. Obviously, if no people volunteered to finance the project, it would have been scrapped, because people didn't like it. This is the principle that justifies any government-imposed obligations or restrictions that are not already existing in *Shari 'ah.*

7. Shura

Shari'ah also requires that decisions in the society be taken in accordance with principle of *shura.* This principle is based on the verses of the Qur'an and is applied in accordance with the sayings of the Prophet (Pbuh): Human beings are

like comb's teeth". This requires that with regard to *shura,* people may only be treated equally; and in a metropolitan society of today's world, it can only be fulfilled by voting.

SECTION III
MEANS OF FULFILLING THE OBJECTIVES OF THE ISLAMIC STATE

The tools available for the Islamic state to achieve its objectives are the following:

1. Changes in the volume of production and employment in the public sector.
2. Tools related to promoting private sector's activities.
3. Public sector's pricing.
4. Fiscal policy.
5. Monetary and credit policy.
6. Investment of public sector's properties and surpluses.

III.1. CHANGES IN THE VOLUME OF PRODUCTION AND EMPLOYMENT IN THE PUBLIC SECTOR

We shall see when we study the principles of ownership in Islam that the Islamic economic system designates considerable part of material resources in the society as public property. Public property, according to the Islamic view, includes minerals on the surface or underground, major energy sources such as waterfalls, land not unutilized in the production process, etc. The economic public sector is based on public properties. This provides an effective tool for introducing changes in the major economic variables by means of changing the volume of production and employment in basic industries like extraction and energy. Obviously those changes will have influences on other economic sectors as well as on aggregate demand in the economy.

III.2. TOOLS RELATED TO PROMOTING PRIVATE SECTOR'S ACTIVITIES

The Islamic state is assigned a significant role in elevating and stimulating the private sector. In addition to its traditional role in maintaining law and order, the following points are emphasized in the Islamic literature on economics and *fiqh.*

a) In the Islamic system, an important use of public property is its distribution to individuals in order to encourage and help them make

productive projects. The Islamic jurisprudence calls for this practice. The Islamic principles of *iqta'* (giving away public property). Detailed rules of *iqta'* are given in *fiqh* books. These rules suggest that distribution may be on a permanent or temporary basis, it may be free or for a nominal fee, but insist that in all cases such distribution must serve the interests of the society and must not be restricted to selected individuals or groups except the poor.

b) Land which is not owned by any body is let free for all potential users. Revivification of land and making it productive through land reclamation and improvement is called *ihya'* in *fiqh* literature. This system entitles the person who revivifies it to claim full ownership of the land.

c) Except in very limited cases, which can be described as cases of daily needs, state-owned lands were entrusted to individuals against some rental fee by the Prophet (Pbuh) and the four *Khalifahs* (Caliphs) after him. This principle was applied by the Prophet (Pbuh) to the lands of Khaibar and Fadak in the northern part of the Arabian peninsula and late, on a mass scale, by the second *Khalifah,* `Umar, to the lands of Syria, Iraq, Persia and Egypt. These lands are known as the lands of *kharaj.* The implication of this principle is that public property should best be invested by means which link it to the private incentive of profit making as far as possible. Furthermore, the Islamic state is not encouraged to engage in economic activities that compete with the private sector. The rare cases when the state decided to run its land directly by employing workers were those lands used for grazing livestock collected as *Zakah* or horses designated for soldiers. This is called a public *Hima* and it was applied on a very small-scale to a few plots of land only. Here again, the *fiqh* writings provide many details stipulating the conditions of public *Hima,* its objectives and its permissible utilization.

d) The Islamic state is also assigned the responsibility of helping, encouraging and supporting the private sector. An often narrated parable is the story of a man from *al ansar* who came to the Prophet (Pbuh) asking him (for financial help). [The Prophet (Pbuh)] said" isn't there anything in your house ? [The man] said, yes, a piece of cloth, part of which we use as a cover and part of which we lay [on the floor] and a jug with which we drink water. [The Prophet (Pbuh)] said: bring them to me. Then, he brought them in; and the Messenger of God (Pbuh) said: who buys these two (things)? A man said: I buy them for one *dirham.* [The Prophet (Pbuh)] said: who offers more than a *dirham?* [He said that] two or three times. [Another] man said: I take them for two *dirham.* [The Prophet

(Pbuh)] gave them, took the two *dirham,* gave them to the man from *al Ansar* and said: buy food with one of them and send it to your family, and buy an axe with the other and bring it to me. Then, with his own hands, the Messenger of God **(**Pbuh) tied it a piece of wood (as a handle) and said to the man: go cut (fire) wood and sell it, and let me not see you for fifteen days. The man went on cutting and selling wood, then, he came with ten *dirham* which he gained. With some (of the money), he bought a piece of cloth and some food... The Messenger of God (Pbuh) said: This is better than begging which will come, on the Day of Resurrection, as a dark spot on your face. (Reported by Al Timidhi, al Nasa'i, Abu Dawud and Ibn Majah).

The behavior of the Prophet (Pbuh), in this incident, indicates that the state is responsible for helping private individuals find decent employment which suit their capabilities. It is worth noticing, however, that resources of both the individual and the state, in addition to publicly free goods, were utilized in the process of finding remunerating work for the unemployed. Moreover, the state's responsibility toward the well-being of all Muslims in general, and its citizens in particular, thus includes the obligation to help them support themselves, thereby raising their standard of living.

e) Taxation is a last resort in the Islamic economic system. In principle and in general, private property is protected even against taxes. The Islamic state can only impose taxes as an ultimate solution and after exhausting all other means. Even when they are levied, they can be levied only to the needed extent and they should not be a means of penalizing the wealthy. To this, one should also add the protection of private property against confiscation, usurpation or any kind of seizure by the state or any other authority or individual.

f) *Shari 'ah* (the Islamic law) also provides another protection to private investment under what is called the principle of private *Hima. Hima* literally means protection. If a person digs a well at a place, other persons are not permitted to dig well(s) within certain radius of that well in order to protect its sources of water. This principle has several other applications in agriculture, industry and retail trade.
Similarly, *Shari 'ah* recognizes a right of preemption in both private and public land and other forms of investments.

g) The institution of *al hisbah* is another means for supporting the activities of the private sector. The responsibility of this institution is to see to it that moral and ethical norms; and safety and health conditions are observed by all actors in the market, and to maintain an environment in which fairness and prosperity can prevail.

h) The social insurance system in Islam is structured to support and promote the private sector's activities and initiatives. Among other things, it provides for the poor and the needy, regardless of any contributions they might have made in the past; it includes' a guarantee of dependents, orphans and handicapped; and, provided resources permit, it has a debt insurance scheme which covers all legitimate debts in society if the debtor fails to repay them. The principal source of financing social insurance is *Zakah* which is a well-defined tax on wealth and income. Most of the regulations of *Zakah,* including its rate structure, subjected items of wealth and income and its exemptions, are given in the texts of the Qur'an and the *Sunnah,* and cannot be altered by man.

The institution of *Zakah* also provides a sort of debt payment guarantee scheme under the item of *gharimin. Gharimin* are those who are under the burden of debts. The origin of these debts must be lawful such as legitimate business, trade, provision for self and family, carrying a responsibility of blood money or any other financial responsibility in the process of reconciling disputes among people or tribes, and so forth. What is relevant here is that it includes business debts. Disbursement to *gharimin is* mentioned in the Qur'an as one of the eight categories for which *Zakah* proceeds may be spent. Such a guarantee would encourage individuals to be innovative and venturous in business.

III.3. PUBLIC SECTOR'S PRICING POLICY

This is a selective policy whereby the state permits certain sectors by providing them with confessional prices of energy, mineral products and other goods and services produced by the economic public sector. For instance, promotion of rural development may be enhanced by lowering electricity prices in rural areas, cheaper water and cheaper transportation if the government provides those kinds of services.

Discriminatory prices of public sector products may aim at privileging selected group of consumers, selected geographical locations or selected sectors and industries.

It may be noted at this point that there is a need for studying the issue of discriminatory pricing of public sector products from *Shari'ah* point of view specially if price policy relates to products of what is called in *Shari'ah* community property الملك المشترك Community property is based on the saying of the Prophet (Pbuh) **:** water, fire, grazing pasture and (according to one version of

the saying) salt are common among all people. The implication of this saying is that people must be left free and equal to extract by their own means any amount they like of this community property. If, for technological reasons, the government produces the services related to community property, then a question arises of whether the government is permitted in *Shari'ah* to discriminate in its pricing between different users. A partial answer to this question may be affirmative if discrimination is made only to privileged poor and the needy. This is based on resemblance to land reserved as *Hima* حمى whereby, according to many Muslim scholars *Hima* land may privilege the poor and the needy but it is not permissible for the rich to have any privileges over the poor in the land of *Hima.*[21] Other forms of discriminatory prices of community property would require more detailed *fiqhi* analysis.

111.4. FISCAL POLICY

The Islamic state can also utilize fiscal tools for promoting the objectives of the Islamic economic system. Fiscal tools include variations in taxation whenever taxes are imposed, variations in public expenditure and changes in public debt.

However, fiscal policy tools must always be guided by the principle of distributive justice required according to the Islamic viewpoint. No tax may be imposed on the poor and fiscal privileges may not be given to the rich in comparison with the poor.

Tools of public debt are obviously restricted to those which do not involve interest. There is a variety of public debt tools which may be based on the principle of ownership such as *Mudharabah, Sharikah* and *Ijarah* certificates. Additionally, public debt tools based on the sale principle of financing can also be issued from an Islamic framework.

Lastly, *Zakah* itself can be used as a tool of fiscal policy although it is not disputed that *Zakah* rates are fixed as stated in the sayings of the Prophet (Pbuh), the timing of collection and distribution of *Zakah,* and the monitorization level of its collection and distribution (i.e., the percentage of *Zakah* that is collected and/or distributed in cash or in kind) are issues left to the authority of the state and manipulation of timing and monitorization level may be used as tools for influencing the economy.

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21 Al Mawardi, Op.cit.

III.5. MONETARY AND CREDIT POLICY

Monetary policy tools include changes in the supply of money through changes in reserve requirement, credit ceiling and open market operations on *Shari 'ah* permitted financial certificates. They also include credit discriminatory policy that aims at promoting (discouraging) certain economic sectors and **industries.**

III.6. INVESTMENT OF PUBLIC PROPERTIES AND SURPLUS OF PUBLIC SECTOR

Not all revenues from economic public sector and from the public properties need to be distributed for public consumption purpose. Some of them may be re-invested in expanding the public property by integrating more industries under its fold. Development policy may specifically benefit from investment of the surplus of the economic public sector.

Economic public sector may also expand with the help of financing from the private sector through Islamically permitted certificates.

SECTION IV
CONSTRAINTS ON THE ECONOMIC ACTIVITIES OF THE GOVERNMENT

The Islamic economic system, being based on the Divine revelation, provides principle and ideas in establishing a balanced relationship between government and individuals, i.e., the extent of government powers and authorities is not left to human reasoning alone but guided by a sort of constitutional boundaries and guidelines given by the revelation. This, in fact, makes the Islamic system unique since it is the system itself that protects individuals vis-a-vis the government. In this Section, I will deal with these institutional constraints that are derived from the Islamic politico-economic system.[22]

There are two categories of constraints about the government activities in the Islamic economic system. First category relates to the general activities of the government in the economic arena and the second category relates to specific constraints that apply only to the use of certain kinds of public properties/ revenues.

IV.1. GENERAL CONSTRAINTS ON THE GOVERNMENT ECONOMIC ACTIVITIES

1. Application of the Principle of Distributive Justice

I do not need here to reiterate the importance of the principle of justice in the Islamic system in general and throughout the Islamic economic system in particular. Islam itself is based on justice and you find this principle essential in all the writings on Islamic economic system. The application of the principle of justice with regard to the economic behavior of the government requires fair distribution of land not utilized in production among individuals who can bring in the production process, equal opportunities for jobs, equal opportunities to benefit from the projects of the public sector, maintenance of balance in the society between geographical areas, sectors, occupations, etc. It also requires that no economic privileges and favors may be given except to the poor and the needy. An example of application of principle of justice in the use of public resources is

22 It is obvious that there are natural constraints imposed by the natural resources available to the country in addition to historical and technological constraints; but since we are talking about Islamic economic system, this kind of constraints would be outside the limits of the current presentation.

that which is given by the Prophet (Pbuh) when Abyad bin Hammal asked to be given a plot of land from which salt can be extracted. The Prophet (Pbuh) accepted that and granted him that land but he was immediately informed that quantity of salt of that land was very big to the extent that it created socioeconomic imbalance in the area, he withdrew the grant and kept that salt land for all people of the community to use with equal opportunities.

The principle of justice also requires that any new investment decision taken by the government should also be based on equity and balance between geographical area, sectors, rural and urban areas, categories of employment, etc. so that the benefits of these investments may either reach all citizens or the distressed groups alone but certainly must not be distributed in such a way as to benefit and/or privilege the rich instead of the poor.

2. Avoidance of what is prohibited in *Shari'ah*

The Islamic *Shari'ah* has its own set of prohibition that applies to the government behavior as much as to individuals and the government is required to abide by the rules of *Shari'ah* in this regard.

3. Government Favors and Privileges

The Islamic *Shari'ah has* also a set of rules regarding distribution of favors and privileges by the government to the people. These privileges may include land grants which is called *iqta'*. They also include appropriation of certain land for certain uses by the government and/or by the community which is called *Hima,* subsidies and tax privileges, licencing and other non-monetary privileges, etc. All these grants, privileges and subsidies must be distributed in accordance with the public needs and/or relief to the poor. This means that the *Shari 'ah* strictly prohibits distribution of government favors and privileges on the basis of family relations with the ruling individuals, social and political power or wealth, etc.

There are examples from the behavior of four *Khulafa'* strictly indicating the application of this constraint. For instance, distribution of grants the Islamic government during the time of 'Umar did not give any privilege to 'Umar and his family and he himself declared that he treated public property and public revenues as if they belonged to an orphan for whom he was only a guardian.[23]

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23 Abu Yusuf, The Book of *al Kharaj,* Al Matbaya al Salafiyah, Cairo, 1352H, pp. 36-46. 224

4. The Constraints of Balance with the Private Sector

The Islamic economic system creates a balance between public and private sectors. If a good part of economic resources in a society is assigned by the Islamic system to the public ownership, that was not meant to reduce or eliminate the private sector. The economic public sector is not supposed to overtake the whole economy or even most of it.[24]

The Islamic *Shari'ah* provides detailed boundaries for each of the public and private ownerships in such a way that determines the scope and role of the economic public sector. The first and most important field of activity of the economic public sector is extraction and energy industries. Although nothing in *Shari 'ah* prevents the economic public sector to go in other industries, the nature of the Islamic economic system does not allow this kind of expansion on behalf of the activities of the private sector. As we have seen earlier the private sector is considered the essential source for investments. The private sector is also the source of *Zakah,* the third pillar of Islam, other financial obligations, spending on family and relatives and charity. On the other hand, inefficiency is a general characteristic of the economic public sector because of lack of personal incentive and because of the bureaucratic burden which is indispensable. This has been talked about in the classical literature one finds it by looking in the history of Islamic economic thinking since Ibn Khaldun. This calls for even more constraint on the economic public sector that restricts it from competing with the private sector in areas where the latter can be more efficient and more successful.

In order to derive the Islamic guidelines that outline the relationship between the public and private sectors and the constraints on the public sector in this regard let us have a quick survey on how Islam treated land utilization and exploitation of minerals, rivers, springs and forests.

With regard to the exploitation of land that was not economically utilized before, the Prophet (Pbuh) provides the concept *ihya'* احياء. This concept requires that individuals, by using their own means, are fully authorized to revivify and reclaim unutilized land. They are, in fact, encouraged to do so by offering them the right of ownership on such land. This principle is a corner-stone in *Shari'ah* for encouraging the private sector to take up productive initiatives, while it was possible that the public sector may take monopoly of this kind of land and utilize it

24 Ahmed al Sul and Falahi Abed al Karim, The Economic System in Islam, Maktaba Wahabah, Cairo, 1977, pp.70-71.

by its own resources specially that such a practice was also made on a small scale and to the extent that is needed for protecting public properties. For instance, the Prophet (Pbuh) made *Hima, i.e.,* certain lands designated for exclusive use by the public sector. This was done with the pasture land preserved for camels taken as *Zakah* and horses reserved for the army. [25]

Also when the Prophet (Pbuh) opened Khaibar, he preferred to keep the land cultivated by the private sector although the land was made public property and he only took a rent from the farmers. This was repeated on a large scale during the time of 'Umar for the newly conquered land of Syria, Iraq, Egypt and Persia. Both two instances indicate a preference towards encouraging the private sector's initiatives and restricting the public sector with regard to land to a background position, i.e., providing lands to farmers and encouragement to developers.

With regard to exploitation of minerals, the *Shari 'ah* selected a different position for this activity by assigning it to the public sector because their benefits relate to the whole *ummah* (community) [26]

The same thing applies on rivers, springs, forests, etc. They are left at the public sector because all Muslims are partners in these resources.[27]

From the preceding discussion the following principles may be derived:

a) In every case where the private sector can provide efforts in promoting production and development, the government must leave that industry for the private initiative. The government is also required to encourage and support private initiatives without sacrificing community's interests. The latter may be done by imposing certain fees or rent for the use of public properties by private individuals.

b) Whenever the public sector can cooperate with the private sector by invoking profit and incentives, the public sector should opt for that. This is clear in the case of agricultural land which is owned by the

25 al Mawardi, al-Ahkam AI Sultaniyah, pp. 185-186.

26 Abed al Salam al Abbadi, Al Milkiyah Fi al *Shari 'ah* al Islamiyah, Vol. I, pp. 353-354. Also see the saying concerning Abyad bin Hammal that the Prophet (Pbuh) abstained from granting him salt land because that would have created serious distortions in the economic distribution of wealth in the society.

27 Abu Yusuf, Op.cit., p.97.

public sector and rented to private individuals for an agreed upon rent.

c) In those cases where public industries can only be secured by direct investment such as *Hima* the government should take direct action and direct investment.

d) In all those cases that the interests of the *ummah* or a segment of it are at stake in such a way that people's interests suffer if that project is left to profit drive of the private sector the government should also take initiative and take charge of such projects.

e) Exploitation of minerals may be done through franchises, given to the private sector provided that the public interests are not affected specially in areas related to size of production, employment and prices of output. This is obviously in addition to 20 per cent obligation of *Zakah*

f) The economic public sector should follow a policy of gap filling so that it will undertake those projects that are either pioneering or necessary from the public point of view, and are not advanced by the private sector with the ability of reallocating them to the private sector as much as possible.

IV.2. SPECIAL CONSTRAINTS

In this regard we will talk about three kinds of constraints with regard to *awqaf Zakah* proceeds, and community property.

In *awqaf,* it is known that *waqf* estate is not really a public property but a property designated for special purpose. It is generally a charitable third sector. The government is not permitted to divert uses of *awqaf* property from original designation.

Zakah proceeds are designated in the Qur'an for eight categories of recipients. Here again the government is not permitted to divert this resource from the Quranic designation to other use although such other usages may very well fall within the public interests.

Lastly, we have seen earlier that projects based on utilization of community property are distinguished from other public property, since they may have restrictions of providing equal opportunity and equal accessibility to the output of these projects for all members of the community.

DISCUSSION

Chairman

There is no doubt that one of the objectives of the state in Islam is to promote the right of life and to advance the Islamic economic system. And it is indeed the state, as you know, which will actually give me inner life (or, light) to the theory and prove its success or failure in providing a viable system. And *Alhamdu Lillah* I believe that the paper given by Br. Monzer Kahf provided a very valuable insight in the major issues under this topic and I trust, Insha Allah, that the discussion will indeed enrich the subject and add underwheel.... (or, render) more or deep insight in understanding these basic issues. I would like to open the floor for questions and comments. Please try to be as brief as you can. I would like to adopt a little bit modified system. I would prefer that as long as the room is small and that every one can speak, ask his question himself, be brief and precise. And the only thing/ problem will be the hustle with the microphone. So, please you can start with any question you would like to ask.

Question: Ijan Latif from Ministry of Economic Affairs and Finance, Iran

First of all, I would like to thank Monzer Kahf for his very good speech, and I would like to ask a question: "Besides *Zakah,* it seems to me that there should be some *kharaj.* The role of *kharaj* should be very important in the fiscal affairs of Islam, especially if the *Zakah* is not enough for the state or the government. Thank you very much."

Monzer Kahf:

The issue of taxes will be discussed in another lecture. However, the word *'kharaj'* was used historically to mean the rent of the land owned by the state, that is owned by the all *Ummah* as represented by the state. So, this is the historical use of the word *'kharaj.* It has started at the time of the Prophet (Pbuh) in Khaybar and then it continued for the conquered land that was made public property and owned by the whole *ummah* during the time of 'Umar and after him.

In brief, *Zakah* is designated for certain usages, it can not be used for outside these usages, i.e., the eight categories mentioned in the Qur'an. The government depends on the availability of other resources especially from public property, to finance its operations. Obviously if there is sufficient revenues from public property, you don't impose any taxes, because you don't need them. But if there is no sufficient other revenues, then you go and talk about taxes. To impose a tax on land owned by Muslims and call *it 'kharaj* is not consistent with the idea of *kharaj. Kharaj* historically means rent of the land owned by the *Ummah* and given to the private sector, to run and cultivate. That rent is called *kharaj.* But, as a Muslim, why should you impose *kharaj* on me? Because the land I have is mine not the *ummah's.* Even if you need the revenue, you talk about taxes not *kharaj,* that is a different issue. Anyway, we will discuss it in some detail, *Insha Allah,* when we talk about public finance.

Question:

This is Habibur Rahman, Rajshahi University, (Bangladesh).

Thank you brother Monzer Kahf. I have some comments, first, in respect of imposition of Muslim Law of Inheritance. Unless this Law of Inheritance is imposed emphatically, you know, there will be a lot of troubles and problems; in Bangladesh especially with regard to women's part of inheritance.

And the second, there should be special mention about women. Because women are, more or less, in global context deprived of their rights and roles under the global systems. So, how the state can help in getting the resources of women promoted, developed and involved in the process of production and distribution. I think these two issues may be included in this paper which may enrich us and the paper as well. Thank you very much.

Monzer Kahf

Thank you, brother. I think you are referring to two important points and perhaps I should have said a word on them when I spoke about 'law enforcement'. For the Inheritance Law, it is in Islam one of the devices that work towards redistribution of wealth in an equitable manner. With regard to the role of women in the economy, I think we realize in Islam that *"al nis 'a shaqa'iq al rijal"* as the Prophet said. The word *shaqa'iq* means the equal part as if they were one thing cut in two halves. This means that men and women are equal halves, i.e., Islam equalizes woman and man in their political and economic rights, work, property,

etc. without any difference. So, if some Muslim societies today for some reasons impose differences, it is their problems, their mistakes, not that of Islam. Thank you**.**

Question

Thank you very much. I am Abdul Hamid from Islamic University, (Kushtia, Bangladesh): "The paper is very exhaustive, there is no doubt about it. But just for the sake of clarification, I would like to raise some issues. Br. Monzer Kahf has, at the initial stage, clarified that this paper although it is called 'economic role' it also covers the politico-economic aspects, that means it also covers the political aspects, that is fine.

And one question, he has said that one of the objectives of Islamic state would be to guarantee a minimum level of living for all. On the other hand, on page 2 of the outlines, he talked about the management of public property in the interests of Muslims. I would like to ask him whether he would anticipate any conflict between the two objectives.

My second point is that, he has said, about the balance, the economic and social balance, as one of the objectives of the Islamic state. I would like to add here that not only we should try to maintain economic and social balance, but also ecological balance, which means if it really disregards the environmental aspects, it might create a problem.

And, another point related to the public-versus-private problems. In the paper, it appears that you are giving too much emphasis on the private ctor, and in analyzing the public sector, you have always pointed out that one of the basic tasks of the public sector should be to give help, assistance and incentive to the private sector. I don't know it would have been more useful if you could find out the activities that should be covered by the public sector and they should be dealt with in the private sector.

Also, you have said that there may be discriminating prices for the public goods. How you would describe this discriminating price for public goods? Because in Bangladesh we have this discriminating policy but it was not successful at least with respect to the prices of fertilizers for producing agricultural commodities.

Another point is, you may have mentioned about the role of *Zakah*. Of course, I don't understand many things about it. In the Qur'an, as we have mentioned, there is a talk about *sadaqah*. Is *sadaqah* as specified in the Qur'an the

same as *Zakah*. And if that is so, then in the Holy Qur'an, the sort of *sadaqah* that has been mentioned, can it be used for economic development? Are you advocating that use of *Zakah* for public development projects? I am not sure whether *Zakah* fund can be used for that sort of development project. Please clarify.

My final point is the credit policy, here I am really confused. Of course, I am really confused in many other aspects too, about the role of credit policy in the public sector. I am not sure whether credit is allowed in Islam. Because, you mentioned yesterday the *Qard-e-Hasan,* of course, it is allowed; it is mentioned in the Holy Qur'an, too and the credit of the loan whether the public institutions can and how, I don't know, how they are going to deal with a loan policy, credit policy giving the dictates of the Holy Qur'an. Thank you.

Monzer Kahf

Thank you Abdul Hamid, too. Coming to these points. The first point - I don't see a conflict. Where is the conflict between guaranteeing a minimum level of living and managing the public property to the best interest of the people, i.e. managing public property to generate maximum return so you can improve your ability to help the poor and to guarantee them their basic needs, and any surplus revenues that is beyond and that is also their right. What you give is coming out of public properties anyhow. Public property is, in principle, a property of all Muslims in a Muslim society and the government in the Muslim society is responsible for any citizens who live there. So guaranteeing the minimum level of living is for any person regardless of religion or race. This is a right of everybody, that is the guarantee of minimum level of living. Therefore, non-Muslim minorities are also taken care of; you cannot leave their level of living lagging or unpromoted and unenhanced simply because they are not Muslims. Moreover, one can definitely argue that you should also care about adequate level of living when resources permit for Muslims and non-Muslims alike. This was done at the time of 'Umar when resources permitted. He had given Muslims and non-Muslims alike.

For the second point I appreciate you worry about the public sector, because of my too much emphasis on the private sector. Perhaps I had too much emphasis because there are some fears in my mind that it is usually under-emphasized by many Islamic writers and we will have time to discuss the public sector more in the other lectures. I think that there are areas where the state should run the economic scene, that is, areas that should not be given up by the state

according at least to majority of *'ulama* and I mentioned among them the mineral and the public sources of energy.

Yet, with regard to land for example, even public land, it would be better to follow the example that was done by the Prophet (Pbuh) and by 'Umar after Him, to give it to the private sector to cultivate instead of keeping it in the hands of the public sector. So there is some balance. There are areas where the state should be in, but we need not to think in terms of existing situations in many Muslim countries where electricity, telephone, water, sewage, and garbage collection should all be done by the state. These need not necessarily be done by the state. We call them public utilities and we can't but to think of them that these should be state's projects, including education. That should not necessarily be the case. And it is not necessarily the case in the Islamic system.

For the discriminatory prices, I mentioned the possibility that the state may use discriminatory prices. Definitely according to the principles I mentioned, there should be no discrimination against the poor. For example, some economists argue that to promote development, you should take savings from agriculture and inject them in industry in order to make a take off in the economy. This can be done through a discriminatory price policy. It seems that this is not acceptable from the Islamic point of view. Because you are taking from the poor and giving to the rich, it should be the other way around. No matter what you do, it can not be accepted in Islam.

The point for *sadaqah* and *Zakah* - the word *sadaqah* in language covers both voluntary and obligatory donations. *Zakah* is a form of *sadaqah* in that sense, but it is obligatory. In the Qur'anic terminology, in many places the word *sadaqah is* used to mean *Zakah* itself. And yet in many other places it is used to mean the voluntary contribution. For instance, even the verse that talks about obligating *Zakah,* uses the word *sadaqah,* not the word *Zakah. "Khudh min amwalihim adaqatan tutahhiruhum wa tuzakkihim beha"* خذ من أموالهم صدقة تطهرهم وتزكيهم بها The verse that talks about its distribution also uses the word *sadaqah "innama al sadaqatu lil fuqara'i wal masakin ...,* إنما الصدقات للفقراء والمساكين..." But in these two verses, definitely and without any dispute among commentators, *sadaqah* means *Zakah,* the obligatory form of *sadaqah* nothing else.

The use of *Zakah* in public developmental project? This was not discussed in my lecture. But I can say a little about it as a quick answer. For example, there is a *fatwa* by the OIC *Fiqh* Academy to the effect that *Zakah* may be used in some projects that are of public benefit provided they are addressed to help the poor and the needy, etc. without giving the ownership of that project to the poor and the

needy. On the other hand, the four schools of jurisprudence, *Hanafi, Maliki, Hanbali* and *Shafr'i* - all of them agree that *Zakah* must be made owned by the recipients, i.e., you give it to the poor, who must own it. You cannot only give him its benefit or its return, you have to give him the ownership itself. Surrendering ownership of *Zakah* proceeds to the poor is necessary according to the four schools of jurisprudence. But that fatwa came using some opinions that are not very famous in the classical writings. On the other hand, I should say, even without going against the opinion of the established four schools of jurisprudence, you can make many public projects and make them owned by the poor and perhaps by doing so you can achieve a double target. For example, you need in your five-year plan school buildings. Build schools from *Zakah,* rent them to the Ministry of Education, let them be owned by the poor and make cooperatives, societies or corporations of them. These cooperatives will collect the rent and distribute it to the owners. Now, you have used the *Zakah* proceeds for the poor, you invest them especially for longer term, you give them full right of ownership and for their children after them, and at the same you achieve your developmental project target. There are many places where *Zakah* can be used in similar ways. You may build hospitals, and rent them to the private or public sector. You build an airport and rent it. You can use *Zakah* in that way as long as you are distributing the equity to the poor with the principle of *tamlik*... that is you make it owned by the poor, to make the project owned by the poor, why not? Through an equity system of shares and stocks.

With respect to the credit policy of the state, there are two points: 1) state institutions that give credit. Like the central banks or like the *Zakah* institution which may give some loans or may work on credit basis. In 1978 I presented a paper on the use of *Zakah* to provide credit. The inflow and outflow of fund in *Zakah* is not synchronized together by definition. So, that lack of synchronization of inflow and outflow of funds allows us to provide credit on the basis of the monetary multiplier. This is the same way you create credit in banks. So, you can create credit through the *Zakah* institution and its branches; exactly by the same way as the banking system behave. However, the more important mechanism is the governmental institutions that provide credit. By using those governmental institutions and their credit policy you can effect improvement in output on sectoral basis and on any other basis to achieve certain objectives. Also comes here the credit policy of the central bank; marginal requirements and other requirements. Even under the *murabahah* and *mudharabah* system there are requirements and tools that the central banks in the Islamic system may use. They also include rate of mark-up and rate of *mudharabahh* or *mushrakah,* rate of distribution of profit, imposing certain limits or ceilings, etc.

Question: K.T. Hussain

Mr. Chairman, before I make the specific point, may I bring to your kind attention that the subject of discussion is Teaching, Islamic Economics at University Level but we are spending our time on particular matters to be covered in Islamic economics. Possibly this would be helpful in planning our curriculum syllabus but there are lots of problems in connection with the teachings of Islamic economics at the university level. Those should also get our attention. From now on I would suggest that we keep this fact in mind and as regards the teaching of Islamic economics itself, planning curricula and so on we should actually give more attention and the organization may have to be recast in that connection.. This is just my personal opinion.

Now, in connection with Monzer Kahfs paper presented this morning, a particular point which I like to bring to his attention is on page 2, 2nd para, item 6, of the outlines the writer is concerned with matters related to *shura.* Now, in case of *shura,* is it necessary to look for the approval of the people or can we rely on an individual's own judgment particularly if the judgment is in the light of some exposure to the teachings of Islam ? Thank you.

Monzer Kahf

Since the issue was brought in more than once, let me take a little time to answer it. The organizers inculcate teaching Islamic economics at university level with discussion of the issues that relate to what is to be taught and that issue include the exposition of Islamic economics, issues of Islamic economics etc. This is our interpretation of the title of the seminar and it is meant for the university professors mainly. So, they have good exposure to Islamic economics and they can select subjects and formulate courses or lectures out of it in their teaching. The objective of the seminar is not restricted to discuss the problems of how to teach Islamic economics alone. Our issue is not problems and manners of teaching Islamic economics at university level rather it is teaching Islamic economics. So this is our interpretation anyway, I think we have the privilege for that interpretation and there is a session on Thursday August 1st that will discuss the issue of teaching Islamic economics in universities.

The point on page 2; I think there is a lot of writings on this issue by many Muslim scholars, one of them is *Shaikh al Qaradawi,* to the effect that a ruler has no right to impose decisions out of his ownself. Nothing in *Shari'ah* permits such a thing without approval of the people. Your wish cannot be an obligation on others simply because you are a ruler. The *Shari'ah* determines what is obligated

and what is not. Other things are to be decided by people themselves; and a government only represents them, it cannot take action without approval of those who have the right to decide. There is a lot of discussion in Islamic political theory on whether Shura is binding or not. Personally I believe it is definitely binding, otherwise we will be just laughing at people and cheating them. If the Shura is not binding, it makes no sense as Ab al Ala al Moududi argues. If you are to consult then you have to be bound by that and I believe in that; I go along with Qaradawi and Mouddudui and many other thinkers including Turabi, Mohammad Selim Awa who wrote on the issue of Islamic political science. That is why I did not represent the other opinion at all which I think does not make a coherent sense.

Question

I am Muhammad Serajul Haq from Chittagong University. Brother, I have two points; first of all the functions of a state can be classified in three categories - actions related to maintaining efficiency, action related to *Shari 'ah* stability and actions related to equity. And I wonder whether we need these functions of a state in Islamic environment. And secondly, there are cases where state actions are called for. For example, the case of market failure, the case of public goods, the case of externalities. Lastly, out of what I have learnt from listening to you and other speakers in the seminar so far, may I come to the conclusion that teaching Islamic economics does not necessarily preclude teaching mainstream economics and in Islamic economics we can complement and modify mainstream economics. Am I correct ?

Monzer Kahf:

Thank you Br. Serajul Haq. I think in your last sentence you are correct for highlighting the complementarity between Islamic and conventional economics, but this calls for you to keep in mind that most of us, who speak about Islamic economics, don't usually like to talk about things that are known **and** are granted in economics, an example of this is that I did not make any details about monetary policy and fiscal policy. If you notice, these are well-known. Taxation, expenditures and deficit, tools of monetary policy other than interest, these are known and accepted in practice. These are the things that you find in regular text books and everyone of us wrote about them. So, in that sense only and from that angle, we see teaching Islamic economics as complementary. On the other hand, do we have to be bound by the standard classification that is mentioned in conventional economics, I think we need not to be bound by that. So from this angle we attempt, at least, to think freshly, without being bound even by the terminology. That is why I avoided the whole issue of market failure, because, all

it tells is: that there are areas where it is better for the state to step in. The simple example is defence. Well, without going through this, we know in *Shari'ah,* that defence is a responsibility of the state, as is law enforcement. These matters cannot be left to individuals. This is known in the Islamic literature as the *wilayat 'ammah.* The *wilayat' ammah* mean public authorities that should be taken only by the State, and *hisbah is* one of them. No one can make an ombudsman out of oneself... Just you can not leave these to the private sector. It may be suggested that one should make specific effort to take the issues from the sources of Islamic economic literature, especially the classical one without putting them in terms of the conventional economics because I feel one need not to be bound by those terminologies and that approach while looking at these issues. This is the reason why I avoided the whole issue of market failure in fact.

Question

My name is Ibrahim Qahatani from King Fahd University, Saudi Arabia.

Appreciating Monzer Kahf s presentation, I have some questions regarding taxes. Since you mentioned in your lecture that during the time of the Prophet (Pbuh), taxes were not raised by him; and in some certain cases he resorted to voluntary contributions, but during the history of Islamic Khilafah taxes were imposed and we have some problem in that. Could you elaborate on it, what relevant taxes and what is the rate of taxes possibly since you mentioned something about that in page three of the outlines, when you talked about public sector's services and you mentioned service taxes. Thanks.

Monzer Kahf

Thank you, Br. Qahtani, I think we will discuss taxation in detail in another lecture. Look at the other outlines that you have, you will find it there. But anyway, in brief, the way I understand it, taxes are looked at in Islam as a last resort. You come to them only when there is very clear justification for them. Without that, no state has any right to impose taxes. Inasmuch as it has other resources it cannot impose taxes. Simple example is during the time of al 'Izz bin Abd al Salam in Egypt, in Cairo, when the ruler wanted to impose taxes. And he told him no, you cannot. He needed the approval from the great Judge, and al 'Izz said no, I would not approve of it and they had clashes so he left and embarked on his way to migrate outside the country. Anyway, the story goes that the ruler could not govern without him. So he asked him back and he told him: well, you can only impose taxes after you exhaust other sources, since the state is rich, you yourself, as a ruler, you were a slave owned by *bayt al mal;*

how come you took over by power (the ruler was a soldier slave owned by *bayt al mal).* Let us start by selling you and other generals of your army and then we can use the return instead of imposing taxes which were needed to fight the Moghul. So he was able to force him sold, but the king then found ways to be freed again, but through that process *bayt al mal* got resources which were used for the battle in which Muslims defeated their enemy even with a very small number. One cannot say that a government that owns huge amount of resources may impose taxes. Take simply many oil rich countries. I think they should not impose any taxes, as long as they have so much resources, and imposing taxes in such countries seems to be outside the limit of Islam

CHAPTER NINE

THE CONCEPT OF OWNERSHIP IN ISLAM

*Monzer Kahf**

Ownership is referred to in the Qur'an many times. Very often earth, heavens and everything in between are attributed to • God as their True and Absolute owner. For instance, Verse 5:17 says "to Allah belongeth the ownership of the heavens and the earth and all that is between". In reference to property the Qur'an is specific, however, in relating ownership to individuals as in Verses 24:61 and 36:71 respectively : " Houses whose keys you own ...", and ".. livestock which you own ".

The Islamic concept of property ownership is derived from this kind of Qur'anic statements, i.e. the Creator is the Owner of everything; and He has made subject to human beings creatures such as the earth, the sun, the moon, the sea, the rivers, etc. (see: Verses : 14:32-34, 16:12-14, 31:20 and 45:13 of the Qur'an). This is based on the idea that human beings are the vicegerent of God on earth as mentioned in the Qur'an 6:165 "It is He Who has made you vicegerent of the earth" and 57:7 " ... and spend out of the substance whereof He has made you heirs...". Vicegerency belongs to all the human race, the children of Adam who are required to act in accordance with the regulations set forth by the Real Owner. However, the expression of many Verses explicitly or implicitly refer to a certain form of property ownership by human beings and the Islamic law, *Shari 'ah,* considers property rights as God given and God regulated**.**

In legal terms, personal property, which is referred to in many Qur'anic Verses is defined in *Shari 'ah* as "an exclusivity over an object vesting the owner, alone and on owner's own behalf, with a legal authority of its use and enjoyment and of its disposal except when legally restricted" [Abbadi: v.1, p.150]. The object of personal property may be material or abstract and it covers intellectual as well as financial properties. Under all circumstances, the object

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matter of personal property carries a moral and religious connotation according to Islamic law. For instance, since the Islamic moral standards condemn alcoholic beverages and other intoxicating substances, these cannot be an object of personal property, i.e., cannot be owned by a Muslim. The same applies to swine and its products as they are religiously prohibited in Islam.[1]

Implications of Property Right

The first and most important implication of this definition is that ownership in Islam is a right or collection of rights allowed by God, the Ultimate Law Maker, not by the society or its legislative authority. By no means, the society and its law-making organs have any legislative power to alter the basic rights laid down by God. Property right is therefore a natural right given by Allah not a societal function decided by the society (Abbadi: V.1, pp. 426-439).

Second, private property is protected by the *Shari 'ah* itself. *Shari'ah* in Islam is the Divine law whose essential landmarks and principles are given in the Divine revelation, and whose details are worked out by human beings on the basis of the Godly revelation as manifested in the Qur'an and the traditions of the Prophet Muhammad. Therefore, *a Shari 'ah* protection is an eternal protection according to the Islamic system. This protection stands against any possible transgression from the government as well as from any other person.

Third, property rights entitle the owner full authority to use, benefit from, exploit and dispose of the owned object. Muslim jurists usually use the term "owners are absolute masters of their properties", which implies a wide range of economic freedom. This is of course within the limits of *Shari'ah* which regulates private and public properties and forbids unfair exchanges.

Fourth, property rights are free of any prejudice on the basis of sex, religion or ethnicity. The Islamic *Shari'ah* equalizes men and women with regard to property rights at an early time in human history, preceding most other legal systems and cultures.

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1 *Shari 'ah* makes exception for religious minorities in as much as their moral standards permit. Thus, under the Islamic law property rights apply to alcoholic beverages owned by a christian or a jew and to swine owned by a christian. Hence, an Islamic court may hear a dispute about them while it may not hear a dispute if those things belong to a Muslim.

Coexistence of Public and Private Properties

From the point of view of property owner, jurists distinguishes between two kinds of property : private and public.[2] Private property is individually owned by private persons.

Public property is owned collectively by the whole society or community. It covers things that benefit all members of a society or a majority of them such as roads, rivers, forests, parks, lakes, natural springs and fountains, pasture lands not privately owned, etc. It also includes land not privately owned, land designated for community use around villages and towns and mineral resources. The legal foundation of public property is derived from the many Qur'anic verses that assign property to the whole society or community in addition to certain sayings of the Prophet Muhammad such as : "people are common partners in three (things) : water, pasture and fire". A version of this saying mentions salt. By analogy to items mentioned by the Prophet, *Shari 'ah* scholars add roads, places of worship and sources of solid and liquid minerals whether they exist underground or on the surface.

As the society is represented by a government, thus according to *Shari 'ah,* an Islamic government is the authority that administers public property on behalf of people and to their best interests. From the point of view of regulating the government power in this regard, public property may be divided in three types[3] : 1) Community public property, 2) non-used public land, and 3) state public property.

1. Public property designated for community use such as roads, rivers and mosques. This type of public property cannot be sold or disposed of by the government nor can it be acquired or owned by private persons. However, if a community public property ceased to produce its desired benefit to the community and becomes deserted, the government may substitute it for a new property that can give

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2 Some Islamic writers like to add a third category, waqf property. Although its use is restricted to the purpose designated by the donor, ***waqf*** property is considered owned by private parties (donor or beneficiaries) by most Muslim scholars. Some, however, believe that once designated for its philanthropic purpose, the waqf becomes a property of no one but God.

3 Some jurists prefer a three fold classification to start with. Accordingly, property may be private, state's or community's.

similar benefit. Community property includes pasture and firewood lands surrounding villages.

In many African countries, community public lands still exist. They are related to a tribal social system. This is a dominant form of land ownership in pastoral areas, but it is also present in farming areas. This form of community ownership is also present in some areas of the North-African Muslim countries where land owned by tribal farming communities is called arashi land in Algeria and Tunisia. Usually tribal customs and traditions determine the distribution of community owned lands among families for cultivation and except for the *ushr,* which is the *Zakah* on agricultural products, there are no taxes or fees levied on families using collectively owned lands.[4] *Ushr* is usually distributed to the poor and needy by tribal chiefs with the help of the village mosque's imam or prayer leader.

A special kind of community public property is called *Hima* (lit.: protected) land. This is a lot of land appropriated by the government for a specific use, military or philanthropic. 'Umar, the Second Khalifah after the Prophet Muhammad, assigned certain lots for the army's horses and camels and for the cattle of the poor and needy.

2. Non-used public land covers all lands that are not included in economic production. In *Shari 'ah* terms, this land is called *mawat* (lit.: dead). According to *Shari 'ah,* individuals have the right of putting this public land into an economic use and this is considered a sufficient cause for earning private ownership of the land. This is called the right of ihya' . revivification). The Islamic state can organize the exercise of this right but it cannot eliminate it.
3. State's public property covers all other public properties whereby the only *Shari 'ah* restriction on the behavior of the government is the criterion of serving the best interests of the people.

Gaining Property Right

Shari'ah recognizes six causes for personal property rights :

4 *Ushr* is ten percent of total agricultural products if the land is rain or river fed and five percent if it is irrigated by underground water.

1. Lawful work in acquisition of unowned mobile things such as obtaining water from a river in a container, hunting and collecting firewood.
2. Revivification of non-used public land. Work of land revivification implies making it productive in agriculture, industry or any other economic use. This means that mere acquisition of land by fencing or demarcation does not create a right of ownership.
3. Growth of an already owned property with or without labor involved. This includes fruits of owned trees and offsprings of owned livestock. It also includes increments in value of owned merchandise.
4. Contractual relationships including exchange contracts such as sale and hiring, contributory contracts such as those involving gifts and last wills, and acceptance of religious and legal spending obligations such as taking *Zakah* payment, alimony, money solemnly vowed to certain lawful purpose and expiatory payments determined in *Shari'ah* for committing certain sins such as breaking the fast in the month of Ramadan or making certain mistakes while performing hajj (pilgrimage to Makkah).
5. Tort liability which creates a right of compensation.
6. Inheritance, where details of heirs and their shares are mostly given in the Qur'an.

Noticeably, the former three causes create a new property right while the latter three transfer an existing property from one person to another.

Prohibited Means of Acquiring Property

On the other hand, *Shari'ah* does not recognize three kinds of means of obtaining property and invalidates ownership resulting from them.

1. Non-contractual acquisition of property belonging to others: this includes : theft, swindle, plunder, looting, usurpation, acquisition by coercion, fraudulent practices, etc.
2. Acquisition of non-used land without its revivification. This kind of acquisition is usually done by demarcation as is called *tahjir* in *Shari'ah* (lit.: demarcation by stones).

3. Exchange relationships that are either invalid or prohibited in *Shari 'ah*. Invalid relationships include contracts lacking some of their basic requirements such as consent of contractors, and prohibited exchanges include : a) interest on loans since the Qur'an mentioned that a lender is only entitled to get. the principal back alone and considers any increment as oppressive (Qur'an 2:219); b) income from gambling (Qur'an 5:90-91); c) bribery and similar exercises; and d) contracts whose object is condemned in *Shari'ah* such as transactions on prohibited substances like alcoholic beverages, prostitution, etc.

Things acquired by prohibited means remain a property of their original owner and should be returned to him/her or to their rightful heirs. If owner or heirs do not exist, such things should be disposed of for charitable purposes on behalf of the true owner.

Restrictions on Property rights

The Islamic *Shari'ah* distinguishes between two kinds of restrictions on property as follows: 1) restrictions on use and disposition, and 2) restrictions resulting from conflicts with the public interests.

1) Restrictions on the use and disposition of one's property:

As the objective of property is the benefits and enjoyment derived from owned things, *Shari 'ah's* regulations aim at assuring that property fulfills its objectives. The Qur'an ordains taking one's best appearance and condemns those who prohibit adornments, beautiful living and good things of sustenance (7: 31-32). At the same time the Qur'an forbids wastefulness "for God loveth not the wasters (7:31) and considers spendthrifts as "brothers of the Satan" (17:27). This led Muslim jurists to treat wasters and spendthrifts as legally inapt to use their own property and to subject them to legal guardians (Abbadi v.2, pp. 86-96).

On the other hand, the use of one's property is constrained by others' rights. This means that extracting benefit and enjoyment of one's property must not be at the expenses of the rights of other individuals nor of the society as a whole. The Islamic law disallows this kind of exercises regardless of personal intention, and charges the harm doer to compensate the injured. Examples of such actions are raising one's

building to an extent that reduces the ventilation and sunshine reaching a neighbor's property (individual harm) and monopolistic practices (societal harm).

A third type of restriction on the use of property is related to inheritance and last will. Since the True Owner of all properties is God and private property is only a Divine grant, the ownership right holds as long as the owner lives, but upon death it goes back to the True Owner. The inheritance law in Islam is strictly founded on this principle. Shares are assigned to different heirs by God in the Qur'an and the owner has no right of changing these shares under any circumstances. The heirs in *Shari 'ah* are: sons and daughters, parents and grandparents, spouses, brothers and sisters, uncles and aunts. Their respective shares are given and a sophisticated detailed chart is drawn according to which the estate is divided. Moreover, a person may make a last will provided that it does not cover more than one third of the estate and it does not alter the relative shares of the heirs. Permission of making last will is called "a charity from God on us" by Abu Bakr, the most prominent companion of the Prophet Muhammad (Pbuh).

A fourth type of restriction on property is based on contractual relations whereby through mutual consent and free will an owner accepts to separate ownership of a property from its usufruct and surrenders one of them without the other.

2) Restrictions stemming out of conflict with the public interests:

In recognition of philanthropic needs in any society, the Islamic *Shari'ah* institutionalized a built-in financial obligation on personal property. This is called *Zakah* (lit.: purification and growth). It ranks as the third pillar of this religion after pronouncement of faith in God and His messenger and performance of prayers. This financial/religious obligation on property has, generally, a rate of 2.5% of the value of property with exemptions related to living expenses. The Qur'an exclusively specifies eight categories of potential recipients and heads of expenditures for the proceeds of *Zakah,* all but one are of charitable and community service nature, the exception is the cost of collection and distribution of *Zakah* itself.

Besides, this obligation, other financial duties or taxes on personal properties are determined by the needs and interests of the society if the stream of public revenues coming out of public property proves to be insufficient. Such taxes are of temporal nature and are determined by the legislative branch of the state.

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DISCUSSION

Chairman

Thanks to Monzer Kahf for his brilliant position of concept of ownership in Islam. Now, it is discussion session, but, I have a comment on Monzer Kahf s speech.

Allah is the creator of the universe and what he has created in the universe belongs to Allah and Allah alone. We, human beings, are the vicegerents of Allah. We can also own property but with instructions of Allah. This is clear in the Qur'an and *Sunnah*. This is the coexistence of private and public ownership. There are two kinds of ownership. Public ownership and private ownership. Private ownership means what individual owns and public ownership means what a community owns. Allah created all the things for us human beings, to exploit it and to use it. For the individual and the community, how can Islam maintain a proper balance or coexistence of public and private ownerships? There is an issue of freedom, less freedom or more freedom!

Chairman

I invite questions from the participants. There is one question from Mr. Tajul Islam.

Tajul Islam

How do you differentiate between state ownership and community ownership?

Monzer Kahf

The government has limited authority with regard to the community public property, whereas the state public property can be disposed of by government decision or whatever collective decision-making process, i.e., by the normal working of the public authority. The community public property cannot be done away within that simple way. There are limits in *Shari 'ah* itself; one of

them is that individuals should be left free to extract usufruct from the community property. The implications are important. For example if people are free to take water from the river as they desire and the government decides to distribute water in pipes through the city, a question arises, whether the government can charge more to water users than the cost of the government investment? It seems the answer is negative because it is their right that you are regulating and organizing, nothing else. They have the right of accessibility to water. Now, the same thing, can you charge them for having solar units or solar heating cells on their roofs? It may not be possible from the *Shari 'ah* point of view to charge such a tax.

On the other hand, a building owned by the state, can be rented by government decision. The matter here is of government disposing of its property. The government, within the decision making process, can dispose of public state property to the benefit of the Ummah, for the need of state. But with regard to community public property, it is not that way. There is a limit on the power of the government. For instance, only if that property is no more used or if it is abandoned totally. Another example, suppose there is a spring in a village, can the government take the water of that spring through a pipe to another place? The government may not be allowed to do so as long as the village has inhabitants who need the water since the spring belongs to that village community; and the state has no authority in changing its use.

Abdul Hamid

First of all I would congratulate Monzer Kahf for giving a clear vision of the concept of ownership in Islam. As Br. Monzer Kahf was telling us about the concept of ownership in Islam, I was thinking of telling the problems we are facing in Bangladesh. I would like to refer to two of the problems that I can immediately remember. To begin with, Br. Monzer Kahf has said that ownership in Islam is not a social function and he has also mentioned that the government cannot restrict ownership of land. Formerly, before 1960 there was no restriction on private ownership or family ownership. But after 1960, there were higher limits put on ownership. So generally, we can say that 20 acres of land a family can own, but not more than that. My immediate question is: is it really allowed in Islam that a limit be put on land ownership such as this 20 acres of land? I am asking this question because it may happen that there is only one person in a particular family and you will have to face this allotment of land. Obviously one person cannot make full utilization of all that average of land. But if utilization of the land is within a family say, there are 25 persons,

definitely what we talk about of land allotment may be applied reasonable. So, do we consider when we put a limit, also the size of family or whether the family in question can make full utilization or not?

My second point is about environment, because 1990 was the environmental year in Bangladesh and 1990 - 2000 decade is called the decade of environment in Bangladesh. So, let us talk about a fear of disenvironment. Assuming that one owns 50 cubic meter of water acres, this can be used for irrigating, high yielding, valued crop or substance. This is the whole water that we have in land, that can fully be utilized for irrigation. Assuming that 1% of the population has got several 50 cubic meters or for several tanks of water. This is a private property; you can use it in any way you like. So, the owner may stop withdrawing water he may take all the water; to irrigate crops. Now, as it is happening in Bangladesh and some other countries too, the people are afraid that there is going to be an ecological imbalance in that respect that ownership drifts away. Is the use of water from the land on that piece allowed as a principle of law in Islam? Thank you.

Monzer Kahf

I am not equipped to answer questions related to *fiqh,* as I am not specialized in *Shari 'ah.* However with regard to putting a limit on ownership of land, some *fuqaha* during the land reform era that prevailed in the 1960's in some Arab countries, Pakistan and Bangladesh, approved of it under certain conditions and with proper compensations. There were many *fuqaha* who opposed it too. It seems to me that we have to think twice in *Shari'ah,* whenever we talk about exceptional cases such as this issue! But when we talk about the system, what is the Islamic system? As a matter of principle, there is no limit on land ownership or on ownership of any other permissible thing. On the other hand, can this be harmful sometimes? At least theoretically, I can think of cases where unlimited ownership of land or business property may be harmful, it may hurt some of the basic interest of the society. Under these circumstances, I think, land reform may be approved.

On the other hand, you may agree with me in most cases we can review in our minds many Muslim countries that imposed these limits and made land reform where they are not in fact exploitative and unfair to the extent that they are changing these systems now-a-days? I think, if you want to really put a limit on land ownership i.e. if you want to talk about the exceptional cases, you have to prove that there is a serious harm that cannot be avoided except by such

measures and that these measures do not create more harm than what you are trying to avoid. In fact, under the exceptional cases, the government can ration the amount of food we eat and the amount of water we drink! But prove to me that there is a necessity for that measure first. Once it is proven, it becomes permissible as an exception.

The second point, I agree with you. I think we can find examples even from the *Sunnah* on the environmental issue. It was widely represented that people should be made to pay for whatever environmental damage they may cause; they should not be let free. People, according to *Shari 'ah,* are responsible for any environmental damage resulting from the use of their property, or the excise of their freedom; and they must pay for it.

More than that there is the concept of private *hima. Hima* means protection, a person who owns a well has a private protection that within the well's vicinity no one is allowed to dig a well.

This is to protect the sources of water of the first well. The third point that you are raising, that some property may have been earned not by means acceptable to *Shari 'ah.* Those definitely must be removed; and if you know your property is of this kind, definitely, you should get rid of it and give it away, where you think it belongs and if you don't know where it was originally and whose it is, you give it to the state or give it to charity. Muslims are required, as individuals and the state is required as an institution, to make that correction. As an individual, who is motivated by the Islamic morality, principles, and commitment, you know that you will be judged on the Day of Judgment by Allah who knows well, and you know, that this property was taken by your father or grandfather or what not through improper means, then **you** are required to return it to where it belonged originally, i.e., the right owner. If you don't know who is the right owner, then you give it away for charity or you give it away to the state. The state is also required, in Islam, to do the same, to take away from you all properties illegally acquired, but only in those cases. The question was raised in regard to Algerian land; that many lands were taken from the French colonists at the time of independence. These lands were previously owned by Algerian and were taken from by the colonialist authority. So returning these lands to Algerians is putting matter to its just order.

But you cannot claim that anyone, who has become rich, had used improper means; you cannot make that claim unless you verify it in the court of justice, i.e. you cannot make a blanket statement. If you talk about justice, then

justice is what the court determines. However, if you have conviction that a property you possess is not really yours, then you are required to implement your own conviction. The example is when we see the new moon of Ramadan. If you saw the new moon and nobody believes you, you must fast alone because you are required to act according to your own knowledge, even if the whole city or country did not fast. But when the issue relates to property of other people you cannot implement your own convictions by changing them into a slogan that runs through the country by mass demonstrations. To be just you are required to have court acceptable evidence.

Question from Hyder Rahman

Please clarify the motion of nationalization in Islam, especially that some Muslim countries claim nationalization in the name of Islam, but does Islam say no?

Let us take as an example Algeria. That country got its independence in the year 1962. The majority of cultivable and actually cultivated land, and real estates were owned by French colonists, of whom almost 98% have left the country in 1962. Would the properties owned by these colonists be nationalized or not? Definitely, yes; in that case nationalization of those properties is a must, because we know that before the year 1830 there was no single French person living in Algeria and we know that there was no single property owned by any French person. We know also that between 1830 and 1962 there was so much exploitation, confiscation, taking land and other properties by force, and abuse of the law against the Algerians and to the privilege of French colonists. Now, what is the position of Islam on that case of nationalization? Of course, yes. It is a case of nationalization where, I think, no two Muslim scholars will differ. Take another case. Nationalization of industry and other businesses in some Muslim countries where industrial and business owners were acting within the law and had entrepreneurial skills with which they built these assets. Now, I think, there is no Muslim scholar today who may argue that it was done with justice, it was so grossly against the principles of Islam. You know why? Because it hits normal people, owning property in the legitimate ways. You may claim that there was some exploitation and verify it and change it. You may claim that there is linguistic in the distribution of wealth. Now, if you want to implement Islam, one should start with the feasible means; means that are within the limits of *Shari 'oh,* e.g. collect *Zakah* for five years in advance and redistribute it. By collecting *Zakah* for five years, you can redistribute at least

+10% of the outstanding wealth of the rich in the nation. Why going into nationalization when you can use other means that are consistent with *Shari'ah?*

The Chairman

I believe that Monzer Kahf has explained his views. I, on behalf of myself and on behalf of all the participants, thank him for his brilliant presentation. I thank you too, colleagues and participants. Thank you.

PART III

SOME MACRO AND MICRO ANALYSIS IN ISLAMIC ECONOMICS

CHAPTER TEN

MACRO-CONSUMPTION THEORY IN AN ISLAMIC ECONOMIC FRAMEWORK

Munawar Iqbal*

The topic of macro-economics almost always begins with a discussion of the consumption function: What is it and why we study it? You are all aware that there is a relationship between aggregate consumption in the economy and some independent variables. The usual independent variable is taken to be disposable current income. However, there are other variables which can explain the behavior of aggregate consumption as will be discussed during the course of this lecture.

The reason we are interested in the behavior of aggregate consumption (and I remind you that this is private aggregate consumption) is that this is one of the most important components of aggregate demand. The topic was made popular by Keynes, and there has been a lot of theoretical development in this area. As you know the basic purpose of studying macro-economics as such is the determination of the level of output and employment. Before Keynes these, as well as the aggregate output, were assumed to always be in equilibrium. Therefore, the emphasis of classical economics was on the distribution of a given level of aggregate output. There are, according to classical economists, automatic tendencies in the economy which always keep the level of output in equilibrium and employment at a full employment level. But Keynes, as you know, after the Great Depression when the level of unemployment went beyond 30 percent started the analysis of the determinants of aggregate output and employment and he popularized a theory of aggregate demand. He popularized the theory that the level of aggregate output in the economy is determined by the equilibrium between aggregate demand and aggregate supply, and it is not always automatically assured that the equilibrium is attained automatically. Therefore, there could be levels of disequilibrium and there could be unemployment in the economy.

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He formulated the question in the equation :

$$C + I + G = Y = C + S + T$$

He then emphasized the fact that since consumption appears on both sides, thus temporarily assuring the balanced budget, taxes are endogenous variables. This is the major contribution of Keynes. He said, therefore, the important thing which will determine whether the economy is in equilibrium is the equality between savings and investment, savings being the residual of income after private consumption, which is a stable and endogenous function of the level of current disposable income. He said that savers and investors are two different kinds of people and that they behave differently.

So if consumption is a function of income, then savings is also a function of income and investment, according to Keynes, was not entirely a function of income, it is not even a function of the rate of interest. Classical economists, as you recall, had the assumption that both saving and investment are functions of the rate of interest. Therefore, the rate of interest is the mechanism which automatically ensures that savings and investments are equal. Keynes, on the one hand, said that savings are not a function of the rate of interest. Savings are a function of the level of income and that is what gives you the consumption function because C + S = Y. So residual savings are a function of income, and consumption is also a function of income. As far as investment is concerned, he said that investment is a function of the marginal efficiency of capital which depends on business expectations and the internal rate of return, etc. So, this is the background that led the theories of consumption into difficulty.

In response to the Keynesian approach, some other secular theories of consumption function were also popularized. The first was the classical theory of consumption function which can be described as consumption being a function of the rate of interest because consumption is the counterpart or residual of savings as the latter is a function of the rate of interest. The attention of classical economists was on the side of saving. Therefore, S is a function of R, rate of interest, then consumption which is the complement of saving is also a function of the rate of interest, because given a level of output, whatever remains after saving is the consumption.

So this is, so to say, the classical consumption function. The Keynesian consumption function, I just gave you, is that consumption which is a function of

the current disposable income. After all you are all teachers and you teach this in your macroeconomics course. There were certain historical facts which were brought to our attention by Kuznet and others. The implication of the function form which Keynes gave is general, but the Keynesian consumption which we write in this way C = a + by has parameters that are the subject of our discussion today. The marginal propensity to consume is greater than zero but less than one and the marginal propensity to consume (mpc) decreases as the level of income increases. These were the two psychological postulates which gave certain characteristics to the consumption function. There were certain empirical studies which showed that if we take into consideration a long period, time series data, then the second postulate, which says that the marginal propensity to consume decreases when income increases may have little empirical support. The marginal propensity to consume comes below the average propensity to consume. However, that decrease is not always confirmed by data. Therefore, as far as the short-run consumption function is concerned, this kind of behavior is observed. The consumption function is not proportional in the short-run. The long-run consumption function is proportional and linear which means that the average propensity to consume equals the marginal propensity to consume in the long-run.

Now a discrepancy exists between the short-run consumption function which is the non-proportional relationship and the long-run consumption function which is the proportional relationship. Both of these were confirmed by empirical studies that give rise to a number of other secular theories of consumption function.

The most important of these are the relative income hypothesis of Deusenbury (I am not going into details because it would take three or four hours). Deusenbury's relative income hypothesis which is that consumption is not only a function of current income but is also a function of relative income i.e, "Y", being previous income that a person has achieved during life. Therefore, **a** person has enjoyed a higher income. If this income falls, consumption falls because there are two kinds of relative income theories. One is that he will try to maintain his previous level of consumption. He will not reduce consumption proportionately. The other is that people behave at the micro level. They do not consume only in relation to current income, but in relation to what the others in their neighborhood are doing. So people, for example, with relatively low income living in high income localities try . to keep up with the Jones. They try to consume. This is the relative income hypothesis which introduces another explanatory variable into the consumption function which is in the level of income of other people around the consumer. There was also Milton Friedman's "permanent income hypothesis" in

which he said that the consumption function is a function of Y, permanent income not a function of current income. There are many details about how he confused permanent income. It is a very technique that he uses in deriving empirical data. Permanent income consumption has two components: transitory consumption and permanent consumption. He said that there is no relationship between transitory consumption and transitory income. The coefficient between transitory consumption and transitory income is zero and between transitory consumption and permanent income, it is also zero. The relationship between permanent consumption and permanent income is a proportional relationship and that is how he explains the discrepancy between the short-run non-proportional relationship between consumption and income and the long-run proportional relationship between consumption and income.

There is also the life cycle hypothesis which says that people relate their consumption not only to their current income but also to the life cycle of their income. That means that they like to maintain a steady level of consumption over a period of time. Therefore, in the earlier stage of their careers when income level is low, people typically borrow to maintain that level of income. Then in the middle stage of their career, when their income increases, their consumption remains the same and they pay off what they have borrowed in the earlier part of their careers, and they save something for their old age. In the later part of their careers, consumption is also higher than income. Therefore, they maintain a proportional or a constant level of consumption. In the earlier period of their life when income is low, they borrow money to maintain that proportional consumption. In the middle period they save because they know that income is higher than consumption. They save their old age when again the level of income falls below the level of consumption. So with these savings, they finance their higher level of consumption in their old age. This is the life cycle hypothesis.

All of these theories have been tested. There are reasonable explanations for the discrepancy between the short-run non-proportional relationship and the long-run proportional relationship provided by these theories. These theories and their conclusions were proved empirically using various techniques. For example, Milton Friedman computed his own series of permanent income. Because permanent income and permanent consumption are not observed in the market, he created his own data series using many assumptions, and he got the relationship that he wanted. Others also tested their theories empirically using data and proved that the discrepancy between the short-run non-proportional relationship between consumption and long-run proportional relationship can be explained by their respective areas. These theories are the most prominent, but there have been a

number of other attempts which have been more broadly concerned than these three theories with the particular discrepancy between short-run behavior and long-run behavior.

Economists have for a long time warned that bottom up consumption and current income are of most importance for permanent consumption. However, there are other explanatory variables which determine the behavior of aggregate consumption and many other variables have been included in the consumption function which range from income distribution, a parameter of tastes, rate of interest, wealth and many others. There have been many arguments between economist but now there is almost a consensus among them that while conventional output or income is one variable of aggregate consumption, it is not the only one.

In general the most popular variable among other variables which are included in the consumption function is the rate of interest. So not only the classical or neoclassical but also the neo-Keynesians include interest rate into the consumption function. Current output or income as disposable income and the rate of interest are the three most popular variables which are normally included in the consumption function. They are included in the studies of Keynesian and neoclassical economists. The controversy is not now whether there are any rules to explain the consumption function between monetarist, neoclassical and Keynesians. The controversy is about whether the income elasticity of consumption is higher or the interest rate elasticity is higher. So these are the kinds of controversies which are now going on in the literature on consumption function.

This, in brief, is the state of the art as far as the theory of consumption function in the secular framework is concerned.

Let us now turn to the Islamic framework. In Islamic economics only a few studies have been done and they almost invariably do not go into this kind of analysis. Are current outputs, wealth or rate of interest, the determinants of aggregate consumption? What the theory attempts to explain with the help of certain explanatory variables is the behavior of aggregate consumption. This has not been the interest of Islamic economics as far as those studies which have been done thus far. Their main interest has been to trace the impact of certain Islamic injunctions on consumption.

Most Islamic economists take for granted, so to say, the Keynesian type of consumption function. With current income as the explanatory variable, they

then study how this will change when we have an Islamic economy or they compare a secular economy with an Islamic economy in which there are certain injunctions which have a bearing on consumption. The two injunctions which have been studied in the contemporary Islamic literature have been *Zakah* and the elimination of *Israf* and *Tabthir. Tabthir is* spending your money on something which is not permissible to begin with, for example, drinking or the eating of pork.

Israf is spending on something which is otherwise permissible to spend your money on, but spending extravagantly. So *Israf is* extravagance. The studies which have been done are basically concerned with the effect of the introduction of *Zakah* and the elimination of *Israf* on the consumption function. Such studies were begun by Mukhtar Metwalli who started with a function which he labeled the secular or subsecular consumption function. He then introduced the level of *Zakah.* There are several studies and almost all of them are very similar as far as the treatment of *Zakah is* concerned.

So this is how they see consumption in the Islamic economy. I refer you to the paper which I distributed. With your permission, I will refer to the equation and you can follow me on the paper, itself.

Equation number two on page 328 shows Islamic consumption as basically dividing society into two income groups i.e. *Zakah* payers and *Zakah* receivers. The proportion of income going to *Zakah* payers is Delta Y and the proportion of income going to *Zakah* recipients is 1-Delta Y. They then transfer a certain proportion, let us say Alpha Y, from the first group to the second group and then look at how the aggregate consumption behaves.

Some of Islamic writers have come to the conclusion that the aggregate consumption in an Islamic economy, that is, the marginal propensity to consume and the average propensity to consume in an Islamic economy, will be higher than in the secular economy, and the argument seems to be very simple. They assume correctly, I believe, that the marginal propensity to consume (mpc) of *Zakah* recipients who are poor people is higher than that of *Zakah* payers. In that case, if you transfer money from a lower marginal propensity of consumer groups to a higher marginal propensity of consumer groups naturally the net effect will be positive, that is, the marginal propensity to consume in an Islamic economy will be higher. This was demonstrated by Metwalli. However, two economists asserted that the mathematical analysis which Metwalli carried out and which I have shown in my paper in equations number 23 and 24 had overestimated, the effect of *Zakah.* When you take this to be the consumption function of a secular economy

(C = a + bY). There are two groups of variables and in order to make a comparison between the Islamic economy and the secular economy, you should start with the functions like: C = a + cY + d △Y

Even in a secular economy there are higher income groups which have a lower marginal propensity to consume and lower income groups which have a marginal propensity to consume which is higher than C. So this is the correct shape of the secular consumption function which has to be compared to an Islamic consumption function. Then we introduced *Zakah,* that is, you take: C = a + cY + ∝△y. Therefore, if we compare the secular economy and the Islamic economy, the marginal propensity to consume is more likely to be smaller in an Islamic economy than in a secular economy.

However, it will be argued by some people that not all *Zakah* should be redistributed because there may not be enough people to receive *Zakah.* Therefore, the aggregate marginal propensity to consume will be smaller in an Islamic economy. This, however, is not correct because a certain proportion of the *Zakah* payment will flow back to the higher income group because all *Zakah* is not given to poor people. As you know out of eight categories, about four categories are directly related to poor people and the other four categories, including *Fisabilillah* and people who are working for *Zakah* may be in a higher income group. So part of this *Zakah* will flow back to the higher income group. Therefore, the net transfer will not be Alpha Y; the net transfer will be something smaller than Alpha. So if, for example, *Zakah* is 3 percent of GDP, some of it will be distributed to rich people including *Gharimeen* (people under debt for payment of their debt), Amileen Alayha (workers of *Zakah* Organization, and al Mu'allafati Qulubuhum (those whose hearts are reconciled), can also be either poor or rich as you know.

So the net transfers to poor people will be something smaller than what the *Zakah* payers usually pay. Therefore, the higher income groups will have a lower marginal propensity to consume. I have shown mathematically that if we take contributions then the effect of *Zakah* in an Islamic economy (marginal propensity to consume) will not necessarily be lower.

As for the consumption model of M. Fahim Khan who has given a different argument in favor of the proposition that the marginal propensity to consume in an Islamic economy will be lower than the marginal propensity to consume in a secular economy, he says that the consumption basket which the Muslim consumer has to choose from will be smaller. This is because there are

certain commodities on which a Muslim is not permitted to spend. Therefore, a smaller consumption basket leads to a smaller marginal propensity to consume. So the average propensity to consume will also be smaller.

However, I have shown that this is not the case. There are many commodities in your consumption basket. If you have "n" commodities, it will not affect consumption as long as the consumer has other substitutes available on which he can spend his money. There is no reason to believe that the elimination of two or three commodities will reduce the marginal propensity to consume. For that matter even in a secular economy, there are certain commodities which are not in the consumption basket of the consumer. For example, in an Indian economy, beef will not be there. In an Islamic economy, pork is not in the consumption basket. In the Hindu economy, beef is not in the consumption basket. So the number of commodities in the consumption basket is not really as important a determinant as Fahim Khan felt while comparing the marginal propensity to consume in two different economies.

There are reasons to believe that the net effect may be either positive or negative. This is basically an empirical question. When we talk about the Keynesian consumption function, that is, C = a + by, the parameter even in a secular economy is determined empirically. This does not mean that the marginal propensity to consume is the same in all secular economies. It differs from one economy to another. It depends on a number of factors including cultural habits. For example, you know that the marginal propensity to save in India is higher because Hindus are by the nature (perhaps due to cultural background) more thrifty. There are other people who are less thrifty. So these are cultural factors. In addition the income which determines the marginal propensity to consume has nothing to do with the theory. If we have a developed theory of the consumption function, then we have to go to the basic determinants of the level of consumption. Is it current income? Does the rate of interest or for that matter the rate of return have any impact on consumption through its impact on saving? These are the kinds of things which we should be discussing if we want to develop an Islamic theory of consumption function.

Many theoretical studies indicate that the marginal propensity to consume in an Islamic economy may be higher than in a secular economy or the other way around; those need to be subjected to empirical investigation. Also, there are permissible experiments. As to the utility of those experiments, I do not say that they are within the Keynesian framework. Finding parameters of the marginal

propensity to consume is an empirical question even in a secular economy. There are no new theories of consumption.

The second injunction which has been studied again within the Keynesian framework as far as its impact is concerned, is the elimination of *Israf* or what I called extravagance. In an Islamic economy both *Israf* and *Tabthir* are prohibited. Therefore, it is natural to assume that because of the prohibition of extravagance, the propensity to consume in an Islamic economy will be lower than in a secular economy at the same level of income and wealth, if other things remain the same. I have introduced the coefficient of *Israf* in equations number 31 and number 32 on page 338.

Now you have two opposing factors working on the propensity to consume. On the one hand, there is the effect of *Zakah* and *Infaq* on the propensity to consume. While on the other, there is the decreasing effect of *Israf* on the propensity to consume which depends on other things in society, the level of *Israf* is secular to begin with. If the level of *Israf* was already low, the effect of its elimination will be smaller. Now, can we come to any conclusion on this? One possible conclusion is that which I have reached in the present analysis. The results are given in Tables, number one, two and three. I took equation number 35 which gives the condition of whether or not the marginal propensity to consume in an Islamic economy will be higher or lower. It will be higher if Delta D-C Sigma is higher than C Delta-Sigma. All these variables are actually in the paper. Inversely it will depend on the effect of net transfer not gross transfer. There is the difference between either the gross transfer, that is Alpha Y, and the net transfer which is the gross transfer minus the amount which does not go to the poor. A certain proportion of *Zakah* does go to the poor. As I mentioned, four categories claim certain proportions of *Zakah. So* the effect of *Zakah* is the amount of net transfers times the difference between the marginal propensity to consume between the poor and the rich. I have introduced *Zakah* and *Israf* parameters for which the value range is greater than zero but less than one, that *is, Israf* may be 10 percent or 20 percent. The difference between the proportion of income which goes to the higher income group and total amount of *Zakah* is because I have assumed that the prohibition of *Israf is* applicable, but this is only an assumption. This assumption may or may not be strictly true, but we assume *Israf* applies only to the higher income group. The lower income groups are actually poor or near the subsistence level. They are not involved in *Israf. Israf,* I feel, is basically applicable to those who have a higher income. Therefore, the effect of *Israf* will depend on the proportion of income that is going to the higher income groups and the net amount of money which is transferred to the lower income groups: certain

estimates of this parameter, that is, that 'the marginal propensity to consume is higher in the higher income groups and lower in the lower income groups. I have developed three different equations which are given in Tables number one, two and three. I am not going to discuss them in details unless someone wants me to explain them. In certain places it is positive. If we assume the values of alpha to be less than 10 percent, then usually the net effects are very small but positive. If we assume the level of *Israf* to be more than 10 percent the net effect on the marginal propensity to consume may be negative, but again it is very, very small.

There are two conclusions which I want to draw from this study or from the literature on the Islamic macro consumption function. The first is that nobody has really taken up the task of developing an Islamic theory of the consumption function. They have taken the Keynesian consumption function and then studied the effect of Islamic injunctions on that consumption function.

The second conclusion is that, as I mentioned even in secular economics the values of the parameters are an empirical question and that will remain so in an Islamic economy. Even if they are one percentage higher, instead of being 8. It doesn't matter whether it is 81 or 79. It is not difficult to understand that the two will vary from one country to another. So, theoretically, we have to see the effect of *Zakah* and the elimination of *Israf* on the consumption function. What the writers have done, does not put the net effect in balance. Therefore, we need not say that the marginal propensity to consume in an Islamic economy will be unduly lower because of the introduction of *Zakah* or unduly depressed because of the elimination of *Israf.* The effect will be very, very marginal.

These are the two conclusions. I think that what is needed from all of these theories to decide whether we will talk about actual income hypotheses or relative income hypotheses or permanent income hypotheses. All of these theories have their micro foundations. They believe that the aggregation of consumption function comes from consumer behavior. So that is what Islamic economics will now have to do. We must start from consumer behavior. How do consumers decide on their consumption basket? Do they only take into consideration the needs of other people? Then we must build these variables into the macroconsumption function and build an aggregate consumption function from there. I think this has not been done and this is the work, the challenge, which we, as economists, must take up.

DISUCSSION

Comment and a Question

Let us, for example, take the effect of *Zakah* on consumption. If you want to find the comparative effect on consumption, we should consider the income policy which is given by the secular government to its people. For *Zakah* in an Islamic country when practiced will affect consumption and this should be measured within the framework of such policy.

Otherwise we cannot do anything and the compulsion is also for the effect. I also question what we consider the *Israf* rationality, that is, why Islam constrains the kind of consumption that has recently been taking place. We take the Western point of view of consumption that what they designate as lavish consumption is not rational. However, at this stage, I do not see any real breakthrough.

M. Iqbal

I agree with you one hundred percent. The one hundred percent was clearly mentioned in my paper, and I would like at this point to add another twenty percent. You are right that Islamic economics, as I mentioned in my talk has not been able to come up with any breakthrough. They have studied certain injunctions on a given theory which is the Keynesian theory. I underscore the importance of the work stating the impact of these injunctions and whether empirically, the value of a certain parameter will be such and such, as even this has policy implications. If after the fully systematic analysis there is no difference, then that is a different story. However, one has begun and has made a contribution.

However, there has not been any breakthrough as far as theory is concerned. I mentioned this and brother Sadi also emphasized the fact. I would now like .to add the other twenty percent as I did not mention it in the course of presenting my paper.

As far as the question is concerned, in my paper, I mention that the assumption that there will be a lot of *Israf* in a secular economy has to be considered more carefully. The assumption of rationality assumes, so to say, that there is neither extravagance nor miserliness for the simple reason that if somebody is spending extravagantly, he is deriving utility. The criterion of rationality is whatever maximizes utility from their perspective. It will not be *Israf.* He is maximizing utility; he gets more utility by having a very big balance. Therefore, he built that balance because he derived utility and that is what is objectionable from their point of view. It is not *Israf.* However, when we compare that to what an Islamic economy gives a man, we say that it can be eliminated. This is oriented to the Islamic economy, and therefore, we have to give a comparative point of view.

We have to emphasize the difference between an Islamic and a secular economy. If there is *Israf* from their perspective, they are getting utility from it, and it is their own private affair and they are justified in doing that.

The second point which you raise even more important. When we introduce *Zakah* we compare taking Alpha out of Delta in terms of income groups. The income of the higher group of *Zakah* payers, strictly speaking, can be known because in an Islamic economy, when we pay *Zakah* and in a secular economy when, for example, they pay welfare tax, it is equivalent.

However, we must remember that in a secular economy aggregate consumption is a function of disposable income and disposable income means that those payments which are compulsory have been taken. Therefore, they take taxes including welfare taxes and other taxes out before they put this line. If we want to compare that with an Islamic economy, we should also take out the *Zakah* payment because this is also a compulsory levy. So the *Zakah* payment should be taken out before we put the line. Therefore, if we take Delta Y that should be the net of *Zakah* because *Zakah is* not disposable. This, therefore, is the other twenty percent which I wanted to add; so I agree with you one hundred and twenty percent.

Comments and Question

I am interested in learning what you think about the fact that most studies of *Zakah* consider only one variable, namely, current income. However, it is possible that most income will come from other private sources. We may find that the difference in income or consumption is very little. Some of you may have had

experience in another country, such as, Saudi Arabia, for example, which **can** act as a basis for understanding many of the problems of the world. Have you seen any of these kinds of problems and can you give us some ideas about them.

M. Iqbal

I think that this is a valid comment. However, we have to make a distinction between *Zakah* assessment and *Zakah* payments. The normal assumption, and I think it is a safe assumption, is that while *Zakah* is assessed both on income and wealth i.e., it is assessed on assets and wealth, it is paid out of current income. Therefore, it is safe to assume that, normally, people do not use their assets to pay *Zakah*. They pay *Zakah* out of their current income, even if the assessment is on the basis of assets and wealth. The payment is out of current income. Therefore, I think as far as the distinction between wealth and income is concerned, in this particular formulation, they take Alpha Y as *Zakah,* which is a proportion of income.

Comments and Question

It would have been better if the speaker could have defined Islamic disposable income minus *Zakah*. Islamic disposable income should be clearly defined as income *Zakah*.

Secondly, I think the speaker avoided a fundamental point while explaining consumption from the Keynesian point of view, that is, the fundamental psychological law, MPC, is greater than zero and smaller than one at zero income. There is consumption where a man or a family plan the consumption level by selling property or by spending previous savings or by borrowing.

My question is: What kind of consumption redistribution can be enacted by Islamic law, even if a man cannot borrow at zero income level? I also have another question. According to the relative income hypothesis of James Densenburg a family tries to maintain its consumption at the previous peak income level. Does Islam permit a family to spend as before even if its income falls?

M. Iqbal

There are two or three points my colleague has mentioned. The first is that Islamic disposable income should be defined. I think I have done this in the form of the question which brother Sadhi asked. Strictly speaking, if you want to

compare the secular economy, we should not take Beta Y Alpha Y because Alpha Y should have already been taken out, because Y, there, is disposable income.

Secondly, as for the question of whether there must be one psychological law stating that the marginal propensity to consume is greater than zero or less than one, I do not remember saying this. I did mention that in the short run the consumption function is an intercept. There is a positive interfact in the short-run consumption market. In the long-run consumption function, the intercept is zero and I pointed out how various people have explained this discrepancy.

The third question regards the Islamic position as to whether somebody can borrow to consume if his level of income is zero. In other words in an Islamic economy, the intercept will be positive. I do not see any reason why not. If somebody has zero income or very low income, if the level of income is lower than the subsistence level of consumption, he may borrow even if the institution of *Zakah* exists. However, this may not be enough in practice in order to reach the subsistence level. In the case of Bangladesh, Pakistan and elsewhere even after the intervention of the institution of *Zakah*, the level of income of certain income groups will be insufficient for subsistence consumption. Therefore, they may borrow; there is no restriction on that.

Comments and Question: (Azher)

I thank Munawar Iqbal for presenting a good paper. My question is that, you have mentioned *Zakah* only in your model. You later mentioned very briefly that we could also include *Sadaqah* which is not a compulsory payment, but is still definitely a payment. I wonder if it would be possible to take both of these together? Would any difficulty arise in this case? That is my first question.

Secondly, from the point of view of modem economics, Kuznet and others, for example, have mentioned that any transfer payment should not be included in income. So far as the secular economy is concerned, *Zakah* and *Sadaqah* are all transfer payments. But from our point of view, when we expend *Zakah* and *Sadaqah*, we expend it on poor people. Therefore, could you not take into consideration the impact of such consumption both in this world and the Hereafter and for that matter could you not take *Zakah* and *Sadaqa* together?

M. Iqbal

I agree with you and I referred to the point that you have raised in my paper as you have pointed out. On page 56 of my paper, you can find the following: "Therefore, it is reasonable to assume that rich Muslims will carry out some voluntary contributions in addition to the obligatory level of *Zakah*. Fortunately, the model given above can easily accommodate the expansionary effect on aggregate consumption refined on the net transfer of income from rich to poor. Therefore, all we have to do is to think of the parameter Sigma as the major of *Zakah+Infaq, i.e.,* the net transfer rather compulsory or voluntary". Within the model this is easily possible and again I do comment on what the effect of *Zakah* will be later on. After my systematic analysis, I comment on what the level of voluntary consumption has to be. If you like I can find this and read it to you.

On page 59, paragraph 3, you can find the following: "With these values the likely net effect of *Zakah* and moderation would be to decrease the marginal propensity to consume," and paragraph 3 or 4, page 59: "With these values or certain values, I have 10 percent of *Israf* and the marginal propensity to the level of *Zakah, 2* percent. If these are the values, then these values are the likely net effect of *Zakah* and the moderation would be to decrease the marginal propensity to consume. If in addition to *Zakah* some voluntary transfers in excess of the level of charity in a secular economy are also made, this negative effect on MPC will be somewhat reduced.

However, it would take an amount of voluntary transfer greater than the compulsory levy of *Zakah* to lead to a marginal 'propensity to consume in an Islamic economy higher than in its secular counterpart".

Therefore, I have tried to take into consideration the level of adjustment, and have given certain reasonable values of the parameter analysis. I have tried to reach a conclusion and by and large have taken both *Zakah* and *Infaq* as net transfer. My analysis is based on the net transfer of *Zakah*, that part of *Zakah* which is close to the higher income groups, + *Infaq*. This is the net transfer in my paper. The effect of net transfer and the elimination of moderation on average will be very small either way.

Comments and Question

I understand the improvement that you have made earlier, but I have a problem with Equation 31. You have a lot of parameters there. I do not know how

you can estimate that kind of equation. We have only one indigenously even on the right-hand side Y, and you have a certain number of parameters on the right-hand side. How can you estimate these parameters separately? I think it can be done. So, could you perhaps suggest some ways of estimating these parameters.

M. Iqbal

Well, I admit that I have not done any practical estimation because that was not the purpose of the paper. However, I do not see any problem in estimating those variables. There are four parameters: D C Sigma and Alpha. For estimation purposes the rule is that the number of endogenous variables should be equal to the number of equations. Then we have to reduce and you can easily estimate. That is the rule. As long as the number of endogenous variables is equal to the number of equations, the system is completely identified. If not, it is underidentified. Here the only endogenous variable, independent variable, is Y. The dependent variable is C. So there is one equation and one variable, see it is determinant.

Comments and Question

If you multiply equation 31, you have, for example, to multiply all the variables there. If you separate Y and C, will they come out in the product form?

M. Iqbal

They do come out in the product form. Equation 35 is in product form of B and C. Sigma is greater than cF Delta Alpha. So they do come out. You cannot separate the effect of various variables, but you can get the net effect and that was the interest here. If you want to get a separate effect, that is given in Equations 23 and 24. That equation gives only the factor of *Zakah.* Then we introduce *Israf* and we ask what is the net effect of *Zakah* and *Israf* in the product form itself. That is the purpose of the paper, we want the net effect. If we want to get the effect of only *Israf,* that is not given in the paper. To that extent, I will agree with you. Thank you all.

ZAKAH, MODERATION AND AGGREGATE CONSUMPTION IN AN ISLAMIC ECONOMY*

Munawar Iqbal*

1. INTRODUCTION

Aggregate consumption is a major component of the aggregate demand in an economy and as such plays a crucial role in determining the level of income and prices. Furthermore, the value of the marginal propensity to consume (or its counterpart, marginal propensity to save) is one of the major determinants of the rate of growth of national income. The stability of national income is also linked with the stability of the marginal propensity to consume through the interaction of multiplier and accelerator. Therefore, Islamic economists are genuinely interested in investigating as to how the consumption function would behave in an economy which is governed by Islamic values and injunctions as compared to secular economy. In recent years some very useful contributions have been made in this field (for example, Metwally 1981 and 1985; Khan 1984; Ahmad 1985 and Darwish & Zain 1985). The controversies arising out of these contributions are in a preliminary stage and it will take some time before some sort of consensus emerges.

The purpose of this note is two-fold:

i) to clarify some of the theoretical issues in the ongoing debate, and
ii) to try to arrive at some conclusions with respect to the values of the relevant parameters and the level of aggregate consumption in an Islamic economy. Section two deals with the first point while in section three we address ourselves to the second issue. Section four gives the summary and conclusions.

* We republish here the article referred to in the lecture of M. Iqbal for the benefit of completing the coverage of the subject.

2. Review and Analysis of Some Views on Consumption Function in an Islamic Economy

It is important to mention at the very beginning that most of the authors use a framework which is not significantly different from the Keynesian consumption function. It is therefore, appropriate to recount very briefly the essential elements of the Keynesian consumption function. His theory, now referred to as "absolute income hypothesis" is based on the following postulates:

i) Current consumption is a positive and stable function of current income.
ii) Marginal propensity to consume is greater than zero and less, than one.
iii) Average propensity to consume declines as income increases.

A simple consumption function based on these postulates is usually written as:

$$C = a + bY$$

With this background we want to show that the Islamic economists writing in this area have committed some theoretical mistakes. We would reveal some of these through the critical survey of the literature in this section.

2.1. General observations

Before going into specifics, we would like to make some general observations which apply to almost all the writings in this area. Firstly, while the writers are genuinely interested in a theory of consumption function in an Islamic framework, what they actually do is to study the effect of certain Islamic injunctions on aggregate consumption within the Keynesian consumption theory or absolute income hypothesis. For example to say that *Zakah* will increase the marginal propensity to consume does not introduce any qualitative change in the model. The size of parameters is an empirical question and is not an essential part of the Keynesian model. If Islamic teachings and values lead one to believe that the basic postulates of a theory are unlslamic then one has to attack that particular postulate(s) and come up with an alternative theory. Unless that is done, one should not claim the "new theory" to be Islamic. If one accepts the basic postulates of a theory, he can still go ahead and study the effect of Islamic teachings on the quantitative magnitudes because that will have important policy implications, but

the distinction between the two cases i.e. Islamic theory and effect of Islamic teachings on a given theory must always be kept in view.

The result of this confusion is that most of the authors have "adjusted" the absolute income hypothesis for *Zakah* and *israf* and have labeled the resulting consumption *Zakah,* Moderation and Aggregate Consumption function as Islamic. Metwally has even labored to "derive" consumption relationships from Islamic teachings which he says are identical to those of the Keynesian absolute income hypothesis (Metwally, 1981:6). He quotes the following two verses of the Qur'an in support of his argument:

1) "Squander not your (wealth) in the manner of a spendthrift. Verily spendthrifts are brothers of the Evil ones" (17:26-27).
2) "Make not thy hands tied (like a niggard's) to thy neck. Nor stretch it forth to its utmost reach lest you become rebuked and destitute" (17:29).

He argues that the above verses clearly indicate that Islam directs that consumption should be related to income. He further maintains that the second quotation given above clearly suggests that consumption expenditure of the believers should vary directly with their income: an increase in income leads to an increase in consumption. However, part of the increase in income will be saved. He therefore, believes (as a credit to Islam) that the postulates of the absolute income hypothesis were anticipated by Islam over 1400 years ago. All he had to do to derive an Islamic consumption function was to incorporate the effect of *Zakah* on aggregate consumption.

The inference made by Metwally is obviously wrong. It better be so. Absolute income hypothesis has been heavily criticized in the recent past. Some of the postulates of the Keynesian consumption function have been shown to be wrong both empirically as well as on *a priori* grounds. Current income is no doubt one of the determinants of current consumption but there are other determinants which if excluded from the consumption function, will render it unstable and thus demolish a major plank of the Keynesian model. One such variable which is now almost universally included in the consumption function is wealth. The resulting function of course will not correspond to absolute income hypothesis.

Now we cannot see any evidence that Islam denies the effect of wealth on consumption. As a matter of fact, Metwally has himself stated that the Qur'an

instructs Muslims to husband their wealth and watch carefully the volume of their expenditure. The behavioral instructions contained in the verses quoted by him, do not relate consumption to current income.

Secondly, most of the writers fail to distinguish between the capitalist model and the capitalist economy. Clearly they intend to compare the capitalist "model" with the Islamic model because there is no capitalist economy. The value of the parameters that they set out to compare will vary from one economy to the other. The only meaningful comparison can be between the implied values of the relevant "models". Therefore, while secular model and secular economy are used interchangeably, one should not forget that one is comparing "models" or ideal states and not actual economies. For example, in the ideal Islamic system consumers will behave neither as spendthrifts nor as misers. Therefore, the aggregate consumption in a secular economy will be higher than that in the Islamic economy only if the secular consumers are spendthrifts and lower only if they are misers. However, the capitalist model *assumes* that they are neither niggards nor spendthrifts. Fahim Khan rightly mentions that the secular assumption of rational behavior for utility maximization implies that the consumer will neither be a miser nor a spendthrift [Khan, 1984:2]. He spends what maximizes his utility. Unfortunately, he forgets this when he goes on to compare the consumption levels implied by the secular model and the Islamic model.

The macro consumption function has a micro-foundation from which it is derived. Once that is accepted, the derivation of a macro function is more or less mechanical. If the consumer is assumed to behave "rationally", then the level of *israf* is zero by assumption. What we mean to say is that in introducing the effect of the prohibition of *israf,* we have to pay attention to the underlying assumption of rationality.

We have argued elsewhere [Iqbal, M. 1985] that the conventional concept of rationality which implies a world of certainty and perfect knowledge on the part of individuals is very unrealistic. However, for the sake of comparison, let us accept that the capitalist consumer does behave according to the conventional concept of rationality. There may still be a lower level of consumption in the Islamic economy than secular economy because of differences in individual perceptions about what constitutes *israf* For a self-centered individual of the secular model, very little will fall in this category because he may well derive "pleasure" from lavish spending on him and hence is quite "rational" by the definition of that model. On the other hand, Islamic model does not assume the individual to be selfish and also warns spendthrifts of punishment in the life Hereafter which result in a very different perception about what constitutes *israf*.

The individual of the Islamic model derives pleasure from fulfilling the requirements of *Shari'ah* and hence from sharing his provisions with others and is happy with a simple living. These are behavioral differences which are part of the models and can be used for a comparative study.

After these general observations, let us review some of the specific results that the writers on aggregate consumption in an Islamic framework have come up with. Most of these relate to the effect of *Zakah* and the prohibition *of israf* on the aggregate consumption. We discuss them in turn.

2.2. Impact of *Zakah* on Consumption

Both Ausaf (1985) and Metwally (1981) have concluded that the marginal (and average) propensity to consume in an Islamic economy will be higher than in the secular economy. They start from a consumption function of the Keynesian type:

$$Cs = a+bY \qquad (1)$$

for the secular economy. In order to arrive at the aggregate consumption function they bifurcate the population into two groups i.e. *Zakah* payers (Group-1) and *Zakah* recipients (Group-2). Group one transfers a certain proportion (a) of their income to group two because of the compulsory levy of *Zakah*.[1] The consumption function in an Islamic economy therefore, becomes:

$$C_I = a + b[\beta + Y - aY] + \delta[(1 - \beta)Y + \alpha Y] \qquad (2)$$

where by is income of group one, (I-b)Y that of group two and aY is the amount of *Zakah* paid. It follows from equations (1) and (2) that:

$$C_I - C_s = \delta (1 + \alpha - \beta)Y - b(1 + \alpha - \beta)Y \qquad (3)$$

$$\left(\frac{C_I}{Y}\right) - \left(\frac{C_s}{Y}\right) = (1 + \alpha - \beta) - b(1 + \alpha - \beta) \qquad (4)$$

$$\text{and } \left(\frac{dC_I}{dY}\right) - \left(\frac{dC_s}{\alpha Y}\right) = (1 + \alpha - \beta) - b(1 + \alpha - \beta) \qquad (5)$$

(1 + a - (3) is obviously positive and less than one. Now they assume that the marginal propensity to consume of *Zakah* receivers is higher than that of the *Zakah*

1. Ausaf makes a distinction between compulsory transfer (a) and voluntary transfer, Sadaqat, (d). However, that distinction is not crucial for the following analysis.

payers i.e. d > a and therefore, the average and marginal propensities to consume as well as the aggregate consumption in an Islamic economy will be higher than the corresponding capitalist economy.

Decomposition vs. Zakah Effect on MPC

Before going on to discuss some substantive issues, one technical mistake should be corrected. As Darwish and Zain (1984) have **rightly pointed out,** in order to study the effect of *Zakah* one should not start with a consumption function like C = a + bY for capitalist economy and then bifurcate it for the Islamic economy because in this function "b" represents the marginal propensity to consume of both the groups. In order to have a meaningful comparison one should start with a function like:

$$C_s = a + c(\beta Y) + d(1 - \beta)Y \qquad (6)$$

where, c and d are marginal propensities to consume of group 1 and 2 respectively. The corresponding function in the Islamic economy would be:

$$C_I = a + c[\beta Y - \alpha Y] + d[(1 - \beta)Y + \alpha Y] \qquad (7)$$

and comparing (6) and (7) one should get:

$$C_I - C_s = (d - c)\,Y \qquad (8)$$

$$\left(\frac{C_I}{Y}\right) - \left(\frac{C_s}{Y}\right) = (d - c) \qquad (9)$$

$$\text{and } \left(\frac{dC_I}{dY}\right) - \left(\frac{dC_s}{dY}\right) = (d - c) \qquad (10)$$

However, Metwally (1985) insists on his position on the ground that we are comparing a capitalist economy with an Islamic economy which has a *Zakah* levy and not two Islamic economies, one with and the other without the *Zakah* levy. In the capitalist economy the consumption function would be, C = a + bY and hence we should compare equation (1) and (2) and not (6) and (7).

Metwally's position can be easily shown to be wrong. The aggregate marginal propensity to consume in any economy is in fact a weighted average of the marginal propensities of various income groups i.e.,

$$C = a + b_1Y_1 + b_2Y_2 + b_3Y_3 + \ldots b_nY_n \qquad (11)$$

where b_is are the marginal propensities to consume of the various groups and Y_is are their proportional incomes. If for analytical simplicity one considers the population to comprise of only two groups with their incomes b^Y and (1 - b)Y respectively, the function becomes:

$$C = a + b_1(\beta Y) + b_2(1 - \beta)Y$$

which is the same as equation (6) with b_1 = c and b_2 = d. In other words the 'b' in Metwally's equation (1) is in fact:

$$b = \sum_{I=i}^{n} b_i w_i \qquad (12)$$

where wi = Error! Switch argument not specified. and in the present case:

$$b = b_1\beta + b_2(1 - \beta) \qquad (13)$$

which gives us equation (6). If different income groups have different propensities to consume, that is so in both the capitalist and the Islamic economies. Therefore, for a meaningful comparison or to study the effect of *Zakah* on aggregate consumption, one must compare equation (6) and (7). What Metwally's analysis in effect implies is that the marginal propensity to consume of *Zakah* payers is equal to the aggregate marginal propensity to consume of the corresponding capitalist economy (both are equal to b). Now when one adds to it another group with assumed higher propensity to consume and takes an average, the aggregate marginal propensity to consume in the Islamic economy comes out to be higher than the one in the capitalist economy even if there were no *Zakah* levy. Thus his results contain two effects: (i) higher aggregate marginal propensity to consume of the Islamic economy inadvertently assumed and (ii) effect of *Zakah*. The two can be isolated by putting Z(= aY) = 0 in his equation (2) yielding:

$$C^* = a + b(\beta Y) + \delta(1 - \beta)Y \qquad (14)$$

$$\left(\frac{C^*}{Y}\right) = \frac{a}{Y} + b\beta + \delta(1 - \beta) \qquad (15)$$

$$\text{and } \left(\frac{dC^*}{dY}\right) = b\beta + \delta(1 - \beta) \qquad (16)$$

Now comparing these with his equations (1) - (3) will give the first effect which is:

$$C^* - C_s = \delta(1 - \beta)Y - b(1 - \beta)Y \quad (17)$$

$$\left(\frac{C^*}{Y}\right) - \left(\frac{C_s}{Y}\right) = \delta(1 - \beta) - b(1 - \beta) \quad (18)$$

$$\left(\frac{dC^*}{dY}\right) - \left(\frac{dC_s}{dY}\right) = \delta(1 - \beta) - b(1 - \beta) \quad (19)$$

Since S > b by assumption, this effect is positive. Similarly a comparison of equations (14) - (16) with his equations (5) - (7) will yield the second effect i.e. the true effect of *Zakah.* This would be equal to:

$$C_1 - C^* = (\delta - b)\alpha Y \quad (20)$$

$$\left(\frac{C_1}{Y}\right) - \left(\frac{C^*}{Y}\right) = (\delta - b)\alpha \quad (21)$$

$$\left(\frac{dC_1}{dY}\right) - \left(\frac{dC^*}{dY}\right) = (\delta - b)\alpha \quad (22)$$

Again since 8 > b this effect is also positive. One can easily confirm that the sum of the two effects will be equal to that arrived at by Metwally.

It should by now be clear that Metwally overestimated the effect of *Zakah* on propensity to consume. However by isolating the effect *of Zakah,* we can see that even though the magnitude of the effect of *Zakah* on MPC and APC will be smaller, it will still be positive. But, even this result needs further examination to which we now turn.

Effect of Assumptions

The above result depends, among others, on two assumptions. First, the marginal propensity to consume of the Zakah-receivers is higher than that of the *Zakah-payers;* and second, there are always enough poor people in the Islamic country to receive *Zakah.* These are the assumptions which have been challenged by Darwish and Zain (1985). Metwally (1985) is definitely right when he says that his analysis should be judged within the framework of his assumptions. However, it is also perfectly all right to analyze the effect of *Zakah* on a different set of assumptions as Darwish and Zain have done. Theoretically, both are on the same plane even though their results are opposite to each other's.

In practice, the predictions of the model whose assumptions are more realistic will be more accurate. Now, it is possible that the assumptions of one

model are more realistic at one time and/or place while those of the other are closer to real situation at another time and/or place. However, on *a priori* grounds, it appears to the present author that Metwally's assumptions under discussion are more reasonable. Our reasons for this preference are as follows:

The evidence on the issue of marginal propensity to consume is mixed. However, the evidence which is more relevant for the present discussion overwhelmingly support the proposition that poor people spend proportionately more on consumption than rich people. This result emerges from cross-sectional data.[2]

Almost all budget studies show that low income families typically dissave, high-income families typically spend less than income and as one moves along the distribution from lower to higher incomes, the higher the income the less the rise in consumption from a further increment of income. The MPC is positive, less than one and declines as income rises .[3]

The results of the budget studies should, however, be interpreted very carefully. While they almost clearly show that average propensities differ widely at various income levels, this may not always imply that the marginal propensities also differ to the same extent. Budget studies show how consumption differs as income differs and not how consumption changes as income changes. Therefore, while the higher average propensity to consume of lower-income groups is almost universally accepted, the opinion about higher marginal propensity to consume of the lower-income groups is divided.

The assumption of higher MPC of the poor seems more reasonable on the basis of one further consideration. The differences in the propensities to consume depend on the "degree" of inequality in the income distribution. The higher the degree of inequality, the greater the effect of transferring income from higher to lower groups. In other words, if income is transferred to people who are "relatively" poor, the "marginal" effect on aggregate consumption may not be very pronounced. However, if the income is transferred to "absolutely" poor people who are unable to fulfill even their basic needs, the effect on aggregate consumption is likely to be

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2 It may be mentioned that the time series studies show that while in the short-run the average propensity to consume at low incomes is greater than at higher income levels, in the long-run the average propensity to consume is fairly constant. However, it should be noted that in the long-run, the income of all groups is increasing. Time series studies, therefore, do not give the effect of income redistribution.

3 For example, see *Study of Consumer Expenditures, Incomes, and Savings,* Wharton School of Finance and Commerce, University of Pennsylvania, (1957).

considerable. Zakah-recipients, generally speaking, fall in the category of "absolutely" poor. Therefore, when dividing the population into only two groups i.e. *Zakah-payers* and Zakah-recipients, it is quite reasonable to assume that the MPC of the latter group is higher.

As for the second assumption, it could be a rare situation that there is none to receive *Zakah.* The incident quoted by Darwish and Zain is an exception and not the rule and theories are not built on exceptions. Nevertheless, the point raised by Darwish and Zain may have some validity on a different ground to which we now turn.

Gross vs. Net transfers

The essential element in the argument of Darwish and Zain is that the total amount of *Zakah* paid by the members of group-1 may not be transferred to members of income group-2. Now this in fact is true and in order this to be so one does not have to assume that there may not be enough people to receive *Zakah.* Part of *Zakah* will not be paid to the poor because there are some categories of *Zakah* expenditure which do not involve transfers to the poor. As is well-known, *Zakah* is to be spent on eight categories: (1) the poor, (2) the needy, (3) officials collecting *Zakah,* (4) those whose hearts are made to incline (towards truth), (5) the (ransoming of) slaves, (6) those in debt, (7) in the way of Allah and (8) the wayfarer.

How much *Zakah* should be spent on each category is controversial. Some jures including Imam Shafii, maintain that each category should get an equal share. However, the majority of jurists maintain that such an equality is not essential and some categories may receive more than the other according to social priorities, and most of them accord a very high priority to the poor[4] and needy, but no category that exists should be ignored altogether. Therefore, even according to the opinions most favorable to the poor, one would think that the whole amount of *Zakah* will not be transferred to the poor. A percentage of gross *Zakah* collected no matter how small this percentage is, will not reach the poor. Furthermore, some of these transfer payments may be in the form of capital assets rather than income available for immediate consumption ?[5]

4. Abu Hanifa even considers "poverty" as a condition for making payments to some other categories.

5 Islamic Jurists have held since long that *Zakah* may be paid in terms of tools or other productive assets. In fact, if funds permit this would be preferable. For further discussion of this point see Qardawi (1980), pp.225-270).

If one uses the above explanation then the effect of *Zakah* on aggregate consumption can be traced as follows:

Supposing that only a fraction (y) of the total amount of *Zakah (Z = aY)* is transferred to group two, the consumption function would look like:

$$C_1 = a + c[\beta - \alpha Y] + d[(1 - \beta)Y + \gamma(\alpha Y)] \quad (23)$$

Comparing this with equation (6) one would get:

$$C_1 - C_s = (d\gamma - c)\alpha Y \quad (24)$$

$$\left(\frac{C_1}{Y}\right) - \left(\frac{C_s}{Y}\right) = (d\gamma - c)\alpha \quad (25)$$

$$\left(\frac{dC_1}{dY}\right) - \left(\frac{dC_s}{dY}\right) = (d\gamma - c)\alpha \quad (26)$$

On the basis of equations (25) and (26) Darwish and Zain conclude that since both d and y are less than one, their product would be a much smaller fraction than d alone and therefore, it is most likely going to fall below c. This implies that the levy of *Zakah* will reduce the average and marginal propensities to consume rather than increase them.

This result would not have been so dramatic, had Darwish and Zain not made a mistake in their turn. Because of this mistake they have underestimated the effect of *Zakah.* This is so because while *Zakah* takes its full toll on reducing the consumption of group one, only part of this money is counted when the positive effect is calculated. This is evident from equation (23). We see that the income of group one is reduced by the amount *aY* but the income of group 2 is increased by only *y(∝Y).* Thus, the sum of the incomes of the two groups is less than Y, [by an amount (1 - *y)∝Y].* It is because of ignoring this amount that they get a negative impact of *Zakah* on aggregate consumption. The money in fact would not disappear. It should somehow be accounted for.

As a matter of fact, part of the *Zakah* money flows back to the members of group one. For example, the officials collecting *Zakah* will receive part of it. Naturally they will fall in one of the two groups. Similarly, some persons in group

one may receive some *Zakah* money as repayment of their loans, and so on. Let us assume that a fraction of e *Zakah* flows back to group one .[6]

The consumption function will then become-

$$C_1 = a + c[\beta Y - \alpha Y + \epsilon(\alpha Y)] + d[(1 - \beta)Y + (1 - \epsilon)(\alpha Y)] \quad (27)$$

Now comparing this with equation (6) again, we will get:

$$C_1 - C_s = (d - c)(1 - \epsilon)\alpha Y \quad (28)$$

$$\left(\frac{C_1}{Y}\right) - \left(\frac{C_s}{Y}\right) = (d - c)(1 - \epsilon)\alpha \quad (29)$$

$$\left(\frac{dC_1}{dY}\right) - \left(\frac{dC_s}{dY}\right) = (d - c)\sigma \text{ where } \sigma = \alpha(1 - \epsilon) \quad (30)$$

Notice that the effect of *Zakah* on aggregate consumption (as well as on propensities to consume) has been further reduced. Previously we found it to be equal to (d - c)aY (equation 8). Now the effect is smaller but it is still positive.

The above results make a lot of intuitive sense. Equation (28), for example says that the aggregate consumption will increase because of *Zakah,* by an amount which is equal to the difference in the marginal propensities for consumption of the two groups times the net transfer to the group with higher marginal propensity to consume.

To sum up the discussion on the impact of *Zakah* on aggregate consumption and the propensity to consume, it appears to us that *cetris peribus,* this effect would be positive. The magnitude of this effect would depend on the amount of net transfer to the poor in the form of income and not the gross amount of *Zakah.* This result will hold in the framework of absolute income hypothesis and in the short run. In the long run as income increases due to the impact of *Zakah* on investment, the marginal propensity to consume may or may not decline. The analysis in this paper does not go into that issue.

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6 There is a small possibility that part of the *Zakah* will flow out of the hands of these two groups i.e. to the government. However, since government is obliged to spend the *Zakah* money on prescribed heads, the likelihood is fairly small and may be ignored. Moreover, for comparative purposes, the sum of the incomes of the two groups should be kept equal to the one in secular economies.

2.3. The Impact of Moderation on Consumption

In the previous section we have discussed the effect of *Zakah, cetris peribus.* In order to have some idea about the overall picture we turn to the analysis of the other major determinants of the propensity to consume in the Islamic economy i.e. the effect of the prohibition of *israf* (extravagance) and *tabdhir* (squandering).[7]

There is a consensus that the Islamic injunctions against *israf* and *tabdhir* will result in a lower average (and marginal) propensity to consume compared to a capitalist economy. The differences arise about the relative strength of this effect vis-a-vis that of *Zakah.* Some writers seem to consider the effect of *Zakah* to be stronger. Thus, Metwally after deriving the expansionary effect of *Zakah* writes, "There are, however, some Islamic teachings which discourage extravagant consumption, luxury spending and remind Muslims of the reward in the Hereafter. These teachings may offset, to some extent, the expansionary effects of *Zakah* on consumption" (Metwally, 1981:50). On the other hand, other writers believe that the contractionary effect on consumption of the prohibition of *israf* will outweigh the expansionary effect of *Zakah.* For example, Fahim Khan writes, "It is not very difficult to see that an Islamic economy will have a lower consumption propensity than if it were a secular economy. The most important basis for this argument is:

a) That Islamic consumer is likely to face a smaller basket of consumption to pick up from than if he were a secular consumer.
b) From within this basket he has to pick without crossing the limits of prodigality (Khan, 1984:8)

We feel that the first reason does not carry much weight because firstly, it is not necessary that the Islamic consumer will face a significantly smaller basket of goods to choose from. (The number of prohibited consumer goods is very small and, then in secular economies also some goods are prohibited). Secondly, even if it were true, a smaller basket does not *per se* lead to a lower propensity to consume as long as the consumer has a sufficiently large number of commodities in that basket (which in fact is the case) and he is free to substitute one commodity for the other. The second reason i.e. prohibition of *israf is* in fact necessary as well as sufficient to have a negative effect on the propensity to consume.

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7 Tabdhir refers to expenditure on forbidden things while *israf* means spending on permissible goods extravagantly.

It is very hard to decide on a priori grounds whether the effect of *Zakah* will be stronger or that of moderation. It depends on the size of a number of parameters and is basically an empirical question. In order to see the likely impact of the Islamic injunction on the level of aggregate consumption we first derive the equation for measuring the net effect and then present sensitivity analysis using some plausible values of the parameters involved.

The effect of moderation reflected in the model as the elimination of *israf* as the economy is Islamized can be introduced into the analysis in a number of ways. The simplest and, at the same time, the most reasonable way is to assume that the consumers in the lowest income group who are barely able to survive on their incomes are not spendthrifts. As for the higher income group, it is assumed that moderation would affect the slope of their consumption function but not the intercept because we recall that the intercept in the present model represents subsistence consumption. On the above assumptions the consumption function of the Islamic economy may be written as:

$$C_I = a + (1 - f)\, c[l\beta Y - \sigma Y] + d[(1 - \beta)Y + \sigma Y)] \qquad (31)$$

where, f is the parameter representing the level of *israf* in **a secular economy and** its value ranges from zero to one.

If we now compare this with the consumption function in a secular economy i.e. equation (6), we will get the net effect of *Zakah* and moderation. Subtracting equation (6) from equation (31) we get:

$$C_I - C_s = (d - c)\sigma Y - cf(\beta y - \sigma Y) \qquad (32)$$

Similarly

$$\left(\frac{C_I}{Y}\right) - \left(\frac{C_s}{Y}\right) = (d - c)\sigma - cf(\beta - \sigma) \qquad (33)$$

$$\left(\frac{dC_I}{dY}\right) - \left(\frac{dC_s}{dY}\right) = (d - c)\sigma - cf(\beta - \sigma) \qquad (34)$$

Equation (32) . gives the net effect of *Zakah* and moderation on aggregate consumption while equation (34) gives the net effect on the marginal propensity to consume. Let us examine the last equation. This equation has two terms. The first term' gives the effect of *Zakah* and has been previously shown to be positive. The second term measures the effect of the elimination of *israf.* Since (b - s), c and f are

all greater than zero and less than one, the value of the second term, cf(b - s), would also range from zero to one. We remember that the first term has the same range. Their net effect would, therefore, depend on the relative size of the two terms. Hence $MPC_I > MPC_S$ as:

$$(d - c)\sigma \gtrless cf(\beta - \sigma) \qquad (35)$$

3. **Sensitivity Analysis for the Effect of Islamic Inactions on Marginal Propensity to Consume**

All of the parameters in equation (35) above except "f' are easily measurable. If one can estimate or approximate "f' the net effect of *Zakah* and moderation in any economy can be measured . It is obvious, however, that it is an empirical question and it is not possible on *a priori* grounds to claim that the marginal propensity to consume in an Islamic economy would be higher or lower than its secular counterpart. At best one can make a conjecture. Even for making a well-informed conjecture one has to consider the likely values of the parameters in equation (35). So the best way to study the likely impact of *Zakah* and moderation is to perform a sensitivity analysis up to the values of the parameters.

Before doing that, we need to make one further observation. So far we have talked about *Zakah* and moderation only. Another major determinant of private consumption in an Islamic economy is *infaq* or voluntary charity. Islam does not absolve its followers of their responsibility towards other members of the society by paying *Zakah* only. The Prophet, peace be upon him, has clearly ordained that:

> *"There is, in property, a right (of others) over and above Zakah".*
> *(Tirmidhi: Kitab al Zakah).*

Even though such payments are generally voluntary,[8] the Islamic moral system is so strong that the rich people will be strongly inclined to take care of the poor because unless they do that, they cannot hope to achieve the pleasure of Allah.

> *"By no means shall ye attain righteousness unless ye give (freely) of that which ye love"* (Qur'an, 3:92)

8 There are some payments which are obligatory such as Nafaqat-i-Wdjiba. Moreover, as an emergency measure to remove poverty, the government may impose additional taxes for this purpose

A person who eats his full while his neighbor is hungry is not a believer!" (al-Khatib al 'Umri: Kitab al-Adab, Bab al-Shafqah).

Therefore, it is reasonable to assume that rich Muslims will carry out some voluntary charity in addition to the obligatory levy of *Zakah.*[9]

Fortunately, the model given above can easily accommodate this. In our model the expansionary effect on aggregate consumption depends on the *net* transfer of income from the rich to the poor. Therefore, all one has to do is to think of the parameters as the measure *of Zakah plus infaq* i.e. the net transfer, whether compulsory or voluntary.

Turning now to the sensitivity analysis, let us consider the likely values of various parameters. For the present analysis, the parameters that interest us most are s and f. So we use "guesstimates" of other parameters and then see how various values of s and f affect the final outcome. It has been assumed that 90 percent income accrues to the higher income groups while 10 percent to the lowest group which comprises *Zakah* recipients. In tables one to three, two values each of c and d have been used to see the effect of alternative scenarios. While each table traces the effect of various values of s and f, under the assumed values of other variables, on the marginal propensity to consume in an Islamic economy, a comparison across the tables reveals the effect of different scenarios. Specifically, the value of the marginal propensity to consume of the higher income group affects the net result not only as an absolute value but also as a relative one (relative to the marginal propensity to consume of the lower income group). A comparison of table one and two reflects the effect of the relative values by changing the difference in the propensities to consume of the two groups whereas a comparison of table one and three traces the effect of changing absolute values while keeping the difference in the propensities to consume as constant.

9 It should, however, be noted that charity is undertaken even in non-Muslim societies. Therefore, it will affect the analysis only to the extent that the level of charity in the Muslim society is greater than its level in the non-Muslim society.

Table 1

Sensitivity Analysis for the Effect of *Zakah* and Moderation on the Marginal Propensity to Consume when d = 1.0 and c = 0.8 and 13=o.9.

MPC_I - MPCs = (d - c)a - cf(B - a).

σ f	0.01	0.02	0.03	0.04
0.00	0.0020	0.0040	0.0060	0.0080
0.05	-0.0016	0.0005	0.0025	0.0046
0.10	-0.0051	-0.0030	-0.0001	0.0011
0.15	-0.0087	-0.0066	-0.0044	-0.0023
0.20	-0.0122	-0.0101	-0.0079	-0.0058

Where: c is the marginal propensity to consume of group i.e. *Zakah-payers.*
d is the marginal propensity to consume of group two i.e. *Zakah*-recipients.
B is share of group one in total income.
F is coefficient of *israf*
σ is net transfer to the poor as a proportion of GNP.

Table 2

Sensitivity Analysis for the Effect of *Zakah* and Moderation on the Marginal Propensity to Consume when d = 0.9 and c = 0.8.

σ f	0.01	0.02	0.03	0.04
0.00	0.0010	0.0020	0.0030	0.0040
0.05	-0.0026	-0.0015	-0.0005	0.0006
0.10	-0.0061	-0.0050	-0.0040	0.0029
0.15	-0.0097	-0.0086	-0.0074	-0.0063
0.20	-0.0132	-0.0121	-0.0109	-0.0098

Table 3

Sensitivity Analysis for the Effect *of Zakah* and Moderation on the Marginal Propensity to Consume when d = 0.8 and c = 0.6.

σ f	0.01	0.02	0.03	0.04
0.00	0.002	0.004	0.006	0.008
0.05	-0.0007	0.0014	0.0034	0.0054
0.10	-0.0033	-0.0013	-0.0008	0.0028
0.15	-0.0060	-0.0039	-0.0018	-0.0003
0.20	-0.0087	-0.0066	-0.0044	-0.0023

The figures in the body of each table show the net effect of *Zakah* and moderation on the marginal propensity to consume in an Islamic economy. A positive figure implies a higher MPC and a negative figure indicates a lower MPC in an Islamic economy as compared to its secular counterpart. The switch in the sign indicates the critical value of a variable given the value of the other variable. For example, if the level of *israf* were 10 percent, then the marginal propensity to consume in an Islamic economy will be smaller if the amount of transfer is 3 percent (of GNP) o. less; but will be greater if the transfer were 4 percent or more; similarly if the level of transfer was known to be 5 percent; then the MPC in an Islamic economy will be higher unless the level of *israf* which is eliminated was 15 percent or more. Comparing across the tables one finds that a higher difference in the marginal propensities of the two groups tends to raise the marginal propensity to consume of the Islamic economy above that of its secular counterpart and vice versa. Similarly a higher absolute value of c tends to raise the marginal propensity to consume of the Islamic economy. All of these results are intuitively obvious. The readers are well aware how relieved one feels when his intuition turns out t') be correct.

Even though the sensitivity analysis presented above can give the net effect for any value of the parameters, let us finish this paper by giving a quick guesstimate for the easygoing reader.

From whatever evidence that is available the estimate of a, the ratio of gross *Zakah* to income would lie around 3 percent of the GNP (Awad: 1984; Zarqa: 1976). Using our theoretical discussion on the uses of *Zakah* funds, we would put the value of E around 0.25 which would give us a s value for net *Zakah* transfer

roughly equaling 2.25 percent. Therefore, we would think that the value of s would be roughly 2 percent of GNP.

As for the level of *israf* and *tabdhir* anybody who is familiar with the life-style of the upper income groups in the secular economies would agree that the "fat" in their consumption is very high. Considering the expenditure on drinking, smoking, gambling, conspicuous consumption, wastage etc. even the most conservative estimate of "f' would lie above 10 percent. As a matter of fact it could be much higher.

With these values the likely net effect of *Zakah* and moderation would be to decrease the marginal propensity to consume. If in addition to *Zakah,* some voluntary transfers *(infaq)* in excess of the level of charity in a secular economy are also made, this negative effect on MPC will be somewhat reduced. However, it would take an amount of voluntary transfers greater than the compulsory levy of *Zakah* to lead to a higher marginal propensity to consume in an Islamic economy than its secular counterpart. What is more important to note is that in either case, the magnitude of change is very small.

4. Summary and Conclusion

After reviewing various opinions about the effects of *Zakah,* moderation and *infaq* on the aggregate consumption function and the propensities to consume and examining these theories critically, we tend to conclude that while the effect of *Zakah* and *infaq* on consumption, *cetris paribus,* would be expansionary and that of moderation contractionary, the net effect cannot be determined unambiguously. It depends on empirical values of a number of parameters. What is even more important is the fact that the magnitude of the net effect on the marginal propensity to consume of the Islamic injunctions taken together will be very small. Contrary to the prevalent opinions, we tend to conclude that the net effect of Islamic injunctions on the marginal propensity to consume will be neutral i.e. MPC will not be significantly different from a comparable secular economy. The sensitivity analysis performed on the likely values of the relevant parameters tends to confirm this conclusion. This is so because the expansionary and the contractionary effects of various injunctions tend to cancel out each other.

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CHAPTER ELEVEN

MACROECONOMIC THEORIZING FROM ISLAMIC PERSPECTIVE

*Sayyid Tahir**

Macroeconomics deals with the study of economic themes at an economy's level. Aggregative constructs aim at both description and prescription. Description concerns understanding the existing realities. By and large, the approach is one of abstraction with the aim of singling out key economic relations and processes at work. Prescription falls in the domain of economic policy for the purpose of controlling the economic performance in some desired direction. Conventionally, for example, full employment without inflation is the major goal. By and large, analysis remains in a static framework. Dynamic macroeconomics focusing on business cycles and growth matters is not on the center stage. Conventional macroeconomics uses existing realities as its terms of reference. This makes the task of theorizing quite simple. Furthermore, propriety of a theory is readily tested by its ability to explain existing realities.

When it comes to the Islamic side, all of a sudden matters become quite. complex. There is no existing Islamic economy, so to say, which can provide a basis for theorizing. However, this does not render Islamic macroeconomics an unnecessary exercise. On the contrary, it opens exciting possibilities for both theorists and policy-makers. It is our earnest belief that every action is either Islamic or Islamic. This simple observation provides both the rationale for the Islamic approach and its broad features in all disciplines in social sciences and humanities, including macroeconomics.

As for Islamic macroeconomics, we envisage it to cover two broad areas. Firstly, the study of an Islamic economy per se. What might it be? How might it work? What policies might be called for to ensure its smooth functioning and to preserve its Islamic character in an otherwise unIslamic

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world? .... If one likes, the "mights" may be replaced by "oughts". This is the area of high theory or leading theory. It involves a deep appreciation of Islamic economic teachings. Moreover, it necessitates intelligent and sophisticated imagineering as to the institutional set-up in Islamic economy, its functioning, the economic processes at work in it, and so on. Secondly, Islamic macroeconomics is likely to involve a study of existing realities in the light of Islamic teachings. This will involve explaining existing realities in terms of departures from the Islamic norms. The principal aim will be to identify macroeconomic policies in order to steer the economy in the direction of the
Islamic ideal.

Islamization of economic life is the biggest challenge facing the *ummah* today. This gives urgency to the task of studying existing realities in an Islamic perspective. In our humble opinion, this is the second stage of Islamic macroeconomic theory and policy. Important insights for Islamization of an unIslamic economy will be gained only after main issues pertaining to the Islamic ideal are settled first. This is why we propose to look at some important considerations in achieving the first task, namely, macroeconomics of an Islamic economy. Incidentally, almost all existing theoretical works in the Islamic macroeconomics area also aim at delineating the Islamic ideal. We propose to divide our discussion in two parts. In part I we look at a suggested approach. In part II we give a flavor of the existing literature.

A SUGGESTED APPROACH

Generally speaking, the following two approaches are possible:

1. Islamization of existing macroeconomics.
2. Reconstruction of Islamic macroeconomics (or, Reconstruction of macroeconomics from an Islamic perspective).[1]

The premise of the first approach is that existing macroeconomics having been developed in the West, is loaded with values peculiar to the capitalistic and secular traditions. These values affect both the choice of topics

1. This paper is prepared for the International Seminar on TEACHING ISLAMIC ECONOMICS AT THE UNIVERSITY LEVEL (July 23-August 5, 1991) to be held in Dhaka under the auspices of Islamic Research and Training Institute, IDB, Jeddah and Islamic Foundation, Ministry of Religious Affairs, Bangladesh.

studied and their scholarly treatment. Since the Western values mostly clash with Islam, an appropriate response is to replace the unIslamic values by the Islamic values and to rework existing macroeconomics. This is the currently dominant Islamization of Knowledge approach. Most of the works produced in recent times follow this line. A typical example is the treatment of interest rate. It is regarded as inadmissible for being *a priori* fixed in financial contracts. One response has been to replace the interest by a notionally variable rate of return. See, for example, the paper "A Model of Interest-Free Islamic Economy" by Syed Tqbal Mahdi and Saif Mahyoub Al-Asly read at the Islamic economics seminar organized by AMSS and IIIT in the USA in 1987. Another extreme response has come from Muhammad Anwar in his *MODELING INTEREST-FREE ECONOMY,* who replaces the interest rate variable by a profit-sharing ratio, the Islamically appropriate variable for financial contracting. These authors do perform some cosmetic surgery on the conventional macroeconomic models adapted by them. But their treatment fails to note that money is regarded as a commodity in the models which they Islamize. Perhaps these oversights could have been avoided if the thinking process was initiated at a much earlier level, namely, identifying the nature of money and the function being performed by interest rate in a capitalist system, and then exploring similar issues in the Islamic context provided that those issues were relevant.

The alternative Reconstruction of Islamic macroeconomics approach --- along the Reconstruction of Islamic Knowledge line --- does not deny the importance of the points of departure for the existing Islamization of Knowledge approach. The difference is, however, in terms of response. According to this approach, we need to identify the issues first, that is, ask the right questions of a theoretical significance, and then systematically try to answer them. The insights gained in this manner are likely to be theoretically sound and better representations of the Islamic ideal.- The process is not as complex and time consuming as it perhaps sounds. In fact, this is the only way to make safe and rapid progress towards the "Islamization of Knowledge Goal". This becomes all the more necessary because, as we are all aware, conventional macroeconomics is in a state of flux today. It does not provide a reliable platform for "Islamization". In what follows we present an outline of the reconstruction approach.

1. Terms of Reference

To begin with, we should be clear that we can at best talk of "an Islamic economy". There is no such thing as "the Islamic economy". For example, there

can be a primitive, nonmonetized economy. Alternatively, there can be a monetized economy. Both can be Islamic in their respective frameworks.

The degree of Islamicity should not be an over-riding consideration in basic modeling. This is because one can always talk of a more and more Islamic economy. There is no end to it. In order not to confuse the issues, basic thinking should focus on an "Islamic" economy versus an "unlslamic" economy. A logical question arises: On what basis do we judge an economy "Islamic" as opposed to "unlslamic"? Such criteria would serve as terms of reference for reconstruction of Islamic macroeconomics. These criteria may be stated in terms of characteristics of an Islamic economy as follows.

Essential characteristics of an Islamic Economy:

1. Concern for the Needy (the have-nots)----
   This stems from Islam's critical emphasis on distribution besides economic efficiency.
2. *al 'Adl* - Justice in the widest sense, including economic justice
3. Safeguards against *al Fahsha'* and *al Munker*

Other Important Characteristics of an Islamic Economy:

4. *al lhsan*

These characteristics can be traced to the Qur'an and *Sunnah.* In our opinion, the first three characteristics are necessary for classifying an economy as Islamic ... the absence of any one would render it unIslamic. The fourth feature is like a sufficient condition. Moreover, it is more relevant for gauging the level of Islamicity of an economy. Thus, macroeconomic models reflecting the first three features- or, not clashing with them- may be regarded as legitimate descriptions of an Islamic economy. It may be noted that the presence of *zakah* and the absence of an interest-based financial intermediation mechanism will be the two most distinguishing features of models of an Islamic economy.

2. **General Guidelines for Macroeconomic Modeling**

Modeling involves description without losing sight of the prescription goal. Any model is essentially an abstraction from reality - perceived reality in the case of an Islamic economy. Modeling process starts with the goals of

analysis. These goals are stated in terms of target variables which are generally limited in number. In the process of abstraction, quite obviously there are some omissions - both in terms of excluded variables and practical details in real life. These ought to be clear to the researcher. Because the ultimate aim of description is prescription, one needs to fit policy instruments in the model. Beyond these points, one should also be careful about mathematical needs in modeling, such as equality between the number of variables to be explained and the number of equations at hand, independence, consistency and solvability of the model. These points may be put in the form of the following checklist.

1. Identify target variables.
2. List the assumptions defining the scope of argument.
3. Take note of relevant economic processes at work.
4. Specify the model, ensuring the mathematical prerequisites and incorporating appropriate policy instruments.
5. Work out performance of the economy (solution).
6. Identify the adjustment mechanism.
7. Do necessary comparative policy analysis.

Specification of the target variables and the economic processes at work holds the key to Islamic macroeconomics. Traditionally, the primary focus of macroeconomic analysis is on income, output, employment and price level - in the case of a closed economy.[4] Then, there are also some secondary variables in these models. For example, interest rate and wage rate. Interest rate serves as bulwark for the financial intermediation process. Wage rate comes in the picture when one wants to highlight the market for labor, usually the sole factor in short-run macroeconomic models.

As argued in Tahir (1987), equity considerations rank at par with the traditional concern for economic efficiency in an Islamic economy. Thus there is a need to accommodate the personal income distribution aspect among the primary target variables in Islamic macroeconomic analysis. Furthermore,

2. These terms are not part of the existing literature. We craft them along the lines of "Islamization of Knowledge" versus "Reconstruction of Islamic Knowledge" approaches. Of these two, currently the first term is in currency.

formal constructs of an Islamic economy may highlight *zakah* and financial intermediation on a profit and loss sharing basis. Besides these two considerations, we may need to take care of policy instruments which have *Shari* 'ah-legitimacy. And, if possible, theoretical constructs should also address the possibility of Islamization of an otherwise unIslamic economy or preservation of the Islamic character of an Islamic economy.

How can we go about the reconstruction of Islamic macroeconomics along the aforementioned lines? There is no quick answer for this question. Interested scholars may refer to the paper "Toward a Theory of Aggregate Output, Income and Economic Inequalities Determination in an Islamic Economy" listed in bibliography. In this paper, economic agents are classified in Poor and Rich consumers classes, besides the traditional Producer, Investor and Government categories. This enables us to endogenize the distribution of disposable income between the two socioeconomic classes in order to trace economic unequally in the economy. Unfortunately, this study does not cover the financial and supply sides of an Islamic economy. We propose to discuss the first of these two things along with some additional points on modeling Islamic economy next.

3. Further Issues in Modeling an Islamic Economy

What will be the nature of the saving and investment process in an Islamic economy? In particular, will savers and investors be the same entities in an Islamic economy? A clarification is necessary because some confusion prevailed on this subject for a while. Moreover, -this question has important implications for specifying Islamic macroeconomic models.

Technically speaking, savers are people who own financial (income) flows generated in the production process but not spent on consumption of the goods and services produced. On the other hand, investors are people who own goods and services generated in the production process but not sold to consumers. In an accounting sense, the value of savings always equals the value of investment goods and services. If one recalls the process whereby savings are generated, all pieces of the puzzle should fit together. Savings originate with income earners who may be investors, but mostly they are workers and owners of other inputs. In this sense, it is clear that by and large savers and investors are different categories. The fact, however, remains that investors need financial resources to cover the cost of investment goods and services, whereas the funds are primarily with the savers.

For a macroeconomic equilibrium it is necessary that investors have access to savings equal to the magnitude of their investment commitments. Financial intermediation bridges the gap between the class of savers and investors. Traditionally, interest rate provides the communication channel between savers and investors. Islamically, savers and investors cannot contract on the basis of a rate of return, let alone the interest rate. The only available option for them is to negotiate via a profit-sharing ratio, with the liability of loss for the provider of funds. But profit-sharing alone is not an exciting proposition for anyone. These two points have been missed so far in the literature on modeling the financial side of an Islamic economy. To be adequate reflection of an Islamic economy, the emphasis should be on contractual arrangements, rather than the fixity or viability of the rate of return, with due margin for *Shari 'ah*permitted economic instincts of all concerned.

Financial intermediation means that there will be a definite role for money. However, it will be one of medium of exchange. As such, money will not be held for its own sake, which is the case with other assets. The Islamic teachings on *riba* imply that money cannot be treated as an asset like property or equity, for example.

In macroeconomic analysis of an Islamic economy, there are also many yet unforeseen challenges. For example, we still have to clarify the policy options which an Islamic state will have in order to control the equilibrium outcome. Policy options may be needed to preserve and to enhance the Islamic character of an Islamic economy. The interaction of an Islamic economy with other economies in, an unIslamic world and policies to preserve its Islamic, character from unfavorable external pressures are other exciting areas.

STATE OF THE ART

So far all macroeconomic literature in Islamic economics focuses on the macroeconomics of an Islamic economy. Notable points in this regard are as follows:

1. Some progress is made in the context of a closed Islamic economy with government, abstracting from the financial considerations and supply side constraints.
2. Some literature is available along the lines of traditional IS-LM models. But there are some problems here. In some cases the interest rate is just renamed as some average rate of return or

defined as a variable rate of return. While in other cases a profit-sharing ratio is simply substituted for the rate of interest. In almost all cases, the working of the profit and loss sharing mechanism is not manifest from the model structure. The models lack the capacity to capture the sequence of events in the case of "loss".

3. There are a few, perhaps two or three, full-scale macroeconomic models of an Islamic economy. These models too do not represent any major break from conventional thinking. They mostly rename the existing terms and rephrase the conventional thinking in "Islamic language".
4. One article to our knowledge addresses the open-economic issues for an Islamic economy.

On the whole, it is difficult to say that an Islamic macroeconomic paradigm has been set forth.

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3 In case of open economy models, exchange rate, balance of payments and other relevant variables are also highlighted. We choose to restrict our discussion to the closed economy case.

CHAPTER TWELVE

INVESTMENT DEMAND FUNCTION IN PROFIT-LOSS SHARING BASED SYSTEM

Mohammad Fahim Khan *

1. INTRODUCTION

Interest has no place in an Islamic economy. The Islamic alternative is that financing either be free of any return or it should bear the risk of loss as well if it expects to earn a return. There are several ways in which financing can be made to earn return in an Islamic way[1]. Though the contemporary practice of Islamic banking has concentrated its operations on what is called mark-up based (trade) financing, the theory of Islamic banking has been advocating the use of what is called, Profit-Loss Sharing (PLS) based financing as first best alternative to the interest based financing[2]. Substantial theoretical literature has emerged during last 15 years in the East as well as in the West, discussing the economics of PLS based financial system as an alternative to interest-based system. Several Ph.D. dissertations have also been written on the subject in Western Universities as well.

Investment Demand has been one of the topics mostly subjected to rigorous analysis. The analyses, however, have been found deficient in one way or the other. The objective of the present paper is to point out some of the deficiencies in some major attempts made in this area and subject an alternative formulation for understanding investment demand phenomenon under PLS system.

2. THE ISSUE

1. The theory of Islamic banking suggesting PLS as an alternative to interest defines the concept of PLS in the following terms:

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1. See Council of Islamic Ideology [26]
2. See for example: M.N. Siddiqi (8), M.U. Chapra (2) and Council of Islamic Ideology .

- Let investor be the one who demands funds for investment in an enterprise.
- Let capital supplier be the one who supplies funds to the investor for investment in the enterprise.
- Both parties agree to share the profit arising out of the investment according to any pre-agreed ratio.
- The loss, if any, will be shared by the two parties in exactly the ratio of their respective capital in the total investment of the enterprise. (If investor does not invest any of his own funds, in which case he will be treated as *Mudharib,* then he will not share any loss).

How the demand for investment funds (by the investor) will be determined in this framework?

2.1 Will the Investment Level be Higher under PLS?

Several writers have argued that under such a system the level of investment will increase, because elimination of interest will allow the firms to invest up to a level where marginal product of investment becomes equal to one.[3]

Their argument is the following:

We have a production function Y = F (L, I) where L and I represent labor and investment respectively. We define profit in the interest based system as

$$P = F(L, I) - I - WL - rI \qquad (1)$$

$$= F(L, I) - WL - (1+r)I$$

where w is price for labor, it is the interest rate on capital and P is profit.

Profit maximizing conditions require that marginal productivity of investment be equal to (1 + r).

3. See, for example, Waqar M. Khan (10), Nadir Habibi (27), Shah Rukh Rafi Khan (29).

$$\frac{dF}{dI} = 1 + r \qquad (2)$$

Correspondingly, we define profit in the PLS based system as

$$P = F(L, I) - I - WL - k[F(L, I) - I - WL]$$
$$\text{or, } p = \{1 - k\}\ [F(L, I) - I - WL] \qquad (3)$$

Where k is the ratio in which profit is to be shared by the capital supplier.

Profit maximizing condition require that:

$$\frac{dF}{dI} = 1 + r \qquad (4)$$

The condition requires that the marginal productivity of investment be equal to unity. Comparison of equation (4) with equation (2) is used to directly imply that investment in PLS based will be higher than that in the interest based system because (1 + r) >1.0 and lower marginal productivity of investment implies higher level of investment.

The above analysis, though rigorous, fails to recognize the supply constraint. Marginal productivity of investment to be equal to unity implies that the opportunity cost of capital is zero. This will be a naive assumption. Islam has nothing against having positive time preference. Besides, there " is risk bearing involved in all investments. These two factors may not allow capital supplier to supply funds unless he finds it quite likely to realize a certain minimum rate of return. This capital owner's reservation rate of return may occur above or below the interest rate. Hence in the above framework, it is not a priori clear whether the investment demand will be lower or higher in the PLS based system. As far as investment demand function is concerned, equations (3) and (4) do not help us. Some alternate formulation is needed.

2.2 **Infinitely Elastic Demand for Investment under PLS ?**

On the other hand, some authors have argued that PLS system implies an infinitely elastic demand for investment funds.[4]

Their argument is following

The investor's status in the enterprise is fixed to the extent of his own investment in the form of capital (physical human or financial capital). The more investment funds he gets from capital supplier, all additional liability of loss will go to capital supplier, while investor will be sharing any additional profit that may come as a result of more investment. In other words, investor does not lose any thing by demanding more and more investment funds, though his gains are likely to increase, the more is the investment.

This argument too is naive. It assumes two things:

a) Profit-sharing ratio is exogenously given and remains constant irrespective of the level of demand for and supply of investment funds.

b) The opportunity cost of capital is zero.

The problem arises because the above formulation assumes k independent of the level of investment demand.

It is, however, unrealistic to assume k independent of I (the level of investment demanded by the investor). There are objective reasons to assume that the higher the I, the higher k will be demanded by the capital supplier to compensate for the risk of putting all his eggs in one basket. (This will be further elaborated in the next session).

If k is a function of I, then in terms of equation (3), the profit

maximization would required $\frac{dF}{dI}$ to be greater than unity.

Equation (3) says :

4 See, for example, Waqar M. Khan (10,30), Nadeemul Haq and Abbas Mirakhor (22).

$$P = [1-k]\,[F(L,I) - I - W]$$

If $K = F(I)$ such that $K' > 0$

$$\text{then } \frac{dP}{dI} = [1-k]\,\left[\frac{dF}{dI} - 1\right] + [F(K,I) - I - W]\,(-K') = 0$$

$$\text{or } k'\,[F(L, I) - I - W] = (1-k)\frac{dF}{dI} - (1-k)$$

$$\text{or } \frac{kP + (1-k)}{1-k} = \frac{dF}{dI} - (1-k)$$

$$\text{or } \frac{dF}{dI} = 1 + \frac{k'}{1-k}P$$

Both things are immediately clear

i) Whether the investment level will be higher in PLS is not certain. It may or may not, depending

a) The level of profit sharing (k)
b) k' (the rate) at which k increases with increase in investment.
c) the level of profit of the enterprise (P).

Capital has an opportunity cost. Its productivity cannot be less than its opportunity cost and hence whether investment level will be higher or lower is either an empirical question or has to be answered in a general equilibrium framework.

ii) There is no question of infinitely elastic demand for investment funds. The investor will demand the investment funds only up to the level where marginal productivity of capital becomes equal to $1 + \frac{k'P}{1-k}$

Hence demand for K2 will not be even theoretically allowed up to the level where its marginal productivity becomes unity.

Hence no question of unlimited demand for investment funds.

3. ALTERNATE FORMULATION

Demand for investment, supply of investment funds and profit-sharing ratio will be determined simultaneously. Supply of capital will not be infinitely elastic at a constant profit-sharing ratio. Beyond a certain level of investments, a capital supplier may like to increase profit-sharing ratio (even at an increasing rate) to increase the supply of his capital. This may be due to the fact that the risks of giving higher amounts to a single investor may increase at an increasing rate, because entrepreneurial abilities of the investor are fixed and marginal productivity of entrepreneur (in producing profits) may start declining after certain level.

On the other hand, investment demand will depend on the profit-sharing ratio and the productivity of capital. The investor will not demand investment funds as soon as the profit-sharing ratio implies payment of a share in profit higher than the marginal contribution of the capital. A reduction in profit-sharing ratio thus may increase demand for investment funds and vice versa.

Consider an investor demanding funds for an enterprise. With Y as output/income, I as capital and L as labor. We write production function as:

$$Y = F(L, I) \tag{5}$$

Since labor and capital are sharing the income of the project and hence do not impose fixed costs, this production function also represents net income function for the project.

$$Y = F(I) \tag{6}$$

As a typical production function, we assume that this production function has a declining marginal productivity of capital, i.e. $F'(I) > 0$, $F''(I) < 0$.

On the other hand, the provider of capital expects to receive certain return on his capital. His expected return, of course, will be directly related with the total amount he invests. In the very simplest form, this relationship can be linear relationship of the type:

$$C = rK \qquad (7)$$

Where C is total return that the provider of capital expects to earn on his capital I and r is based on his own utility function or on the opportunity cost of capital.

In the interest-based framework, the provider of capital demands a fixed r from the user of his capital. In the Islamic framework, the provider of capital cannot demand a fixed r. It can only fix a share in the income or profit of the project.

Let this share be called as k. Since income, i.e. Y is not fixed and varies at different levels of I, therefore, the profit-sharing ratio becomes a function of the amount of capital. At different levels of I, the changing productivity of capital will require supplier of capital to adjust profit-sharing ratio (k) so that his rate of return r remains unchanged.

Using equation (6) and (7), we can write:

$$k = \frac{C}{Y} = \frac{rK}{F(1)} \qquad (8)$$

This equation shows that profit-sharing ratio will vary as more and more capital is invested, because C is increasing at a constant rate and Y is increasing a declining rate.

This fact can be more clearly seen in the following diagrams:

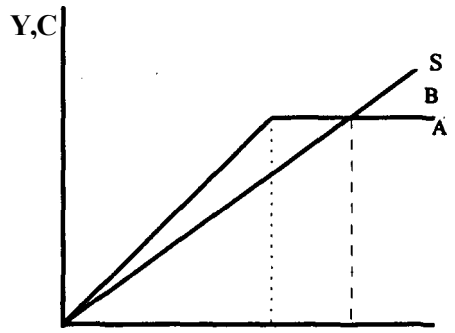

Fig. (1)

The curve A is the production function representing equation (K). The line B shows the total return expected by the capital owner at different amounts of capital to be provided by him. This is a straight line representing equation (K).

4. INVESTMENT DEMAND FUNCTION Two things are clear from Fig (1).

Firstly, the profit-sharing ratio (k) is different at different levels of (I). The value of (k) can be observed at only level of I as a ratio of the corresponding value at line B to the ratio of the corresponding value at curve A.

It can be noted that beyond a certain level of I, the profit-sharing ratio starts increasing until it reaches a level equal to 1.0. This will occur at Io.

Secondly, it will not be in the interest of the investor to demand any amount of capital from the capital owner. A profit maximizing investor will demand only that much capital from the capital owner that will allow him to retain maximum profit. In terms of Figure (1), he would demand that much amount of capital against which the distance between curve A and Line B is maximum. (The distance between curve A and Line B measures the income to be retained by the investor after paying the share of capital supplier from the income of the enterprise.)

Hence, again the assertion that under PLS there will be infinite demand for capital is not valid.

The argument can be taken a step further.

Under PLS arrangement, the supply schedule for capital funds may not be a linear function as shown by equation (7). Since capital owner is subjected to bear losses up to the full extent of his capital, capital supplier would not like to give as much capital as demanded by the investor at a constant rate of return r. Giving all his money to one investor would mean putting all his eggs in one basket. He would like to spread his investment among different enterprises unless *a Mudharib* is willing to offer a higher than r return - higher enough to compensate the risk of putting more capital in one enterprise.

Thus a higher supply of capital for the same investor would mean a higher income sharing ratio with the same investor. In other words, we will have to re-write equation (7) as follows:

$$C = g \quad (I) \qquad (9)$$

with $g'(I) > 0$

$g''(I) > 0$

The profit maximizing investor then faces the following profit function:

$$P = Y - C$$

$$P = F(I) - g(I)$$

Optimum demand for capital by investor will be for that level of K where,

$$F'(I) = g'(I)$$

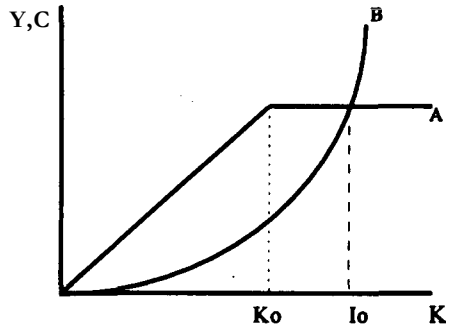

Fig (2)

This can be shown in the following diagram as well:

Curve A represents the production function as shown by equation (6). Curve B represents the capital supply schedule of the capital owner as shown by equation (9).

Profit maximizing investor will demand I where the distance between a curve and B curve is maximum reflecting the maximum profit left with the *Mudharib* after paying the income-sharing of the capital owner.

Once again this proves that the demand for *Mudharabah* capital will not be infinite when F" (I) <o and g" (I) >o.

Keeping in view the conclusion of Fig. (1) and Fig. (2), we can define a relationship between I (the effectively demanded level of investment and k (the profit-sharing ratio) as below:

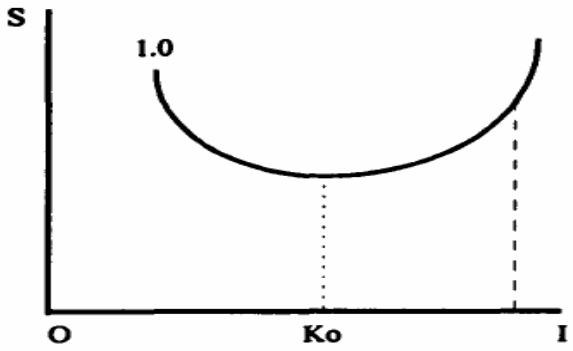

Fig. (3)

Between zero and Io level of investment for this project, the effective relationship between I and k is negative. Beyond Io, the portion of the curve is irrelevant from the point of view of demand for investment as the investor will have no reason to demand any investment beyond Ko.

Within the range of o to Io, we observe I = I (k) with I' <o.

5. MARKET DEMAND FOR INVESTMENT

Once more dimension needs to be added when discussing market demand for investment and that is the riskiness of the enterprises where investments are intended. Coming back to Fig.(2), the position of the supply schedule B will depend on how risky is the project. The more uncertain is the productivity/profitability of the project (curve A), the higher will be the B curve to compensate for the higher risk bearing.

The following diagram explains the point:

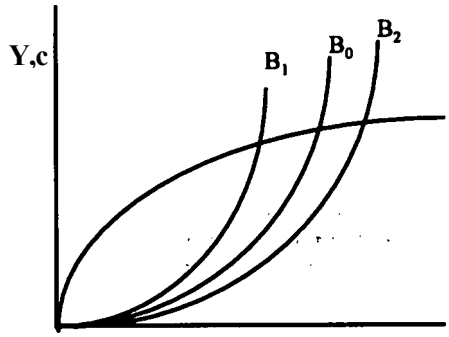

Fig.(4)

Bo is the supply schedule of the funds owner referring to a certain riskiness of the project involved in curve A. The supply schedule of the funds owner would have been higher than Bo (say, at B1) if the project were more risky and the supply schedule would have been lower than Bo (say, at B2) if the project were less risky. (The schedules Bo, B1, and B2 may not be referring to the same person). The economy may be having projects of varying riskiness. The economy may be having projects of varying riskiness. The economy may also be having funds owners with varying degrees of risk aversion.

We assume that there are 'n' sets of projects having different levels of riskiness 81, 82, 83..84. The demand from these sets of projects and the supply of funds available for each set of project determines respective equilibrium level of s for each set of project. In the economy, thus there will be 'n' sets of 's'. Let us see the market demand for the I the set of projects that corresponds to level of riskiness.

The k value in the market of a particular set of project will determine the market demand for investment for that set of projects. The market demand will decline as the "s" in the market of particular set of project goes up and the market demand will go up as the k value goes down. Suppose marginal project is yielding a return Co and hence yielding kC as a share of the funds owner in the return. If k increases, the marginal project would be compelled to reduce its demand for investment [as explained in Fig. (2) and Fig. (3)] because it would mean shifting up of the supply schedule (curve B). Ifs goes down, not only the existing projects may increase their demand for investment, because decline in s means downward shifting of supply schedule, but also some projects previously not feasible may become feasible from the investor's point of view.

We thus draw the conclusion that the market demand for investable funds will be negatively related to the profit-sharing ratio's. This relationship, we may express as

$$I = I(k) \qquad (10)$$

This will be referred to as investment demand function.

Properties of k

a. k varies between 0 and 1.

It is possible for k to become zero.

k = 0 implies that the owner of funds supplies his funds to the investor with no share in profit. This also implies that he will also not share or bear any loss and the investor is obliged to return the full amount at some time in future. It is thus possible that the owners of funds may supply their funds at k = 0. This may occur due to several reasons:

1) Expected profits are too low and risk of loss is considered too high to be compensated by the share in the expected profits.

2) Spirit of helping a poor investor and allowing him to keep all the profits till his enterprise is developed to the extent that it can afford paying a sizable share in the profit.

These two factors become particularly important when there is also an incentive of avoiding the penalty (z) on money balances *(Zakah* at the rate of 2.5 per cent) and there is also religious encouragement to help the needy.

b) It is possible that there may be a lower limit on k which may refer to as s below which k may not decline except to become zero. This will happen when equilibrium value of k happens to be the value that generates such low expected return for the owner of funds which they find not worth accepting because of the larger risks involved. In such a situation, owners of funds rather prefers to advance their funds at k = 0 for reasons already explained.

c) It is not possible for k to become unity or more than unit though it may approach to unity. This is because k = 1 implies that owner of funds will take all the profits that investor makes which will not be a rational situation from the investor's point of view and hence he may cease to effectively demand any amount of investible funds. k may be approaching to unity if the profitability of investment or productivity of capital is very large and/or supply of investible funds is very scarce.

6. BANK'S DEMAND FOR INVESTMENT FUND: CASE FOR INFINITELY ELASTIC DEMAND

It may be instructive to consider a bank as an investor that demands investible funds from the depositors.

Bank has the ability to diversify its portfolios and hence ensure a certain return R on its investment with a negligible risk. The diversification of investment in a large (and/or open economy) can enable a bank to reduce risks to almost (though not exactly zero) and still earning a substantial return R on its investment. This ability creates an opportunity for such owners of funds who do not want to take substantial risk but are looking for earning some return on the funds owned by them.

These features can enable a bank or a financial intermediary to have an infinitely elastic demand for investible funds of small savers. This may occur because:

a) the risk associated with investment does not increase with the increased investment;
b) there are large number of suppliers of capital so that no one holds a significant portion of the total supply of capital and hence is not able to influence the profit-sharing ratio;
c) the investor (the bank) has access to and enjoys the credibility of the large number of suppliers available;
d) there are large number of feasible projects available to the investor (the bank). and
e) the bank is able to adequately diversify its investment over such large number of projects that the risk is reduced to almost negligible level.

Based on the past track record, banks can offer a profit-sharing ratio to attract sufficient funds from the suppliers. They will not, have to change the profit-sharing ratio as long as they are attracting deposits from large number of small savers. They will thus have an infinitely elastic demand for deposits on a fixed and predetermined profit-sharing ratio as long as the capital is scarce in the economy and the bank faces no dearth of viable projects.

7. DISCOUNTING FOR TIME VALUE OF MONEY

Discounting for time value of money for the purpose of investment decision making poses no special problem in a PLS system. The appropriate discount rate will still remain the opportunity cost of capital for investor in a particular project will be the expected rate of return on his capital that he expects by supplying his capital on PLS basis in projects of similar riskiness. This is the conclusion that has been drawn by Zarqa as well. [7] Thus expected rate of return on capital in the marginal project in each class of projects of similar riskiness will serve as a discount rate for the respective class of projects. There is nothing new about using expected rate of return on capital as discount rate in

7 See, for example, Nadir Habibi (27).

investment decision making. The actual practice, in fact, uses Ro rather than interest rate as the discount rate .[6]

The discount rate Ro contains two elements of the opportunity cost of capital:

a) A compensation for the pure time value of money or the pure time preference reflecting uncertainties associated with time alone; and

b) A compensation for bearing the risks other than those attributable to time alone.

In public sector projects, the consideration for type-b risk may be negligible as distribution of risk over large number of tax payers maximizes these considerations. These projects are, therefore, required to be discounted for the pure time preference alone. The most representative discount rate reflecting pure time preference alone will be the expected rate of return on non-time deposits of the banks. The average rate of return on such deposits paid in the past would be a close estimation of the expected rate of return and hence of the discount rate.[7]

In case of open economy models, exchange rate, balance of payments and other relevant variables are also highlighted. We choose to restrict our discussion to the closed economy case.

6 See, M. Anas Zarqa (31).
7 For more arguments on this, see, M. Anas Zarqa (31).

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CHAPTER THIRTEEN

GROWTH STABILITY AND INFLATION IN AN ISLAMIC MACRO FRAMEWORK

M. Fahim Khan

The description of a complete Islamic economic framework and analysis of the stability and growth aspects of an economy within this framework is not a simple task. At this stage only the following question is being addressed to:

If interest is eliminated from the economy (because it has been categorically forbidden in Islam) and is replaced by an Islamic alternative then what will possibly be the implications on growth and stability of an economy?

Of course, elimination of interest is not the sole factor that would Islamize an economy but it is still important to study the impact of its elimination only as most of the conventional economic analysis and discussion on growth and stability centres around interest rate. Once the effect of elimination of interest has been crystallized, the introduction of other elements of Islamic economic system will be simple from the point of view of studying their impact on growth and stability.

Even with this simplification there still remains a big question and that is, what Islamic alternatives we can introduce as a replacement of interest. One very simplest view based on the practice of existing Islamic banks can be that we can take the mark-up based financial system as an alternative to interest. Islamic economists, however, are critical of this approach on the ground that this will not reflect the true spirit of Islamic economic system and would simply be an instrument to bring the interest from back door and hence nothing will change in the economy. Islamic economists believe that a true Islamic alternative to interest would be the introduction of profit-loss sharing based financial system in the banking system in which any loan will always be free of interest and any financing will have to be based on the concept of profit-loss sharing. This paper will, therefore, only be considering the growth and stability effects of introducing profit-loss based sharing system in place of interest based financial system.

The growth and stability analysis of an economy requires the development of an appropriate macro-economic model which too is not a simple task. This paper will attempt to present only a simple macro economic model to point out the growth and stability effects of introducing Profit-Loss sharing based system.

Before discussing the growth and stability effects in the framework of an Islamic macro-economic model, let us have an overview of the broad features of profit-loss sharing system from the point of view of growth and stability.

Growth

Growth in economy will fundamentally come from growth in the endowment of the factors of production i.e. land, labor, capital and entrepreneurship and/or from their improved productivity. Assuming that changing the financial system will not have a direct and immediate implication on the labor supply and the land available in the economy, we will, therefore, restrict our analysis to the effect of introduction of Profit-Loss Sharing (PLS) based system on the two factors; namely capital and entrepreneurship only. As regards capital, the basic question that needs to be asked, would be whether introduction of PLS system will increase or decrease investment activities in the economy. The contemporary literature on this have discussed two types of arguments. One line of argument is that since there is no interest in the economy, therefore, investment can be made until marginal productivity of interest becomes zero whereas in the interest based system the investment will have to be stopped where marginal productivity of investment becomes equal to interest rate. Hence, the investment level in Islamic economy will be higher than in the interest based system. The other line of argument is that investment level under the PLS System will decline because Profit-Loss Sharing system will involve an extra-cost for the owner of capital because of the asymmetry of information with respect to the productivity of enterprises. Capital owner will have to incur extra cost in order to monitor and acquire information about the profitability of enterprise where they have invested their capital and this extra cost being a deadweight loss will imply reduced investment activities.

Both the arguments are in fact incorrect. This is not correct to assume that in the absence of interest, investment can be made until the marginal productivity of investment becomes zero. No economy has abundance of capital. Capital is always scarce and there will always be an opportunity cost for capital and investment will be made only to the level where the marginal

productivity of investment becomes equal to this opportunity cost. Whether opportunity cost of capital at a particular point of time was equal or not to the interest is an empirical question and the answer will determine whether or not investment level be same, higher or lower if PLS is introduced at that particular point.

Similarly, it is also not correct to say that the PLS system involves extra information cost which is a deadweight loss. Extra information cost will be incurred to identify the efficient and profitable and reliable projects which in turn will result into a higher rate of return for capital owners because he will be getting the return on the basis of share in the profit. The fact that capital owner will be monitoring the efficiency, profitability and reliability of the enterprise which will be contributing to the efficiency of the entrepreneur means that the information cost cannot be simply a deadweight loss. It will be rather a positive contribution to the economy and hence will have a positive impact on investment.

After the introduction of PLS in the financial system the Islamic banks will be obtaining a share in profit of their clients on their asset side. They will not be taking fixed rate of interest from their clients. Everybody knows that profits are higher than the rate of interest because they include a premium for risk also, therefore sharing the profit may end up giving the banks a higher return. Since the banks have to share their profits with the depositors according to pre-agreed ratio and the bank's profit are likely to be higher than the rate of interest, the depositors will also end up getting a higher return on their deposits. That is what is in the theory. What will be in actual practice that depends on how efficiently the Islamic banks operate or what is the actual situation. In theory, however, we have reasons to believe that the rate of return on deposits given to the depositors may be higher than the interest rate. If that is the case then, of course, the supply of investible funds would be higher than as compared to what it would be under the interest based system. On the demand side, since the banks would be providing financing on the basis of the profit and loss sharing, the fact that the banks are willing to share the losses will motivate several potential investors to come forward. Previously when they were supposed to pay only a fixed rate of interest, many potential investors fearing that they may not be able to make profit higher than rate of interest would not come to the bank. They will just stay away. Many potential investors who were shy in the interest based system to go to the banks will now be motivated because of the profit loss sharing phenomena. Hence there will be higher demand for investment.

The conclusion is, there will be higher demand for investment, there will be a higher supply for investment and the equilibrium level is likely to occur at a rate of return higher than the interest rate.

This was with respect to the effect on introducing PLS system on the capital formation in the economy. What about the other factor involved in growth i.e. entrepreneur. How does elimination of interest affect this factor? Entrepreneurs are the human beings who organize the other factors of production to make more production and bear risk in this process. This risk bearing aspect is what makes one an entrepreneur. The entrepreneurs can not organize production out of nothing. They need some capital to hire different factors of production. When they use the capital they of course take risk because this capital may be lost in the process. Entrepreneurs who do not have their own capital will have to find out capital from someone else to take this risk. But if this capital is available on the condition that he will have to return it in full plus a fixed interest on it, many of the entrepreneurs would like to shy away because they do not have means to guarantee the repayment of capital with interest. Many people despite having potential would like to be away from entrepreneurial activities and would rather like to look for a wage paid job. If the capital becomes available to the people only on the basis of profit-loss sharing, then several people who were potentially very good entrepreneurs but did not have the capacity to bear the risk will now be willing to come forward and take up entrepreneurial jobs. The new entrepreneurs will emerge. The role of entrepreneurship in the economy will increase and we will have a solid reason to believe that the supply and demand of the fourth factor of production i.e. entrepreneur will definitely be at a higher level in an Islamic economy than what it will be in an unIslamic economy or in interest based economy. This possibility of increase in a factor of production which is an important factor for growth, of course, gives a lot of hope for growth in an Islamic economy.

Stability

Regarding stability in the economy, again we ask the question that when we eliminate interest rate and instead introduce profit-loss sharing system, what do we lose that will affect the stability? What was there in the interest based system that will not be available now to us and will cause instability in the economy? The argument that is given in this respective is the following:

In a system with fixed interest rate, investors know what is the cost of capital and hence they can take appropriate investment decisions. When we

eliminate the interest then investment decisions will have to be made on the basis of uncertain profit and this will lead investors to make wrong decisions. The fluctuation in rates of return will change costs of capital. The people who invested on the basis of an expectation will realize their mistakes when they see the actual return and will come back and withdraw their investment and this will create instability. Such an argument certainly does not have a sound basis. When people invest, they don't invest on the basis of interest. Interest does not lead people to decide how much to invest. If I have a lot of money and if I want to invest, it is not interest that I will look at it. The first thing that I will look at is the project that is available to me. How much rate of return it has. Interest can only lead me not to invest, but it can not force me to invest. Investment will always be on the basis of the rate of return that I am seeing in a certain project. Even in the interest based system investment decision are always made on the basis of expected rates of return. Absence of interest will hardly make any difference with respect to stability in investment. On the contrary it is the presence of interest that creates instability in the investment as discussed at length in economic literature.

A second argument in an interest-based system is that the policy makers have interest rate as a policy variable in their control to keep the economy stable. They can always manipulate this policy variable if there are any shocks in the economy, in order to bring back the economy to the equilibrium path. Government, for example can increase the bank rate to reduce the investment demand and vice versa. With the elimination of interest it is apprehended that Government will lose this policy variable. This is not the case with the replacement of interest rate by profit-loss sharing based financial system. The profit sharing ratio of the banks with the depositors and the profit sharing ratios of the banks with their clients on assets side have been shown to serve as an effective policy variable. It has been shown rigorously that this policy variable is more effective than the interest rate.

An interesting argument made in the literature in favor of the stability aspect of Islamic banking is the following:

On its liability side, a bank is obliged to guarantee principal as well as a certain fixed rate of interest. On the other hand, bank is vulnerable on its asset side. Any shock on the asset side e.g. failure of the businesses where bank has invested, puts the bank in critical situation. Its liabilities do not match the assets. Any effort to stop paying depositors or delaying the payment to the depositors on such an account will make the depositors panicky which will

further add to the troubles of the banks. Several hundreds of banks are reported to have collapsed on this ground. It was pointed out in the literature that this failure of the banks is because their liabilities are fixed but their assets are not. In order to remedy the situation, a scheme of deposit insurance was introduced. But recent failures of several banks indicates that even this did not contribute much towards stability of a bank. A paper on this subject was published in the IMF Journal showing that Islamic system maintains through the profit-loss sharing mechanism a balance between the liabilities and assets of the banks. If the assets of the bank decline the liabilities to the depositors also decline to the same extent because bank is committed to share the profit-loss with the depositors. This makes the banking system more stable.

Coming to another aspect of salability i.e. inflation we again ask the same question, what element of the profit-loss sharing system will make the economy more inflationary compared to the interest based system. We cannot find any argument that the profit-loss sharing system will create inflation, and interest based system will not. On the contrary we can give several arguments which will prove that profit-loss sharing system will reduce inflation. One basic argument is that under profit-loss sharing system there will be no loans but investments only. This will discourage consumption and promote investment. Banks will be discouraged to give loans for consumption purposes because banks will not be able to share the profit with them. There is no profit calculation in consumption and hence, they will either depend on mark-up based financing which gives low return and which also requires them to be involved in trading or they will have to depend on leasing which will be costly business for the bank because they have to own and maintain the asset. The general consumption loans are expected to decline. When general consumption loans decline, and investments increase instead, then of course this has a negative effect on inflation. In the profit-loss sharing system most of the financing from the banks will be taken for productive purposes because banks have to share the profit. The bank financing will mostly create production which will lead to an increase in supply of goods and services which in turn will absorb the demand rather than create any inflationary pressures. Hence there are reasons to believe that introduction of profit-loss sharing system will have a dampening effect on inflation, but there is no reason to say that introduction of PLS system, profit-loss sharing system will increase the inflationary pressure in the economy.

With this general discussion on growth and stability aspects of introducing profit-loss sharing system, we can turn to a more rigorous analysis

of these aspects in the framework of a macroeconomic model for the economy as whole.

Several attempts have been made to develop macro economic models for an Islamic economy. These models usually, being income determination models, have been developed primarily to study the stability aspect of an Islamic economy like any macroeconomic model developed in the secular framework. No attempt has been made so far to describe the macro economic framework of an Islamic economy in the context of growth and development. In the secular framework, we do find macro models related with growth through the concept of full employment equilibrium suggesting that manipulation of aggregate demand may improve fuller utilization of productive capacity and hence generate growth in the economy. Also, Leif Johansen discussed the macroeconomic framework in relation to growth in the economy by explaining the price impact in the model and hence showing that casual demand encourages growth by increasing the profitability implicit in the rise in price level. Such an attempt for economic development in general for an Islamic economy in particular , though very much needed, has not yet been made.

The secular attempts referred to above related macro economic models to growth through manipulation of aggregated demand. I feel that an Islamic economy will potentially have a macro model where development can be manipulated through supply side.

In one of my earlier papers relating to Development Strategy in an Islamic framework (7) it was emphasized that growth in Islamic economy can be manipulated through supply side by mobilizing human resources through the peculiar nature of Islamic financial system. No formal macro model, however was presented in this respect. In the present paper I want to develop a macro model to show that the Islamic Financial System generates an implicit macro framework that leads the economy to full employment and then continues it towards further growth and development. The paper will utilize the conventional ISLM Framework to link a simple income determination model to growth in . the economy. The ISLM Framework will be developed under the assumptions of Islamic economy. The ISLM framework will particularly highlight the investment function in Islamic economy and money demand functions and then will link this framework to the process of economic development in the economy.

The Model

We assume an economy with unemployed resources so that supply of output is perfectly or almost perfectly elastic and all prices remain constant. The aggregate supply curve for output is horizontal and so is the labor supply curve (at least a very big chunk of the total labor stock).

We assume an Arthur Lewis type economy.[1] There is surplus labor available with an almost infinitely elastic supply at a constant wage,[2] say W.

An economically active population can be divided into two categories, (a) those who work as what we may call entrepreneurs (working for themselves to earn a profit and not earning a wage or salary), and (b) those who work as what we call labor (working for someone else). We thus write Human Resource equation as:

$$H \quad E+L \qquad (1)$$

Where:

H	=	is stock of economically active human resources,
E	=	is that part of human resource that is active as entrepreneurs[3], i.e. working for (uncertain) profits,
L	=	includes all those who are either working for someone else for wages in a modern sector or are disguised unemployed in the subsistence sector.

L has two types of labor (a) those employed in the modem sector (call this labor as L1) and (b) those employed in subsistence or traditional sector (call this labor as L2). Bulk of L2 is disguised unemployed in the sense that their removal form the traditional sector is possible without affecting the output of the traditional sector.

1. See Arthur Lewis [3].
2. This may be a subsistence wage as assumed by Arthur Lewis or a market-cum-reservation wage of labor in a labor surplus economy as in Khan's framework [1].
3. This includes self-employed.

The output that L2 shares in the traditional sector is sort of average product in the sector. This average product determines a floor for the minimum wage that L1 will demand in the modern sector.[4] We may call this W which is assumed to remain constant as long as there is a surplus stock of labor in the traditional sector.

The employment of labor in the modem sector (L 1) is generated by the demand for labor from the entrepreneurs (E) which, in turn, depends on the following:

i) Marginal productivity of labor
ii) Reservation wage W referred to above

The employment of human resources (H) into E depends on the following:

a) Opportunities for the human resources to avail to work for themselves;
b) Expected profits (P) from entrepreneurial activities;
c) Availability of the capital requirement for the activity;
d) Willingness and ability of human resources to avail of an entrepreneurial opportunity yielding a certain expected return (P) by beating certain risks.

Since W is assured in the subsistence sector to all the **population,** the human resources will take up entrepreneurial work only if it ensures a certain minimum expected profit (P) for them. The reservation for expected profits is a function of W.

$$P = F(W) \qquad (2)$$

Expected profits (P) from possible entrepreneurial opportunities motivate resources to organize profitable enterprise. Such enterprises once initiated may also generate demand for labor (L).

4. For further elaboration of this hypothesis see Fahim Khan [1]. The theory basically is that of Arthur Lewis [3].

There may also be a minimum capital requirement to generate a minimum reservation of expected P desired by the entrepreneurs. However, the more capital is available to an entrepreneur, the more profits (P) he expects to make.

A typical entrepreneur may perceive a potential entrepreneurial activity as below:

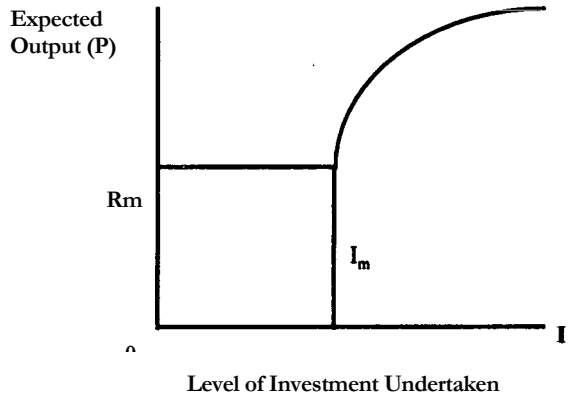


Fig. (1)

Rm = Minimum expected output that may motivate a typical human resource to take up an entrepreneurial activity.

Im = Minimum level of investment required to generate R profit in the activity.

The curve implies diminishing marginal output on investments as more and more funds are used by the same entrepreneur.

We further assume the following:

a) Savers and entrepreneurs are different agents. Savers are owners and suppliers of invertible funds and entrepreneurs are users of these funds.

b) There is no cost charged or profits made by institutions for financial intermediation. (This is only for simplifying the analysis. The assumption can be withdrawn without affecting conclusions).

c) There are no funds available on an interest-basis.

d) Owners of funds can supply funds to the entrepreneurial human resources only on a profit/loss sharing basis. Under this arrangement owners of funds agree to share the actual profits according to a pre-agreed ratio and to share the losses (if any) in the proportion of their funds in the total investment of the enterprise. (If the entrepreneur has no investment of his own, all losses will have to be borne by the supplier of the funds.)

e) There is a tax (Z) on the ownership of money balances or all such assets that are susceptible for investment or are susceptible to growth or generating income. The tax is exempted in initial stages of development if it is given as a loan to a potential or a low income earning entrepreneur. (As an economy grows even the loans to entrepreneurs may become taxable.)

f) Growth in GNP comes by mobilizing human resources by motivating them to take entrepreneurial activities when wage paid jobs are not available. The supply of finance on a profit-loss sharing basis provided the motivation and incentive to the human resources to take up entrepreneurial activities.

   The entrepreneurial sector competes with the wage paid sector and an equilibrium is simultaneously achieved in the wage paid labor market and in the entrepreneurial labor market.

g) Entrepreneurial sector serves a catalytic role. When it moves it makes the other sector (the wage paid sector move) and hence the entrepreneurial sector plays a catalytic role for growth in the economy.

This model of growth in GNP has two basic elements:

- There is no interest in the economy.
- All finances/investments are available on profit-loss sharing system.

What type of macro framework will result in the economy if the above strategy is to be implemented and what implications will such a framework have for growth to be discussed in the rest of the paper?

The above mentioned elements are primarily expected to affect investment demand and money demand. The reformulation of macro framework, therefore, concentrates on reformulation of these two sectors only.

Investment Demand

Determination of Profit-Sharing Ratio and Demand for Funds at Micro Level.

An entrepreneur, intending to avail himself of a particular entrepreneurial opportunity, generates demand for investible funds. The effective demand of the entrepreneur for investment funds depends on expected profits (P) that the entrepreneur can earn from the potential entrepreneurial activity. This P, in turn, depends on:

- Total profits (R) expected from the entrepreneurial activity.
- Share in the profits claimed by the owner of funds.

The profits that the supplier of funds will expect to receive on his investment may increase at a constant rate implying a constant expected rate of return on his funds or it may increase at an increasing rate because the risk may increase for the supplier of funds as he supplies more and more funds to the same entrepreneur. There may be a limit beyond which the supplier of funds may not be willing to supply the funds irrespective of the expected profits. This limit may depend on various factors including the human capital of the entrepreneur seeking the funds.[5]

On the other hand, an entrepreneur may expect certain profits from his enterprise at different levels of investment as has already been shown in Figure (1).

5. For more discussion, see Khan [2].

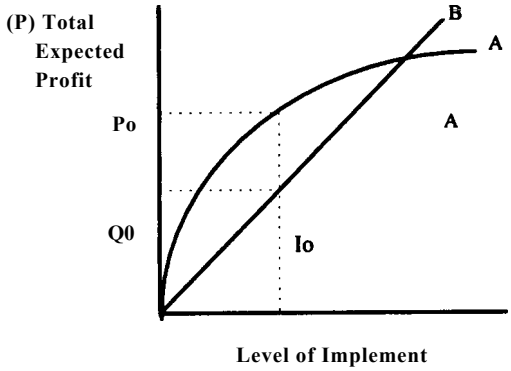


Fig.(2)

The expectations about the profits for the entrepreneur, as well as for the supplier of funds from the investment in a potential enterprise, can be shown together in the following diagram:

Curve A shows the total expected profits that the entrepreneur expects to make from his enterprise with different levels of investment.

Curve B shows the expected profits that supplier of funds wants to claim for his investment in the enterprise.

The entrepreneur will effectively demand that amount of investment funds which leaves him the maximum expected profit after paying the share of the supplier of funds. In the above diagram the effective demand would be I_o. At this level of investment, the enterprise is expected to make a total profit Po out of which supplier of funds expects to claim Q_o. The ratio of Q_o to Ro at Io os ao. This is an optimum point for both the parties and becomes a basis for entering into a mutual contract. The contract between the parties will then be made to include the following:

1) Supplier of funds will supply an amount of Io to the entrepreneur to invest.
2) Supplier of funds shares in the actual profits. Share of the supplier of funds in the actual profits of the enterprise will be determined according to the pre-agreed ratio ao.
3) If entrepreneur has made no investment of his own, all losses will be adjusted against the investment made by the supplier of funds.

Investment Demand Function at Micro Level

The 'a' - value is agreed upon ex-ante and determines the planned level of investment. The changes in 'a' will affect the effective demand of investment funds from the entrepreneur. The changes in 'a' may occur as a result of shifts in A or B or both.

Curve A may shift up or down depending on the shifts in the level of human capital, technology available to human resources and various environmental factors affecting the entrepreneurial productivity of human resources.

The ratio of expected profits at each point of the curve B to the expected profits at the corresponding points on curve A would be referred to as profit-sharing ratio for the corresponding levels of investment.

Curve B may shift up and down depending on various factors such as availability of more investible funds with the owners of funds, improved credibility of the users of funds, reduced risks due to an improved political and economic climate etc.

An upward shift in Curve A (other things remaining the same) means reduction in 'a' as the ratio to Q_o/Ro goes down at all levels of investment. This may lead to an increase in the entrepreneurs effective demand for investment funds.

An upward shift in Curve B, on the other hand, means an increase in 'a' at all levels of investment and hence may lead the entrepreneur to reduce its effective demand for investment. It should be noted that Curve A and Curve B are determined independently of each other.

The equilibrium point for an entrepreneur to enter into a contract with the owner of the funds will occur when the marginal productivity of investment in the enterprise becomes equal to incremental increase in the expected profits claimed by the owner of the funds. (For further elaboration see Appendix).

We thus draw the conclusion that the entrepreneurial demand for investible funds will be negatively related to the profit-sharing ratio 'a'. This relationship, we may express as:

$1 = F(a)\ Fa < 0$ (3)

This will be referred to as investment demand function.

'a' varies between 0 and 1. It is possible for 'a' to become zero.

When 'a' = 0 implies that the owner of funds supplies his funds to the entrepreneur with no share in profit. This also implies that he will also not share or bear any losses and the entrepreneur is obliged to return the full amount at sometime in future. The possibility that the owner of funds may supply their funds at a = 0 may occur due to several reasons:

1) Expected profits are too low and risk of loss is considered too high to be compensated by the share in the expected profits.
2) The action of helping a poor entrepreneur and allowing him to keep all the profits till his enterprise is developed to the extent that it can afford paying a share in the profit.
3) Avoiding the penalty (Z) on money balances as already mentioned.

It is possible that there may be a lower limit on 'a' which we may refer to as 'a' below which 'am' may not decline except to become zero. This will happen when optimum value of 'a' happens to be the value that generates such low expected return for the owner of funds which they find not worth accepting because of the larger risks involved. In such a situation, owners of funds rather prefer to advance their funds at a =0 for reasons already explained.

It is not possible for 'a' to become unity though it may approach to unity. This is because a = 1 implies that owner of funds will take all the profits that the entrepreneur makes which will not be a rational situation from the entrepreneur's point of view and hence he may cease to effectively demand any amount of investible funds. 'a' may be approaching to unity if R is very large and/or supply of investible funds is very scarce.

Investment Funds Market: Macro Perspective

At this state, it is important to recognize that the economy may have projects of varying degrees of risk. On the other hand, economy may also have fund owners with varying degrees of risk aversion. In other words, there will be 'n' sets of projects having different levels of riskiness si, s2 ... Sn. The demand

for these sets of' projects and supply of funds available for each set of project determines respective equilibrium level of 'a' for each set of project. In the economy thus, there will be 'n' sets of 'a'. To keep the analysis simple, we assume homogeneity with respect to the riskiness and hence we get rid of the third dimension to reflect si.

We assume large number of entrepreneurs and large number of suppliers of funds. An entrepreneur chooses a supplier whose return-risk preferences (Curve B) enable him to agree upon an optimum value of 'a' yielding him maximum expected profit (P).

In this process of search, it is possible to enter into a contract jointly with more than one suppliers, in order to arrive at optimum investment-profit-sharing-ratio package. We will, therefore, refer to the supply of investible funds in terms of units of investment funds (rather than owner of investment funds) available at different levels of 'a'. At macro level, curve B thus is replaced by an upward supply curve as shown below:

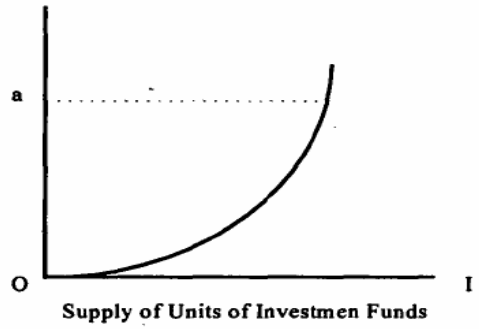


Fig. (3)

On the other hand, the available investment funds look for more productive entrepreneurs so that they are able to claim more profit. The most productive entrepreneur believed to be generating the highest return (R) at all levels of investment would be chosen first. At this stage, we may not distinguish between entrepreneur and enterprise. In the presence of surplus stock of human resources, we assume that each entrepreneur represents a single enterprise. Hence, we need not distinguish between profitability of an enterprise and productivity of an entrepreneur. Competitive conditions can be

assumed to ensure that profitability of enterprises is equalized over all enterprises in the economy. The investment funds market, thus, will determine three things:

i. Profitability of marginal enterprise in the economy (R);
ii. Investment level in the economy (I);
iii. Profit-sharing ratio (a) for the owner of the investment funds.

Because of the assumption of large numbers of enterprises/ entrepreneurs in the economy, we can also assume that the profitability (R) of the enterprises in the economy at the margin will not be affected by the changes in the level of investment (I) and profit-sharing ratio (a).

Hence at macro level, while the investment will continue to be negatively related to the 'a'-value, as shown in equation (3) the (total) profits per enterprise (R) will remain fixed in the background in a short run perspective.

Goods Market Equilibrium

Let us take the simplest model of goods market:

Y	**=**	**C+I+G**	**(4)**
C	**=**	**Private Consumption**	
I	**=**	**Investment Demand**	
G	**=**	**Government Expenditure**	
Y	**=**	**Aggregate Demand (Equal** to **Aggregate**	
C	**=**	**Supply)**	(5)
I	=	io is	(6)
G	=	G (Exogenously given)	
Y	=	Ao - Ala	(7)

Where $A_o = \dfrac{b_o = i_o + G}{1 - b(1-t)}$

$A_1 + \dfrac{i}{1 - b(1-t)}$

Equation (7) shows a negative relationship between 'a' **and** Y. This is an IS curve in our framework with positive slope.

Money Demand
Money Demand Function

Demand for real money balances will depend on the level of real income and the expected return on financial assets.

It depends on the level of real income because individuals hold money to finance their expenditures which in turn depend on their income.

$$L = by \qquad (8A)$$

The demand for money depends also on the expected return on financial assets. The higher the expected return on the financial assets the less worthy it is to hold money.

This part of the demand for money may not be directed at speculative demand for money. This part of demand for money, in an Islamic environment has the following elements.

Besides the transaction demand for money, there is a demand for meeting the short term borrowing needs of others. With the importance attached to *Qard-ul-Hasan* and with the embarrassment attached with not helping a brother in need, the Islamic environment would require every one to keep some cash for meeting the short-term borrowing needs of others. The money necessary for such situation, however, will depend on cost of holding money which of course is the expected rate of return on investment. The lower the rate of return the higher the demand for this purpose. The demand for money motivated by altruistic considerations in fact, will be a function of both income (Y) and rate of return (Q). While it will be positively related to Y, it will be negatively related to Q. This part of the demand for money for some cash for altruistic purposes can be written as:

$$A = a2\ Y - hQ \qquad (8B)$$

The equations (8A) and (8B) can be combined to write:

$$LA = ky - hQ \qquad (8)$$

As far as speculative demand for money is concerned, theoretically it can exist on the same based economy. The expected rate of return will be more volatile than the fixed interest rate and hence increase the urge to speculate. Though speculation will always be on an expected rate of return but it can always be translated into the profit-sharing ratio prevailing in the market. Thus, the higher the profit-sharing ratio the lower will be the speculative demand for money and vice versa.

There is generally an impression given by Islamic economists that speculative demand for money cannot exist in an Islamic economy because of the prohibition on gambling.

Since there will be a natural urge to hold money in periods of low expected returns in order to be able to invest in periods of high expected returns and since such an urge cannot be institutionally controllable, some speculative demand for money is inevitable. It can, however, be said that the speculative demand for money will be shadowed by the altruistic demand for money. In periods of low expected return on investment the urge to hold money for altruistic purposes will be more than in periods of high expected return. There is some institutional control on speculative demand for money in the form of *zakah*. That will only reinforce the altruistic motive for holding money. The speculative motive will, therefore, still keep the form of demand function the same as shown in equation (8).

Hence, the demand for real money balances increases with the level of real income and decreases with the expected rate of return on financial assets. We can write demand for money function as:

$$LA = K Y - h Q , k > o ; h > o \qquad (8)$$

L = Demand for money

Q = Expected profits on financial assets for the owner of the asset.

But we know that Q = aR.

Since R is exogenously given to money holders as far as money demand is concerned, we can write equation (8) as:

$$LA = kY - haR$$

or LA =kY - h'a *(9)*

where h' = hR

Money Market Equilibrium

Assuming a fixed money supply (M) and a constant price level (P) implying fixed real money balances $\frac{M}{P}$ we write money market equilibrium as:

$$KY - h'a = \frac{M}{P} \qquad (10)$$

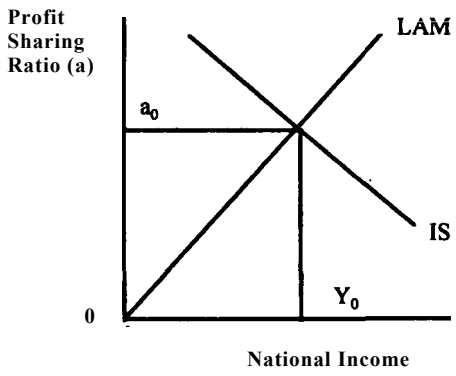
This gives a relationship between a and Y as below:

$$a = \frac{I}{h'}(kY - \frac{M}{P}) \qquad (11)$$

This is the equation which will be referred to LAM curve in order to distinguish it from the LM curve that represents interest-based speculative demand for liquidity. LAM curve is based on the demand for liquidity that is motivated by profit-cum-altruistic considerations.

Income Determination - 'ISLAM' Framework

IS and LAM curves determine equilibrium level of income as usual except that we have profit-sharing ratio (a) instead of interest as shown below:



***(Fig.* 4)**

Slope of LAM Curve

LAM **curve is represented** by the equation.

$$LAM = \frac{I}{h'}(kY - \frac{M}{P}) \qquad . (12)$$

Is there a vertical section in the LM curve ?

The answer depends on whether 'h' can be zero i.e. whether demand for money can be insensitive to changes in 'a'. (Equation for money demand being M = kY - h'a). 'a' may cease to have any effect on demand for money when Q (the expected rate of return for the owners of the financial assets) is very low. At very low Q, the owners of financial assets may not prefer to invest at positive 'a' as a matter of risk aversion. Positive 'a' means also the responsibility to bear the losses. The low Q may not tempt the financial assets owner to bear the responsibility of loss implied in this Q. On the other hand there is a cost in holding money. The holders pay Z on the amount held. In such a situation where holders of money do not like to invest on a profit/loss sharing basis and also want to avoid the penalty Z, they may prefer to lend the money to those who need it. Money lent, in our framework, does not share any profit and is liable to be returned in full at some future date. This may also be referred to as investment with a = 0 (i.e. neither earning any profits nor bearing any losses).

The money demanded will remain insensitive to **'a'** until Q reaches a certain level (Q) beyond which owners of financial assets become responsive to changes in 'a'. With R (expected total return on investment) as given, this implies, that there is a corresponding 'a' as well below which h'a is zero. Hence it is possible to have a vertical section below a certain a. There may not be any vertical section, if R is not low.

Is there a horizontal section in LAM curve? The answer depends on whether it is possible for money demand and financial assets to be perfect substitutes of each other. In terms of lower Q, we have already discussed that it is not possible that any addition to money supply may add to the money demand because of the existence of a cost (Z) of holding money.

Thus, the LAM curve cannot be horizontal at lower values of -Q. It may be vertical up to a certain level of 'a' and after that it will have a positive slope. However, there is a limit to the value of 'a' as it cannot be equal to or greater

than unity. If R is very high, there is scarcity of capital and there is excess supply of human resources willing to take entrepreneurial jobs, the 'a' may rise to a very high level, still leaving enough P (expected return for the entrepreneurs from the investment) to induce him to remain in the entrepreneurial job. As 'a' approaches to unity, the LAM curve will become flatter and flatter. At higher levels of 'a' with R being very high, Q will also become very high which enables the entrepreneur to demand more money as they can afford to pay Z on their money balances out of the Q earned on the finances already invested. Hence the bulk of any addition to the money supply at this stage may simply add up to the money demand. The horizontal section of LAM curve is possible at very high (close to unity) level of 'a' values. Such a horizontal section may not occur at a very low level of R may mean P to be less than Pm (a thousand point of entrepreneurial human resources to remain in entrepreneurial jobs). Thus,

we may observe two extreme positions as below:

1. ' When Q is very low due to lower values of R, LAM curve may be vertical below a certain level of 'a'.
2. When Q is high because of higher R, LAM curve will be horizontal as 'a' approaches to unity.

In between these two extreme situations, the slope of LAM curve will depend on the slope of money functions which is an empirical question.

In this framework, it is important to recognize that the slope of LAM curve will be different at different stages of economic development. Whereas the vertical LM curve will occur at initial stages of development, the horizontal section of the curve may occur at advanced stages of economic development.

Slope of the IS Curve

Can the IS curve have any horizontal section? To see this we reconsider the IS equation viz.:

$$Y = Ao - A1\ a \qquad (12)$$

or

$$a = A - A'Y \qquad (13)$$

$$A' = \frac{1-b(1-t)}{i} \qquad (14)$$

b = Marginal propensity to consume

t = Rate of income tax

I = Responsiveness of effective demand of investment funds to the profit ratio

IS can be horizontal if A1 is infinity or 'A' is zero. This can be possible either when i is infinity or when b(1-t) is equal to unity. For i to be infinite, it implies that more and more investment funds can be offered by the owner of funds without any change in 'a' and the entrepreneurial human resources are available to utilize the increased supply of financial resources without a change in'i'.

For b (1-t) to be equal to unity implies that there are no taxes on income and the marginal propensity to consume is equal to unity. Let us consider under what circumstances any of these two conditions may hold good.

It may be convenient to start by considering investment demand as a function of Q (the expected return on investment to be paid by the entrepreneur to the owner of the funds). We ask the question: Is there any level of Q at which investment may continue to be done without decline in Q? In our framework this can occur as below:

i) For a given R on investment for an entrepreneur there wilt be a level Q which leaves just that amount of P which is threshold point for human resources to stay in an entrepreneurial job.

ii) There is surplus stock of human resources, which implies an infinitely elastic supply curve of entrepreneurs at Pm. This surplus stock cannot compete to raise Q because that would mean a return to them below P.

iii) Any additional supply of financial assets in this situation does not have to offer a lower Q to get themselves deployed with an entrepreneur.

iv) Hence investment can continue to take place at Q because of the surplus supply of human resources. It is not necessary that new entrepreneurs always have to come from the surplus stock in the subsistence sector. Labor already employed in the modern sector can take entrepreneurial jobs vacating wage-paid jobs in the modern sector to be filled by the surplus labor in the subsistence

sector. The investment function, thus, may have a horizontal section.

Infinitely elastic portion in the investment curve may occur without the presence of the surplus stock of labor. This may occur in a situation where R and P are such that they leave Q which is not acceptable to the owner of funds. Accepting Q (expected return for owners) also means responsibility of bearing the loss, if it should arise. The risks may be too high to be compensated by Q. But owner of investible funds cannot keep the funds idle in view of the existence of the tax Z. An easy alternative to them would be to give their financial resources temporarily to an entrepreneur with 'a' = 0 which would mean neither sharing the profit nor bearing the losses. Besides avoiding tax Z, the various considerations may also complement the motivation of advancing one's resources on 'a' = 0 when R, P and Q are too low. These considerations have already been elaborated in section 3.2.

In this case a horizontal section in the investment curve will occur at 'a' = 0 as shown below:

Now we come to consider the conditions when [1-b(1 4)] may approach to zero and hence may cause IS curve to have a horizontal section. The expression [1-b (1-t)] can approach to zero only if b approaches to unity and t approaches to zero. This can occur, generally, at very low levels of personal income. We can safely say that in the initial stages of development when R is very low [1-b (1 -t)] may approach to zero. This is because when R is low, P and Q will also be low and P will not be low if W is not low. Hence low P, Q and W imply low personal incomes in the economy which in turn may make 1-b (1-t) approaching to zero.

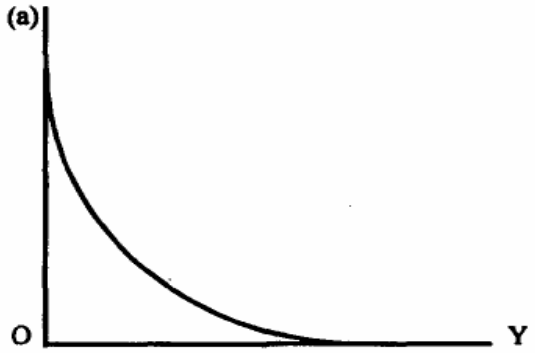


Fig. (5)

The conclusion of all above is that slope of IS curve may be horizontal at some low level of R if the economy is in the initial stages of development.

Since R is given per entrepreneur, the investment function expressed in (a, I) space will be as below:

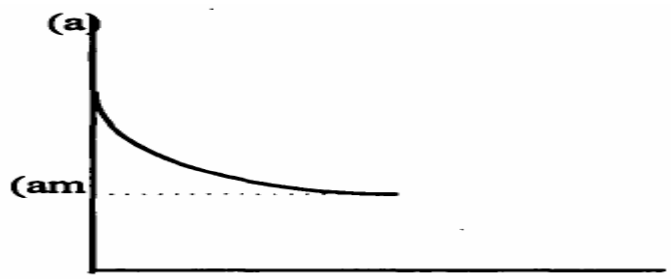


Fig (6)

This in turn implies that there can be a horizontal section in the IS curve in the initial stages of development when there is surplus stock of human resources and the return on investment is quite low.

At advanced stages of economic development when surplus labor has been absorbed and R is not too low the IS curve will have a negative slope as shown in the equation (13) where the magnitude of slope will depend on the values of marginal propensity to save and the responsiveness of investment to the values of 'a'.

Is there a vertical section in the IS curve?

We again revert to equation (13) viz.

$a=A-A'Y$

Economic Development and the Macro Framework Efficacy of Monetary Policy vis-a-vis Fiscal Policy

LAM has been shown to be vertical for having a steep slope when 'a' is very low and rates of return (Q and P) are also lower. In such cases, fiscal policy will be ineffective whereas monetary policy will have full impacts on GNP. When returns (Q and P) are higher and 'a' is also closer to unity, the LAM curve has been shown to be flatter. The monetary policy, in this case, will cease to be very effective and government spending (preferably to help improve the productivity of human resources) will produce more effective results on growth and employment.

It means that in our framework, the government will have to rely more on monetary policy when the economy is in the initial stages of development. But as the economy grows, government may use both policies. Ultimately when the country has sufficiently developed, government may have to rely only on fiscal policy.

This appeals to common sense. In the initial stages of development, (meaning low incomes of capital, low income of labor and low income for entrepreneurs), the lack of taxable capacity may substantially limit government spending. Monetary policy may be a better alternative. When a country has sufficiently developed, people own a lot of financial assets and they are earning high rates of return on them, pumping more money may not be as helpful to the economy as government spending that may achieve certain social goals are well while expanding the GNP.

Process of Economic Development

We start with the following situation. The economy is at a very low stage of development. There is a stock of surplus labor. R is very low and so is W, P and Q. This implies a horizontal IS curve.

Government has to rely on monetary policy. Hence, government decides to increase the money supply. It instructs the monetary authority to purchase government shares in private enterprises. The monetary authority selects suitable enterprise and purchases the shares (a) from the owners of the funds of these enterprises. This increases money supply in the economy. Increased money supply looks for new entrepreneurs. (No portion of it can be held because of the tax ' Z). New entrepreneurs with new investment

opportunities are generated, implying some absorption of the surplus labor from the subsistence sector. The output and employment in the modem sector increases without affecting the output of traditional sector because of the presence of surplus labor.

The aggregate demand and hence output increases by the full effect of the new investment. As more and more money is injected not does only employment and output increase but the entrepreneurial productivity improves through learning by doing and through the competition that newly entered entrepreneurs pose to the existing entrepreneurs. In the process R improves. This is in turn raises Q as well as P. This means demand for money goes down. The IS curve becomes horizontal at a higher level of 'a'. The above process continues with IS curve shifting in horizontal jumps till all surplus labor is absorbed. Now R is at a higher level than from where we started and there is no surplus so that 'a' has to be reduced to attract human resources to employ additional supply of investible resources. But reduced 'a' will also affect money demand. A choice has to be made between monetary policy and fiscal policy depending on which of the two will be more powerful given various parameters. R keeps on improving till we reach a stage where IS curve becomes vertical. Monetary policy loses its significance. Fiscal policy becomes important. Now it is time for government to take up big development projects of its own. This will further increase R forcing 'a' to come down and once again, we are on a downward sloping IS and an upward sloping LAM. The process continues till a stage comes where the government's role ends up in the economy and self sustaining growth may take place.

Low Income Trap

In the horizontal section of the IS curve, it is possible that even the money supply may not be effective if demand for investible funds from the entrepreneurial human resources ceases to exist. This may happen when the entrepreneurial liabilities of human resources are extremely limited due to illiteracy or due to extremely bad infrastructure (absence of roads etc.) or extreme political instability etc.

In such a case, mere injection of money supply may not be enough. It will have to be supplemented by measures conducive to generate entrepreneurial demand for investible resources.

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APPENDIX

Demand For Profit Sharing Capital

Consider an entrepreneur demanding capital for an enterprise. With Y as output/ income, K as capital and L as Labor, we write production function as:

$$Y = F(K,L) \qquad (1)$$

Since labor and capital are sharing the income of the project and hence do not impose fixed co,ts, this production function also represents net income function for the project.

Assuming that the entrepreneur is the only labor in the project and hence the labor component is faked we can write the production function as:

$$Y = F(K) \qquad (2)$$

As a typical **production** function we **assume** that this **production** function **has** a declining **marginal productivity** of **capital,** i. e. $F'(k) > 0$, $F''(k) < 0$.

The function, in other words, has the following form:

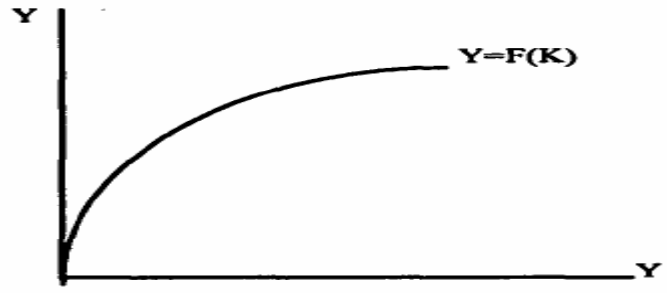

Fig. (1)

On the other hand the provider of capital expects to receive a certain return on his capital. The expected return, of course, will be directly related with the total amount he invests. In the very simplest foam, this relationship can be linear relationship of the type:

$$C = rK \qquad (3)$$

Where C is total return that the provider of capital expects to earn on his capital K whereas 'r' is based on his own utility function.

In the interest-based framework, the provider of capital demands 'r' from the user of his capital. In the Islamic framework, the provider of capital cannot demand 'r'. It can only fix a share in the income or profit of the project.

Let this share be called 'a'. Since income, i. e. 'y' is not fixed and varies at different levels, of K, therefore, the profit-sharing ratio becomes a function of the amount of capital.

Using equation (3) and (2) we can write:

$$a = \frac{C}{K} = \frac{rk}{f(K)} \qquad (4)$$

This equation shows, that profit-sharing ratio will vary as more and more capital is invested because C is increasing at a constant rate and Y is increasing at a declining rate.

This fact can be more clearly seen in the following diagram:

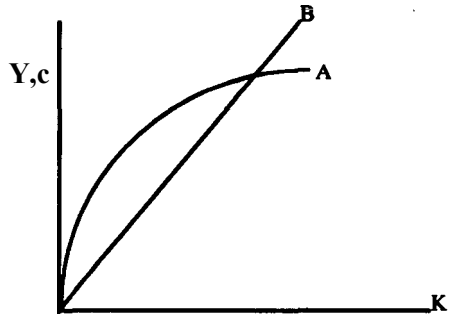

Fig. (2)

The curve A is the production function representing equation (2). The line B shows the total return expected by the capital owner at different amounts of capital to be provided by him. This is a straight line representing equation (3).

Two things are clear from Fig (2).

Firstly, the income sharing ratio (a) is different at different levels of (K). The value of (a) can be observed at any level of K as a ratio of the corresponding value at line B to the ratio of the corresponding value at curve A.

It can be noted that beyond a certain level of K, the income sharing ratio starts increasing until it reaches a level equal to 1.0. This will occur at KO.

Secondly, it will not be in the interest of the entrepreneur to demand any amount of capital from the capital owner. A profit maximizing entrepreneur will demand only that much capital from the capital owner that will allow him to retain maximum profit. In terms of Figure (2), he would demand that much amount of capital against which the distance between curve A and line B is maximum. (The distance between curve A and Line B measures the income to entrepreneur after paying the share of capital owner from the income of the enterprise.)

Hence, the assertion[9] September 11, 1931 that under the **profit-sharing** system there will be infinite demand for capital is not valid per se. The argument can be taken a step further.

Under a profit-sharing arrangement, the supply schedule for capital funds may not be a linear function as shown by equation (3). Since capital owner bears all losses of an enterprise, a capital owner would not like to give as much capital demanded by the entrepreneur at a constant rate of return 'r'. Giving all his money to one entrepreneur would mean putting all his eggs in one basket. He would like to spread his investment among different enterprises unless an entrepreneur is willing to offer a higher than'r' return - higher **enough** to compensate the risk of putting more capital in one enterprise.

9 Several scholars make the assertion that profit-sharing system would mean infinitely elastic demand for investment.

Thus a higher supply of capital for the same entrepreneur would mean a higher income-sharing ratio with the same entrepreneur. In other words, we will have to rewrite equation (3) as:

$$C = g(K) \qquad (5)$$

with $g'(K) > 0$

$g''(K) > O$

The profit maximizing entrepreneur then faces the following profit function:

$$R = Y - C$$

$$R = F(K) - g(K)$$

Optimum demand for capital by entrepreneur will be for that level of K where,

$$F'(K) = g'(K)$$

DISCUSSION

Comment and Question

I have nothing to contradict what Mr. Fahim said. But I possibly can say a little lightly some views of my own which may strengthen his view point. In the context of Bangladeshi, economy, we have an unorganized sector, where the interest rate is very high, then we may have interest bearing banking system, as he mentioned, then we have Islamic banking system. The interest rate is higher in the unorganized sector than in the organized sector, i.e., interest-bearing banking system.

As I am associated with the banks I know that the banking system has been driven to such a position that they will not be able to meet their obligations. They are running at losses but still they are showing profits. Eventually they will not be able to meet their commitments. In this situation, introduction of Islamic banking system, I think, will bring about tremendous improvement in the economy. When the Islamic banking system is introduced, then you either invest your funds yourself or you make it available to the banking system. If you don't invest then you will have to pay *Zakah.*

Now the contributions of Islamic banking system to the economy will depend on how the Islamic banks make their investments. If they can choose right kinds of entrepreneurs, they will not only be able to sustain the rate of growth in the economy but also they can possibly bring about a technological improvement. In that case, the production function will shift upward and they will be able to make higher rate of return on the same amount of investment. This will lead to an increase in the return on deposits which in turn will increase the supply of funds for the banking system. Therefore I think, if Islamic banking system is introduced it will not cause any harm to the society rather it will bring about more funds to invest and will bring about more return, possibly more than the rate of interest that interest bearing banking system could offer. So I think Dr. Fahim is right in what he says.

My question is I feel that his exposition is quite right and valid in an Islamic environment but I feel that to achieve an Islamic environment is not an easy affair. It will have to go through a transitory period. My question is

whether the instruments that you have used to explain the investment phenomenon will be equally efficient in a transitory period, that is in a transition from non-Islamic system to Islamic system.

Answer

Thank you for your comment. Well that is an empirical question. In theory, we do not ' find any reason why it should pose, any problem, even in the transition. It is basically an empirical question that how you design your transition. If you design your transition in a well planned manner, you don't find any reason to believe that it may create problems. There can be several problems in transition. There can be problems in manpower and in implementation plan. There can be problems in the commitment. There can be several exogenous factors that may interact with the transition period. That is a different story.

Question

I am not making any new question, just I desire to get a clear idea about your discussion on consumption loans. I think it is not true that Islamic Banks do not offer a loan for consumption purposes. I think they can offer loans for consumption purposes in some commodity form such as they can purchase a refrigerator, a television set and others. They can lease them to the consumers or sell them for a higher price. So, I think it is not true that an Islamic bank does not offer a. loan for consumption purposes.

Answer

The leasing is not the banks business, because the banks need to have separate department for this purpose which does not fit in into the nature of their functions. Commodity trading too has similar problem. So the banks will be inclined to do more investments rather than leasing and commodity trading. Hence, there will be a tendency to make direct investment than to meeting the consumption need and if that happens then that will not be creating inflation but rather reducing it.

Question

Dr. Fahim Khan has taken for a discussion of very complicated issues "Growth, Stability and Inflation under Islamic Framework". These concepts or terms are not coherent to each other but are contradictory to each other, even in conventional economy. Growth, stability and inflation are still contradictory. They are being carried on how to maintain a proper balance between these terms or concept. If we want economic growth, we can not maintain stability; if we try to maintain stability, we can not ensure growth or tab inflation.

Answer

Your question if I understand correctly is that there is conflict between growth, stability and inflation. How these conflicts will be removed in Islamic economy? Well, this is a good question that was not a subject of this discussion. I did not try to see the achievement of these three objectives simultaneously. What I was saying is what will happen to these three things, if we change the system particularly in the transition from interest-based to the Islamic system. We said that nothing bad will happen and instead something good may happen.

Your question, however, is that how an Islamic economy will focus on these three things together and how it will blend these three objectives. The answer could be found by developing a macro model. There is a paper which is available with me. It has been written by an IMF staff showing the growth and stability in a macro economic framework of an open economy. They have shown that the growth and stability will improve and they will not be contradictory to each other. They will be reinforcing each other. That is an elaborate mathematical model which will not be possible to discuss here.

Your point is related to general equilibrium of the economy. General equilibrium of the economy has to be studied after we have become clear about the micro elements of the economy. When these elements are clear then you can make your own model to study how the general equilibrium will be achieved and whether there will be a higher level of income, more stability and lesser inflation.

Question

You have said that when a bank advances money, it will not advance loans for consumption purposes and hence there may not be inflationary pressure. But even in the profit-sharing system of Islamic banks perhaps the consumption loan may continue. Even if the loan is not advanced for consumption there may be inflation due to maximization of profit. Consumption loans alone do not determine the inflation.

Answer

Most of the loans will be going to productive activities. The creation of the new entrepreneur and more productivity, will at least neutralize the cost effect. The profits are already there in the economy. They are already creating inflation. Nothing worse will happen by replacement of interest by profit-sharing. There will be a dampening effect on inflation as more production will be available that may absorb these excess demand.

CHAPTER FOURTEEN

CONSUMER BEHAVIOR IN AN ISLAMIC ECONOMY

Muhammad Anas Zarqa*

Little attention has been paid by Muslim economists to empirical studies of consumer behavior in Islamic societies. One study was carried out on the behavior of Muslim consumers in a Muslim community in one town in Great Britain. It was part of an empirical study.

So there are some studies which have been conducted, and I would be most appreciative if any of you could guide me to any other studies which have tried to empirically investigate the question of actual Muslim consumer behavior. Some empirical investigation or estimates about consumer behavior in Muslim countries in general are, of course, available. But these studies are of the traditional Western type in that they do not try to investigate the existence or nonexistence of any particular Islamic aspect of that behavior. For instance, a brother yesterday told me that he had a study on the estimation of the consumer aggregate demand function broken down by major categories for consumers in Jordan and on estimation also of, I think, Eagle's curve for Jordanian consumers. Now this is a study for one particular Muslim country, but the brother did not try to investigate to what extent these functions have any Islamic peculiarity or Islamic dimension. Therefore, I am probably justified in saying that on the empirical side we have very few studies and that there is a definite scope for many more studies. Most of what has been done now is the formulation of a sensible model for consumer behavior in Islam starting with certain given that Islam stipulates for that behavior and then trying to see analytically what consequence these given have for the utility function of the consumer and possibly for his demand function.

Let me now try to review some of the main efforts in this area in chronological order. There are contributions by Dr. Monzer Kahf, Dr. Fahim

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Khan, Dr. Shawqi Dunia, Dr. Mohammed Afr and Dr. BenDjilali. There is a good note by Dr. Asaduzzaman and finally there is one very recent contribution. It has not been published yet but it will soon be published in the Review of Islamic Economics from London by Dr. Abdul Hamid Mahbub. This last contribution is the most important because it is probably more detailed and rigorous than the others.

I will draw your attention to a few points. First I tried to underscore the fact that in my judgment, the traditional economic theory of consumer behavior is not directly applicable to the Muslim consumer. We have to make some modifications in the traditional approach on the subject. In order to make these modifications, we have to take account of certain particular aspects that Islam emphasizes. So this is a point. It is a negative point. The standard way of treating the matter is to modify the traditional theory before it is applicable to the Muslim consumer.

Secondly, I also call your attention to the fact that Islamic injunctions and rules related to consumption should not be introduced in the analyses as constraints on consumer behavior. I think it is analytically incorrect to do so. Instead, they have to be incorporated in the legal framework and the function itself should not be constrained. Then I point out that reward in the Hereafter depends on consumer behavior in this life. The interaction between consumer behavior in this life and the expectation in the Hereafter is a complicated relationship. Initially, people perhaps feel that when one reduces his consumption in this life and spends more in the way of Allah, then he will earn a greater reward. I have tried to show that the relationship is not that simple. It is much more complicated than the initial presumption. I have tried to bring the contribution of al Gazali and al Shatibi who wrote the famous books "Ihiya' Ulum al Din" and "al Muwafaqat", which are really encyclopedias of Islamic science. A1 Gazali made an extremely important contribution to what we may call the social welfare function. I am sure that A1 Gazali's ideas can have a bearing on the relationship between consumer behavior now and the Hereafter.

Another point that I have tried to make relates to the *Shari 'ah.* The Islamic *Shari'ah* tries to modify the consumer utility function. Standard economic theory takes the utility function as given exogenously and considers it to be unique to the individual. Some how like born with the individual. It is not affected by his actions or the actions of others. This is how it is treated in standard economic theory.

In the *Shari 'ah* the approach is different. There are some elements of the human utility function which the *Shari 'ah* accepts as given. They are basic traits of the human being, and you cannot eliminate them. However, you can modify this utility function a lot by religious instruction and by making the consumer aware of it. So I feel that in the *Shari 'ah* we have to underscore the difference which economists ignore, that is the difference between the preference function and the utility function. In economics the standard way is to assume that what you prefer is your utility. The *Shari 'ah* emphasizes that your preference function may or may not coincide with your true utility function and the *Shari 'ah* tells you what your true utility function is and encourages you to make your choice function conform or to become identical with your true utility function.

Finally, I indicated the important interdependence between the utility of different Muslims. That means that *Shari 'ah* assumes that there is a lot of interdependence. However, in my analysis, there are two major drawbacks**.** The first one is that I paid attention in some detail only to the possible relationship between consumer behavior and the Here-after. Secondly, I did not show in what way this relationship actually affects a consumer's choice and the normal way they may influence man's demand for goods and services or his demand function.

My analysis was only preliminary, and I could not carry it forward to show in detail in what way it affects the demand function. Later Dr. Monzer Kahf wrote an important paper in which he made several important points. One of them is that the consumer utility function in Islam as a function essentially consists of two categories of spending: consumption now and in the Hereafter. He further suggested that we should deal with two objectives in the function when we deal with consumer behavior in Islam (one function is related to the Hereafter and the other is related to the here and now) and that the amount which the consumer expends is constrained, of course, by his budget. He also addressed the idea of rationality and stated that a Muslim consumer is acting rationally in the usual sense of trying to maximize utility. However, his utility is itself not only a function of what he consumes but also in some way a function of what he expends in the way of Allah or in what he expends to help others. However, Dr. Kahf did not carry the analysis further to reach the stage where he derives the demand function from this in light of the utility of the consumer.

Dr. Fahim Khan tried to capture analytically the relationship between savings versus consumption in three categories of expenditures. The three

categories of expenditures are expenditure in the way of Allah, expenditure on consumption and savings. He tried to show how these things are related in the utility function of a Muslim consumer.

Dr. Shawqi Dunia, in 1984, wrote a general treatment of consumer behavior. There were other writers and I am not ignoring their contributions, but some of the writing was really of very poor quality and not much attention should be paid to them. One writer, for example, mistakenly challenged the idea of using the indifference curve. He said that this is not acceptable from the Islamic point of view. Others challenged the idea that a Muslim consumer tries to maximize utility. They tried to criticize the idea of utility itself as being non-Islamic. Dr. Shawqi Dunia, however, made a good contribution in that his objections were from *a Shari'ah* point of view. He emphasized and supported from various texts in the *Shari 'ah* the argument that the concept of utility is an entirely Islamic concept. It need not mean pleasure in pure sense only. It has a wider connotation, but it is a very valid Islamic concept.

Secondly, he demonstrated that those objections to the use of the indifference curve are baseless. There is no reason to object to this. He rigorously dismissed the objection to the consumer trying to maximize utility. So this was the contribution of Dr. Shauqi Dunia. He did not, however, try to reach a detailed analysis from the utility function down to the demand function. However, he did try to underscore the fact that a consumer will have to make his own consumption, saving and expenditure in the way of Allah.

Dr. BenDjalali and Dr. Bashir made the following contribution. They began with the idea of there being three categories of preferences of Muslims: demand for necessities, utility derived from conveniences and utility derived from luxuries. They assume that the consumer first tries to make a selection among necessities. After that he moves on to conveniences where he makes another decision as to how to select among conveniences and then later he makes a similar decision among luxuries. Dr. BenDjilali and Dr. Bashir showed that it is possible to derive standard indifference scales for the Muslim consumer taking into consideration these three classes of consumption goods. The two authors in their paper emphasized the importance of taking into consideration the idea of the, consumer caring for others. However, analytically they did insert that in the analysis. So we can say their contribution probably lies in showing that even when we accept the idea of necessities being given more importance than conveniences which are more important than luxuries, we still can derive standard indifference curves and use them in the usual ways.

Later, Dr. Mohammed Afr conducted a large study on the subject. He took a rigid initial point and analyzed it in detail. He assumes that the consumer initially divides his income into various proportions: some to "In the way of God", some to necessities, conveniences and luxuries . He takes this percentage distribution of income over the categories, not only of consumer goods but also in the expenditure in the way of Allah, in various ways. He then goes on to show how the consumer can rationally allocate expenditure within these categories and within each category and how he can allocate his expenditures taking into consideration the Islamic injunctions about consumer behavior. Dr. Afr did not tackle the important question of how to determine this percentage. He took the starting point that the consumer divides his income among these categories.

Finally, there is a very interesting note by Dr. Assaduzzaman from Colombia University. I have not been able to check the note of Dr. Assaduzzaman recently, so I may be making an incorrect summary of what his point was. Dr. Asaduzzaman, as I recollect, showed that if you start with the concept of the necessities, of basic needs that have to be satisfied and which cannot be traded against other goods and services, i.e., when you have what they call lexicographic utility function, then a lot of the utility analysis which is now conventionally presented in economic theory becomes invalid. It has to be rewarded on an entirely different line. So his note was very insightful in emphasizing this analytical point. We should not feel that consumer behavior theory is a closed field in which there is nothing to contribute. Even though it has been extensively discussed by economists there is still room for some entirely new approaches in this consumer behavior.

However, Dr. Assaduzzaman in his brief note of about 18 pages, called attention to some facts without giving much detail. He did not say that this lexicographic utility function is more representative of the Islamic injunction in consumption than the standard treatment. He did not say that at all, and in fact, if you want my own personal opinion, I never felt sympathetic to the idea that in Islam we are called upon to satisfy necessities before we go into conveniences. The question of necessities and conveniences can be qualitative. The physical necessity . of keeping life and the body together is, of course, common to all human beings. You need food, shelter clothes, whatever. However, when you go beyond these very few and elementary things, you have people attaching similar significance to various necessities or to the level of various necessities. Let me say that a lexicographic function is more representative of the Islamic attitude of consumption. I think that this remains to be demonstrated for. I have not seen any convincing argument in this regard. I will give you an opposing argument. Dr. Naqvi from Islamabad in his book, Ethics and Economics, said that the lexicographic function was more representative of the Islamic attitude

than the usual treatment. Let me give a counter example. It is documented that the Prophet (Pbuh) used to live a very frugal life and in some cases went for a long period without sufficient food and felt so hungry that he tied a stone on his stomach. Yet, in spite of this very frugal or subsistence living, he spent money on perfume. It is reported in the *Sunnah that* the Prophet (Pbuh) sometimes spent as much on perfume as he spent on food. Now, of course, you will notice that there is a very important idea here. I will draw your attention to another fact so that we do not make the wrong deduction from this example.

Let us look at the opposite example between perfume and garlic. The Prophet (Pbuh) refused garlic, but he did not say that it is prohibited. People very often used to come to the Prophet (Pbuh) to ask for advice or for *a Fatwa* or opinion on a private matter. They would sit very close to him, and so he said that as people come very close to talk to me, I cannot have any offensive smell. This may also explain why he spent so much on perfume. He felt it was his public duty. It was his duty because of the special position held as head of state, prophet, and judge consulted in all these things.

Let us try to generalize. For the Prophet (Pbuh) and for people in a similar position who have to interact a lot with other people, perfume may be a necessity, but to others it is not. So what I want to say is that we have to look carefully at this lexicographic function where we satisfy necessities first without any trade-off between necessities and conveniences and with the same goals for convenience and luxuries. I do not think that anyone can make a really watertight case in that direction. I feel that it is much more sensible to take the standard position in economic theory. There is always some trade-off between any one good and another good. There is always some trade-off. The extent of the trade-off may be high or low, but there is some trade-off. I think this is probably more realistic than the assumption of a continuous kind of utility function.

Now, let us look at Abdel Hamid Mahbub's recent contribution in the Review of Islamic Economics. Unfortunately, Dr. Mahbub's paper is in Arabic so many of you will not be able to directly benefit from it. However, let us hope that someone will translate it into English. I will now try to very briefly summarize about Dr. Mahbub's paper, even though he is quite critical of other studies in the field including my own. However, his criticism has always been very insightful and valid. As far as I can see, Dr. Mahbub did the following things: First of all, he clearly presents an analytical version of the question of how to spend in the way of Allah or for the benefit of other people and for one's own benefit. This is helpful, I think, especially for teachers who want to present to their students a very clear-cut graphic analysis of this matter.

He assumes that a consumer makes some assumptions for arriving at consumer equilibrium. Firstly, the consumer expenditure on his own consumption and his dependents'. E-2 is the consumer expenditure in the way of Allah, or to others, since this has no direct relationship to family consumption**.** Now he assumes that the consumer first makes a choice between these two types of expenditure. He assumes further that the consumer will have different scales between these two types of expenditure. He says a Muslim consumer will derive utility not only from expenditure on his own and his family's consumption, but he will also derive utility, little or much depending on his level of Iman, from what he spends in the way of Allah on which he gives to other consumers and it is explicit in the function, which is not the compulsory type of financial obligation. *Zakah is* not included in the E-2. This is *Sadakah,* the things he does voluntarily, beyond what is strictly obligatory and required by the *Shari'ah. So* he says suppose a consumer prefers to spend all of his money on his own and his family's consumption. This could be represented by some form of consumer behavior. It is possible to find a consumer who spends all his expenditure on his self and his own family.

Let us compare some points in order to explain Dr. Mahbub's idea. He says that if the consumer is willing to give up a little of his own consumption in order to increase expenditure to the way of Allah or to give to other consumers lies at the same level utility as a consumer behavior which gives much more weight to his own expenditure compared to the expenditure on others. This may be where most people are. Most people will attach much higher importance to their own consumption than to giving to others. However, suppose we look at those who find the trade-off between their own consumption and that of others. This is a majority number of consumers. They sacrifice their own consumption for improving other people's consumption, i.e., the consumption of needy people. A lot has been said of the existence of the indifference curve which emphasizes the assumption of Dr. Mahbub. It is necessary that the consumer derives some utility from the expenditure on others. So the starting point of the utility function of this Muslim consumer is the function of E-1 and E-2. This is the crucial starting point and Dr. Mahbub says it is very sensible to have indifference curves.

Suppose we look at a single consumer. When the consumer allots a high level of expenditure for himself and his family, it may be that at this level he is more willing to be generous. He is willing to give, that is, he includes more of others' consumption in his own function, even though this will help others. Only when the level of his own expenditure on himself and his family is low, i.e., he is close to the level of necessities, he is not willing to make the same sacrifices as before. So his trade-off between E- 1 and E-2, will become much

smaller. It is quite sensible to have an indifference curve drawn in this standard fashion. Now, Dr. Mahbub says to take the budget constraints as usual. Suppose that the budget increases. The consumer then reaches the equilibrium. In this case he will be expending on himself and his family. So in a sense what Dr. Mahbub states that the consumer will spend so much on others. What of the income he will allocate in the usual consumer analysis fashion over various goods and services ? If this is his budget line in the first diagram where he allocates income between E-1 and E-2 in the second diagram, the income with the budget line would have to move in parallel fashion to express the fact that a lower amount is available to spend. An amount less than the total income is now available to spend on the usual good Y and other good X. So there will be a budget line when you go by the standard analysis of consumption. It will be at a lower level. However, the consumer is not decreasing this utility by spending on others because he derives utility from this depending on his level of Iman. His utility map is quite like a horizontal indifference curve. He will be willing to give very little for the benefit of others so his rate of exchange between E-1 and E-2 would be very small. However, in all cases the consumer is increasing his utility when he goes from a situation in which he spends everything on himself to a situation in which he allocates income for himself and his family and for other poor people.

Mahbub's treatment is probably the most rigorous and systematic. He has more to say which I cannot summarize at this point. He does rigorously show that it is possible to have a consumer who spends nothing on others. The analysis can accommodate this and he has underscored a very interesting point with a consumer at the zero level. This does not mean that this consumer is completely without sympathy for others, but at the rate of transformation which he accepts, he finds that he still has to spend everything on himself. If his income changes or his situation changes, he moves on to spend a little on others. People who spend a lot of others and little on themselves are also on unusual case. The more usual case is when people attach a higher importance to their own and their family's consumption and a lower importance to the consumption of needy people or in the way of Allah. So I feel that Mahbub succeeded in carrying the analysis a step forward and I will not elaborate further. I hope his paper will, Inshallah, be published later in English so that all of you can judge for yourselves.

Now, let me finally move to the suggestions for further research. One direction is of course empirical. However, it has to have some Islamic element in the sense that if one wants to carry out empirical studies on this area, he has to take one particular Islamic injunction which is supportedly related to

consumer behavior and see to what extent it is actually observed in society. So this is one direction.

The other is to go a little deeper into analyzing the relationship between what we spend in the way of Allah and what we spend on our own consumption. One thing which I suggest is that this research be conducted by someone who is mathematically trained. Consumer behavior has to be dealt with by people who are quite good in mathematical economics because the subject itself is rigorously treated. You cannot be satisfied with descriptive discussions. One has to be very clear in this area, so that one can explore the nature of Muslim expenditures in the way of Allah. Let me call your attention to one simple fact. In the Qur'an, Allah Subhanahu wa Ta'ala, says in *Sura al Imran* (and in other verses the same phrase is repeated, " You reach the level of righteousness when you spend out of what you love", i.e., he will spend out of his own money or wealth for the love of Allah. He will spend in the way of Allah or spend on the other categories of needy people, even though he loves wealth. Also the Prophet (Pbuh) was asked once what *Sadaqah* gets the highest reward. He says you get the greatest reward once you spend money when you are healthy and you are stingy. You want more wealth and you are afraid of poverty. When you spend in this condition, you will get the highest reward. In other words, the *Shari 'ah is* not saying to us that we should spend in the way of Allah when we feel we do not care for money. No, the *Shari 'ah* says that human beings do care for money. Indeed, they love money; but they must spend in the way of Allah in spite of that. This is the things. So, consequently, we can see that it is an incorrect depiction of the utility of the Muslim consumer which somehow shows that he spends because he does not care for money. This is the wrong way of depicting the thing. It is not right. We have to assume that he is a standard human being. He likes wealth and when he spends from his income, there is a certain negative element of utility, but this is compensated for by his concern for the Hereafter. So there is one negative element and there is another positive element which will overcome or compensate for that. Somehow these matters can be dealt with by people who have the inclination and the mathematical training. With this I think I have to stop. I look forward to the comments and suggestions of my brothers and sisters.

DISCUSSION

Professor Azharuddin of Rajshahi University

Thank you very much Professor Zarka for presenting a good paper and also a good analysis. My question is that you have got a utility function as you have shown by E-1 and E-2. E-1 represents what the individual spends on himself or on his family and E-2 for others as an informal *Sadakah.*

My question is can we distinguish between E- 1 and E-2 ? It is said the *Shari 'ah* that when a "Momen", that is, the believer in Islam spends even for his family that is also a part of *"Ebadah"* and when he spends for others, he has got the desire for having the *Sawab,* which is the benefit not only in the present but also the Hereafter. If so, how can we distinguish between E- 1 and E-2 ?

Answer: Professor Zarqa

You remind me of a very well-known *Hadith* which says the following: "What you spend on your own self, Allah counts as *Sadaka* for you; what you spend on your wife Allah counts as *Sadaka".* This actually supports your contention. I do not have a satisfactory answer, but I think the point is absolutely valid. One of the Sahaba was very sick and though he was about to die. He said to the prophet (Pbuh) that "I have money and I have only one daughter I have no other relatives, I like to give my money as a will in the way of Allah. The prophet (Pbuh) said, no. This is the famous *Hadith* which limits the proportion of one's wealth which can be queathed to a maximum of one-third. As for the remainder that *Hadith,* the prophet (Pbuh) told this Sahaba, who had been *Tawab,* to survive and live and he did not die on that occasion. He told him that what is spent on your family is also *Sadaqah* because it was clear that the Sahaba was under the impression that he will get rewards from Allah only for what he spend on others, and the Prophet (Pbuh) informed him that what your will leave for your daughter is also in Allah's sake and He would reward you for it. So do not think that spending on others is the way to get a reward. Spending on the necessities of your own family and so on is also one way to please Allah. So your question stands. I do not think the diagram is a contradiction. As Dr. Mahbub emphasizes, the consumer derives utility from both types of expenditure. Now his utility is not like the utility that he spends

on others. Clearly it is not utility in the usual hedonistic sense. It is the feeling that one has done something good which will be rewarded in the Hereafter. There is no harm at all in concealing the utility one derives from the expenditure on oneself as also being one aspect of the reward. It is better and more convenient to spend on one's family and at the same time to know that acting in accordance with the *Shari 'ah.* So I do not feel that there is a contradiction, but your point is that we should try to think of them as opposite categories.

Question and Comment: Professor Siraj of Chittagong University

I have an observation to make. First of all, I think that it was significant when Asaduzzaman told us that he thinks that lexicography can function better. The fact is that there is no such thing as lexicography jurisdiction. The lexicography ordering cannot be brought to the function.

Answer

I fully agree with you. I did not at all mean to say the opposite. If I recall correctly, underscoring this thing, the whole consumer or utility analysis has to be recast differently if we take this approach.

Question and Comment

The second point is that if you allow for interdependent function then the whole analysis breaks down because interdependent functions do not permit you to fulfill the optimal conditions. This analysis breaks down and you have the theory of second best which says that if one of your conditions is violated then the other conditions are no longer valid. So the whole thing breaks down.

Answer

This only goes to show that it is a suitable interpretation. You can be sure that this breakdown of major results in consumer behavior is because of this externality, when your own utility depends not only on your own expenditure but on what others are doing. He deals with this question at some length and relates that economists analytically distinguish between when my utility depends positively on your utility and when my utility depends on what you consume of a particular type of goods. This introduces a certain complication and presents pareto optimum by the competitive market. He deals

with this at some length but I am not sure that I have fully comprehended what you want to say to be able to present an answer to you. But his paper does address this problem at some length and it is a very clear answer.

Question

What are the prices involved there?

Answer

You have a budget line and then in the first stage you are allocated at your income between E-1 and E-2. From there you determine how much to allocate for E-q, which you draw in the second diagram where your total income is equal to this loan. If you mean the prices, Dr. Mahbub avoided this problem in the following way. Your observation is very correct . He made utility a function, not of expenditure but of price and quantity, and this is how he overcomes this problem.

So if spent and his budget in this direction it has to have the same slope. So the budget line in the first diagram would have to have a slope of minus n by definition. But in the second diagram, he may have a solution depending on the prices of the goods. Regarding this paper by Dr. Mahbub, I do hope that we can elicit the comments of this brother later.

Z. Islam (Comments and Question)

Our brother said that Dr. Mahbub has taken an amount of expenditure for spending on E-1, spending E-1 on his own family and dependents. Actually the utility function for a Muslim consumer is an integrated utility function of these two expenditures. We can take it in this way. Actually we are isolating the expenditure for this family in another utility function. Are we not ? The total utility function for a Muslim consumer is a function that could be detailed in two utility functions that have been derived here. Janab Zarka, I mean the starting point is not valid, this cannot change utility for a Muslim consumer. He says he is a Muslim, so he has to have one and same degree of desires like other human beings. So I think we cannot assume that the utility function has the two arguments E-1 and E-2. However, he has gone from E-1 to allocating it away to maximize utility for his own consumption.

Ishaque Ali Khondar (Comment and Question)

Regarding the proper blending of reward in the Hereafter and consumption in this world, the diagram on page 31 this is shown on the vertical axis and free on the horizontal axis. By "free" we mean that consumption is related to reward. If we consume more, the reward will be less. This is depicted in this paper.

Answer

This does not depict the correct position of Islamic consumption. It does not. We should not take this to be a good representation of what Islam wants us to do. The relationship is much more complicated. I will present another diagram which shows that it is much more complicated than this simple negative relationship.

Question

This diagram clearly depicts the compromise between soul and body in this materialistic world and especially in this aspect of life as blended in this diagram. If we consume less we can have a greater reward. If we consume more we can have more reward. This is the negative slope of the transformation curve.

Answer

I am presenting this as a point of criticism, by saying that it is not suitable to represent a Muslim consumer. The diagram that was distributed to you needs to be corrected. You should correct your own copy where the question of the lines should be taken out. It is incorrect. It should go down . Everyone should correct one's own copy. When you reach the point where you have the frontier, cut the horizontal line. From then on, you should go down. It should go down because when we go beyond *Isiah,* we get less reward. We cannot stay on the same level. So it has a starting with punishment. So it has to go from here. It should go down. Please correct your copy. It is not part of the function here. Brothers, this complicated diagram somehow integrates the idea of necessities, convenience, the luxuries and *Isiah,* setting the limit to the consumer's behavior. This is a valid criticism that. Mahbub makes of my paper

and it is an entirely valid criticism. I am suggesting something to limit consumer choice, but I do not show in what way this will affect the demand function.

Questions

In order to expand consumer behavior, we have the marginal utility approach and also the indifference curve. In the Islamic framework, we have the utility approach and the indifference curve analysis approach in order to expand consumer behavior in the modern economy. However, we explain the consumer behavior under the Islamic framework. We have the utility approach, the indifference curve approach and the revealed preference theory approach for explaining consumer behavior.

Answer

Yes, but the revealed preference approach is not all that different from the indifference curve approach. Revealed preference only proves a single point without asking the consumer anything. If he makes numerous choices then his utility function is derived by observation. That is the only thing that revealed preference theory prices show. It does not contradict. It is not a different approach. He was just trying to emphasize that Samuelson said that you can derive the utility function of the consumer by observation alone without asking him anything derive.

Question

That is not my question. My question is: In order to explain consumer behavior, can we apply any other alternative approach under the Islamic framework ? That is my question. The utility approach and indifference curve are all right, because we have discussed them under the traditional system. Can we give any alternative approach ? Can we give an Islamic explanation ?

Answer

We can apply the revealed preference approach to this. I definitely believe that topics in economics are open to new approaches. We are seeing this now in almost every department of economics. Of course, it has been so thoroughly analyzed that one definitely could not say that there can be no new approach. However, I feel that what the brothers have done so far did not show that we cannot have the Islamic concept using the standard approach. We have

noticed all these things in utilizing basic economic tools, but by modifying them to bring in Islamic concepts, I cannot say that they are different tools. They are the standard tools but modified it to capture Islamic specifics. I feel that we can handle basic Islamic concepts using the same tools. However, this is not to say that in the future we cannot come up with new approaches. I would not care to make such a statement.

Question and Comments

(Janab Jafar from the Ministry of Foreign Affairs) : Thank you Mr. Chairman for kindly giving me the floor. I have just one small question. The diagram which you presented here, it depicted and stated that your utility is a function of E-1 and E-2, does this apply to the believer of the Muslim consumer alone or the behavior of every individual consumer, because we found that every individual spends something for others. This means that the things the utility is a function of E-1 and E-2 for every individual whether he is a Muslim or not, because you have said that E-2 represents the optional charity, *Sadaka,* not the mandatory one. So there may be a difference of degree not of kind that every man spends something for E-2. So how can we restrict this function to only explaining the behavior of the Muslim consumer. This is my question.

Answer

I This is a very important point and I definitely will still say that for same that this kind of commodity observing is very valid. In fact we know that human beings in general like to do good, at least Allah made human beings desire to do something good. This is a part of their makeup. Now religion comes and nurtures and increases this, but it is there in the human heart. So definitely, I think, that this is also a very useful insight. We need not say that our approaches are only applicable to Muslims. Perhaps it is which be said of all human beings. Muslims are motivated by the Hereafter, but of non-Muslims, 88 per cent will be motivated by better satisfaction. They feel better in giving something to others even though they do not expect a reward in the Hereafter.

Question

It seems there are functions, E- 1 that is consumption for conventional benefit and E-2 for others in the way of Allah. However, I think that utility to be derived from consumption for myself and for my family is measurable, but the utility for other purposes that is, spending on E-2 which is mostly psychological

and even spiritual is not measurable. Then how utility can be **a** function of E plus E-2, which is more psychological and spiritual and which is not a measurable utility as a function of E-1 + E-2 ?

Answer

No, E-1, E-2 are two objectives in one function.

Question

(Professor K. T. Hossain of Dhaka university) Thank you sir. First of all, I would like to thank Dr. Zarqa very much for presenting us with a very enlightened study on consumer behavior in respect of the social welfare function. I have only just received this paper and it, of course, deserves very careful study. I think some of our brothers have taken this matter very seriously and have studied it. In the meantime, I have noticed that the consumption functions which are already known to us as students of traditional economics are not mentioned in Dr. Zarka's paper. I see here no mention of it. Of course, I have not finished Dr. Zarka's paper yet. However, from the section that I have read come across modality as a consumption function. So I wonder if brother Zarka would care to enlighten us on whether he took account of the consumption function and possibly undertook an approach for extending it beyond the time horizon of modality possibly in the form of something of Islamic.

Answer

The paper which is in your hand was written in 1975 and presented to a conference in 1976. Of course, it is now quite old. *Alhamdulillah* I and other brothers have made more specific and rigorous contributions. At the time, I somehow tried to provide myself another Muslim economists with the possibility of collecting Islamic injunctions which I expected would have some analytical impact. However, I could not take the analysis much further at the time. So my paper basically discusses some of the Islamic injunctions and their potential analytical impact. But I do not go beyond that. I tried to negate one thing: that we cannot apply standard consumer analysis without any modification and that we have to introduce some modification to capture the spirit of the Islamic injunction. However, I did not carry the analysis any further. As you will see, I have not attempted at all to derive any consumption function or any demand for goods, etc. Most of my treatment is qualitative and preliminary, but I would definitely say, Inshallah, that those of you who will

later read Mahbub's paper will find that he has taken, a significant step forward in presenting a rigorous and integrated picture. Of course, it is not analytically convenient to bring too many Islamic injunctions. You need to know what different brothers have done and Mahbub actually captures all the various contributions. He puts forth all the Islamic injunctions and shapes them into one expenditure on self and one expenditure on others, *Fisabilillah*. From this fundamental fact of Muslim consumption behavior which everyone agrees is correct, he goes on to derive a further conclusion. However, there are other aspects to consumer behavior than this, so there is still a possibility for other brothers to make a contribution, Inshallah.

Dr. Mahbub states that he finds no fault with the three standard assumptions that traditional economics has made about consumer preferences: that the consumer can prefer one collection of expenditures and goods over another, that these preferences are transitive and I forget the third one. These three fundamental assumptions permit the drawing of an indifference curve. He says that in his own estimation there is nothing unacceptable in these assumptions about consumer preferences so he adopts them and he built the model.

He can express a preference or indifference between any two collections of expenditures.

Question

Thank you Mr. Chairman. I first of all would like to thank brother Ahmed Zarka for presenting a lucid lecture on the very complicated issue-before "us. Now my question concerns the model that he has presented which was done, by Dr. Mahbub. He has assumed that E- 1 represents goods and only voluntarily *Sadaka,* not *Zakah* or compulsory. How does the function differentiate between them.

Answer

Compulsory obligation expenditures are deducted from it. So he takes the disposal income where the consumer can allocate his income as he has pledged. He would not consider the consumer free to *pay Zakah* and I think that this probably is a sensible analytical position. I think so, but I do not know> Someone may challenge this but I think it is sensible, because you see he wants to show the consumer's decision. However, if something is required, he has no

choice about it. There is no choice from the point of view of a Muslim. There is a need approach as far as I can see.

Chairman's Note

I think there are no further questions from the floor. I like to conclude this session by again expressing my thanks to brother Dr. Anas Al-Zarka for his presentation on consumer behavior in an Islamic society. Before concluding, I inform you that there will be an announcement from our brother from the Islamic Foundation. I should probably conclude and then the announcement can be made. Therefore, I would like to close this session by congratulating all of your for giving your whole-hearted cooperation in running this session in a very effective manner. *Assalamualaikum*.

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ISLAMIC DEVELOPMENT BANK (IDB)

Establishment of the Bank

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent by a Conference of Finance Ministers of Muslim countries held in Jeddah in Dhul Qa'da 1393H (December 1973). The Inaugural Meeting of the Board of Governors took place in Rajab 1305H (July 1975) and the Bank formally opened on 15 Shawwal 1395H (20 October 1975).

Purpose

The purpose *of* the Bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari'ah.*

Functions

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms of economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods among member countries, providing technical assistance to member countries, extending training facilities for personnel engaged in development activities and undertaking research for enabling the economic, financial and banking activities in Muslim countries to conform to the *Shari'ah.*

Membership

The present membership of the Bank consists of 52 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference and be willing to accept such terms and conditions as may be decided, upon by the Board of Governors.

Capital

The authorized capital of the Bank is six billion Islamic Dinars. The value of the Islamic Dinar, which is a unit of account in the Bank, is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund. The subscribed capital of the Bank is **3,654.78** million Islamic Dinars payable in freely convertible currency acceptable to the Bank.

Head Office

The Bank's headquarters is located in Jeddah, Saudi Arabia and it is authorized to establish agencies or branches elsewhere.

Financial Year

The Bank's financial year is the Lunar Hijra year.

Language

The official language of the Bank is Arabic, but English and French are additionally used as working languages.

The Editor

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